

Chapter 2 – Principles and Whole Tax Structure Principles

I. Principles

A. Introduction

The General Assembly directed the TSC to ***“have as its goal, a tax system that provides sustainability, appropriateness, and equity.”*** Accordingly, the principles developed by the NCSL, with minor changes, were adopted by the TSC to guide our analysis of the current structure and our evaluation of possible recommendations. Before applying the principles, it is important to note three considerations.

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1) The principles are designed to be applied to the tax structure as a whole. Although each tax contributes to the structure, and the role of each tax in meeting each goal is important, some principles can only be evaluated by looking at the bigger picture. Achieving revenue stability through a balanced variety of revenue sources, for example, requires looking at the combined effect of all the pieces.

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2) Some principles are conflicting. For example, taxes that are the simplest are not likely to reflect the ability to pay. Or, a tax that is in line with one in a neighboring state may not raise sufficient revenue. The principles do not include measurements of success, but rather they reflect general goals that can be met to different degrees. Tradeoffs and balancing are required. Again, the goal is to look at the whole structure and the whole set of principles.

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3) The goal of aligning a state tax system with the principles is a moving target. For the tax structure to reflect these principles over time, it must respond to changes in needs for revenue, changes in the economy, and changes in the population. To a certain extent the structure can be designed to minimize the frequency of legislative intervention needed, but maintaining the right mix of revenue sources and tax levels to meet changing public needs will require periodic review, analysis, and modernization.

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This chapter evaluates Vermont’s tax structure, and the major tax types within that structure, based on the principles of sustainability, equity, and appropriateness. It then makes the case for an ongoing study of income, taxes, transfer payments, and government benefit programs in order to better understand the equity and progressivity of our tax structure as a whole. Finally, it offers a few words on the role of Pigouvian Taxes, revenue sources designed on the theory that shifting taxes away from socially beneficial activities and onto socially harmful activities can achieve social goals and increase economic efficiency.

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B. Sustainability

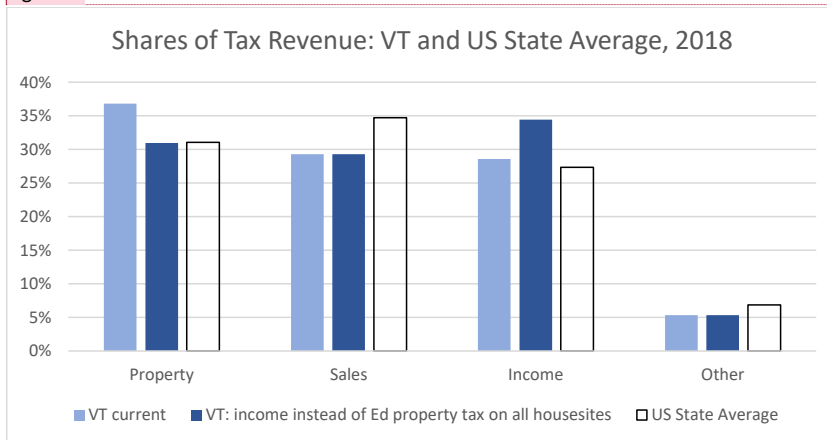
- Comprises elements that are complementary, including the finances of both state and local governments.
- Produces revenue in a reliable manner, prioritizing stability, certainty, and sufficiency.
- Relies on a balanced variety of revenue sources.

1. Structure

Balance

Although there are no accepted optimal proportions, it is generally agreed that a state's tax portfolio should include a mix of consumption, property and income taxes both to provide a broad tax base and to promote revenue stability, as different taxes tend to have different economic cycles. The chart below shows the average mix in all states, the current mix in Vermont, and the mix that would result if the tax on all housesite property were replaced with an income-based tax as recommended by the commission.

