Lake Champlain Chamber

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To: Vermont Tax Structure Commission; Deb Brighton – Chair; Stephen Trenholm - Vice-Chair; Bram Kleppner – Member

CC: Sean Sheehan

From: Lake Champlain Chamber

Date: January 21, 2021

Re: Response to request for comments on draft report of the Tax Structure Commission

In 2019, when the Tax Structure Commission (Commission) was created, the Lake Champlain Chamber supported the effort. As with the Blue Ribbon Tax Commission, several years ago, we agree that Vermont's tax structure should be looked at holistically in an effort to keep the structure revenue-neutral while adapting with the times.

With due respect to the work of the Tax Structure Commission, the people of Vermont, the state's economy, and its businesses are in a time of great unrest and uncertainty. While there are recommendations worthy of consideration, now is not an ideal time to inject any further uncertainty. From a perspective of economic stewardship, we feel such dramatic changes are not advisable when the economy is in a more fragile state, and participants are looking to their government for stability and predictability. COVID-19 has created a hidden tax on everything, and every Vermonter has had to cope and adapt to this reality.

Furthermore, the delivery of this report comes at the start of a new Presidential term, with a President with dramatically different perspectives on the needs of the country and the legislative ability to shape tax policy to meet that perspective. Vermont would be well-served to take a wait-and-see approach to tax legislation, at least until the second half of the legislative biennium, pending the health and strength of the economy. It is the Lake Champlain Chamber's hope that with any proposal, this sentiment will be included and that this proposal will begin a period of planning and inventory of options for a future date.

For the purposes of our comments, we will follow the same layout as your recommendations and we focus mainly on the eight recommendations prominent in the summary of recommendations.

1. Restructure the homestead education tax

These recommendations discuss how we push pain to different places without addressing the crux of the issue, that the cost of the services exceeds Vermont's ability to pay. The Lake Champlain Chamber understands that this Commission was limited in its purview to revenue; however, a discussion needs to be had to address spending. Much as our natural world is confined by the laws of physics and therefore does not have an infinite capacity for resources, so too does our state's economy. Vermont taxpayers are confined by the size of our state's economic activity and do not have a boundless capacity to provide new revenue to the state. We must work to bring our education spending in line with Vermonters' capacity to pay in the interim and then work to expand the tax base by attracting and retaining more residents and employers to the state. We appreciate the Commission's comments to that effect later in the report, and we add perspective to that later in our comments.

A. Eliminate the Property Tax Credit

The Lake Champlain Chamber agrees that the complexity is overwhelming the effectiveness of the current homestead education tax. One could take it a step further to say that this tax credit might be creating some of the inefficiencies in our housing market. We would support looking at further administration of the property tax at the state level to avoid the need for an income lookback to avoid the complexity.

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.

From an economic sense, there needs to be some tax on homestead property to create rent, and therefore opportunity cost. Without such price-signals, individuals do not have incentives to find efficient use of the property or "right-size" properties. Vermont is one of the most "over-housed" populations in the country, perhaps because we do not efficiently or effectively create the proper price signals. Vermont's current Property Tax Credit system effectively works as rent control for some residents. Economists would tell you that rent control is an effective way of ruining an area's housing market, as individuals are not subject to proper price signals to push them to efficient housing options. Proper price signals and additional housing stock could spur retirees to leave homes that exceed their current needs while creating housing opportunities for a family that is unable to find such a home.

Concerns more broadly

It would seem that the Commission took the position that income is a better indicator of a person's wealth than property, which is partially correct. The state had concluded that taxing a person's wealth (even if all we are considering as their wealth is their home) without any context of income is inappropriate, and what you are proposing would be taxing a person's income without any context of wealth, or more appropriately, net-wealth. Making an assessment of a person's wealth based on income is still not as helpful and will often serve those well situated in life to the detriment of those who are trying to accumulate wealth through high incomes.

Wealth, or to be more holistic, net-wealth, can be defined as financial and nonfinancial assets net debts; this would include assets ranging from financial instruments, entitlements, housing, and tangible personal property as well as the presence, or lack of, debt from various sources including education, housing, personal, and medical expenses. Income, on the other hand, is the return on investment of labor, capital, or both. With enough time generating income, a person can hopefully achieve a higher net-wealth. However, when income is treated as wealth, one-time life events, such as the dissolution of a business or farm upon retirement or a long-term debt obligation, such as medical, student, or mortgage debt, make individuals appear more or less wealthy than they might actually be.

