Vermont Legislative Joint Fiscal Office

One Baldwin Street • Montpelier, VT 05633-5701 • (802) 828-2295 • Fax: (802) 828-2483

FISCAL NOTE

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Prepared by: Graham Campbell

H.541: An act relating to changes that affect the revenue of the State

Bill Summary

This bill makes numerous changes to various state revenue sources. These include:

- Changing the definitions of "operator" and "rent" to include online travel agencies (OTAs) and their associated transaction fees or commissions.
- Reducing the percentage exclusion within the current capital gains exclusion from 40% to 30% and limiting the percentage exclusion to $450,000 in total capital gains exclusions. This would effectively limit the exclusion to capital gains of $1.5 million or less.
- Expanding the cap on the Downtown and Village Center Tax Credit program from $2.4 million to $2.6 million.
- Expanding the cap on the Affordable Housing Tax Credit and the First Time Homebuyer Tax Credit by $125,000 each.
- Increasing the estate tax exclusion over two years. Beginning January 1, 2020, the estate tax exclusion rises from $2.75 million to $4.25 million. On January 1, 2021, the exclusion rises to $5 million.
- Making significant changes to the Land Gains Tax such that it would apply to a small number of land transfers. Only land subdivided by the transferor within six years prior to the sale or exchange would be subject to the tax. This section also exempts land transferred in a downtown development district, a village center, or new town center development.
- Expands the tax base for the Property Transfer Tax and Clean Water Surcharge to include transfers of controlling interests in a property. This would include property transfers where a business or entity takes a majority ownership stake in a property without a title change.
- Updates the Fuel Tax to include any nonprofit agency and any governmental entity in Vermont.
- Extends the sunset for the health information technology tax to July 1, 2020.
- Extends the sunset for Home Health Provider Tax to July 1, 2021.

Fiscal Impact

This bill would generate an additional $7.65 million in total State revenues in FY20 (Table 1). This revenue impact is spread across different funds:

- $4.5 million in General Fund revenues.[1]
- $930,000 in Education Fund revenues.
- $2.22 million in special fund revenues

Table 1: H.541 Revenue Impacts				
		Revenue Impact (millions)		
Section	**Provision**	**FY2020**	**FY2021**	**FY2022**
	General Fund			
1	Capital Gains Exclusion Pct Exclusion down to 30%, $450k cap (Effective July 1, 2019)	$2.49	$4.97	$4.97
2	Expansion of First Time Homebuyer Credit	-$0.13	-$0.25	-$0.38
2	Expansion of Affordable Housing Credit	-$0.13	-$0.25	-$0.38
3	Downtown Tax Credit Expansion	-$0.20	-$0.20	-$0.20
4-5	Raise Estate Tax Exclusion to $5m by FY22 ($4.25m Effective Jan 1, 2020)	$0.00	-$4.48	-$7.61
6-7	Updating M&R Tax for Online Travel Agencies (OTAs)	$2.78	$3.10	$3.18
8-14	Controlling Interest changes to Property Transfer Tax	$0.47	$0.71	$0.82
15-16	Land Gains Tax only applies to subdivided land within 6 years (Effective Jan 1, 2020)	-$0.78	-$1.60	-$1.67
19	Extension of the Home Health Provider Tax	$0.00	$0.00	-$10.40*
	Subtotal General Fund	**$4.50**	**$2.00**	**-$11.67**
* Tax sunsets July 1,2021. Assumes no extension				
	Education Fund			
6-7	Updating M&R Tax for Online Travel Agencies (OTAs)	$0.93	$1.03	$1.06
	Subtotal Education Fund	**$0.93**	**$1.03**	**$1.06**
	Special Funds			
6-7	Updating M&R Tax for Online Travel Agencies (OTAs)- PILOT Fund	$0.19	$0.19	$0.20
8-14	Controlling Interest: Department of Taxes, Property Valuation and Review Fund	$0.03	$0.04	$0.05
8-14	Controlling Interest: Housing and Conservation Trust Fund	$0.71	$1.10	$1.20
8-14	Controlling Interest: Municipal and Regional Planning Fund	$0.24	$0.36	$0.42
8-14	Controlling Interest: Clean Water Fund	$0.20	$0.30	$0.40
17	Fuel Tax language updated to include non-profits and updates sunset	$0.85	$0.85	$0.85
18	Extends sunset for health information technology tax	$0.00	$-4.10[a]	$-4.10[a]
	Subtotal Special Funds	**$2.22**	**-$1.26**	**-$0.98**
[a] Tax sunsets July 1,2020. Assumes no extension				
	Total Revenue Impact	**$7.65**	**$1.77**	**-$11.59**