Figure 1



Currently, Vermont's reliance on the property tax is above average and its reliance on the sales tax is below average. The commission has recommendations to decrease the reliance on the property tax (by replacing the housesite education property tax with an income-based tax) and for increasing the base of the sales tax to eliminate most expenditures and to include services. Because the commission is also

¹ Includes State and Local taxes; Source: US Census State and Local Government, with a correction for local property taxes paid. "VT Current" attributes the portion of the homestead education tax which is paid based on income (\$162.3M) to the income tax category, not property tax. [This does not show the recommended change concerning renters which is assumed to be a credit equal to, and offsetting, the additional tax amount.](#)

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recommending a decrease in the sales tax rate, the net effect will be revenue neutral and the sales tax proportion relative to total revenue will therefore remain the same.

But, even with this type of balance, the revenue stream can be volatile, depending on changes in the taxbases, changes in the population, changes in the economy, and changes made by the legislature. Volatility can result not only in changes in the tax base from year to year, but also in changes between the time the budget is prepared and when the tax revenue is actually collected. This volatility is seen in the income tax and the sales tax. This within-year volatility is dealt with by maintaining a stabilization reserve and/or adjusting the budget mid-year to account for changes.

This within-year revenue volatility is mostly avoided by the property tax for two reasons. First, rather than keeping the same rate from year to year, the property tax rate is set each year to raise the revenue needed. The rate is calculated by dividing the amount needed by the tax base—so the right amount is billed. Second, rather than applying the tax rate to the coming year's tax base, which is unknown at the time the budget is being developed, the property tax rate is applied to a tax base that is determined and fixed before the rate is set.

But volatility is also an issue for the taxpayer. The stability of the Education Fund, for example, results from the property tax functioning as a shock absorber, making up for the combined increases and decreases in other revenue sources so that the Education Fund is filled. The income tax, in contrast, varies depending only on the taxpayer's income, making it less of a problem for the taxpayer. While this means the tax revenue is variable, it also serves as an automatic stabilizer to the economy; in recessionary times, the tax is reduced, enabling consumer spending.

2- Sustainability and the Major Tax Types

Sustainability and Education/Property Tax

The principles call for the taxes of state and local governments to be complementary. The current state/local system relies disproportionately on the property tax, which is the main source of local government revenue. Shifting the residential education tax from a property tax to an income-based tax, as recommended by the commission, would reduce this as indicated in the chart above.

Because property tax, however, is generally thought to be more stable, a shift to an income-based tax could make the Education Fund revenue less stable. To increase stability, the tax rate should be set annually to raise the needed amount, as it is with the property tax. It is important to note that the property tax is generally paid out of income; during the pandemic we see nonpayment of property tax bills because incomes, and not the property values, have decreased. However, a shift to an income-based tax could make the Education Fund revenue less stable. To increase stability, the tax rate should be set annually to raise the needed amount, as it is with the property tax.

Because the Education Fund has multiple sources supplying varying amounts each year, and because the Education tax serves as the shock absorber to make the fund whole after accounting for the changing sources and uses, the commission recommends creating an ongoing advisory commission to monitor the

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Education Tax and to make recommendations for the rates, annually, as well as for any changes needed for continued sustainability.

Sustainability and Consumption Tax

With consumption taxes, the broader the base, the more stable and sustainable the tax revenue. This is because with a broader base, any particular category or industry makes up a smaller part of the tax base, and growth or decline in that category or industry has a smaller effect on overall tax revenue, and more chance of being offset by a different industry moving in the opposite direction. This is true both of short-term impacts (COVID-19 drastically reduces tourism for a few seasons) and long-term impacts, like the accelerating and expected permanent decline of gas-powered cars.

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In addition, our recommendation is not only to broaden the base, but also to lower the rate. Lower rates are by their nature more stable than higher rates, both economically (less likely to stimulate efforts to find lower-price substitutes) and socially (less likely to cause informal and formal protest and action).

Taken together, we believe these steps will make Vermont's consumption taxes significantly more sustainable over the next two decades. Sales taxes are by their nature regressive — everyone pays the same, regardless of ability to pay. In fact, taken in isolation, our recommendation to extend the sales tax to all consumer purchases of goods and services makes Vermont's sales tax more regressive. Currently, necessities like groceries are exempt, and lower income households spend a higher percent of their income on groceries than do higher income households. This means that including groceries and other necessities, as we recommend, adds to regressivity.

