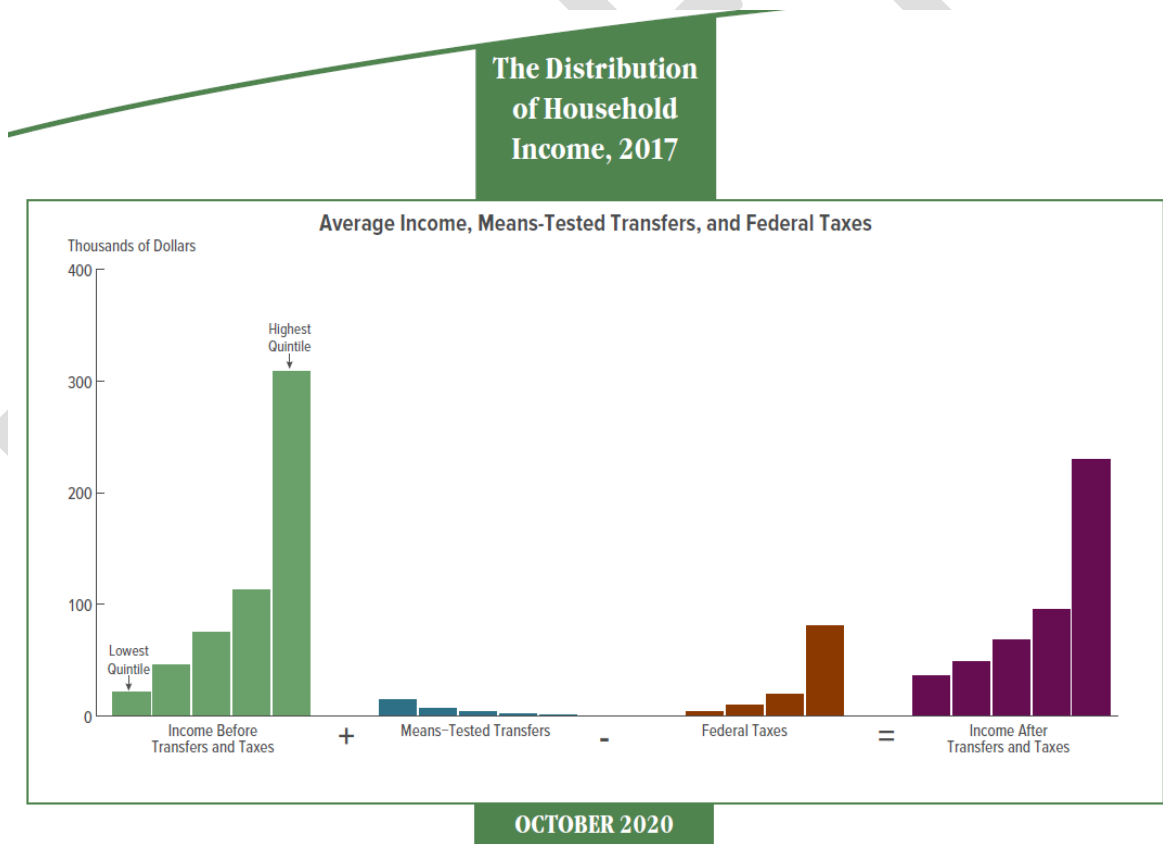


## 4. Restructuring Support for Low-Income Vermonters

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 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.

The Legislature directs the Joint Fiscal Office to estimate the income needed to meet the basic needs of Vermont families.<sup>1</sup> 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.<sup>2</sup>

A concurrent study could look at the ability of these same hypothetical family types, at different income levels, to meet that basic needs budget. 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 access. 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.

