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Draft Report of the Vermont Tax Structure Commission

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DRAFT

1. Introduction

In some respects, the history of taxation in Vermont is the history of a state trying to deal with alternatives to the property tax, or trying to find a better way to tax income.

- Paul Gillies, *The Evolution of the Vermont State Tax System*

This report is written by three Vermonters of different backgrounds and varying tax system experiences. We first convened in December 2018, tasked by the legislature and Scott Administration with developing long-term recommendations to help make the State's overall revenue system more fair, more sustainable, and simpler. From the beginning, we committed to operate by consensus. We believed, and continue to believe, our commission should only put forth recommendations that all three of us can support.

We worked for almost a year and a half before COVID shut down much of Vermont in March 2020. Given the uncertainty in the early days of the pandemic around the nature of the disease and its potential effects on our society and our economy, we suspended our work for a few months. Once it became clear that some economic activity would continue, and that there were measures people could take that would allow them to keep functioning during the pandemic, we resumed our work.

As we deliver this report at the start of 2021, infections and deaths are climbing across the country but the distribution of effective vaccines have allowed us and everyone else to look forward to a post-pandemic world.

The pandemic impacted both the logistics of our work as well as the data and issues we were tasked with analyzing.

In terms of logistics, we had hoped to travel the state to hear Vermonters' concerns and to talk through priorities and solutions in-person. We did hold meetings in the State House and various public libraries throughout our first year. We also scheduled a spring 2020 series of community panel discussions with experts to explore key revenue issues. Alas, that series had to be cancelled and our last several months confined to public Zoom meetings. All told, we still managed to hold 36 public meetings, both in-person and online, and take written and oral testimony from more than 60 experts and members of the public (Appendix X).

In terms of data, it is clear to us that the pandemic has accelerated some long-standing trends: more shopping online and less bricks & mortar retail, more remote work, more use of video for professional and social gatherings, more telemedicine, more remote education. It is not clear that other than accelerating these trends, the pandemic will change the contours of our economy. Our data comes from the pre-COVID economy; our recommendations (summarized in Chapter 2) will be implemented in the post-COVID economy. We therefore have accounted for the COVID-induced acceleration of the above-mentioned trends in our recommendations, but they are not recommendations for a COVID economy – they are recommendations for a healthy post-COVID Vermont economy.

Our approach was to work within each major tax area, and among the major tax areas, to make the overall tax burden on Vermonters more fair relative to horizontal equity, with people of similar ability to pay bearing similar tax burdens, and vertical equity, with an effort to ensure that those with less ability to pay bear a lesser burden, and those with a greater ability to pay contribute a greater amount.

We recognize the Principles of a High-quality State Revenue System apply to the entire tax structure—not to each tax. No individual tax can achieve them all. We discuss these principles and Vermont’s tax structure in Chapter 3.

We recognize the conundrum posed by income and wealth, with the latter being a more accurate barometer of ability to pay but also far more difficult to assess. In Chapter 4 we discuss the interplay between income and assets and what it means for fairness. Then in Chapter 5, we lay out two big reasons to restructure support for low-income Vermonters.

Our predecessor, the Blue Ribbon Tax Structure Commission of 2009-2011, concentrated on income tax reform and made significant recommendations, several of which have been enacted in recent years (Appendix X). With that in mind, we chose to concentrate the bulk of our time on education and consumption taxes.

We believe our diverse experiences are a strength and we wanted each of our voices to come through. As a result, you may notice significant shifts in writing style from chapter to chapter.

We recognize that Vermont’s school spending is among the highest in the nation and the education property tax is often cited as our state’s most burdensome. Chapter 6 lays out a proposal to restructure the homestead education tax and make other reforms to the way we pay for education.

Chapter 7 enumerates steps for Vermont to dramatically expand its sales tax base while slashing the tax rate. The plan is bold, but the concept is not unique. Ten years ago, the Blue Ribbon Tax Structure Commission also called for a significant expansion of the tax base. That’s two separate commissions, with six different people from a variety of backgrounds, all agreeing that it doesn’t make sense for Vermont to have one of the narrowest sales tax bases in the nation.

We discuss opportunities for income tax and estate tax modernization in Chapter 8, then identify obsolete and inefficient taxes in Chapter 9.

In Chapter 10 we propose a timeline for our recommendations and call attention to steps that must be taken before some of the recommendations can be implemented.

In Chapter 11, we discuss Vermont’s changing landscape and how three key areas of change – demographics, technology, and climate – underscore the importance of having an agile tax structure. We provide neither comprehensive analyses nor forecasts but rather offer thoughts on how to approach the tax implications of such significant changes.

Finally, in the report's Appendices, we provide additional detail on our legislative charge, the steps we took in approaching our work, Vermonters' testimony, and other materials we produced during our tenure.

We have worked to simplify the overall tax system in two major ways. First, we have endeavored to make recommendations that will make many individual taxes simpler. Second, we have made recommendations to eliminate a number of taxes outright. Falling into both these categories is the homestead education property tax, which currently is exceptionally complicated. We have recommended eliminating the education property tax on homestead housesites and replacing it with an increase in the state income tax. We have also recommended eliminating the Telephone Personal Property Tax.

On the subject of making our overall tax system more sustainable, we have been mindful of recommending changes that will make our tax system responsive to changes in the economy, and technology, and the environment without requiring further legislation. We hope that our recommendations regarding the education property tax make that more sustainable. We believe it removes one of the biggest sources of potential instability in Vermont's tax system, which is the growing demands by Vermonters for lower property taxes, and for property taxes that do not grow disproportionately.

We hope our recommendations improve Vermont's overall tax system in terms of making it more fair, simple, and sustainable.

2. Summary of Recommendations

The Commission makes the following recommendations:

1. **Restructure the homestead education tax**
2. **Broaden the sales tax base**
3. **Modernize income tax features**
4. **Undertake analysis in order to eliminate tax burden/benefit cliffs**
5. **Improve administration of property tax**
6. **Create a comprehensive telecommunications tax**
7. **Utilize tax policy to address climate change**
8. **Collaborate with other states to build a fairer, more sustainable tax system**

Recommendation 1: Restructure the Homestead Education Tax

Key components:

- A. Eliminate the Property Tax Credit*
- B. Eliminate the homestead education property tax, and implement income-based education tax for all residents (owners and renters) with rate tied to locally voted budgets.*
- C. Levy the non-homestead education property tax on all property except the residence and 2-acre site.*
- D. Create renter credit to offset the non-homestead property tax effectively paid through their rent.*

The commissioners agree that the complexity is overwhelming the effectiveness of the current homestead education tax.

We recommend eliminating the Property Tax Credit [\(1A\)](#) and levying a direct tax instead. The current system, with a homestead property tax in one year and an income-based credit coming in the following year, blurs the connection between the budget vote and the tax bill. It also leads people to see the credit as a subsidy rather than a means to calculate each household's fair share. It creates administrative issues for local officials who need to apply the credit to the tax bills, and then answer questions from homeowners. There are also confidentiality concerns, as the credit amount is an indication of household income. In addition, it means that a tax increase in one fiscal year is only partially covered in that year; some of the cost must be made up in the following fiscal year.

The current system allows homeowners to choose the lesser of the education property tax on their housesite or a tax on their income. This double system creates more than double the trouble, as it forces the match between the two systems, administered by different levels of government, with different calendars, with different confidentiality requirements. We recommend moving to a single system and, to maintain equity, we recommend a direct residential tax on income [\(1B\)](#).

Before endorsing income, we examined:

- Whether house value is a good proxy for wealth, and we found that it is not; house value is a high proportion of net worth for low income households and a low proportion of net worth for high income households.
- Whether house value is a good indication of income, and we found that it is not; a house value of average value is owned by households of all incomes.
- Whether a housesite exemption could offset the regressivity of the property tax without necessitating an income-based adjustment, and we found we could not.

Given the divergence between the value of a house and both income and wealth, and given the impracticality of determining, measuring or taxing net worth, the commission believes that income is the best way to measure taxpayer equity and the most progressive way to tax residents for education at this time.

Commented [SS1]: Deb, do you want to add a sentence or two to address 1C?

While the historical and administrative reasons for the distinction between renters and homeowners are clear, the commission could not find a principle-based justification for treating the two groups of residents differently. The commission believes the locally voted education tax should be based on the income of all residents. Renters would receive a credit to offset the education property tax paid through their rent (1D). We recommend initiating a process of data collection and analysis to enable the implementation of this change.

The commission believes that the equity of the locally voted education tax is crucially important. Unlike many other taxes, it both collects and distributes. After the allocation of categorical grants, we rely on the locally voted tax to raise the amount needed to provide the education of the students in each district. If this tax is inequitable, it is likely that education will be distributed inequitably. For this reason, we believe the relationship between income, poverty, and education spending is vitally important to track. At this time, it appears that a combination of district consolidation, heavier weighting for poverty, and moving to an income-based tax for residents will improve the equity of the education tax.

Recommendation 2: Broaden the Sales Tax Base

Key components:

- Expand the sales tax base to all consumer-level purchases of goods and services except health care and casual consumer-to-consumer transactions.*
- In health care, extend the provider tax to those provider categories that are not currently included.*
- Use the gain from broadening the base to protect low-income Vermonters and reduce the sales tax rate to 3.7%.*
- Continue to eliminate the sales tax on business inputs.*

All other things being equal, a broader tax base is more fair, more sustainable/stable, and simpler than a narrow tax base. If you combine a broader tax base with a lower rate, the new system becomes even more sustainable.

Vermont has one of the narrowest sales tax bases in the nation. There are a variety of historical reasons for the exclusion of various industries and economic categories from the sales tax. We examine each of those reasons, find that there are only three categories whose exclusions from the sales tax still make sense: health care, whose complexity requires separate treatment; casual sales for which the administrative burden of sales tax collection outweighs the potential revenue; and business inputs [\(2A, 2D\)](#).

In particular, we believe there are more efficient ways to protect low-income Vermonters from the burden of a sales tax on necessities, and more effective way to promote public goods than exemptions from the sales tax. We also believe that there is nothing inherent in services that makes them less amenable to a sales tax than goods, and the historic exclusion of most services from the sales tax will become more destabilizing over time as services become a larger and larger portion of the consumer economy.

As part of its proposal, the commission recommends extending the sales tax to those grocery-type items currently exempt from the Meals tax, including items like whole pies, cakes, loaves of bread, etc., to be consistent with the extension of the sales tax to groceries.

We conclude that health care is not amenable to a sales tax, but that we can create a functional approximation of a sales tax on health care, without limiting Vermonters' access to health care, by extending the provider tax to the remaining health care provider categories that are not currently subject to the provider tax [\(2B\)](#).

Finally, we recommend putting almost all of the gain from broadening the sales tax/provider tax base into lowering the sales tax rate to around 3.7% [\(2C\)](#).

Commented [SS2]: 2D might be a stretch here, since it's just mentioned at the end and doesn't discuss how the state should continue to eliminate. Add a phrase elsewhere related to it? Or fine like this?

Commented [SS3]: You could add a "2C" here, but because it's framed as belief rather than a recommendation, maybe you want to add a sentence or phrase to the last paragraph about how the rec will protect low-income VTers?

Commented [SS4]: See comment below in Rec 4 – if that one says "significant portion" to help low-income, that should probably be referenced here, rather than saying almost all will go to lower rate.

Recommendation 3: Modernize Income Tax Features

Key components:

- A. Expand the personal income tax base.*
- B. Study the effect on Vermont Pass-through Entities of an entity level tax.*
- C. Examine opportunities to improve Vermont's estate tax.*
- D. Explore options to improve the corporate income tax.*

We recommend expanding the personal income tax base by a) continuing to promote Vermont as a remote worker destination and ensuring that rural areas have the infrastructure such as high speed broadband internet to support remote workers, and b) continuing to review tax expenditures to ensure these expenditures are accomplishing the purpose for which they were intended [\(3A\)](#).

We recommend studying the effect on Vermont Pass-through Entities (PEs) of an entity level tax to replace the present system of non-resident withholding and composite return filing [\(3B\)](#). Consider mandatory composite filing for all PE with non-resident members. Continue to allow the individual non-residents to file a Vermont return and take a credit for their share of the taxes paid.

We recommend examining opportunities to improve Vermont's estate tax by: a) continuing to monitor what our neighboring states and the federal government are doing relative to exemptions, b) studying the possible elimination of the present estate tax structure and replacing it with a “[deemed sale](#)” type of tax on death [\(3C\)](#).

We recommend exploring several aspects of corporate income tax, including: a) the effect of adopting Finnegan with respect to Unitary Tax apportionment, b) the effect of adopting a Single Sales factor approach to apportionment for multistate corporations, c) tax expenditures related to the corporate tax to ensure they are still serving their intended purpose [\(3D\)](#).

Recommendation 4: Undertake Analysis [in Order to Eliminate Tax Burden/Benefit Cliffs](#)

Key components:

- A. Undertake an ongoing study of income, taxes, and the transfers or benefits that help families meet their basic needs.*
- B. Find ways to lessen the steepness of the tax and benefit cliffs.*

Although we think of taxes as payments to government, the redistribution of those payments, through benefits and credits, is crucial in determining the equity of the whole structure. A comprehensive and ongoing study of income, taxes, and the transfers or benefits that help families meet their basic needs would help future legislatures look at changes over time, recommend adjustments, and measure progress [\(4A\)](#).

As has been demonstrated in the Basic Needs reports, different family types have different needs. Looking at the combined effect of taxes and public benefits for different family types at different income levels would reveal where the family may go backwards—earning more in wages but losing a greater amount in benefits (aka the benefit cliff). This is devastating if it is unexpected; if it is anticipated, it is a disincentive to work. We need to make it a reality for people to work more hours, take on more responsibility in their job, earn more money, and see some improvement in their ability to make ends meet.

There is a crucial link between our other recommendation to broaden taxes—particularly the sales tax—and this recommendation to analyze the current distribution of taxes and benefits, and to remedy the unintended problems. [A significant portion](#) of the new revenue resulting from the broadened sales tax would be deployed to strengthen and rationalize the distribution system to support lower-income Vermonters, and to make sure that no one is harmed by the tax changes [\(4B\)](#).

Commented [SS5]: Per comment above, saying “significant portion” here would seem to indicate it should be mentioned above.

Recommendation 5: Improve Administration [of Property Tax](#)

Key components:

- A. Move expenditures for mental health services and for employee health insurance from the Education Fund to the General Fund.*

- B. Establish an ongoing Education Tax Advisory Committee.*
- C. Develop a program at Property Valuation and Review to appraise large and/or complicated property and to defend the appraisals.*
- D. Study alternatives to the common level of appraisal.*

In order to align local budgets with the costs local officials can actually control, we recommend the State move expenditures for mental health services and for employee health insurance from the Education Fund to the General Fund [\(5A\)](#), along with proportionate revenue sources.

We also call for an ongoing Education Tax Advisory Committee to monitor the system, to report regularly, and to make annual recommendations to the Legislature [\(5B\)](#). Annual recommendations would include the tax rate(s) and yield(s) and the amount of the stabilization reserve. Other recommendations, such as adjusting student weights or other changes to the system could be brought to the Legislature's attention as needed.

We recommend the creation of a program at Property Valuation and Review to appraise large and/or complicated property and to defend the appraisals [\(5C\)](#). We also recommend analyzing other ways in which local administration could be strengthened and supported by the State. The current per-parcel payment should be reviewed and a payment schedule that is based on both the size of the town and the certification of the local officials should be considered. We believe that the State can make investments in the administration of the property tax that will be offset by increased tax revenue.

Finally, we call for a study of alternatives to the common level of appraisal (CLA) [\(5D\)](#). The State must ensure Vermonters in different towns pay a comparable education tax on properties of equal value and therefore must be able to determine what constitutes equal value. However, the CLA can contribute to wild swings in valuation estimates and tax liability. Several alternatives have been proposed and should be studied to evaluate fairness, simplicity, and administrative burden.

Recommendation 6: Create a [Comprehensive Telecommunications Tax](#)

Key components:

- A. Repeal the Telephone Personal Property Tax.*
- B. Study changing FCC regulations.*
- C. Craft a comprehensive telecommunications tax with an adequate revenue stream to sustainably support the Vermont Universal Service Fund, E911 and public access services.*

We recommend repealing the [Telephone Personal Property Tax](#) ~~TPP tax~~ as it is declining every year and is based on somewhat outdated technology as a base for the tax [\(6A\)](#), and replace the lost revenue with another source based on more contemporary and long-term

sustainable technology, or simply increase other telecommunications taxes on the providers to make up for this lost revenue.

We recommend creating a comprehensive telecommunications tax, with careful attention to changing FCC regulations [\(6B\)](#), that also supports the Vermont Universal Service Fund, E911 and public access services [\(6C\)](#).

Recommendation 7: Utilize Tax Policy to Address Climate Change

Key components:

- A. Implement tax credits and exemptions to reduce the upfront cost of some investments that will make the transition to a low-carbon economy possible.*
- B. Take a fresh look at the role of taxes in mitigating climate change.*
- C. Whether it is a carbon tax or a cap-and-trade agreement, care must be taken to return revenue to lower-income households.*

Even though the commission strives to keep the tax base as broad as possible, we support the use of tax credits and exemptions to reduce the upfront cost of investments that will make the transition to a low-carbon economy possible [\(7A\)](#).

We recognize that Vermont, being farther north and farther from the Atlantic than many northeastern cities, will see interest from people moving to avoid the consequences of climate change. At the same time, we recognize that intact forests are important tools in addressing climate change as they store carbon, prevent erosion and flooding, and protect biodiversity. Are we able to guide new development toward villages and away from forests? The Vermont Climate Action Commission report puts it this way: “Demographic change, greenhouse gas emissions, severe weather, and financial challenges prompt a fresh look at Vermont’s smart growth strategies and land use governance as means to address climate change.” We agree. And we recommend that the fresh look include role of taxes in the mix [\(7B\)](#).

Although the tools chosen to speed the transition to clean energy may not technically be taxes, we recommend carefully returning revenue or benefits to overcome any potential regressivity [\(7C\)](#).

Recommendation 8: Collaborate with Other States to Build a Fairer, More Sustainable Tax System

Key components:

- A. Add an annual excise tax to the registration fees for electric cars.*
- B. Partner with other states to coordinate and strengthen our tax structures.*

C. Work with other states to develop uniform asset-reporting requirements and collect information.

Every state in the nation is evaluating decreases in gasoline consumption as a threat to transportation funds. We recommend that Vermont add an annual excise tax to the registration fees for electric cars as their contribution to the Transportation Fund in lieu of paying gas taxes (8A). This tax should persist until the technology is available to charge each vehicle for the miles, or even better, the pound-miles it travels on Vermont roads. We also recommend that VTrans and Department of Taxes track other approaches as they progress in other states to ensure that our system continues to evolve and adopt best practices.

Commented [SS6]: Write out?

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 (8C). The effort of the Multistate Tax Commission to bring clarity and consistency to the sales tax through the coordination of member states is a recommended model.

The commission recommends collaborating and partnering with other states to coordinate and strengthen our tax structures (8B). Some past successful efforts include streamlining the sales tax with the Multistate Tax Commission and joining the Regional Greenhouse Gas Initiative. This type of partnership has the advantage of reducing the “race to the bottom” in which states try to lure business by lowering taxes; it clarifies jurisdictional issues; it simplifies filings for businesses in several states; and it improves the state’s tax structure. Rather than moving to the middle, together we may be able to move the middle, and end up with a fairer system.

3. Principles and Whole Tax Structure

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.

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.
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.
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.

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.

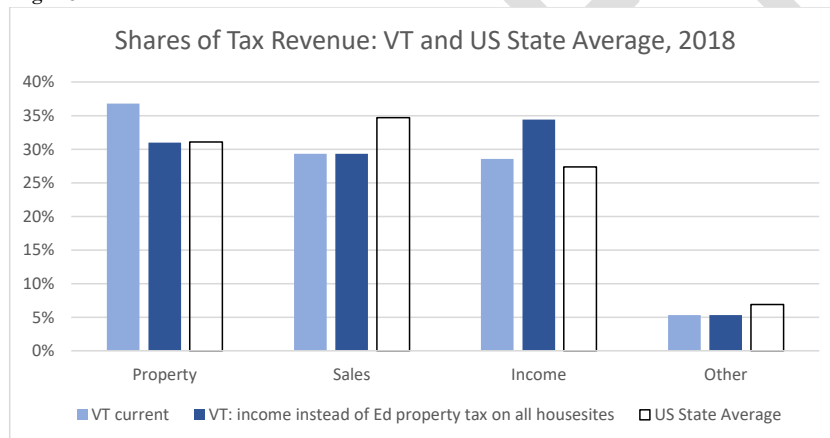
Sustainability

- 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.

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 recommending a decrease in the sales

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.

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.

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.

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 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.

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.

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.

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.

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 13.8% (Sommeiller, Price, & Wazeter, 2016) See a more comprehensive discussion of this topic in [Chapter 4](#).

Overall, Vermont's tax system slightly progressive. It is one of only five state tax systems that doesn't worsen income inequality, as measured by an inequality index calculated by the Institute on Taxation and Economic Policy (ITEP). However, an ITEP analyst cautions that this doesn't mean the tax system is consistently or robustly progressive. For example, the effective tax rate is higher—rather than lower-- on the middle quintile of earners than it is on the next quintile of higher earners. And, she points out that the top one percent of earners pay only very slightly more than families in the middle quintile of the income distribution. She concludes: "This lack of meaningful progressivity in taxing top earners is a notable departure from Vermont's strong progressive tradition in other policy areas. By definition, Vermont's top earners are much more able to pay a higher tax bill than the vast majority of families. And yet together, the state and local governments ask these fortunate individuals and families to pay a rate that is nearly identical to the rate it charges the state's middle class." (Davis, 2020)

Commented [SS7]: Replacement paragraph from Deb – 12/27/2020

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

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

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

changes in the Education Tax so that the tax rate now is the same in any district with the same spending per pupil.

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.

DRAFT

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 (Teachout, Manchester, & Wexler, 2017):

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.

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.

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.

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.

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

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.

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.

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 do 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 Tax

~~In Vermont, the income tax is appropriate since income is a good indicator of a person or entity's ability to pay. Most states have some form of an income tax. For example, New Hampshire, which does not have a personal income tax, taxes interest and dividends and business income at the entity level. 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~~

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~~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.~~

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.

~~Taxing Bads Not Goods~~ ~~the Role of Pigouvian Taxes~~

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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.

Gund proposes to tax resources, to encourage a reduction in their use; pollution, to discourage it, and land, to discourage sprawl (Vermont Green Tax and Common Assets Project, 2009). 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.

4. 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.”⁶ 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 principles 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.”⁷

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

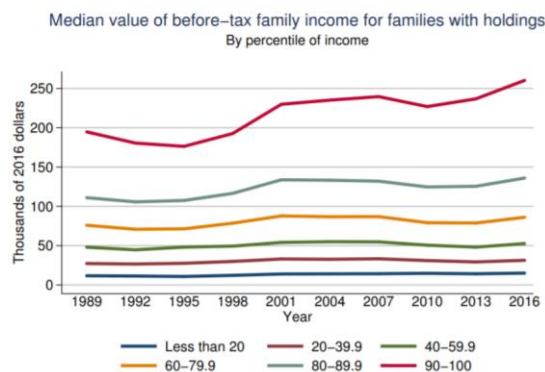
Income is the generally accepted way to measure the ability to pay in the United States. Nationally, the highest income categories have seen the greatest income growth. Data from the Federal Reserve Board’s Survey of Consumer Finances show that the median income of families in the top income decile increased 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 ⁸

⁶ Staff of the Joint Committee on Taxation. 2015. Fairness and Tax Policy. JCX-48-15

⁷ <https://www.taxpolicycenter.org/briefing-book/how-should-progressivity-be-measured>

⁸ 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.⁹

As shown in Table 10, 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.

Table 10

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 2016.¹¹ The Gini coefficient ranges from 0 in a perfectly equal

⁹ <https://www.epi.org/publication/income-inequality-in-the-us/>

¹⁰ <https://www.irs.gov/statistics/soi-tax-stats-adjusted-gross-income-agi-percentile-data-by-state>

¹¹ Congressional Budget Office. 2019. Projected changes in the distribution of household income, 2016 to 2021.

distribution (in which each household has the same 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.¹²

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.”¹³ 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.”¹⁴

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 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).¹⁵

Table ¹⁶

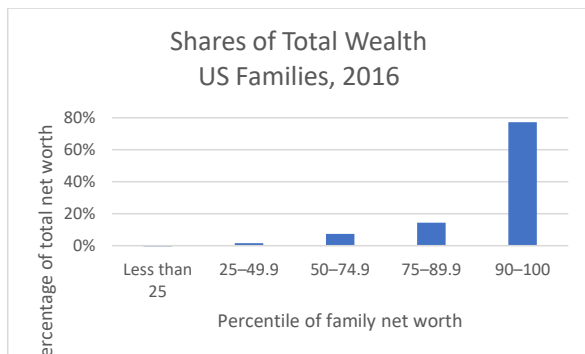
¹² Note that the definitions of income and the unit (family, household, tax return) differ in each study so the coefficient isn’t comparable. However the trends are consistent.

¹³ Saez, Emmanuel, and Gabriel Zucman. 2019. “Progressive Wealth Taxation,” Brookings Papers on Economic Activity, Conference Drafts, September 5-6 2019, p. 6.

