

Principles of a High-Quality Tax System

Joyce Manchester
Joint Fiscal Office
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Six key principles or “pillars”

- Based on “**NCSL Tax Policy Handbook for State Legislators**, 3rd Edition, 2010
- <http://www.ncsl.org/documents/fiscal/TaxPolicyHandbook3rdEdition.pdf>
- Also informed by the **Blue Ribbon Tax Commission Final Report**, 2011
- <https://ljfo.vermont.gov/assets/Subjects/Final-Report/f9d97528dc/2011-Blue-Ribbon-Tax-Structure-Commission-FINAL-REPORT.pdf>
- Also see **The Vermont Tax Study, 2005-2015**
- <https://ljfo.vermont.gov/assets/docs/reports/6ca6f1666c/2017-10-Year-Tax-Study-Full-Report-Compressed.pdf>

Vermont Tax Structure Commission

Act 11 Sec. H.17

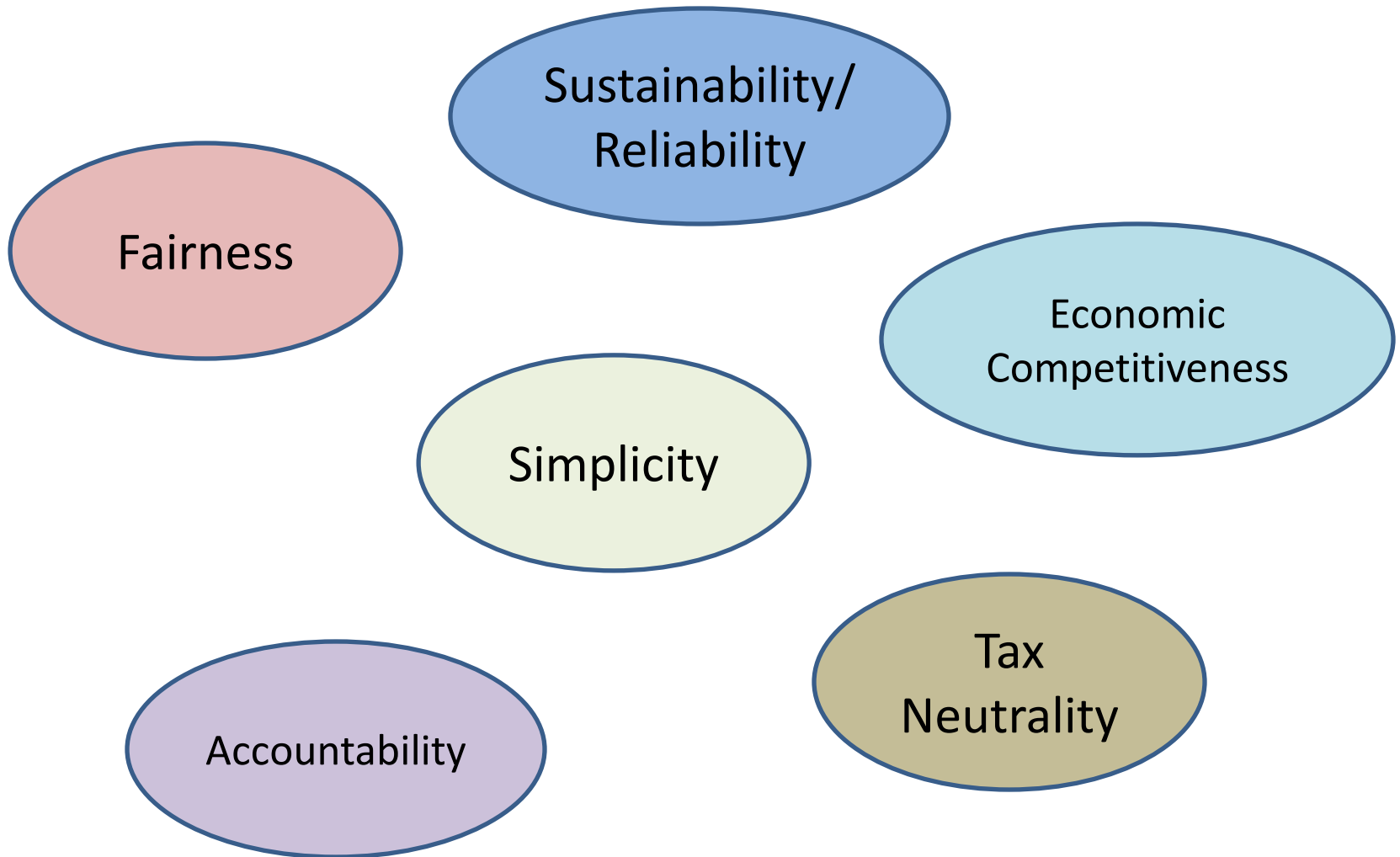
(c) The Commission shall prepare a structural analysis of the State's revenue system and offer recommendations for improvements and modernization and provide a long-term vision for the tax structure.