However, we do not make this recommendation in isolation. We note the vital importance of protecting low income households from bearing any additional burden, and have recommended a comprehensive review of the income, transfers, and taxes for low income Vermonters to ensure that 1) no one is bearing an undue burden of taxation relative to their resources; and 2) that Vermont eliminate the benefit "cliffs" that causes a low income household to be worse off when their income increases. We believe that if these issues are addressed in conjunction with our recommendations on the sales tax, we can achieve the goals of making the sales tax simpler, more sustainable, and fairer through a broader base and a lower rate while at the same time protecting low income Vermonters from bearing any additional burden due to the expansion of the sales tax base to include necessities.

Sustainability and Income/Estate Tax

Vermont taxes both individual and corporate income tax, as well as imposing tax on trusts. Business income generated by pass through entities is taxed at the individual level.

Sustainability of Vermont's income tax system is highly dependent on the ability to adapt to economic factors in the state and the world in general. All but five states in the United States and most foreign jurisdictions have a form of income tax indicating popularity and in turn stability again, provided the system is adaptable to changes needed.

Volatility exists in the Vermont income tax system, because it is collected based on the premise of income which can vary due to economic factors, size and composition of population and other factors which affect all states. Unfortunately, the size and composition of our population tends to potentially exaggerate volatility. Despite this, income tax in Vermont has been relatively stable when compared to other Vermont taxes.

The estate tax is even more volatile because it requires a death which cannot always be predicted. It is definitely not a stable predictable source of tax revenue.

The recommendations of the Commission do not affect the volatility or sustainability of the income tax or estate tax.

C. Equity

- Imposes similar tax burdens on people in similar circumstances.
- Imposes a higher burden on people with greater ability to pay, and minimizes taxes on individuals with low income.
- Promotes equity and fairness, both actual and perceived.

1. Structure

The principles call for imposing a higher burden on people with greater ability to pay, which is also known as vertical equity or progressivity. In applying this principle to taxes, income is generally used as the measure of ability to pay.

The equity principles take on particular significance when considering the decades-long trend of rising inequality in the United States and in Vermont. The Economic Policy Institute reports that the share of total income captured by the top 1% of U.S. families doubled from 10% in 1979 to 20.1% in 2016. The gap also grew in Vermont, albeit from a somewhat lower base and at a slower rate. In 1979, the top 1% of Vermont families captured 7.8% of total income; by 2013 this share had risen to 13.8² (see a more comprehensive discussion of this topic in Appendix X) .

Overall, the current tax structure in Vermont is slightly progressive, according to a national study which notes that Vermont's tax system is one of only five state tax systems that isn't regressive and that Vermont's "large income gap between lower- and middle-income taxpayers, as compared to the wealthy, is somewhat narrower after state and local taxes than before."³ As explained later in this chapter, the commission recommends the state undertake a more detailed analysis of the tax incidence, using actual Vermont data.

² <https://www.epi.org/publication/income-inequality-in-the-us/>

³ Who Pays? 2018. Institute on Taxation and Economic Policy. www.itep.org

Average Effective State and Local Tax Rates⁴

Percentage of total state and local taxes as a share of income for non-elderly residents



The personal income tax is Vermont’s most progressive tax, not only because it is based on income, but also because it has different filing statuses, standard deductions, exemptions, and credits designed to further refine ability to pay and to target transfers.

Other taxes, such as the sales tax, avoid regressivity by exempting goods that are necessities. The Tax Structure Commission recognizes that an individual tax may be regressive, but it is the progressivity of the overall structure that is most important. Imposing a flat tax that falls more heavily on lower-income households may be easy to administer because it is simple, and it could actually make the overall tax structure more progressive assuming the revenue is directed toward meeting the needs of the lower-income households, either through the income tax, tax credits, or other programs.

For example, levying a sales tax on heating fuel may be regressive because fuel purchases are a higher percentage of the income of lower income households than of higher income households. Yet it may play a valuable role in discouraging the use of fossil fuels—and it raises revenue. If the amount of money lower-income households pay in the fuel tax results in an equivalent income tax reduction or credit, the regressivity is offset, the state receives more tax revenue from the higher-income taxpayers and nonresidents than it did without the tax, and fuel consumption is discouraged.

