

## Income, Assets, and the Ability to Pay

One of the principles adopted by the commission is that the overall tax structure should impose a higher burden on people with greater ability to pay, and minimize the burden on people with low incomes. The words may differ, but this is a generally accepted principle of taxation throughout the United States and the OECD countries. However, according to staff of the Joint Committee on Taxation, “The notion of ability to pay (i.e., the taxpayer’s capacity to bear taxes) is commonly applied to determine fairness, though there is no general agreement regarding the appropriate standard by which to assess a taxpayer’s ability to pay.”<sup>1</sup> While most tax analyses use income to measure the ability to pay, others agree that this definition from Investopedia would be more appropriate: “Ability to pay is an economic principle that states that the amount of tax an individual pays should be dependent on the level of burden the tax will create relative to the wealth of the individual. A tax structure that succeeds is considered progressive; a tax structure that does not is considered regressive. According to the Tax Policy Center of the Urban Institute and Brookings “a tax is progressive if, on average, household tax burdens rise with incomes.”<sup>2</sup>

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In order to better understand the ability to pay, how it is changing, and the extent to which Vermont’s tax structure upholds our principle, we would like to measure, track and analyze changes in both income and wealth.

### **Income**

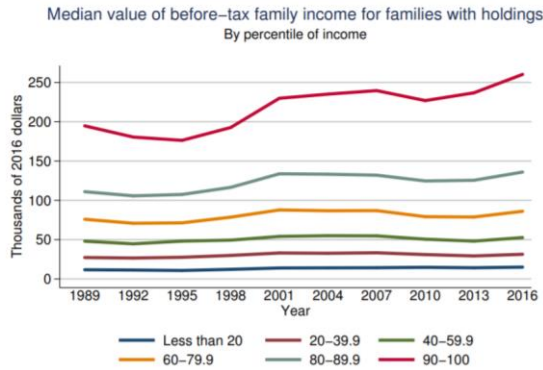
Income is the generally accepted way to measure the ability to pay in the United States. Nationally, the highest income categories have seen the greatest income growth. Data from the Federal Reserve Board’s Survey of Consumer Finances show that the median income of families in the top income decile increased by 34% (in constant dollars) between 1989 and 2016; the increase in the lowest quintile was 29%. This further concentrated the share of income at the top. In 1989 the median income in the top decile was 213 times the median income in the bottom quintile; by 2016 it was 252 times the income in the bottom quintile.

Table <sup>3</sup>

<sup>1</sup> Staff of the Joint Committee on Taxation. 2015. Fairness and Tax Policy. JCX-48-15

<sup>2</sup> <https://www.taxpolicycenter.org/briefing-book/how-should-progressivity-be-measured>

<sup>3</sup> SCF national survey, <https://www.federalreserve.gov/econres/files/BulletinCharts.pdf>



The Economic Policy Institute examines income inequality by comparing the income of the top 1% of the families to the remaining 99%. Their measurements indicate that the gap is growing in Vermont as well, but it is not as wide. In 1979, the top 1% captured 7.8% of the total income of Vermonters; by 2013 this share had risen to 13.8%; in the US as a whole, the percentage grew from 10% to 20.1% according to the EPI report.<sup>4</sup>

While Vermont's median income is similar to that of the US as a whole, [Vermont's wealthier half is not as wealthy. In 2017, a family reached the top five percent in Vermont with an income of \\$179,967; the U.S. average was \\$209,515. the higher income percentiles have lower thresholds in Vermont than in the United States as a whole, as computed by the IRS from income tax returns.](#)

Table <sup>5</sup>

Adjusted gross income floor on percentiles 2017						
	Descending cumulative percentiles					
	Top 1 percent	Top 5 percent	Top 10 percent	Top 25 percent	Top 50 percent	Top 75 percent
United States	516,714	209,515	146,621	84,646	42,589	20,840
Vermont	390,859	179,967	131,509	81,013	42,664	21,875

