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Recent Trends in the City's Business Income Taxes

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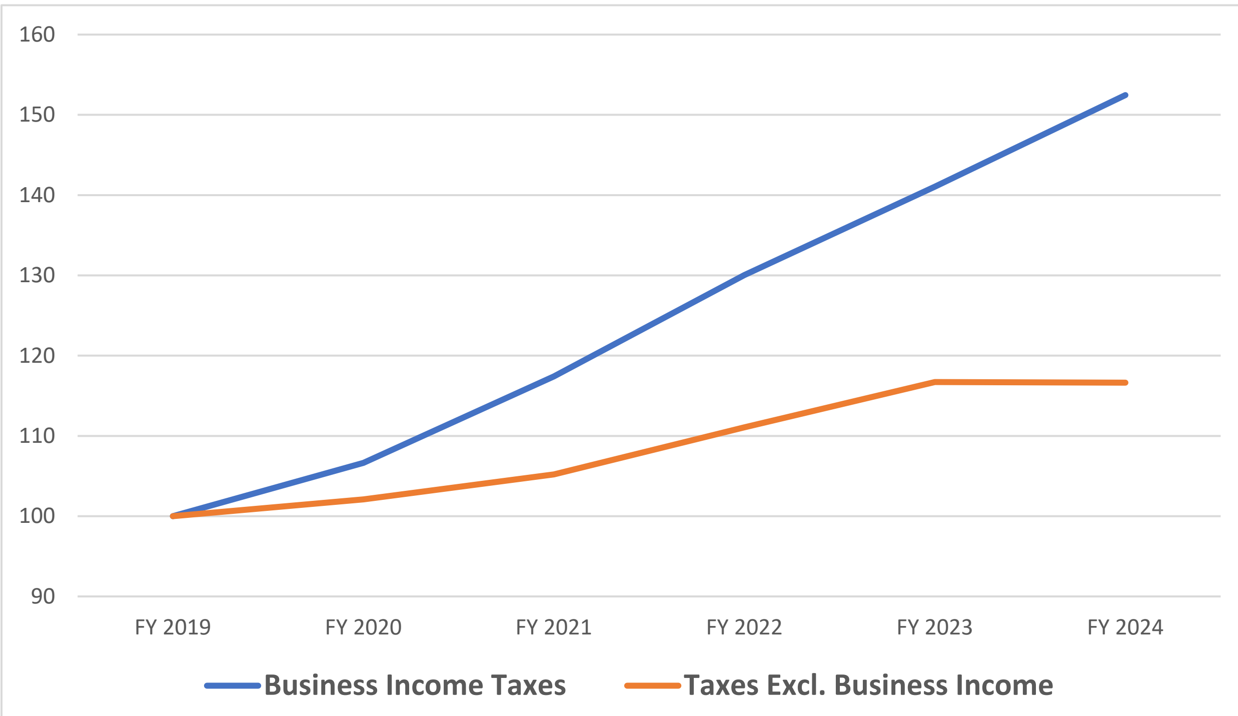
Introduction

In recent years, City taxes on business income have outpaced other revenue sources and have consistently and significantly outperformed forecasts. Chart 1 shows that since FY 2019, business income taxes (inclusive of tax audits) have increased by more than 50% whereas all the other tax revenues combined grew by 17%. In FY 2024, business income taxes represented 14.1% of all City tax revenues, 3 percentage points higher than in FY 2019 and the highest share since FY 2013.

Chart 1. Business Income and All Other City Tax Revenues (FY 2019 = 100)



Source: Office of the NYC Comptroller analysis. Business income taxes include the Business Corporation Tax (BCT), the Banking Corporation Tax (BTX), the General Corporation Tax (GCT), and the Unincorporated Business Tax (UBT). Audits are included in this chart for consistency with data as presented in the City's Annual Comprehensive Financial Report. Audit revenues are shown separately in Chart 13.

In this fiscal note, we provide background on the City's business income taxes, analyze recent trends, and look at the latest revenue forecasts. We have four main conclusions:

1. C-corporations and flow-through entities are taxed under separate regimes, with different rules for the calculation of the tax base and combined reporting. This adds complexity for businesses and tax administrators alike, as most recently seen in rulemaking for the allocation of the income of corporate partners. The City should

evaluate the economic benefits and fiscal implications of conforming the treatment of flow-through entities to that of C-corporations.

2. In the last ten years, the tax liability of C-corporations were affected by two main legislative changes:

    a. Starting in 2015, the City unified and reformed the tax regime of C-corporations. While expected to be revenue neutral, the reform likely decreased tax revenues, at least in the short run.

    b. Starting in 2018, the Tax Cuts and Jobs Act (TCJA) increased the City's tax revenues. One reason is that the federal tax code expanded the City's tax base without affecting its tax rate. In addition, after the passage of TCJA corporate income generally increased in the U.S.

3. The relationship between tax liability and fiscal year revenues is relatively tight but several factors can generate significant forecast errors:

    a. First, tax revenue growth rates are volatile and do not persist one year to the next.

    b. Second, businesses have up to three years to settle their liability, and preliminary estimates fluctuate quite significantly for several quarters, particularly for larger C-corporations.

    c. Third, the relationship between financial sector tax liability and Wall Street profits is volatile and at times difficult to interpret.

    d. Fourth, the link between economic conditions, profits, and tax liability is affected by filing behavior, as evidenced by the long and variable lags of tax audit revenues.

4. Forecast errors have been especially high in recent years and the latest set of forecasts from the City's fiscal experts shows a wide range of potential outcomes. On the upper bound, our office projects a moderation of revenue growth rate in this year and the next. This view has so far been validated by economic and collections data. On the lower bound, the November Financial Plan assumed two consecutive years of decline over the same period. In the recently published January Financial Plan, OMB's forecast was revised slightly above our office's in FY 2025 and FY 2026 but shows a revenue drop in FY 2027.

    While it is likely that short-term projections will converge toward the high end of the current range, the outlook is particularly uncertain due to the policies of the second Trump administration. The destabilizing effects of widespread tariffs intended to reduce the federal deficit will have a negative effect GDP and corporate profits, and will increase prices. On the other hand, looser regulations and an expected wave of merger and acquisitions and IPOs could lift revenues from the financial sector, information, and professional services.

    The volatility of business income taxes, coupled with their higher share of City tax revenues, make the adoption of a policy to regulate the City's rainy-day fund even more important. Our proposals for target size, deposits and withdrawals are detailed here and here. Based on our latest forecast, the formula we proposed calls for a deposit of ~$850 million in the City's Revenue Stabilization Fund in FY 2025.

Overview of the City's Business Income Taxes

The City has a complex system of business income taxes, which are administered by the City's Department of Finance (DOF):

- The Business Corporation Tax (BCT) applies to C-corporations.
- The General Corporation Tax (GCT) applies to S-corporations.
- The Unincorporated Business Tax (UBT) applies to sole proprietors (IRS Schedule C businesses) and unincorporated entities (partnerships and LLCs).
- The Banking Corporation Tax (BTX) applies to banks that are also S-corporations.

In addition to the above, the Pass-Through Entity Tax (PTET) is an optional tax on pass-through entities (specifically, S-corporations and partnerships) created in 2022 to circumvent the $10,000 cap on the State and Local Tax deduction from federal individual taxable income. The tax is structured to be revenue neutral for the City (and revenue-losing for the federal government) as PTET payments are offset by corresponding City Personal Income Tax (PIT) credits. For this reason, PTET is excluded from the analysis.[1]

While in general the City only taxes the personal income of its residents, business income of entities doing businesses across taxing jurisdictions is allocated based on *apportionment* and *sourcing* rules.

Apportionment determines the tax base of businesses that operate in more than one jurisdiction. Between tax year 2011 and 2020 (the latest for which detailed information is available), on average 72.2% of the City tax liability came from multi-jurisdiction businesses. For C-corporations, the average since the inception of BCT in tax year 2015 is 92.7%.

Historically, NYC used a three-factor formula that weighted equally the share of sales taking place in NYC, the share of payroll in NYC, and the real estate occupied in NYC. Between 2009 and 2018, the City gradually transitioned to only using the share of sales, a "single sales factor". In general

[1] The City levies a number of other taxes on businesses that are also not part of the analysis. The major ones are the Commercial Rent Tax on renters of commercial space in certain areas of Manhattan, the Utility Tax on the gross receipts of utilities and telecom businesses, and the Hotel Tax on the number and rate of hotel rooms sold. Owners of commercial real estate are subject to the Real Property Tax.

terms, a single sales factor lowers the tax burden on businesses with workers and real estate in the jurisdiction but a relatively low share of sales in it (and *vice versa*).

Sourcing determines the location where sales take place. In general, “cost of performance” attributes receipts to the location where a service is performed. “Market-based” sourcing attributes receipts to the location where the customer receives the benefit. For instance, under cost of performance sourcing, the receipts of a NYC-based law firm for services provided within NYC to a New Jersey resident are attributed to NYC. Instead, under market-based sourcing the receipts are attributed to New Jersey.

While BCT adopted market-based sourcing, GCT and UBT use cost of performance for services provided within NYC, except for sales of tangible personal property.[2] The difference can generate administrative complexity, as seen most recently in the formulation of rules regarding the allocation of partnership income to corporate partners: initially, DOF proposed to allocate the income based on UBT provisions but subsequently decided to adopt BCT’s sourcing.[3]

It is plausible that in the aftermath of the pandemic and with the growth of remote work, sourcing based on the cost of performance may have pushed flow-through entities to locate outside of New York City. At the time of the creation of BCT, the City studied options to conform GCT and UBT to the treatment of C-corporations but ultimately abandoned the effort due to the difficulty of achieving revenue neutrality. After more than 10 years, it would be worthwhile to revisit the issues involved in terms of potential economic benefits and fiscal impact.

Table 1 summarizes the main features of the taxes, with the exclusion of BTX which is a minor revenue stream since the creation of BCT in 2015.[4]

[2] The City’s cost of performance sourcing for services only includes services performed within NYC, regardless of the location of the client benefiting from them (this excludes, for instance, services provided at a client’s office outside of NYC by employees connected with the NYC office of a business).

[3] The decision is explained here.

[4] More detailed summaries can be found in the Mayor’s Office of Management and Budget (OMB) annual tax revenue forecasting documentation. DOF’s statistical profiles and tax expenditures reports also provide summaries.