¹⁴ <https://www.brookings.edu/blog/up-front/2019/06/25/six-facts-about-wealth-in-the-united-states/>

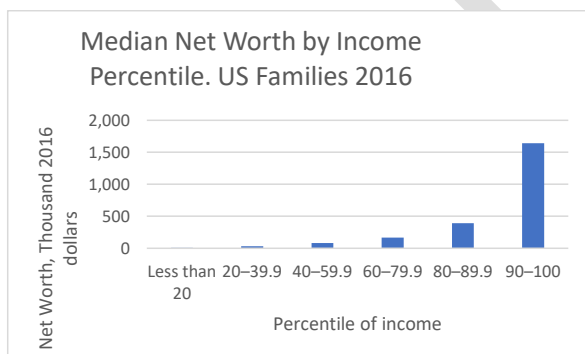
¹⁵ JFO/ Vermont Tax Department

¹⁶ SCF National survey data, 2016



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

Table ¹⁷

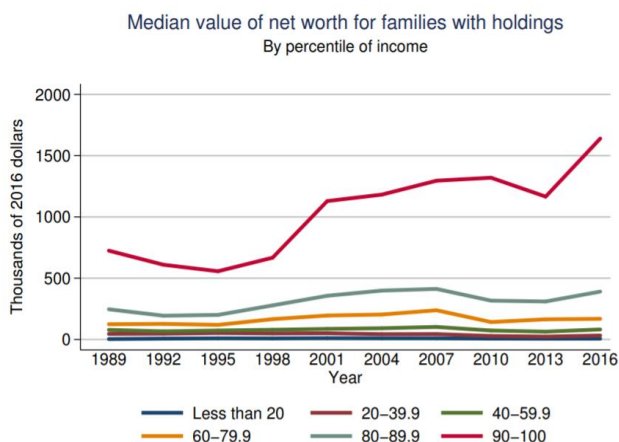


The data indicate that the concentration of net worth in the highest income decile is growing at a greater rate than the concentration of income. In 1989 the net worth of U.S. families in the top decile was 3.7 times their median income; by 2016, it was 6.3 times their median income. For families in 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 ¹⁸

¹⁷ SCF National survey data, 2016

¹⁸ SCF National survey <https://www.federalreserve.gov/econres/files/BulletinCharts.pdf>



While there are differing views on how to measure wealth¹⁹, 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.

¹⁹ 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 Kimmel, 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.realeclearmarkets.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 ¹	Tax while holding	Tax at Transaction ²	Federal Tax Preference ³	Vermont Additional or Specific Tax Preference
Financial Assets	42%				
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%				
Nonfinancial Assets	58%				
Vehicles ¹	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.

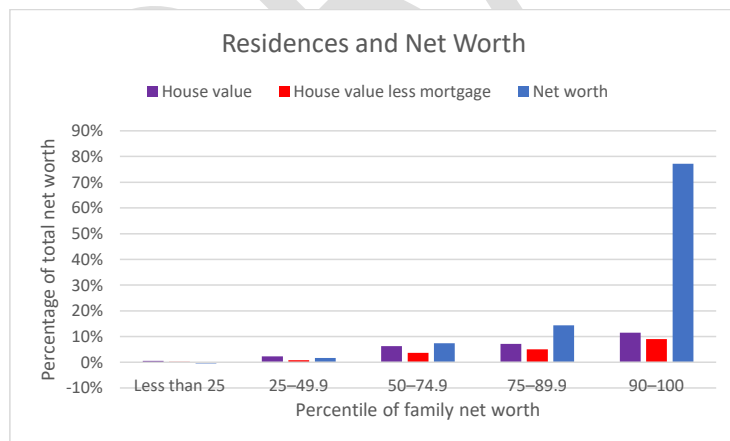
Ironically, assets are recognized as a component of the ability to pay when it comes to transfers. Some public benefit programs have asset tests that limit the eligibility for assistance or reduce the benefits. This means that, at the lower end of the income scale, assets affect redistribution of income. 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 ²⁰

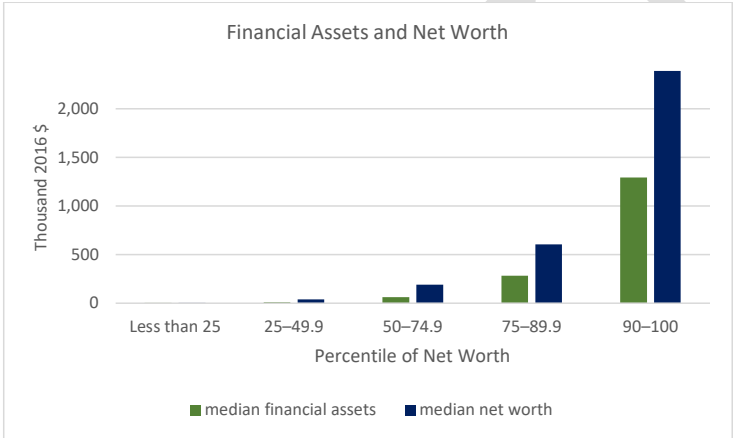


²⁰ SCF 2016

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 unreasonable to use the house value as a proxy for net worth. For families at the low end who own their home, the value the house may exceed their net worth because it is mortgaged and the family has few other assets. In contrast, the value of residences is only 14% of the aggregate net worth of families in the top decile.

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.

Figure 21



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.

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. ²²

²¹ SCF 2016

²² https://read.oecd-ilibrary.org/taxation/the-role-and-design-of-net-wealth-taxes-in-the-oecd_9789264290303

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.”²³

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, 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. 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.

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 clarify and consistency to the sales tax through the coordination of member states is a recommended model.

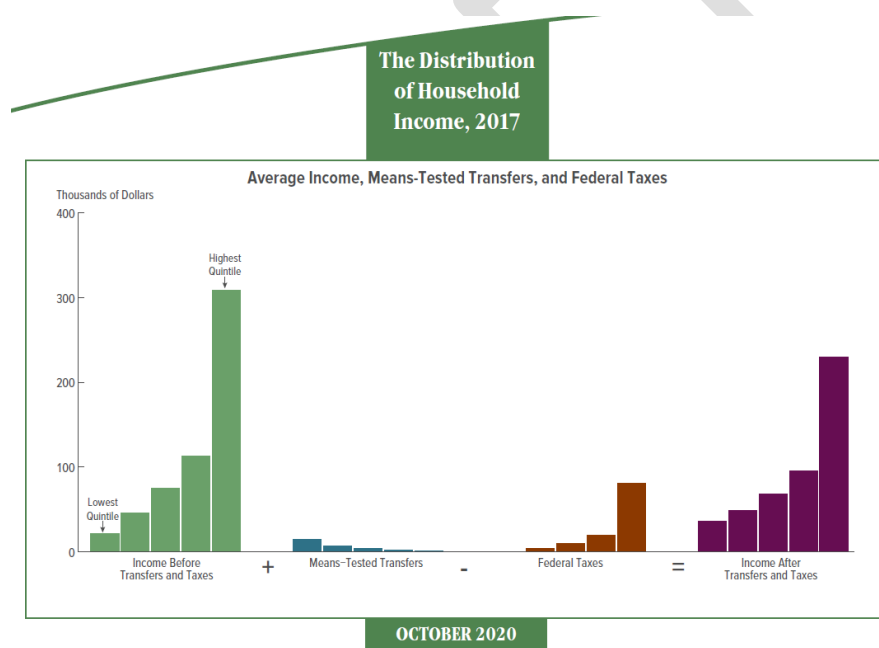
²³ <https://www.floridabar.org/the-florida-bar-journal/the-florida-intangible-tax-the-real-voluntary-tax/>

5. Overall Restructuring of the Tax and Transfer System

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.²⁴ 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.²⁵

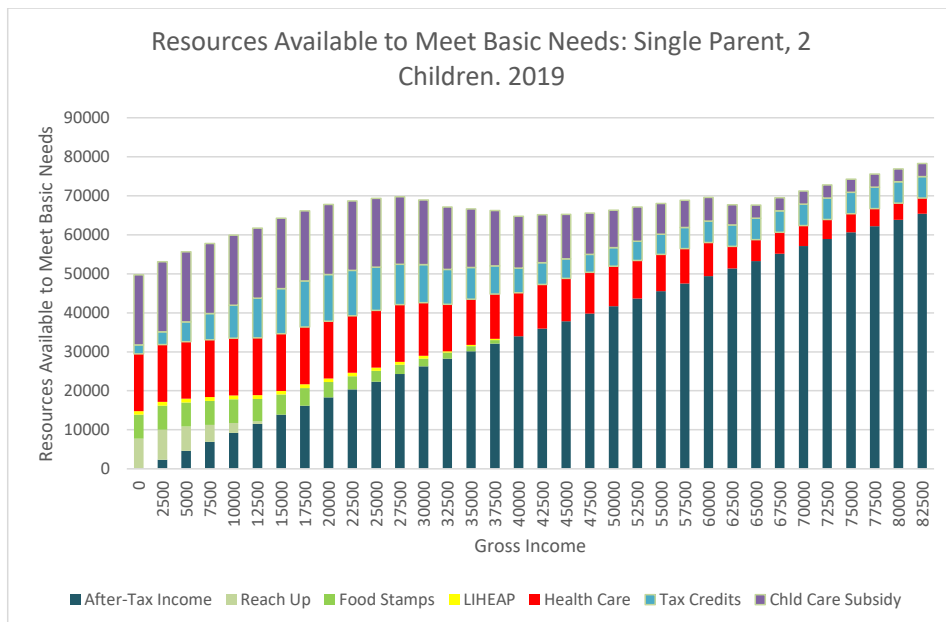
A concurrent study could look at the ability of these same hypothetical family types, at different income levels, to meet that basic needs budget. It would illustrate points at which the families net worth decreases (aka benefit cliffs), and disclose exactly which taxes and transfers contribute to the 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 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.

²⁴ 2 V.S.A Section 505

²⁵ <https://ljfo.vermont.gov/assets/Subjects/Basic-Needs-Budgets/2c974b591b/2019-Basic-Needs-Budget-and-Livable-Wage-report-FINAL-1-15-2019-v2.pdf>



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 3.7% and harmonize the provider tax rate at 3.7%. 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 3.7%. 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.

6. ~~Taxes Used to Fund Education~~ Tax Reform

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Introduction

Before attempting to evaluate or suggest improvements to the Education Tax, the commission sought comments, criticisms, and suggestions from legislators, municipal officials, school teachers and administrators, representatives of government and education organizations, and citizens. And they delivered. First, we just listened. Then we methodically organized, analyzed and discussed the comments we received before looking for ways to address them. If there was a common theme, it was that the system's strength is equity, and its weakness is complexity.

Although we looked at ways to address the different issues individually, we do not recommend a new box of Band-Aids. Instead, we looked for more fundamental structural changes that would address as many of the issues as possible while maintaining equity. We evaluated five possible approaches; two were rejected, three were considered improvements to the current system, and we recommend one of those three.

Our recommendation is to replace the current education tax on the primary residence (and up to two acres) with a locally-voted tax on income. This would abolish the homestead property tax and the property tax credit. For many households, the tax bill would be the same as the net bill under current law; the change would make the bill direct (as opposed to requiring a credit in the following year) and there would no longer be a double system of property tax and income tax on each housesite.

We do not see any principle-based reason that the education tax should be different for renters than for homeowners, and we recommend that renters be taxed on their income and credited for education taxes assumed to be paid through their rent. To design and implement this component, we recommend initiating reporting, data collection and analysis.

The sections that follow document key issues that we considered in coming to our recommendations. Rather than presenting only the points that support our recommendations, we attempted to indicate different interpretations and different solutions.

The five approaches to structural change that we examined are outlined in the Appendix to the chapter.

Background

Education is both a state and a local responsibility, and its funding comes from both broad-based state taxes and a locally voted tax. Finding the right state and local balance in both governance and revenue is a constant challenge, not only to ensure educational quality, but also to ensure equity between school districts.

Traditionally, K-12 education in the U.S. has been partially funded with state taxes, and partially with local property taxes. In Vermont, as in many other states, the property tax was adjusted in two ways to reduce inequities. First, in recognition that the value of a home did not necessarily indicate the ability to pay, a circuit-breaker program capped the tax bill on a house based on the income of the owner. Second, in recognition that the disproportionately small tax bases of some districts made it difficult to raise enough to provide an adequate education, various formulas were developed to distribute state funds to help support these districts. Both remedies focused on aiding those with the least ability to pay (homeowners with low incomes, or districts with low tax bases per pupil) and not on adjusting the overall system so that all homeowners or all districts had reasonably equal ability to support education.

In the 1990s, what was known as the Foundation Formula was the mechanism for determining the state aid distribution. Basically, the state estimated the amount needed to provide an adequate education and compared this with the amount that could be raised with a property tax at a uniform foundation rate, district by district. If a district could not raise the adequate amount at the foundation rate, state aid made up the difference. Districts could levy an additional property tax to raise additional revenue, and most did.

As noted by the Governor's Blue Ribbon Commission on Educational and Municipal Financing Reform in 1993, the success of the Foundation plan, like all the plans before it, followed a predictable trajectory. When the program was passed, there was an infusion of state funds, making property tax rates drop. Because the level of the property tax was reduced, the level of inequity was reduced. But the profile of inequity was not changed, and over time, as the state share decreased, the inequity became urgent again.²⁶

In the Brigham decision of 1997, the Vermont Supreme Court decided "that the current system for funding public education in Vermont, with its substantial dependence on local property taxes and resultant wide disparities in revenues available to local school districts, deprives children of an equal educational opportunity in violation of the Vermont Constitution."²⁷ The opinion notes that "We must confront the constitutionality of the system in light of the limited nature of the Foundation Plan's purpose. The object of the Plan is not equality of educational opportunity generally, or even equality of local capacity to facilitate opportunity. It is only to equalize capacity to produce a minimally adequate

²⁶ Governor's Blue Ribbon Commission on Educational and Municipal Financing Reform: Final Report and Recommendations. 1993. P.11

²⁷ Brigham v. State. 96-502. (1997). P. 1

education, assuming the voters can sustain the state-selected rate.”²⁸ They concluded: “We find no authority for the proposition that discrimination in the distribution of a constitutionally mandated right such as education may be excused merely because a “minimal” level of opportunity is provided to all.”²⁹

In response to the Brigham decision, the legislature made fundamental changes to the education funding system, some immediately with the passage of Act 60, and others over time. The main changes are:

- To reduce between-district disparity in ability to raise revenue, all non-homestead property is taxed at a uniform state rate, and the revenue is shared by all districts.
- To reduce between-district disparity in the ability to raise revenue, the homestead education tax rates are a function of the district’s voter-approved spending per pupil—and not a function of the district’s Grand List. For a given spending per pupil, the rate is the same in any district. This applies to all districts; it applies to all spending levels.
- To better reflect the ability of taxpayers to pay the tax, the education property tax on a housesite (house plus up to 2-acre site) is adjusted to reflect the household income.

Perhaps the most important feature of the system is its ability to maintain equity through changes in the economy and in state and federal revenue, avoiding the predictable path of past funding formulas. There are two main reasons for this. First, unlike earlier systems, all districts now benefit from state support of education, and all legislators have an interest in supporting adequate funding. Earlier systems provided state aid for districts with low tax bases but wealthier districts did not benefit from the scheme. Second, the equity provisions are integral to the tax rate and apply to all levels of spending, so the equity does not erode over time if state General Fund and federal contributions to the Education Fund decline.

The income component is not direct. The housesite tax has been referred to as an income-sensitized property tax. There are actually two rates set annually in each district -- one for property and one for income, determined by spending per pupil in the district, divided by the state-set yields. Effectively, homeowners pay the lesser of the housesite value multiplied by the property rate or the household income multiplied by the income rate. In practice, however, they pay the school property tax in one year and then receive a credit in the following year if the property tax paid on their housesite exceeds the tax that would have been due if they had paid on income.

The commission recognizes the important and significant advances made in reducing the disparity between school districts, and in reducing the regressivity of the education tax. However, after a generation of experience with the new system, the commission sought

²⁸ Brigham v. State. 96-502. (1997). P. 6

²⁹ Brigham v. State. 96-502. (1997). P.22

comments, criticisms, and suggestions from legislators, municipal officials, school teachers and administrators, representatives of government and education organizations, and citizens.³⁰

What follows is a discussion of the main issues raised, especially as they relate to principles of taxation accepted by the commission. The main focus was the locally voted homestead tax; there was general support for the state tax on non-homestead property.

Following the discussion of the issues is a summary of our recommended changes, along with comments as to how they relate to issues raised during the study and to the principles adopted by the commission.

The Appendix includes a summary of the other models considered.

Issues

Complexity

The most common criticism was the bewildering complexity of the locally voted homestead education tax. According to the Vermont League of Cities and Towns, “The education property tax system is endlessly complicated, confusing and disconnected from the education budgets that voters adopt at the local level.”

Although several people testified that the current system is a vast improvement over the earlier property tax and that complexity is a small price to pay for the gains in equity, the commissioners agreed that the complexity is overwhelming the effectiveness of the current education tax.

The complexity is primarily due to: use of a credit that comes a year late and causes the tax bill to be disconnected from the budget vote; and utilization of both property value and income to determine the contribution of each household, creating what is essentially a double system.

The tax is not direct; homeowners to pay a property tax and, in the following year, receive a credit for the difference between the property tax and what they would have paid based on their income. Even though the net result may be the household income multiplied by the district’s income tax rate, the two-year process is cumbersome and confusing. The amount of the homestead tax bill is not directly related to the budget voted that year and therefore somewhat unpredictable, as it includes a credit based on the prior year. In addition, homeowners must apply for the credit and complete a detailed compilation of the income of all household members which is error prone. The state Department of Taxes calculates the

³⁰ Reference summary of issues and also list of people who testified and links to testimony?

credit for each household and sends the information to each town. Local officials subtract the credit from the tax due on the property tax bills, often twice as a result of late filings and corrections. And, because there is no longer a clear link between the budget voted and the voter's tax bill, the cost control and accountability of the budget process is weakened.

The commission recommends ~~abolishing-eliminating~~ the Property Tax Credit and implementing a direct tax in its place.

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The process is further complicated by the process involved in forcing the match between the two systems, administered by different levels of government, with different calendars, with different confidentiality requirements. For local and state officials, the administration of the double system is confusing and time consuming; for legislators and policy makers, the complexity has resulted in spending penalties, income caps, house-value caps, and special rates—all of which further compound the complexity. And, local officials are often stuck with trying to explain the tax bills to taxpayers.

The commission recommends replacing the hybrid property/income homestead tax base with a single tax base; and, to maintain equity, that single tax base should be income.

Equity

The commission's accepted principles incorporate two standard concepts of tax equity: horizontal equity and vertical equity. Horizontal equity calls for equal taxation of people in equal situations. Vertical equity calls for greater tax burdens for people with greater ability to pay. While these are clear in concept, they are more difficult to evaluate in practice.

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Most of the equity discussion involved the locally voted tax on the housesite and the income-based credit. In addition to complexity, the current double system leads to different characterizations of the tax and different impressions of its equity. The Blue Ribbon Tax Structure Commission of 2011 noted two different perspectives: income tax adherents who believe most residents pay an education tax based on their income; and property tax adherents who believe the current system is a property tax on the housesite, with a subsidy based on income.

Depending on the starting position, people measure equity differently. The income tax adherents may feel that equity results from the net (property tax minus the credit) education tax because it rises as incomes rise. So, in their view, households in the same district with equal incomes should pay the same tax, even though one owns a \$400,000 house and the other owns a \$200,000 house. Property tax adherents may feel that equity results when people with higher value housesites pay a higher property tax. In their view the tax bill of the \$400,000 house should be twice that of the \$200,000 house, and the Property Tax Credit is considered a subsidy for those less able to pay.

This position leads to perceived inequities of the current system, focused on the credit rather than on the net tax people pay. The household with the \$400,000 house will receive a larger credit than the household with the \$200,000 house, although the two net bills would be the same because the household incomes are the same. Looking at the credit rather than the net tax leads to the perception that the system is unfair.

It is important to note that the owners of the \$400,000 house still do pay twice as much as the owners of the \$200,000 house in municipal property taxes, assuming their incomes exceed \$47,000. Municipal taxes support services and investments—including roads, recreation programs, libraries, and town government—that are more variable from town to town, less controlled by state, and more related to the value of property.

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³¹ Final Report: Blue Ribbon Tax Structure Commission, 2011, P. 41

~~government—that are more variable from town to town, less controlled by state, and more related to the value of property.~~

Two main reasons are offered to support the property tax adherent’s view of the vertical equity of an education property tax on residences. The first is that higher income people tend to have higher value houses. The second is that the residence is a type of wealth that most people have, and it is a good proxy for total wealth, which is also an indication of ability to pay.

According to the American Community Survey, 72% of Vermont primary residences were owner-occupied in 2018, and 28% were renter-occupied. Looking at [Vermont tax data on](#) owner-occupied households only, the median value of the house site increases as the household income increases (Table 1).

Table 1.³²

2017 Household Income	# Owner-Occupied House Sites	Median House Site Value
< 47,000	52,410	144,896
47,001 - 90,000	58,991	183,708
90,001 - 136,500	33,766	232,785
136,501 - 200,000	13,818	285,949
200,001 - 300,000	5,665	351,761
300,001 - 500,000	2,645	418,733
500,001 - 1,000,000	1,048	485,479
> 1,000,000	434	582,394

However, the distribution is not tidy. In any income category there is quite a range of house values in a given year (Figure 1).

Figure 1³³.

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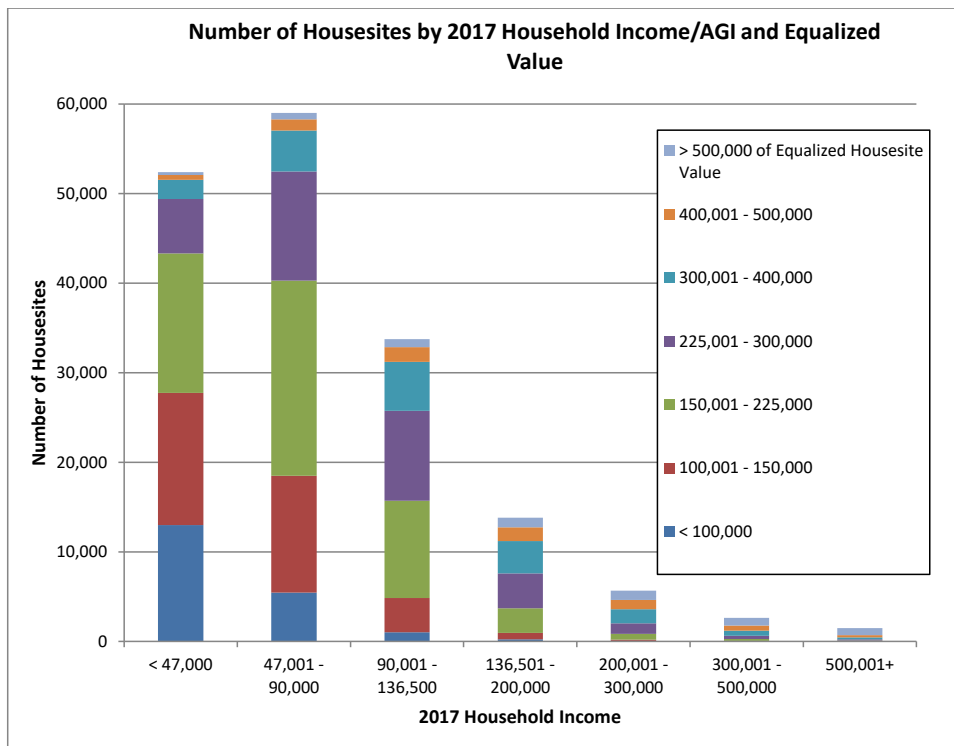
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³² Vermont Joint Fiscal Office

³³ Vermont Joint Fiscal Office

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As discussed in (Chapter XX), Vermont does not have data on assets of its residents so the commission relied on national data to look at whether the value of a residence was a good proxy for wealth. At the national level, the Federal Reserve Board's Survey of Consumer Finances collects information on the assets and liabilities of families, and estimates the family net worth—the difference between the family's gross assets and its liabilities. For families with low net worth, the primary residence often exceeds 100% of their net worth because they own few other assets and the residence is mortgaged. The Survey estimates that value of the primary residence represents 88% of the net worth of families between the 50th to 75th percentiles of net worth but only 25% of the net worth of the families in the top decile.

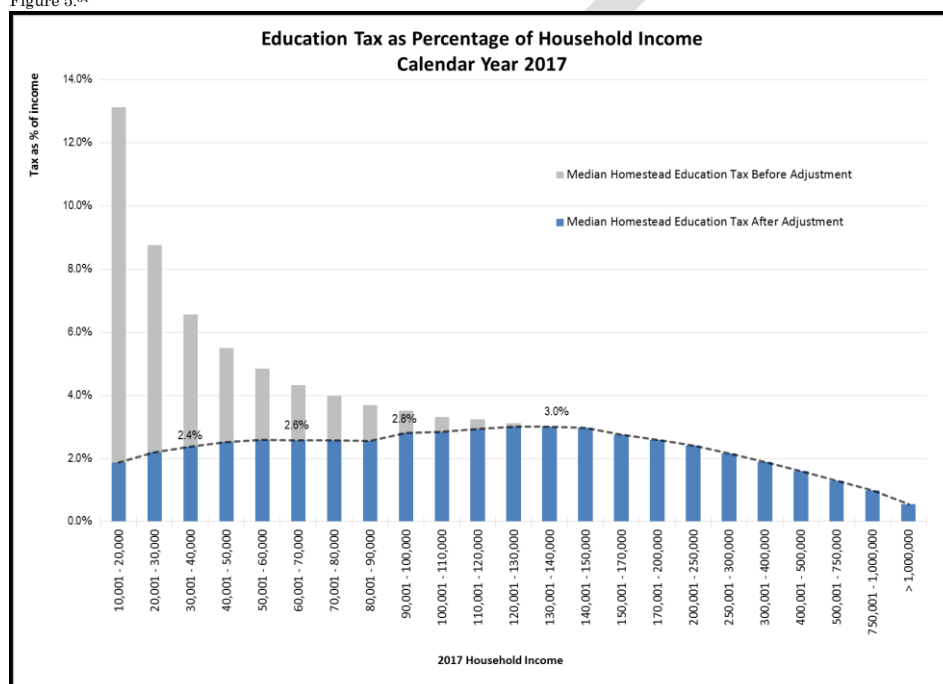
Given the divergence between the value of a house and both income and wealth, and given the impracticality of determining, measuring or taxing net worth, the commission believes that income is the best way to measure taxpayer equity and the most progressive way to tax residents for education at the present time. However, the commission agrees that wealth is an important component of a household's ability to pay, and we would like further research on how wealth could be measured or included in the tax structure. (Chapter XX)

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Using income as the indicator of the ability to pay, Figure 5 illustrates the vertical equity of the current homestead education tax, before and after the credit. The bars in the chart below show the property tax on the housesite, before the credit. The dashed line shows the net education tax paid (after the credit). While the bars indicate that the housesite property tax is extremely regressive, the net tax (after the credit) is somewhat progressive up to incomes of about \$140,000, and regressive at higher incomes. There are also jumps resulting from various housesite and income caps. It is clear that the current homestead tax has improved vertical equity of the education tax and of the tax structure as a whole, but it is not a progressive tax.