Looking at the income distribution as a whole, the Congressional Budget Office has computed the Gini Coefficient to measure the difference in inequality of household incomes between 1979 and 2016.<sup>6</sup> The Gini coefficient ranges from 0 in a perfectly equal distribution (in which each household has the same

<sup>4</sup> <https://www.epi.org/publication/income-inequality-in-the-us/>

<sup>5</sup> <https://www.irs.gov/statistics/soi-tax-stats-adjusted-gross-income-agi-percentile-data-by-state>

<sup>6</sup> Congressional Budget Office. 2019. Projected changes in the distribution of household income, 2016 to 2021.

income) to 1 in a perfectly unequal distribution. The coefficient rose from 0.41 in 1979 to 0.51 in 2016, indicating inequality has increased. The coefficient rises in periods of expansion and falls in recessions. An analysis of the adjusted gross income of Vermont taxpayers indicates a similar trend in the overall increase between 1979 and 2018, and in the years of rise and fall.<sup>7</sup> ~~The studies, including one using IRS SOI data, indicate that the coefficient for Vermont is slightly lower in 2017 than it was in 2006, a period that included the Great Recession and recovery.~~

~~Similarly, an Economic Policy Institute study indicates that the top 1% claimed more of Vermont's income in 2007, before the Great Recession, than in 2015. While the 1% captured 41.8% of the income growth in the US between 2009 and 2015, the 1% in Vermont captured only 20.9% of the state's growth in the post-recession expansion period.<sup>8</sup>~~

Table<sup>9</sup>

	Top 1% share of all income		
-	1973	2007	2015
United States	9.2%	21.7%	21.0%
Vermont	7.9%	17.0%	14.1%

### Assets

It is clear that assets also play a role in the ability to pay, and that role has been growing. According to economists Emmanuel Saez and Gabriel Zucman, “aggregate household wealth has increased from 3 times annual national income around 1980 to about 5 times national income in 2018.”<sup>10</sup> To put the magnitude of value of assets in context, Eleanor Sawhill of the Brookings Institution estimates that it is “more than five times as much as all the goods and services produced in the U.S. economy in a single year. If that amount were divided evenly across the U.S. population of 329 million, it would result in over \$343,000 for each person. For a family of three, that’s over a million dollars in assets.”<sup>11</sup>

The Survey of Consumer Finances calculates family net worth by subtracting liabilities from assets. The data indicate that net worth is highly concentrated. The 10% of families in the top net worth decile accounted for 77% of the total in 2016. The inequality of net worth is even more extreme than the

<sup>7</sup> Note that the definitions of income and the unit (family, household, tax return) differ in each study so the coefficient isn’t comparable. However the trends are consistent.

<sup>8</sup> <https://www.epi.org/publication/the-new-gilded-age-income-inequality-in-the-u-s-by-state-metropolitan-area-and-county/#epi-toc>

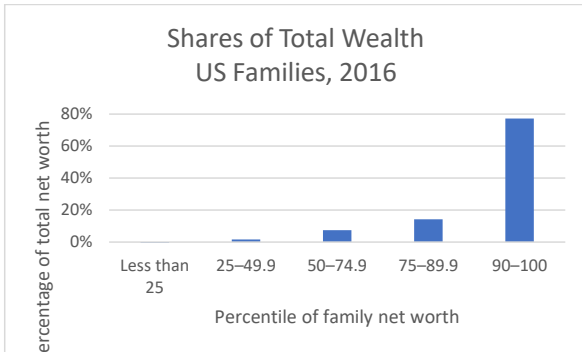
<sup>9</sup> <https://www.epi.org/publication/the-new-gilded-age-income-inequality-in-the-u-s-by-state-metropolitan-area-and-county/#epi-toc>

<sup>10</sup> Saez, Emmanuel, and Gabriel Zucman. 2019. “Progressive Wealth Taxation,” Brookings Papers on Economic Activity, Conference Drafts, September 5-6 2019, p. 6.