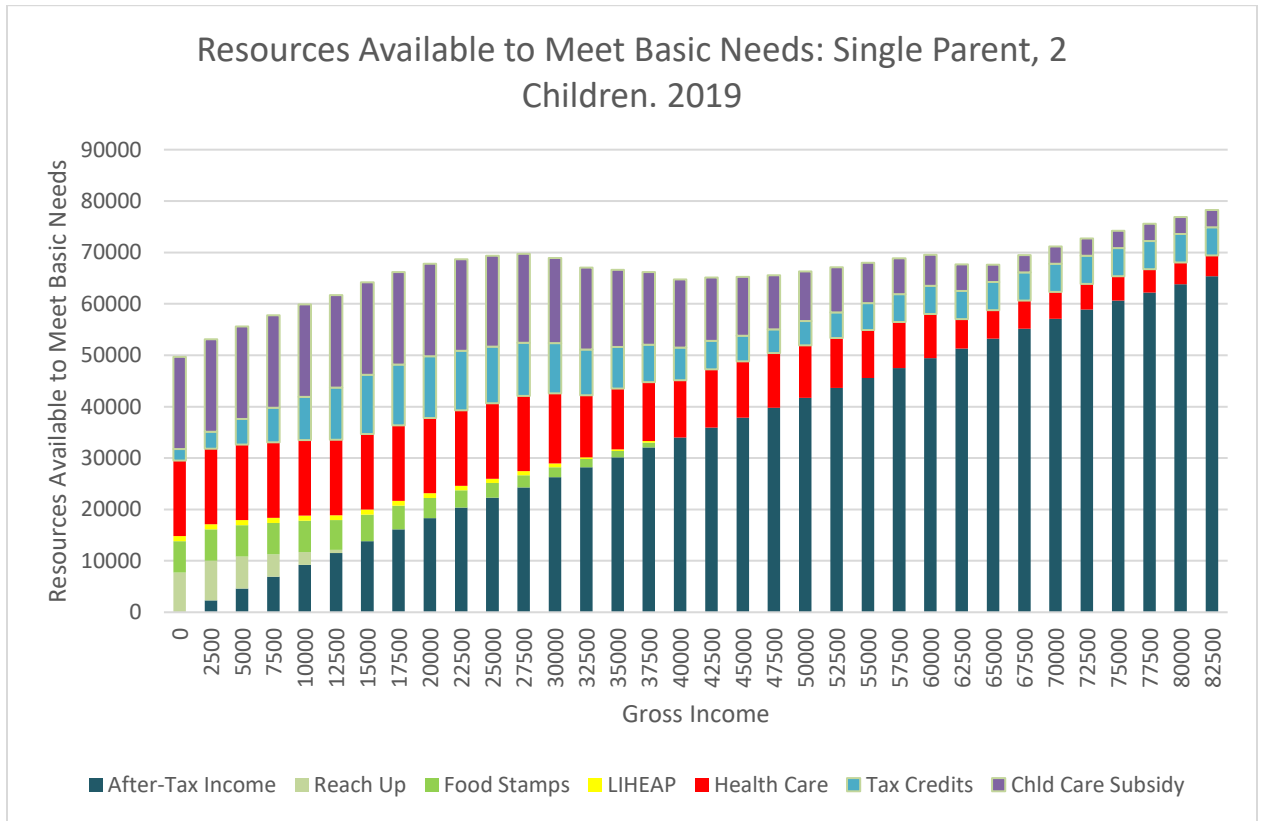
This dismays unsuspecting families, and discourages work for those in the know. It is the unintentional result of good intentions, but it needs a redesign. In addition to looking at each tax provision or transfer program in isolation, we need to look at the combined effect. In addition to looking at 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

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<sup>1</sup> 2 V.S.A Section 505

<sup>2</sup> <https://jfo.vermont.gov/assets/Subjects/Basic-Needs-Budgets/2c974b591b/2019-Basic-Needs-Budget-and-Livable-Wage-report-FINAL-1-15-2019-v2.pdf>

created a marginal rate that is greater than 100% for some families who do not have enough income to meet their basic needs.



Note: Child Care Subsidy includes the Pre-K voucher

Since most single parents with children are women, we'll assume that this family is headed by a single mom. Note that as she works her way up from no income at all to an annual income of \$27,500, she has more and more resources available for her and her children. Indeed, it is a testament to the Vermont community that someone with no income at all will have about \$50,000 in resources, and as her income climbs from zero to \$27,500, her total resources go from \$50,000 to \$70,000.

However, as she continues to work hard and get raises and promotions, or takes on a second job, as her income goes up, her situation gets worse. From an income of \$27,500 to an income of \$40,000, every extra dollar she earns takes more than a dollar out of her total resources. It isn't until she's worked her way up to an income of \$60,000 (and please reflect for a moment on how incredibly difficult it is to work your way up from earning \$27,500 to earning \$60,000) that she's back to the resource level she was at when she was earning \$27,500.

However, then she hits another setback, and doesn't get back to her \$27,500 level until she gets to \$67,500. Over years of hard work, she's added \$40,000 a year of

income to her family, she's more than doubled her income, and yet she's exactly where she was all those years ago when she was earning \$27,500.

This is clearly not the intent of anyone working on these programs, and we don't believe it would be too hard to solve, and that's the first reason to restructure Vermont's system of low-income assistance.

There is another reason to restructure Vermont's system of support for low-income Vermonters. The changes we are proposing to the sales tax and the health care provider tax will cause low-income Vermonters to pay tax on some essentials, like groceries and home heating, and some public goods, like education, that are currently exempt from the sales tax.

As we will describe in the following chapters, we do not believe these exemptions are an efficient way to protect low-income Vermonters from the burden of these taxes, nor are they an effective way to promote public goods. We do firmly believe that low-income Vermonters must be protected from these burdens.

We recommend extending the sales tax to essentially all consumer transactions, and extending the provider tax to all categories of health care providers, using the gains from broadening the base to 1) protect low-income Vermonters and 2) lower the sales tax rate to 3.6% and harmonize the provider tax rate at 3.6%. If you enact those recommendations, it will mean that the additional tax burden on low-income Vermonters will be approximately as follows, by household income decile:

Lowest income decile: \$11.5 million

Second income decile: \$14 million

Third income decile: \$15.5 million

Fourth income decile: \$17 million

These, then, are roughly the amounts that we need to transfer to these households to keep them whole. With the expansion of the sales tax base and the provider tax base that we recommend, we also recommend setting the sales tax rate and the provider tax rate at 3.6%. This this will raise about \$65 million more than our current sales and provider taxes do, which will allow us to return the \$58 million to low-income Vermonters and have all these changes be roughly revenue neutral.

The low-income Vermonters with whom we have spoken, and advocates for low-income Vermonters, have been consistent in their assertion that it is important that these monies not arrive in a lump sum at the end of the year. Rather, it is important to find a mechanism to distribute these payments on at least a monthly basis, and bi-weekly would be even better.

There are many benefits to Vermonters and Vermont's economy to broadening these tax bases and lowering the rates, but evolution of Vermont's support for low-

income Vermonters must come first to ensure that no one is harmed in the transition.

DRAFT