Figure 5.³⁴



One additional question about taxpayer equity was raised. Currently, the education tax on housesites does not vary depending on the number of people in the household. In contrast, the Personal Income Tax uses deductions and exemptions to adjust for the size of the family supported by the income. The commission recognizes the tradeoff between simplicity and equity and does not have a strong preference in this case.

³⁴ Joint Fiscal Office

The between-district horizontal equity received little comment. The commission did not receive testimony questioning the guaranteed yield system that provides equal per-pupil revenue for equal homestead tax rates. Nor did it receive testimony questioning the state education tax on non-residential property. The commission believes both provisions have increased between-district horizontal equity substantially, understandably, and simply.

Although the Brigham decision used equal spending per pupil as a yardstick, the legislature acknowledged that the cost of educating students to state standards can vary by district based on the differing needs of the students, the size of the school, grade levels, and transportation. For that reason, two districts might not be able to reach the same educational standards with the same spending per pupil. Currently, the variation in the needs of districts is addressed in two ways.

- Categorical state aid is sent to districts based on their need for certain programs, including transportation and special education.
- Per Pupil Weighting adjusts the student count used to calculate the spending per pupil that determines the tax rate. Heavier weights increase the student count and decrease the rate needed to fund a given budget. Currently weights are applied to account for grade level, English Language Learners, and economically disadvantaged students.

Comparing the spending per weighted student across districts shows that the extreme disparity that triggered the Brigham case has been reduced. An analysis by Public Assets Institute found that spending for 2/3 of the (weighted) pupils in the state fell within \$1,400 of the \$15,400 state average. They calculated that the standard deviation in spending per student had narrowed by 35% since the passage of Act 60.³⁵

Yet there are reasons to examine between-district equity more carefully. The commission heard concern that high-income districts were spending more than low-income districts. To examine the relationship between the household income of homeowners and spending per pupil, we looked separately at three categories of districts in 2018: PreK-12; elementary; and high school. We also looked separately at union districts and town districts.

Of course, spending per pupil depends on multiple interacting factors. The most consistent trends we found were:

In general, spending per pupil was lower in districts with more students.

In general, in districts with more students, the incomes of homeowners were higher.

Putting those two prominent trends together, it would seem that spending per pupil would be lower in districts with higher incomes. But that was not generally true. Holding enrollment constant, there was also an offsetting tendency for higher-income districts to spend more per pupil. Because this relationship was not statistically significant except in town elementary districts, and because the relationship between enrollment and spending

³⁵ Presentation to Vermont Tax Structure Commission, August 29, 2019. Public Assets Institute. P. 1

was stronger in all types of districts, on average districts with higher incomes did not spend more per pupil.

There were significant differences between traditional town districts and union districts. Town districts generally had fewer students, lower spending per pupil, and greater between-district variation in spending per pupil, than union districts. Controlling for enrollment, there was a positive relationship between spending per pupil and income in town elementary districts, although it only accounted for about 5% of the variation in spending per pupil. There was only a slight decrease in spending as enrollment increased in these districts.

Union districts, on the other hand, generally had more students, higher spending per pupil, and less between-district variation in spending per pupil, poverty ratios, and incomes. In general, the larger the enrollment in the union district, the lower the spending per pupil. In union districts there was little relationship between the spending per pupil and the average income of homeowners.

It makes sense that by combining smaller town districts, unions would tend to reduce the between-district variation in poverty and income, and blunt the impact of sudden changes that make the spending per pupil more volatile in small districts. This snapshot is from 2018, when Act 46 was in the early stages of implementation, and there were still 108 town elementary districts. It is likely that the relationship between income and spending will decrease as these small school districts are incorporated into larger unions.

As mentioned earlier, the extra cost of educating students in poverty is addressed by weighting those students. If the weighting scheme were successful, we would see inequality in spending per pupil, and equality in spending per equalized (weighted) pupil; higher poverty districts would spend more per pupil than lower poverty districts, but the spending per equalized pupil would be same. The data indicate that, to a certain extent, this is successful. Controlling for enrollment, spending per (unweighted) pupil tends to be slightly higher in higher-poverty districts, which is not what would be expected. But spending per equalized pupil still tends to be lower in higher-poverty districts, indicating that the weighting did not convince voters to support the full supplement per poverty student.

The 2020 weighting study calculates a substantially higher weight for poverty than the current weight.³⁶ This would mean that high-poverty districts would be able to spend more per pupil at their current tax rate, and presumably it would increase spending in those districts. And, because the poverty rate is generally higher in districts with lower incomes, increasing the poverty weighting would tend to offset the difficulty that lower-income households may have in paying taxes.

~~The cost of educating students with different needs, and the distribution and allocation of funds to appropriate programs, are beyond the scope of this commission. But we do look at~~

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³⁶ Study of Pupil Weights in Vermont's Education Funding Formula

~~the ability of the tax to achieve the goals. We are not convinced that applying such a substantial poverty weight will result in the locally voted education tax raising the optimal amount for educating economically disadvantaged students. Perhaps categorical grants for specific interventions such as tutoring and after school programs may also play a role, leaving less compensating to be expected of the locally voted tax.~~

The commission believes that the equity of the locally voted education tax is crucially important. Unlike many other taxes, it both collects and distributes. After the allocation of categorical grants, we rely on the locally voted tax to raise the amount needed to provide the education of the students in each district. If this tax is inequitable, it is likely that education will be distributed inequitably. For this reason, we believe the relationship between income, poverty, and education spending is vitally important to track. At this time, it appears that a combination of district consolidation, heavier weighting for poverty, and moving to an income-based tax for residents will improve the equity of the education tax.

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Volatility

Several people commented on the volatility of the Education Tax, and the commission looked at this in two ways: volatility in terms of the total amount raised for Education, and volatility in the bills of taxpayers.

For most state taxes, such as the sales tax or the income tax, the revenue raised varies from year to year depending on changes in the tax base. Volatility in the revenue is a challenge to steady budgeting to meet state needs. Volatility is an issue even within a single fiscal year, as budgets are developed and approved without the knowledge of the amount that most state taxes will raise during the year. Usually estimates are fairly close, but a budget adjustment process is routine.

However, for the Education Property Tax the process is reversed; the budget determines the education property tax rate needed each year to raise the necessary amount. And, in contrast to other state taxes, the property tax base is known before the rate is set, so there is very little guesswork. With the exception of delinquencies, the property tax will bring in the amount budgeted. As a result, the Education Property Tax does not result in insufficient revenue due to year-to-year changes in the tax base.

However, this shifts the volatility to the taxpayer. The education property tax functions as the shock absorber that allows the Education Fund to be filled. The education property tax must be increased or decreased in response to changes in the tax base (especially due to appreciation as estimated by the Common Level of Appraisal), changes in education spending, changes in uses such as health insurance, and changes in the other revenue sources in the Education Fund including the Sales Tax, the Rooms and Meals Tax and one-time money like federal funding after during the Great Recession or the COVID pandemic.

In some years, education property tax bills have increased at a rate that exceeds the increase in school spending, frustrating voters. This is not unique to Vermont; local rates will rise to compensate for falling state aid in any state that relies on a combination of state and local funding for education. But Vermont's system has more moving parts.

Some possibilities suggested for reducing the volatility in the tax bills are:

- Create a stabilization reserve, to be used to stabilize tax rates
- Eliminate the Property Tax Credit which essentially passes on a tax increase from the prior year to the current year (or pay for it out of the General Fund)
- Reduce disparity in increases in spending between districts
- Index state funding to some measure of spending growth
- Move to two-year budgeting
- Separate funding for capital construction from annual expenses
- Stabilize the yield at a certain spending level, shifting the volatility to higher spending districts
- Stabilize the adjustment of listed value to taxable value (CLA) if using a property tax
- If using an income tax, make it less progressive than the Personal Income Tax
- Use categorical grants to offset uncontrollable costs or special programs
- Limit uses other than Education Spending from receiving support out of the Education Fund; move spending on mental health services and employee health insurance to the General Fund.

The commission also heard concerns that replacing the homestead property tax with a direct tax on residents' incomes would increase volatility—both in the taxpayers' bills and the revenue received by the Education Fund to support education. The change would mean that the Ed Fund would be more reliant on fewer people at the top end of the income distribution—and their income tends to be more variable. For example, in 2018, the top 5% of the housesites accounted for 14% of the total value of housesites; in contrast, the top 5% of income filers accounted for about double that percentage of total income, or 30% of total Adjusted Gross Income of Vermont residents. Many national studies have looked at the volatility of state revenue and point out that the personal income tax tends to reflect the business economic cycle, resulting in declines in revenue during economic downturns. However, the volatility of revenue of the personal income tax results from a combination of the volatility of the underlying tax base, changes in tax policy, changes in the distribution of income within a progressive structure, and changes in tax rates. Unlike the personal income tax, the proposed education tax would not have brackets and the rate would be set annually to match the revenue needed.

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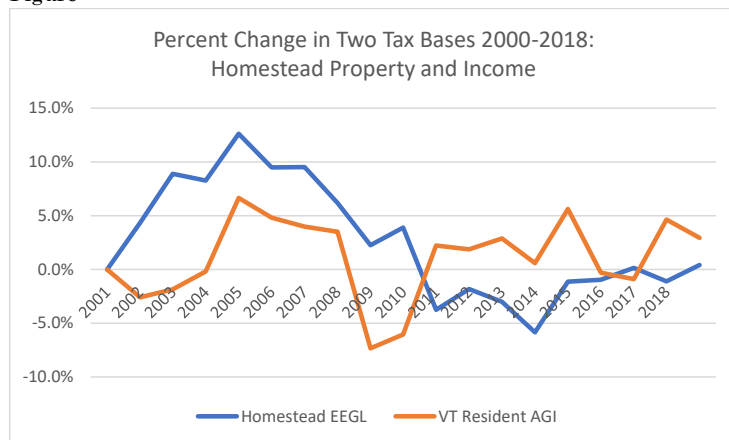
An analysis of the changes in only the two tax bases between 2000 and 2018 indicates the income base has actually been less volatile. The average annual change in the homestead equalized value (Homestead EEGL) in constant 2018 dollars was 4.7%, with a standard deviation of 3.8%. The average annual change in the Adjusted Gross Income (AGI) of

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Vermont residents was smaller – 3.3%--and the standard deviation was 2.2%. The number of years that the tax base declined was equal. Assuming that the tax rate would be set each year to raise the revenue needed, it does not seem that the rate would be significantly more volatile from year to year using an income base.

Figure ³⁷



Shifting from the current homestead education to an income-based tax would increase the chances that Education Fund tax revenue actually received in a year would not match the budget estimates because the income tax base would not be completely known at budget time. However, an income-based tax would not need to assume the same volatility of Vermont's Personal Income Tax. Some possibilities suggested to reduce volatility are:

- Setting the rate annually to raise the required amount, as is done currently with the education property tax
- Basing the tax on the prior year's income, as is effectively done with the current education property tax credit, so the revenue estimate would be more accurate
- Using a stabilization reserve

For an individual taxpayer, the income-based bill could be more volatile than a property tax bill—especially if the taxpayer's income is more volatile than the house value. However, this volatility would be tied to the ability of the taxpayer to pay the bill. If the tax is based on the prior year's income, taxpayers with sudden changes in income would not see the concomitant change in their tax bill until the following year. This is also true of the current homestead education tax, as the property tax credit is based on the prior year's income.

³⁷ Source: Vermont Department of Taxes

Cost Control

Many people felt that education spending is too high, and several legislators expressed frustration that they were unable to keep spending from increasing. The commission feels the spending level is not in its scope, and that the tax structure is not the best agent for accomplishing the most efficient delivery of quality education. However, the commission does recognize the potential for some controls on spending to be built into the tax system, and these would be preferable to separate penalties or incentives.

At one extreme, spending could be controlled if the state took over the system of taxation and revenue distribution. This would allow the legislature to set the uniform tax rate(s) each year, and distribute the revenue to each district based on a state determination of need.

Assuming the tradition of local control, locally voted budgets and local tax rates continues, higher spending could be constrained by reducing the yield (increasing the rate) as per-pupil spending increases. The current system essentially halves the yield at spending levels that exceed 121% of the prior year's average.

Representative Beck has suggested a variation to this approach that would direct the Education Fund's revenue from the non-residential tax, non-property tax sources, and a basic homestead tax to support per-pupil spending at a base amount estimated to provide an adequate education. Compared to current law, this would result in lower rates for spending up to that base amount. For spending above this base amount, the yield would be significantly lower than current law (and therefore the rate would increase more sharply) because the yield would be supported only by the homestead taxes of the districts spending above the base amount. This approach would tend to lower and stabilize the tax rates in the low-spending districts and increase both the amount and the volatility of the tax in higher-spending districts.

The commission believes that the confusion surrounding the current Property Tax Credit and the double system for determining the tax bill has removed the direct link between the budget vote and the tax bill. The first step in improving cost control and accountability within the tax structure should be simplifying the system so that voters have a clear idea of the effect their vote on the school budget will have on their tax bill. And, for the local tax to effectively control costs, those costs should be controllable. We recommend moving health care for school employees and mental health services to the General Fund.

What the Education Fund Should Pay For

There seems to be general agreement that the uses of the education fund should be limited so that the non-residential property tax and the locally voted homestead tax are only covering the costs of education that the voters have some control over. This would make it more likely that a district's rate would rise and fall in sync with its spending, rather than

with other spending, strengthening the connection between the budget vote and the resulting tax bill. When the Legislature established the Education Fund in Act 60, it explicitly listed eligible uses, and stated that “upon withdrawal of funds from the Education Fund for any purpose other than those authorized by this section, 32 V.S.A chapter 135 (education property tax) is repealed.

The commission recommends moving expenditures for mental health services and for employee health insurance from the Education Fund to the General Fund, along with proportionate revenue sources. This would remove some of the most uncontrollably volatile costs from the locally voted tax, so that the budgets would be more directly related to education expenses, more predictable, and more easily controlled by the voters. It would also give the Legislature greater ability to manage some of the costs that they now feel are out of their hands.

The commission recommends further study of the costs now covered by the Education Fund to see what the effect would be on both the level of the local tax and the volatility.

Renters

The current system raises education taxes from homeowners through an annual tax bill based on a school budget approved by voters – homeowners and renters. Because rental property is taxed for education at the non-homestead rate, it is assumed that renters contribute this amount through their rent.

As a result, the two groups are taxed for education at different rates. And the connection between the local budget vote and the effect on their tax bills is different. While the historical and administrative reasons for this distinction are clear, the commission could not find a principle-based justification for treating the two groups of residents differently.

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Ongoing oversight

Assuming we continue to have a locally voted education tax, finding the right balance will always be a challenge. The tax rates must be set each year, with a careful analysis of anticipated changes in incomes, property values, school district spending, and anticipated Education Fund revenue from other sources such as the sales tax and the rooms and meals tax. As demonstrated by the recent weighting study, equity in spending needs to be evaluated to ensure the weights are effective. Similarly, what is distributed through categorical grants and what is considered spending on general education to be raised via the local tax should be reviewed and analyzed periodically. Rather than create a special commission to tackle each of these when a crisis arises, the state would be better served by an ongoing review process and regular reports to aid the legislature.

There are a few examples of similar state efforts. The Debt Affordability Advisory Committee makes annual recommendations of the maximum level of the state's general

obligation debt, after an annual study of history and projections. The recommendation is advisory, but generally followed because of the thorough and consistent review. Similarly, the Current Use Advisory Board, after analyzing the economic situations for farms and forestry, establishes use values that reflect the income-producing capability of the land. These efforts create stability in the programs, as well as enabling Legislative decisions to be based on sound research.

The commission recommends establishing an ongoing Education Tax Advisory Committee to monitor the system, to report regularly, and to make annual recommendations to the Legislature. Annual recommendations would include the tax rate(s) and yield(s) and the amount of the stabilization reserve. Other recommendations, such as adjusting student weights or other changes to the system could be brought to the Legislature's attention as needed.

Property Tax Administration

In addition to comments about the complexity resulting from the administration of the homestead tax, the commission heard several concerns about the local administration of the property tax in general. The property tax was once only a local tax, but it now is predominantly a state tax and the competence of local listers is crucial to ensure that the state tax is being administered correctly, consistently and fairly.

Times have changed since Vermont towns began electing citizens to serve as Fence Viewers, Listers and Weighers of Coal. Although the duties of Weighers of Coal and Fence Viewers have evaporated, the duties of listers have increased substantially, and so has the expertise required to do the job.

Listers were so named because their main job was to make lists. Every household had an individual list of taxable possessions. The listers compiled these individual lists into the town's Grand List, and the tax for each type of property was set by the state so they didn't need to appraise. To do the job with the support of the electorate, they needed to be honest, and good penmanship was a plus. The work was seasonal, between sugaring and planting.

At this point, the job continues throughout the year and listers need to know, among other things: appraisal practices; Act 250, Open Meeting and Public Records laws; chapters 112-135 of Title 32; how and when to capitalize income to value property; how to understand and value easement restrictions; how to use standard software for valuing, compiling, reporting and updating.

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And once they master the job, there will be changes. They need to learn how to value the new types of property--such as cell towers, wind turbines, solar installations and subsidized housing--that may have special tax treatment. They need to understand and implement the latest changes in laws such as the education property tax or current use. And, they must adjust to frequent changes in the software and in reporting requirements.

Yet most of the listers have none of this experience when they are first elected to serve.

There is no authority to ensure that all the locally elected listers function responsibly, consistently, and competently in conformance with state laws. The Division of Property Valuation and Review has tackled this challenge admirably by offering courses, certification programs, webinars, training materials, forms to use for special property, handbooks, and frequent one-on-one assistance to listers. Significant progress has been made in the standardization of practices. However, the Division has little control, and training has been limited by funding.

One particular concern is the ability of small towns to appraise large and complicated properties and to defend the appraisals. For example, consider a \$4 million property in a town with a municipal tax rate of 30 cents. If the listed property were reduced to \$2 million as the result of an appeal, the town would be out \$6,000 per year, which is not enough to warrant an expensive defense. The state, on the other hand, would be out \$32,560 per year. The state not only has better ability to appraise and defend appraisals, it also has more at stake.

The commission recommends developing a program at Property Valuation and Review to appraise large and/or complicated property and to defend the appraisals. We also recommend analyzing other ways in which local administration could be strengthened and supported by the state. The current per-parcel payment should be reviewed and a payment schedule that is based on both the size of the town and the certification of the local officials should be considered. We believe that the state can make investments in the administration of the property tax that will be offset by increased tax revenue.

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Recommended Structural Change to the Homestead Tax

Process

The commission considered five possible approaches to changing the locally voted homestead tax. The intention was to preserve or further the equity gains of the current system while reducing complexity.

After modifying and evaluating different approaches, we recommend levying an education tax, at a locally voted rate, on the income of all residents. This would eliminate the Property Tax Credit and the option of paying an education property tax on the housesite. Because renters are assumed to pay an education tax through their rent, they would receive a credit designed to offset that cost.

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Two of the alternative approaches considered are actually small steps toward the recommendation. Model 1 would allow a homeowner to pay the lesser of the tax on the

housesite or on income, as in current law, but without using a credit. This would make the tax bill directly reflect the budget vote, and remove the confusion caused by the credit that is related to the prior year's bill. Model 2 would similarly abolish the property tax credit but, in addition, it would eliminate the option of paying a housesite property tax. This would remove the double property/income calculations and move to one tax base: income. While the commission supports these changes, we don't feel either model goes far enough. Our recommendation adds changes to the way renters are paying for education.

Two approaches were rejected. Model 3 looks at property as the tax base, and uses a generous homestead exemption to address regressivity. After further analysis, this approach was rejected because, in order to maintain equity, it would require substantial adjustment based on income and would not be an improvement over the current double income/property system.

Model 4 eliminates the locally voted tax entirely and imposes a uniform state school tax. This approach was also rejected. Although it has many tax advantages, the commission concluded that local control and local democracy are more important than tax simplicity.

These are not fully detailed models; in all cases there are components that could be changed. For each approach, the purpose, a general description of how it could work, its advantages and disadvantages, and the commission's recommendations are outlined.

The recommended approach is discussed below; the others are outlined in the Appendix to the chapter.

Recommended Structural Change to the Homestead Education Property Tax

We recommend levying an education tax, at a locally voted rate, on the income of all residents. We recommend eliminating the Property Tax Credit and the option of paying an education property tax on the housesite. Because renters are assumed to pay an education tax through their rent, they would receive a credit designed to offset that cost.

Purpose: To simplify current law by taxing all residents on income, and providing the same link between voting decisions and tax bills for both renters and homeowners.

FY 21 example. (School budget voted in March, 2020 for 2020-2021 school year)

Local Residential Education Income Tax
Income as of Dec. 31 2019, filed in April 2020
X
Spending per pupil FY21 / (Income rate X yield FY21)

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-
1. The budget presentation to voters includes the estimated income rate so people can estimate what their tax bill will be if the budget is approved.
 2. Local residential education taxes are paid to the state. The town does not send out education bills for declared house sites.
 3. The local Grand List includes a code (expanded SPAN) for each rental unit within a property, and an assessed value.
 4. All residents file their 2019 Adjusted Gross Income (AGI) and a residence declaration with their VT income tax form by April 2020.
 5. Installment payments, estimated taxes, or withholding would be paid by residents to the state between April 2020 and April 2021.
 6. Reconciliation takes place in April 2021. If the filer has overpaid, a credit would be issued; if the filer has underpaid, a payment would be due.
 7. The rental credit would be refundable, and it could be deducted from the withholding or estimated payment. The Tax Department would determine the tax paid on the rental unit by using the Grand List. The Landlord Certificate would be used to verify the renter and the rental unit.

4.—

- ~~5. Installment payments, estimated taxes, or withholding would be paid by residents to the state between April 2020 and April 2021.~~
- ~~6. Reconciliation takes place in April 2021. If the filer has overpaid, a credit would be issued; if the filer has underpaid, a payment would be due.~~
- ~~7. The rental credit would be refundable, and it could be deducted from the withholding or estimated payments. The Tax Department would determine the tax paid on the rental unit by using the Grand List. The Landlord Certificate would be used to verify the renter and the rental unit.~~

The school district budget vote would determine the local income rate, based on the spending per equalized pupil. At the time of the vote, taxpayers will have a good idea of what their tax bill will be by applying the estimated rate to the AGI that they are filing around the same time. If their income goes up or down during the year, the tax bill will not change. This is essentially what happens now, as the current property tax credit is based on the prior year's income.

For simplicity, AGI should replace household income. The AGI would not be adjusted for household size, although a case could be made for reducing the taxable income to account additional household members. As the filing status and number of exemptions already appear on the income tax form, no new paperwork would be required.

If the legislature feels there should be a maximum education tax, this could be set at a certain income level as is done with the social security tax.

Landlords would need to file annually, as they do now. However, they would not need to calculate allocable rent. The landlord's filing would list the names of people responsible for rent. If the renters change during the year, the landlord would indicate the responsible renters by month.

The commission envisions listing each rental unit separately in the Grand List, and dividing the assessed value of the entire building between units--which could be done proportionally by rent. However, the renter credit could also be less specifically tied to the unit, along the lines of the recent changes in the renter rebate program.

Housesite property could be defined as it is currently, or it could have a maximum value, indexed to some measure of appreciation.

There would be one statewide equalized rate for all non-housesite property. The town would send education property tax bills for all non-housesite property only.

If the legislature feels the tax is too high for lower-income households, the district rate can be phased in smoothly rather than using the current circuit breaker. For example, homeowners could pay 50% of the district rate at incomes of 0, rising to 100% for incomes of \$100,000. There would be no separate paperwork needed; there would be no credit. This could be designed to avoid two issues with the current circuit breaker: it creates a sudden jump in tax bills when incomes exceed \$47,000, and it insulates eligible taxpayers from the tax consequences of the budget vote.

Taxing renters in the same way as homeowners is recommended by the commission, although more analysis is needed to better understand the advantages, disadvantages, rate implications, and administration of the change for renters before it can be implemented. The commission recommends initiating reporting and data collection on renters and rental units as soon as possible to enable further analysis.

Pros:

- Provides meaningful property tax relief for more Vermont homeowners and renters
- Strengthens link between local vote and local tax bill, for all district residents
- Consolidates the spending and revenue resulting from one school year to one fiscal year so Education Spending and Tax rates are in sync
- Eliminates the taxpayer confusion resulting from the adjustment
- Eliminates household income calculation; can use AGI
- Shifts the focus to what is a fair tax amount to pay, rather than what is a fair subsidy
- Eliminates tax jump at incomes of \$90,000
- Reduces regressivity that now occurs at high incomes

- Less likely to affect behavior of high-income homeowners because renters are treated the same way as homeowners

Cons:

- Administrative changes at both the state and municipal levels to account for renters
- May influence high-income homeowners to choose another state as their residence

~~Reference Appendix 6-1 features the Commission's with evaluation of other options.~~
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7. Consumption Tax Reform

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"From the point of view of government policymakers, a good tax raises a lot of money without causing people to avoid the tax by distorting their spending (or voting) behavior. By that measure, a sales tax is a very good tax indeed: a body of research shows that, overall, sales-tax rates are not noticeable enough to consumers to make them change their behavior."