- The Commission's analysis shall include a review of Vermont's income taxes, consumption-based taxes, the education financing system, tax expenditures, and property and asset-based taxes. The Commission shall have as its goal a tax system that provides **sustainability, appropriateness, and equity**. *For guidance, the Commission may use the Principles of a High-Quality State Revenue System as prepared by the National Conference of State Legislatures. . . .*

(e) The Commission shall begin its work by:

- (1) updating and incorporating the relevant work of the Blue Ribbon Tax Structure Commission created by 2009 Spec. Sess. Acts and Resolves No. 1;
- (2) updating and incorporating work from the existing studies of **Vermont's education finance system** since the enactment of 1998 Acts and Resolves No. 60 and 2004 Acts and Resolves No. 68;

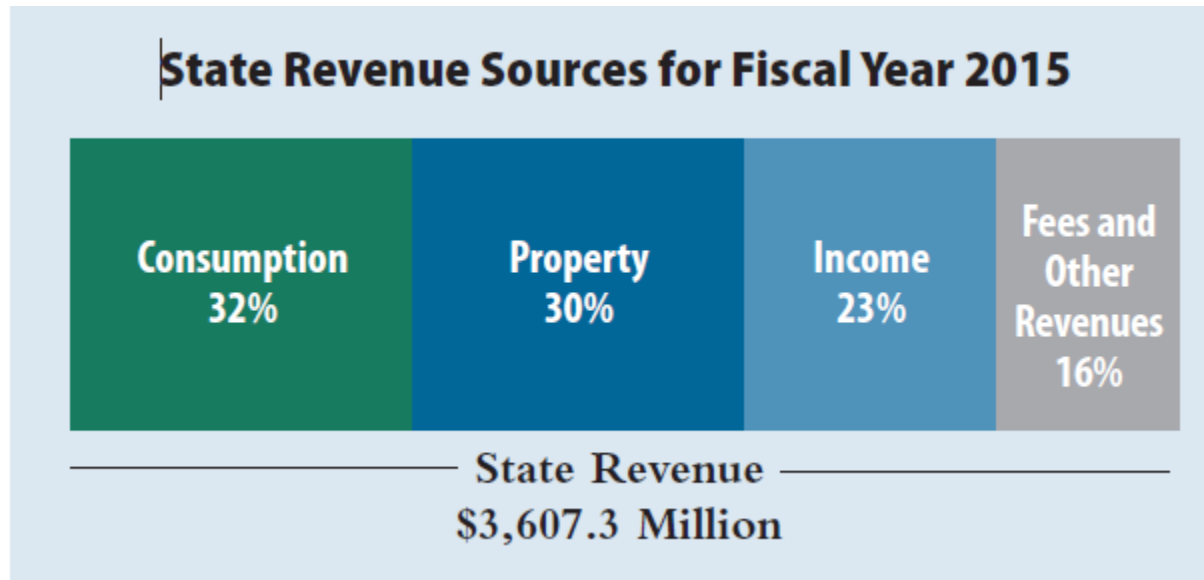
What are the six key pillars?