Table 1. Summary of main features

	BCT (C-Corporations)	GCT (S-Corporations)	UBT (Partnerships, LLCs, Proprietors)
Apportionment	Single sales factor		
Sourcing	Market-based	Cost of performance, except for sales of tangible personal property.	
Tax amount	Highest of: 1. Income tax; or 2. Capital tax; or 3. Fixed Dollar Minimum based on receipts	Highest of: 1. Income tax; or 2. Income-plus-compensation base tax; or 3. Capital tax; or 4. Fixed Dollar Minimum based on receipts	Income tax
Income tax rate	Manufacturing: 4.425% - 8.85% Small businesses: 6.5 % - 8.85% Major financial corporations: 9% All others: 8.85%	8.85%	4%
Capital tax rate	0.15% up to $10m	0.15% up to $1m	n/a

Source: NYC DOF. Investment income under GCT and UBT is allocated using investment allocation percentages, which are themselves determined using issuer allocation percentages (available here). The issuer allocation percentages source investments within and outside New York City. Major financial corporations are those with more than $100 billion in assets. The lower tax rate for manufacturing corporations phases out for allocated income of $10 to $20 million and income before allocation of $20 to $40 million. The lower tax rate for small businesses phases out for allocated income of $1 to $1.5 million and income before allocation of $2 to $3 million. Insurance corporations are not subject to BCT and GCT for income deriving from insurance services and non-insurance activities (i.e., real estate and financial services), except for out-of-state corporations insuring property in the City against loss or damage by fire. The tax equals 2% of all gross direct premiums less return premiums. Cooperative housing corporations are taxed at a rate of 0.04% on capital allocated to New York City under both BCT and GCT. GCT has an additional 0.075% tax on subsidiary capital allocated to New York City (in general, investments in the stock and indebtedness of corporations – net of associated liabilities – for which the filer owns more than 50% of the stock).

Business Corporation Tax (BCT)

As mentioned above, BCT went into effect starting in tax year 2015. Before then, the City taxed C-corporations under GCT and BTX. The City's BCT was generally designed to conform to NYS' franchise tax on corporations which was reformed one year prior.[5]

In general, a C-corporation for federal tax purposes is subject to BCT if it does business, employs capital, owns or leases property, or maintains an office in NYC. A business is subject to BCT if it passes an "economic nexus" threshold of receipts from NYC, which in 2024 was $1,128,000.[6] For C-corporations moving to BCT, sourcing was changed from cost of performance to market-based.[7] BCT also adopted combined reporting provisions that, in general, require corporations operating the same ("unitary") business enterprise and have common ownership or control (defined as more than 50% of voting stock) to file a single tax return. BCT's combined reporting does not require the existence of transactions or distortions to the tax liability among the members of the combined group.[8]

General Corporation Tax (GCT) and Unincorporated Business Tax (UBT)

GCT is imposed on S-corporations and qualified subchapter S subsidiaries that do business, employ capital, own or lease real estate, or maintain an office in NYC. Under GCT, combined

[5] The NYS Department of Taxation and Finance adopted final regulations for its corporate tax. DOF is expected to conclude its rulemaking process in 2025 and adopt rules that differ in some respects from the State's.

[6] The receipts thresholds listed below apply to tax years beginning on or after January 1, 2024. Business that are part of a unitary group with receipts of $1,128,000 or more from NYC sources are subject to BCT if their receipts from NYC sources exceed $11,000. The thresholds were introduced in 2022 (at $1 million and $10,000, respectively) and have been indexed for inflation. The thresholds are a form of "bright line" economic nexus: they apply regardless of whether corporations do business, employ capital, own or lease tangible property, or maintain an office in NYC. In addition, corporations are subject to BCT if they issues 1,000 or more credit cards to customers with a NYC mailing address or have merchant customer contracts with 1,000 or more locations in NYC or if the sum of credit card customers and merchant locations equals 1,000 or more. Starting in 2022, corporations with at least 10 customers or merchants that are part of a unitary group with at least 1,000 customers or merchant locations are also subject to BCT. Exemptions from BCT include insurance corporations, publicly supervised utilities, and certain foreign or alien corporations. Publicly traded partnerships that did not opt out of GCT beginning in tax year 1996 are subject to BCT. Corporations that are partners or members in a partnership and meet the above requirements may also be subject to BCT. Conditional on meeting certain criteria, BCT filers may elect to use the three-factor formula in effect in tax year 2017 for tax years 2018 or later.

[7] A summary of new sourcing rules is available here. Some categories of receipts such as sales of tangible personal property, rentals of real and personal property, and broker/dealer activities were subject to market-based sourcing before the reform.

[8] Corporations that meet the ownership test can elect to file combined returns even if they don't engage in a unitary business. The election is irrevocable in the year it is made and the following six years.

reporting is generally subject to an ownership threshold (80%) and on the existence of substantial intercorporate transactions, regardless of the transfer price used in such transactions.[9]

UBT is imposed on every individual or unincorporated entity carrying on a trade, business, or profession wholly or partly in NYC. A full credit is allowed if the tax is up to $3,400, and a partial credit is allowed for tax liabilities between $3,400 and $4,500. Proprietors are allowed exemptions for $15,000, so that UBT liability after the $3,400 credit is zero for net incomes up to $100,000. Partnerships are allowed an exemption of $5,000 plus $10,000 per partner, so that UBT liability is zero for net incomes up to $90,000 plus $10,000 times the number of partners.

Business income subject to UBT to the City's Personal Income Tax (PIT). To limit the extent of double taxation, the City allows residents with taxable income up to $42,000 a 100% PIT credit for the UBT paid by the business entity. The credit percentage declines gradually to 23% for taxable incomes higher than $142,000. Corporations and partnerships that are themselves partners receive a UBT paid credit. There is no combined reporting under UBT.

Income derived from trading on one's own account ("self-trading") is, with some exceptions, exempt from UBT.[10] As a consequence, private equity and hedge funds, which are typically organized as LLPs or LLCs, are subject to UBT for their management fees but not for carried interest (the performance fee based on realized profits).

The Composition of Tax Liability

The analysis in this section is based on data on tax liability in the year it was incurred rather than collections by fiscal year, which are affected by filing deadlines as well as occasional accounting adjustments.[11] Most of the data used in the analysis is provided by DOF's Division of Tax Policy and Data Analytics, to whom we are indebted for the detailed and timely reports that are made available to all fiscal monitors. Because part of the analysis focuses on the impact of the corporate tax reform of 2015 and the Tax Cuts and Jobs Act (TCJA) of 2017, we separate the liability of C-corporations from that of flow-through entities (S-corporations, partnerships, and sole proprietors). Unless otherwise noted, the discussion and charts in this and the next section refer to tax years.

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[9] In the absence of substantial intercorporate transactions, combined reporting may be required in case of distortions to the GCT liability originating from transaction or other arrangements among the members of the group.

[10] See here for the DOF's rules.

[11] It should be first noted that, in general, under the City's modified accrual accounting conventions, business income taxes collected in July and August are accrued to the previous fiscal year. As to accounting adjustments, the City argued that $185m in GCT and BTX collected in June 2015 was an advance of future years' liability due to the uncertainty introduced by the changeover to BCT. The accrual removed $185m in corporate tax revenues in FY 2015 and was reversed in FY 2017, increasing revenues in that year.

C-Corporations and Flow-through Entities

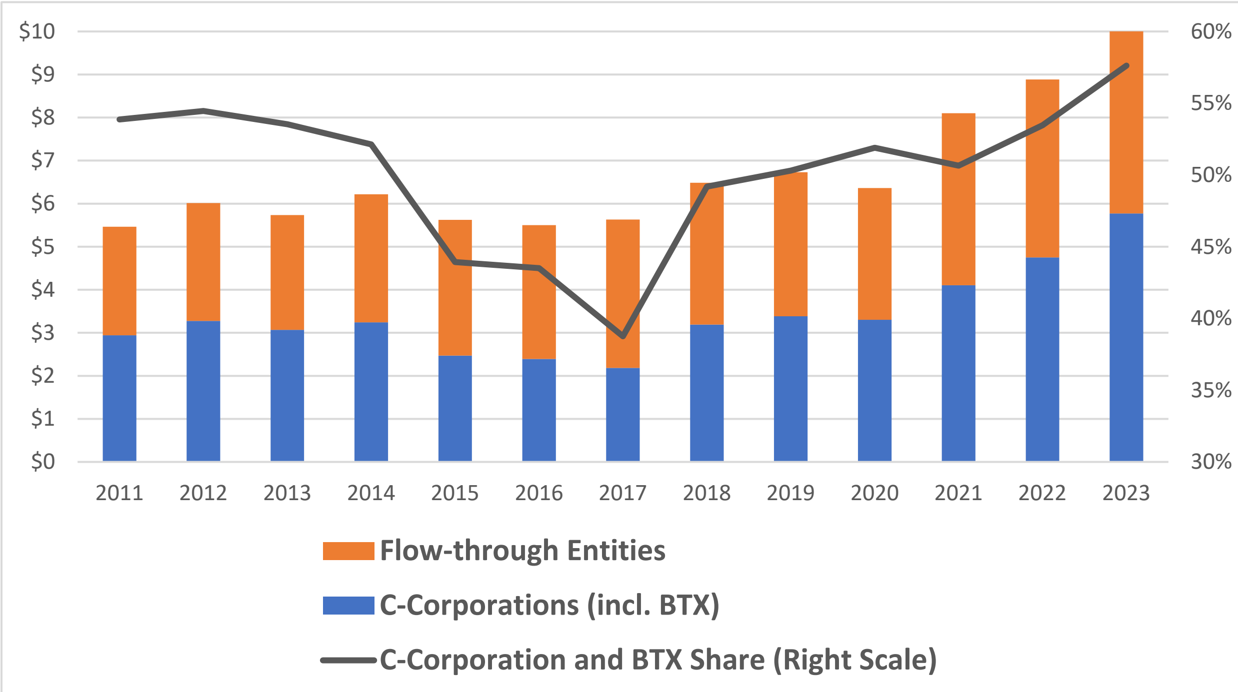
Total tax liability and its breakdown by entity type is shown in Chart 2. Due to data limitations and to maintain consistency, when available we add post-2014 BTX liability to the total of C-corporations. The main takeaway from Chart 2 is that business income taxes attained a higher baseline level in the aftermath of the pandemic, with C-corporations regaining the majority share of total liability after the drop in 2015-2017.

