VERMONT LEGISLATIVE
Joint Fiscal Office

2023 Vermont Tax Expenditure Reviews

As part of the: 2023 Vermont Tax Expenditures Biennial Report

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Prepared by
The Vermont Department of Taxes
and the Legislative Joint Fiscal Office
in accordance with
32 V.S.A § 312

VERMONT

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2023 Vermont Tax Expenditure Reviews

Introduction

The 2023 Vermont Tax Expenditure Report is part of a continuing effort to catalogue all exemptions, exclusions, deductions, credits, preferential rates, or deferral of liability as defined in 32 V.S.A. §312(a) applicable to the State's major tax sources and provide an estimate of the fiscal effect for each. Tax expenditure reporting is now in its eighteenth year in Vermont and is improved to reflect more recent research and recommended best practices.[1]

As part of the 2023 Tax Expenditure Report, the Joint Fiscal Office, with assistance from the Vermont Department of Taxes, has completed reviews of certain tax expenditures as required by Sec. 40 of Act 134 (2016). These reviews are classified as "expedited" or "full".

An expedited review analyzes the purpose of a tax expenditure, delineates its costs and benefits, and considers whether it meets its policy goal.

A full review includes the elements of an expedited review but also includes a quantitative analysis of the economic impact of the tax expenditure, consideration of the direct and indirect economic and social benefits of the tax expenditure, and a comparison of the effectiveness of the tax expenditure with alternate policies.

Act 134 (2016) tasked the Joint Fiscal Office with developing recommendations for the standards and processes to conduct full reviews of tax expenditures.[2] One of the recommendations of the report was for the Joint Fiscal Office to conduct ad-hoc full reviews of one to three tax expenditures per biennium. This report includes a full review of the Earned Income Tax Credit.

The same act also established a schedule for the expedited and full reviews. For the 2023 Tax Expenditure Report, tax expenditures related to promoting income security, encouraging work, exemptions for the necessities of life, implementing State tax policy and other priorities were reviewed. The 2025 report will include reviews of tax expenditures related to economic growth, investment, and incentivizing desirable activity.

The Joint Fiscal Office completed these reviews with data assistance and legal analysis as needed from the Department of Taxes.

[1] NCSL Tax Expenditure Budgets and Reports: Best Practices http://www.ncsl.org/documents/task_forces/Tax_Expenditure_Report.pdf

[2] "2016 Act No. 134 Sec. 40. Evaluation of Tax Expenditures." Prepared by the Joint Fiscal Office. 14 January 2017. https://ljfo.vermont.gov/assets/docs/reports/d58aecb7c7/2017-Evaluation-of-Tax-Expenditures.pdf

Tax Expenditure Full Reviews

Earned Income Tax Credit Full Review

Executive Summary

The Earned Income Tax Credit (EITC), as established in 32 V.S.A. § 5828(b), provides refundable tax credits to low- and moderate-income workers and families. The credit works by reducing personal income tax liability for filers based on income level, marital status, and number of dependent children.

The statute in 32 V.S.A. § 5828(b) reads,

A resident individual or part-year resident individual who is entitled to an earned income tax credit granted under the laws of the United States shall be entitled to a credit against the tax imposed for each year by section 5822 of this title. The credit shall be 38 percent of the earned income tax credit granted to the individual under the laws of the United States, multiplied by the percentage that the individual's earned income that is earned or received during the period of the individual's residency in this State bears to the individual's total earned income.

In Vermont, filers who receive the EITC at the federal level are entitled to 38% of that amount to offset their Vermont state tax liability.

In any given year, approximately 36,000 to 45,000 filers claim the EITC in Vermont. In 2021, the EITC resulted in $28.6 million in foregone State tax revenue, making it the largest tax credit offered in Vermont and the largest Personal Income tax expenditure aside from the Personal Exemption and Standard Deduction. The credit is fully refundable, which means if the value of the credit is greater than the amount of taxes owed, claimants are entitled to a payment for the difference between taxes owed and the credit.

JFO conducted a full review of the EITC as part of the 2023 Tax Expenditure Report and made the following major findings:

1) **The Vermont EITC offsets most conventionally regressive taxes for most types of eligible taxpayers.**

- Based on analysis of household spending on consumer staples and the taxes on those products, JFO estimates that the EITC offsets taxes paid for 63.7% of EITC claimants on average. This varies by filing status and income, with most married and head of household filers having their taxes completely offset by the EITC.
- The only groups of EITC claimants that did not have their regressive taxes fully offset were single childless claimants with income of $15,000 or less and Head of Household (HoH)[3] claimants with income of $40,000 or more. However, these filing statuses and income groups still saw their regressive taxes offset by 69.7% and 77.5% on average respectively.

2) **The Vermont EITC likely creates unequal incentives for low- and moderate-income working families and individuals depending on their filing statuses.**

- The Federal design of the EITC, and by extension, the Vermont EITC, could be disincentivizing work for single, childless individuals because of small maximum credits, steep phase-ins, and phase-outs of the credit. For example, for every dollar a single childless taxpayer earns in the phase-in range, their credit grows by 7.65% while a HoH filer's grows by 34%.

[3] From the Vermont Department of Taxes Website, Head of Household Filing Status "for the purposes of income tax, a filing status used by an unmarried taxpayer who pays over half the cost of maintaining a home of a qualified individual"; https://tax.vermont.gov/individuals/personal-income-tax/filing-status

- Some academic literature has shown that the EITC encourages work for certain taxpayers, such as single filers with children, but not others.

3) HoH filers who claim the EITC make up a disproportionate share of overall claims and are more likely to claim it on a persistent basis.

- 54.4% of total HoH filers claim the EITC compared to 6.2% of married filers and 7.0% of single filers.
- HoH filers also account for 40.7% of total EITC claimants despite representing only 7.9% of tax returns in the state. HoH EITC claims account for almost 60% of total aggregate claims in Vermont in a typical year.
- Of the HoH filers who claimed the EITC in 2019, 82.4% of them claimed it at least one other time during the 2010-2018 period. 37.7% claimed it at least five times or more, and 15.7% claimed it every year going back to 2010.

4) The temporary expansion of eligibility and credit sizes for tax year 2021 in the American Rescue Plan Act (ARPA) resulted in a significantly different composition of Vermont's EITC filers and total credits claimed, most notably for childless individuals.

- From 2010 to 2020 the total number of EITC claimants decreased from roughly 45,000 to 37,000 claimants, likely because of an improving economy after the Great Recession. This was coupled with the total value of the EITC received by claimants decreasing in nominal dollars from roughly $25.7 million in 2010 to $25.2 million in 2020. In 2021, the number of EITC claimants jumped to 48,781 and the total cost was $28.6 million.
- Tax year 2021 saw a dramatic influx of first-time claimants. There were 16,897 first-time claimants in 2021 compared to 6,598 in 2020. Single childless filers made up the overwhelming majority of first-time claimants in 2021. 12,981 single childless filers claimed the EITC for the first time in 2021 compared to 4,022 in 2020.
- The large influx of single first-time claimants and the increase in total claimants in general was due to changes on the federal level that made credit amounts and eligibility requirements more generous and removed age restrictions for single filers. This change was temporary and will not apply to subsequent tax years, so the total number of EITC claimants and particularly the number of single childless claimants will likely decrease sharply in the future.

JFO highlighted three areas for legislators to consider, should they decide to alter the program.

- Legislators should consider clarifying the statutory intent of the Vermont EITC.
  - Because of the current unequal incentives created by parameters set by the federal credit, legislators could consider clarifying the statutory intent to emphasize the importance of a more equitable work incentive structure.
- Because the EITC is a flat 38% of the Federal EITC, legislators should consider whether the State has the desired level of control over eligibility and credit amounts.
  - Legislators could consider better ways to target or change the eligibility of the Vermont EITC. Some states have achieved this by decoupling from federal eligibility and definitions, creating standalone EITCs based on desired personal income levels. Other states have kept their federal linkups but simply increased or decreased the percentage levels for certain groups.

  - Decoupling in some way from the federal EITC would make Vermont's EITC less prone to unpredictable federal legislation. However, it would come with a greater administrative burden.
- Legislators could consider adjusting the Vermont EITC to provide more equity across filing statuses.
  - As a result of federal eligibility and parameters, the credit rewards filers who are married and those with children. Legislators should consider whether single childless filers should be entitled to more support to align their incentives with other filing statuses.
  - In particular, for low- and moderate-income single childless filers, the credit may not be achieving the statutory purpose. This group is less likely to have traditionally regressive taxes offset, especially at the lower end of the income spectrum. Furthermore, relative to other filing statuses, the incentive to work for single childless filers is much weaker due to slower phase-ins, steeper phase-outs, and smaller credits. Slower phase-ins have the effect of providing a smaller credit amount for every additional dollar of earned income. Steeper phase-outs mean that single claimants credit reduces faster than for other filing statuses.

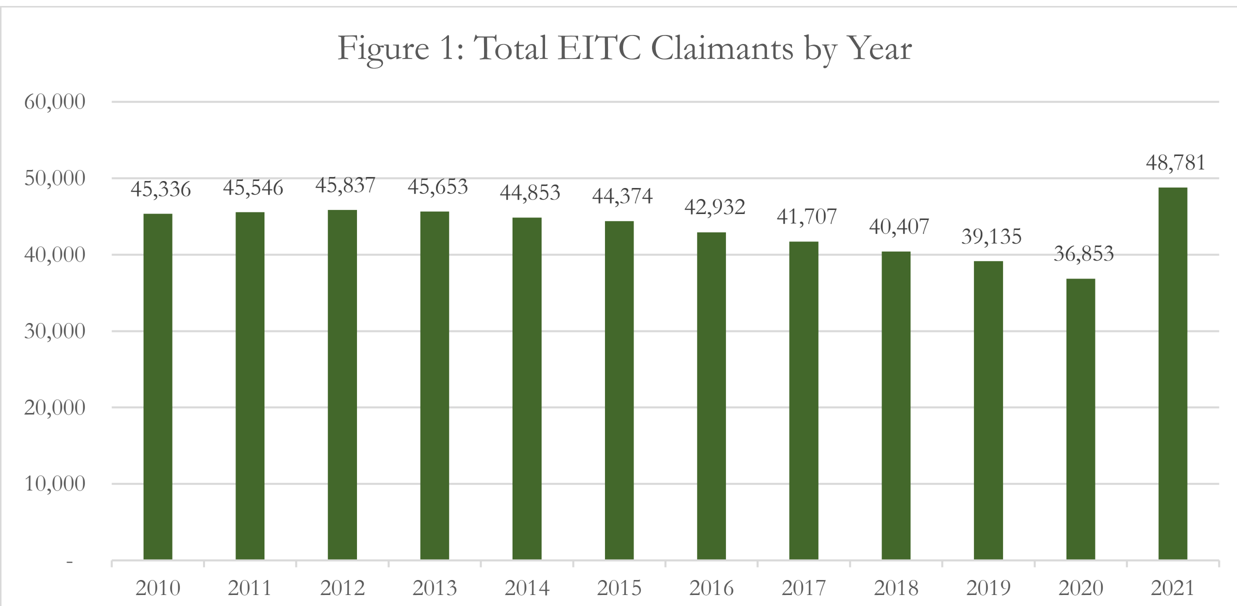
Overview

The Vermont Earned Income Tax Credit, per 32 V.S.A. § 5828(b), is a refundable tax credit to low- and moderate-income workers and families. The credit, as partly laid out in the statutory purpose, is intended to bolster the economic security of working families.

Filers can claim the credit if their personal income is sufficiently low based on federally defined income brackets, and the credit is adjusted based on the number of dependent children they claim and the marital status of the filer. Because the credit is refundable, if the value of the credit is greater than the amount of taxes owed, claimants are entitled to a payment for the difference between taxes owed and the credit.

In Vermont, as of tax year 2022, filers who receive the EITC at the federal level are entitled to 38% of that amount to offset their Vermont state tax liability. As at the federal level, the credit is refundable in Vermont.