[1] H.97 (Budget Adjustment) also contains a change to the distribution of funds from the Department of Taxes Computer Modernization Fund to the General Fund from 80% to 40%. That change generates an additional $4.8 million for the General Fund. The House Budget bill furthers that change from 40% to 30% generating an additional $1.2 million.

Explanation/Methodologies

<u>Section 1: Reducing the percentage exclusion for the Capital Gains Exclusion from 40% to 30% and limiting the percentage exclusion to up to $450,000 in capital gains.</u>

Vermont currently allows income taxpayers to exclude a portion of their capital gains from their taxable income. Taxpayers can either exclude up to $5,000 of capital gains or 40% of their capital gains on realized gains on certain assets, mainly businesses, farms, or investment properties.

Section 1 of the bill reduces the 40% exclusion to 30%. It also limits the amount of capital gains a taxpayer can exclude to $450,000, effective July 1, 2019. **This section is expected to generate an additional $2.49 million in FY20**. **A full year of implementation increases the additional revenue to $4.97 million in FY21 and FY22.**

Sources: Chainbridge Tax Model based upon 2016 tax year data.

<u>Section 2: Expansion of the Affordable Housing and First Time Homebuyer Tax Credits</u>

Section 2 of the bill expands two existing credits administered by the Vermont Housing Finance Agency (VHFA): the Affordable Housing Tax Credit and the First Time Homebuyer Tax Credit.

The current first year credit allocation for the Affordable Housing Credit is $300,000 for a maximum limit of $1.5 million over any 5 year period. The bill proposes to raise the first year credit allocation to $425,000, for a maximum 5 year allocation of $2.125 million.

The current first year credit allocation for the First Time Homebuyer Tax Credit is $125,000. This section of the bill raises the first year credit allocation to $250,000 and extends the program through FY2026. Because the program was set to expire in FY22, all credits awarded thereafter would be new fiscal cost relative to current law.

Both of these tax credits are 5 year tax credits, meaning a claimant claims the credit for 5 consecutive years. As such, the total credits awarded in a given year are the current year's first year credit allocation, plus any credits from the previous five years. For any increase in the size of first year credit allocations, the cost increases each year by the size of that increase over the next five years.

The FY20 cost of increasing the first year credit allocations of the Affordable Housing Tax Credit and the First Time Homebuyer Tax Credits is $125,000 each, for a total of $250,000. However, in FY21, the cost is FY20's second year cost ($250,000) plus the first year costs in FY21 ($250,000) for a total cost of $500,000. This continues over the next five years. Table 2 details the complete cost of the expansions over the next 5 fiscal years.

Table 2: Fiscal Impacts of Tax Credit Expansions in Section 2 (GF)					
	FY20	FY21	FY22	FY23	FY24
Expansion of Affordable Housing Credit	-$125,000	-$250,000	-$375,000	-$500,000	-$625,000
Expansion of First Time Homebuyer Credit	-$125,000	-$250,000	-$375,000	-$625,000	-$875,000
Total	**-$250,000**	**-$500,000**	**-$750,000**	**-$1,125,000**	**-$1,500,000**

Sections 4 and 5: Raising the estate tax exclusion

Currently, the estate tax is 16% on the value of any estate over the exclusion amount of $2.75 million

The bill proposes to raise the estate tax exclusion over the course of two years. Beginning January 1, 2020, the estate tax exclusion rises from $2.75 million to $4.25 million. On January 1, 2021, the exclusion rises to $5 million.