Between 2011 and 2017, the total liability across all taxes fluctuated between $5.5b and $6.2b. Over this period, the share of taxes paid by C-corporations declined steadily, in part, as explained later, due to the 2015 corporate tax reform. Total liability rose above $6b after the passage of TCJA due to the increase in C-corporations' tax base and income (explained further below). The pandemic drove liability down slightly in 2020 before a combination of economic policy interventions, higher profit margins, and inflation pushed liability steadily higher afterwards.[12] As of the third quarter of 2024, the preliminary estimate of 2023 total liability is $10.0 billion, 57.4% higher than in 2020. Over this period, the growth of tax liability was 74.8% for C-corporations (including BTX) and 38.7% for flow-through entities. The share of tax liability attributable to C-corporations rose accordingly, reaching 57.6% in 2023.

The tax liability for 2022 and 2023 will likely be revised downward as businesses file their final returns. Based on typical patterns, the final 2022 total should change by less than $100m while the final 2023 total should settle around $9.4b or $600m lower than preliminary estimates.

[12] See Palazzo B. (2023) "Corporate Profits in the Aftermath of Covid-19", *FEDS Notes*, September and Bivens J. (2024) "Profits and Price Inflation Are Indeed Linked", Working Economics Blog, *Economic Policy Institute*, September.

Chart 2. Tax Liability by Entity Type ($b, %)



Source: NYC DOF, Office of the NYC Comptroller analysis. Before 2015, BTX liability is added to the C-corporation component of GCT. Some of the pre-2015 BTX liability is attributable to S-corporations but the breakdown is not published. For consistency, when available we add post-2014 BTX liability to C-corporations liability. Liability for 2021-2023 is preliminary and as of the third quarter of 2024. The near totality of the liability for 2021-2022 is derived from final filings. Most of the 2023 liability is derived from final filings, except for BCT where ~85% of the liability is based from declaration and extension filings. As reported by DOF in its statistical profiles, tax liability is based on activity and income reported during a calendar year. In 2020, 62% of BCT filers and the near totality of GCT and UBT filers reported on a calendar year basis.

Financial and Nonfinancial Sectors

In 2023, the Finance and Insurance sector represented 49.0% of the C-corporation liability and 24.7% of pass-through entities' liability. Commercial banking and the Securities and Commodities subsectors constitute the vast majority of liability among C-corporations. Securities and Commodities (i.e., hedge funds, private equity, etc.) accounts for the near totality of pass-through entities' liability.

Chart 3 shows that Finance and Insurance C-corporation liability dropped abruptly in 2015 and started recovering after the enactment of TCJA, patterns that are explored more in detail later in this fiscal note. Perhaps more interesting is the relative stability of the tax liability of flow-through entities, which hovered around $700m from 2011 trough 2019, before rising to $1.1b on average in 2021-2023. The temporary spike in 2017 was likely due to taxes paid on non-qualified deferred compensation plans held offshore set to be recognized as taxable income by federal legislation passed in 2008 and flowing through to the City liability.[13] The reasons behind the recent

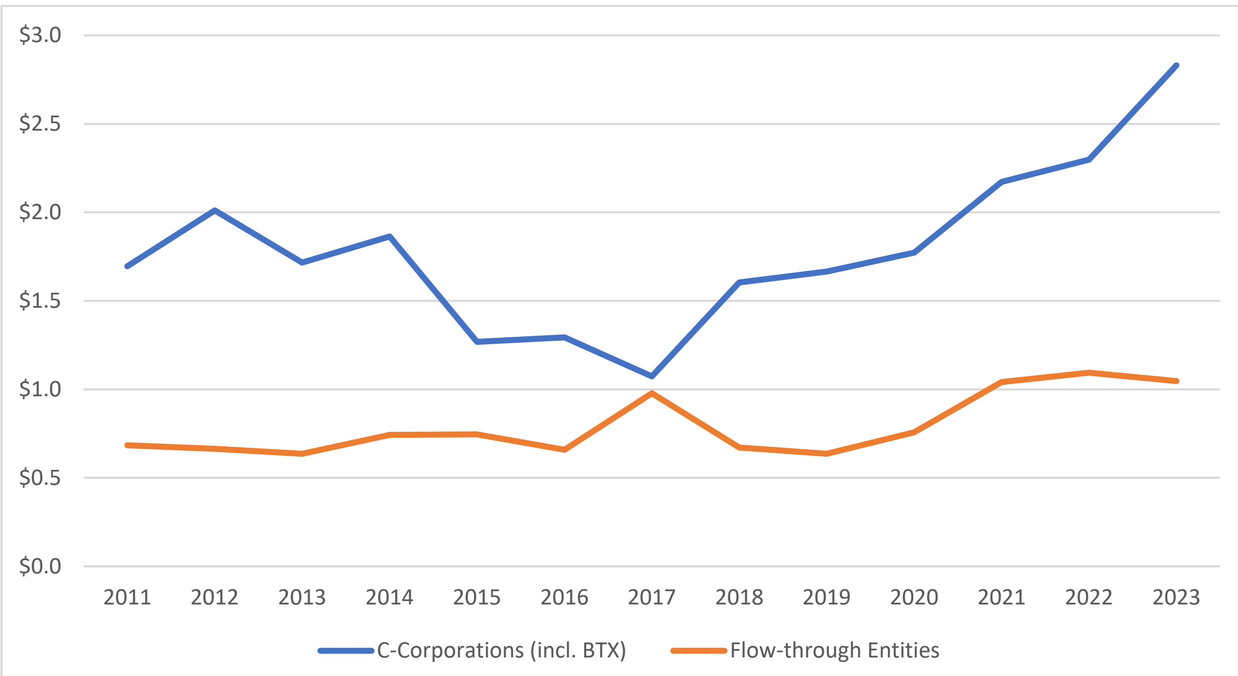
[13] See DOF memorandum 18-6. Connecticut also experienced an increase in tax revenues due to the same reason.

divergence between the liability of C-corporations and that of flow-through entities are not clear. As mentioned above, one component may be due the interaction of cost of performance sourcing and the economic repercussions of the COVID-19 pandemic.

Overall, it is hard to detect a negative impact on the financial sector's profitability from the pandemic. On the contrary, the sector benefited from fiscal and monetary policy interventions in 2020 and 2021 and its liability continued to grow strongly afterwards.

Net payments (calendar year payments net of adjustments but gross of refunds) from financial sector firms between January and September 2024 grew 9.6% from the same period in 2023. Net payments from June to September 2024 (which exclude the March and April deadlines for final returns, extensions, and declarations on 2023 liability) grew 13.2% year over year, suggesting that the total financial sector tax liability continued to grow in 2024.

Chart 3. Finance and Insurance Liability ($b)

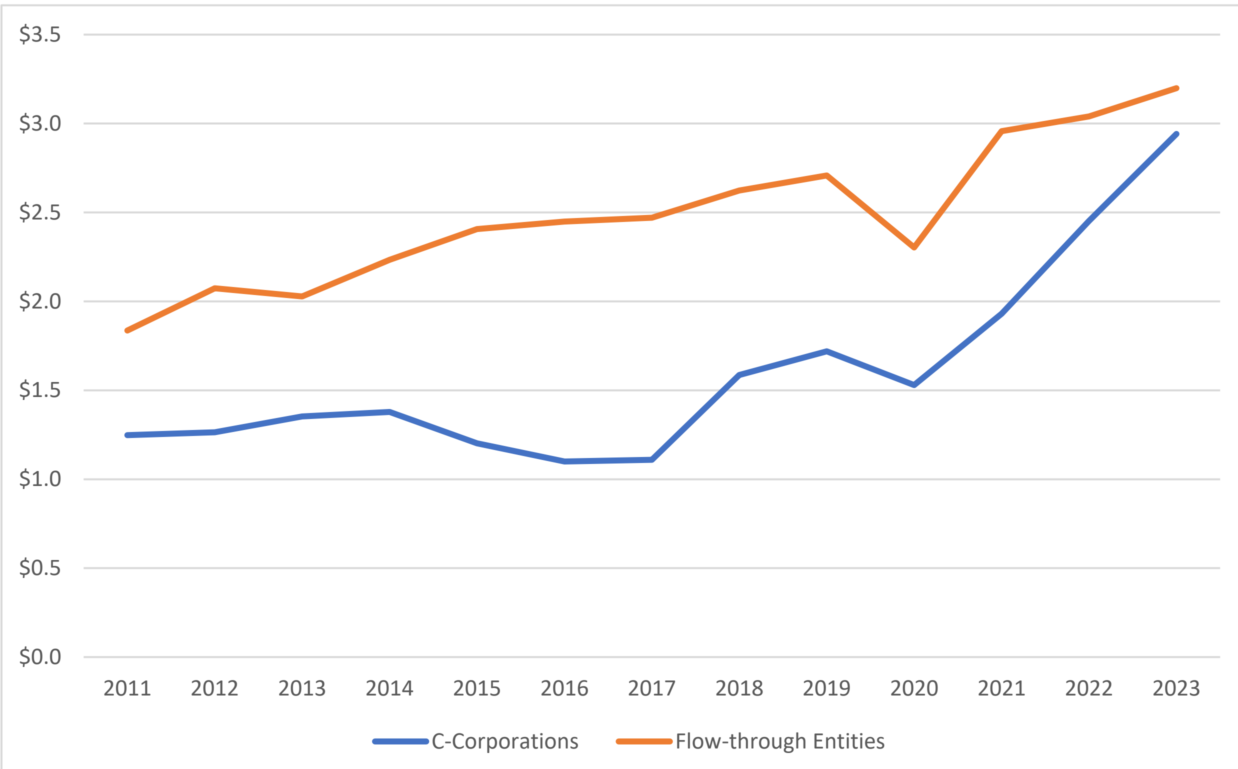


Source: NYC DOF, Office of the NYC Comptroller analysis. See notes to Chart 2. Finance and Insurance are defined by DOF as: firms engaged in banking, lending, or financing activities; funds and trusts; securities and commodities brokers and dealers, and exchanges; insurance agents and brokers; and related industries.

As shown in Chart 4, the liability of nonfinancial C-corporations has been historically more stable but also increased steeply in 2021-2023 after a temporary drop in 2020. The two largest contributors to the tax liability are the Information and Services (including professional and business services) sectors. Similarly, nonfinancial flow-through entities suffered from a temporary decline in profitability in 2020 but the tax liability recovered and resumed trend growth in 2021-2023. The Services sector has the largest tax liability among nonfinancial flow-through entities.