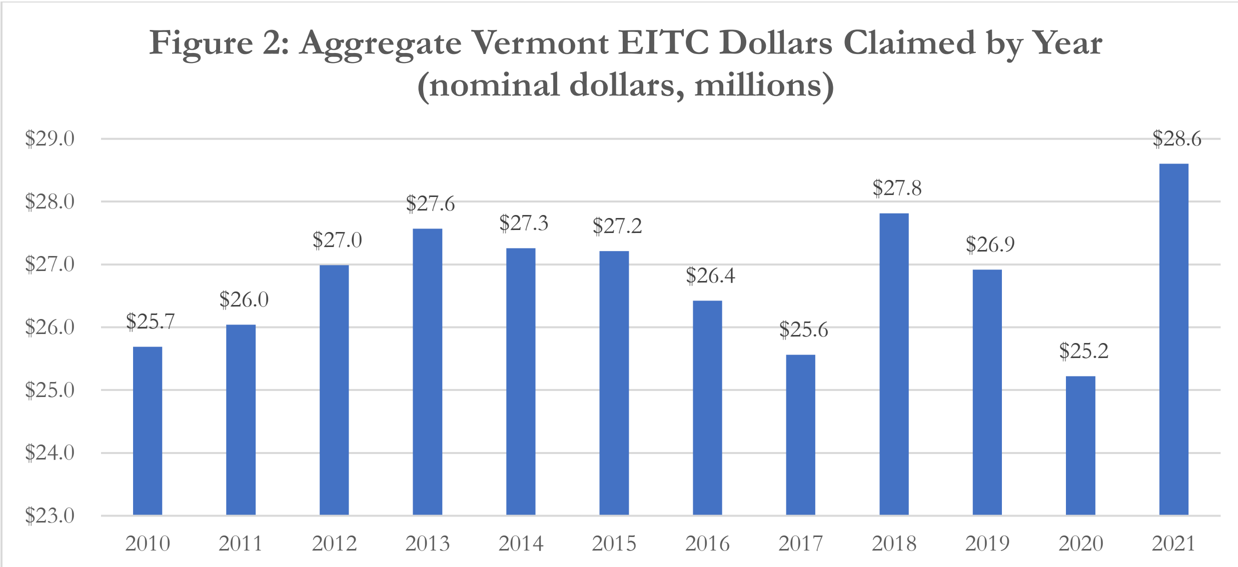
In tax year 2021[4], 48,781 taxpayers claimed the Vermont EITC. This represented an increase of almost 12,000 claimants when compared to 2020. This influx was largely due to temporary eligibility changes for single childless filers. Before 2021 the number of EITC claimants in the state steadily decreased from 45,336 in 2010 to 36,853 in 2020 (Figure 1).



Source: Vermont Tax Department, JFO Analysis

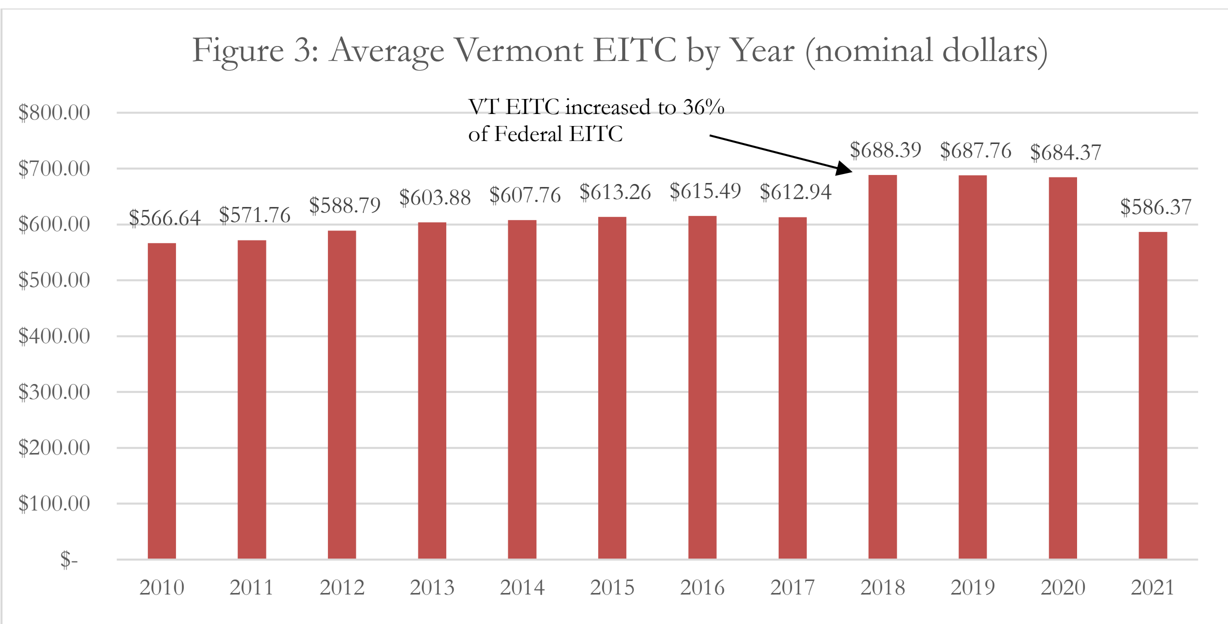
Over the same period, from 2010 to 2021, the total amount of credits awarded to claimants was volatile and did not follow a clear trend. At its lowest point in 2020, $25.2 million in credits were claimed. At its highest point in 2021, $28.6 million in credits were claimed.

[4] Defined as January to December 2021



Source: Vermont Tax Department, JFO Analysis

While the nominal[5] total value of credits was volatile from 2010 to 2021, the average credit amount per filer remained relatively consistent. From 2010 to 2017, the average credit rose modestly from $566 in 2010 to $612 in 2017. In 2018, Vermont increased the State credit from 32% to 36%[6] of the federal credit. As a result, the average credit rose to $688 and stayed roughly at that level until 2021, when the average dropped significantly to $586 (Figure 3). As will be discussed later, this was largely due to temporary changes made at the federal level and subsequent increase in the number of single childless claimants. Single childless filers tend to have lower average EITC amounts.

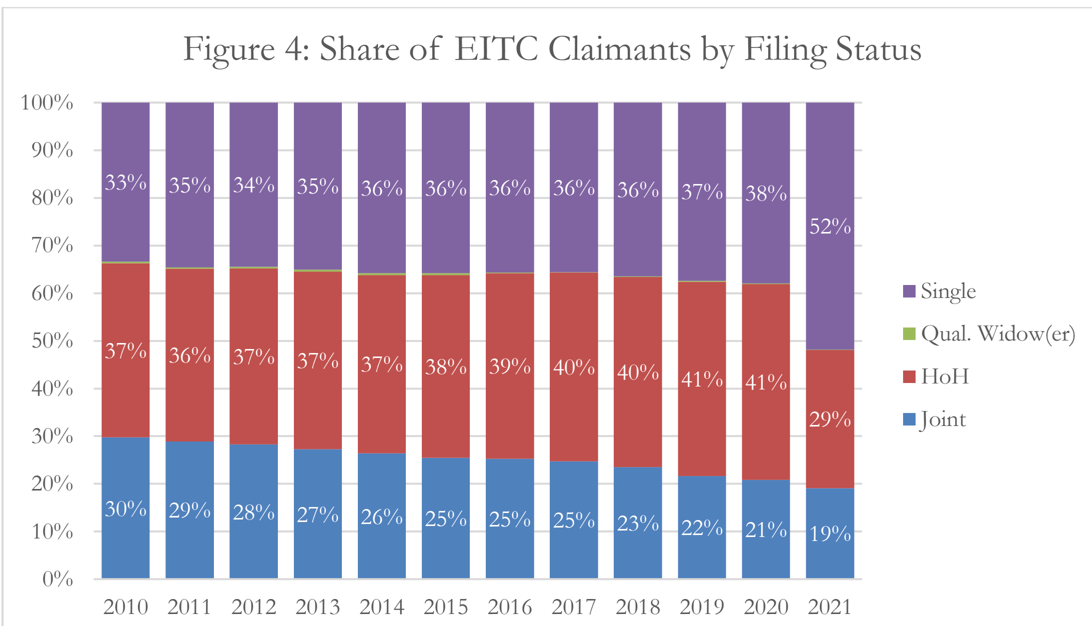


Source: Vermont Tax Department, JFO Analysis

[5] Nominal dollars are not adjusted for inflation.
[6] The State credit was later increased from 36% to 38% in 2022.

The period from 2010 to 2020 also saw a steady change in the composition of EITC claimants by filing status (Figure 4):

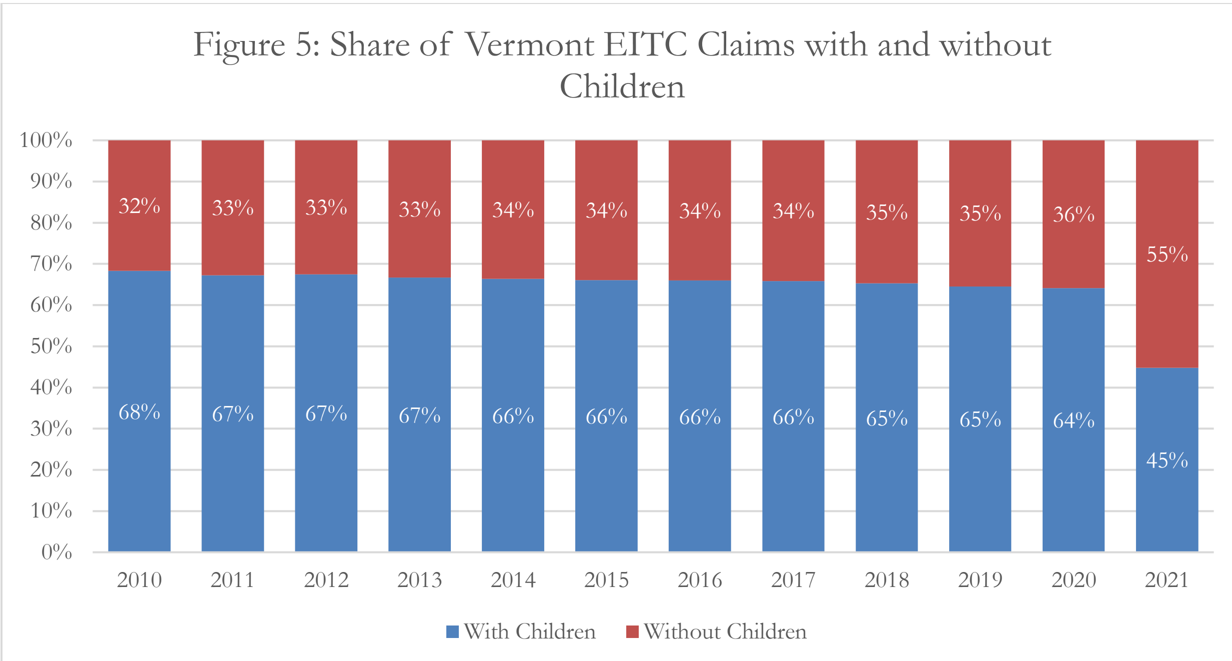
- Over this period the share of single and HoH filers steadily increased: In 2010, 33% of claimants were single and 37% were HoH. By 2020 the share of single filers had risen to 38% and HoH claimants had risen to 41%.
- The increasing share of single and HoH filers resulted in a declining share of married joint filers. In 2010, this group represented 30% of all EITC claimants. By 2020, they were only 21%.
- As a result of federal changes to the EITC, tax year 2021 showed a sharp shift in the composition of claimants by filing status: single filers represented 52% of claimants (up from around 35-38% in a normal year), while HoH and joint filers fell to 29% and 19% respectively.