Sustainability and Reliability

- Revenues are
 - Relatively constant over time
 - Corporate and personal income taxes tend to be the most volatile
 - Sales taxes tend to be more stable
 - Not subject to unpredictable fluctuations
- This goal often leads to a balanced mix of taxes
- The number and type of tax changes are kept at a minimum to allow individuals and businesses to plan for the future
- Revenue sources provide the revenue growth necessary to finance the desired rate of spending growth

Vermont's Balance among Tax Types

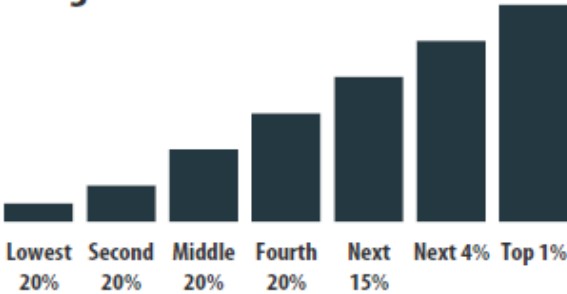


Fairness

- Do taxpayers in similar economic circumstances pay similar shares of income as taxes?
 - Horizontal equity
 - 2 single filers with income of \$60,000; but one has a mortgage...
- Do taxpayers with higher income pay larger shares of income as taxes?
 - Vertical equity, or progressivity
 - Effective VT income tax rate on income of \$50,000 is about 2.3%; on income of \$150,000 it's about 4.0%
 - Does the system minimize both regressivity and the share of taxes paid by low-income households?
 - Regressive taxes fall more heavily on low-income taxpayers

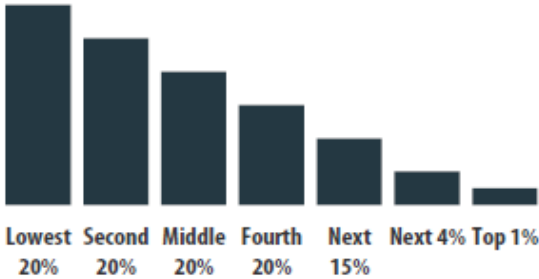
What does tax fairness/progressivity mean?

A Progressive Tax



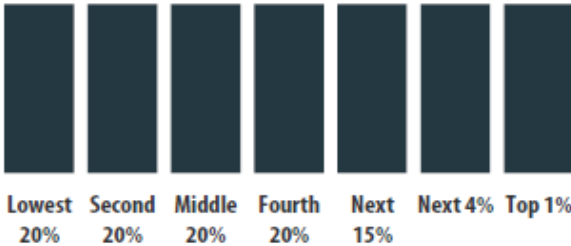
A **progressive tax** is one in which upper-income families pay a larger share of their incomes in tax than do those with lower incomes.

A Regressive Tax



A **regressive tax** requires the poor and middle-income to pay a larger share of their incomes in taxes than the rich.

A Proportional Tax



A **proportional tax** takes the same percentage of income from everyone, regardless of how much or how little they earn.

New ITEP report: *Who Pays?* 6th Edition

- ITEP Tax Inequality Index Ranking
 - Vermont's state and local tax system does not worsen income inequality and ranks 49th on ITEP's Tax Inequality Index. [Tax law as of Sept 2018 at 2015 income levels.]

					Top 20%		
Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$21,200	\$21,200 to \$39,100	\$39,100 to \$59,500	\$59,500 to \$94,000	\$94,000 to \$196,000	\$196,000 to \$460,100	over \$460,100
Average Income	\$11,500	\$29,200	\$49,200	\$74,800	\$131,100	\$279,700	\$993,600
TOTAL TAXES	8.7%	9.0%	10.1%	9.1%	10.4%	10.0%	10.4%

2016 Vermont Effective Personal Income Tax Rates, or Net Vermont Tax Divided by Federal Adjusted Gross Income (AGI)- Residents Only