– "How Do People Respond to Sales Tax Increases," Baker et al., 2017.

Introduction

Consumption taxes are an important source of revenue in all 50 states and DC. Even states with no sales tax, like New Hampshire, tax some services and impose excise taxes. In Vermont, consumption taxes take the form of the Sales & Use Tax, the Meals & Rooms Tax, the Motor Vehicle Purchase and Use Tax, and Excise Taxes. For a variety of reasons, both economic theory and tax policy theory approve of most consumption taxes when applied broadly at a low rate. Our goal is to make the Vermont tax system overall more fair, more sustainable, and simpler, and our recommendations for consumption taxes aim to further those goals in the overall financial picture of Vermonters, and specifically with respect to consumption taxes.

Our most general recommendation to achieve those goals is to broaden Vermont's sales tax base. As we discuss below, among the 45 states with a sales tax, Vermont's sales tax base is unusually narrow. Much of what we recommend about broadening Vermont's sales tax base follows recommendations made by the Blue Ribbon Tax Commission, and we note that two different commissions, separated by ten years and made up of six different Vermonters with very different backgrounds, having together taken testimony from a broad range of Vermonters, have reached the same conclusion and made the same recommendation. Our recommendations would move Vermont into the group of two or three states, including Washington State, New Mexico, and Hawai'i, with the broadest sales tax bases in the nation.

We recognize that in terms of tax policy, being in the middle of the pack of states provides a sense of safety. It's less likely that Vermont will go very wrong if the state is doing things that are working in a good number of other states. There are, however, areas in which Vermont prides itself in being in a small minority, or even standing alone: Vermonters are proud of being one of the lowest-crime states in the country; Vermonters are proud of being one of only a very few states with no billboards; and in tax policy, Vermonters can be justly proud that Vermont is one of two or three states that are leading the way in using the state tax code to reduce inequality. We see very little risk to Vermont's reputation or economy in being among the few states with the broadest sales tax base, and much benefit in terms of the fairness and stability of our sales tax system. We also feel that having one of the lowest sales tax rates in the country poses no risk and provides both economic and reputational advantages.

The sales tax was created as a tax on tangible personal property (TPP), which by definition did not include services. Over the years, all 45 states with a sales tax have expanded it to include some services, although often with the questionable justification that a particular

service, like ski rental, is a substitute for a purchase, like buying skis. In addition to all the categories left out of the tax by definition, there are others that are specifically exempted by statute. In Vermont, these include a variety of necessities like groceries, clothing, and home heating oil.

We examine the reasons that some categories of goods and services are either exempt or excluded from the sales tax, and weigh the logic and the evidence as to whether those reasons are compelling or not.

We also examine the hurdles to expanding the sales tax base, including the likely concerns from people in businesses that do not currently collect sales taxes and from low-income Vermonters and advocates for low-income Vermonters, and we also consider various technical and administrative challenges.

For the most part, the sales tax applies only to private consumption – purchases made for government use by the federal, state, and local governments are exempt. However, purchases made for individuals using federal dollars, as when a Medicare patient buys a piece of medical equipment and Medicare pays for it, are eligible for the sales tax. Purchases made by tax-exempt non-profits are generally exempt (subject to some limits), but when a consumer purchases something from a tax-exempt non-profit, it is generally taxable.

Since health care makes up about a third of the consumer-level economic activity in Vermont, we examine the current taxes on health care and whether there is a way to simplify and broaden them without restricting Vermonters' access to health care.

Finally, we examine the question of what mix of lowering rates and increasing revenue Vermont should pursue based on a broader sales tax base, and conclude that after protecting low-income Vermonters and administrative costs, essentially all of the gain should be put toward lowering the rates.

Value-Added Taxes, Transaction Taxes, and Gross Receipts Taxes: Three Things We Do NOT Recommend

Globally, the value-added tax (“ad-valorem” or “VAT”) is the most common form of consumption tax, used in over 160 countries including all European countries, Canada, Australia, Japan, India, China, and almost all the countries in Latin America.³⁸ A VAT is collected at each step of the production process, from raw materials to consumer, but is not charged on the value of the product, but only on the value that is added at each step of the process. If you imagine Vermont with a 6% VAT, an ice cream company buys cream from a farmer for \$2/lb. The farmer collects \$2.12, and sends 12 cents to the state. The ice cream company then sells a pint of ice cream to the local grocery store for \$3, and collects \$3.18, but, having already paid 12 cents in VAT, only sends 6 cents to the state. The grocery store sells the pint of ice cream to you for \$5, collects \$5.30, of which it sends 12 cents to the

³⁸ International Monetary Fund, <https://www.imf.org/external/np/fad/tpaf/pages/vat.htm>

state. The end result is the same as a 6% sales tax – you, the consumer, pay 6%, or 30 cents, on your \$5 purchase of ice cream, and the state collects 6%, or 30 cents, on that pint.

From the consumer's point of view, there is no difference between a sales tax and a VAT. From the point of view of the businesses involved in the supply chain, a VAT is more burdensome to administer, although this is somewhat offset by the fact that businesses are relieved of the burden of determining whether a customer is a consumer or a business. From the government's point of view, the revenue raised is the same, but the VAT has two advantages – it's harder to evade, and the government receives the revenue in multiple payments over time instead of one payment at end of the process, when the consumer makes the purchase. Because the US has a somewhat unusual system of taxing authorities at the federal, state, and local levels, it does not seem that the VAT is viable in the United States. A VAT can only work at the federal level, so you either take away the states' ability to levy a sales tax and do a national VAT instead, or you layer a national VAT on top of a sales tax, which leads to double taxation of sales.³⁹ "A VAT, however, requires a national entity to operate the system of remittances and credits because of interstate transactions. Therefore, it would be exceedingly difficult, if not impossible, for a state on its own to implement a VAT."⁴⁰

We therefore do not recommend consideration of a VAT for Vermont to replace the sales tax.

Tax theory discourages a broad transaction tax, which would include the application of a sales tax to business inputs, with purchases at wholesale being the most prominent example. The reason for this is straightforward.

As an example, take a company whose business model requires 50% margins.

In a state without taxes, the company purchases a product at wholesale for \$50 and sells it to the consumer for \$100.

If you apply Vermont's 6% sales tax to the consumer purchase, the company buys it for \$50, sells it for that same retail price of \$100, and the consumer pays \$106, including the \$6 in tax.

If you apply the 6% sales tax to both transactions, the company pays \$53 for the product at wholesale, and sells it for a retail price of \$106 (to maintain their 50% margin target). Then you apply the 6% sales tax to that, and the consumer pays \$112.36.

Breaking down the \$112.36 that the consumer paid, you see that \$50 is the wholesale cost, \$53 is the retailer's margin, and \$9.36 is tax. Note that of that \$9.36 in tax, \$3 is tax at the wholesale level that got passed on to the consumer, another \$6.18 is the tax the consumer pays on the underlying \$103 of wholesale price plus retail margin, and 18 cents is the 6% consumer tax on the 6% wholesale tax, yielding an effective consumer tax rate of 9.09% ($\$9.36/\103), and an increased cost to the consumer of \$12.36 compared to the taxless transaction. The state ends up collecting \$9.36 more, but the consumer ends up paying \$12.36 more.

³⁹ Graham Campbell, Memo on Transaction Tax Details, May 21, 2018.

⁴⁰ Ibid.

This effect (“pyramiding” or “cascading”) is roundly discouraged by tax theory. It is more efficient for all parties for the state to simply levy a 9.36% sales tax at the consumer level, and exempt the wholesale purchase. The state ends up with the same revenue; the consumer pays \$3 less; the wholesaler is relieved entirely of the administrative burden of collecting and remitting sales tax; and retailer is relieved of the burden of paying sales tax on their purchases, and can sell their wares to consumers at a slightly lower price.

For the same reason, we do not recommend a gross receipts tax. While a small handful of states impose a gross receipts tax, these taxes typically apply to business-to-business (“B2B”) transactions as well as consumer purchases (“B2C”), and therefore cause the same pyramiding as a transaction tax.

The Effects of Adding, Increasing, Removing, or Decreasing the Sales Tax

We also examined the effect of changes in the sales tax on levels of consumption and/or access due to price elasticity of demand, which is to say, how much demand or access decreases/increases in response to an increase/decrease in the sales tax. In general, consumer-level demand is price inelastic in the range of price changes caused by adjusting sales tax rates. Per research done at the Kellogg School of Business at Northwestern University in 2017, *“(t)he researchers saw no impact on household spending habits four months to a year after a sales-tax increase.”*⁴¹ There is some evidence that in the month prior to a sales tax increase, consumers stockpile goods, so demand goes up in the month prior and then down in the months after, but once that stockpile is worked off, demand goes back to where it was prior to the tax increase. Presumably, the opposite is also true –in the month ahead of an announced decrease in the sales tax, people may purchase less, waiting for the tax to go down. It is also important to note that price elasticity of demand varies based on household income – lower-income households are more likely to reduce their purchases in response to a small price increase than are higher-income households. Price elasticity of demand also varies based on the magnitude of the change in price. While a 5% price increase may cause a 3% decrease in demand (price elasticity of demand of -.6), a 50% price increase may cause a 40% decrease in demand (price elasticity of -.8).

Demand is particularly inelastic for necessities like health care, groceries, education, residential energy use, and clothing, which are the five biggest categories that are currently exempt from the sales tax in Vermont. As is often the case, health care is unique in that “demand,” which is to say, how much people buy, is often determined not by the consumer/patient, but by the doctor. A further factor distorting “demand” in health care is the fact that often neither doctor nor patient knows or much cares how much a particular treatment costs. Both of these phenomena are likely to be important factors in the inelasticity of health care “demand.” We reiterate our recommendation from Chapter 5 that we make structural changes to the Vermont’s programs for low-income Vermonters to ensure that the changes we are recommending do not reduce access to any of these necessities for them.

⁴¹ “How Do People Respond to Sales Tax Increases,” Baker et al., 2017.

Another factor decreasing the net effect of the changes we are recommending is that even if demand did have some price response in the range of changes we are examining, our recommendation to broaden the base and lower the rate would mean that there would be a slight decrease in demand for the roughly 50% of purchases of goods and services that are not currently subject to the sales tax, but that would be partially offset by the increase in demand for the 50% of consumer goods that are currently taxed, as the tax rate for these things would go down.

We will therefore assume that changing the sales tax by a few percentage points will not have a material effect on demand. However, in the accompanying [Vermont Sales Tax Calculator](#) (Tax Structure Commission, 2021), we have included four calculations: for both holding low-income Vermonters harmless from the application of the sales tax to categories currently not taxed and making no provision to do so, we model scenarios with both price elasticity of demand and no elasticity. You will see that the inclusion or exclusion of price elasticity of demand does not make a large difference to the results, while holding low-income Vermonters harmless does make a meaningful difference.

In contrast with the changes of a few percent that we are contemplating here, a 60% tax, such as the excise tax Vermont levies on cigarettes, does in fact change consumer behavior in the intended manner – it reduces smoking, especially among young people. We are therefore mindful of the effects on demand in the analysis of the excise tax.

Vermont's current 6% sales tax exempts or excludes some categories of goods and most categories of services. We now examine the reasons for those exemptions, and we will explore opportunities to make Vermont's sales tax more fair, more sustainable, and simpler by expanding the base and reducing the rate, while at the same time exempting business inputs.

Why Are There Exemptions to the Sales Tax in Vermont?

There are hundreds of categories of goods and services in the United States economy, and states have made very different choices about which ones to tax. Vermont currently taxes consumer purchases of most goods that are not deemed necessities, and exempts most necessities like groceries, clothing, home heating, and medical products. Vermont currently exempts most sales of business inputs. Finally, Vermont currently taxes about 45 of the 20 or so services that are taxed by at least one other state (See Appendices 7-1 and 7-2).

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It is also true that the exemptions to Vermont's sales tax have been enacted over many decades by many different legislatures, and the original intent of each exemption is not always clear. However, there appear to be six main reasons that some categories of goods and services are exempt or excluded in Vermont:

1. To protect low-income Vermonters from the financial burden of paying a tax on necessities, like groceries, clothing, home heating, and health care.
2. To encourage public goods, like education and newspapers. Health care falls into this category as well.
3. Since the sales tax was originally just on goods, many services, like limousine rental, are exempt simply because they've always been exempt. Along with its other categories, health care also falls into this category.

4. Some categories are exempt because the sales tax is deemed too hard or too complicated to collect, for the seller and/or for the Tax Department. Health care and education are probably the only two sectors to fall into all four of these categories.
5. Some categories are so small that the administrative burden to collect the tax are greater than the revenue from the tax. This includes “casual sales,” one-time events like yard sales.
6. To avoid taxing business inputs.

This leads to three big questions:

1. Are sales tax exemptions an efficient way to protect low-income Vermonters, and if not, is there a better way to achieve this goal?
2. Are sales tax exemptions an effective way to promote public goods, and if not, is there a better way to achieve this goal?
3. Is the benefit of the historic exclusion of services from the sales tax likely to outweigh the costs of that exclusion as the economy continues to evolve toward more services?

We will examine each question in turn in the following sections.

Are Sales Tax Exemptions an Efficient Way to Protect Low-Income Vermonters?

For purposes of this report, we define low-income Vermonters as those living in households in the lowest four deciles of household income. This very roughly corresponds to households making less than 80% of the median income⁴², which is the definition used by HUD, USDA, and Vermont’s Agency of Commerce and Community Development in its housing needs assessment. This definition is broader than some other measures, as it equates very roughly to between 250% and 300% of the federal poverty line⁴³, so it yields higher and more conservative estimates of the costs of protecting low-income Vermonters than other measures would. While we define low-income Vermonters as those in the lower 40% of the income distribution for purposes of discussion and illustration, please note our recommendation in Chapter 5 for an analysis of the total financial picture of households ranging from the lowest household incomes up to 400% of the federal poverty line and a policy initiative to eliminate benefits cliffs for people moving up through those income levels and to insulate them from additional burden based on our proposed changes to Vermont’s tax structure

For reference, median household income in Vermont is around \$62,000⁴⁴, and the federal poverty level for a family of three is \$21,720⁴⁵, so for a family of three, 80% of median

⁴² <https://www.census.gov/quickfacts/VT>.

⁴³ https://www.healthvermont.gov/sites/default/files/documents/pdf/VHHIS_Report_2018.pdf, Appendix B, p.

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⁴⁴ <https://www.census.gov/quickfacts/VT>.

⁴⁵ <https://aspe.hhs.gov/poverty-guidelines>

household income is around \$49,600, 250% of the federal poverty line is \$54,300, and the 40th percentile of household income in Vermont is around \$49,900⁴⁶.

Health care, groceries, home energy, education, clothing, and car repair services account for about 85% of the private consumer spending that is currently not included in the sales tax in Vermont (See Appendix 7-3). Health care is the largest sector, and is the most complicated case, and the one with the most reasons for exclusion, so we will examine health care in separate section below.

Starting with groceries: according to the US Bureau of Labor Statistics, low-income Vermonters spend about 27.8% of Vermont's total private spend on groceries⁴⁷. That means that right now, by exempting groceries from the 6% sales tax, Vermont is giving up about \$126.1 million in sales tax revenue⁴⁸ to provide \$35.1 million in relief to low-income Vermonters.

To be clear, we are not recommending a 6% sales tax on groceries. Our recommendations are laid out below. At this point, our goal is simply to think through whether or not exempting groceries is an efficient way to protect low-income Vermonters from a sales tax of any level on groceries.

If Vermont levied the 6% sales tax on groceries, collected the \$126.1 million in taxes, and refunded that \$35.1 million in grocery sales tax collected from low-income Vermonters, there would be no harm to low-income Vermonters. Conservatively assuming a 15% cost to administer a rebate program, the state would have an additional \$85.8 million which it could put toward lowering the sales tax rate and/or increasing spending, in whatever ratio the legislature decided was appropriate.

As noted in Chapter 5 of this report, we would encourage a comprehensive review of income, benefits, and taxes by income level in order to eliminate disproportionate loss of benefits as income increases ("benefit cliffs"), rather than looking at each element of support for low-income Vermonters in isolation. That being said, Vermont currently provides food support to low-income Vermonters through 3SquaresVT and Vermont WIC, which programs could provide part of the mechanism for rebating grocery sales tax payments to the lower end of the low-income spectrum, with a new mechanism required for remitting sales tax payments to people in the higher end of the low-income spectrum.

"States frequently exempt consumer goods, such as clothing and groceries, but these blanket exemptions are ineffective ways to lessen the regressive nature of sales taxes. . . If states are still concerned about the somewhat regressive nature of sales taxes, several policy options are more effective tools than blanket exemptions. Grocery tax credits, expanded Earned Income Tax Credits, or an increased standard deduction in an income tax would provide assistance without introducing the same degree of

⁴⁶ <https://data.census.gov/cedsci/table?g=0400000US50&tid=ACSDP5Y2019.DP03>

⁴⁷ <https://www.bls.gov/cex/2019/aggregate/decile.pdf> -- state-level data not available, assumes Vermont mirrors national data.

⁴⁸ Vermont Tax Expenditures 2019 Biennial Report, 2019.

economic distortions.”
– TaxFoundation.org (bolding ours)

When one looks at the other big categories of private consumer spending that are currently exempt from the sales tax, one finds the same pattern. Using 6% as an example, in home energy consumption, the state is foregoing roughly \$42.1 million in revenue⁴⁹ to protect low-income Vermonters from an \$13.2 million expense. As with groceries, as part of a comprehensive review of the income, benefits, and taxes in low-income households, we note that Vermont already has a mechanism for providing support to low-income Vermonters’ residential energy purchases in the Low-Income Heating Assistance Program (LIHEAP). If you extend the sales tax to residential energy, the state could collect the \$42.1 million in tax revenue, and distribute \$13.2 million back to low-income Vermonters through the LIHEAP program, and end up (again assuming a 15% administration cost) with \$26.9 million per year for increasing spending and/or decreasing the rate.

Low-income Vermonters spend about 17.4% of the total private dollars spent on education⁵⁰, so again, using 6% as an example, the state is foregoing \$59.1 million in revenue to protect low-income Vermonters from \$10.3 million in sales tax burden.⁵¹ Clothing and automobile repair follow the same pattern.

In general, we conclude that exempting broad categories of necessities is not an efficient way to protect low-income Vermonters from the financial burden of paying a sales tax on necessities, and that better mechanisms exist or can be developed that even at a 15% cost of administration, will hold low-income Vermonters harmless, and increase Vermont’s capacity to raise revenue and/or decrease the sales tax rate. Again, it is not our recommendation that refund mechanisms be developed for each category of goods and services to which we extend the sales tax. Instead, we refer to our recommendation in Chapter 5 that the legislature look at the full financial picture for low-income Vermonters including income, transfers, and taxes in the context of our recommendations, and adjust the programs that support low-income Vermonters accordingly.

Are Sales Tax Exemptions an Effective Way to Promote Public Goods?

“A body of research shows that, overall, sales-tax rates are not noticeable enough to consumers to make them change their behavior. In other words, we tend to adopt an attitude of “it is what it is” about sales tax—even when the rates go up—and just get on with the business of purchasing what we need.”

– “How Do People Respond to Sales Tax Increases,” Baker et al., 2017.

⁴⁹ Vermont Tax Expenditures 2019 Biennial Report, 2019.

⁵⁰ <https://www.bls.gov/cex/2019/aggregate/decile.pdf> -- state-level data not available, assumes Vermont mirrors national data.

⁵¹ Bureau of Economic Analysis, <https://apps.bea.gov/iTable/iTable.cfm?reqid=70&step=1&isuri=1&acrdn=4#reqid=70&step=1&isuri=1> . See also <https://accd.vermont.gov/sites/accdnew/files/documents/DED/CEDS/CEDS2020FullReport.pdf> .

What is true of rates going up is equally true of rates doing down. A 6% sales tax is not enough to discourage consumer behavior, and exemption from a 6% sales tax is not enough encourage consumer behavior.

The list of public goods that Vermont tries to encourage and/or make more affordable with sales tax exemptions includes two big items: health care and education. As noted above, we will examine health care separately.

Education in this context includes only private spending on education – private payments for K12 and private payments for college. This includes both public and private institutions. Total private education spending in Vermont in 2019 was \$984.6 billion.⁵² Low-income Vermonters spent about 17.4% of that.⁵³ There are several important barriers for low-income Vermonters to accessing education:

“Higher education in Vermont—for both two and four-year colleges—consistently ranks as the most expensive in the nation, while simultaneously offering the lowest state funding, according to a 2019 report from the College Board⁵⁴ . . . For the 80% of CCV students who are enrolled part-time, supporting students outside of the classroom is a major issue. . . The lack of access to a car or daycare for their child can really derail a great student from completing their classes.”

-- Burlingtonfreepress.com 1/20/2020

In light of these issues, the presence or absence of a sales tax would not appear to be a significant factor in accessing education. Expanding higher education in Vermont might be better achieved through larger-scale subsidies or refunds of the tuition for low-income and middle-income Vermonters, combined with services like transportation, remote learning, and childcare for students for whom those things are a barrier. If college tuition is \$40,000, and we add a (say) 3.7% sales tax to that, the price of that tuition goes up to \$41,440. Combining several estimates of price elasticity of demand for higher education⁵⁵ to arrive at .6, that \$1480 increase might reduce access to education by 2.2%, whereas the inflation adjusted growth in public college tuition over the last 20 years of 65%⁵⁶ has probably reduced access by almost 40%. The problem is not the \$1480 in sales tax, it's the \$40,000 in tuition.

⁵² Bureau of Economic Analysis,

<https://apps.bea.gov/iTable/iTable.cfm?reqid=70&step=1&isuri=1&acrdn=4#reqid=70&step=1&isuri=1>

⁵³ Consumer Expenditure Survey, Table 1110, “Deciles of income before taxes: Annual expenditure means, shares, standard errors, and coefficients of variation,” 2019. <https://www.bls.gov/cex/tables.htm#annual>

⁵⁴ <https://research.collegeboard.org/pdf/trends-college-pricing-2019-full-report.pdf>

⁵⁵ <https://www.reed.edu/economics/parker/f10/201/cases/elasticity.html>

⁵⁶ <https://usafacts.org/articles/college-tuition-has-increased-but-whats-the-actual-cost/#:~:text=After%20adjusting%20for%20inflation%2C%20the,%25%2C%20respectively%2C%20since%202000.>

There are a number of smaller categories of public goods that are exempt from sales tax in Vermont as well: newspapers; admission to school sporting events; membership services from environmental, human rights, social, civic, and business organizations; sports instruction; other amusement and recreation industries; and others.

We do not in any way dispute that these things are good for the community and deserve Vermont's support. We simply do not believe that a sales tax exemption is an effective way to support, encourage, or expand them. We do believe that exempting these activities, while not providing meaningful support to the activity, does create complexity, unfairness, and instability in Vermont's tax system, and causes the rate to be higher than it would otherwise be, and those negative consequences outweigh the very limited benefit the exemptions provide.

We conclude that exempting public goods from the sales tax is not an effective way to expand those goods, and that if the legislature does indeed wish to support, expand, and encourage these and other public goods, an approach may be to analyze the barriers to expansion, and address them head-on with appropriate means and mechanisms. We do not believe that the sales tax exemption, either alone or in combination with other measures, provides Vermonters with meaningful access to these public goods.

We recognize the very important public policy role that taxes in general play in encouraging public goods and discouraging public bads. As noted, the excise tax on cigarettes continues to be an effective tool to discourage smoking, especially among young people, and has played a significant role in reducing suffering and premature death, improving health, and reducing health care costs for Vermonters. Federal tax credits have undoubtedly accelerated the very beneficial transition to electric cars. The data suggest, however, that because the sales tax has a relatively low rate, and therefore changes to the sales tax are on the order of a few percent, it is not among the more effective taxation tools for discouraging or encouraging behavior.

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Does the Exclusion of Services from the Sales Tax Still Make Sense?

The General Assembly concludes that structural deficiencies in Vermont's current revenue and budgeting structure, combined with a change in the State economy from an economy based on goods to an economy based on services, requires an examination and rethinking of Vermont's current sales tax base.

—Act 57 of 2015, Sec. 94.

Per the Vermont Department of Taxes "Sales Tax on Services Study" (2015), services were initially excluded from the sales tax in the 1930s because goods "constituted a large portion of household consumption, wealthier people bought more of them, and they were easier to quantify. Also, it was widely believed at that time that taxing a service would be like taxing the jobs associated with that service, and jobs were already scarce in that era."

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In principle, excluding some services from the sales tax raises an issue of fairness, as it puts Vermonters who don't happen to use that service at a disadvantage, and it also puts individuals and companies who happen to produce something that is taxable at a disadvantage. As we have noted, the exclusion or inclusion of any service in the sales tax does not meaningfully change demand, so this fairness issue is more one of principle than practice.

However, more serious consequences of exempting most services from the sales tax are that doing so makes sales tax revenue less stable and less sustainable, makes the tax system more complicated, and forces the state to impose a higher tax rate to achieve any given revenue goal. These problems will become more pronounced as the portion of the economy represented by services continues to grow. While a crisis like COVID leads to a vast reduction in some service sectors associated with tourism, the broader the base, the less likely a particular crisis is to have a disproportionate negative effect. If we taxed only services, COVID would have been far more damaging to state revenues than it has been. If we taxed groceries, as we recommend, COVID would have been much less damaging to state revenues.

We conclude that there is nothing inherent in the service sector that justifies a blanket exclusion from the sales tax, and that the widespread exclusion of services adds complexity, unfairness, and instability to Vermont's tax system and inflates Vermont's sales tax rate. As with goods, our recommendation explicitly exempts the purchase of services by businesses.

The Human Hurdles to Expanding the Sales Tax to New Goods and Services

The experience of the past has shown that any industry that has not been included in the sales tax will view the prospect of their new inclusion in the sales tax with concern. Their objections cluster around losing sales, and around the administrative burden of collecting and remitting the sales tax.