Source: Vermont Tax Department, JFO Analysis

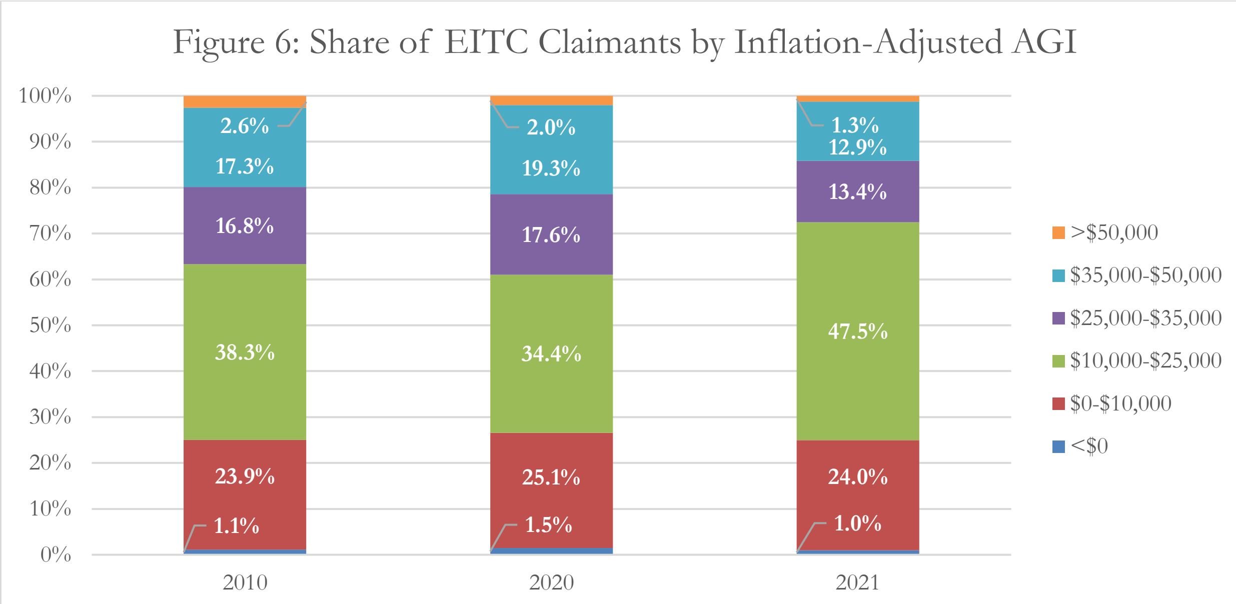
Notably, 2021 was the first year the HoH filers did not make up the largest share of EITC claimants. The significant influx of single EITC claimants resulted in single filers making up not only the largest share of claimants, but also the majority of claimants. This dramatic shift was the result of temporary changes to the eligibility criteria for single childless workers that increased the earned income threshold required to qualify for a credit. The impact of these changes in 2021 will be discussed in the Major Findings section.

There have been some slight shifts in the composition of EITC claimants based upon their number of qualifying children. From 2010 to 2020 the share of claimants with no qualifying dependent children rose slightly from 32% to 36%, before increasing sharply in 2021 to 55%. This increase in the share of childless claimants was inversely experienced by all cohorts of EITC claimants with children. The share of claimants with at least one child was 68% in 2010 and decreased slightly through 2020 at which point their share was 64%. Because of the sharp increase in claimants with no children in 2021, the share of claimants with at least one child fell to a 10-year low of 45%.



Source: Vermont Tax Department, JFO Analysis

In a typical year 60% to 65% of EITC claimants have incomes of $25,000 or less. 2021 was an anomaly because in that year the share of total EITC claimants with an income of $25,000 or lower jumped to 72.5%. However, as will be discussed in the Major Findings, this jump was largely due to temporary changes in the federal EITC, which flowed through into the State credit. The Vermont EITC is predominantly claimed by the lowest earning Vermont workers, which is largely a function of the federal definitions of who qualifies for the credit.



Source: Vermont Tax Department, JFO Analysis

From 2010 to 2020 the number of EITC claimants in all income groups decreased from 45,336 to 36,853 or by 18.7%. During this time the number of EITC claimants earning $25,000 or less decreased at a faster rate than those earning more than $25,000. The share of EITC claimants with an inflation-adjusted Adjusted Gross Income (AGI) of $25,000 or less was 63.3% in 2010 and by 2020 had fallen to 61.0% (Table 1). This decrease was driven by a disproportionate decrease in claimants with an AGI between $10,000 and $25,000 which saw their share of total EITC claimants decrease from 38.3% in 2010 to 34.4% in 2020. In fact, claimants with this level of income, along with those with AGI greater than $50,000, were the only groups that saw their share of total EITC claimants decrease over the ten-year period.

Table 1: Share of Vermont EITC Claimants by Inflation-Adjusted AGI

AGI (Inflation Adjusted) ($)	2010	2020	2021
<$0	1.1%	1.5%	1.0%
$0-$10,000	23.9%	25.1%	24.0%
$10,000-$25,000	38.3%	34.4%	47.5%
$25,000-$35,000	16.8%	17.6%	13.4%
$35,000-$50,000	17.3%	19.3%	12.9%
>$50,000	2.6%	2.0%	1.3%

Source: Vermont Tax Department, JFO Analysis

This trend was reversed sharply in 2021 as claimants with AGI between $10,000 and $25,000 increased from 34.4% in 2020 to 47.5% in 2021. Overall, regardless of the year analyzed, the majority of EITC claimants have AGI $25,000 and below. As this section has noted, the composition of EITC claimants, and aggregate and average claims generally changed modestly from 2010 to 2020 but shifted dramatically in 2021. This is due to significant, but temporary, changes in the eligibility criteria and credit amounts made on the federal level that flowed through onto Vermont tax returns. These changes will be discussed in detail in later sections.

Federal Overview

Because the Vermont EITC functions as a percentage of the federal EITC, it is important to understand the mechanics of the federal credit.

Qualification for the EITC

To claim the EITC, filers must have what the Internal Revenue Service defines as *earned income* and meet certain AGI and credit limit thresholds for the current, previous, and upcoming tax years. Earned income includes all taxable income earned from working for an employer, oneself, or from a business or farm the filer owns. For most taxpayers, this means wages, salaries, tips, or self-employment income.[7]

These criteria are set at the federal level and flow through to the State return. Vermont does not establish eligibility at the State level.

Three primary criteria must be met to for a filer to be eligible and to determine the credit amount:

1. Filers are required to have earned income.
2. The taxpayer's AGI must be within certain bounds for single and married filers. These bounds are based on the taxpayer's number of qualifying children. The AGI thresholds for the 2022 tax year, which vary by filing status and number of claimed dependent children, are shown below (Table 2).

Table 2: AGI Thresholds for the 2022 Tax Year		
Children or Relatives Claimed	**Filing as Single, Head of Household, or Widowed**	**Filing as Married Filing Jointly**
Zero	$16,480	$22,610
One	$43,492	$49,622
Two	$49,399	$55,529
Three or more	$53,057	$59,187

3. Filers cannot have investment income greater than $10,300 in the 2022 tax year.

For childless taxpayers, the federal EITC also includes age restrictions. In tax year 2022, the EITC is available to childless filers ages 25 through 64. This was changed for tax year 2021 when, on a one-time basis, the federal government reduced the minimum age from 25 to 19 years old and eliminated the maximum age of eligibility. Filers with children are not restricted by age.

A key tenet of the EITC is that it varies based on the number of qualifying dependents claimed by the taxpayer. Qualifying children must have a valid Social Security number and must not be claimed by more than one person. Filers must show that the claimed child meets certain additional conditions based on age, relationship, residency, and dependency.

Calculation of the Federal EITC

[7] Other types of earned income include income from a job where employers did not withhold tax, benefits from a union strike, certain disability benefits, and nontaxable combat pay.

The calculation of the federal EITC is complex and involves three important parameters:

1. a maximum credit,
2. a phase-in and,
3. a phase-out.

Filers credits are calculated by adjusting the maximum credit depending upon their income and qualifying children.

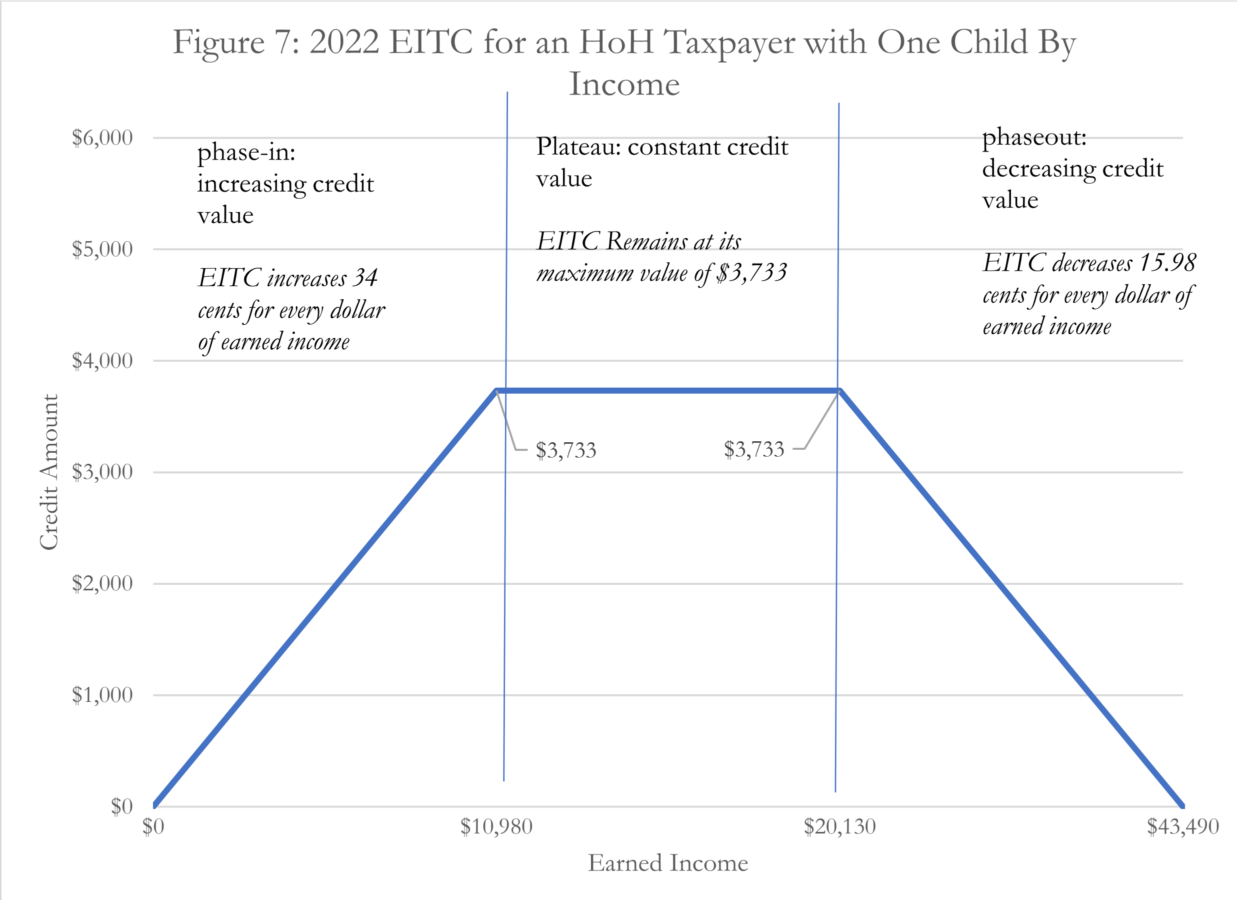
The maximum credit amounts vary based on the number of dependent children claimed. These maximum amounts represent the most a claimant can receive, but do not represent a guaranteed amount. The maximum credit amounts can be found in the table below.

Table 3: Tax Year 2022 Maximum EITC Amounts

Children or Relatives Claimed	Maximum Credit Amount
Zero	$560
One	$3,733
Two	$6,164
Three or more	$6,935

The federal EITC phases in as a percentage of earned income – called the "credit rate" – until the credit amount reaches its maximum level as determined by a combination of filing status and the number of claimed dependents. The EITC amount remains at this maximum level over the subsequent range of earned income until it reaches the "phaseout amount threshold." At this point every dollar of earned income above the "phaseout amount threshold" decreases the credit amount by a set percentage called the "phaseout rate" until it reaches zero.[8] An example of this structure can be seen below in Figure 7.

[8] https://sgp.fas.org/crs/misc/R43805.pdf



Source: "The Earned Income Tax Credit (EITC): Legislative History", Congressional Research Service, April 28, 2022. Formatting by JFO.

For the federal EITC, the amount filers can receive if they meet the previously discussed income thresholds depends on their earned income and is subject to phase in, phase out, and maximum credit amounts. The EITC parameters by marital status and number of qualifying children for 2022 can be found below[9]:

Table 4: Structure of Credit Calculation for Unmarried Filers

Parameters	**Unmarried Filers**			
Number of Qualifying Children	**0**	**1**	**2**	**3+**
Credit Rate	7.65%	34%	40%	45%
Earned Income Amount	$7,320	$10,980	$15,410	$15,410
Maximum Credit Amount	$560	$3,733	$6,164	$6,935
Phaseout Amount Threshold	$9,160	$20,130	$20,130	$20,130
Phaseout Rate	7.65%	15.98%	21.06%	21.06%
Income Where Credit = 0	$16,480	$43,492	$49,399	$53,057

[9] https://sgp.fas.org/crs/misc/R44825.pdf, Adjusted for inflation by JFO.