<sup>11</sup> <https://www.brookings.edu/blog/up-front/2019/06/25/six-facts-about-wealth-in-the-united-states/>

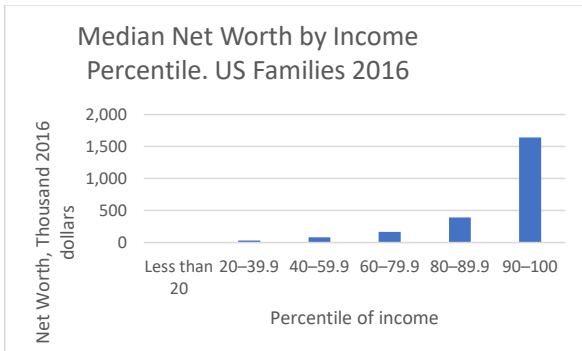
inequality of income; the before-tax income of the families in the top income decile accounted for 50% of the total income nationally (2016) and 41% in Vermont (2018).<sup>12</sup>

Table <sup>13</sup>



Although there is not a perfect correlation, families in higher income deciles are wealthier.

Table <sup>14</sup>



The data indicate that the concentration of net worth in the highest income decile is growing at a greater rate than the concentration of income. In 1989 the net worth of U.S. families in the top decile was 3.7 times their median income; by 2016, it was 6.3 times their median income. For families in the lowest income decile, the median net worth is less than the median income and it crept up slowly; it grew from 29% of the median income of the quintile to 43% between 1989 and 2016.

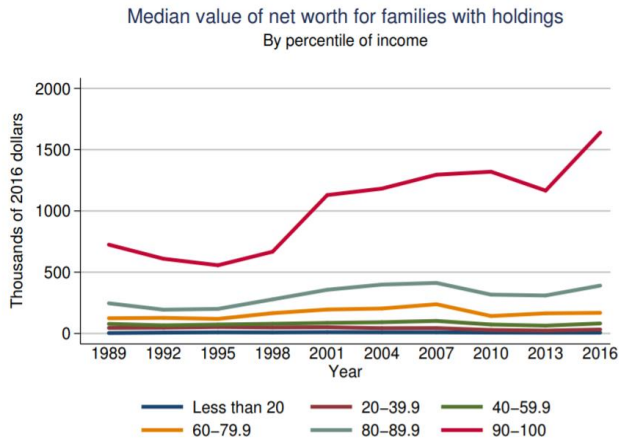
Table <sup>15</sup>

<sup>12</sup> JFO/ Vermont Tax Department

<sup>13</sup> SCF National survey data, 2016

<sup>14</sup> SCF National survey data, 2016

<sup>15</sup> SCF National survey <https://www.federalreserve.gov/econres/files/BulletinCharts.pdf>



While there are differing views on how to measure wealth<sup>16</sup>, and assets are notoriously difficult to identify and tax, the commission feels it is important to understand more about their value, their distribution, their importance in the economy, and how they are taxed. There are two main questions:

- should assets be considered in the “ability to pay” that is used to determine the progressivity of the tax structure?
- Should assets be taxed differently and more consistently than they are currently?

The table below provides the average value of each asset class as a percentage of total family assets, based on the Survey of Consumer Finances.

<sup>16</sup> See, for example, Kennickell, Arthur B. (2017). “Lining Up: Survey and Administrative Data Estimates of Wealth Concentration,” Finance and Economics Discussion Series 2017-017. Washington: Board of Governors of the Federal Reserve System, <https://doi.org/10.17016/FEDS.2017.017>.

Brickner, Jesse, Jacob Krimmel, Alice Henriques, and John Sabelhaus (2016) “Measuring Income and Wealth at the Top Using Administrative and Survey Data,” Brookings Papers on Economic Activity, Spring 2016. 261-331

Burtless, Gary. 2019.