We see several ways in which the legislature can address these concerns: first, making the expansion as close to universal as possible makes it more difficult for any one industry to argue that it should be exempt or excluded. Second, you can present the data that show that sales in a sector do not, in fact, decline when they go from being exempt from the sales tax to included in the sales tax. Finally, we note that the burden of collecting and remitting the sales tax has decreased a great deal due to the advances in sales tax software.

We expect that you will hear some passionate and emotional testimony from people asking you to continue to exempt or exclude their business or their industry from the sales tax. Some of this testimony will include dire predictions about the effects on Vermont businesses, and on the economic competitiveness with other states. We would recommend that your consideration of these concerns be married to a consideration of any supporting data. We note that while Hawai'i is in a unique position in the middle of the ocean, Washington State, for instance, is similar to Vermont in that shares a border with Canada and fairly rural borders with a couple of US states, and Washington State does not seem to have suffered from its broad tax base.

Summary of Categories Not Currently Subject to Sales Tax, Potential Sales Tax, and Level of Protection Required for Low-Income Vermonters (See Appendix 7-4 for breakdown by decile)

Current untaxed category	Total consumer activity in Vermont by category	% of total activity by low-income Vermonters	Total tax revenue at a 3.76% sales tax	Portion of total tax revenue that would come from low-income Vermonters
Education	\$984,600,000	17.4%	\$35,445,600	\$6,167,534
Automotive services	\$316,000,000	22.9%	\$11,376,000	\$2,605,104
Services not related to personal property	\$283,333,000	21.1%	\$10,199,988	\$2,152,197
Professional services	\$143,333,000	21.1%	\$5,159,988	\$1,088,757
Related to personal property besides cars	\$133,333,000	21.1%	\$4,799,988	\$1,012,797
Hair, Skin, & Nails	\$125,000,000	23.3%	\$4,500,000	\$1,048,500
Veterinary services	\$83,333,000	21.1%	\$2,999,988	\$632,997
Household Services	\$75,000,000	19.7%	\$2,700,000	\$531,900
Funeral	\$25,000,000	21.1%	\$900,000	\$189,900
Travel	\$16,667,000	21.1%	\$600,012	\$126,603
Groceries	\$2,102,500,000	27.8%	\$75,690,000	\$21,041,820
Residential energy	\$702,500,000	31.4%	\$25,290,000	\$7,941,060
Clothing	\$503,333,000	21.7%	\$18,119,988	\$3,932,037
Newspapers	\$39,833,000	27.0%	\$1,433,988	\$387,177
Sales of mobile/modular homes	\$5,000,000	100%	\$180,000	\$180,000

Sources for category values: 2019 Vermont Tax Expenditure Report; Bureau of Economic Analysis, <https://apps.bea.gov/iTable/iTable.cfm?reqid=70&step=1&isuri=1&acrdn=4#reqid=70&step=1&isuri=1>; <https://accd.vermont.gov/sites/accdnew/files/documents/DED/CEDS/CEDS2020FullReport.pdf>

Sources for portion of spending by low-income Vermonters: Table 1110. Deciles of income before taxes: Shares of annual aggregate expenditures and sources of income, Consumer Expenditure Survey, 2018, Bureau of Labor Statistics (<https://www.bls.gov/cex/2018/aggregate/decile.pdf>). State-level data not available, so we assumed that the distribution of spending across income deciles in Vermont matched that of the United States.

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Health Care, the Sales Tax, Provider Taxes, the Insurance Premium Tax, and Health Insurance Claims Assessments

Vermonters use a variety of health care services and goods:

- Visits (in person or via telemedicine) to the doctor's office, the dentist, the psychotherapist, the chiropractor, etc.
- Ambulatory surgical centers and *outpatient hospital services*.
- *Stays at hospitals and nursing homes*
- *Intermediate care facility, home health*, and nursing services
- Services of managed care organizations
- Lab and x-ray services
- *Emergency ambulance services*
- *Prescription* and non-prescription medications
- Prescription and non-prescription medical devices

We generally think of health care as exempt from taxes, but in fact all the categories above in *green italics* are already subject to something like a sales tax in Vermont via the provider tax. Further, all health care services listed above which are covered by private insurance are taxed. Every time an insurance company receives a premium payment from a Vermonter, the insurance company pays a 2% tax on that revenue, and every time a Vermonter submits a valid claim, the insurance company pays a claims assessment of 0.999% on that claim. These two taxes on insurance companies get factored into the premiums that Vermonters pay.

The provider tax is imposed on most categories as a net patient revenue tax, which is a gross receipts tax minus contractual discounts/refunds that providers give to payers; charity care; and bad debt. This makes provider taxes functionally similar to a gross receipts tax, which outside of health care is the functional equivalent of a sales tax, as a gross receipts tax on a business gets passed on to consumers via higher prices.

The Effect of Applying the Sales Tax to Health Care on Low-Income Vermonters

Currently, low-income Vermonters are insulated from the cost of health care in a number of ways. For those living below 138% of the federal poverty level, the Medicaid program provides access to health care with very little in the way of out-of-pocket costs. For those between 138% and 400% of the federal poverty level who do not receive health insurance through their employer, the Affordable Care Act ("ACA") provides meaningful subsidies for insurance premiums and caps on out-of-pocket spending. For those between 200% and 300% of the FPL, Vermont provides assistance as well. The state also supports low-income Vermonters with Dr. Dynasaur (kids and pregnant women), long-term care assistance, and prescription drug assistance.⁵⁷

⁵⁷ <https://info.healthconnect.vermont.gov/Medicaid>, <https://www.greenmountaincare.org/>, <https://www.greenmountaincare.org/health-plans/long-term-care>

One complication in health care is that Medicaid patients typically have no or very low co-pays. However, Medicaid and other programs for low-income Vermonters often have fixed payment levels for particular services, and if a provider adds a sales tax to a bill that's already at the maximum reimbursement rate, payment of the full sales tax is likely to fall entirely onto the patient, potentially increasing their co-pay by multiples. It is not clear that the prohibition on balance billing would apply to a sales tax for Medicaid patients. As the additional sales tax might present an insurmountable financial barrier to some Vermonters, we cannot recommend a sales tax on health care without finding a mechanism to protect low-income Vermonters from this burden.

Many states do impose a sales tax on some health care transactions. Of the 45 states with a sales tax, plus the District of Columbia:

- Four states (Delaware, Hawai'i, New Mexico, and Washington State) currently apply a sales tax or a gross receipts tax to physicians' and dentists' work.⁵⁸
- Thirty-seven states impose the sales tax on non-prescription drugs (See Appendix 1).
- One state (Illinois) currently applies a (1%) sales tax to prescription drugs.
- Thirty-two states apply the sales tax to non-prescription medical devices.⁵⁹
- Nine states apply the sales tax to medical devices regardless of whether they are prescription or non-prescription.⁶⁰

We examined the possibility of creating a mechanism by which charges for Medicaid would be exempt from the sales tax. While the states cited above apply a sales tax to some health care expenditures, as we worked through the practical implications of trying to apply a uniform sales tax across all patient-level health care expenditures, it became clear that a system to exempt Medicaid charges from the sales tax rapidly becomes unreasonably complicated and burdensome. Vermont's dual drives toward universal primary care and paying providers based on outcomes add further dimensions of complexity to this question.

We believe that the importance of keeping access to health care as free from barriers as possible, combined with the complexity of how health care for low-income Vermonters is paid for, means that it is not practical to apply the sales tax to health care, either in place of the provider tax or only on those categories of health care that are not subject to the provider tax.

Health care makes up about 18.8% of Vermont's total economic activity⁶¹, and about a third of Vermont's consumer activity, so although health care is not amenable to the sales tax, any analysis of consumption taxes in Vermont that ignores health care is incomplete. We therefore include the provider taxes in our analysis of consumption taxes, and note that every state except Alaska imposes provider taxes.

⁵⁸ Delaware and Washington by way of a gross receipts tax -- Federation of Tax Administrators 2017 State Sales Tax Survey (<https://www.taxadmin.org/sales-taxation-of-services>, data included as Appendix 1)

⁵⁹ <https://salestaxhelp.com/states-tax-medical-devices>

⁶⁰ Ibid.

⁶¹ https://gmcboard.vermont.gov/sites/gmcb/files/Misc/2018_VT_Health_Care_Expenditure_Analysis_Final_%20July_%202020.pdf

The provider tax has a unique feature in that Vermont and other states use revenue from the provider tax to help pay for Medicaid, and those provider tax dollars spent on Medicaid trigger the release of matching (at various rates) federal Medicaid dollars to the state.

“Beyond Medicaid, states have the policy option to tax most types of providers and services and to designate or earmark the revenue for any state purpose.”⁶²

As noted above, outside of health care, a gross receipts tax gets passed on to consumers via higher prices. In health care, however, there are a variety of ways that providers support the expense of the tax: some providers can charge patients more and some cannot; some providers can charge insurance companies more, and some cannot. The options available to hospitals are different from those available to independent practitioners.

We note also that as it now stands, the provider tax in Vermont is not levied at all on some categories of health care, and it is levied at different rates (between 3.3% and 6%) on the various categories on which it is levied. On prescriptions, it is not levied at a rate at all, but at a fixed dollar amount of 10 cents per prescription, which on average ends up being about 0.15%. All of this inconsistency adds complexity. It probably also reduces fairness, although again, health care pricing and net revenue are affected by so many factors that the underlying “sales” numbers are inconsistent to begin with. Further, the partial application of the provider tax to health care reduces stability of the tax revenue and increases rates compared to a system in which the provider tax was applied equally to all health care providers.

As noted above, there are four possible reasons that part of health care is exempt from the tax in Vermont: to protect low-income Vermonters; to promote health care; because it’s seen as too complicated; and because it’s always been exempt. We will now examine the first three of those reasons as they apply to expanding the provider tax.

Do the Current Categorical Exemptions from the Provider Tax Increase Vermonters’, and Particularly Low-Income Vermonters’ Access to Health Care?

As far as maintaining the partial provider tax exemption to expand access to health care as a public good, RAND analysis of the available data⁶³ suggests that the price elasticity of demand for health care is -1.7 , which is to say, demand is very inelastic. This is even more true for low-income households who receive health care through federal and state programs, since Medicaid, state programs, and the ACA provide them with lower levels of cost-sharing, and “studies consistently find lower levels of demand elasticity at lower levels of cost-sharing.”⁶⁴ This is in addition to health care’s particular distortions of the “purchase” decision, described above.

⁶² <https://www.ncsl.org/research/health/health-provider-and-industry-state-taxes-and-fees.aspx>

⁶³ “The Elasticity of Demand for Health Care,” RAND, 2005.

⁶⁴ Ibid.

This means that a 3.7% provider tax on those categories of health care goods and services that are currently exempt, even if it were passed on entirely to the consumer, would result in a reduction of health care utilization in those categories of less than seven tenths of one percent. If you harmonize the provider tax rates across all provider classes, the increase in the tax in half the health care areas will be partially offset by decreases in the tax in some of the other areas.

Are there Undue Complexities in Extending the Provider Tax to All Provider Categories?

One of the main complexities in the United States' health care system is just how many parties are involved in paying for Vermonters' health care:

- The federal government through Medicaid, Medicare, TRICARE, subsidies provided by the ACA, and the federal government's portion of federal employees' health care expenses.
- Individuals and families with private insurance, through premiums, deductibles, co-pays, co-insurance, and payments for non-covered medical expenses.
- Employers that provide health insurance to their employees and their employees' families, through premiums and contributions to HSA-like mechanisms for reimbursing employee out-of-pocket expenses, or through direct payments of claims
- Private insurance companies, through their portion of patient expenses.
- The state government through the state portion of Medicaid; state programs to assist low-income Vermonters with health care costs; and the state's portion of state employees' health care expenses.
- Local governments, including local school systems through the local governments' part of insurance premiums and out-of-pocket health care costs for town employees and teachers and other school system employees.
- Hospitals, which pay for all or part of the care for several groups of patients: emergency care patients, regardless of ability to pay; Medicaid patients, for which they are reimbursed only part of the cost of care; and patients who simply don't pay their bills. To offset the costs of that portion of services for which the hospital doesn't get paid, hospitals are forced to increase charges to private insurance companies. To cover those increases, private insurance companies do two things: increase the premiums that organizations and individuals pay; and reduce coverage by increasing patients' out-of-pocket expenses.

Vermont health care providers and legislators have done a great deal of work over the years on expanding the provider tax, including investigations into including some of the categories that are currently outside the provider tax system. We have studied the PHPG VT Health Care Related Tax Study Report (2012). We acknowledge the barriers that exist now or existed in the past, including reporting and administrative barriers and resistance from particular provider categories. We note the fact that many providers, like dental practices, do not routinely produce annual financial statements, and that there would be some cost to each practice to begin to track the inputs to the Net Patient Revenue calculation. This issue also affects independent physician practices, chiropractors, and other practitioners whose finances are not currently regulated by the State. It is also true

that to administer, monitor, and collect provider taxes from these health care sectors will require resources and potentially new regulatory authority for some State entity. We do not see any of the concerns, costs, or hurdles as outweighing the benefits to fairness, sustainability, and simplicity that expanding the provider tax to all categories of providers will create.

We are sensitive to the concerns that imposing a provider tax on physicians' practices and on dental practices may make it harder to attract young physicians and dentists to Vermont, and the consequent concern that fewer doctors and dentists practicing in the state will in fact be a significant barrier to access.

However, we note that there is a decline in primary care [physicians](#) and dentists now, and since they are currently not included in the provider tax, there are clearly other causes of this decline. We recommend that the legislature identify those causes and address them. We also note that the imposition of the provider tax has not led to a decrease in providers in those categories in which it has been imposed.

Another factor is the relative number of Medicaid patients that each category of provider treats. Those with higher Medicaid patient populations generally get higher reimbursement rates when the provider tax is imposed on them, while those with lower Medicaid patient populations pay the provider tax, but see a smaller offset from increased Medicaid reimbursement rates.

The recent cases of dentists and emergency ambulance service providers gives us an illustrative contrast. The legislature studied the prospect of extending the provider tax to dental practices. That effort foundered on three snags: first, dental practices don't typically produce audited financial statements, so calculating and monitoring Net Patient Revenue would be difficult; second, many dental practices have few or no Medicaid patients, so increased Medicaid reimbursement rates are of limited value to them; and finally, dentists can support well-organized and well-funded lobbying campaigns.

On the other hand, the effort to extend the provider tax to emergency ambulance services was successful, and indeed had the support of emergency ambulance service providers. Like the dentists, the ambulance services did not typically produce audited financials. Unlike the dentists, the ambulance services all serve a meaningful number of Medicaid patients. By applying a provider tax to emergency ambulance services, the State was able to increase the Medicaid reimbursement rate, and the ambulance services ended up with more revenue.

As increasing Medicaid reimbursements is not a great benefit to those providers who don't treat Medicaid patients, a different approach to securing provider support may be 1) to decide at the outset that all provider classes will be included, so there is no in-or-out decision to be made, and no reason for a provider class to lobby to be in the "out" group; 2) to provide hard numbers in terms of what the inclusion of all provider classes means for how low the provider tax rate will be, and indeed how much lower the state sales tax will be.

As the example of the emergency ambulance service providers shows, implementing adequate financial record-keeping and reporting is not particularly difficult or expensive.

Hawaii's excise tax on health care services applies to doctors and dentists and includes amounts received from patients and health insurance companies,⁶⁵ and Michigan specifically taxes medical services when provided by Medicaid managed care organizations.⁶⁶

Since we believe the provider tax can be extended to the provider categories that are presently exempt without harming low-income Vermonters, and without limiting Vermonters' access to health care, and without undue complexity, and since we see meaningful benefits for Vermonters in terms of a lower sales tax rate and a consistent provider tax rate, and a simpler and more fair tax system, and since we see benefits to the state government in terms of a more stable and sustainable revenue stream and a simpler tax code, we recommend replacing Vermont's partial and inconsistent provider tax with a consistent provider tax on all providers of consumer health care, and using the revenue from the expanded provider tax to harmonize provider tax rates with each other and with the sales tax rate.

As noted on p. 32 of the 2012 PHPG study, "the actual calculation methodology is different for each of the existing assessments, reflecting the State's long-standing value of working collaboratively with the relevant provider classes to implement the assessments in a manner that is acceptable and transparent for the providers, while also being administratively streamlined for both providers and the State." We hope that spirit of cooperation between the providers and the State can continue.

That study also notes (pp 6 & 7) that when extending the provider tax to new categories of provider, there are several important implementation tasks, including:

- Policy development – defining the classes, conferring with CMS, etc
- Potential impact on Section 1115 Waivers
- Administration – updating taxpayer lists, collecting data, collecting the tax
- Staffing – there must be sufficient resources at the responsible State entity to administer the program.

We expect that Vermont will continue to use the provider tax to fund the portion of Medicaid currently funded with the provider tax, and that will trigger the release of the same federal dollars to Vermont. We rely on the current mechanisms for protecting low-income Vermonters from unaffordable health care costs to continue to do so with the categories of health care that will be newly subject to the provider tax. We also refer back to our primary recommendation in Chapter 5 regarding low-income Vermonters and the tax code.

Therefore, although our preference would be to eliminate the provider tax and apply the sales tax uniformly to all consumer-level transactions, for reasons of fairness, simplicity, and sustainability, we recommend expanding the provider tax to include those categories of providers not already covered. We further recommend harmonizing the provider tax rates

⁶⁵ <https://salestaxhelp.com/medical-services-taxable>

⁶⁶ Ibid.

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across all categories of providers, and to match the provider tax rate to the sales tax rate (2B).

We estimate that about \$2,395,322,000 of Vermont health care expenditures are not currently subject to the provider tax.⁶⁷ Extending a 3.7% provider tax to this activity would generate about \$88 million, of which about \$8 million would come from low-income Vermonters.⁶⁸

Per best practice, we recommend consultation with CMS before any changes to taxation and assessments on health care.

We also note that any large-scale reforms to health care, up to and including moving to a single-payer system, have the potential to drastically change any current or future health care taxes.

There is one more topic on the subject of taxing health care in Vermont. Vermont imposes an Insurance Premium Tax of 2%, paid by the insurance companies on the premiums they collect, and a claims assessment of 0.999% on every claim that is submitted to a private insurance company.

Hospitals build their budgets based on all their expected expenses and all their expected sources of revenue. They set the rates they charge commercial insurers based on the expenses the hospital hopes to cover with commercial insurance revenue. This typically does not include the provider tax, which the hospital usually plans to cover with Medicaid reimbursements from the state and federal governments. Insurance companies set their premiums so as to cover the bills from the hospital, and the claims assessment, and the Insurance Premium Tax. This means those taxes get paid by a number of payers:

- For consumers with individual insurance:
 - For consumers who qualify for the ACA's federal and state premium tax credits, the consumer pays for part of those taxes through their premiums, and the federal and state taxpayers pay for the rest through their taxes.
 - For consumers who do not qualify for those tax credits, the consumer pays for the Premium Tax and the claims assessment through their premiums.
- For consumers who get their insurance through their employer, the consumer and the employer together pay the Premium Tax and the claims assessment through their premiums.
- The employees of self-insured companies don't pay the Premium Tax, but they do pay the claims assessment.

There is a small problem here with paying taxes on taxes – since the premium includes money for the claims assessment, taxing the premium in effect is taxing both the money the insurance company collects for its operations and profit, and the money it collects to pass on

⁶⁷ LIFO State Health Care Resources Fund 2019 Revenue breakdown, and Green Mountain Care Board's 2018 Vermont Health Care Expenditure Analysis

⁶⁸ Table 1110. Deciles of income before taxes: Shares of annual aggregate expenditures and sources of income, Consumer Expenditure Survey, 2018; "Distribution of Total Population By Federal Poverty Level," Kaiser Family Foundation, <https://www.kff.org/other/state-indicator/distribution-by-fpl>

to the state in claims assessments. This could be solved by allowing insurance companies to deduct the amount they pay in claims assessments from the amount they collect in premiums before they calculate their Insurance Premium Tax.

Further Considerations on Expanding the Sales Tax Base

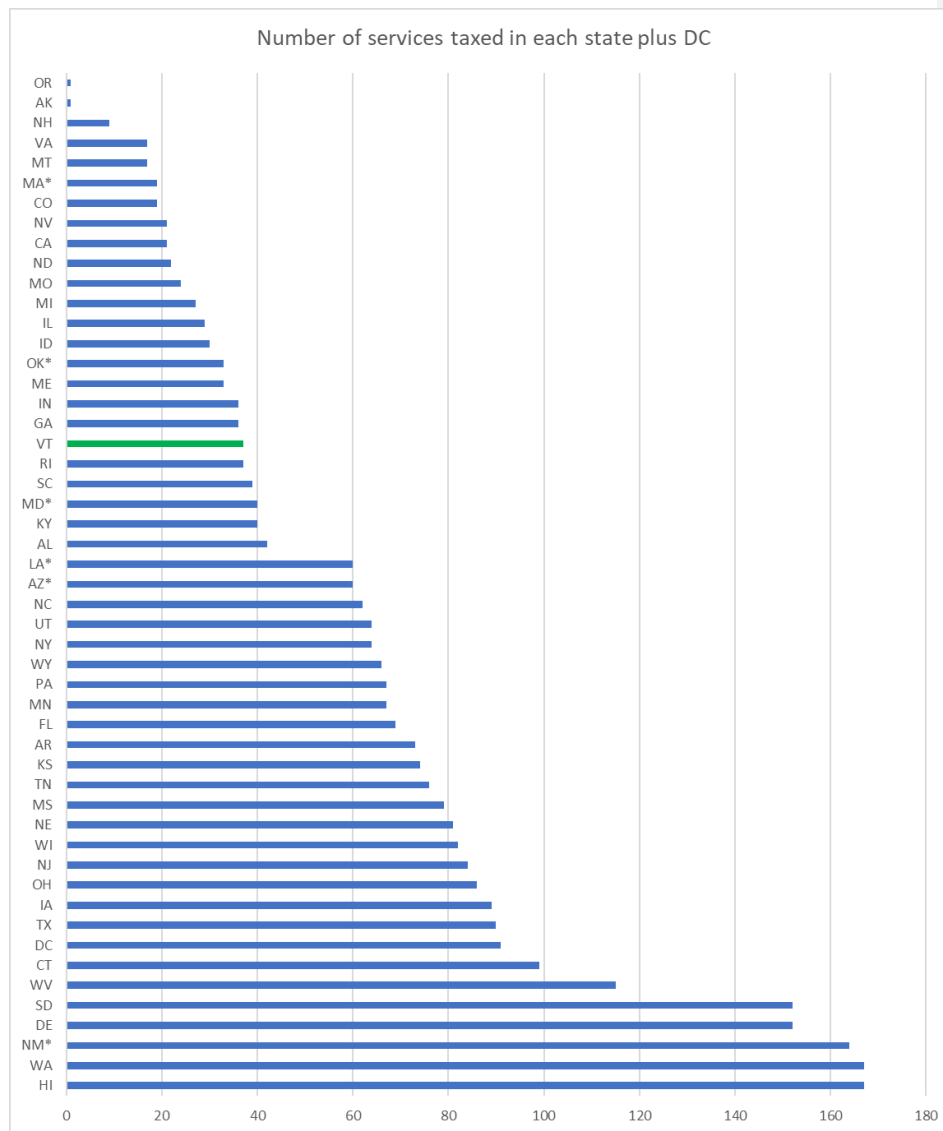
Meaningful (sales tax) base broadening (is) a worthwhile endeavor, as base expansion allows for greater tax neutrality and revenue stability, and can be paired with more targeted relief for low-income households.

– TaxFoundation.org

We conclude that there are no good reasons to exempt any categories of goods and services from the sales tax, with the single exception of health care, for which we recommend broader provider taxes. We further note that there are some affirmative reasons to include as many categories as possible.

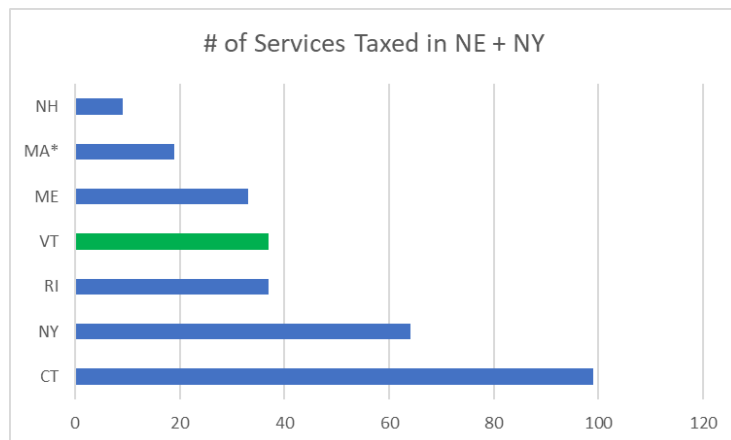
Historically, the sales tax has been applied mostly to goods purchased in person, and as the economy evolves toward more services and more online transactions, it is important to the goals of fairness and sustainability that the tax structure shift with it.

By some measures, Vermont has a fairly narrow sales tax base. If you look just at the number of services Vermont taxes, you see that Vermont is on the lower end of the spectrum.



From VT Dept of Taxes, updated with 2017 data from the FTA study

If you take the same look at New York and New England, you see that Vermont is middle of the pack.



From VT Dept of Taxes, updated with 2017 data from the FTA study

Among the top five states in terms of tourism as a percent of the total state economy, Vermont has by far the narrowest sales tax base and collects the least in terms of sales tax as a percent of total state and local government revenue.⁶⁹ (Due to differences in how states define various taxes, these are not perfect comparisons. For instance, Vermont's per capita number does not include the Meals and Rooms tax.)