Table 5: Structure of Credit Calculation for Married Filers

Parameters	Married Filers			
Number of Qualifying Children	**0**	**1**	**2**	**3+**
Credit Rate	7.65%	34%	40%	45%
Earned Income Amount	$7,320	$10,980	$15,410	$15,410
Maximum Credit Amount	$560	$3,733	$6,164	$6,935
Phaseout Amount Threshold	$15,290	$26,260	$26,260	$26,260
Phaseout Rate	7.65%	15.98%	21.06%	21.06%
Income Where Credit = 0	$22,610	$49,622	$55,529	$59,187

Once a taxpayer has calculated their federal EITC, it is straightforward to calculate the corresponding Vermont EITC. All Vermont taxpayers that claim and receive the federal EITC can receive 38% of that amount on the State level. All eligibility criteria and calculations are derived from the federal credit.

II. Legislative History

Federal EITC History:

The federal EITC was first established at the federal level in 1975 on a temporary basis before being made permanent in 1978. The credit was created as a wage earnings-based credit for workers with children. At the time, it was calculated as equal to 10% of the first $4,000 in earned income, which resulted in a maximum credit amount of $400, the equivalent of almost $2,200 in 2020 dollars. The credit then phased out at incomes between $4,000 and $8,000. This means that for every $100 earned over $4,000 the maximum credit amount was decreased by $100. In 1978, the maximum amount was increased to $500.

Over the following twenty or so years, the federal government gradually increased the eligibility and size of the EITC. Below is a brief overview of some of these milestones:

- 1986: The maximum credit was increased to $800. All major parameters of eligibility and calculating the credit were adjusted by inflation.
- 1990: The maximum credit was adjusted to better reflect family size. Different maximum credits were introduced depending on the number of dependent children.
- 1993: Workers with no qualifying children were made eligible for the credit. Because the expansion was largely seen as an offset for increase gasoline taxes at the same time, the credit for childless individuals was set well below that of families. The maximum credit for families with dependent children was also increased.
- 1997: The definition of income used for the phase-in and phase-out of the credit was expanded to include certain types of passive income. In addition, to alleviate fraud concerns with the EITC, the federal government began requiring individuals who claimed the credit to submit their Social Security Number.
- 2002: Adjustments were made to the phase-out income levels for married taxpayers to correct for a marriage penalty in the credit. Prior to this, for many low-income taxpayers claiming the credit, filing for the credit on a joint return resulted in less credit than filing as separate individuals. To minimize this penalty, the income level where the phase-out begins for married couples was increased.

- 2009: The maximum credit was increased for families with three or more children. Prior to the change, a family with two children would have a higher maximum credit than a family with three children. In addition to this, the maximum credit for joint returns was increased to provide further correction to the marriage penalty.

In 2021, several temporary and permanent changes were made to the EITC. These were made as part of the American Rescue Plan Act signed by President Biden on March 11, 2021.

- The maximum credit amount for claimants without children was temporarily expanded from $543 to $1,052.
- In response to the COVID-19 pandemic the bill also included a temporary income-lookback in which filers could use their 2019 income to calculate their 2020 and 2021 EITCs if it would result in a higher amount in each year.
- The maximum EITC in 2021 for childless claimants nearly tripled from $538 in 2020 to $1,502. This significant change will revert to previous tax year's parameters in 2022, resulting in a maximum credit for single childless of $560 after adjusting for inflation.
- The minimum and maximum ages were broadened for most filers with no qualifying children. The minimum age was lowered from 25 to 19 and the maximum age of 65 was removed altogether.

All temporary changes made for the 2021 tax year were for 2021 only. In 2022 parameters returned to their 2020 levels after adjustments were made for inflation. As noted above, the main result of this is that single filers without qualifying dependent children will see their credit amounts reduced significantly.[10]

As the Overview section demonstrated and Finding #3 in the Major Findings section will detail, the temporary changes in 2021 at the Federal level had a dramatic impact on the aggregate credits claimed in Vermont, as well the composition and average credits claimed for that tax year.

Vermont EITC History:

Vermont's EITC, which is built as a percentage of the federal credit, is a remnant of how the State used to calculate a taxpayer's personal income tax liability. Prior to 2002, Vermont's personal income tax liability was simply a percentage of the federal tax liability, also called the "applicable percentage". The percentage for calculating the EITC was initially 23% in 1980 but this percentage changes over the years.

Act 258 (1988) established the Vermont EITC in 32 V.S.A. § 5828(b). The credit allowed individuals who were entitled to the EITC at the federal level to receive a credit against their Vermont state personal income taxes. The tax credit was equal to the "applicable percentage" which meant that the percentage of the federal tax liability that was used to determine state tax liability was also applied to the EITC amount received by individuals on the federal level.

In 1988, the "applicable percentage" was 25.8%, which meant that a filer's Vermont state personal income taxes were equal to 25.8% of what they owed to the federal government. As such, their

[10] https://sgp.fas.org/crs/misc/R44825.pdf

Vermont EITC was 25.8% of the federal EITC. Like on the federal level, the Vermont EITC was refundable.

Act 49 (1999) amended 32 V.S.A. § 5828(b) so that EITC filers were entitled to the greater of the "applicable percentage" or 25% of the federal EITC. In effect this set the percentage of the federal EITC that filers were entitled to equal to 25% because in the same legislation the "applicable percentage" for calculating tax liability was lowered from 25% to 24%.

Act 119 (2000) 32 V.S.A. § 5828(b) further increased the percentage of the federal ETIC that Vermont filers were entitled to from 25% to 32%.

In 2002, Vermont established its own independent personal income tax system, repealing language associated with "applicable percentage" and replacing it with income brackets with corresponding tax rates. However, despite this decoupling from the federal personal income tax system, the Vermont EITC remained set as a percentage of the federal EITC, at 32%.

Act 14 (2005) removed all reference of the "applicable percentage" previously used to calculate the EITC specifically. Because Vermont's income tax system was no longer tied to the federal system using this "applicable percentage." The EITC statute was altered to remove reference to the "applicable percentage".

Act 11 (2018) increased the State EITC amount to 36% of the federal credit.

Act 138 (2022) increased the State EITC to 38% of the federal credit.

III. Statutory Purpose

The purpose of the Vermont Earned Income Tax Credit as stated in 32 V.S.A. § 5813(s) is "to provide incentives for low-income working families and individuals and to offset the effect on these Vermonters of conventionally regressive taxes."

To the first part of the statutory purpose for low income working families and individuals, the federal EITC is limited to filers with low- and moderate-income levels. Because the Vermont EITC piggybacks on the federal EITC, the target population for the Vermont credit is identical to the federal credit.

To the second part of the statutory purpose, "to offset the effect" of regressive taxes, regressive taxes in this instance likely refers to taxes levied on consumer staples. While Vermont exempts many consumer staples (food, medicine, heating fuel) from sales tax, numerous other consumption taxes are applied to goods and services without any exemptions for low-income Vermonters. These include gasoline taxes, transportation taxes, and sales taxes on household goods like furniture and appliances. As such, the EITC's stated goal is to offset these taxes paid in an income-targeted way, rather than a blanket exemption. While this report will focus on regressive taxes currently in place in Vermont, which are primarily consumption-based, in the future if a tax such as a payroll tax were introduced it could meet the definition laid out in the statutory intent.

This report will evaluate Vermont's EITC against the purpose in 32 V.S.A. § 5813(s).

IV. Major Findings

1) The Vermont EITC offsets most conventionally regressive taxes for most types of eligible taxpayers

One half of the statutory intent of the Vermont EITC is to offset the effect of conventionally regressive taxes on low-income working families and individuals. Put another way, the EITC is meant to provide relief to lower-income Vermonters who spend a higher proportion of their income on these taxes than higher-income Vermont. As noted earlier, these taxes are typically consumption-based taxes and for the purpose of this exercise are considered taxes on consumer staples.[11]

To analyze the extent to which the EITC offsets the taxes paid on these goods, JFO utilized data from the Bureau of Labor Statistics Consumer Expenditure Survey for 2019. The survey asks households across the United States the amount they spent on a variety of household goods in a given year. JFO used the survey from households in the in the Northeast US.[12] Average household spending on these items, and in turn the taxes paid on those items, were collected and compared to the average EITC received by claimants by filing status.

As a reminder,

- single filers are defined as taxpayers who are unmarried,
- married filers are defined as a couple that is married at the end of the tax year, and
- Head of Household filers are defined as taxpayers who are unmarried and pay over half the cost of maintaining the home of a qualified individual,
- qualified widow(er) is defined a an individual within two years following their spouses death.

JFO focused on the income groups making $50,000 or less annually because this captures the vast majority of EITC claimants. As Table 6 shows, the average household in the Northeast region of the sample is estimated to have paid $716 in consumption-based taxes in 2019. This number is lower for the income groups eligible for the EITC. Those making $15,000 or less are estimated to have spent $248 while those with incomes between $40,000 and $50,000 paid $469 on average.[13]

Next, JFO compared the average EITC for these income groups to the average taxes paid. Generally, the Vermont EITC offsets these conventionally regressive taxes on average at all points in the EITC-qualifying AGI range for married filers.

- On average, HoH filers have their regressive taxes fully offset until they reach an AGI above $40,000.
- Single filers have their regressive taxes fully offset at all qualifying incomes above $15,000.

Average EITC Amount Received by Filing Status[14]

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[11] For a complete list of the consumer staples subject to regressive taxation that were considered for this analysis please see the appendix at the back of this report.

[12] The Northeast Region of the sample was used because the Vermont sample is relatively small and therefore is characterized by large margins of error.

[13] It is likely that average expenditures for married and HoH filers are higher than the average, while for single filers their actual expenditures are likely lower than the average. This is, of course, not true in all cases, but there are typically more consumer staples purchases in multi-person households, particularly those with kids, compared to those living alone or without kids.

[14] Average EITC amounts for widowed tax filers could not be reported due to disclosure limitations.

Table 6: JFO Analysis of Regressive Taxes Paid vs. Vermont EITC					
Average Estimated Regressive Taxes Paid in the Northeast					
	Average for all Filers	Less than $15,000	$15,000 to $29,999	$30,000 to $39,999	$40,000 to $49,999
Average Estimated Taxes Paid	$716.37	$248.44	$324.47	$416.77	$469.25
Average Vermont EITC by Filing Status					
Household Income		Less than $15,000	$15,000 to $29,999	$30,000 to $39,999	$40,000 to $49,999
Married		$565.84	$1,239.44	$1,044.11	$583.30
HoH		$1,018.86	$1,265.14	$555.31	$363.46
Single		$172.40	$843.24	$539.63	$729.17

Source: Chainbridge Tax Simulation, Bureau of Labor Statistics, Consumer Expenditure Surveys, 2020-2021 and JFO Analysis

Two notable cohorts do not have their regressive taxes fully offset by the Vermont EITC:

- HoH filers with an AGI of $40,000 to $50,000. These filers, however, represented only 6.4% of HoH claimants, meaning that for the vast majority of HoH claimants, the EITC offsets regressive taxes paid on average.
- Single filers earning less than $15,000. This group represents 48% of single filers claiming the EITC, a considerable number of claimants. Moreover, this group represents roughly a third of overall EITC claimants in a given year.

At the lower end of the income spectrum, or those HoH filers earning less than $30,000, their average EITC is equal to approximately three times what they are estimated to pay in regressive taxes annually. Those earning between $30,000 and $40,000 receive 33.2% more on average from the EITC than they are estimated to pay in regressive taxes annually. Generally speaking, lower-income HoH EITC claimants are well-supported, and their regressive taxes are offset, but a small percentage of those within the phase-out range are not fully offset. Overall, every other cohort receives more from the EITC than they are expected to pay in regressive taxes.

In total, JFO estimates that on average, 63.7% of total EITC claimants see their regressive taxes fully offset by the credit. That being said, there are some noted gaps for some specific single and HoH filers. However, even for these groups, their regressive taxes are estimated to be offset on average by upwards of 65%.

2) The Vermont EITC appears to create unequal incentives for low- and moderate-income working families and individuals between filing statuses.

The other half of the statutory intent of the EITC is to provide incentives to low-income working families and individuals.

A challenge in evaluating whether the program is meeting this goal is that the intent does not explicitly state what those incentives should be. For filers to be entitled to the EITC they must have earned income, which necessitates working, which could suggest that the incentive is for people to enter the workforce. However, once they are working and become eligible for the EITC, the statutory purpose is silent on whether "incentives" mean more than incentives to work, or also incentives to earn more such that they eventually become ineligible for the credit or other State supports.