Take, for example, the proposal to move from property tax to income tax to pay for education; the paradox here is that a person of wealth could invest that wealth in the property only to then not be taxed because they have the privilege of choosing to not fully participate in seeking taxable income, unlike their less wealthy counterparts who need income to pay down the balance of their property in an attempt to accumulate wealth.

People take various life trajectories in this modern world, and some of them require individuals to have a higher amount of income at points in their life than other parts. Most young professionals in our state, with no outside help, require a great deal of income to bridge an opportunity chasm that exists between them and successful adulthood. While they may appear wealthy due to the indicator you selected, they will actually be effectively losing more of their income to debt obligation while paying a higher tax rate.

Additionally, income represents an unstable base for such an essential service as education. Property is a safe and stable source of revenue that forecasters can set their proverbial compass to, while income is subject to large economic swings due to economic trends. An education fund supported by an income and sales tax would be highly susceptible to the economic conditions of the day, and in a typical recession (reminder, our current recession is far from typical) both revenues would be greatly depressed.

Finally, the Lake Champlain Chamber believes that the proposed timeline is much too aggressive given our current COVID-19 challenges and would advocate that any such changes be pushed out further in the future if they were to be considered.

2. Broaden the sales tax base

While the Lake Chamber appreciates the tenacity exhibited in this section, such changes present many challenges unique to Vermont, which we feel the Commission did not address. Furthermore, from a perspective of economic stewardship, we feel such a dramatic change is not advisable when the economy is in a more fragile state and participants are looking to their government for stability and predictability.

A. Expand the sales tax base to all consumer-level purchases of goods and services except health care and casual consumer-to-consumer transactions.

The Lake Chamber is not completely sure we can share your optimistic view that "there is nothing inherent in services that makes them less amenable to a sales tax than goods." This change has such broad and far-reaching implications, it should not be taken lightly. We agree that the transition of modern, highly-developed nations' economies, such as the United States economy of which Vermont is a component, to being an economy predominantly based on services rather than goods is a reality, it doesn't have to be inevitable. Perhaps more attention should be paid at the state level to driving economic activity that produces tangible goods. Certainly, one major lesson of the pandemic and parallel recession is that these businesses were less impacted, making our communities more resilient.

We would also like to note what a massive change moving toward a tax on services would be administratively, both for the state and for Vermont small businesses. The move would require an expansion of the Vermont Tax Department to help Vermont businesses, who have never handled trust taxes, understand their obligations and inevitably drive compliance when many do so incorrectly due to the complicated nature. In addition, these service-based small businesses, that likely operate on slim margins, will now have to dramatically rethink how they do business and a possible need to acquire never previously necessary bookkeeping services. Just imagine how difficult this change might be for sole-proprietors, of which the state has many doing everything from plowing snow from driveways to carpentry to software development.

All tax decisions have consequences, negative and positive, and while you have painted a utopian picture of what can go well in this change, you have not convinced us that you have fully considered what could go wrong. We would appreciate a robust explanation of the challenges with such a change. We present evidence of that in the below section-c.

C. Use the gain from broadening the base to protect low-income Vermonters and reduce the sales tax rate to 3.6%.

While the change may be net-neutral, such an effect will likely not translate the same way to consumer behavior (this is in fact the entire premise behind the topics in recommendation-7). In keeping with the well-established theories of economics, humans follow price signals, adapting behavior to minimize the impact of the added cost, and we should have a much, much more exhaustive discussion around what the behavioral impact might mean for a low-income person whose groceries would under this proposal be taxable. The *marginal impact* (moving from 0 to 3.6%) of this increase is massive for many and is even larger due to one thing you overlooked and we discuss below.

Issues Around Local Option Taxes

One issue with this proposal seemingly neglected by the Commission is the nexus of the Vermont sales tax with the numerous local option taxes, created by charter change procedures, as Vermont is a Dillon Rule state. This makes a change such as this particularly troubling as municipalities across the state have put forth local option taxes to their constituencies on the basis of Vermont taxes.