Vermont: A Tourism-dependent Outlier

- Vermont is one of only five states in which the Accommodations and Food Services sector accounts for over 4% of Gross State Product.
- The other four states all rank in the top 10 for widest state sales tax breadth. Vermont ranks 42nd (fourth to last among states with statewide sales tax).
- General Sales Tax accounts for over a third of state and local tax collections in three of the states, a fifth in Maine, but only 10% in Vermont.

Tourism-dependent states tend to lean more heavily on sales taxes in order to alleviate the tax burden on state residents.

	Accommodation and Food Services as % of GSP	Acc. and Food Services Rank	State Sales Tax Breadth	Breadth Rank	State & Local General Sales Tax Collections per Capita	Sales Tax Collect. Rank	General Sales Tax as % of State & Local Tax Collections
Nevada	11.9%	1	54%	4	\$ 1,846	4	41%
Hawaii	8.4%	2	105%	1	\$ 2,431	2	37%
Vermont	4.8%	3	25%	42	\$ 627	45	10%
Maine	4.1%	4	44%	8	\$ 1,080	27	20%
Florida	4.1%	5	43%	9	\$ 1,323	16	36%

Source: GSP Share from U.S. BEA. Tax collections from Tax Foundation Facts and Figures 2020.

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⁶⁹The Tax Foundation calculates each state's Sales Tax Breadth based on what percent of consumer transactions are included. <https://taxfoundation.org/2021-state-business-tax-climate-index/#Sales>

Similarly, among the top five states in terms of retail as a percent of the total state economy, Vermont has by far the narrowest sales tax base and collects the least in terms of sales tax as a percent of total state and local government revenue.

Vermont: An Outlier Among States with Large Retail Trade

- Vermont is one of only five states in which Retail Trade accounts for over 8% of Gross State Product.
- General Sales Tax accounts for 20-46% of state and local tax collections in the other four states, but only 10% in Vermont

Likewise, states with economies dependent on retail trade tend to lean more heavily on sales taxes for state revenue.

	Retail Trade as % of GSP	Retail Rank	State Sales Tax Breadth	Breadth Rank	State & Local General Sales Tax Collections per Capita	Sales Collections Rank	General Sales Tax as % of State & Local Tax Collections
Washington	9.0%	1	39%	16	\$2,476	1	46%
Maine	8.8%	2	44%	8	\$1,080	27	20%
Mississippi	8.7%	3	46%	6	\$1,180	20	32%
Idaho	8.3%	4	40%	14	\$ 984	33	26%
Vermont	8.2%	5	25%	42	\$ 627	45	10%

Source: GSP Share from U.S. BEA. Tax collections from Tax Foundation Facts and Figures 2020.

Additionally, of the 45 states that have a sales tax, plus Washington DC, Vermont is one of only seven states that exempt all three of groceries, clothing, and prescription drugs.

Tax theory suggests that as a general rule, a broad base is better than a narrow base. There are at least three reasons for this:

- The broader the base, the more stable and sustainable the tax revenue, as 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.
- A narrow tax base implies judgements and discretionary choices about what should or should not be exempt. Sometimes intentionally, sometimes inadvertently, these choices necessarily advantage some consumers over others, and advantage some businesses and non-profits over others, calling the fairness of these taxes into question, regardless of the nobility of their goals.
- The broader the base, the more choices policy makers have for the mix of increasing revenue and decreasing tax rates.

The Vermont tax code has some odd inconsistencies: for instance, Vermont deems transportation a necessity, so the state exempts automobile repair services, but taxes the purchase of automobiles and gasoline. Vermont exempts the purchase of home heating, but taxes the purchase of the home.

With Vermont's sixty or so exemptions from the sales tax, Vermont also has issues of unfairness and complexity. One usually thinks of tax fairness from the point of view of the person paying the tax, and from that point of view, Vermont's patchwork of taxable and non-taxable purchases inadvertently favors people who happen to consume more of the non-taxables and handicaps people who happen to consume more taxables. It is also valuable to look at fairness from the point of view of the people producing the goods: it is unfair to tax the work of people whose labor creates goods, but not to tax the work of people whose labor produces services.

By trying to use the sales tax as a tool to encourage community goods, and exemptions from the sales tax for necessities as a tool to protect low-income Vermonters, the legislature puts itself in the position of having to decide what's necessary, and what's good, and what's not. Food is a necessity; is soda? Is candy? Does the legislature want to be in the business of making judgements about what's necessary if it doesn't have to? Clothing is necessary; is a \$50 hat? A \$500 pair of boots? A kidney transplant is necessary – is a fourth round of chemo? How about cosmetic surgery? How about cosmetic surgery to correct a deformity that is causing meaningful emotional distress to the patient? Whatever the legislature decides is necessary will necessarily be subjective and somewhat arbitrary, and distortive. Taxing clothing above \$150, for instance, will cause some consumers to buy the \$145 dress they like less, and not get the \$154 dress they like more, since the \$154 dress with a 6% sales tax becomes \$163.25, and somewhat insignificant 6% difference between \$145 and \$154 becomes a more meaningful 12.6% difference. The legislature is charged with making these difficult and important distinctions when necessary, but all other things being equal, it is probably better to reduce subjectivity in the tax code when possible.

Vermont's current system also puts state revenue at risk, as the economy can evolve away from taxable categories, like gasoline, and toward untaxed categories, like home electricity used to charge electric cars. While this shift is clearly beneficial for the environment, and therefore to be applauded, it does raise the question of how we pay for roads and other elements of our transportation system.

We note that the Blue Ribbon Tax Commission Recommendations 2A and 2B recommended expanding the sales tax to include "all consumer-purchased services with limited exceptions for certain health and education services and business-to-business service transactions," and all consumer purchases of goods, "retaining only the exemptions for food and prescription drugs." As we have seen, we see no compelling reason to exclude consumer purchases of education or food, and we see no compelling reason not to extend the health care provider tax to the remaining exempt categories of providers, and to harmonize the provider tax rates with each other and with the sales tax rate.

Because we find no compelling reason to exempt any form of consumer activity from the Vermont sales tax, with the proviso that it be levied as a provider tax on health care, and in view of the advantages for fairness, simplicity, and sustainability, we recommend that Vermont's sales tax base be expanded to include all consumer purchases of goods and services (2A), and to exclude all business inputs (2D), and that Vermont's provider tax,

See Chapter 10 for our recommended implementation plan and timeline.

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If Vermont Expands the Tax Base, What Should the Legislature Do with the Money?

When you expand the base, you have to decide how much of the additional revenue you are going to spend, how much you are going to rebate to low-income Vermonters, and how much you are going to put toward lowering the tax rate.

In approximate numbers, if you apply the sales tax to all consumer-level purchases (in the form of an expanded provider tax for the health care sector):

1A. With the current 6% sales tax, and a 6% provider tax, making no accommodation to protect low-income Vermonters, you would add around \$500 million in sales tax/provider

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tax revenue (Tax Structure Commission, 2021)⁷⁰ to the current sales tax revenue of \$389.3 million⁷¹ and the current provider tax of \$172 million.⁷²

1B. With the same assumptions, but rebating to low-income Vermonters the full amount collected from them, and assuming a 15% cost to administer the rebate program, a 6% sales tax will raise an additional \$375 million. (Tax Structure Commission, 2021)

2A. If you choose to make this change revenue-neutral, and use the broadening of the tax base to reduce the tax rate, making no accommodation for low-income Vermonters, you can lower the rate to 3.3%⁷⁴.

2B. In the revenue-neutral scenario, if you hold low-income Vermonters harmless, you can lower the sales tax rate to 3.7%.⁷⁵

We have reviewed the suggestion that a 3.7% sales tax on necessities would not cause any significant harm to low-income Vermonters, due to programs already in place and due to inelasticity of demand. On balance, we believe that ensuring the well-being of all Vermonters is so important that the legislature should exercise an abundance of caution, and we therefore do not recommend adding a tax to any category without an affirmative way to keep low-income Vermonters whole, as recommended in Chapter 5

If you expand the sales tax to all consumer purchases, and you ensure that low-income Vermonters will not bear any new financial burden, the last question we examine in this section is how much of the additional revenue Vermont should allocate to new spending, and how much Vermont should allocate to lowering the sales tax rate.

There are significant unmet needs in Vermont toward which additional revenue could be allocated, including adapting our infrastructure for the changes in weather expected from climate change.

There are also significant benefits to a meaningful lowering of the Vermont sales tax rate:

- Vermonters pay a low, uniform sales tax rate, making things more fair for all Vermonters, and reducing the minor distortions in economic behavior created by a higher rate imposed inconsistently.
- Holding low-income Vermonters harmless means they will not bear any increased costs for the things they purchase in the newly taxed categories, and, as with all Vermonters, the tax they pay on things that are currently taxed will go down, so low-income Vermonters should be unaffected or even marginally better off.
- While Vermont businesses will ultimately benefit from a simpler, fairer system that treats every business's output the same, we are aware that for businesses that have never collected or remitted sales tax, the prospect can be daunting. This is particularly true for the many businesses who provide services to consumers and to other businesses, as they will have the burden of keeping their sales to consumers (taxable) separate from their sales to other businesses (not taxable). We note that one of us works at a small manufacturing company that sells both to consumers and to other businesses, and does not have any difficulty in charging sales tax to consumers and exempting sales to businesses. We also note that sales tax

compliance software is more readily available now than when Florida and Massachusetts expanded their sales tax bases. We also recall the recent objections to the increased administrative burden raised by local providers to extending the sales tax to software, but note the tens of thousands of businesses in Vermont who currently collect and remit the sales tax without much effort. If the West Wardsboro General Store can comply, one expects that a software company can comply.

- The Vermont government benefits from a more stable and sustainable Vermont tax base, and a simpler tax code that is easier to administer.
- The Vermont economy benefits from an increased competitive advantage on sales tax relative to New York's 4% rate and Massachusetts's 6.25% rate. As with Vermont, localities in both states add a local sales tax to that, so in some cases Vermont's advantage will be even larger. Vermont will also have an advantage compared to every other state with a sales tax except Delaware and Colorado, and a decreased competitive disadvantage relative to New Hampshire and the four other non-sales-tax states.

We therefore recommend that the revenue from expanding Vermont's sales tax base be used first to hold low-income Vermonters harmless, and that most of the remainder be used to lower the sales tax rate, with the smallest part used to fund additional spending. Specifically, we recommend applying a 3.7% sales tax to all consumer purchases of goods and services, harmonizing the provider tax at 3.7% and expanding it to include all health care categories, creating mechanisms to make this change neutral for low-income Vermonters, and deploying the additional \$20+ million in new revenue first to cover the administrative costs of collecting sales tax and provider tax from a larger number of entities, and second to tackle some of the current unmet needs and anticipated future needs that we have identified (2C).

We would suggest that it is much easier to expand the base to include everything than it is to expand the base to include almost everything. If there is a single exception, there will be pressure from industries/companies/sectors and their lobbyists to give them an exemption as well. This is misguided, since as we've noted, a sales tax exemption does not encourage any significant amount of additional activity⁷⁶, and as we've seen, collecting and remitting the sales tax does not appear to be particularly burdensome for the thousands of businesses large and small in Vermont who do so, but, as we all know, sometimes people are not particularly good at assessing the likely consequences of any given course of action. .

This change will make the sales tax more fair, more sustainable, and simpler; it will do no harm to low-income Vermonters; and it will make Vermont's sales tax third-lowest among the 45 sales-tax states and DC, after Delaware (gross receipts tax) and Colorado (2.9% sales

⁷⁰ See Vermont Sales Tax Calculator online at XXX

⁷¹ Current sales tax base and sales tax revenue from VT Dept of Taxes, "06302020SUTStatsFiscalReport75Day"

⁷² https://ljfo.vermont.gov/assets/Meetings/Tax-Structure-Commission/2020-11-09/a0673e9861/GENERAL-351044-v1-2020_Provider_Tax_presentation.pdf

⁷³ See Vermont Sales Tax Calculator, online at XXX

⁷⁴ Ibid.

⁷⁶ As noted above, sales increase in the month or so before a sales tax is imposed or raised and decrease for a couple of months after before returning to their pre-increase level, and presumably the same phenomenon occurs in reverse when one lowers or eliminates a sales tax.

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tax). We do note these recommendations, along with giving Vermont one of the lowest sales tax rates in the country, will also give Vermont the broadest sales tax base in the country. This is an advantage for all the reasons discussed above; however, it does mean that there are some categories of goods and services that Vermont will include in the sales tax that are taxed in only a very small number of other states.

We note one final advantage of this approach: legislative efficiency. If you do in fact include all the major categories of consumer transaction (except health care) in the sales tax, you and future legislatures will avoid the perennial and chronic discussion and debate about whether to include or exclude this or that category or industry. Imagine not having to talk about that particular issue for the next, say, 10 years.

As a last word on the sales tax, we recommend excluding from the sales tax all business inputs (2D), including some that are currently taxed, including commercial art and graphic design, sign construction and installation, rental of hand tools to licensed contractors, and “bulldozers, draglines and const. mach.” short term and long term.

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Meals Tax

There are currently eight exemptions to the Vermont Meals tax. Vermont taxes restaurant meals, and we are proposing to tax groceries, but the notion of an additional tax on meals prepared at home is almost nonsensical, and four of the eight exemptions to the Meals tax exist simply to avoid taxing meals prepared at a person’s “home,” even if it’s a temporary home, including retirement communities, summer camps, hospitals, convalescent and nursing homes, and schools. We support these exemptions.

Two of the remaining four exemptions to the Meals tax exist to allow non-profits to use as much of the money they raise from selling meals as possible toward their mission, whether they sell the meals on their premises or at fairs/picnics etc. The statute specifically requires 100% of the income from selling these meals to be used for the non-profit’s mission. We support these exemptions as well.

The seventh exemption to the Meals tax is for meals provided to people who work in restaurants and hotels during their shift. The total dollar value of this benefit is relatively small, the hassle of keeping track of the value of the meals consumed by staff when they’re working is high, and the value of the benefit to relatively low-wage workers is high, so we do not see any justification for ending this exemption, and support its continuation.

The final exemption from the Meals tax is for grocery-type items furnished for take-out, including “whole pies, cakes, and loaves of bread, single-serving baker items sold in quantities of three or more, deli and candy sales by weight, whole uncooked pizzas, and larger containers of ice cream, salad dressing, sauces, cider, or milk.”⁷⁷ Since we are recommending that the sales tax be extended to groceries, we recommend repealing this exemption and reclassifying these items as groceries and including them in the 3.7% sales tax.

⁷⁷ Vermont Tax Expenditures 2019 Biennial Report, 2019.

Rooms Tax

The Vermont Rooms tax is intended to tax the act of staying somewhere temporarily for fun or for work. It is not intended to tax anyone's long-term accommodation. Of the six exemptions to the Rooms tax, four are designed to avoid taxing people's residences: those exemptions are for rooms at a retirement community; in a hospital, sanatorium, convalescent home, nursing home, or assisted living facility; student housing; and summer camp accommodations. We support continuing these exemptions.

The fifth exemption to the Rooms tax is for rooms rented on the premises of a non-profit. As with the exemption to the Meals tax, the purpose of this exemption is to allow the non-profit to further their public-service mission. While data is not available on how much money this is, it is hard to imagine it is a meaningful amount of money, and we support continuing this exemption.

The final exemption to the Rooms tax is rooms provided employees of hotels and restaurants as part of their jobs. The value of housing provided as part of employment is reported as part of the employee's income, so we support maintaining this exemption from the Rooms tax.

Excise Taxes

This Commission took no testimony on the Excise tax, and as noted, we believe it is generally working as intended, and is applied to appropriate categories as appropriate rates.

As discussed further below in the sections on long-term structural changes to our economy, climate, and society, we expect that over the next 20 years, gasoline use will drop dramatically. We note that California has just passed a law banning the sale of new gas-powered passenger cars as of 2035, following in the footsteps of several European countries with similar legislation. We also observe more and more electric cars on Vermont's roads, and expect that Vermont's newly formed Climate Council will work to accelerate the transition to clean transportation, whether or not Vermont joins the regional Transportation Climate Initiative. This is a great step forward for the fight against climate change, and a step forward for the environment in general as well as new industries and new jobs.

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The other side of the coin is the fact that our roads, which are the backbone of our transportation infrastructure, are supported by the Gasoline and Motor Fuels taxes. This change in technology affects both private passenger vehicles, public transportation vehicles, and public safety vehicles. Further, as a result of the pandemic, we are seeing less driving, which is also resulting in lower taxes collected from this source.

Over time, this source of revenue for the transportation fund is likely to erode gradually then suddenly. There are also issues of fairness – right now, people driving gas-powered cars are paying for the roads that people driving electric cars are using for free.

We fully support the transition to zero-emissions vehicles, and one of us has driven an electric car for over two years. We have been ~~very~~ deliberate in thinking through the implications of this transition for Vermont and Vermont's ability to pay for its transportation system as fewer and fewer people use gasoline and pay gas taxes. Vermont is not alone in trying to figure out how to manage tax revenue through this transition. Per recent research conducted by the National Council of State Legislatures⁷⁸, "(t)wenty-eight states have laws requiring a special registration fee for plug-in electric vehicles." These fees range from \$50 (Colorado & Hawai'i) to \$212.78 (Georgia).

That same article notes that in addition to special registration fees, over a dozen states are considering Road User Charges (RUCs), also known as Vehicle Miles Traveled (VMT) fees or Mileage-Based User Fees (MBUF). Instead of collecting gas taxes, these programs aim to charge drivers based on how many miles they drove. We can imagine a time when the technology will allow for even greater precision, and the State will be able to charge vehicle owners for the pound-miles they travelled, capturing the wear on the roads of both the distance the vehicle traveled and its weight.

At the moment, however, based on ease of implementation, we recommend a special ~~annual~~ ~~registration~~ fee for electric vehicles, to be set based on what the average Vermonter pays in state gasoline taxes in a year.

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Conclusion

We are aware that implementing these recommendations will require a great deal of work on the part of the legislature, the Vermont Department of Taxes, the LJFO, and others in state government. These recommendations will also require quite a bit of work on the part of the affected businesses and other organizations. We hope these recommendations regarding Vermont's consumption taxes will further the goals of making both Vermont's consumption taxes and Vermont's overall tax system fairer, simpler, and more sustainable over the next 20 years, and we believe the benefits for Vermonterers and for Vermont are worth the effort.

⁷⁸ <https://www.ncsl.org/research/energy/new-fees-on-hybrid-and-electric-vehicles.aspx>

8. Income Tax Reform

Personal Income Tax

Throughout the history of Vermont Taxation, Income Tax has proven to be the best indicator of a person's ability to pay. Paul Gillies mentions this in his paper "The Evolution of the Vermont State Tax System" which the Vermont Historical Society published in 1997 (Gillies, 1997). Personal Income Tax is the largest General Fund source of revenue in Vermont, accounting for nearly two thirds 56-59% of those funds. It is also the largest "income tax" source of revenue in Vermont.

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The Personal Income Tax in Vermont tends to be more resilient to the aging population effect the entire country is facing as compared to other states, partially due to its treatment of income items as taxable which closely follows the federal treatment.

The Commission studied the using income as a means to fund education, replacing the Homestead Property Tax with an income tax. The challenge is the tax rate needed to fund education added to the already existing income tax rates. Currently, Vermont's highest tax rate is 8.75%. If a rate of 2.5% was needed to fund education without using any property tax, the highest rate would now be 11.25%, a double-digit tax rate. Vermont cannot control the publishing of state income tax rates and comparisons. This double-digit rate could put Vermont at a competitive disadvantage when trying to attract people to move to Vermont. Presently many taxpayers pay their education funding tax based on income, but because it is a property-based tax with an alternative income-based calculation, the income tax rates published do not reflect these property taxes even though they are based on income and not property value. Taxing property based on income should not be called an income tax, rather it should retain its character as an education tax and be a separate and distinct tax, stated as a separate payroll deduction and also a separate item on estimated tax payments and tax returns filed.

Commented [SS35]: Should this be "use of" ?

The Commission solicited comments and the option to give testimony from a list of stakeholders regarding the tax system as it stands now, what parts of the system are troubling and suggestions from these stakeholders on improvements. Stakeholders include members of the business community, CPAs, the Vermont and Lake Champlain Chamber of Commerce, and many other groups.

The Commission received only one item of public comment regarding the personal income tax. That comment was regarding the medical expense deduction which the legislature addressed in its 2019 session.

In 2018, 372,821 tax returns were filed. Of those, 207,166 returns, which represents 56% of returns filed, were filed showing Adjusted Gross Income (AGI) of less than \$60,000. Of all returns filed, 80,901 were filed showing no tax which is 22% of all returns filed. An Earned Income Credit was claimed on 39,625 returns, which represents 11% of all returns filed. For those reporting AGI of \$150,000 or greater, 24,916 return were filed which is 6.7% of all returns filed.

According to the JFO Ten Year Tax Study published in 2017 for years 2005-2015, of the total **income** taxes collected in 2015, personal income (PIT) tax was 86% of that total. This percentage stayed the same in Tom Kavet's report dated August 2, 2019. For FY 2018, the percentage increased to 89.7%. For FY 2018, PIT was 41% of total General Fund Revenues. In FY 2020, this tax is forecast to be 40.8% of General Fund sources by Tom Kavet in this same report.

The legislative change made to use federal adjusted gross income as the taxable starting point makes it easier to compare Vermont to other states because that is the most common tax base used by states as a starting point for taxable income. The legislature retained personal exemptions as well as a standard deduction for all taxpayers. This system allows personal exemptions across all four filing statuses, contributing to the "fairness" goal of our personal tax structure. The legislation retained a credit up to \$1,000 for voluntary charitable contributions and a modified medical expense deduction which was added to give residents with high medical expenses, the primary population being older residents, the "fairness" our system strives to achieve. It does not, however, allow a deduction for fees to long-term care facilities.

There are four filing statuses with rates ranging from 3.35% to 8.75% with the highest rate starting at \$200,200 of taxable income for single individuals, \$121,875 for married filing separately, \$243,750 for married filing jointly and \$221,950 for head of household.

In 2018, although the top tax bracket rate was 8.75%, the average rate, which takes into account the personal income tax of Vermont residents divided by their Vermont taxable income, was 5.2% (before credits). The average rate is substantially lower than the top rate because many residents do not reach the higher brackets, and, for those who do, the highest rate applies to only a portion of their income. For example, a person whose Vermont taxable income is \$300,000 and is married filing jointly would have a total Vermont tax of \$ 19,698. The average tax rate in this case would be 6.6%, even though each dollar of taxable income over \$243,750 is taxed at 8.75%.

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The Study also concluded that the upper 5% of taxpayers paid 48% of the individual income tax in 2015. This also supports other research done that shows the majority of the Vermont population is in the lower income cohorts, the higher the effective tax rate, more taxpayers would be in the upper income cohorts. It is important to note that pass through entity business income is part of the personal income tax revenue stream because, although the

income may be generated from business activities, it is reported as personal income because it passes through to the individual owners.

The Ten -Year Tax Study also looked at Income Tax Expenditures by value. A tax expenditure is a tax deduction or credit that is available to decrease taxable income in the case of a deduction or exemption, or the actual tax itself, in the case of a tax credit. These expenditures are used to aid certain individuals or to incentivize certain behavior. According to the Ten Year Tax Study prepared by the JFO, in 2015, the Earned Income Tax Credit accounted for 49% of Vermont income tax expenditures, the 40% capital gains exclusion accounted for 18%, the flat \$5,000 capital gain exemption accounted for 13%, the exclusion of income from Vermont Municipal Bond interest accounted for 5% and all others accounted for 15%. The legislature has reduced the 40% capital gain exclusion by placing a ceiling on the amount of gain that is subject to the exclusion which will bring down the cost to Vermont of this tax expenditure.

Recommendations of this Commission:

The Commission has few recommendations regarding the Personal Income Tax. The Legislature restructured the personal income tax within the last three years which incorporated the shift in the tax base from federal taxable income to federal adjusted gross income but retained the standard deduction and personal exemptions, added a tax credit for charitable contributions with a maximum credit of \$1,000 and a formula based medical expense deduction. This was a major change to Vermont Personal Income Tax. These changes were recommended by the Blue-Ribbon Tax Structure Commission in their 2011 report.

Recommendations made by the Blue-Ribbon Tax Commission in that same report that were not adopted by the Legislature were:

- Implement a lower, flatter rate and bracket structure
- Implement a residential credit as a transparent alternative to deductions
- Evaluate all remaining personal income tax expenditures for removal
- Reduce the number of filing statuses from four to two, single and joint

In response to the first bullet point, the Legislature did reduce the all brackets by .2% and reduced the number of tax brackets from five to four.

In response to the second bullet point, the Legislature left in the standard deduction.

Vermont has one of the most progressive personal income tax structures in the Country. As this is one of the goals of a fair tax system, this Commission has minor recommendations to change the structure.

The Commission discussed a wealth tax in the spirit of progressivity. Many states have studied some form of wealth tax but have found that it is extremely difficult to administer and very subjective when it comes to valuation of assets that are not publicly traded or

available. Florida had a form of wealth tax which it eliminated a few years ago because of its complexity in administration. The Commission has not studied in-depth and is not recommending a wealth tax at this time although many European Countries have a form of wealth tax and some states are exploring some form of Wealth Tax.

- Continue to promote the remote workers living in Vermont and provide the things needed for remote work such as [high-speed](#) broadband and expanded cell phone service. This will increase the taxpayer base in the state, providing additional personal income tax revenue and future stability to the personal income tax. It is also a climate conscious approach to increasing the population and tax base of the state which minimizes the amount of motor vehicle traffic which helps to minimize our carbon footprint.
- Continue to review the tax expenditures to ensure these expenditures are accomplishing the purpose for which they were intended. For instance, the Tax Department and JFO issued the Biennial Report, Vermont Tax Expenditures, on January 15, 2019. This report is done every Biennium. There are some expenditures that have remained at zero for FY 2016, 2017 and are project for FY 2020 to also be zero. Such expenditures should be looked at more closely to see if they are obsolete and should be repealed, or if changes need to be made to modernize them.