Vermont data show that persistent EITC claims (meaning those that claim every year) only exist for roughly 10% of a typical year's cohort. Looking specifically at 2019 claimants, a large percentage (82.4%) received the credit at least one other time since 2010, while 37.7% received the credit at least 5 other times. What this analysis does not show, however, is whether the EITC is acting as an incentive or disincentive to work for any of these claimants. What it does show is that for a small portion of EITC claimants, the EITC could be acting more as a wage support than an incentive to earn more income or to enter the workforce.

Table 7: Share of 2019 Vermont EITC Claimants that Claimed One or More Times Between 2010 and 2018

2019	Joint	HoH	Single	Total
At least once	86.9%	90.0%	71.7%	82.4%
5 times or more	32.2%	50.6%	26.8%	37.7%
Every Year	9.4%	15.7%	6.2%	10.8%

Source: Vermont Tax Department, JFO Analysis

Academic literature has sought to answer whether the EITC provides incentives (or disincentives to work using the federal EITC:

- One paper (Nichols and Rothstein, 2016) noted that it is possible in some instances that the EITC could discourage people from work. The EITC requires some work to qualify for the credit, but some workers may opt to maintain or reduce their hours to a level that entitles them to the credit. There are opportunity costs present within both the phase-in and phase-out ranges of the EITC. In the phase-in range, every extra dollar of earned income is worth even more because the EITC amount goes up. Conversely, within the phase-out range every extra dollar of earned income results in a reduced EITC.
- On the other hand, another paper (Francis, 2006) suggested that the EITC successfully encourages people to work and finds little evidence to support the notion that the EITC prompts people to work less.[15] The strongest incentive was found to be for single workers, particularly those with children, to work for at least part of the year to qualify for the credit.[16]
- Further, in 1996 a paper written by Eissa and Liebman found that the EITC did have an observed incentive effect on tax filers with and without children. The paper found that single women with children increased their relative labor force participation by 2.8 percentage points compared to those without. The paper did not find a meaningful change in the number of hours worked by single women with children who were already in the labor force, but the findings overall suggest that the credit could have a positive effect on encouraging people who otherwise would not work to enter the labor force.[17]

[15] https://www.nber.org/digest/aug06/earned-income-tax-credit-raises-employment
[16] https://www.nber.org/system/files/chapters/c13484/c13484.pdf
[17] https://www.jstor.org/stable/2946689

- Single women have been a popular cohort of the population in EITC research. Another paper (Sikivie, 2019) found evidence that the EITC has a strong impact on the likelihood that a single woman will enter the workforce. The study estimates that the EITC increases employment of single mothers who work on average 1,600 hours per year by 7.5 percentage points. However, in contradiction to the 1996 paper by Eissa and Liebman, Sikivie found evidence that the credit reduced the hours single mothers who were already working worked by an average of 15 hours per year.[18] This could theoretically be the result of those single mothers reducing hours to in turn reduce their income so that they could maintain their maximum credit amount.
- One paper found that married women in the phase-out range of the EITC are approximately 5% less likely to work, and if they do work, they work 20% fewer hours per year than married women who live in households outside of the phase-out range.[19]

The contradicting conclusions of the literature further suggest that the structure of the EITC can create different incentives for different types of taxpayers.

Finally, it is important to note that the credit is relatively small for single and childless adults. Because of this, it is worth questioning whether the credit creates substantive incentive to work for these filers. In addition to much smaller credit amounts, single childless claimants face a much more gradual phase-in and a much steeper phase-out of EITC benefits than HoH filers with even just one claimed qualifying dependent, showing that the credit structure changes dramatically if the filer has a child. Single childless filers see their credit phase in at a rate of 7.65% compared to 34% for HoH filers. This means that for every additional dollar of earned income claimants have they receive 7.65 cents if they are a single filer and 34 cents if they are a HoH filer. This very gradual phase-in range for single childless filers, at a minimum, is a smaller incentive to work than for any other filing status.

Moreover, single filers start to see their credit amount phase out once they reach $9,160 in earned income. For HoH filers, the phase-out begins at $20,130 of earned income. This means that single, childless filers face a much harsher reduction in their credit for every additional dollar earned relative to other filing statuses. This may create a disincentive to work relative to other EITC claimants.

3) Head of Household filers who claim the EITC make up a disproportionate share of overall claims and are more likely to claim it on a persistent basis.

HoH filers, while representing a relatively small population in Vermont's overall taxpayer universe, make up a significant share of EITC claimants. From 2010 to 2019 the share of EITC claimants who were HoH filers was consistently between 36% and 41%, representing between roughly 15,000 and 17,000 filers. At the same time, HoH filers represent less than 8% of total tax returns in Vermont (Table 8). What this means is that if a taxpayer is filing as HoH, it is more likely than not that they are claiming the EITC: in 2019, 54,4% of HoH filers claimed the EITC.

[18] https://scholarworks.gsu.edu/cgi/viewcontent.cgi?article=1165&context=econ_diss
[19] https://www.nber.org/digest/apr99/married-women-work-less-because-eitc

Table 8: 2019 Taxpayers by Filing Status and Shares Claiming the EITC

Total Filing Status - Residents	Count of Total Filers	Share of Total Filers	Share Claiming EITC
Married	124,171	35.2%	6.2%
HoH	27,864	7.9%	54.4%
Widowed	148	0.0%	31.8%
Single	200,571	56.8%	7.0%
Total	352,754	100.0%	10.4%

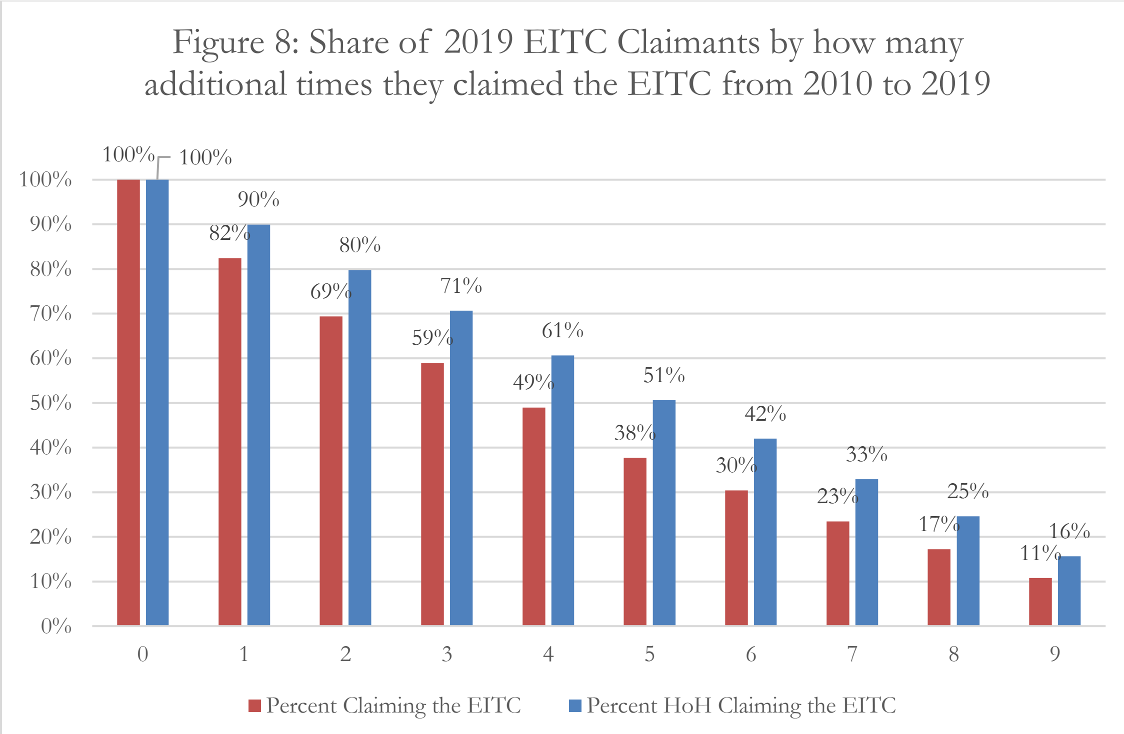
Source: Vermont Tax Department, JFO Analysis (columns may not add up to 100% due to rounding)

By contrast, in 2019 single taxpayers make up approximately 56.8% of total taxpayers but represent only 37.4% of EITC claimants. In the same year, only 7% of single filers claimed the EITC. The same pattern holds for married couples.

Given that HoH filers are more likely to claim the EITC than other taxpayers, it can be inferred that this group must have disproportionately lower incomes that would make them eligible for the EITC. Data from 2019 shows that 67.7% of all HoH filers have an AGI of $50,000 or lower, which is roughly what the range of eligible AGI was in 2020 for HoH filers to qualify for the EITC.

JFO also sought to investigate the extent to which taxpayers regularly and persistently claimed the EITC over a number of years. Looking at the cohort of 2019 EITC claimants, JFO counted how many times they had claimed the EITC going back to 2010. The results indicate that there is a small group of persistent filers who claim the EITC over a long period. This small group contains a disproportionate number of HoH filers.

Of the cohort of total 2019 EITC claimants 82.4% received the credit at least one other time, 37.7% received it in at least 5 years, and 10.8% claimed every year going back to 2010 as shown in Table 8. However, using the same methodology for HoH claimants only, JFO found that 90.0% claimed at least one other time, 50.6% claimed five times or more, and 15.7% claimed every year from 2010 to 2019.



What this shows is that HoH households are more likely to be repeat EITC claimants and 4.9 percentage points more likely than the average EITC claimant to have claimed the credit every year going back to 2010.

HoH filers also account for a majority of the total EITC despite representing a relatively small group of filers overall. HoH claimants received $15.2 million in credits compared to $4.3 million for single claimants in 2019. This amounts to over 57% of total credits issued in Vermont. The disparity between HoH and single filers can be explained by the parameters of the credit defined at the federal level. While HoH filers are subject to the same AGI threshold as single filers when determining eligibility, they fall under more generous parameters when calculating the credit amounts they are entitled to receive.

Table 9: Vermont EITC Amount and Share Received by Filing Status

Filing Status	**EITC Amount (millions)**	**Share of Total EITC Received**	**Share of Vermont Tax Returns**
Married	$7.08	26.6%	35.2%
HoH	$15.20	57.1%	7.9%
Widowed	$0.07	0.3%	0.04%
Single	$4.25	16.0%	56.8%
Total	**$26.60**	**100.0%**	**100.0%**

Source: Chainbridge Tax Simulation, JFO Analysis

As an example, imagine two households: a HoH filer with one child making $35,000 and a single filer with no children making the same amount.[20] In this scenario, using the EITC calculation parameters for tax year 2019, the HoH filer would qualify for an EITC of $970 on their federal return which would result in a Vermont EITC of approximately $350. In this scenario the single filer with no children would not qualify for the EITC on the federal or State level.[21] The EITC is intentionally structured this way to give filers with children a higher credit amount because they face higher costs associated with caring for their children.

This illustrates how significant the difference in EITC generosity is for single filers without children and single parents who can claim at least one qualifying dependent child. As a basis of comparison, 14,201 or 51.0% of HoH filers and 128,555 or 64.1% of single filers had income of $35,000 or less in 2019, but HoH filers received 57.1% of total EITC benefits while single filers only received 16.0%. It should also be noted that in addition to the EITC, many HoH filers may be eligible for additional federal and State benefits like the Child Tax Credit and Child and Dependent Care Credit that single filers are not eligible for.

That is not to say that larger credit for unmarried filers with children is inappropriate. Studies have found that the EITC has had the effect of reducing child poverty rates. The value of the credit itself, along with the incentives to work have helped and encouraged many households increase their annual earnings above the poverty line. The EITC has been credited with lifting approximately 4.7 million children out of poverty.[22]

Finally, it is worth noting HoH claimants receive a disproportionate share of credits relative to singles because design of the EITC federally, not because of the way the EITC is designed in Vermont. Legislators seeking to change this system would first need to decouple part of Vermont's EITC from federal definitions and parameters.

4) **The temporary expansion of eligibility and credit sizes for tax year 2021 in the American Rescue Plan Act (ARPA) resulted in a significantly different composition of Vermont's EITC filers and total credits claimed, most notably for childless individuals.**

From 2010 to 2013 the number of Vermonters claiming the EITC hovered steadily around 45,000 taxpayers. Starting in 2014, the number of claimants began to steadily decrease until it reached its lowest point in 2020 at 36,853 claimants, an approximate 18% reduction. No major changes to the eligibility criteria occurred from 2010 to 2020 other than regular annual adjustments for inflation. In 2021 the number of claimants jumped to 48,781, an approximate 32% increase.