Relative to current law, raising the exclusion is expected to have no fiscal impact FY2020. In FY2021, the cost increases to $4.48 million, increasing further to $7.61 million in FY2022 once the exclusion is fully phased-in.

Sources: Department of Taxes data, January 2019 Consensus Revenue Forecast.

Sections 6-7: Online Travel Agencies (OTAs)

Under current law, online travel agencies[2] (OTA) themselves are not required to remit the 9% rooms tax. In a typical transaction, when a customer reserves a room through an OTA, the OTA collects the 9% tax on the *listed* price of the room. The OTA then forwards an agreed-upon room rate to the operator (which is often 15-20% less than the listed room rate) plus the 9% rooms tax on only that agreed-upon rate. The operator remits the 9% tax on the agreed-upon rate to the Department of Taxes. The OTA keeps the 9% rooms tax on the difference between the listed rate and the agreed-upon rate.

The following example illustrates this process:

[2] These include most online travel websites, including Expedia, booking.com, Priceline, but also includes booking websites for short term rentals, including AirBnB, HomeAway, and VRBO.

Listed Price online for Hotel room	$100
OTA collects 9% rooms tax on listed price	$100 x 9% = $9
OTA sends Hotel 80% of listed rate	$80
OTA sends Hotel rooms tax on listed rate	**$80 x 9% = $7.20**
OTA keeps 20% service charge on listed rate	$20
OTA keeps rooms tax collected on listed rate	**$20 x 9% = $1.80**
Hotel remits rooms tax to Department of Taxes	$7.20
Rooms tax left unremitted by OTA	$1.80

This section requires OTAs ("booking agents") to remit the rooms tax on all amounts collected by the OTA. In the example above, the OTA would be required to collect and remit to the Department of Taxes both the $7.20 it was previously sending to the Hotel, but also the $1.80 in rooms tax it was previously keeping.

JFO estimates that requiring OTAs to collect and remit rooms tax on all amounts listed by the OTA will generate approximately $2.8 million in additional meals and rooms tax revenue in FY 2020 and growing in future fiscal years. 75% of this revenue will go to the General Fund and 25% will go to the Education Fund.

Table 3: Estimate of Additional Revenue on OTA Fees (in millions)			
Fiscal Year	**FY 2020**	**FY 2021**	**FY 2022**
Total Estimate	$2.7	$3.1	$3.2
Of which: General Fund	$2.0	$2.3	$2.4
Of which: Education Fund	$0.7	$0.8	$0.8

In addition to this revenue, the section also requires booking agents to remit the rooms tax on all amounts collected at the point of sale. Booking agents include websites that list short-term rental properties, in addition to websites that list traditional hotels and motels. Under current law, rooms tax is due on short-term (or any) rentals if the operator rents the room for greater than 15 days in a calendar year, and remittance of the tax is the responsibility of the operator, not the booking agent. The Department of Taxes and JFO have estimated that there is 40% noncompliance[3] amongst short-term rentals who use booking agents other than AirBnB[4]. This section would require booking agents to collect on behalf of those noncompliant operators.

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[3] Fiscal Note: S.204 of the 2018 Session.
https://ljfo.vermont.gov/assets/docs/fiscal_notes/76ee30e86b/2018_S_204_fiscal_note_-_short-term_rentals_house_ways_and_means.pdf

[4] In 2016, AirBnB signed an agreement with the Department of Taxes to collect rooms tax on behalf of operators on its platform.

JFO estimates that closing the noncompliance gap amongst short term rentals would generate an additional $1 million in rooms tax in FY 2020 and growing in future fiscal years. 75% of this revenue will go to the General Fund and 25% will go to the Education Fund.