Net payments from nonfinancial sectors between January and September 2024 grew 6.8% from the same period in 2023. Net payments from June to September 2024 grew 8.5% year over year, suggesting that the overall tax liability continued to grow in 2024.

Chart 4. Nonfinancial Sectors Liability ($b)



Source: NYC DOF, Office of the NYC Comptroller. See notes to Chart 2.

Effects of Major Legislative Changes on the Liability of C-corporations

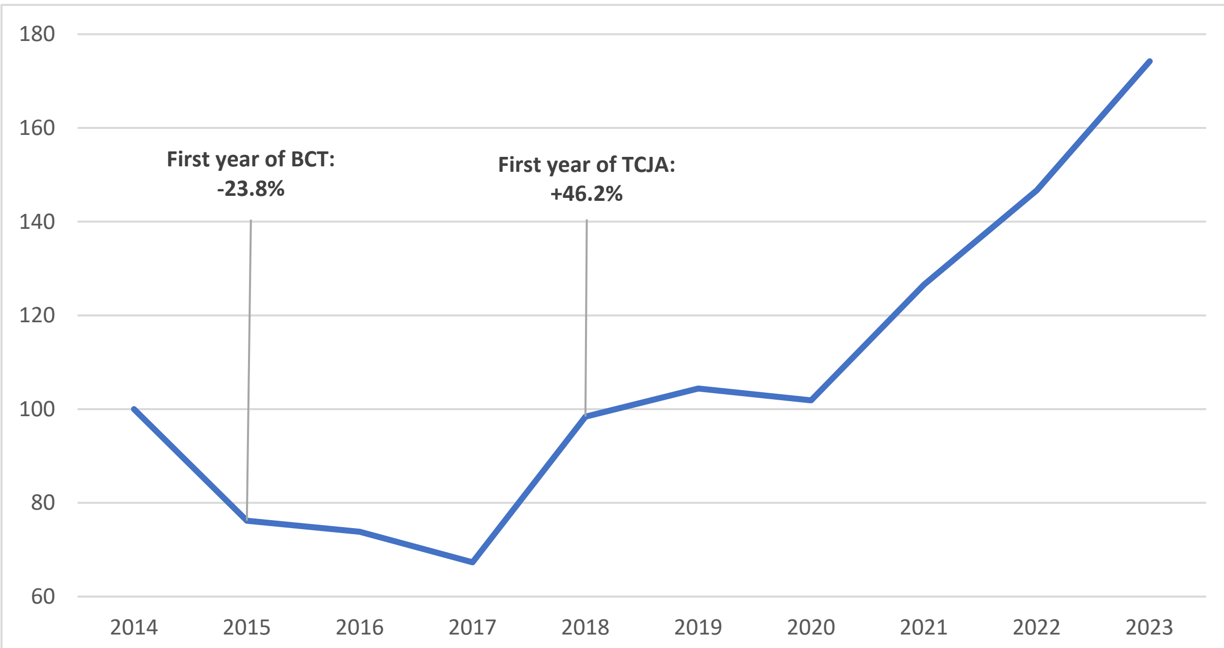
In this section we look at the impact on the tax liability of C-corporation of two major legislative changes: the creation of BCT and the passage of the Tax Cuts and Jobs Act (TCJA). Chart 5 shows tax liability between 2014 and 2023. The chart illustrates a few points:

1. In 2015, in correspondence with the start of BCT, tax liability dropped by 23.8%. The tax liability continued to decline in 2016 and 2017.
2. In 2018, the first year TCJA went into effect, the tax liability jumped by 46.2%, back to 2014 level. The increase was not temporary, as it would be the case if corporations merely

shifted income from 2017 to 2018 to take advantage of a lower federal tax rate. Instead, tax liability increased in 2019, before falling slightly in 2020.

3. Between 2020 and 2023 the tax liability grew at an extraordinary annual average rate of 20.5%. While 2023 liability is mostly based on declarations and extension filings and is expected to be revised down slightly over time, net BCT payments continued to grow in 2024 (+8.7% January through September and +5.4% June through September over the corresponding periods in 2023).

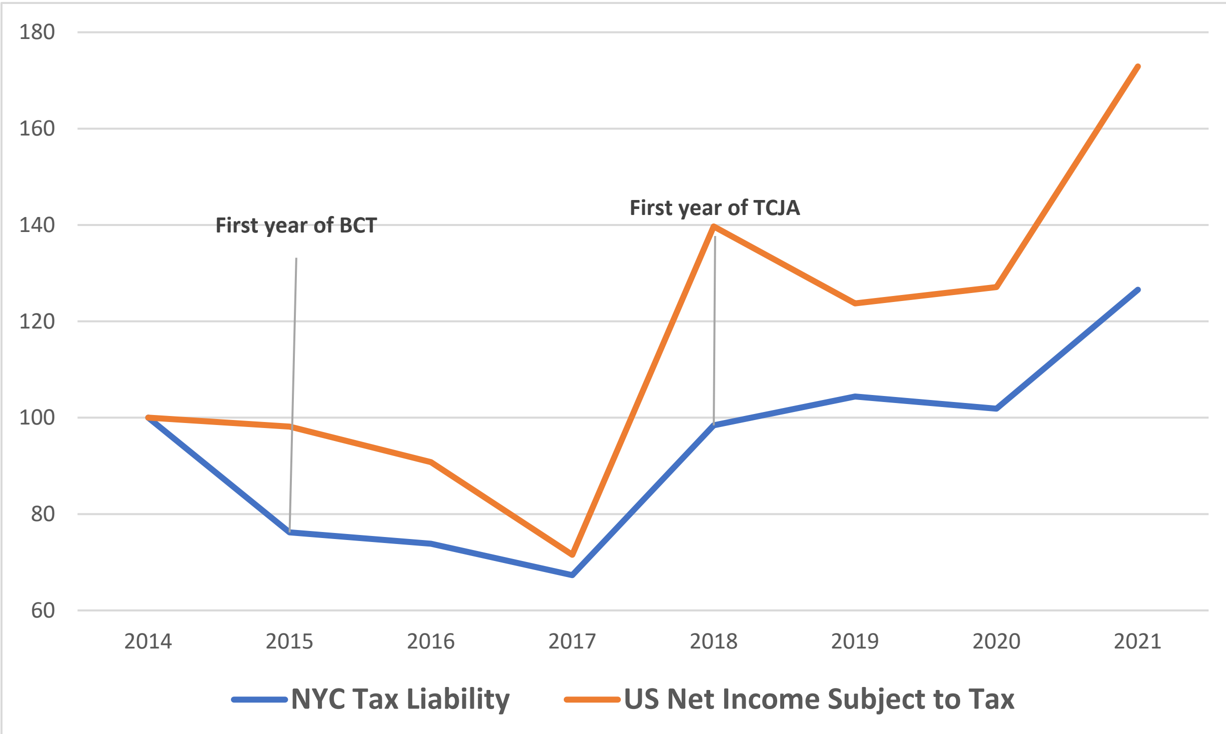
Chart 5. C-corporations' Liability (2014 = 100) [UPDATE]



Source: NYC DOF, Office of the NYC Comptroller analysis. See notes to Chart 2.

In Chart 6 we add federal data on income subject to tax for all active corporations (excluding S-corporations and other entities) up to tax year 2021, which is the latest available. While not perfect, the co-movement between the two series is evident and confirmed by the 2021 jump in federal income and City tax liability. Federal corporate income does not show a significant change in 2015, suggesting that the drop of City tax liability was likely driven by the tax reform. On the other hand, federal data shows a significant drop in income in 2017, followed by a spike in 2018, and lower but still elevated levels in 2019 and 2020. These dynamics appear to be broadly in line with the changes in City tax liability, although the income shifting from 2017 to 2018 is more pronounced in federal data.

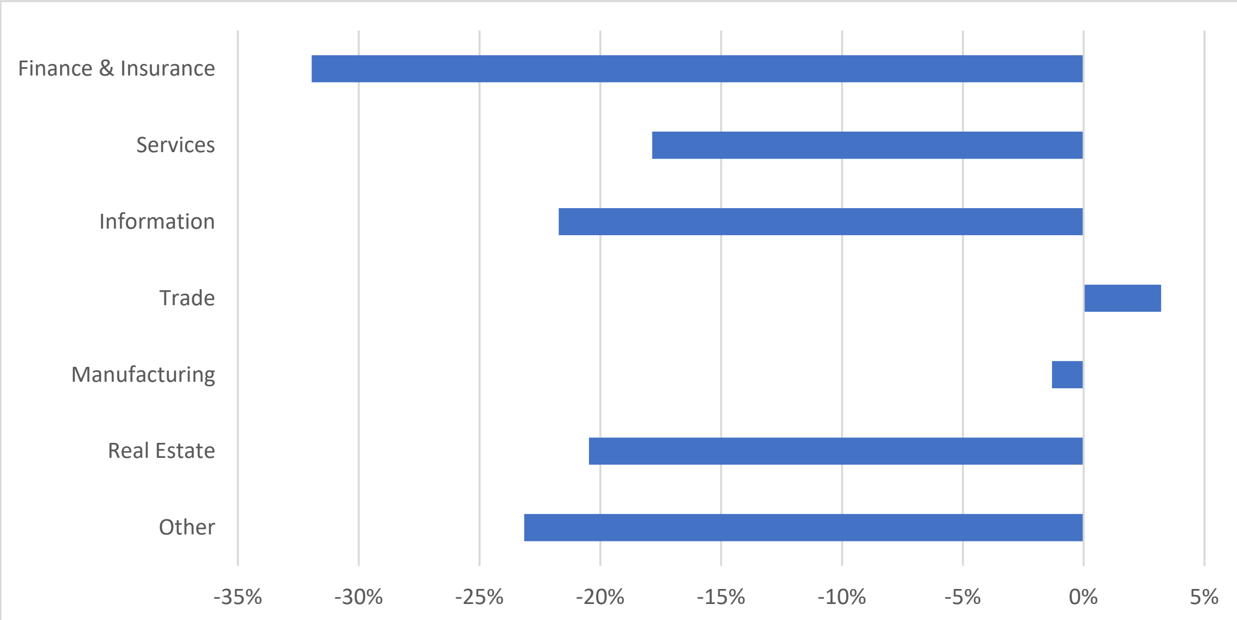
Chart 6. C-Corporations' NYC Liability and Federal Income Subject to Tax (2014 = 100)



Source: NYC DOF, IRS Statistics of Income, Office of the NYC Comptroller analysis. See notes to Chart 2 regarding NYC data. IRS data are derived from table 5.3: Returns of Active Corporations, other than Forms 1120-S, 1120-REIT, and 1120-RIC. IRS data are for the nation and include income apportioned to NYC.