This jump was due to the passage of ARPA in March 2021. In that act, the federal government made several temporary changes to the EITC. However, most important was that it tripled the maximum credit amount for single childless filers and increased the age, earned income, and AGI thresholds used to determine eligibility.

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[20] If a single person has one child, they are able to file as HoH, which entitles them to a more generous EITC calculation.

[21] https://apps.irs.gov/app/eitc

[22] https://www.nber.org/system/files/chapters/c13484/c13484.pdf

The first notable result of this expansion is that there was a significant spike in first-time EITC claimants in 2021. In 2021 16,897 filers claimed the EITC for the first time compared to 6,598 filers who claimed for it for the first time in 2020.

The second result is that the number of single childless claimants increased dramatically. In 2021, 12,961, or 76.7%, of first-time EITC claimants were single filers. In 2020, prior to the expansion of eligibility, this percentage was 61%. No other group saw their eligibility and benefits increase to the extent that single childless claimants did.

Single filers also represented a much larger share of EITC claimants in 2021 than they did the previous ten tax years. The federal expansion of the EITC for single childless filers increased the threshold of how much earned income those claimants could have before the credit was phased out completely. Previously the credit would phase out completely at $15,820. In 2021, the amount of earned income a single childless claimant could have before the credit was phased out completely increased to $21,430, roughly a 35% increase from $15,820.

As part of JFO's analysis, single childless first-time EITC claimants earning between $9,000 and $22,000 in AGI[23] were investigated further, because claimants falling in those income ranges were made eligible specifically because of the expansion. There were 9,823 single childless first-time claimants in this AGI range which accounts for 75.8% of the 12,961 first-time single claimants in 2021. This indicates that the expansion of the income eligibility alone made thousands of people instantly eligible.

This pushed the overall share of single EITC claimants from 38.0% in 2020 to 51.8% in 2021. None of the other filing status cohorts saw their share of total claimants increase by any amount. HoH filers saw their share of total claimants decrease the most, falling from 41.1% to 29.0% despite having about only slightly fewer claimants.

Table 10: 2020 & 2021 Count and Share of Total Vermont EITC Claimants by Filing Status

Filing Status	2020		2021	
	Count	Share	Count	Share
Joint	7,665	20.8%	9,306	19.1%
HoH	15,149	41.1%	14,157	29.0%
Qual. Widow(er)	47	0.1%	45	0.1%
Single	13,992	38.0%	25,273	51.8%
Total	36,853	100.0%	48,781	100.0%

Source: Vermont Tax Department, JFO analysis

Because of the expanded eligibility criteria for childless claimants, the number of filers claiming the EITC with no qualifying dependent children almost doubled, from 13,220 in 2020 to 26,032 in 2021. All other claimants with 1, 2, and 3 or more dependent children saw their share of total EITC claimants decrease. As Table 11 below shows, this was not because of any significant changes in the number of claimants with one or more children, but because of the sudden influx of single childless filers.

[23] AGI was used as a proxy for earned income, because for EITC claimants the

Table 11: 2020 & 2021 Count and Share of Total Vermont EITC Claimants by Number of Children

No. Qualifying Children	2020		2021	
	Count	Share	Count	Share
0	13,220	35.9%	26,932	55.2%
1	12,470	33.8%	11,371	23.3%
2	7,745	21.0%	7,130	14.6%
3 and above	3,418	9.3%	3,348	6.9%
Total	36,853	100.0%	48,781	100.0%

Source: Vermont Tax Department, JFO analysis

This huge influx of single childless claimants had a notable impact on the average credit size issued in Vermont. Generally, single filers, and particularly those without children, have stricter eligibility criteria which in turn allows for lower credits on average. Commensurate with the significant increase in single childless claimants, the average EITC decreased from $684 in 2020 to $586 in 2021 even though the aggregate value of credits issued jumped from $25.2 million in 2020 to $28.6 million in 2021. Simply put, more people qualified for the credit but at lower than historically average credit amounts.

Table 12: 2020 & 2021 Total and Average Vermont EITC Amounts

	Filing Year	
	2020	2021
Total EITC	$25,221,129	$28,603,666
Average EITC per Claimant	$684.37	$586.37

Source: Vermont Tax Department, JFO analysis

Finally, the temporary federal changes to the EITC in 2021 drew in newly eligible claimants based on age. Previously only filers who were between the ages of 25 and 65 were eligible for the EITC, but in 2021, the minimum age was lowered to 18 and the maximum age was removed altogether. Overall, the 2021 changes resulted in 8,929 became newly eligible claimants: 6,662 claimants between the ages 18 of 25 and 2,267 above the age of 65. Barring those people who turned 25 and are now eligible under the previous age restrictions, none of these claimants will not be eligible to receive the EITC in 2022.

IV. Considerations for Legislators

1) Legislators could consider clarifying the intent of the Vermont EITC.

As noted in the Major Findings section, while the Vermont EITC is achieving its statutory intent by some measures, there are some notable gaps. The credit effectively offsets all or most of claimants' regressive taxes, but there are gaps for a nontrivial number of taxpayers. Furthermore, the structure of the credit does appear to create unequal incentives for low- and moderate-income working families and individuals across different filing statuses.

To further clarify the statutory purpose, legislators could consider what incentives are most important. Possible solutions for clarifying the statutory purpose around incentives would be to make it clearer that the incentive is to encourage Vermonters to enter the workforce or that the credit is meant to act as a wage subsidy for low- and moderate-income Vermonters to encourage them to continue to work. Further the statutory purpose could explicitly state that the credit is meant to provide equal treatment to all filing statuses.

2) Legislators could consider if it is important for Vermont to have more control over eligibility and credit amounts.

The Legislature may want to consider whether the current federal parameters of the EITC are aligned with its goals. The Vermont EITC is directly tied to the federal amount as a flat percentage of 38%. This lack of control over the credit raises two areas of consideration. First, it means that Vermont's EITC eligibility criteria and credit amount calculations are based on the federal structure. Second, it makes Vermont credit subject to unpredictable changes in federal legislation.

To the first consideration, there could be benefits to decoupling from the federal credit in order to target and enhance the credit for certain populations. For example, this review has highlighted the relatively minimal credit for single childless individuals. The changes for tax year 2021 significantly increased the credit size and eligibility for this group. The federal government decided during 2021 that low-income working single childless taxpayers needed more support and made the EITC more generous – albeit temporarily for one year. The Vermont Legislature linked up to Federal statutes and changes for that year, meaning they allowed them to flow through to Vermonters, generally signaling approval for the policy reasoning behind the changes. If the Legislature wanted to keep these changes beyond tax year 2021, it would require decoupling from the federal credit.

The Legislature may also be concerned about certain groups of people and opt to adjust their credit. For example:

- It is worth considering the extent to which single childless EITC claimants have become reliant on the enhanced credit from 2021. If these filers depended upon this enhanced credit, the credit's parameters reverting to pre-2021 levels would have a meaningful negative impact on their financial situation.
- Legislators may also consider if the higher likelihood that HoH filers will claim the EITC is reason to provide them with additional support. The fact that HoH filers are much more likely to claim the EITC and to claim it repeatedly is indicative of the fact that they tend to be lower earning and in greater need of assistance even in the face of more generous eligibility criteria and higher average credit amounts.

If the Legislature wants to address either of these concerns, the remedy would likely involve decoupling from the Federal EITC. Because Vermont provides a flat percentage for all filing status types and number of claimed qualifying dependents, there is no mechanism currently in place to make any changes to eligibility or credit size. This is true for filers today but will also be true of any future changes that are made at the federal level, either temporary or permanent, going forward.

In addition to having control over eligibility and credit size, the current link to the federal system exposes Vermont to the whims of federal legislation. Currently, if the federal government were to make any changes to the EITC, the only course of action for Vermont is to take the changes wholesale or not at all through the annual conformity link-up. Taking any federal change wholesale has been the historical approach in Vermont but one could imagine a case where Vermont may not want to fully accept federal changes, such as a drastic cut back in the credit for married couples or a significant expansion of the credit which creates pressure on available Vermont revenues.

While providing a flat percentage of the federal EITC to Vermonters is simple and easier to administer, if the Legislature wanted more direct control over the EITC it would require a separate system and structure to be set up. Currently, 31 states offer an EITC, but only three of those have established a system that is disconnected from the federal EITC. The vast majority of states who offer an EITC do so as a percentage of the federal EITC, although at differing levels. California, Minnesota, and Washington are the only states that have setup EITC systems that calculate credits at the state level based on income rather than as a percentage of the federal EITC.

If legislators see the EITC as a way to target specific types of taxpayers, then a separate system could be devised that would provide more targeted benefits. This would have the additional result of giving the State more control of the tax expenditure going forward as it would no longer be subject to changes in credit amounts or eligibility on the federal level. However, setting up a standalone State EITC detached from the federal program would require more administrative resources and complicate a relatively simple program on the state level. Additionally, without increasing the total tax expenditure incurred by the EITC, providing more generous benefits to one group would have to come at the expense of less generous benefits to another group.

In the absence of targeting certain cohorts more directly with a standalone EITC separate from the federal program, legislators have the option of increasing the flat percentage that is applied to the federal EITC and then provided to Vermonters. This was last done so during the 2022 legislative session when the flat percentage was increased from 36% to 38%. Doing so would enhance the benefits of all filing statuses, albeit in a less targeted way.

3) Legislators may consider altering the Vermont EITC to provide more equity across filing statuses.

In evaluating whether the Vermont EITC is meeting its statutory intent, JFO notes that the EITC is less likely to fulfill the intent for single filers, without children.

If the legislature wants to fully offset traditionally regressive taxes for this group, it could consider boosting either credit amounts or making eligibility criteria for single childless taxpayers more lenient. As JFO found, the majority of low-income single childless filers do not have their regressive taxes fully offset, so this would be one area to consider boosting benefits in order to better align the performance of the credit with its intent. Boosting credit amounts for single childless filers would also move toward better aligning the performance of the credit with the intent of providing incentives. Given how much less generous the credit for these filers, there are clear structural differences in incentives.

Other states appear to have recognized the inequities between single filers and other statuses and have taken steps to address them. Some states have stopped short of implementing a standalone EITC decoupled from the federal credit. Two states and the District of Columbia provide flat percentages but recognize that the value of the credit for childless filers is significantly lower.

- Washington, D.C. provides 70% of the federal EITC to claimants with children but 100% to childless workers.

- Maine provides 12% of the federal EITC to claimants with children but 25% to childless workers.
- Maryland provides 45% of the federal EITC to claimants with children but 100% to childless workers.

On the other hand, Oregon and Wisconsin take the opposite approach and provide increasing flat percentages of the federal EITC the more children claimants have. In Oregon, claimants are entitled to 9% of the federal EITC, but can receive 12% if they have dependents under the age of three. In Wisconsin claimants with one child can receive 4% of their federal credit, 11% if they have two children, and 34% if they have three or more children. Wisconsin does not provide childless claimants with a state EITC which highlights differences in how support for childless filers is viewed.[24] The federal government in 2021 also recognized the inequities that exist in the structure of the EITC for single childless filers and dramatically increased the size of their credit, albeit on a temporary basis.

[24] https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/state-and-local-backgrounders/state-earned-income-tax-credits

Appendix

To conduct the analysis of whether the Vermont EITC offsets traditionally regressive State taxes, JFO compiled average consumer expenditures from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey (CES). The CES provides average household expenditures by geographic area, types of goods and services, and income ranges. This analysis utilized the data available for the Northeast region which is the most geographically specific area delineation available. For the purpose of this analysis, JFO focused on consumer staples that are subject to a tax in Vermont. The goods and associated taxes considered were as follows:

- Alcoholic beverages: 6% sales tax
- Natural gas: 0.75% gross receipts tax
- Electricity: 0.5% gross receipts tax
- Fuel oil and other fuels: $0.02 per gallon
- Residential phone service:
- Cellular phone service
- Laundry and cleaning supplies: 6% sales tax
- Other household products: 6% sales tax
- Postage and stationery: 6% sales tax
- Household textiles: 6% sales tax
- Furniture: 6% sales tax
- Floor coverings: 6% sales tax
- Major appliances: 6% sales tax
- Small appliances and miscellaneous housewares: 6% sales tax
- Miscellaneous household equipment: 6% sales tax
- Cars and trucks, new: 6% purchase & use tax
- Cars and trucks, used: 6% purchase & use tax
- Gasoline, other fuels, and motor oil:
- Toys, hobbies, and playground equipment: 6% sales tax
- Personal care products and services: 6% sales tax

The estimated taxes paid as a result of spending on these consumer staples was calculated and broken out by income group. These values were then compared to the average EITC received by Vermont claimants broken out by filing status and by the same income ranges used by the CES.