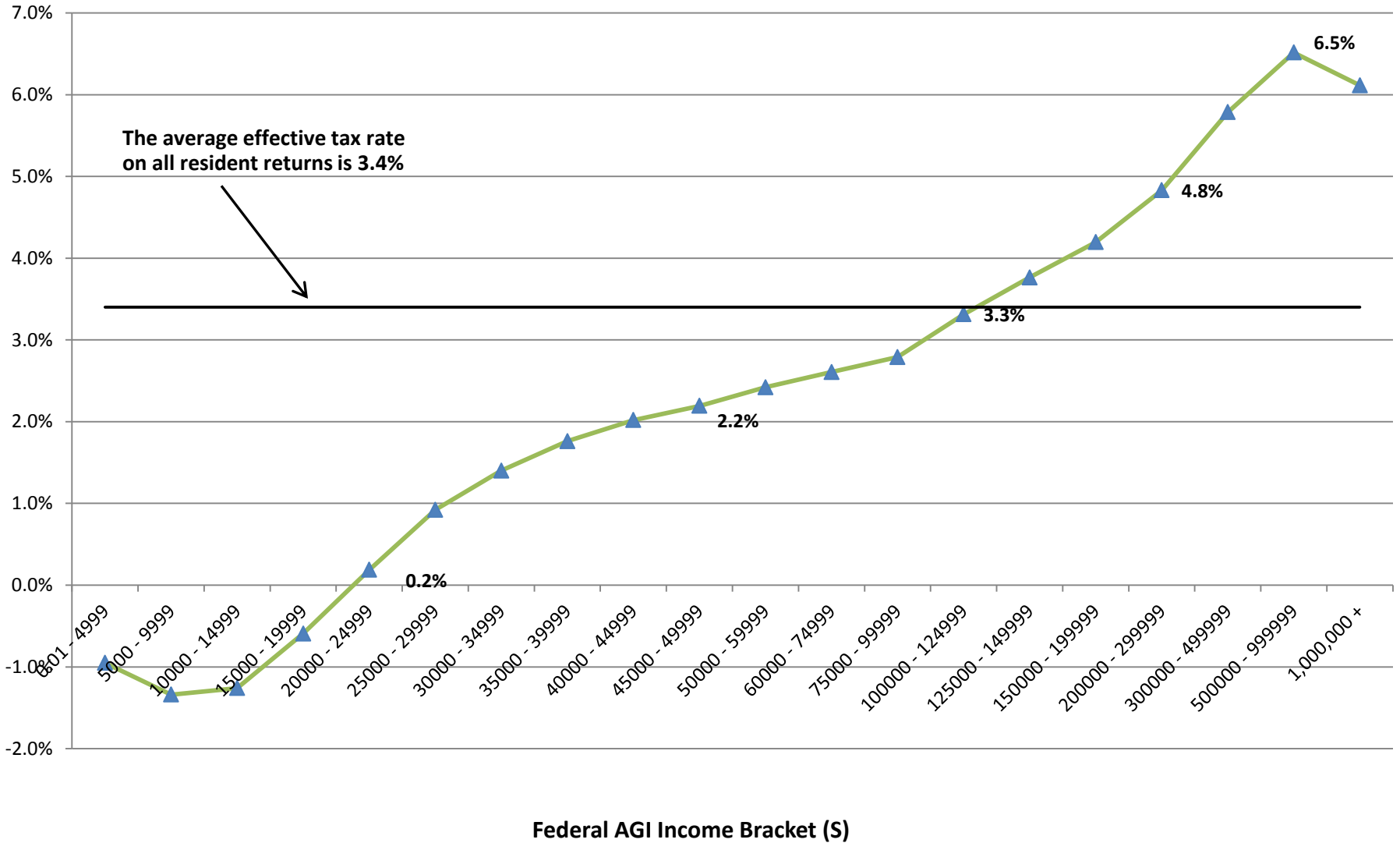
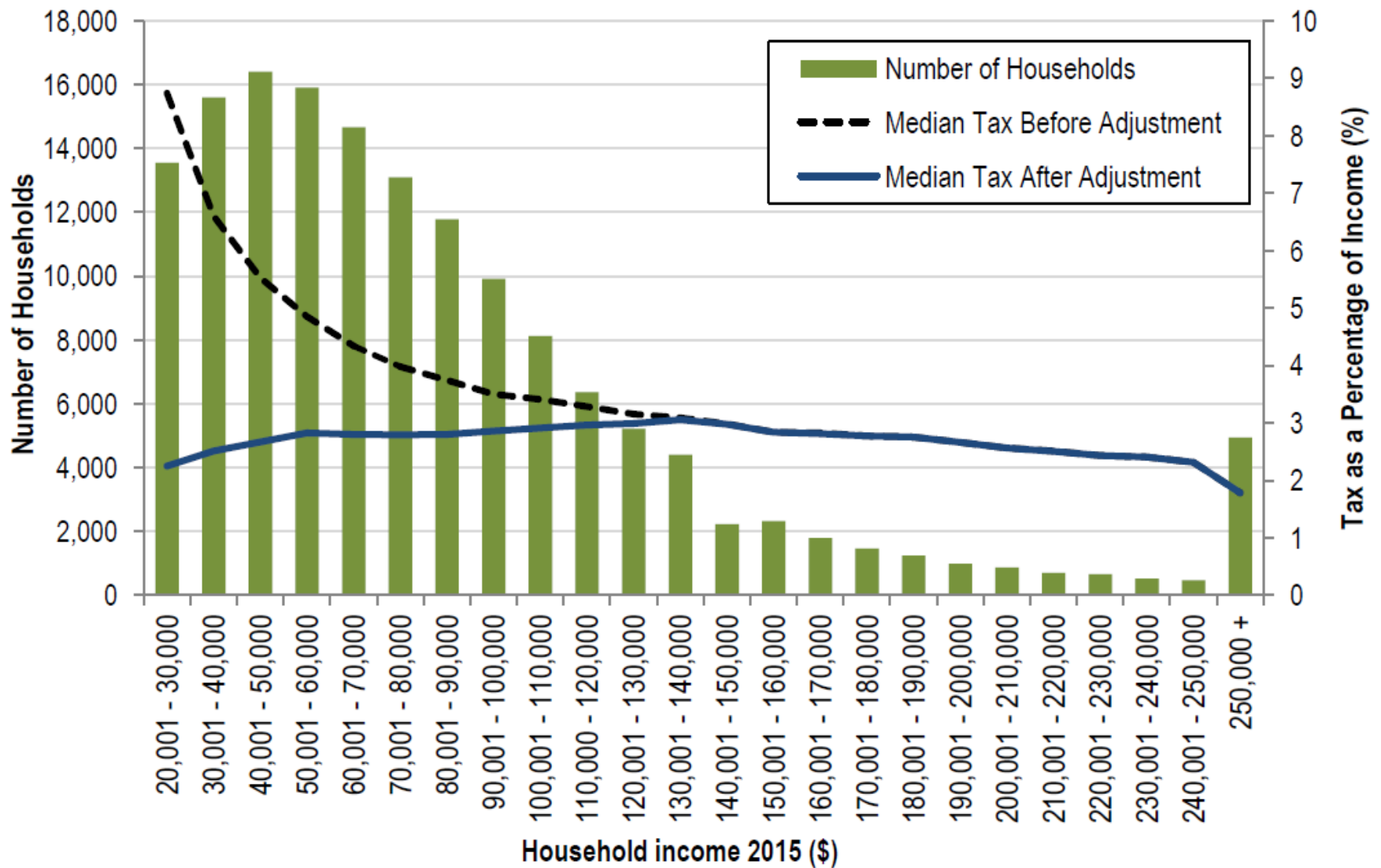