Table 4: Estimate of Additional Revenue from Closing Short-Term Rental Tax Gap (in millions)			
Fiscal Year	**FY 2020**	**FY 2021**	**FY 2022**
Total Estimate	$1.0	$1.1	$1.2
Of which: General Fund	$0.77	$0.83	$0.87
Of which: Education Fund	$0.23	$0.28	$0.29

In total, JFO estimates that in total, this section of the bill will raise rooms tax revenues by $3.8 million in FY2020, growing to $4.2 million in FY21 and $4.4 million in FY2022. 75% of this revenue will go to the General Fund and 25% will go to the Education Fund.

Table 5: Estimate of Total New Rooms Tax Revenue (in millions)			
Fiscal Year	**FY 2020**	**FY 2021**	**FY 2022**
Total Estimate	$3.7	$4.2	$4.4
Of which: General Fund	$2.8	$3.1	$3.3
Of which: Education Fund	$0.9	$1.1	$1.1

Sources:

These estimates relied upon the following sources:

- Pennsylvania estimates on HB1511 of 2018
- 2017 Tourism Benchmark Report, Vermont Department of Tourism and Marketing[5].
- Lodging Magazine
- Department of Taxes data
- January 2019 Consensus Revenue Forecast

<u>Sections 8 to 14: Controlling Interest Changes to the Property Transfer Tax</u>

Under current law, the property transfer tax is due on the transfer of deed in a property. This section of the bill would extend that liability to transfers of controlling interest in a property.

The estimate for this section of the bill represents baseline revenues for typical year-to-year controlling interest transfers. However, this revenue could be very volatile due to large one-time

[5] "2017 Benchmark Report: Tourism in Vermont." Vermont Department of Tourism and Marketing. December 2018. https://accd.vermont.gov/sites/accdnew/files/documents/VDTM/BenchmarkStudy/VDTM-Research-2017BenchmarkStudyFullReport.pdf

controlling interest transfers in any given year. The additional revenue generated by these sections could be significantly higher in any single year due to these large one-time events.

The Joint Fiscal Office estimates that this section will generate an additional $1.6 million in baseline property transfer tax revenue in FY20 and growing in future years. The property transfer tax contains two components[6]:

- Property transfer tax revenues themselves which are allocated in the following fashion:
  - The first 2% are these revenues are retained for the Department of Taxes for administration costs
  - The remaining 98% are dedicated as follows:
    - 33% to the General Fund
    - 50% to the Housing and Conservation Trust Fund
    - 17% to the Municipal and Regional Planning Fund
- The Clean Water Surcharge (0.2%), the revenues of which are dedicated to the Clean Water Fund

Table 6: Revenue Estimates from Sections 8-14 (in millions)			
Fiscal Year	**FY2020**	**FY2021**	**FY2022**
Total Revenue	**$1.68**	**$2.56**	**$2.90**
Of which: Department of Taxes Property Valuation and Review Fund	$0.03	$0.04	$0.05
Of which: Housing and Conservation Fund	$0.71	$1.1	$1.2
Of which: General Fund	$0.47	$0.71	$0.82
Of which: Municipal and Regional Planning Fund	$0.24	$0.36	$0.42
Of which: Clean Water Fund	**$0.23**	**$0.35**	**$0.41**

This estimate is based upon data from other states that have similar controlling interest provisions within their property transfer taxes. Based upon these other state experiences, revenues from controlling interest transfers tend to increase year over year for the first two to three years as practitioners become more adept at applying the law to controlling interest transfers. This explains the ramp up in revenues in succeeding fiscal years.

Administrative costs for the section of the bill are expected to be minimal for the Department of Taxes. However, it is possible additional resources may be needed in the future should the Department discover future needs to ensure compliance.