The decline in 2015 City liability was broad-based, as seen in Chart 7. The large and widespread decline suggests that BCT lowered tax liability, particularly for financial firms who may have benefited disproportionately from the new sourcing rules. The drop in finance and insurance took place despite the increase in the tax rate from 8.85% to 9% for major financial corporations (firms more than $100 billion in assets). It is possible that the part of the initial drop in liability was due to taxpayers taking the option to amortize pre-2015 net operating losses over two years. Another explanation could be filing behavior, with initial revenue losses recouped by subsequent audits (although, as shown in Chart 13, the evidence does not yet clearly support this hypothesis).

Chart 7. The Drop in 2015 C-corporations' Liability by Sector



Source: NYC DOF, Office of the NYC Comptroller analysis.

The increase in 2018 liability took place after the passage of TCJA, which included significant changes to the treatment of corporations and flow-through entities. The changes introduced new rules for income earned domestically and abroad that lowered federal liability but increased the tax base.[14] Because the starting point for the calculation of BCT is federal taxable income, the City benefited from some of the base-broadening provisions while at the same time avoiding most of those that would have reduced it. Below, we highlight the two provisions that are likely to have increased the City's tax base the most:[15]

1. The limitation on the deduction for interest expenses for businesses with more than $25 million (indexed for inflation) in gross receipts on average in the previous three years.[16]

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[14] See Joint Committee on Taxation, December 2017 and Phillips A. and Wlodychak S. "The Impact of Federal Tax Reform on State Corporate Income Taxes", EY, 2018.

[15] Some of the TCJA provisions that have flown-through the City's tax include the increase of in expensing limit for investments by small business and accounting rules for small firms. These provisions would lower City revenues but given the concentration of the tax base toward large firms, they likely had a muted impact. In 2022, R&D expenses went from being expensed to being amortized over five years.

[16] The federal limitation equals business interest income plus 30% of adjusted taxable income and other smaller components. The Coronavirus Aid, Relief and Economic Security (CARES) act passed in 2020 temporarily raised the percentage to 50% in 2019 (retroactively) and 2020. The City decoupled from the increase from 30% to 50% and also disallowed a carryforward for the difference. This and other CARES provision that the City decoupled from are outlined in DOF memorandum 20-6. The City also Starting in 2022 the limitation is calculated after the subtraction

Available data on the limitation on the deduction of interest expense, suggests that it affected most directly the manufacturing and information sectors.[17] Because interest income increases the basis on which the limitation is calculated (see footnote 16), it is unlikely that it affects the financial sector meaningfully.

2. The creation of Global Intangible Low-Tax Income (GILTI). TCJA introduced a partial territorial tax system where foreign-earned income is not subject to federal tax. Accompanying the reform were measures to address tax avoidance which included GILTI, a minimum tax targeted at income derived from intangible assets (such as patents, copyrights, trademarks, etc.).[18] The IRS estimates that two thirds of US-wide GILTI in 2018 came from the manufacturing and information sectors.

In Chart 8, we break down the 2018 increase in City liability by sector. The increase was large ($1.0 billion or +46.2%) and broad-based which suggests a structural change affecting all economic sectors. The Information sector's liability, in particular, doubled in 2018 consistent with TCJA's tax base changes and accounting for nearly one fifth of the overall increase. A rough estimate obtained from allocating 2018 US GILTI income to the top 1% of BCT taxpayers in that year, yields an estimate of approximately $100 million.[19]

Finance and Insurance was responsible for more than 50% of the 2018 increase in tax liability and is at odds with the industry reporting only 6.3% of 2018 GILTI nationally and with the likely small impact on the industry of the limitation on the interest paid deduction.

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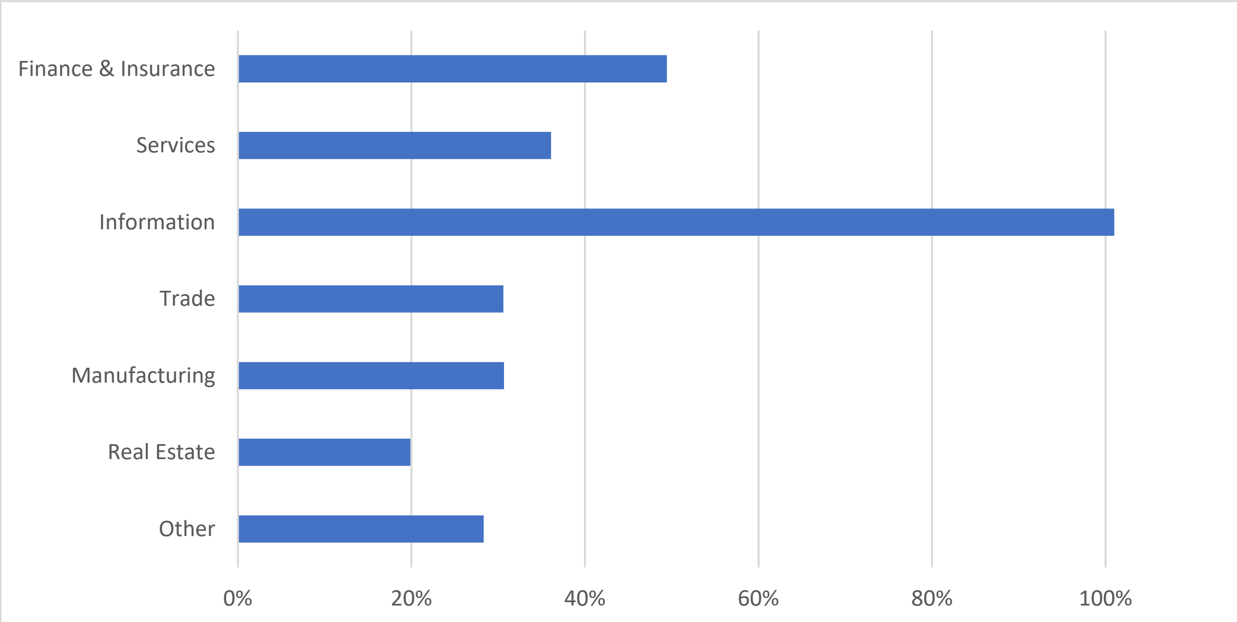
of depreciation and amortization expenses from income, which lowers its amount. An example of the calculations is available here. NYC rules for the allocation of interest expenses are in DOF memorandum 18-11.

[17] See Richmond J., Goodman L., Isen A. (2023) "Tax Policy, Investment, and Firm Financing: Evidence from the U.S. Interest Limitation".

[18] Generally, GILTI equals the income of a Controlled Foreign Corporation (CFC), minus allocable deductions, in excess of a 10% return on tangible business assets. GILTI enters NYC income for BCT, GCT, BTX, and UBT for proprietors. UBT partnerships are not required to include GILTI in their NYC income unless they elect to be treated as C-corporations for federal taxes. GILTI enters income net of the IRC Section 250 50% deduction (37.5% starting in 2025). At the same time, GILTI enters the business allocation percentage in the denominator, lowering the percentage of income that is allocated to NYC. Detailed explanations can be found in DOF memoranda 18-9 and 18-10. Primers on GILTI are available here and here. The deduction on Foreign Derived Intangible Income (FDII) is excluded for BCT and GCT, but not for BTX. Detailed information can be found in DOF memoranda 18-9 and 18-10. The deemed repatriation of foreign-earned income and the associated deduction (IRC section 965), as well as the Base Erosion and Anti-abuse Tax (BEAT) did not flow through to NYC.

[19] We divided the BCT liability of the top 1% of taxpayers available from DOF's statistical profile for 2018 (Table 5) by 8.85% (the rate at which most liability is based on, as can be seen in Table 11) to obtain taxable income. We then took the share of BCT taxable income to US "gross income less total exclusions" from IRS Form 8993, Table 2 to allocate net GILTI to the BCT taxpayers. The implied BCT liability is $93.2 million. NY State and the City taxed GILTI similarly in tax year 2018 but the State mostly exempted it starting in tax year 2019. To confirm the relatively minor role of GILTI is worth noting that City and State tax liabilities did not diverge in 2019 and 2020, the last year for which State data are available at the time of writing.

Chart 8. The Jump in 2018 C-corporations' Liability by Sector



Source: NYC DOF, Office of the NYC Comptroller analysis.

Based on the above, it is likely that a substantial part of the increase in City tax liability was due to altogether higher corporate income, rather than the base-broadening provisions of TCJA. This is supported by NY State data. An early estimate of the potential impact on the NY State corporate tax base (which largely overlaps with the City's) between 2018 and 2027 indicated a potential increase of 12%.[20] Instead, NY State saw a much larger increase of 49.0% in 2018,[21] comparable to the City's 46.2%.

Other impacts likely attributable to TCJA have taken place over time but cannot be isolated with the data available to us. In particular, since 2018 BCT's financial sector liability has been supported by a wave of conversions of asset managers (KKR, Ares Management, Apollo Global Management LLC, and Blackstone) from publicly traded partnership to C-corporations to take advantage of lower federal tax rates. To the extent that these entities did not opt out of GCT in 1996, the end result was an increase in BCT liability and a decrease in UBT liability.