Figure 39. Education Tax as a Percentage of Household Income, CY 2015



Simplicity

- A high-quality revenue system:
 - Is easy to understand and minimizes compliance costs, such as time and effort necessary to comply with the law
 - Is as simple as possible to administer, raises revenue efficiently, and is administered professionally
- A high-quality tax system requires informed taxpayers who understand how tax assessment, collection, and compliance work
 - There should be open hearings, and revenue estimates should be fully explained and replicable.

Starting point for Vermont individual income taxes is now federal AGI as of Act 73, passed in 2017; Act 11 passed in June 2018 made additional changes effective in 2018

Federal AGI



Interest income and dividends from non-VT state & local obligations

- Income from U.S. government obligations
- A portion of capital gains
- Vermont-defined personal exemptions (\$4,150 each)
- Vermont-defined standard deduction based on filing status
- All Vermonters can claim a 5% non-refundable credit for charitable contributions; maximum amount of contributions eligible is \$20,000
- Income-eligible Social Security beneficiaries can claim an exemption for the taxable portion of their Social Security benefits



Vermont taxable income

Economic Competitiveness

- A high-quality revenue system is responsive to interstate and international economic competition
 - And also to high-tech changes such as internet sales and driverless cars
- It provides a level playing field devoid of unnecessarily high rates and compliance burdens
- It discourages tax liability-shopping and interstate migration