[https://www.realclearmarkets.com/articles/2019/06/04/putting\\_a\\_tax\\_on\\_wealth\\_means\\_we\\_must\\_first\\_measure\\_it\\_103770.html](https://www.realclearmarkets.com/articles/2019/06/04/putting_a_tax_on_wealth_means_we_must_first_measure_it_103770.html)

National distribution of assets (2019) and Vermont taxes (and tax expenditures) for each asset type					
Assets - as classified by Survey of Consumer Finances	% of total assets <sup>1</sup>	Tax while holding	Tax at Transaction <sup>2</sup>	Federal Tax Preference <sup>3</sup>	Vermont Additional or Specific Tax Preference
<b>Financial Assets</b>	<b>42%</b>				
Transaction accounts	5%	indirectly, bank franchise tax			
Certificates of deposit	1%	tax on interest; indirectly, bank franchise tax			
Savings bonds	0%	indirectly, bank franchise tax			
Bonds	1%	tax on interest on non VT muni bonds	Capital Gains Tax	Capital gains on sale of bonds is subject to lower rates than ordinary income	Interest on VT Muni Bonds not taxable. Capital gains on bonds sold receive up to \$5000 in capital gains exclusion from income
Stocks	6%	tax on interest or dividend; qualified dividends taxed at cap gains rates federally but regular rates in VT	Capital Gains Tax	Capital gains are subject to lower rates than ordinary income	Eligible for the \$5,000 capital gain exclusion
Pooled investment funds	9%			Capital gains are subject to lower rates than ordinary income	Eligible for the \$5,000 capital gain exclusion
Retirement accounts	15%	Taxable when withdrawn, except for Roth which receive no tax deduction for contribution and then earnings		Tax on contributions and income earned within accounts is deferred until withdrawal begins at retirement (except Roth)	
Cash value life insurance	1%	Indirect tax: insurance premium tax on firms			
Other managed assets	4%		Capital Gains Tax	Capital gains are subject to lower rates than ordinary income	Eligible for the \$5,000 capital gain exclusion
Other	1%				
<b>Nonfinancial Assets</b>	<b>58%</b>				
Vehicles <sup>1</sup>	3%		Purchase and Use Tax; Capital Gains		
Primary residence	26%	Annual property tax		\$250,000 cap gain exclusion (\$500,000 for MFJ); home mortgage interest deduction	Same as Federal
Other residential property	6%	Annual property tax	Capital Gains Tax	Capital Gains are subject to lower tax rates than ordinary income	Qualifies for 40% cap gain exclusion up to the cap or the \$5000 exclusion
Equity in nonresidential property	3%	Annual property tax;	Capital Gains Tax	Capital Gains are subject to lower tax rates than ordinary income	Qualifies for 40% cap gain exclusion up to the cap or the \$5000 exclusion
Business equity	20%		Capital Gains Tax	Capital Gains are subject to lower tax rates than ordinary income	Qualifies for 40% cap gain exclusion up to the cap or the \$5000 exclusion
Other	1%				

1- 2019 Survey of Consumer Finances, <https://www.federalreserve.gov/econres/scfindex.htm>

2- The estates of Vermont residents who die with more than \$4.25 million in assets are subject to Vermont's estate tax, <https://tax.vermont.gov/individuals/estate-tax>

3- In fiscal year 2018, tax expenditures reduced federal income tax revenue by roughly \$1.4 trillion, and they reduced payroll taxes and other revenues by an additional \$136 billion. These federal tax expenditures generally carry through to impact state tax revenue, including Vermont's. <https://www.cbpp.org/research/federal-tax/policy-basics-federal-tax-expenditures>

Totals may not add to 100% due to rounding.

There are many opinions about whether and how assets should be taxed. A common conception is that income is a flow and assets are a stock. Income is received annually and should be taxed annually; the stock should not be taxed until it comes out of storage and becomes income. Another view holds that

the annual increase in the value of the assets should be considered income, and subject to the income tax. Discussions of taxing wealth are further complicated by considerations of the life cycle of a family; at least a portion of wealth is future retirement income.