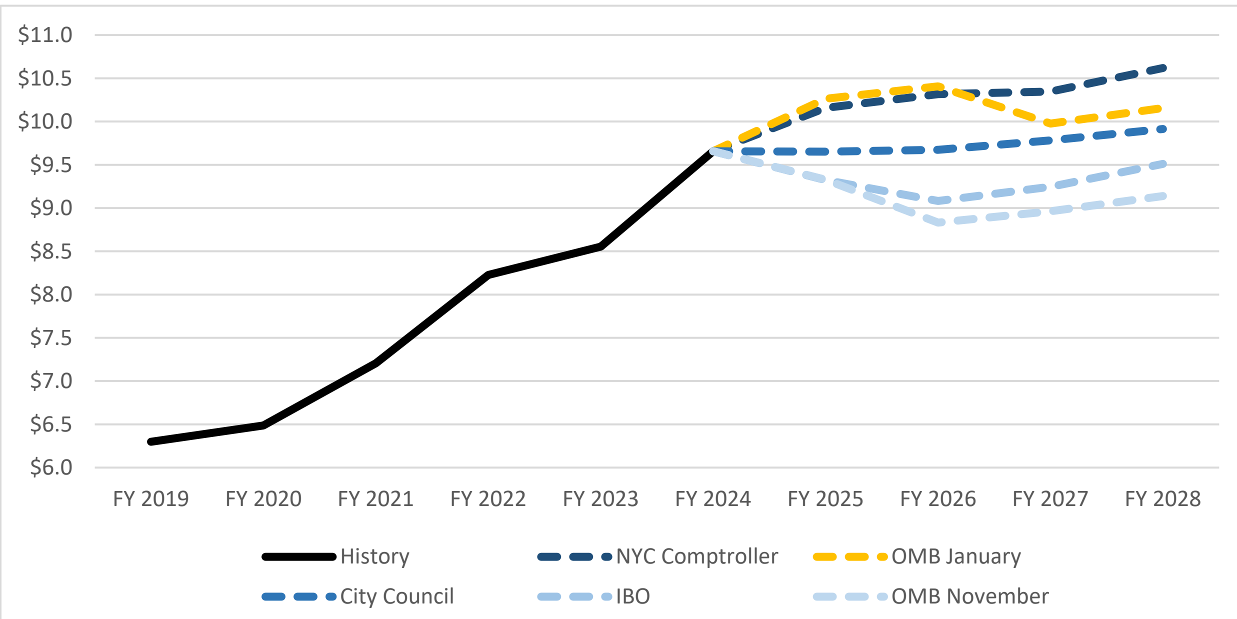
[20] See Phillips A. and Wlodychak S. "The Impact of Federal Tax Reform on State Corporate Income Taxes", EY, 2018. The analysis assumed NY State would conform to FDII (see footnote 14) and GILTI. NY State did not conform to FDII and started exempting 95% of GILTI in tax year 2019 (see Deloitte, Multistate Tax Alert 7/31/2019).

[21] See NYS Department of Taxation and Finance's Tax Facts.

Where Art Thou Business Income Tax?

Forecasting business income tax revenues is difficult and results can be volatile. The latest projections from the Mayor's Office of Management and Budget (OMB) and the City's fiscal monitors illustrate this point. Chart 9 shows that two forecasts (OMB and IBO) assume sequential declines in FY 2025 and FY 2026 followed by a moderate rebound. We instead project 5.2% growth in FY 2025, followed by much lower rates afterwards. Our view is based on a firm outlook for the U.S. economy and corporate profits, high Wall Street profits in calendar year 2024 (+74.8% year over year through the third quarter),[22] and the 7.4% annual growth observed on a fiscal year basis through November 2024. Lastly, the NYC Council's forecasts constant revenues through FY 2026, followed by moderate growth afterwards. OMB's January forecast follows closely ours in FY 2025 and FY 2026 before projecting a revenue drop in FY 2027.[23]

Chart 9. Latest Revenue Forecasts by Fiscal Year



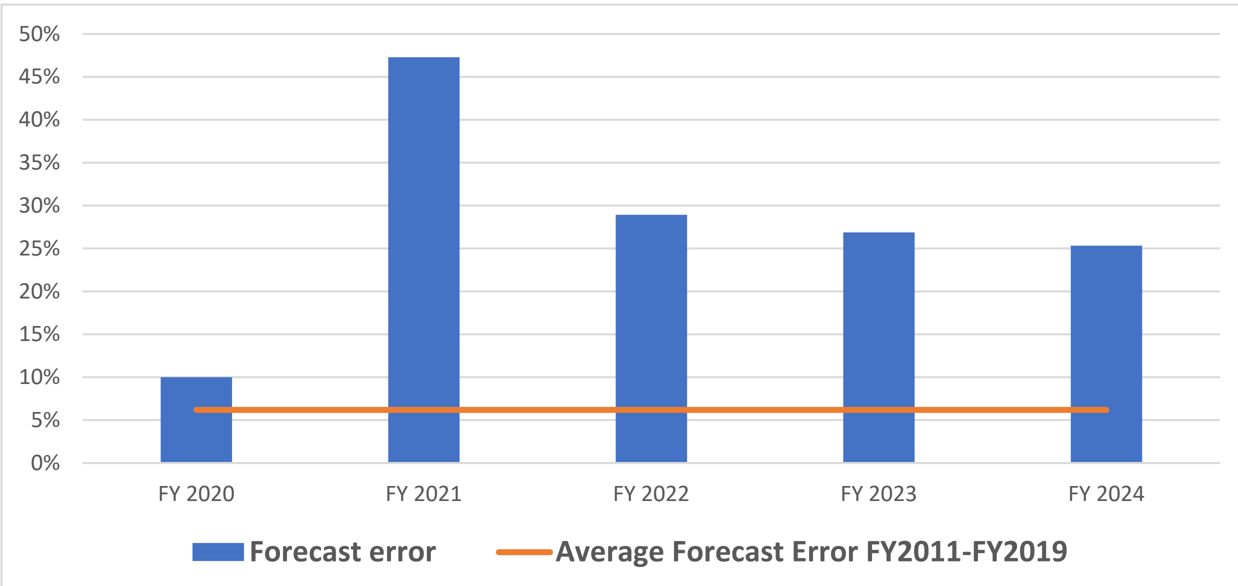
Source: Office of the NYC Comptroller (Dec. 2024), NYC IBO (Dec. 2024), NYC Council (Dec. 2024), NYC OMB (Nov. 2024 and Jan. 2025). The projections are based on economic forecasts formulated in the Fall of 2024 or, in the case of OMB, in the Spring. The forecasts do not incorporate the potential impacts of policies announced by the incoming Trump administration. Data are net of audit revenues.

[22] Our expectation is for Wall Street profits of $41.7b in 2024 based on profits of $35.6b the first three quarters of the year (already exceeding the full 2023 profits of $26.6b). Net payments from the financial sector (which exclude refunds) grew 9.6% on a year-over-year basis in the first three quarters of 2024, and by 13.2% in the June-September period, which reflect more closely estimated payments on 2024 liability.

[23] The forecasts are shown separately for BCT/GCT and UBT in the appendix.

Forecasting is challenging also at short horizons. Chart 10 shows that during the high-growth period between FY 2020 and FY 2024, the 1-year forecast error of budget projections (estimates as of the adopted budget vs. actuals) far exceeded the pre-pandemic average of 6.2%. Our models did not fare any better.

Chart 10. Business Income Taxes: Forecast Error of Budget Projections FY2020-FY2024



Source: NYC OMB, Office of the NYC Comptroller. Forecast error calculated as the absolute value of the percentage difference between final fiscal year amount and the projection at budget adoption (immediately before the start of the fiscal year). Amounts exclude tax audit revenues.

In this section, we explore some of the issues involved in forecasting business income taxes. The section closes with a discussion of potential upsides and downsides from the incoming Trump administration. We include a short description of our forecast model in the appendix.

Persistence, Volatility, and Budget Forecast Errors

A contributor to such large forecast errors is the difficulty to predict growth rates. This can be shown by looking at their persistence and volatility.[24] *Persistence* is the degree to which the

[24] We apply the methodology of Edgerton J., Haughwout A.F., Rosen R. (2004) "Revenue Implications of New York City's Tax System," *Current Issues in Economics and Finance*, Federal Reserve Bank of New York, Vol. 10(4), April.

growth rate in the current and previous year correlate. A number close to one indicates that high growth in one year is followed by high growth in the next, a negative number indicates that growth in one year is followed by declines in the next, and numbers close to zero indicate a weak relationship between growth rates. *Volatility* is a measure of the error made in using this year's growth rate to predict next year's and is reported in relation to the property tax, which is the least volatile revenue source. Table 2 summarizes results for common-rate-and-base (CRB) revenues, which are intended to net out the effects of changes to the City's tax code, as provided by OMB.[25] The regression results show that business income taxes have historically been both volatile and not persistent.

Table 2. Persistence and Volatility of CRB Revenues FY 1985-2019

	All Taxes	Property Tax	Business Income Taxes
Persistence	0.15	0.62***	-0.09
Volatility relative to the property tax	1.3	1.0	4.5

Source: NYC OMB, Office of the NYC Comptroller. Notes: Persistence is the coefficient of a regression of the tax growth rate on its value the prior year, a constant, and current economic conditions as measured by the growth rate of NYS Department of Labor's *Index of Coincident Economic Indicators* (ICEI). Asterisks denote statistical significance (* 5%; ** 1%; *** 0.1%, robust standard errors). Volatility is the standard error of the regressions' residuals relative to the standard error of the regression for the property tax. Results for business taxes are not qualitatively affected by controlling for current economic conditions (see Table A2 of NYC Comptroller (2022) *Preparing for the Next Fiscal Storm*.

Given the previous evidence, it is not surprising that projections have been particularly inaccurate since FY 2020. On the one hand, the pandemic-induced recession should have lowered tax revenues significantly. On the other, yearly growth rates have been very persistent, something that models are not quite able to adapt to.

Tax Liability and Fiscal Year Revenues

Businesses have up to three years to file final returns and liability data takes roughly six quarters to stabilize along relatively predictable patterns. Final returns information is particularly lagged for large taxpayers and BCT filers. The lag complicates forecasting because businesses can overpay or underpay their liability in any given fiscal year.

[25] CRB estimates should limit the volatility attributable to policy changes, but they are largely based on ex-ante studies. For instance, the City's corporate tax reform is assumed to be revenue neutral while the evidence in this fiscal note suggests it created revenue losses.