Income Taxation related to [Pass-through Entities](#)

The taxation of [Pass-through Entities](#) (PE), although more of a business income tax, generally falls under the Personal Income Tax structure due to its pass-through nature. Nationwide as well as in Vermont, most small businesses are organized as some form of pass-through entity, which passes taxable income and loss to its owners to be reported on the owner's personal income return. Therefore, this income although business related, is recorded as personal income and not business income. It is important for the reader to understand that Vermont Income Tax is either Individual or Corporate and not Individual and Business.

The Commission solicited testimony from various stakeholders as previously mentioned but received no public testimony regarding PEs.

The Commission prepared a Backgrounder on the taxation of pass-through entities and non-resident withholding. Reference is made herein to that Backgrounder.

As with the rest of the country, the growth in pass-through entity as a choice of business entity for taxation has grown in popularity over the years. The following chart is from Table 1 of the Backgrounder for illustration purposes:

	2009	2010	2011	2012	2013	2014	2015	2016	2017
C Corp (1120)	10,436	10,386	10,285	10,121	9,798	9,738	9,777	9,637	9,559
S Corp (1120S)	14,649	14,620	14,213	14,208	14,233	14,331	14,608	14,568	14,468

Partnership (1065)	9,384	9,406	9,864	9,778	9,899	10,188	10,737	10,989	11,327
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Most LLCs are taxed as partnerships, LLPs are taxed also as partnerships. The main difference is that an LLC can elect to be taxed as either a flow through entity (partnership) if it has more than one member, a Disregarded Entity (DRE) if it is single member, a C Corporation subject to the Corporate income tax, or an S Corporation which is taxed as a **PE**. An LLP is almost always taxed as a **PE**. The other main difference is that an LLC member has limited liability whether part of management or not, and an LLP has general and limited partners. A general partner does not have limited liability protection and a limited partner cannot participate in management. This table illustrates the shift from C Corporations which are taxed at the entity level, to pass-through entities, which are taxed at the individual level. This also accounts for the decrease in the percentage of total tax revenue that the corporate tax has exhibited.

The challenge in the tax collection from pass-through entities is not with entities that are owned by Vermont residents, rather with those that are owned by non-residents. Vermont presently has two ways to collect the tax from these non-residents at the entity level. The first is mandatory non-resident withholding required by the entity for entities with 50 or less non-resident shareholders, partners or members. **PEs** with more than 50 non-resident shareholders, partners or members are required to file a composite return, and business entities with less than 50 non-resident shareholders, partners or members may elect to file a composite return. The difference between non-resident withholding and composite filing is that owners who are included in a composite return are relieved of the obligation to file their own income tax return, provided there is no other income or activity that creates a requirement to file in Vermont.

In 2017, the Department of Tax initiated a Program to Improve Outcomes Together (PIVOT) project to study how it processes Non-Resident Withholding. The Department of Tax has implemented all changes that were recommended.

The Non-Resident Withholding is a very important part of the individual income tax collection structure. Although it places some administration on the pass-through entity itself, it is necessary to ensure collection of the tax from non-resident owners as well as parity with resident owners who are required to pay estimated taxes.

As a result of changes in federal tax law in the Tax Cuts and Jobs Act of 2017, the federal itemized deduction for state and local income, real property and other deductible taxes for individuals is capped at \$10,000. This has led a handful of states to institute a tax at the entity level which is deductible on the entity level federal return, some mandatory and some elective. The IRS has now ruled that these entity level tax structures will be respected.

Recommendations of this Commission:

- Study the effect on Vermont PEs of an entity level tax for the reasons stated above to replace the present system of non-resident withholding and composite return filing.

Commented [SS37]: Edits per Steve 1/3 (though I changed PTE to PE)

Estate Tax

Vermont is one of only twelve states that has an estate tax. Six other states have an inheritance tax. The only state in the geographic region of Vermont, i.e. New York and New England, only New Hampshire does not have an estate tax. According to the Ten Year Tax Study conducted by JFO (2005-2015), the average annual estate tax revenue was \$22.3M with years ranging from a high in 2011 of over \$35M to a low in 2015 of less than \$10M. By its nature, the estate tax is not a predictable and stable source of tax revenue as evidenced by the large swings from year to year in actual tax collected. According to the In FY 2020, this tax is forecast to be 2% of General Fund sources and 1% of total revenue sources.

In FY 2020, this tax was forecast to be 2% of General Fund sources and 1% of total revenue sources.

The Commission solicited public testimony from stakeholders but received no public comments or public testimony regarding the estate tax.

The Vermont Estate Tax is assessed based on taxable estate before exemption, less a \$5M exemption, with a flat tax rate of 16% on taxable income after applying the exemption.

The Vermont Estate Tax has been overhauled by the Legislature over the last four years and presently is in line both in rate and exemption amount with our neighboring states. For these reasons, the Commission did not study the Estate Tax in great depth.

The Commission discussed Inheritance Taxes as compared to the Estate Tax. The difference between the two taxes is as follows:

- The Estate Tax is assessed against the decedent's estate based on the fair market value of the decedent's taxable estate less the Vermont exclusion.
- An inheritance tax is assessed against the person receiving the inheritance, subject to certain exclusions depending on the relationship to the decedent.

The Estate Tax is assessed against the estates of both Vermont residents and non-residents who own property in Vermont. This effectively taxes the wealth transfer of assets located in Vermont, either by physical location or ownership by a Vermont resident. The decedent's

property that is included in their estate receives what is known as a step up in basis to the fair market value of the property at the date of death. This stepped-up basis becomes the new basis for the beneficiaries of the estate. There is a perceived fairness to the step up because the decedent acquired in most cases those assets with funds that had already been subject to the income tax. Elimination of the basis step up would subject the asset to both the estate tax and personal income tax when the property is disposed of by the beneficiary of the estate.

An inheritance tax would be paid by residents of Vermont who are beneficiaries of an estate, the estate being a resident or non-resident of Vermont makes no difference. An inheritance tax coupled with the estate tax has the potential to tax the same assets twice. Also, an inheritance tax would be much harder to enforce than the estate tax, since death is a matter of public record whereas an inheritance from a nonresident would need another layer of individual reporting which adds complexity to the system.

Recommendations of this Commission:

1. Continue to monitor what our neighboring states are doing relative to the estate tax and also recommendations of the Multistate Tax Commission and the federal estate tax legislation. Although the Vermont Estate Tax has completely decoupled from federal, it is important to make sure the Vermont exemption is not greater than the Federal exemption since the Vermont exemption is set and not scheduled to change with any changes in the Federal estate tax exemption.
2. Study the possible elimination of the present estate tax structure and replace it with a “deemed sale” type of tax on death, similar to the Canadian structure. In Canada, the tax is assessed on the decedent’s final tax return and taxes fifty percent of the gain on the decedent’s estate property as if the estate property was sold at the fair market value at date of death, subject to certain rules such as marital transfers at death not being taxable until the second of the spouses dies. This type of structure would still need to have some form of exemption to maintain the progressivity of Vermont’s overall tax structure. This would be a major change and would have to be carefully analyzed since no other state has this structure. There is also no US State data to model the effects of such a change, but there is data available from the Canada Revenue Agency (CRA).

Corporate Income Tax

The corporate income tax is a tax levied on the taxable income of a corporation that is taxed as a C Corp. Vermont is one of 45 states, as well as the District of Columbia that levy a corporate income tax on business profits. According to the JFO Ten Year Tax Study, of the

total income taxes collected in 2015, corporate income tax was 13% of that total. In FY 2020, this tax is forecast to be 8% of General Fund sources and 5% of total revenue sources. The Commission received no public comments or testimony from the solicitation sent to stakeholders regarding the corporate income tax.

One controversial source of corporate tax revenue as a result of the 2017 Tax Cuts and Jobs Act has been the repatriation of foreign earnings. It is the opinion of both the Vermont Department of Tax and Legislative Council that this repatriated income is subject to Vermont tax and has accounted for an uptick in 2019 and expected 2020 fiscal corporate tax collections. The Commission did not study this element as it is considered to be a one-time affect based on a major change in federal tax law.

The Vermont Corporate Income Tax Brackets are as follows:

Tax Bracket (taxable income)	Tax Rate (%)
\$0+	6.000%
\$10,000+	7.000%
\$25,000+	8.500%

The starting point in calculating Vermont taxable income is federal taxable income plus or minus state specific differences.

The Commission prepared a Backgrounder entitled Corporate Income Tax-Sourcing of Sales of Services in May of 2019. Legislation was passed and will become effective Januray 1, 2021 changing Vermont's sourcing of service revenue to Market Based.

Vermont, like many states, is a unitary tax state. Under a unitary tax approach, governments treat a multistate corporation as a group made up of all its local branches, instead of treating each local branch as an individual entity separated from the global chain. The profits that the multinational corporation declares as a group are then apportioned to each state where it operates based on how much of its real economic activity took place in that state. Further, under unitary tax, there are two approaches to determine what is included in the receipts factor numerator of each member, Joyce and Finnegan (both named after California Administrative Tax Decisions).

The difference between the "Joyce" and "Finnigan" methods is receipts factor calculation. Under "Joyce," a unitary member not having any apportionment factors in Vermont is not taxed in Vermont. Under the "Finnigan" method, taxation of the combined group is as though all of the members of the combined group are taxed in Vermont. Vermont is a member of the Multistate Tax Commission (MTC) and both Vermont and the MTC use Joyce. Currently, the MTC is hearing testimony and considering adopting Finnegan to replace Joyce.

Pursuant to Act 51, The Vermont Department of Tax (VDT) prepared “Act 51 Vermont Corporate Income Tax Report” and submitted it to the Legislature on December 16, 2019. In this report, the VDT studied a Single Sales Factor Apportionment and also the experience of states that switched from a multi-factor to a single factor, the exclusion of overseas business income of an affiliated group, changing the Bank Franchise Tax to tax banks under the Corporate Tax, and alternatives to the Corporate Tax such as a Gross Receipts Tax. The VDT’s conclusion was the following:

Each of these changes on its own will alter the landscape of Vermont corporate income and requires delicate consideration before abrupt delineations are made. Further, adjustments to tax regulations and/or statutes cannot be viewed in isolation as the impacts can spread over several tax types and taxpayers.

Recommendations of this Commission:

- Request that the Tax Department study the effect of adopting Finnegan with respect to Unitary Tax apportionment. As a member of the MTC, if Finnegan is adopted by the MTC, although Vermont does not have to adopt it, conformity with the MTC as a member is important provided the switch is either revenue positive or at a minimum, revenue neutral.

9. Obsolete and Inefficient Taxes

Telephone Personal Property Tax

The Telephone Personal Property Tax (TPP) is a tax on every person or entity owning or operating a telephone line or business in Vermont. The tax equal to 2.37 percent of net book value as of the preceding December 31st of all personal property located in Vermont, used in whole or in part for conducting a telecommunications business. The applicable law is located at Vermont Statutes Title 32, Section 8521.

Commented [SS38]: Rewrite from Steve 1/3

Any person or entity that owns or operates a telephone line, or that owns or operates a business that provides telecommunications services, is subject to the telephone personal property tax. Persons or entities that provide traditional telecommunications services through a public switched telephone network (PSTN) are subject to the telephone personal property tax. Persons or entities that provide telecommunications services through mechanisms other than a PSTN, including Voice over Internet Protocol (VOIP) technology, are also subject to the telephone personal property tax.

All personal property used in whole or in part for conducting a telecommunications business is subject to this tax, including personal property under construction, materials, and supplies. Property subject to tax as real property is not subject to the Telephone Personal Property Tax.

“Net book value” of personal property means the original cost less depreciation of the property as computed for the federal income tax return required to be filed with the federal authorities for the corresponding tax year. Accelerated depreciation taken in accordance with Federal income tax law, including “bonus depreciation” under IRC § 168(k), is includable when calculating net book value. This depreciation would include bonus depreciation allowed at the federal level. This can result in the case of currently allowed 100% bonus depreciation in a taxable net book value of zero.

Per Fiscal Facts and the Vermont Tax Study, 2005-2015, TPP revenue fell from \$10.5M in 2005 to \$7.9M in 2010, \$7.7M in 2015, \$4.7M in 2018, and was forecast to drop to \$3.2M by FY21.

According to the Vermont Department of Tax, there are currently sixteen filers and the annual cost to administer this tax is about \$25,000.

The telecommunications landscape is changing rapidly in Vermont as well as the entire United States. “Land lines” as they are referred to are in many cases being replaced solely by cellular phone communications, which is not subject to this tax, rather is taxable in another Section of the Vermont Tax Code. This would beg the question of how much new investment in property subject to this tax will be made going forward, which will be a contributing factor to the annual decline in revenue from this tax.

The following recap was found in a 2015 white paper authored by the National Conference of State Legislatures entitled “Property Taxation on Communications Providers: A Primer

for State Legislatures” (NCSL Executive Committee Task Force State and Local Taxation, 2015).

In Vermont, most businesses pay property taxes on real property and personal property. Property generally is assessed at 100 percent of fair market value. In the case of business personal property, a town may provide that such property is to be assessed at (1) fifty percent of its cost (with a ten percent floor), or (2) at its net book value (with a ten percent floor), at the election of the taxpayer. Most intangible personal property is nontaxable, and a specific exemption exists for money, securities, mortgages, and other evidences of debt. Municipalities, at their discretion, may elect to not tax business inventory. Valuation methods for real and personal property vary from locality to locality, but the cost (based on replacement cost), income, and market data approaches are used. Real and personal property, except land and buildings, used in carrying on a telephone business in Vermont is exempt from local taxation. Each person or corporation owning or operating a telephone line or business in Vermont, excluding resellers of telephone transmission capacity who do not own or operate and telephone lines or transmission facilities in the state, are subject to central assessment by the Vermont Department of Taxes, Division of Property Valuation and Review. This state-imposed tax is imposed on the net book value of all personal property of the owner or operator located in the state. Cable companies are assessed locally. A state-imposed education property tax is also levied on all nonresidential property. Real and personal property, except land and buildings, used in carrying on a telephone business in Vermont is exempt from the education property tax. Cable companies are subject to the education property tax.

Recommendations of this Commission:

1. Consider the repeal of this tax as it is declining every year and is based on somewhat outdated technology as a base for the tax and replace the lost revenue with another source based on more modern and long-term sustainable technology.
- 1.2. Consider not repealing this tax, but subjecting cell tower equipment to this tax. Currently, if the cell provider owns the tower, the equipment is considered personal property. If the landowner owns the tower, it is considered real property. The property tax is based on the rental income generated from the lease, much the same as commercial and residential building leases (Income Lease Approach). The cell tower should no longer be classified as real property under this recommendation, and the cell company would be subject to the TPP. A better measure of value for purposes of the TPP would be either the income approach or the undepreciated book value of the equipment, not the tax value. The book depreciation should be calculated using the useful life of the tower and a straight-line depreciation method.

Gasoline and Motor Fuel Taxes

As noted in Chapter 7, we expect the sales tax on gasoline to become obsolete over the next 20 years, and we similarly expect the excise tax on gasoline to become obsolete. See Chapter 7 for our recommendations on phasing in a sales tax on home energy and an annual registration fee for electric vehicles, and continued monitoring of the development of mileage charges as potential venues for providing revenue to maintain Vermont's transportation network during and after the transition away from gas-powered cars.

Commented [SS39]: Replaced by Bram 12/29

10. Timetable

		Track 1: The three major taxes		Track 2: The overall tax structure
1st Biennium	2021	<u>Property tax/education financing</u> 1. Move to income rather than housesite value for all homeowners 2. List rental units separately in the Grand List. Compile/ analyze rent/income data.	Create committee to monitor Education Finance and recommend rates	Carry out Incidence Study for VT Tax and Benefits.
	2022	Migrate to funding education by taxing all residents on income	Move expenditures for mental health and staff health care from Education Fund	Overhaul of taxes/transfers for low-income Vermonters to: 1) eliminate benefits cliffs and 2) ensure that low-income Vermonters are not harmed by any of the changes we

				are recommending to the tax system.
2nd Biennium	2023	Consumption taxes: expand sales tax to remaining untaxed consumer transaction.	State to take over appraisal of large commercial properties	
	2024	In lieu of including health care in consumption taxes: extend provider tax to remaining untaxed provider categories; lower and harmonize rates.	State support of professional local assessment administration	Investigate taxation of net worth/ assets/wealth
3rd Biennium	2025	Income tax		If taxing wealth is viable, set up reporting requirements for disclosure
	2026			If viable, incorporate a wealth tax into tax structure

11. Our Changing Landscape and the Tax Structure

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We would be remiss to write a report on the long-term prospects for Vermont's tax structure without discussing some of the key social, economic, and environmental changes that will impact our state and our revenue system over the coming decade. There will invariably be others, as the current pandemic serves as all too stark of a reminder, so this section is not intended to be exhaustive. It also does not attempt to offer comprehensive analyses or forecasts. Our aim instead is to underscore the importance of having an agile tax structure and to offer thoughts on how to approach three areas of change:

- Climate Change
- Technology
- Demographics

Climate Change and the Tax Structure

Many state, national and global scientific experts have predicted the likely consequences of climate change and suggested approaches to reduce carbon emissions. The commission

relied on those forecasts and tried to imagine the corresponding tax implications. First, we looked at predicted effects of climate change that might affect the tax bases and tax revenue, absent interventions. Second, we looked at approaches to mitigate and adapt to climate change that might either affect current tax bases or that might rely on new taxes, changes to existing taxes, or tax credits. We then considered the combined effect of climate change and Vermont's response on the tax structure.

Tax Related Consequences of Climate Change

Briefly, the main immediate climate consequences in Vermont are expected to be: warmer temperatures; longer summers, shorter winters, and unpredictable shoulder seasons; intense and unpredictable weather events; more precipitation in the winter but summer drought. These, in turn, will lead to stress and decline in some native species but increased productivity of some crops and weeds; spread of invasive species, ticks and tick-borne diseases; storm damages to structures, infrastructure, forests, and agriculture. In general, there will be damages to health, homes, forests, infrastructure, agriculture, labor, tourism, and supply chains. Nationally, the effect has been estimated to be a loss of 1% to 3.1% of average GDP by the end of the century.⁸⁰ The composition of Vermont's GDP by sector looks similar to that of the nation.

2019 GDP ⁸¹	US	VT
All industry total (million \$)	21,427,690	34,785
Agriculture, forestry, fishing and hunting	0.8%	1.2%
Mining, quarrying, and oil and gas extraction	1.5%	0.5%
Utilities	1.6%	1.9%
Construction	4.1%	3.3%
Manufacturing	11.0%	9.3%
Wholesale trade	6.0%	4.9%
Retail trade	5.5%	7.4%
Transportation and warehousing	3.2%	1.7%
Information	5.2%	2.6%
Finance, insurance, real estate, rental, and leasing	21.0%	19.4%
Professional and business services	12.8%	10.9%
Educational services, health care, and social assistance	8.8%	14.0%
Arts, entertainment, and recreation	1.1%	1.0%
Accommodation and food services	3.1%	5.3%
Other services (except government and government enterprises)	2.1%	2.3%
Government and government enterprises	12.3%	14.3%

⁸⁰ RCP8.5. T. Deryugina, S. M. Hsiang, NBER Working Paper 20750 (NBER, 2014); www.nber.org/papers/w20750

⁸¹ BEA

However, there are ways in which Vermont's economy is different. The Bureau of Economic Analysis looks at outdoor recreation as a component of GDP—teasing out recreation activities from several of the traditionally tallied categories shown in the table above. In the US as a whole, outdoor recreation accounts for 2% of GDP; in Vermont it accounts for 5.2% of GDP and 4.4% of Vermont's employment.⁸² This total includes not just the recreation activity itself, but also associated expenditures.

Although outdoor recreation in all seasons is important to the economy, snow sports account for nearly half of the outdoor recreation value added. A NOAA study projects Vermont will have 25-34 fewer days below freezing per year by 2080.⁸³ The shorter snow season will be punctuated by more interludes of rain and warmth, severely reducing the snowpack for snowmobiling and back county skiing, and challenging the ability of snowmaking to save the alpine ski season. Because the season is projected to start later, it is less likely that Vermont ski areas will be able to open during the Christmas/New Year's holidays by the second half of the century, even with significant increases in snowmaking.⁸⁴

Agriculture is also more important in Vermont than in the nation as a whole. The market value of products sold in 2017 was estimated to be \$780 million.⁸⁵ Just as with snow sports, agriculture is part of the Vermont brand and is the foundation of many value-added enterprises, including tourism.

According to the USDA, climate change may affect dairy not only by stressing cows, but also by changes in crop production; changes in feed-grain availability, and price; and disease and pest distributions.⁸⁶

Maple trees will suffer as the Vermont climate changes. One Vermont study concluded "climate projections under a low emissions scenario indicated that by 2071 55% of sugar maple across the state would likely experience moderate to severe climate-driven stress relative to historic baselines, increasing to 84% under a high emissions scenario."⁸⁷ The yield and sugar content of maple sap are projected to drop due to shorter seasons, fewer

⁸² <https://www.bea.gov/news/2020/outdoor-recreation-satellite-account-us-and-states-2019>

⁸³ https://www.climate.gov/sites/default/files/station_locations_lrg_0.png

⁸⁴ Climate Change Vulnerability of the US Northeast Winter Recreation - Tourism Sector. 2007. Daniel Scott * Department of Geography, University of Waterloo, Canada Jackie Dawson Department of Geography, University of Waterloo, Canada Brenda Jones Department of Geography, University of Waterloo, Canada

⁸⁵ USDA Census of Agriculture www.nass.usda.gov/AgCensus

⁸⁶ USDA, Climate Change and Agriculture in the United States: Effects and Adaptation, USDA Technical Bulletin 1935. Washington, DC, 2012, www.usda.gov/oce/climate_change/effects_2012/effects_agriculture.htm

⁸⁷ The complex relationship between climate and sugar maple health: Climate change implications in Vermont for a key northern hardwood species. 2018. <https://epscor.w3.uvm.edu/2/biblio?f%5Bauthor%5D=2498>

freezing nights, and stressed trees.⁸⁸ And, a shorter and less predictable fall, with a diminishing pop of bright maple leaves, will dim the foliage tourist season.

Apple trees, balsam Christmas trees, and northern hardwood forests as we know them will also be stressed as their preferred climate changes and new pests, diseases, and invasive species gain foothold.

As dire as it may seem, Vermont is expected to be better off than many other parts of the US. For many crops, production is projected to increase in Vermont due to longer growing seasons and CO2 fertilization. In the southern part of the US, on the other hand, production is projected to decrease due to heat and drought.

Vermont is predicted to have a relative advantage in more than just agriculture; one national study projected climate change consequences on agriculture, energy demand, crime, labor and mortality and showed all Vermont counties doing relatively well in comparison to other parts of the country.⁸⁹ The study results indicate a “large transfer of value northward and westward.”

This may lead to what is perhaps the most significant consequence of climate change on the Vermont economy: in-migration. It is estimated that 40% of US residents live in coastal areas, which are most likely to experience flooding and hurricane damage. In neighboring Massachusetts alone, 62,069 homes are at risk of being underwater if sea levels rise by 6 feet.⁹⁰ Cities, which have concentrations of industry as well as residents, are also projected to be hotter and to have higher levels of air pollution than rural areas. Although several studies have located the houses and businesses at risk and the potential for out-migration, few have attempted to give more shape to where the migrants will go except: inland and north.

Obviously, the effects of climate change will be far ranging and substantial. However, they do not necessarily indicate a change in Vermont’s tax structure. While some enterprises may decline, others, such as renewable energy, information, and construction are likely to grow--especially after considering Vermont’s advantage relative to other parts of the country. While there may be reductions in property values due to storm damages and perceived risk as well as decreased demand for slope-side condominiums, reconstruction

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https://www.uvm.edu/femc/attachments/project/999/annualMeeting/2017/presentations/Rapp_FEMC_ImpactsOfClimateChangeOnMapleSyrupProduction_121417.pdf

⁸⁹ Hsiang, S., Kopp, R.E., Jina, A., Rising, J., Delgado M., Mohan, S., Rasmussen, D.J., Muir-Wood, R., Wilson, P., Oppenheimer, M., Larsen, K., and Houser, T. (2017). Estimating economic damage from climate change in the United States. *Science*. doi:10.1126/science.aal4369

⁹⁰ Rao, Krishna. 2017, June 2. “Climate Change and Housing: Will a Rising Tide Sink All Homes?” Zillow Research.

and in-migration may add new development to the property tax rolls. Consumption taxes will need ongoing revision as new services are developed to deal with changes and as consumers spend more on services and less on goods. The rooms and meals tax is likely to suffer disproportionately, although it is also possible that Vermont will provide a welcome escape from the hot cities, offsetting some of the loss of winter tourism.

Tax-Related Efforts to Reduce Carbon Emissions and Adapt to Consequences

The Legislature has looked at both pricing and non-pricing options for reducing climate emissions, and recently commissioned a decarbonization study to provide objective estimates to help craft the state's response.⁹¹ Pricing options generally involve carbon taxes, or cap-and-trade programs that would increase the price of emitting carbon. Non-pricing approaches include things like incentives to purchase electric vehicles, investments in public transportation, and regulations or performance ~~standards~~-standards. For Vermont to reach its emission goals, both pricing and non-pricing initiatives are being developed.

The pricing approaches tend to be more comprehensive and more cost effective. The main difference between the types of pricing options is that a climate tax sets a price for carbon, but not the emission level that results. A cap and trade approach, on the other hand, sets the emission level allowed, but not the price. In addition, carbon taxes tend to apply to all carbon emissions while cap-and-trade programs tend to apply to only certain sectors such as electricity or transportation. As with taxes in general, the broader the base, the more effective and less distortionary it can be, at a lower rate.

Both pricing approaches result in revenue to the state, which can be distributed to make investments to further the goal of carbon reduction, to reduce the cost of electricity, to reduce taxes, and/or to make payments to households to help offset the cost increases due to the carbon pricing. Some of the options to return this revenue to the economy are tax related: tax credits, tax exemptions, and reductions in tax rates.