Household Income	**Total Northeast**	**Less than $15,000**	**$15,000 to $29,999**	**$30,000 to $39,999**	**$40,000 to $49,999**	**$50,000 to $69,999**
Average Taxes	$716.37	$248.44	$324.47	$416.77	$469.25	$612.22

Source: Bureau of Labor Statistics, Consumer Expenditure Surveys, 2020-2021 and Joint Fiscal Office analysis

Tax Expenditure Expedited Reviews

Child and Dependent Care Credit and Low-Income Child and Dependent Care Credit Expedited Review Prepared by the Vermont Department of Taxes

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	Recommendations
Current Child and Dependent Care Credit: Refundable credit for 72% of federal Child and Dependent Care Tax Credit for care services provided in Vermont. 32 V.S.A. § 5828(c)	To provide cash relief to employees who incur dependent care expenses to enable them to remain in the workforce. 32 V.S.A. § 5813(r)	$5 million for fiscal year 2024	Consider whether the federal eligibility requirements that form the base of the Vermont credit align with the intended target population of Vermont workers. Consider whether tax credits are the most efficient means to support caregivers in the workforce.

Background

Until the 2021-2022 session, Vermont had two types of Child and Dependent Care Credit (CDCC): 1) a refundable Low-Income Child and Dependent Care Credit (LICDCC) of 50% of the federal Child and Dependent Care Credit for Vermonters with incomes under $40,000 (married filing jointly) or $30,000 (everyone else) and 2) a non-refundable Child and Dependent Care Credit of 24% of the federal credit for Vermonters who qualified for the federal credit but did not qualify for the low-income Vermont credit.

The Legislature changed and combined these credits in Act 138 of 2022. The Vermont Child and Dependent Care Credit is now 72% of the federal Child and Dependent Care Credit for care services provided in Vermont (32 V.S.A. § 5828(c)). The credit is now refundable for all eligible Vermonters and became effective January 1, 2022.

Vermont's credit piggybacks on the federal CDCC, which allows employed taxpayers to claim expenditures on care for their children and other dependents. The eligible expenditures are capped by the lowest of the federal care expenditure cap amount, the taxpayer's earned income, or the spouse's earned income on a joint return. AGI is then used to determine how much of the capped expenditure a taxpayer may claim; those with lower AGI can claim up to 35% of the capped expenditure, while those with the highest eligible AGI can claim 20% of the capped expenditure. This is the phaseout.

During the COVID-19 pandemic, the American Rescue Plan Act (ARPA) made the federal credit more generous by increasing the cap on eligible care expenses, changing the phaseout percentage of expenses that could be claimed by taxpayer AGI level, and making the credit refundable in some cases. These changes were generally positively received and, along with other credits such as the Child Tax Credit, dramatically but temporarily reduced the number of children in poverty.[25] The changes in Vermont reflect the positive changes in ARPA.

Public Policy Objectives

The public policy objective of the child and dependent care credit (CDCC) expansion is to make Vermont more affordable for families in the workforce who must pay for care for their children and other dependents. During the COVID-19 pandemic, the need to care for children who could no longer attend schools and daycares led large numbers of workers – especially women – to exit the labor force in order to care for their children. People across the nation began paying attention to the interdependencies between available care and available labor. Vermont responded with a suite of tax credit changes and introductions that included the CDCC expansion in order to help workers afford to remain in or re-enter the labor force.

Estimates and Analysis

New credit format

The CDCC was the fourth most-used expenditure in Vermont in its previous form.[26] The current version increases both the total expenditure and the number of taxpayers served. It is expected to cost $5.0 million with the new design in FY 24.

After the change, the most generous possible credit will be $3,612 (or $1,512 Vermont credit + $2,100 federal credit) for a Vermonter with two dependents and an AGI of $15,000 or less. The average Vermont credit per taxpayer claimed in FY 22 was $436.

Previous credit format

The following table provides actual expenditures for the last three reported fiscal years of the previous credit format. The CDCC was more frequently claimed than the LICDCC. In fiscal year 2022, the Credit for Child and Dependent Care cost $5.4 million and was claimed by 12,424 taxpayers. This credit year built on the more generous federal base for tax year 2021 (collected in fiscal year 2022) under the American Rescue Plan Act as discussed above. Because the federal credit allowed more people to claim more money, the Vermont credit did as well.

[25] See e.g., Wolters, B., Smith, L.K., & McHenry, K. (2021, April 19). The effects of the child and dependent care tax credit on childcare affordability. Bipartisan Policy Center. https://bipartisanpolicy.org/report/the-effects-of-the-child-and-dependent-care-tax-credit-on-child-care-affordability/

[26] Campbell et al. (2021). *Vermont tax expenditures: 2021 biennial report*. Vermont Legislative Joint Fiscal Office and Vermont Department of Taxes. p. 81. https://ljfo.vermont.gov/assets/Subjects/Tax-Expenditure-Reports/012ba9923e/2021-Tax-Expenditure-Report-FINAL-v2.pdf

Expenditure	FY 2019 Actual	FY 2021 Actual	FY 2022 Actual
Credit for Child and Dependent Care	$1,694,000	$1,320,821	$5,415,865
Low Income Child and Dependent Care Credit	$44,000	$69,068	$73,384

Source: 2019 credit information from the 2021 Tax Expenditure Report, 2021 and 2022 information from the 2023 Tax Expenditure Report

Childcare costs

The rest of this analysis will focus on childcare costs because, although they are not the only care costs eligible for reimbursement under this credit, they have been the recent focus of discussion in Vermont. Childcare costs are increasing rapidly. The average cost of childcare in the US increased 28% between 2010 and 2020.[27] American families spent $7,131 on childcare on average in 2021.[28] The national Department of Health and Human Services considers childcare affordable if it costs no more than 7% of annual income.[29] Using the 7% national guideline, the annual income at which $7,131 in care expenditures would be affordable is $101,871. Although lower-income families tend to spend less on childcare than higher-income families, childcare costs do not decline linearly with income; those with lower incomes must spend a proportionately larger share of their annual income on care.[30]

The most recent Let's Grow Kids annual economic impact assessment for childcare provides some Vermont-specific statistics. Tuition costs for center-based childcare in Vermont range from $14,300 for a preschooler to $15,080 for an infant, as seen in the table below.[31] The median income for a family with children under age 6 is $69,000.[32] A median family with one child would end up spending 21-22% of their income on center-based tuition, depending on the age of their child[33] – far above the affordable 7% recommended above. More children would mean more tuition expenditure.

[27] *How much are families spending on childcare?* (2022, April 7). USAfacts.org. https://usafacts.org/articles/how-much-are-families-spending-on-childcare/

[28] ibid

[29] ibid

[30] ibid

[31] Cope, Heather. (2022). *Childcare is everyone's business: Annual economic impact of a comprehensive childcare system for Vermont.* Blue Otter Consulting and Let's Grow Kids. https://letsgrowkids.org/client_media/files/2022EconomicImpactReport.pdf

[32] ibid

[33] ibid

Child Age Group	Cost of Center Based Tuition	Percent of Vermont Median Income: Single Parent Vermonters ($32,489)	Vermonters with Children Under 6 ($69,000)	Married Vermonters ($103,345)
Infant	$15,080	46%	22%	15%
Toddler	$14,560	45%	21%	14%
Preschool	$14,300	44%	21%	14%
Average	**$14,647**	**45%**	**21%**	**14%**

Source: https://letsgrowkids.org/client_media/files/2022EconomicImpactReport.pdf and https://info.childcareaware.org/hubfs/2021%20Price%20of%20Care%20State%20Sheets/Vermont_Price%20Fact%20Sheet%202021.pdf

Considerations

The Vermont Child and Dependent Care Credit can apply to children older than five, while the Vermont Child Tax Credit applies only to children aged five and younger. This allows the CDCC to provide some relief for families with older children, as long as those families pay for childcare and meet the federal income thresholds. Families with young children may claim both the CDCC and the Child Tax Credit if they are eligible for both credits.

Federal limitations for the CDCC flow through to Vermont because the federal credit is the starting point for the Vermont credit. Therefore, changes in federal eligibility and expense caps will affect the Vermont credit.

Federal expense cap changes are particularly salient right now: the American Rescue Plan Act of 2021 temporarily made the federal CDCC much more generous before reverting to previous levels in tax year 2022. The largest base federal credit in tax year 2021 was $8,000 but the largest base federal credit in tax year 2022 was $2,100. These changes are shown in the table below. The effects of these changes to the federal base can also be seen in the difference in Vermont actual expenditures detailed in the "previous credit format" section above.

Federal Credit Consideration	Tax Year 2021 (ARPA)	Tax Year 2022
Largest possible federal credit	$8,000	$2,100
Maximum qualifying expenses for 2 dependents	$16,000	$6,000
Minimum own or spouse earned income to avoid limiting expense eligibility	$16,000	$6,000
Percent of expenses eligible for federal credit	50%	35%
Max federal AGI for largest claim percentage	$125,000	$15,000
Federal AGI at which taxpayer is ineligible to claim credit	$438,000	No limit

Although the Vermont CDCC is now fully refundable, the federal credit that forms the basis for calculations is not. This means that neither the Vermont credit nor the federal credit can exceed the taxpayer's federal tax liability; if a taxpayer has zero liability, they become ineligible for the CDCC regardless of care expenditures.[34] This is especially important for taxpayers in lower income brackets who may benefit from other credits – especially the refundable Earned Income Tax Credit – that reduce or eliminate their federal tax liability and therefore reduce the CDCC amount that they can claim. The Tax Policy Center found that eligible taxpayers in the lowest 20% of the income distribution were likely to receive much smaller CDCC credits than average,[35] likely because of this tax liability constraint. High-income taxpayers (with annual incomes of $100,000 or more) receive a disproportionately high share of CDCC benefits federally.[36] [37] This skewed distribution carries through to the Vermont credit. Vermont's refundable credit addresses some of this disparity but cannot help people who were ineligible in the non-refundable base. It can, and does, help workers closer to the middle of the income distribution who still face burdensome care costs but who are ineligible for many of the other income-based childcare subsidies in Vermont.

This credit design comes with a tradeoff: relying on the federal credit as a base means that the Vermont credit is constrained by federal requirements, as noted above, and expands and contracts in line with federal eligibility. However, starting with the federal credit allows for simplified calculations on Vermonters' tax returns. Additionally, using the federal credit contains the scope of the CDCC expenditure; as long as the Vermont credit uses a percentage of the federal credit, big changes to what qualified claimants can realize – such as the shift from 24% to 72% of the federal credit in Act 138 – can be made with relatively small additional budgetary cost.

The federal CDCC is intended to be a credit to workers and therefore constrains eligible care expenditures to be less than or equal to the earned income of the lowest-earning spouse.[38] This can lead to different credit amounts for the same income: a couple with two dependents and $40,000 of earned income would get a higher credit if they each earned $20,000 than if one earned $39,000 and the other earned $1,000. If one spouse does not work (or attend school full time), the couple is ineligible to claim the credit.[39] In practice, the current federal credit design privileges two-income families who pay for formal care from a licensed facility or provider over single-parent families, families who use informal care (such

[34] Maag, E. *Understanding child care subsidies in the tax system*. (2017, May 24). Testimony to Democratic Women's Working Group. https://www.taxpolicycenter.org/publications/understanding-child-care-subsidies-tax-system/full

[35] ibid

[36] *Expanding child care choices: Reforming the child and dependent care tax credit to improve family affordability*. (2021, February). Joint Economic Committee SCP Report No. 2-21. https://www.jec.senate.gov/public/_cache/files/afc93ce5-7e97-4be1-a683-1993f7fc45ed/2-21-child-care-choices.pdf

[37] Sawhill, I. & Welch, M. *The American Families Plan: Too many tax credits for children?* (2021, May 27. Brookings. https://www.brookings.edu/blog/up-front/2021/05/27/the-american-families-plan-too-many-tax-credits-for-children/

[38] People who are married under state law are considered married by the IRS and can file a joint return. See *Answers to frequently asked questions for registered domestic partners and individuals in civil unions.* (2022, September 29). Internal Revenue Service. https://www.irs.gov/newsroom/answers-to-frequently-asked-questions-for-registered-domestic-partners-and-individuals-in-civil-unions#:~:text=Can%20registered%20domestic%20partners%20file%20federal%20tax%20returns,dependent%20is%20his%20or%20her%20registered%20domestic%20partner%3F

[39] *Publication 503: Child and dependent care expenses*. (2021). Internal Revenue Service. https://www.irs.gov/pub/irs-pdf/p503.pdf

as from a family member or neighbor), and families where one spouse stays home to provide care.[40 41] The Vermont credit has these same constraints because it is based on the federal credit.