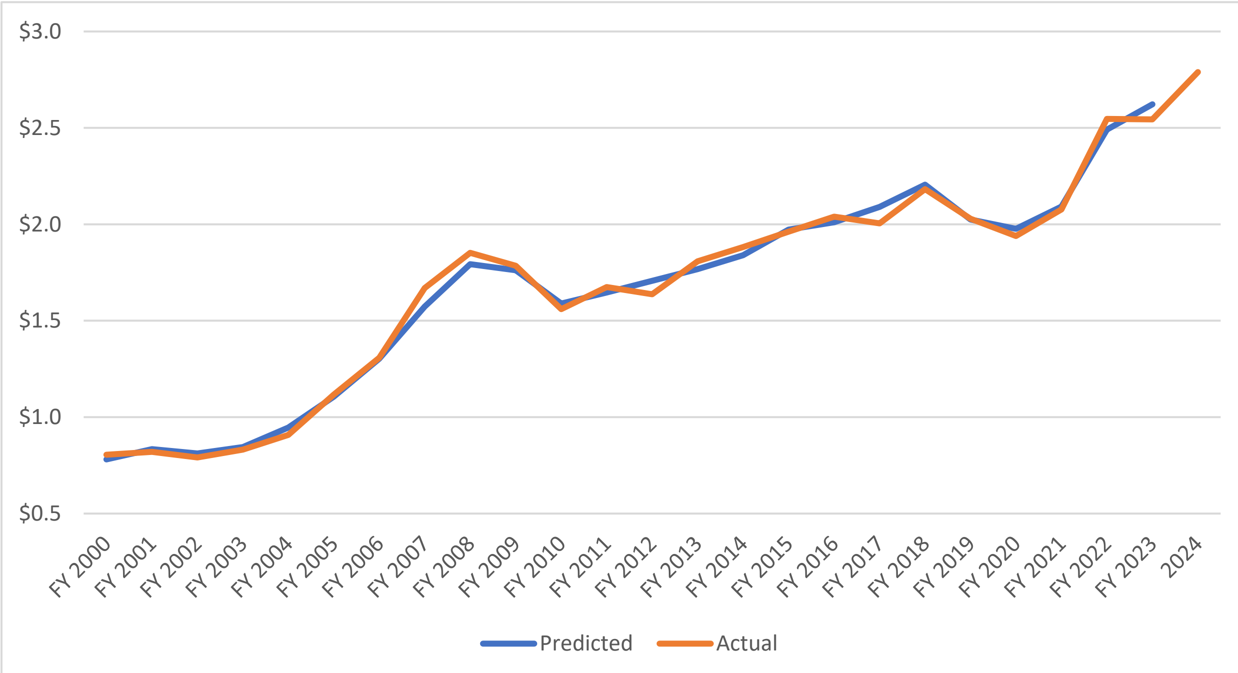
Chart 11 shows historical BCT, BTX, and GCT fiscal year revenues against predicted values using tax liability information. In particular, the chart shows fiscal year *t* revenues against a weighted average of year *t* and year *t-1* liability, with weights derived using regression analysis (see the Chart's notes for details). The final tax liability for 2022 and 2023 is estimated to be $6.2b and $6.8b, respectively. Chart 11 shows that deviations of FY revenues from predicted values are temporary, suggesting that the increase in revenues in FY 2024 could be in part due to payments catching up to liability.

Chart 11. BCT, BTX, and GCT Revenues ($b)

Source: NYC DOF, NYC OMB, Office of the NYC Comptroller analysis. See notes to Chart 2. Predicted values are derived from a regression of FY *t* revenues on year *t* and year *t-1* liability without constant. The sample is FY 2000 through FY 2021 to avoid using 2022 and 2023 liability, which remains preliminary. The regression also includes a dummy FY 2007 to improve the fit of the regression (this is the reason why predicted values coincide with historical in that year). At the time of writing, there are 2 ½ years of data for 2022 liability and 1 ½ years of data for 2023 liability. Final liabilities are estimated by averaging percentage quarterly revisions for between two (for 2022) and six more quarters (for 2023). Percentage revisions are larger and less predictable in the first six quarters but normalize afterwards. The averages are calculated over 2019-2023 to capture recent filing behavior (longer periods deliver similar averages).

Chart 12 applies the same techniques as Chart 11 to UBT data. The final tax liability for 2022 and 2023 is expected to remain essentially unchanged from the preliminary amounts of $2.6b and $2.7b, respectively. Chart 12 shows a very close and stable relationship between liability and revenues, likely due to the faster filing of final returns for UBT taxpayers. As is the case for BCT, BTX, and GCT, predicted values for FY 2023 are higher than collections, suggesting that the growth in FY 2024 may be in part due to payments catching up to liability.

Chart 12. UBT Revenues ($b)



Source: NYC DOF, NYC OMB, Office of the NYC Comptroller analysis. See notes to Chart 2. Predicted values are derived from a regression of FY t revenues on year *t* and year *t-1* liability between FY 2000 and FY 2021 to avoid using 2022 and 2023 liability, which remains preliminary. See the note to Chart 11 regarding the estimate of 2022 and 2023 final liability. Quarterly revisions after the six quarters of data are smaller for UBT than they are for the BCT/BTX/GCT aggregate.

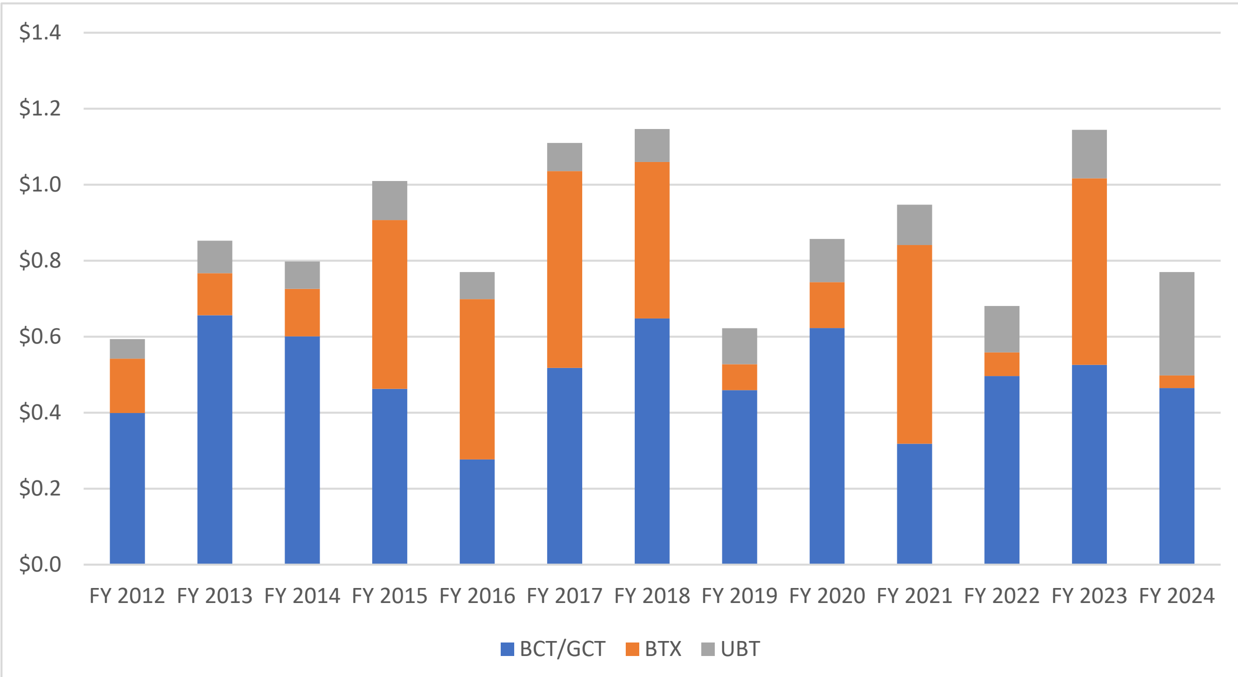
Compounding the noise around the relationship between data on profits, tax year liability, and fiscal year revenues are the long and uncertain lags of tax audit settlements. Chart 13 shows audit revenues by fiscal year separately for BCT/GCT, BTX, and UBT. Between FY 2011 and FY 2024, tax audits represented 11.7% of business income tax collections and nearly $1 billion per year on average. Their lag and volatility are maybe best illustrated by the $1 billion in BTX audits collected in FY 2021 and FY 2023 on pre-2015 liability.

It is perhaps worth adding a few observations:

1. The largest taxpayers are in the financial sector, as reflected by the amount of BTX audit revenues over time.
2. GCT/BCT audit revenues have not changed appreciably over time: the annual average amount of GCT/BCT audits in FY 2011-2017 was $500 million. This is identical to the annual average in FY 2018-2024. However, the second half of the sample fully includes financial institutions under BCT. This could potentially signal a lower revenue stream as a percentage of total collections going forward. A partial offset could come from UBT audits, which spiked to $272 million in FY 2024 and remain elevated in FY 2025 ($127 million as of December).

3. There are no data that attribute the settlements to their respective tax years to reconstruct a true liability amount, and it is not possible to determine to what extent fluctuations in fiscal year revenues and tax year liability are due to tax compliance and audit effort.

Chart 13. Tax Audit Revenues ($b)



Source: NYC DOF, NYC OMB, Office of the NYC Comptroller analysis.

Wall Street Profits and Financial Sector Liability

Because of its share of total liability, the financial sector is of particular importance to forecast tax revenues. In Chart 14, we look at the relationship between liability and NY Stock Exchange member firms' profits ("Wall Street profits") and separate, perhaps a little heuristically, five time periods:

1. In 1999-2005 profits and liability were, with the exception of 2005, following a linear relationship and the average implicit tax rate (liability over profits) was 7.9%.