Equity and the Major Tax Types

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Equity and Education/Property Tax

The principles call for imposing similar tax burdens on people in similar situations, which is also known as horizontal equity. The unequal tax burdens in school districts, resulting from unequal Grand Lists, formed the basis of the Brigham decision and the subsequent changes in the Education Tax so that the tax rate now is the same in any district with the same spending per pupil.

⁴ Both graphs from “Who Pays? 2018.” Institute on Taxation and Economic Policy. www.itep.org

But vertical equity is still an issue. For households with incomes less than \$140,000 or so, the tax education tax increases slightly as a percentage of income; it drops at higher incomes. Changes recommended by the commission would move all households to paying a flat percentage of their income. While this would not result in a progressive tax, it would improve the progressivity of the overall structure.

Equity and Consumption Tax

Sales taxes are by their nature regressive – everyone pays the same, regardless of ability to pay. In fact, taken in isolation, our recommendation to extend the sales tax to all consumer purchases of goods and services makes Vermont’s sales tax more regressive. Currently, necessities like groceries are exempt, and lower-income households spend a higher percent of their income on groceries than do higher-income households. This means that including groceries and other necessities, as we recommend, adds to regressivity.

However, we do not make this recommendation in isolation. We note the vital importance of protecting low-income households from bearing any additional burden, and have recommended a comprehensive review of the income, transfers, and taxes for low-income Vermonters to ensure that 1) no one is bearing an undue burden of taxation relative to their resources; and 2) that Vermont eliminate the benefit “cliffs” that causes a low-income household to be worse off when their income increases. We believe that if these issues are addressed in conjunction with our recommendations on the sales tax, we can achieve the goals of making the sales tax simpler, more sustainable, and fairer through a broader base and a lower rate while at the same time protecting low-income Vermonters from bearing any additional burden due to the expansion of the sales tax base to include necessities.

Vermont has a progressive income tax structure. Because of tiered rates that increase as income increases, a form of progressivity is achieved since those at higher income levels pay a larger percentage of their income due to the rate steps as opposed to say, a flat tax rate on all income.

Vermont’s tax system achieves tax equity to some degree because of its progressivity. With respect to personal income tax, Vermont also offers other ways of achieving tax equity such as the earned income credit, renter’s credit and other business-related credits such as the Research and Development Credit and the Business Investment Tax Credit for Solar Investment.

Equity and Income Tax

Vermont has a progressive income tax structure. Because of tiered rates that increase as income increases, a form of progressivity is achieved since those at higher income levels pay a larger percentage of their income due to the rate steps as opposed to say, a flat tax rate on all income. Vermont also offers other ways of achieving tax equity such as the earned income credit, renter’s credit and other business-related credits such as the Research and Development Credit and the Business Investment Tax Credit for Solar Investment.

Here is one of the major findings of the Vermont Tax Study 2005-2015:

Vermont’s progressive income tax structure results in most Vermonters paying relatively low effective tax rates. Across most income levels, Vermont has an effective income tax rate lower than those in other New England states and New York. Vermont’s effective tax rate begins to climb more steeply at adjusted gross income (AGI) levels exceeding \$100,000. In 2015, Vermont had the highest marginal tax rate in New England and New York at 8.95 percent; in Vermont,

that rate applies to taxable income above \$411,000. The state relies on these upper-income taxpayers for a significant share of total income tax revenue: the top 5 percent of resident tax filers, with AGI over \$165,500, paid 48 percent of resident income taxes in Vermont in 2015. Similarly, a relatively small share of taxpayers account for most of the corporate and estate tax revenues. Eighty-four percent of corporate income taxes are paid by larger, mainly out-of-state businesses. Despite roughly 5,400 deaths in Vermont annually, only about 84 estates per year are subject to the estate tax. Combined, the Corporate Income Tax and Estate Tax accounted for a relatively small share of total state tax revenues, 3.3 percent in 2015. Because Vermont's three income-based taxes — on individual income, corporate income, and qualifying estates— are linked to the federal tax code, changes in federal tax policies could have major implications for state revenues.⁵

The recommendations of the Commission do not affect the fairness of the income tax.