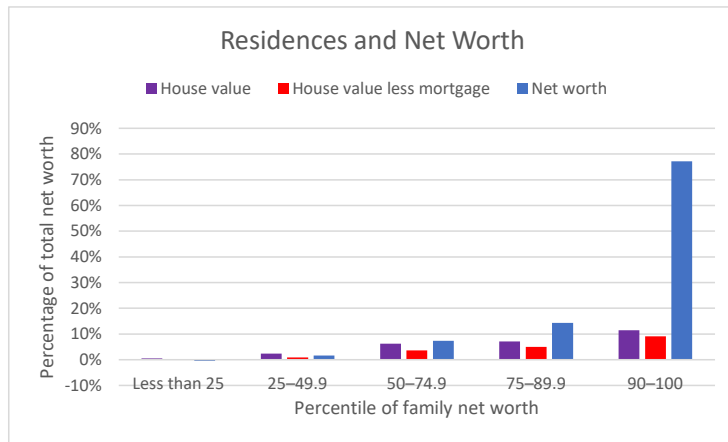
Ironically, assets are recognized as a component of the ability to pay when it comes to transfers. Some public benefit programs have asset tests that limit the eligibility for assistance or reduce the benefits. This means that, at the lower end of the income scale, assets affect redistribution of income. At the higher end of the income scale, they do not.

The most notable exception to any of the views of how assets should be taxed is the annual taxation of the full value of real estate.

The commission heard particular concern over the relationship between the value of a residence and the ability to pay in discussions about the education property tax. Although an income tax on residents would more directly reflect the generally accepted measure of ability to pay, several people defended the appropriateness of a property tax because house value is a proxy for wealth—another indication of the ability to pay.

The following chart breaks out the aggregate value of residences and of net worth as percentages of total net worth. Because the property tax is levied on the full value of the residence and net worth is calculated after subtracting debt, the chart shows both the full value of residences and the value after subtracting mortgage and home equity loans.

Figure <sup>17</sup>



Although the value of residences is lower in the categories of lower net worth and higher in the categories of higher net worth, it would be difficult-unreasonable to use the house value as a proxy for net worth. In the categories comprising half of the familiesFor families at the low end who own their

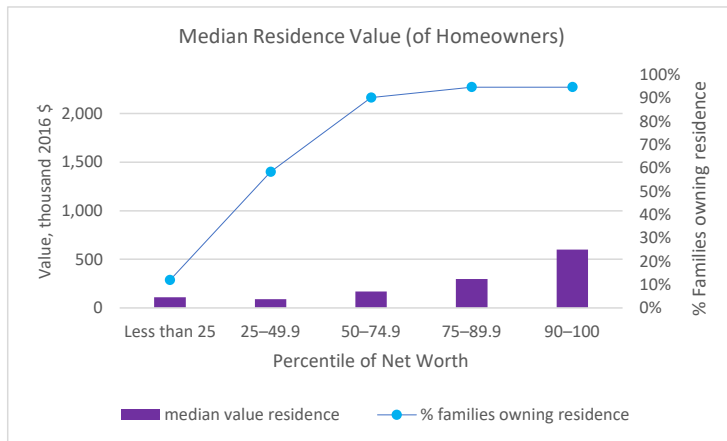
<sup>17</sup> SCF 2016

home, the aggregate value of residences the house may exceed their net worth because it is mortgaged and the family has few other assets, exceeds the net worth. In contrast, the value of residences is only 14% of the aggregate net worth of families in the top decile.

The chart above includes all wealth, including that held by outliers with extreme wealth. In contrast, the two following charts show the median values of residences of those owning their home, of financial assets, and of total net worth.

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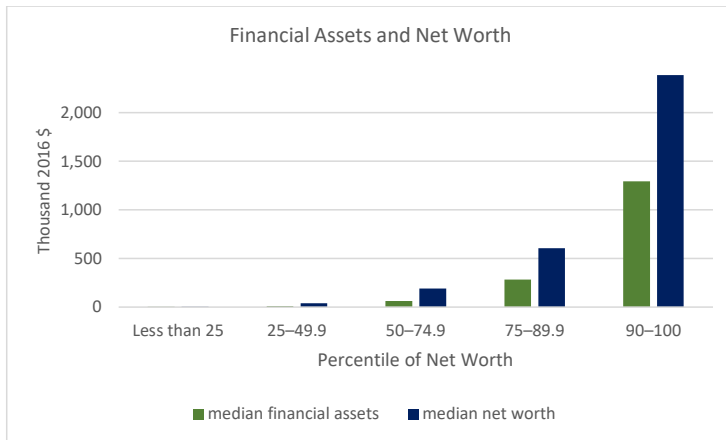
Table <sup>48</sup>