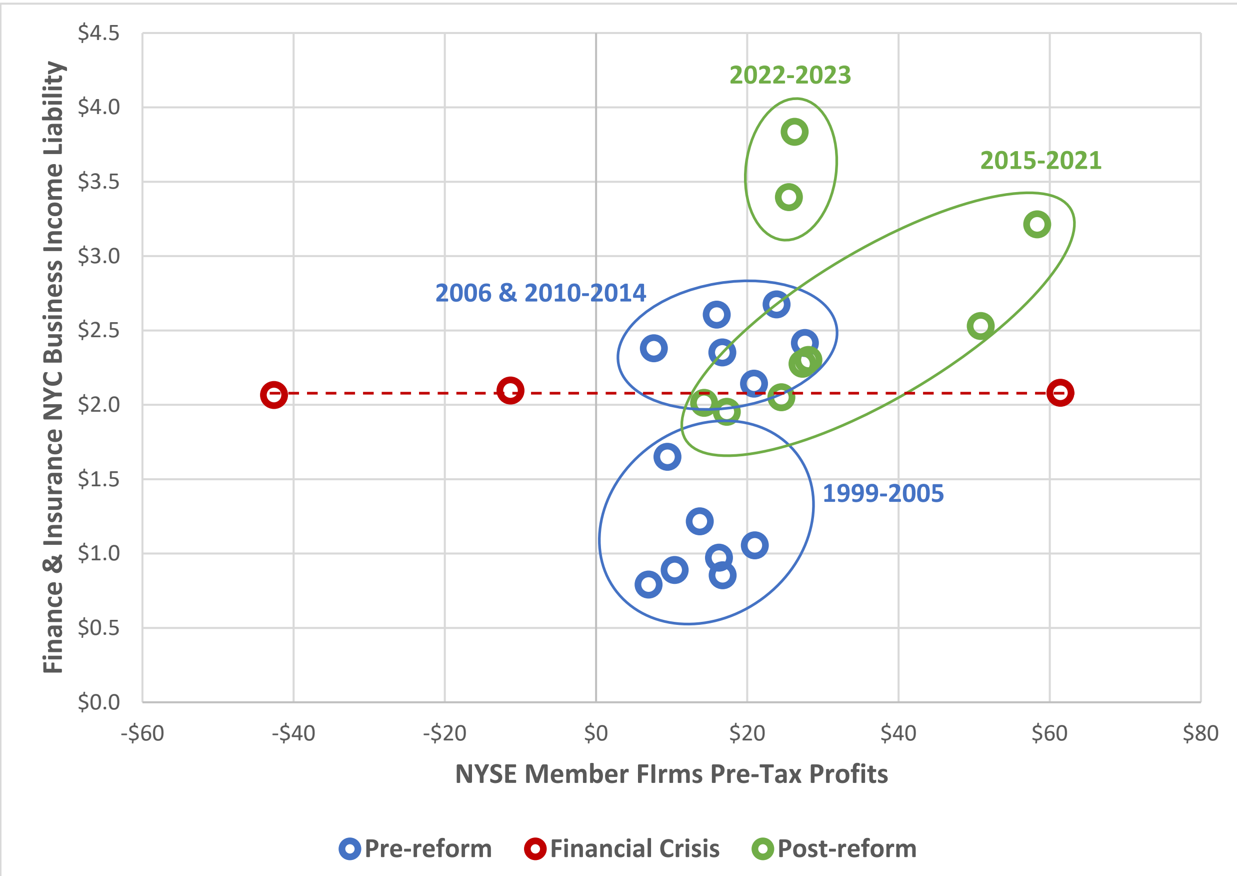
2. During the financial crisis (2007, 2008, and 2009) the tax liability remained constant at $2.1 billion irrespective of whether the industry booked losses (of up to $42.6 billion) or profits (of $61.4 billion, the highest on record in nominal terms).

3. In 2006 and 2010-2014, the tax liability moved above $2 billion despite profits being roughly comparable to those during 1999-2004. The average tax rate jumped to 12.9%.

4. In 2015-2021, after the corporate tax reform, liability normalized on a relatively clean linear relationship and an average tax rate of 7.4%.

5. Preliminary data on the 2022 and 2023 liability suggest another upward jump, with an average tax rate of 14.0%. It is obviously possible that the financial sector tax liability in 2023 (which is still mostly not final) and in 2024 will settle closer to the 2015-2021 relationship, and that businesses overpaid their 2023 liability.

Chart 14. Wall Street Profits and Financial Sector Liability 1999-2023 ($b)



Source: NYC DOF, InterContinental Exchange, Office of the NYC Comptroller analysis. See notes to Chart 2.

Expectations on Federal Policy Changes

Federal tax policy will be a major focus of attention in 2025, mainly due to the extension of expiring individual tax provisions. At this time, proposals concerning the corporation tax appear to have a limited direct impact on the City's business income taxes.

In January, the House of Representatives' Ways and Means Committee collected a menu of potential measures that could be part of the budget reconciliation process. Two options contemplate the reduction of the federal tax rate to either 20% or 15%. This change would not affect the City's business taxes. The tax rate could be lowered to 15% on manufacturers by reinstituting the Domestic Production Activities Deduction, a 28.5% deduction that was repealed by TCJA. This deduction would also not flow through to BCT.

TCJA changed the tax treatment of R&D expenses from expensing to 5-year amortization starting in 2022. This change increased the City's tax base. One of the Ways and Means options calls for the return to expensing, which could lower City's tax base. The reinstitution of TCJA's bonus depreciation of investments in equipment was mentioned on the campaign trail but not included in the Ways and Means document. Even if enacted, the provision would not affect the City's tax base.

The reversion to the less stringent pre-2022 rules for the interest paid deduction limitation would, without changes to State legislation, lower the City's tax liability in the manufacturing, management, and information sectors.[26] As discussed earlier, the limitation likely increased City revenues in its less stringent form. The rules in place since 2022 should have further broadened the City's tax base and the proposal would reverse this incremental impact.

The imposition of tariffs would have an indirect impact on the City's business income taxes through their impact on GDP, consumption, and overall profit margins. The NYC economy is unlikely to benefit from onshoring of manufacturing activities or to be hurt directly by retaliatory tariffs (because exports are not sourced to New York City).

Looser regulations could impact the financial and tech sectors through lower capital requirements and a wave of mergers and acquisitions and Initial Public Offerings. Reports from recently released 2024Q4 earnings of large banks signal high expectations for 2025, including for dividends and buybacks. If these expectations were to be realized, there would also be positive repercussions on personal income taxes.

Obviously, the cost of tax cuts could be borne directly by the City's budget and New Yorkers through a reduction of federal aid, as outlined by our office in various reports issued in the past few months.[27]

Conclusions

Over the past several years, revenues from the taxation of business income fluctuated significantly, driven by both economic conditions and legislative changes. The 2015 reform of the

[26] See Richmond J., Goodman L., Isen A. (2023, October 31). *Tax Policy, Investment, and Firm Financing: Evidence from the U.S. Interest Limitation.* https://jordan-richmond.github.io/research/s163j_jmp.pdf.

[27] See Office of the NYC Comptroller (2024) *Protecting NYC*, *NYC's Federal Funding: Outlook Under Trump*, and (2025) *Risk for Medicaid and other NY State Healthcare Programs*.

City’s tax on C-corporations led to revenue declines, at least in the short term. Conversely, the 2017 Tax Cuts and Jobs Act (TCJA) resulted in an increase in tax liability, as the federal law expanded the City’s tax base without reducing its tax rates.

In addition to adjustments to tax policy, tax revenues have been influenced by the volatility of corporate profits. The composition of tax liability has also evolved, with non-financial sectors such as technology and professional services becoming increasingly important contributors alongside Wall Street firms. While the financial sector still accounts for a large share of corporate tax payments, the expansion of other industries has introduced some diversification of the tax base. Tariffs, regulatory shifts, and changes in corporate taxation during the Trump administration could all influence revenues in ways that are difficult to predict.

As part of a more strategic approach to business taxation, the City should also investigate the economic benefits and fiscal implications of harmonizing the taxation of flow-through entities to that of C-corporations.

Looking ahead, the City should carefully balance its reliance on business tax revenues with the need for stability and predictability in its budget. Given the increasing role of business taxes in the overall revenue stream, the City needs a more robust approach to managing its budgetary and long-term reserves, ensuring that revenue shortfalls can be addressed without disrupting essential services.

Acknowledgements

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Appendix

An ideal approach to forecasting business income taxes would be to estimate the total tax liability in each year for each major type of tax and then separately calibrate a method of distributing such annual liabilities into fiscal year revenue streams. However, thus far, we have been unable to assemble the data and modelling necessary to follow this approach.

Instead, our current model is based on estimated reduced-form equations which model revenues by fiscal year directly. Two separate equations are estimated for corporate taxes (BCT, GCT, and BTX) and the unincorporated business tax (UBT).

To render the series stationary, we model each as a share of U.S. nominal GDP. In examining the historical data on these shares, tax collection shares higher than the long-run average tend to gradually converge toward the mean share.

Equations (1) and (2) show the variables used in the models for the Corporate Tax and UBT shares of GDP. The equations are estimated simultaneously as a system.

$$(1) \quad \genfrac{}{}{0pt}{}{Corporate\ Tax}{as\ Share\ of\ GDP}_t = f\begin{bmatrix} Net\ Corporate\ Tax\ as\ Share\ of\ GDP_{t-1}, \\ \Delta US\ Corporate\ Profits_{t-i\ for\ i=1\ to\ 3}, \\ \Delta Wall\ Street\ Profits_{t-1}, \\ \Delta NYC\ Total\ Wages_{t-1}, \\ Special\ event\ indicators_t \end{bmatrix}$$

$$(2) \quad \genfrac{}{}{0pt}{}{UBT}{as\ Share\ of\ GDP}_t = f\begin{bmatrix} UBT\ as\ Share\ of\ GDP_{t-1}, \\ NYC\ Corporate\ Tax\ as\ Share\ of\ GDP_{t-1}, \\ \Delta US\ Corporate\ Profits_{t-i\ for\ i=1\ to\ 3}, \\ \Delta NYC\ Total\ Wages_{t-1}, \\ Special\ event\ indicators_t \end{bmatrix}$$

The explanatory variables use baseline forecasts by Moody's Analytics' Economy.com model (U.S. nominal GDP and U.S. corporate profits) as well as our own projections of Wall Street Profits and NYC Total Wages. Special event indicators are dummy variables that correspond to three unusual (fiscal) years—2007, 2016, and 2018.

We conducted out-of-sample tests of the forecast model's performance by estimating a sequence of forecasts using samples ending in each of several earlier years. We then compared these forecasts to actual values observed in the following fiscal year. In Table A1, we show these one-year ahead forecast errors for FYs 2016 through 2024—using samples ending in 2015 through 2023, respectively. Overall, the absolute values of the retrospective errors are smaller than the prior forecast errors that were noted above, in Chart 10. While the results are encouraging, actual tax revenues for FY 2024 were significantly underestimated, signaling the need for further refinements.

Table A1. One-Year Ahead Model Forecast Percent Errors

Fiscal Year	BCT/GCT	UBT	All Business Income Taxes
2016	8.6%	-3.4%	4.3%
2017	2.7%	5.9%	3.9%
2018	12.2%	-3.8%	6.0%
2019	-5.4%	7.1%	-1.3%
2020	-9.3%	3.9%	-5.3%
2021	-1.0%	0.5%	-0.6%
2022	9.7%	-1.0%	6.4%
2023	-7.0%	9.3%	-2.2%
2024	-22.4%	1.7%	-15.4%
Mean Absolute Percent Error 2016-2024	**8.7%**	**4.1%**	**5.0%**
Mean Absolute Percent Error 2020-2024	**9.9%**	**3.3%**	**6.0%**

Source: Office of the NYC Comptroller.