Equity and Estate Tax

By its nature, the Estate tax is progressive. It is designed to tax the wealth upon the death of an individual over a certain threshold. Those decedents that fall below the threshold do not even have to file a return. In 2016, legislation was passed to simplify this tax. There is now a set threshold and a flat rate for all taxable estate over that threshold. The flat rate does however detract slightly from its progressivity, since an estate that is one dollar over the threshold is taxed at the same flat rate as millions of dollars over the threshold. The threshold at present; however, is high enough so that decedents in the low net worth cohort at death pay no tax. The simplicity outweighs the progressivity from an overall compliance standpoint, mainly the less complicated a tax is, the more widespread compliance.

The Estate Tax has a mechanism called the step up in basis in the law. This simply means that because a decedent's estate is taxed on the fair market value of his or her property at date of death, the property passes to the beneficiary at that value. When the beneficiary sells that property, the stepped-up basis is used to calculate their taxable gain or loss. On the one hand, this is regressive because it gives the beneficiary a perceived unfair advantage since the appreciation the decedent realized during life escapes income taxation because any future taxable gain is measured using the fair market value at date of death. On the other hand, since the estate pays a rate of 16% on the total fair market value (the decedent's original cost does not enter into the calculation), the decedent's estate is in effect paying a higher rate versus an income tax rate. Also, if the step up did not exist and the estate is taxed at full fair market value, the taxable appreciation of the decedent would be taxed twice, once at the estate tax level and then again at the beneficiary income tax level. This would add an unfair double tax. If the step-up was removed from the law, the Estate Tax would become even more regressive since everyone receiving property from an estate would pay tax on the taxable appreciation realized by the decedent across all income cohorts. Yet another argument against the step-up would be for those estates below the threshold that don't pay estate tax, the appreciation on the property up to the decedent's date of death permanently escapes taxation.

⁵ <https://ijfo.vermont.gov/assets/Uploads/6ca6f1666c/2017-10-Year-Tax-Study-Full-Report-Compressed.pdf>

The recommendation of the Commission to study the model of treating the Estate Tax as a taxable sale at date of death would eliminate the missed taxation on the decedent's lifetime taxable appreciation. This would add regressively to the Estate Tax since this would be payable by all income cohorts regardless of their net worth.

D. Appropriateness

- Is easy to understand and minimizes compliance costs.
- Is as simple as possible to administer, raises revenue efficiently, is administered professionally, and is applied uniformly.
- Is transparent and accountable to taxpayers.
- Is responsive to interstate and international competition.
- Minimizes its involvement in spending decisions and makes any such involvement explicit.

1. Structure

The principles call for tax simplicity and conformity for at least three reasons. First, individuals and businesses operate in multiple jurisdictions and may be subject to multiple filing requirements, which can be especially costly and burdensome if a state government does not coordinate with other states, the federal government, and local governments. Second, state staff will be better equipped to provide fair and consistent customer service, minimize errors, and use a smaller proportion of revenue on administration if the tax system is simplified. Third, it must be transparent and accountable to taxpayers.

The principles also acknowledge competition between states. As borne out by the proliferation of state tax rankings in recent decades, policymakers face increasing pressure to use revenue systems as a tool for economic development. The principles note, however, that benefits have to be measured against costs. When making decisions about where to locate, businesses will consider a state's service levels and amenities as well as taxes.

Finally, the principles recognize that taxes disincentivize behavior and tax breaks incentivize behavior. Deductions, exemptions and credits all intend to foster certain activities, but they come at the cost of shifting the tax burden to other taxpayers. Policymakers must continuously evaluate the effectiveness of all tax expenditures and tax earmarks to ensure these tools are delivering their desired result more efficiently than alternative options.

Appropriateness and the Major Tax Types

2. Verticals

Appropriateness and Education/Property Tax

The commission recommends strengthening state support for professional administration of the property tax at the local level.

The commission recognizes the baffling complexity of the current homestead education tax and hopes to simplify this by: replacing the dual property/income calculations with an income-only tax; eliminating the property tax adjustment; making the bill directly connected to the budget vote.