The value of financial assets, on the other hand, increases as net worth increases, as shown in the chart below. Although nearly 100% of the families have a financial asset of some kind, even a piggy bank, the financial assets and net worth are low for half of them. As the median value of net worth increases, the value of a house becomes less important and the value of financial assets makes up a larger and larger share. Using the same vertical scale and the same groupings of families by net worth, the chart below shows the median value of financial assets and of net worth.

<sup>48</sup> SCF 2016. Note that the percentiles of net worth include all families — not just those owning houses





It appears that financial assets serve as a better indicator of net worth than residences do, but houses are certainly easier to locate and value. The median value of financial assets, as a percentage of net worth, rises as net worth rises. The relationship is the opposite for residences. The median value of a residence, a percentage of net worth, drops from over 100% at the low end of the scale to less than 25% of net worth of families in the top decile.

While a case could be made for a wealth tax, experiences in other states and countries have not been particularly successful. Twelve OECD countries had variations of a wealth tax in the 1996, but now, although interest in the wealth tax continues, only four countries have one. Reasons for the decline include: it encouraged rich people to move to their assets and/or themselves to other countries; it was a disincentive for foreign investment and slowed economic growth; it was difficult to administer; avoidance was difficult to control; there were liquidity problems for people who had assets and little cash; and it didn't raise much revenue.<sup>19</sup>

In the United States, Florida levied a tax on intangible personal property (such as stocks and bonds) with generous exemptions so that it was effectively only a tax on the wealthy. Over time the rates decreased, avoidance increased, and the tax was basically gutted. In fact, it was so easy to set up ownership structures to avoid the tax that an article in the Florida bar journal concluded: "What is known is that some old adages are not always true. Yes, all die, but may not have to pay taxes, at least not the Florida intangible tax."<sup>20</sup>

The commission agrees that wealth is an increasingly important determinant of the ability to pay, and should influence our evaluation of the progressivity of our tax structure. The commission recognizes that an asset or wealth tax could improve the ability of the state to sustain tax revenue as the economy changes. However, the commission does not recommend a wealth tax at this time, cannot make

<sup>19</sup> [https://read.oecd-ilibrary.org/taxation/the-role-and-design-of-net-wealth-taxes-in-the-oecd\\_9789264290303](https://read.oecd-ilibrary.org/taxation/the-role-and-design-of-net-wealth-taxes-in-the-oecd_9789264290303)

<sup>20</sup> <https://www.floridabar.org/the-florida-bar-journal/the-florida-intangible-tax-the-real-voluntary-tax/>

~~recommendations to meld wealth into the measurement of the ability to pay, or to change the ways in which wealth is currently taxed, for several reasons.~~

~~First, there are no Vermont data on the level or distribution of assets to allow necessary detailed analysis. Second, we realize it is extremely difficult to define, track and tax assets. ~~Asset taxes attempted elsewhere have been dubbed “voluntary taxes” and abandoned. Finally, for reasons of competitiveness, the state would not want a tax that is more important than our high quality of life in determining one’s.~~ Third, we are sobered by the experiences of others, acknowledge the problems, and recognize that a national wealth tax would be more appropriate in avoiding some of the jurisdictional and avoidance issues. ~~residence.~~~~

~~But the commission doesn’t want the conversation to end with the prior paragraph. The commission recommends collecting information on assets in Vermont, initiating reporting requirements if necessary, and working with other states to explore the issues and to design and evaluate possible uniform approaches. The effort of the Multistate Tax Commission to clarity and consistency to the sales tax through the coordination of member states is a recommended model.~~

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