Sources:
This estimate relied upon data from the Connecticut and Maine Departments of Revenue, the Department of Taxes 2018 Property Valuation and Review Annual Report[7] and the January 2018 Consensus Revenue Forecast.

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[6] In previous fiscal years, the Legislative budget and the Administration's proposed budgets have allocated a certain amount of property transfer tax revenue to these funds. The remaining property transfer tax revenues are then distributed to the General Fund, notwithstanding the statute on the allocation of the various funds.

This estimate assumes that the vast majority of controlling interest sales will pay the 1.25% property transfer tax rate. Transfers that pay this tax are non-principal residences and principal residences on the marginal value above $100,000

Sections 15-16: Land Gains Tax

These sections of the bill redefine the definitions of land transfers subject to the tax. Should this bill become law, only land subdivided by the transferor within six years prior to the sale or exchange would be subject to the tax. This section also exempts land transferred in a downtown development district, a village center, or new town center development.

Together, these changes would greatly reduce the current tax base for the land gains tax. In 2017, of all returns that submitted a land gains tax, less than 15% had been subdivided and those properties paid land gains tax totaling around $400,000. The further exemption of land within a downtown or village center district would further narrow the subset of properties subject to the tax.

As such, JFO estimates that this section of the bill will reduce General Fund revenues by $1.55 million in FY20. As the current land gains tax generates between $1.6 and $1.75 million per year, these changes will reduce revenues from the tax by 88%. The number of returns that would be required to complete a land gains return is expected to drop significantly.

Sources: Department of Taxes

Section 17: Fuel Tax

This section clarifies that all Vermont entities purchasing heating or dyed diesel fuels, kerosene, propane, electricity, natural gas or coal shall pay the Fuel Tax without any exemptions. Current statute states that any residence or business shall pay the Fuel Tax, which in effect exempts nonprofit agencies, municipal, state, and Federal governments.

The inclusion of these agencies' fuel purchases is expected to generate $850,000 in FY20. All these additional revenues will be dedicated to the Weatherization Fund[8].

Sources: Vermont Fuel Dealers Association, Seven Days Nonprofit Navigator[9], Federal Reserve Bank of St. Louis, The Urban Institute[10]

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[7] "Annual Report: Based on 2018 Grand List Data." Division of Property Valuation and Review. Vermont Department of Taxes. https://tax.vermont.gov/sites/tax/files/documents/PVR-Annual%20Report-2018%20Grand-List-Data.pdf

[8] This estimate does not include any Fuel Tax rate increases that occur in H.439

[9] https://nonprofits.sevendaysvt.com/

[10] "The Nonprofit Sector in Brief 2015." Brice McKeever. The Urban Institute. October 2015. https://www.urban.org/sites/default/files/publication/72536/2000497-The-Nonprofit-Sector-in-Brief-2015-Public-Charities-Giving-and-Volunteering.pdf

Section 18: Health Information Technology tax

There currently exists a 0.999% tax on the value of all private health insurance claims, of which 0.199% of this is deposited into the Health Information Technology (HIT) Fund. The current 0.999% is scheduled to decrease to 0.8% on July 1, 2019, eliminating the 0.199% that is deposited into the HIT fund. This section extends the current rate. **This extension is revenue neutral for FY20.**

Should the Legislature choose not to extend this sunset beyond July 1, 2020, the fiscal impact on the HIT Fund would be -$4.1 million in FY21 and FY22.

Section 19: Home Health Provider Tax

There currently exists a tax on net patient revenues from core home health and hospice services equal to 4.25%. This tax was set to sunset July 1, 2019. This section would extend the sunset until July 1, 2021. **This extension is revenue neutral for FY2021.**

Should the Legislature choose not to extend this sunset beyond July 1, 2021, the fiscal impact on the General Fund would be -$10.4 million in FY22. -$4.8 million of this impact would be losses from current revenue from the tax and an additional -$5.6 million would be as a result of a loss of federal matching dollars.