The locally voted education tax is different from other taxes in because it both collects and distributes. If this tax is unfair, it is likely education will be distributed inequitably. For this tax, perhaps the most important component of appropriateness is unambiguous equity, as it would support both the collection of revenue and the appropriate distribution to school districts.

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Clearly, Vermont's residential education tax is different than that of other states. Most Vermont homeowners now pay an income-sensitized property tax which is a locally voted tax rate applied to their income. The average rate is 2.5%. The commission's recommendations call for making the income-based residential tax more direct and comprehensive. Although it would still average 2.5% of income, it would no longer be called a property tax. This change in terminology may make state-to-state comparisons more challenging, but in practice there would be little change in the amount of net tax for most taxpayers. The change would, however, increase the education tax on higher-income households which may prompt them to claim their residence in another state.

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Appropriateness and Consumption Tax

As we look at the appropriateness of the sales tax with a broader base and lower rates, and evaluate that against each of the components of appropriateness, we find:

- **Is easy to understand**

Presumably, any tax with fewer exceptions is easier to understand – it's easier to understand what's taxed, and requires fewer explanations of why certain categories are exempt from the tax.

- **Minimizes compliance costs.**

Cash register, payment, and tax compliance technology have made calculating the sales tax due on any given transaction close to effortless for merchants. It is also easy to report and remit totals due to the state. However, it is true that state audits of individual merchants due turn up instances of non-compliance, sometimes in the form of purchases made by a company which the company improperly deemed to be exempt from the sales tax. The more we are able to exempt business inputs from the sales tax, and the more we are able to include all consumer purchases in the sales tax, the rarer such instances of non-compliance should become.

- **Is as simple as possible to administer, raises revenue efficiently, is administered professionally, and is applied uniformly.**

The sales tax is very well understood and is currently administered across broad swaths of the Vermont economy. It is efficient and administered professionally, and our recommendations will increase the uniformity of its application.

- **Is transparent and accountable to taxpayers.**

While certain sectors have lobbied to keep their particular industry exempt from the sales tax, there has been no broad tax-payer resistance to or demands for reform to the sales tax. Consumers may not be explicitly aware of the categories that are exempt from the sales tax, but in general seem to understand the sales tax and to expect to pay it on many of their purchases.

Excise taxes are different – we believe that most consumers are not aware of the level of taxation on gasoline, alcoholic beverages, or tobacco products, so there is an opportunity for greater transparency in these areas.

- **Is responsive to interstate and international competition.**

Lowering our sales tax rate will make us more competitive compared to New York and Massachusetts, and will reduce our competitive disadvantage relative to New Hampshire.

- **Minimizes its involvement in spending decisions and makes any such involvement explicit.**

The lower the rate, the less a tax affects spending decisions. The broader the base, the less a tax affects spending decisions, and the fewer involvements that require explicit explanation there are.

Appropriateness and Income/~~Estate~~ Tax

In Vermont, the income tax is appropriate since income is a good indicator of a person or entity's ability to pay. Even states such as New Hampshire that do not have an income tax so to speak, have taxes that are based on certain types of income such as the Business Profits Tax which is levied on all businesses regardless of whether the income at the federal level is taxed at the entity or individual level, and the tax levied on interest and dividends.
~~The commission's recommendations do not affect the appropriateness of the income or estate tax.~~

Appropriateness and Estate Tax

The estate tax is appropriate in that it captures and taxes wealth accumulated during lifetime if the estate exceeds the thresholds set in the law and these thresholds are set at an appropriate level that does not unfairly tax those in the lower income and wealth cohorts.