To achieve reasonably similar reductions in carbon, either approach would result in a slight reduction in GDP, which could be offset to different degrees by different uses of the resulting state revenue and non-pricing activities. A reduction in the GDP would mean a reduction in tax revenue, in addition to the reduction in gas tax revenue. However, when accounting for the environmental and health benefits, all options considered by the decarbonization study commissioned by the legislature would result in net benefits.

At the current time, Vermont is participating in the Regional Greenhouse Gas Initiative (RGGI) that covers electricity ~~generation, and~~generation and is considering joining the Transportation Climate Initiative (TCI), a regional cap-and-trade program that covers carbon emissions in the transportation sector. While regional cap-and-trade programs increase fuel prices, they do so for all participating states. In contrast, a Vermont carbon

⁹¹ An Analysis of Decarbonization Methods in Vermont. 2019. Marc A.C. Hafstead, Wesley Look, Amelia Keyes, Joshua Linn, Dallas Burtraw, Robertson C. Williams III

tax on the same sectors would cause the loss of revenue to neighboring states and the perception of Vermont having higher taxes.

Pricing approaches are likely to be less successful in reducing emissions in Vermont than they would be in other areas in the country because a high proportion of our emissions come from activities that are necessary, and therefore less likely to be reduced if the price is increased. About 43% of Vermont's emissions come from transportation while only 28% of the emissions in the US do. Similarly, 24% of Vermont's emissions come from heating, while only 10% of the emission in the US do.⁹² Reducing the use in these sectors is difficult unless there are viable alternatives to meeting the need. For this reason, non-pricing approaches that provide economically feasible alternatives are needed, even though in isolation they may be less cost effective than pricing approaches.

Both the Vermont Energy Action Network (EAN) and the Vermont Climate Action Commission (VCAC) have recommended numerous non-pricing actions to reduce emissions, generate energy from renewable sources, and sequester carbon. Many recommendations would provide incentives to help Vermont families transition off fossil fuels. Some of these do not require public funds. The electric utilities can provide financing for some of the investments needed by households and businesses to switch from fossil fuels to electricity.⁹³ This type of investment would meet the Tier 3 requirements of Vermont's Renewable Energy Standard while also increasing electricity sales. But other incentives recommended to be expanded, such as the Electric Vehicle purchase incentive and the Clean Energy Development Fund incentives, would be publicly supported. In addition, because transition investments are difficult, if not impossible, for lower income households, public funding is recommended for expanding loan programs and doubling the Weatherization Assistance Program.

Many recommended initiatives are state infrastructure projects, requiring public funding. These include state aid for school biomass projects and expanding public transit and rail infrastructure.

While most climate change programs often focus on reduction of emissions and/or renewable generation, the VCAC notes that sequestration is also important and frequently overlooked. They recommend investments to conserve forest land not only for sequestration, but also for flood protection which is increasingly important in weathering the intense storms in the changing climate. This may be looked at as preventing emissions, as the report states: "Every acre of forest lost to development has the potential to release a

⁹² This estimate comes from An Analysis of Decarbonization Methods in Vermont. P.14. According to Vermont's Energy Action Network, 28% of Vermont's emissions come from heating.

<https://www.vtenergydashboard.org/uploads/slideshow/EAN-report-2018-highres-compressed.pdf>

⁹³ Vermont Climate Action Commission. 2018. http://anr.vermont.gov/about_us/special-topics/vermont-climate-action-commission

hundred metric tons of carbon dioxide equivalent into the atmosphere – like adding 25 cars for a year.”⁹⁴

The most obvious effects of Vermont’s responses to climate change are likely to be a reduction in the fuel-dependents sectors of the economy, an increase in the electricity and green energy sectors, a slight reduction in the GDP from pricing which may be offset by growth induced by the non-pricing actions, a reduction in the gas tax revenue, and the need for more funding for transition initiatives.

In Combination

The commission appreciates the efforts being made in mitigating and adapting to climate change. Our scope is only to consider the tax implications, and to align them with the principles adopted by the commission. We are looking only at a short-term forecast of a transition period; our assumption is that investments made during this transition period will protect the state and strengthen the economy over the long term. As such, we offer a few observations.

In combination, climate change and programs to address it, are likely to decrease GSP slightly during the transition period, and therefore reduce revenue from current taxes at current rates. The greatest hits will probably be in the Gas Tax and the Rooms and Meals tax.

Because lower income households pay a higher percentage of their incomes in fuel, any increase in fuel prices is likely to be regressive. Whether the pricing mechanism is called a tax or not, the commission recommends returning enough of the resulting revenue to households to offset the regressivity.

The commission supports the use of tax credits and exemptions to reduce the upfront cost of some investments that will make the transition possible, even though in general the commission strives to keep the tax base as broad as possible. But it is important to also enable citizens who can’t afford to make an investment at all to transition off fossil fuels. Combining an upfront incentive with a loan that can be paid off through savings in a short period of time may be helpful, although outside of the tax code.

We would like to address the apparent contradiction in our support for using the tax code to support the transition to a clean energy economy on one hand, and our recommendation to charge owners of electric cars an annual road use fee in lieu of paying gasoline taxes. Right now, the vast majority of cars on the road are gas-powered; twenty years from now, the vast majority of cars on the road will be electric. Part of our job is recommending structures that will allow us to maintain our roads during and after this transition. Another way of putting it is that we will need roads even when there are no more gas-powered cars. As noted, we

⁹⁴ VCAC Final Report. P.55

support making the purchase and operation of electric cars as affordable as possible to encourage their rapid adoption, and we also believe that every vehicle should help pay for the roads it uses. Over a dozen states already have special road fees for electric vehicles, and some lower versions of the same fee for hybrid vehicles. States are also investigating the possibility of charging vehicles for the number of miles they travel each year, tying each taxpayer's contribution to the road maintenance even more closely to their actual use. We recommend that Vermont follow these developments closely.

In comparison with a Vermont-only pricing program, regional partnerships have the benefits of retaining the state's actual and perceived competitiveness in the region and reducing the incentive to buy fuel or conduct business over state lines. The commission agrees that the tax structure should be responsive to interstate competition.

If the pricing mechanisms are successful, carbon emissions will drop each year, and the pricing will need recalibration to continue the progress. In this process, using the revenue from carbon pricing to replace other taxes (such as lowering the income tax rate in the lowest bracket) could destabilize the tax structure. Instead, we recommend that returns to the economy from the pricing mechanism be made in transitional payments and investments that help offset the costs of the transition. Once we reach steady state, the tax structure could be rebalanced.

While in-migration could benefit the economy and boost tax revenues, it is not clear how it would be accommodated. Much of our infrastructure is inadequate to support growth in village centers, and many of our village centers are near rivers. At the same time, we have a goal of keeping our forests intact, for multiple ecosystem benefits as well as for carbon sequestration and flood resiliency. Vermont's response to rapid development in the 1980's included the Land Gains Tax and the Use Value Appraisal Program. Although these taxes are still in place, it is not clear to the commission that we have the right tools to direct potential development at this point in time.

The Vermont Climate Action Commission report puts it this way: "Demographic change, greenhouse gas emissions, severe weather, and financial challenges prompt a fresh look at Vermont's smart growth strategies and land use governance as means to address climate change." We agree. And we recommend that the fresh look include role of taxes in the mix.

Technological Change and the Tax Structure

Technology has changed our lives in many ways. Our Tax Structure must also keep up with these technological changes to be sustainable in the future. The financial needs of the state which are funded primarily by the taxes will continue despite this changing landscape of technology.

Changes to the Way We Travel

As transportation technology evolves, there is less and less dependence on fossil fuels to power the vehicles that we use to travel, both locally and long-distance. More and more alternative fuel vehicles are on the road today, and that number is increasing year. This creates a positive environmental impact which is very positive. The other side of that change is the decrease in the use of fossil fuels which at present are the major source of tax revenue that is used to maintain our roadway. The same holds true for public transportation vehicles as well.

Technology is also affecting the way we book leisure time events, air travel and lodging. As more and more services for reservations become digitized, the tax structure must evolve with it and tax these items to the same extent they are at present despite the use of e-tickets and on-line booking for lodging, etc.

Changes to the Way We Live and Work

Technology is also changing the way we live. The pandemic has shown us that many jobs can be done remotely, i.e. working from home. This presents a great opportunity for people to live in Vermont and enjoy the tremendous lifestyle it offers, while maintaining a position that may not be available with a Vermont based organization. This is something the state has been working on to begin to rebalance the demographics of the state and the aging population. This is something that will not only increase the younger population of the state, it will also increase the higher income earners, and have a positive effect on the personal income tax collections. As this evolves, the traditional nexus for the employer of having an employee working in the state will have to be revisited so it does not become a discouragement for employers with headquarters and operations in another state to allow their employees to work remotely in Vermont. This will also hold true for Vermont based employers as well. The difference here is the decrease in the demand for office space that will result from this. This will tend to depress the value of office properties from an education funding tax and municipal property tax standpoint. It will also decrease the income from these rentals and ultimately the amount of income tax revenue collected from the property owners. The tax structure will need to contain new sources of revenue to make up for the two pieces of lost revenue mentioned in the previous sentence.

Many households in Vermont now utilize solar power and excess energy storage units as their source of electricity. This is an excellent use of renewable energy and certainly reduces our carbon footprint which is important to stop climate change and global warming. Many of these households are connected to the grid and therefore contribute to the taxes ultimately paid by the Public Utility they are connected to. The state through its tax structure must continually monitor the amount of revenue from the use of electricity in taxes and be able to replace those lost taxes with another sustainable source of revenue.

The use of landline telephone service has decreased over the years as VoIP technology develops as well as the use of cellular telephones. The Telephone Property Excise tax is a tax that, from a collection standpoint, continues to diminish every year. As mentioned in another part of this report, it and other obsolete taxes need to be phased out and new sources of tax revenue found.

Our purchasing habits have also changed due to the advances in technology. The ability to purchase on-line has increased the ability of Vermont residents to order goods from around the world on-line and have them delivered, many times in the next day. As a result of the Wayfair case, many of these transactions are presently captured by the sales tax which would be the equivalent of a resident purchasing the good at a brick and mortar store in Vermont. The tax structure must continue to monitor enforcement and take the appropriate measures to promote a high level of compliance to sustain its revenue from the sales tax. This change in purchasing habits does; however, bring a consequence to other taxes in the tax structure of the state. Lost jobs at brick and mortar stores means lost wages which means lost income tax revenue. This also leads to a decrease in the need for retailers to invest in large brick and mortar establishments to sell their product and consequently a drop in the education property tax as well as the municipal property tax. The structure must be flexible and provide new sources of revenue to make up for the lost tax revenue from these retail brick and mortar establishments.

Many of our purchases today are digital rather than tangible property, such as audible and e-books. Also, our movie watching habits have changes as well. Although people do still go to the movie theatre, that is down from years past. Movie rentals is another area that has dramatically changed. Not that many years ago, if you wanted to rent a movie, you went to the local movie rental shop, rented the movie, watched it and returned it. Today with the streaming services available, we rent them digitally streaming them over our computers and smart televisions that are connected to the internet. Music is available as well through on-line subscription services as well as in many cases for free. Not that many years ago, we purchased record albums, then tapes and finally CDs which are all tangible personal property subject to sales tax. The tax structure must be flexible to find new ways of taxing the things we always paid tax on that may be out of the reach of the tax system without adapting itself to the new technology.

These are just a few examples of how the changing landscape with respect to technology will affect the tax system, and the structure must constantly be evaluated and change to be sustainable and provide the necessary revenue that the state needs to provide the services to the residents it must provide.

As this summary points out, our changing landscape with respect to technology affects the three major tax types, Income, Sales and Use and Education Funding Property Tax/Municipal Property Tax. To preserve the sustainability of the tax structure, the legislature should study the effects technology has already had on our tax structure as well as ten years down the road, what it might look like.

Changes to Business Because of Technology

All of the changes noted in the previous sections will also have an impact on how business is conducted because of changes in technology.

As manual tasks continue to become automated, there will be a shift in employment for those workers that perform manual tasks such as check-out clerks, receptionists, assembly and piece workers and order takers will be replaced by technology. Those displaced

workers will need to be retrained to assist with the technology that replaced the, set up and maintenance.

One piece of technology that has and will continue to change business is the internet. Businesses no longer have to rely on foot traffic in their brick and mortar stores, they can now sell virtually all over the world from their location in Vermont. They will now need to employ new technology to take, process and ship orders as well as comply with federal and state tax rules. The upside of this for the state should be more revenue in the long run from sales tax and business taxes. Another upside is that after the initial shock of technology taking workers places, the retraining and reemployment of these displaced individuals should lead to higher paying jobs.

Vermont now sources revenue from services using market-based sourcing. As Vermont based service businesses branch out and remotely do work for customers in other states, unless the business is a pass through entity and all of its owners live in Vermont, the state may see a decline in tax revenue as many Vermont businesses will now be better equipped to perform services remotely to destinations all over the US. The upside of the ability of businesses to do work remotely and are based outside of Vermont, the market-based sourcing rules will subject those service providers to income tax due to market-based sourcing.

Another by-product of technology changes for businesses is the use of less paper and the need to keep paper copies of records, etc. These can be stored and accessed in the “cloud” and the business can operate in an almost paperless environment.

Long-term Decline in the Value of Commercial Real Estate

We note another possible long-term trend driven by the trends toward more online shopping, and more remote work. These trends have the potential to make commercial real estate less valuable.

The businesses most impacted by COVID are bars and restaurants, and we are likely to see more closures before the end of the pandemic. In principle, there is no reason for bars and restaurants not to return to pre-pandemic levels in the post-pandemic world, although it is quite possible that the number of new restaurants and bars will not be as great as the number that went out of business.

Retail stores are a different story. Even pre-pandemic, bricks & mortar retail was in trouble, with thousands of brick and mortar store closures each year among retailers large and small. These closures have happened in small towns, suburbs, and big cities, and in remote malls and on Main St. This trend has been accelerated by COVID, and there is no reason to expect that the pandemic will meaningfully change the decline in bricks & mortar retail in the post-pandemic world.

This could lead to a decline in demand for retail spaces, both for food and drink and for products. That in turn would lead to a decline in the rents these spaces are able to command, which would reduce the building’s cash flow, which would reduce the value of the

building, which would reduce the building's appraisal, which would reduce the property taxes the state and municipality receive from it.

Similarly, to the extent that some of the work that has moved out of the office and into the home office stays in the home office, and to the extent that new businesses start with the assumption that they will not have a commercial office and that all their work will be done remotely, it is possible that demand for office space in Vermont's cities and towns will decline, leading to the same decline in value on the Grand List.

It is difficult to predict whether any of this potential decline will be offset by other factors. Will people find other ways to use former retail and former office spaces productively, creating new demand for them? Can these spaces be effectively repurposed to meet our growing needs for day care, health care, social services, and elder care? Will the trend toward smaller households and smaller homes be partially offset by the fact that new homes may all need two spaces in them that can be used as home offices?

We do not know, but we do want to raise the possibility of a long-term decline in the value of commercial real estate, and the potential need to offset that declining source of tax revenue by augmenting a different source.

Conclusion:

As technology continues to evolve, so must the tax structure and tax laws.

Demographic Change and the Tax Structure

In 2019, this Commission published a report on the effects of demographic changes on Vermont's revenue system (Appendix XX⁴, "POPULATION CHANGES AND VERMONT STATE REVENUE").

That paper reports that while Vermont's total population level is (at least temporarily) stable, the state is undergoing three large demographic trends: the population is aging; it's shifting to the Greater Burlington area and surrounds from everywhere else in the state; and it's dividing into smaller households.

We identify implications for Vermont's revenue system, ASSUMING THOSE TRENDS CONTINUE, AND ASSUMING NO CHANGES TO VERMONT'S TAX SYSTEM:

Implications of an Aging Population for Vermont's Three Major Revenue Sources

1. Reduction in income taxes

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“• Vermont has benefited in recent years from substantial income tax receipts from the large cohort of baby boomers progressing through their peak earning years.
• Younger baby boomers (age 55-64 in 2018) currently account for more than a fifth of tax returns and more than a quarter of personal income tax dollars. As the state’s most populous age cohort progresses through their senior years, their decreasing incomes will no longer contribute as disproportionately high of a share of income tax revenue.” P34

2. Reduction in consumption taxes

“• Compared to other age groups, seniors tend to spend more on mostly non-taxable services, such as health care, rather than the taxable goods favored by younger cohorts.

• This drop could be partially mitigated due to seniors tending to work and spend later in life, because seniors as a whole are now wealthier than other generations, and because the state benefits from tourism by empty nesters and recent retirees from nearby states.” P35

3. Education property taxes

As people age, become empty nesters, and retire, they tend to downsize, so an aging population can lead to lower overall property taxes.

Implications of Urbanization for Vermont’s Three Major Revenue Sources

1. Increase in income taxes

Statistically, the urban area around Burlington provides higher-paying jobs than the rural areas, so to the extent that the population shifts to the Greater Burlington area, we expect average incomes, and income tax revenue, to increase. “The counties that are losing population are the lowest-income counties.” (P 20)

2. Increase in consumption taxes

As incomes increase and become more concentrated in the Burlington area where there are more, and more varied, opportunities for consumption, we expect consumption to increase as well.

3. Increase in education property taxes

Property values tend to be higher in Greater Burlington, so to the extent that migration leads to an increase in housing units in Chittenden County, we would expect total education property tax revenue to increase.

Implications of Smaller Household Size for Vermont’s Three Major Revenue Sources

Per the paper in **Appendix xx1**,

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“Vermont real per capita income has increased five percent while the state’s median household income has fallen four percent. This divergence between per capita income and median household income is driven by two factors. First, smaller households mean fewer earners per household and total income is spread across more households.

Second, greater inequality, with greater concentration of income among high-earners, serves to pull up the average more than the median. The first factor can suppress revenue to the extent that tax benefits are given at the household level (as opposed to by filing status or number of dependents), while the second factor produces increased revenue through a higher effective tax rate in a state with a progressive income tax (like Vermont).” PP20-21

All in all, we would expect that the change in household size would not greatly affect **income tax revenue**.

We would expect a very gradual increase in **consumption tax revenue** as household size decreases, since there are that many more households that need to be equipped with kitchenware, furniture, entertainment systems, etc.

As far as **property tax** is concerned, Vermont has a disproportionate number of larger houses (see P17 footnote). This is driven by the prevalence in rural and formerly rural areas of large, rambling farmhouses that grew over many decades to accommodate large farming families; large homes built in towns before the Great Depression designed to accommodate a family and their servants; and “McMansions” built in the 1980s and 1990s during a trend toward larger homes.

However, with smaller households, and the trend toward smaller, more energy-efficient and cost-efficient houses, economists expect demand for the larger houses is likely to fall, so prices will fall, and appraised value will fall, and grand list value will fall. This will be partially offset by new construction of smaller houses, growing the grand list. It is also likely that some of the larger homes will be divided into two-family homes or multi-family homes.

One of the household configurations that is growing is multi-person non-family households, so it is likely that some of these formerly single-family homes will be occupied by unrelated adults.

All in all, we would expect declining revenue from education property taxes based on the trend toward smaller households.

Why These Trends Might Change, and Implications for Vermont’s Tax System

External factors affecting these three trends (aging, urbanizing, shrinking households), combined with the changes we recommend to Vermont’s tax system, lead to a different set of implications.

Changes in technology, the economy, and the climate all have the potential to significantly affect Vermont’s demographic trends.

First, the age structure of Vermont's population is driven by births, deaths, domestic and international in-migration, and domestic and international out-migration. There is not much reason to expect Vermont's birthrate or deathrates to change, although both are certainly possible. However, there are several factors which could lead to meaningfully increased in-migration from other states:

1. There are many reasons that some people don't want to live in Vermont, the long, cold, dark winters primary among them. Vermont's winters are getting shorter and warmer, which means that:
 - a. More people who live here will be willing to spend all winter here (fewer snowbirds). That means more local consumption from people who otherwise would have spent two to six months somewhere warmer.
 - b. There is likely also to be a new trend of people who live in areas that become uninhabitably hot during the summer, or prone to too many violent storms during hurricane season, who are the opposite of snowbirds, who instead of fleeing south to avoid the cold and snow flee north to avoid the heat and hurricanes.
2. When surveyed, 66% of Americans say they'd like to live in a small town or rural area. "Given six choices of a type of place where they could live, 27% of Americans choose a rural area, more than any other option . . . 39% would choose a town, a small city or a suburb of a small city."⁹⁵ The barriers to their actually living in places like that include the lack of employment, the lack of good schools for their children, and the lack of cultural experiences. However, per our paper on demographics, most of Vermont's rural areas are what are called high-amenity rural areas, which is to say, rural areas with access to good schools and recreational and cultural activities.
3. Twenty years ago, we saw in-migration by people fleeing terrorist attacks on urban areas, and recently, we have seen in-migration driven by people fleeing pandemic hot-spots. These people are either moving year-round to what had been a vacation home, or simply moving to Vermont. School enrollment in Windham County is up for the first time in a very long time. "The Covid-19 pandemic is bringing a new crop of students to the state, as newly remote workers decamp from urban areas to Vermont, which has made [national headlines](#) for its low rates of infection."⁹⁶

Advances in communication technology now mean that many people no longer need to live near their employer. This removes another one of the big barriers to moving to Vermont, which was lack of good jobs. For many people, a Vermont with mild winters and plentiful employment opportunities is a much more attractive place to live, and this is particularly true of the rural areas. People moving to Vermont tend to be younger and have (or soon give birth to) children, and to the extent that they are pursuing a rural or small-town environment, they are likely to settle outside of Greater Burlington. This may temper or reverse all three of the big trends of aging, urbanizing, and shrinking household size.

⁹⁵ <https://news.gallup.com/poll/245249/americans-big-idea-living-country.aspx>, 2018.

⁹⁶ <https://vtdigger.org/2020/08/04/the-pandemic-is-bringing-students-to-vermont-mostly-in-towns-without-schools-%EF%BB%BF/>

The implications for our tax system are generally positive. More people earning good incomes means more income tax revenue. More people living in Vermont means more consumption tax revenue.

Further, even if the population does continue to age, our recommendation that Vermont continue to expand the consumption tax base to include all consumer-level purchases of goods and services means that the shift in consumption caused by an aging population (purchases of fewer goods and more services, like health care services) will not erode the consumption tax base.

Our recommendation that we complete the many-decades-long process of transitioning the source of education finance from property tax to income tax means that the effect of any future trends on homestead property tax revenue will affect only local revenue, not state revenue. To the extent that people move year-round to what had been their vacation homes, the state will go from collecting non-homestead property tax to collecting income tax.

All in all, we believe that our recommendations mitigate or even neutralize the threats to Vermont's revenue system posed by the long-term changes that may arise from Vermont's changing demographics.

Underlying all our recommendations is a belief that our economy and our climate and our population are all becoming less stable, and Vermont will need to be ever-vigilant and ever-agile to be successful in continuous adaptation to a changing world.

12. Conclusion

Reforming and restructuring a state tax system is hard. It is probably harder than creating an entire tax system from scratch. Our economy, technology, and climate are changing faster than ever, and designing a tax system that will evolve appropriately as our world changes is daunting. In addition, the modern economy is growing more complex, which makes designing a fair and sustainable tax system that is as simple as possible even more challenging.

Then there is the human factor. People are properly cautious about change and are even more wary of change that involves their money. There are hundreds and hundreds of companies, industries, and interest groups in Vermont, each of which is naturally more focused on their own well-being than on Vermont's overall well-being. The goal of making our system more fair implies that it is not perfectly fair right now, which in turn means that right now some people are bearing more than their fair share of the tax burden, and some are bearing less. That means that moving toward more fairness means that some people will have a greater relative burden than they do now. They will not like that. You will hear from them.

The main objections they will raise are:

- 1) *The sales tax is already regressive and expanding it to necessities like groceries will make it more regressive.* We note that we recommend expanding the sales tax base only AFTER you have restructured the support system for low-income Vermonters to ensure they are not harmed by these changes.
- 2) *Applying the sales tax to things like education will make it less affordable at a time when there's already an affordability crisis in higher education.* We note that exempting education from the sales tax has not made education readily accessible, and a 3.7% sales tax will not be the difference between affordable and unaffordable. On a \$40,000 college tuition bill, 3.7% is \$1440. Grants of \$10,000 or \$20,000, or very low-interest, long-term loans, are a rather more meaningful way to make education more affordable.
- 3) *Some of them will be concerned about the administrative burden of collecting and remitting the sales tax,* although as noted, every corner store in the state has figured out what products to charge sales tax on and which are exempt, and in many cases who should pay the sales tax and who is exempt.

We are confident that you will hear these objections because we heard them. We hope we have addressed them adequately and appropriately. We are also aware that the Governor and the legislature have been convening commissions like ours regularly since at least 1929. When the legislature was considering a cigarette tax in 1938, a lobbyist published a brochure arguing against the cigarette tax because it would be regressive and would damage Vermont businesses (Gillies, 1997). The more things change . . .

Gillies also points out that “every five years or so another commission is appointed to study the system and propose improvements that will repair the problems of fairness, progressivity, and a sufficient tax base to justify funding of necessary expenses” (Gillies, 1997).

Our commission is part of that series, preceded by the Blue Ribbon Tax Commission and undoubtedly followed by another commission in the not-too-distant future. Our goals were to design a tax system for Vermont that would be as good as possible for as long as possible.

Evolving our tax system is difficult and daunting and complicated, but it is vitally important for the well-being of our Vermont community. We wish you luck, patience, and wisdom as you undertake this part of the journey. We are grateful to everyone in the legislature and the administration for your work on this, and for everything you do every day for Vermont. We are grateful for the opportunity you gave us to contribute, we hope this report is useful to you, and we stand ready to help in any way we can.

Respectfully submitted,

Deb Brighton, Commission Chair
Stephen Trenholm, Commission Vice-Chair
Bram Kleppner, Commissioner

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