The decisions made by voters after charter change deliberations, complete with cost and revenue estimates from their dutiful town clerks that are then reviewed by the Vermont General Assembly, and signed by the Governor will all now be dramatically changed in a way never imagined. Municipalities may find themselves bringing in more revenue than they possibly expected, and thus having a detrimental effect on their economy. Additionally, because the local option tax is a fixed, added percentage on top of the state tax rate, the *marginal* impact of such a change is even higher on populations that are financially at risk from such a change.

D. Continue to eliminate the sales tax on business inputs.

The Lake Champlain Chamber agrees that if this non-advisable change you suggested to broaden the base were to be contemplated, continuing to eliminate the sales tax on business input would be the correct course of action to avoid a pyramid scheme of bureaucracy.

3. Modernize income tax features

A. Expand the personal income tax base.

The Lake Champlain Chamber is happy to see expanding a tax base by recruiting more people that would pay taxes included as a part of your recommendations; however, we would have wished to see this theme displayed more prominently throughout your whole report. While there is a great deal of discussion around pushing tax burden from one area to another or bringing more under a tax, there is little that gets at the crux of the issue; Vermont's spending is high and growing in some areas such as pension obligations at an unsustainable rate while Vermont's population and economic output are not growing at as fast a rate.

We applaud your desire to continue to promote Vermont as a remote worker destination and ensure that rural areas have the infrastructure such as high-speed broadband internet to support remote workers. To that, we would also add that Vermont can benefit by bolstering its transportation offering to ease access to major metropolitan areas on the east coast, as well as airline offerings to major tech hubs further away.

Additionally, Vermont must make a more concerted effort to attract, retain, and grow anchor employers that provide a safe harbor for residents and budding entrepreneurs if we wish to grow our personal income tax base. Finally, the high cost of childcare in our state has meant some Vermont families have had to do the difficult math and realize that it is an economically more viable option for one parent to stay home, and the recession has put on full display that the parent usually identifies as a woman. Making strides in childcare affordability would go a long way towards bringing these parents back into the workforce, broadening the personal income tax base, and promoting gender equality.

B. Study the effect on Vermont Pass-through Entities of an entity-level tax.

The Lake Champlain Chamber supports this proposal for the reasons stated by the Commission, as well as the meaningful opportunity that such an action would provide to take advantage of recent Treasury action to retain more tax dollars in Vermont. On November 9th, the U.S. Treasury issued Notice 2020-75 announcing proposed regulations that allow a particular workaround of the $10,000 cap created by President Trump's 2017 "Tax Cuts and Jobs Act" on state and local taxes (SALT) for some businesses. We believe that this opening may provide an opportunity to extend a benefit to struggling small businesses, at no cost to the state of Vermont, while also reducing the cost of administration in some instances for the Department of Taxes.

The Lake Champlain Chamber understands there is still a great deal to explore, however, such opportunities for a revenue-neutral win-win are rare, and we ask that you give this one serious consideration. Some New England states already have enacted a policy to facilitate such a workaround by enacting legislation under which noncorporate businesses can pay state income taxes at the entity level rather than at the individual level on their owners' returns. Specifically, under this regulation, the SALT cap would not apply to income tax payments made by Partnerships and S Corporations, and to capitalize on this, Vermont would need to allow for the option for state income taxes to be paid at the entity-level.

We know some would contest that the best outcome would be to repeal the SALT cap altogether, however, despite its inclusion in coronavirus relief bills forwarded by the House, and recent election outcomes, it does not seem likely in the near future for a number of reasons. First, we will be facing a divided government, with a Senate that will likely still not favor any action on SALT deductions. Second, the President-elect's policy proposals thus far have not included any action on this issue. Third, the political window for such action will not likely open until 2023 (if at all), at which time it might be more convenient to let the provisions sunset (in 2026). Finally, the state would be none-the-worse if we elect to make these changes, and then federal legislative action is taken in the next three years on the broader issue.

C. Examine opportunities to improve Vermont's estate tax.

Given the recent changes to the tax at the Vermont level and the changes expected at the Federal level as proposed by the Biden Administration, we think that it would be best to take a wait-and-see approach to react to any federal changes. This tax is a large component of long-term planning for individuals with the means to leave a jurisdiction to avoid it, and too much uncertainty and activity in such an area sends the wrong message to a highly mobile demographic.

D. Explore options to improve the corporate income tax.

The Lake Champlain Chamber is in agreement with the need to explore the options put forth by the Commission in this area. While we are in a multi-state Tax Commission that recommends Joyce, our businesses are likely paying more if they are doing business in Finnegan states. The most beneficial system for businesses based here would be Finnegan.