Recommendation 1: ~~Commission an Incidence Study~~

In order to understand the equity and progressivity of our tax structure, we recommend undertaking a comprehensive and ongoing study of income, taxes, and the various transfer payments and government

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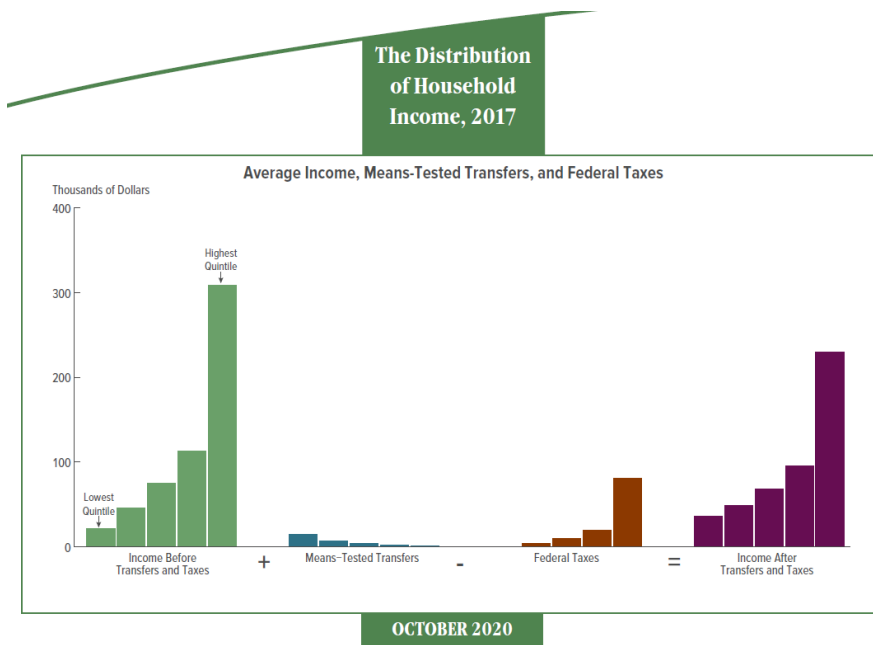
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benefit programs. This would help future legislatures look at changes over time, recommend adjustments, and measure progress.

The study would first divide households, adjusted by size, into deciles by market income. Next, it would compute transfer payments received by each of those deciles. Finally, it would compute taxes paid by each decile.

There are two approaches. The first would be based on state totals, similar in both methodology and assumptions to the national studies done by the Congressional Budget Office. The difference would be the addition of state taxes and state transfer programs.



A second approach may be considered in order to differentiate between types of households. This may be particularly important in shining a light on specific inconsistencies, such as different treatment for households with children or renters, or for determining if there are income levels at which there are sudden increases in tax liabilities or decreases in transfer payments. In this approach, different family types are created with average or hypothetical characteristics, and the transfer payments and taxes paid are calculated based on those characteristics, showing the net resources available to the family type at different income levels.

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The Legislature directs the Joint Fiscal Office to estimate the income needed to meet the basic needs of Vermont families.⁶ The basic needs study, completed every other year, looks at six hypothetical family types:

- Single Person
- Single Person, Shared Housing
- Single Parent with One Child
- Single Parent with Two Children
- Two Adults with No Children — both wage earners
- Two Adults with Two Children — one wage earner
- Two Adults with Two Children — both wage earners

For each family type, the study estimates the cost of meeting its basic needs which include food, housing, transportation, child care, clothing and household expenses, telecommunications charges, health and dental care, renter's insurance, life insurance, and savings.⁷