Individual Income Tax Rates by Vermont Taxable Income Bracket

Preliminary Vermont Tax Rates and Tax Brackets–2018 Tax Year		
Married Filing Jointly	Single	Tax rate (%)
0 - \$64,600	0 - \$38,700	3.35
\$64,601 - \$156,150	\$38,701 - \$93,700	6.40
\$156,151 - \$237,950	\$93,701 - \$195,450	7.60
\$237,951 and over	\$195,451 and over	8.75

How Does Vermont's Top Individual Tax Rate Compare to That in Other States?

Top Tax Rate Comparison, MFJ -- NE States, Tax Year 2018		
State	Top Rate (%)	On Taxable Income (\$) Above:
Connecticut	6.99	1,000,000
Maine	7.15	100,000
Massachusetts	5.1	0
New York	8.82	2,155,350
Rhode Island	5.99	139,400
Vermont	8.75	237,950

Note: New Hampshire does not tax an individual's earned income (W-2 wages). The state does tax, at a **5%** rate, income from dividends and interest.

Effective rate comparison by AGI level, State Income Tax Liability as a percentage of AGI; 2013 and 2014

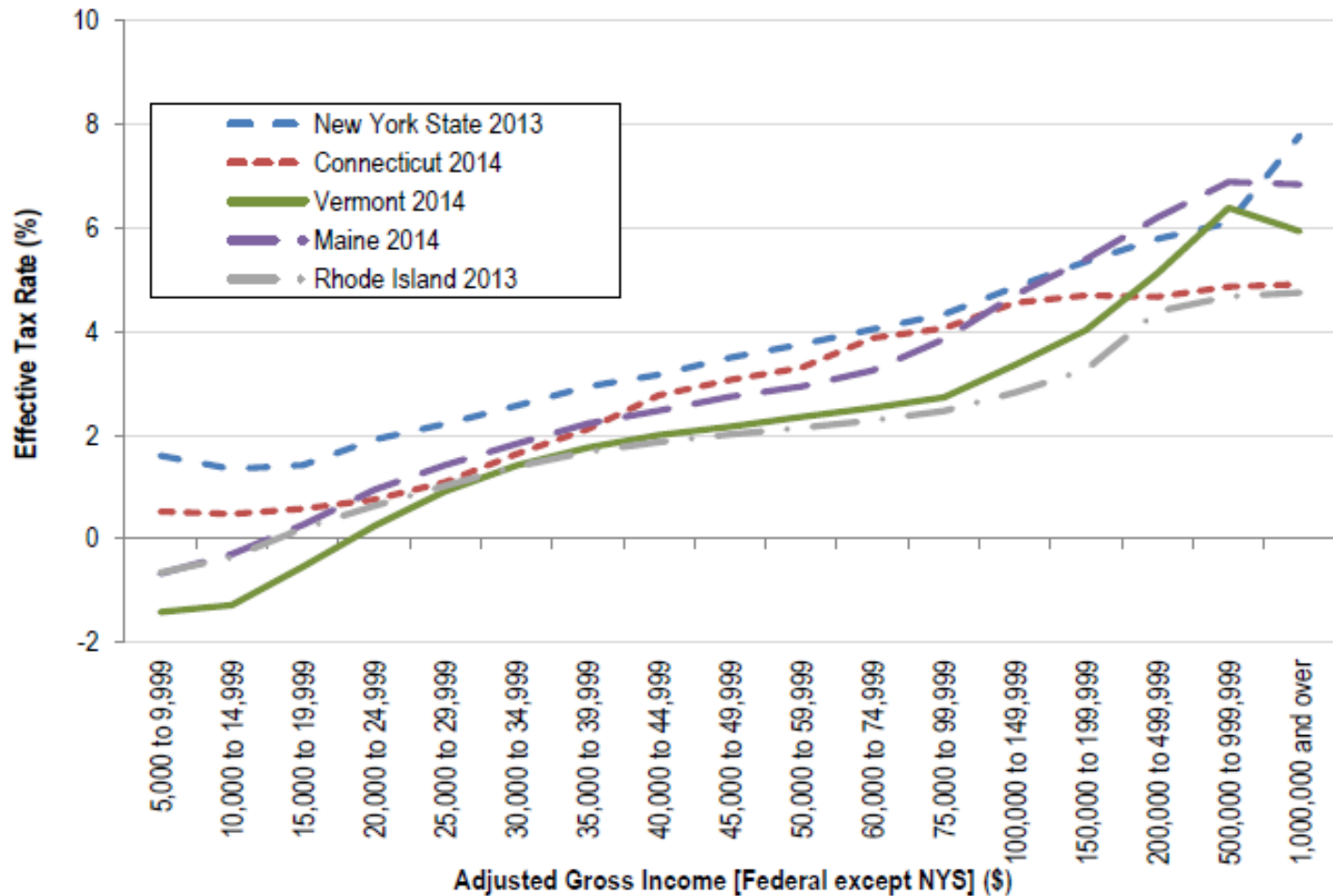
Effective tax rate at AGI of \$200,000 - \$500,000