4. Undertake analysis in order to eliminate tax burden/benefit cliffs

The Lake Champlain Chamber has long agreed and said the same thing you did; the benefits cliff is devastating if it is unexpected and if it is anticipated, it is a disincentive to work. We agree that Vermont needs 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.

While we share your determination to rectify such issues, and have advocated to remedy them in the past, we have always been met with the refrain that this would come at too substantial of a cost. Upon examining your proposal further, it does not seem that the change in the expanded sales tax base would be enough to cover that cost given our previous understanding of the depth and breadth of the problem.

5. Improve the administration of property tax

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

The Lake Champlain Chamber would bifurcate this proposal. Certainly, we agree that the mental health of students should be paid out of the general fund, as these costs should be part of broader social services and not education. To pay these costs from the education fund would be to mask the full scope of spending on mental health in the state.

With regard to employee health insurance, we respectfully disagree for similar reasons, as these costs are another component of the total remuneration of our state's educators, and therefore an important component of the total cost of delivering education in this state. Thus the revenue to pay for that cost must be part of the education fund and to do otherwise is to deceive voters of the true cost of these services.

7. Utilize tax policy to address climate change

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.

The Lake Champlain Chamber will always agree that "carrots" are favorable to "sticks" and as such we agree with this recommendation. However, this is not a new activity in Vermont, which boasts one of the first efficiency utilities in the country and has a robust Tier-III system to its Renewable Portfolio Standard created in 2015. Before anything new is created, it would behoove the state to see if the resources in those programs need to be merely re-directed. We feel it is likely those efforts are adequate for the task.

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.

The Lake Champlain Chamber would add to this that, in addition to taking care to prevent any such price on carbon from being regressive, Vermont cannot take such a trajectory alone must be done as a regional or national effort. Regional solutions are needed for this global issue, as local carbon pricing would likely drive economic inequality within the state or achieve a false sense of emission reductions as Vermont's environmental externalities would just adjust to this price signal by moving into neighboring states.

8. Collaborate with other states so each state can build a fairer, more sustainable tax system

A. Add an annual excise tax to the registration fees for electric cars.

The Lake Champlain Chamber agrees that this is the correct course of action, as these vehicles do have the same impact on our transportation infrastructure as their fossil fuel counterparts, which contribute to the upkeep of that infrastructure through the gas tax. We would note that this brings to the forefront that this tax might be disincentivizing behavior our state wants to promote, and in fact incentivizes through subsidies and other tax credits. It might be best to continue exploring paying for this through a tariff on electric charging. These charges alone will likely not make up the change in this tax as we see the prevalence of EVs increase, as a large percent of the fuel tax is paid by people visiting from out of state.

B. Partner with other states to coordinate and strengthen our tax structures.

The Lake Champlain Chamber is a strong proponent of increased regional collaboration and regional solutions. As the largest chamber of commerce in the state, it is not lost on us that Vermont as a state would not make it into the top 30 in a list of U.S. cities by population and likely wouldn't come close to the top 100 by Gross Domestic Product. Such size limitations make it abundantly clear that we are at the whim of our neighbors and that we do not have the economies of scale to make meaningful change on larger economic, societal, or environmental issues unless we work in partnership with others.

About the Lake Champlain Chamber

These comments were prepared by the Lake Champlain Chamber's advocacy team, who on behalf of our membership would like to thank you for your work. We appreciate the Commission's work on behalf of the State of Vermont as well as the opportunity to offer comments on your draft report. Please feel welcome to reach out with any questions.

The Lake Champlain Chamber is a non-profit organization based in Northwest Vermont that is in the business of seeking and supporting economic opportunity for all Vermonters. We believe that a good job—in the private, public, or non-profit sector—is the best path to economic well-being and resiliency.

As a business membership organization, we serve our business community with benefits and solutions. We also foster connections between employers and employees, among big companies and small, between our member-employers and their representatives in Montpelier.

We focus in five main areas:

1. Advocating for economic opportunity
2. Celebrating business ownership and entrepreneurship
3. Promoting a robust, diversified visitor economy
4. Cultivating community leadership
5. Nurturing emerging talent

To learn more about the Lake Champlain Chamber, please visit our website at Lccvermont.org

If you have any further questions, please contact;

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