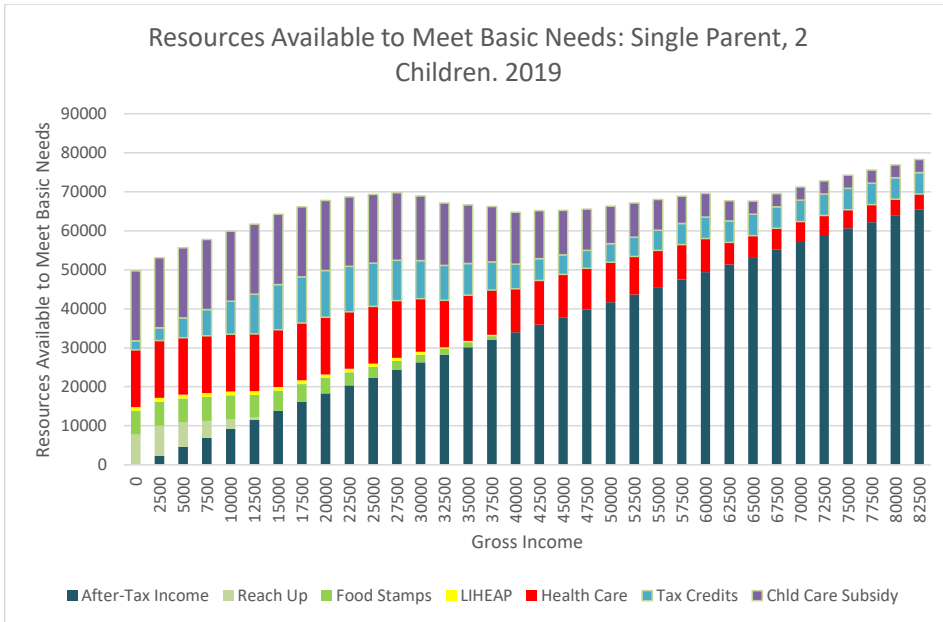
A concurrent tax and transfer study could look at the ability of these same hypothetical family types, starting with a very low market income and moving up until they could meet their basic needs. It would illustrate points at which the families net worth decreases (aka benefit cliffs), and disclose exactly which taxes and transfers contribute to the problem.

As an example, the chart below is based on one of the families in the JFO Basic Needs Budget Report: one working parent with two children, aged four and six. The gross wages are on the horizontal axis. The net wages, after subtracting taxes, plus all state and federal benefits (including tax credits) make up the total net resources available to the family. It illustrates that there are points at which a family may earn more income and lose ground. The net wage increases steadily, but the combined decreases in tax credits and various benefits result in the family having fewer resources to make ends meet.

This dismays unsuspecting families, and discourages work for those in the know. It is the unintentional result of good intentions, but it needs a redesign. In addition to looking at each tax provision or transfer program in isolation, we need to look at the combined effect. In addition to looking at averages by income category, we need to look at different family types. In addition to looking at smoothly phasing out each benefit, we need to look at smoothly phasing in a family's ability to pay. We worry that a federal top bracket income tax rate of 50% would be too high, with the assumption that it would discourage work. However, we effectively have created a marginal rate that is greater than 100% for some families who do not have enough income to meet their basic needs.

⁶ 2 V.S.A. Section 505

⁷ <https://jfo.vermont.gov/assets/Subjects/Basic-Needs-Budgets/2e974b591b/2019-Basic-Needs-Budget-and-Livable-Wage-report-FINAL-1-15-2019-v2.pdf>



Note: Child Care Subsidy includes the Pre-K voucher

Recommendation 2: Study Impacts of Eliminating Estate Tax's Step-up Basis

The recommendation of the Commission to study the model of treating the Estate Tax as a taxable sale at date of death would eliminate the missed taxation on the decedent's lifetime taxable appreciation.

The Role of Pigouvian Taxes

We understand the school of taxation thought that favors taxing "bads" and not goods, which is to say, taxing things that we as a society want less of, like pollution, and less of things we as a society want more of, like work. In particular, we have studied [A Green Tax Shift for Vermont, a 2009 report from UVM's Gund Institute et al. on moving Vermont's tax system to one much more dependent on taxes designed to encourage responsible environmental stewardship.](#)

We admire the thoroughness of Gund's analysis and the comprehensive nature of the plan for taxing bads presented in the report. We further agree with the sound economic principle articulated in the Gund report that the true cost of a product, including the environmental costs to produce it, should be borne by the producer, and that internalizing externalities allows the free market to better address environmental concerns.

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Gund proposes to tax resources, to encourage a reduction in their use; pollution, to discourage it, and land, to discourage sprawl. As with many taxes on "bads", the system is designed to reduce its own tax base over time. The goal is to reduce resource use and pollution. We do not dispute the importance of those goals for Vermont; however, transforming the tax system to achieve those goals would be undermine one of our three primary goals: sustainability. The goal of taxing a "bad" is to make it go away, and therefore one starts with the goal of making the tax unsustainable. We therefore view taxing "bads" as policy tool to aid in the transition from current practice to a better practice, but not as an integral component of the tax system we are recommending.