RI	4.4%
MA	4.5%
CT	4.7%
VT	5.1%
NY	5.8%
ME	6.2%

Source: The Vermont Tax Study, 2005-2015;

2013 data for NY, RI; 2014 data for CT, VT, ME; 2016 data for MA

Figure 20. Effective Rate Comparison by AGI Level for the New England States and New York, Tax Liability as a Percentage of Federal AGI, 2013 and 2014



Note: The Effective Income Tax Rate is calculated using Federal AGI, except in New York, which uses state AGI in its calculation. New Hampshire does not tax income, and data was unavailable for Massachusetts.

Comparison of State Sales Tax Rates

	State Sales Tax Rate	Meals
Connecticut	6.35%	6.35%
Maine	5.5%	7.0%
Massachusetts	6.25%	6.25%
New Hampshire	None	9.0%
New York	4.0%	4.0%
Rhode Island	7.0%	7.0%
Vermont	6.0%	9.0% (10% alcohol)

All the New England states exempt grocery food, but CT, ME, NY, and RI tax nonessential food such as candy and soda. Vermont began taxing soft drinks in July of 2015. Vermont exempts all clothing and footwear.

Tax Neutrality

- Tax policy can influence economic behavior
 - Encourage or discourage consumption of goods and services
 - Influence decisions to save and invest
 - Affect fundamental business decisions about the use of labor and capital
- A quality tax system tries to minimize the effect of the tax system on the allocation of resources

Tax Neutrality, continued

- When lawmakers decide to use the tax system to make budget decisions or influence behavior, those decisions should be explicit and subject to frequent evaluation and review
- How can lawmakers reduce the effect of taxation on economic decisions?
 - Use broad bases and low rates
 - Spread taxes across a wide range of sources and economic activities

Accountability

- Taxes should be explicit, not hidden
- A high-quality tax system aims to minimize credits and exemptions in the tax code
 - Review credits and exemptions frequently to determine their cost in lost revenue and to determine whether they unfairly benefit some taxpayers at the expense of others
 - Tax-exempt nonprofits for charitable, religious, educational, scientific, literary purposes; social welfare organizations, etc.
- A high-quality tax system uses taxes that are paid directly and openly by taxpayers
 - Taxes that are designed to flow through to consumers provide less accountability
 - Provider taxes, sales taxes at the wholesale level

Is it possible to design a perfect tax system?

- Policy makers must weigh what is most important to them
- Trade-offs frequently occur
 - Consider fairness vs. simplicity
 - E.g., property taxes in Vermont
 - Consider tax neutrality vs. discouraging negative behavior
 - E.g., cigarette taxes, soda taxes

Recommendations of the Blue Ribbon Tax Commission

- Restructure the personal income tax
 - E.g., implement a lower, flatter rate and bracket structure
- Broaden the sales tax base
 - E.g., include all consumer-purchased services except certain health and education services and business-to-business service transactions
- Enhance scrutiny of tax expenditures
 - E.g., sunset all tax expenditures that remain in the tax code in a multi-year cycle and require a sunset for new tax expenditures
- Invest in tax policy resources
 - Develop a tax incidence study
- Note: Tax Structure Commission now underway
 - Final report due Jan. 15, 2021