Finally, the Legislature should consider whether a tax credit is the most effective way to make Vermont affordable for workers who must pay for child and dependent care. The same amount of money could be used to invest directly in improving universal pre-k, used to expand the EITC, or directly subsidize care for the lowest-income families.[42] A recent multi-policy welfare analysis found that programs that invest directly in child health and early childhood education are the most beneficial for improving social welfare, while programs aimed at adults that have spillover effects on children (such as tax credits) have high but less-pronounced benefits.[43] This would imply that, for instance, enhanced investment in universal pre-k would be a better investment than the CDCC. Recent pandemic-era spending on child-oriented tax expenditures such as the CDCC and child tax credits has been deservedly praised for reducing child poverty, but it is also prudent to step back and evaluate whether other programs might be even more effective.

Legal History

Child and Dependent Care Tax Credit (original)

2001	Credit established as 24% of federal Child and Dependent Care Tax Credit. Nonrefundable. Taxpayers must choose between this CDCC and the LICDCC below.
2021	Credit combined with LICDCC below. Citation for original credit removed from 32 V.S.A. § 5822(d)(1).

Low Income Child and Dependent Care Credit

2001	Credit established as 50% of federal Child and Dependent Care Tax Credit. Refundable. Eligibility capped at $40,000 federal AGI for married filing jointly and $30,000 federal AGI for everyone else. Care services must be provided by a licensed Vermont facility to be eligible for credit. Taxpayers must choose between this and the CDCC above.
2021	Credit increased to 72% of federal. Credit refundable for all taxpayers. Name changed to Child and Dependent Care Credit. Effective January 1, 2022.

State Comparisons

The first table below shows the most generous possible credit by state. Calculations are done using the information about state credits in the second table below and the tax year 2022 federal Child and Dependent Care Tax Credit limits from federal form 2441. With larger allowable federal credits (as in tax year 2021), the order of generosity changes.

Currently, Vermont has the 11th most generous maximum CDCC credit in the country. The $15,000 AGI for the most generous Vermont credit comes from the AGI at which one can receive the maximum federal credit of 35% of care expenditures.

[40] *Expanding child care choices* (2021, February).
[41] Maag 2017
[42] Sawhill and Welch 2021
[43] Hendren, N. & Sprung-Keyser, B. A unified welfare analysis of government policies. (2020). *Quarterly Journal of Economics*, 135(3), 1209-1318.

Most Generous Possible CDCC Credits by State

Calculated using federal CDCC limits for 2022

State	Most generous possible credit	AGI for most generous	# Dependents for most generous	Filing status for most generous
Oregon	18,000	49,000	6+	S, HH
New York	9,000	15,000	5	
Louisiana	7,350	15,000	3+	
Idaho	6,000		2	
Hawaii	4,800	25,001	2	S, HH, MFJ
Montana	4,800	18,000	3	
Virginia	2,100	no limit	2	
Minnesota	2,100	15,000	2	
Nebraska	2,100	15,000	2	
Ohio	2,100	15,000	2	
Vermont	1,512	15,000	2	
New Mexico	1,200	30,450	3	
Delaware	1,050	15,000	2	
Maine	1,050	15,000	2	
California	1,050	15,000	2	
New Jersey	1,050	15,000	2	
Colorado	1,000	15,000	2	
Washington DC	672	15,000	3	S, HH, MFJ
Maryland	672	15,000	2	MFJ
Georgia	630	15,000	2	
Iowa	630	15,000	2	
Kansas	525	15,000	2	
Rhode Island	525	15,000	2	
Kentucky	420	15,000	2	
Oklahoma	420	15,000	2	
Massachusetts	360		2	
Arkansas	288	10,000	2	
South Carolina	147	15,000	2	S, HH, MFJ

State Child and Dependent Care Tax Credits

State	Amount	Refundable	Qualifications
Oregon	A percentage, determined by an online calculator, of: $12,000 for one dependent $24,000 for two dependents	Yes	Must be low-income Employment-related Can base on either federal AGI or OR AGI Do not need to claim federal CDCC Limited by OR earned income and spouse's OR earned income Not available to MFS Children must be under 13 to qualify Must provide proof of expenses
New York	At least 20% of federal If NY AGI > $40k, lesser of 20% + 80% * (15,000 / 15,000) 20% + 80% * ((65,000 - NY AGI) / 15,000) If NY AGI < $40k, lesser of 100% + 10% * (15,000/15,000) 100% + 10% * ((40,000 - NY AGI) / 15,000) Capped at $7,500 for 3 dependents, $8,500 for 4 dependents, $9,000 for 5+ dependents	Yes for residents	Based on NEW YORK AGI, not federal Qualified for federal credit
Louisiana	50% of federal credit regardless of federal tax liability or whether they claimed it for AGI up to $25k, 30% of federal for AGI $25k-35k, 10% of federal for AGI $35k-60k, 10% of federal for AGI > $60k, capped at $25 PLUS for children under 6, 50% to 200% of the above credit per child based on child care facility grade	Yes for AGI up to $25k For AGI over that, can be carried forward 5 years	Credit increases as quality rating of child care program increases Additional school readiness credit for children under age 6
Idaho	$6000 less earned income for two dependents $3000 less earned income for one dependent		Must claim federal Capped at $3k for one dependent and $6k for two Limited by earned income Start with expenses incurred, not with federal credit

State	Amount	Refundable	Qualifications
Hawaii	25% of qualifying expenses	Yes	Capped at $2400 for 1 dependent, $4800 for two Limited by AGI, earned income, spouse's earned income Cannot claim if MFS
Montana	$2,400 for 1 dependent $3,600 for 2 dependents $4,800 for 3 dependents with steep phaseout over $18k AGI		Expense deduction, not credit Reduced by 1/2 of amount that AGI exceeds $18k
Virginia	100% of federal AS A DEDUCTION rather than a credit		Must be eligible for federal CDCC Expense deduction, not credit
Minnesota	100% of federal Phaseout lesser of credit or $600 - 5% * (AGI - 52,230)	Yes	Phaseout
Nebraska	100% of federal under $22k Reduce by 10% for every $1k over	Yes if AGI under $29k (even if fed tax limited)	Max AGI $31k
Ohio	100% of federal under $20k 25% of federal under $40k		
Vermont	72% of federal	Yes	Must be VT resident
New Mexico	40% of expenses Capped at $480 per dependent, $1,200 total	Yes	Must be gainfully employed Modified gross income less than or equal to double federal minimum wage (<= $30,450 in 2021) Max AGI $31,160 Dependent under age 15 Can't be used with other NM assistance programs
Delaware	50% of federal	No	Limited by lowest earned income of spouse

State	Amount	Refundable	Qualifications
Maine	25% of federal 50% of federal with highest care provider certification	Yes up to $500	Must claim federal child tax credit for the dependent to qualify Child care credit percentage doubles if the care provider has a specific qualification Dependent care (non-child) has a different structure: $300 per dependent stepping down for AGI > $400k MFJ or $200k other
California	50% under $40k AGI, 43% under $70k, 34% under $100k	No	Must earn $100k or less Must have earned income Care must be necessary for gainful employment Must file MFJ if married Capped at amount of federal credit or $3k for 1 dependent or $6k for 2+ dependents Must retain extensive records to substantiate
New Jersey	50% of federal under $20k AGI 10% under $150k AGI	Yes	Max AGI $150k
Colorado	50% under $60k AGI CDCC 25% under $25k AGI LICDCC LICDCC max $500 for 1 child or $1000 for 2+	Yes	Must successfully claim federal credit for CDCC Must meet criteria for federal credit but not have federal tax liability for LICDCC Children 13 and younger Can claim one of LICDCC or CDCC Must be full or part year CO resident Married must file jointly and it will use lower of the two earned incomes

State	Amount	Refundable	Qualifications
Washington DC	32% of federal Capped at $1k per child + COLA	Yes	Children under age 4 Income up to $153,400 for S, HH, MFJ Income up to $76,700 for MFS Only one person may take the credit per child Not eligible for this when become eligible for district pre-K program Qualified child development facility
Maryland	32% of federal limited by AGI and tax liability Cap $143k for MFJ $92k for individuals Steps down 1% for each $2k over $30k and $3k over $50k	Yes if AGI under $75k for MFJ, $50k for individual	Meet federal requirements AGI caps and phaseout
Georgia	30% of federal	No	
Iowa	30% of federal up to $90k AGI	Yes	Eligible and allowed federal Choose between CDCC and Early childhood development tax credit
Kansas	25% of federal	No	
Rhode Island	25% of federal	No	Limited by RI income tax liability
Kentucky	20% of federal	No	
Oklahoma	20% of federal under $100k AGI	No	Must choose between % of CDCC and % of CTC
Massachusetts	$180 for 1 dependent $360 for 2 or more	Yes	Dependent must be under 12, over 65, or disabled Must choose between Household Dependent Tax Credit and Dependent Care Tax Credit
Arkansas	20% of federal (federal as of 1993)	Yes	Must qualify for federal credit Care must be necessary for gainful employment Care provided by qualified individual or approved facility
South Carolina	7% of federal Capped at $210 for 1 dependent $420 for 2+	No	Cannot claim if MFS

Source: State tax department websites and Committee for Economic Development 2022 https://www.ced.org/child-care-state-tax-credits

Military Pay Exemption – Expedited Review

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	Recommendations
This exemption exempts from Vermont Income military pay for full time active duty with the US armed forces earned outside the State, the first $2,000 of income earned in the state for National Guard training (if the filer's income is under $50,000), and funds received through the federal Armed Forces Educational Loan Repayment Program.	The statutory purpose of the exemption for military pay in subdivisions 5823(a)(2) and (b)(3) of title 32 is to provide additional compensation for military personnel in recognition of their service to Vermont and to the country	$1.9M	Consider if these types of income should remain part of the apportionment calculation (where the percentage of total income that is Vermont income is calculated) or if they are better structured as subtractions from taxable income like Vermont's social security exemption, which would provide a (slightly) greater benefit and more accurately exempt the income from taxation.

Public Policy Objectives

The Legislature states that the public policy objective for the exemption for these three types of military pay is to provide additional compensation for military personnel in recognition of their service to Vermont and to the country.

Estimates and Analysis

Exempting the types of military income included in this provision costs the state about $1.9M per year and reduces the taxes of about 2,000 filers compared to what their taxes would have been without the exemption.

Legal History

This credit was created in Act 61 (1966).

State Comparisons

Many states include preferential treatment towards military pay (and military retirement pay) in their tax codes, but the treatment varies widely across states. The American Bar Association assembles a helpful guide to state tax treatment of military income and the most recent version available is here: Military State Tax Guide (2021 Ed.) (americanbar.org)

Trade-In Allowance – Expedited Review

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	Recommendations
When someone buys a new car and trades in their old one as part of the transaction, the "trade-in allowance" (meaning the value the seller credits the buyer for the car they are trading in as part of transaction) is not taxed under the Purchase and Use Tax.	The statutory purpose of the exclusion for the trade in allowance from the purchase and use tax under 32 V.S.A. § 8902 (4) and (5) is to ensure the use value of a vehicle is taxed only once.	$44.9M	Maintain the current treatment of the trade-in allowance to avoid double taxation.

Public Policy Objectives

The Legislature stated that the public policy objective of the exclusion of the trade-in allowance from the purchase and use tax is to avoid double taxation.

Estimates and Analysis

Based on data from the Vermont Department of Motor vehicles, adjusted for inflation and assumptions around price elasticity.

Legal History

This exclusion was created in Act 327 (1959) when Vermont's Motor Vehicle Purchase and Use tax was established.

State Comparisons

The vast majority of states that apply a sales tax to the purchase price vehicles do not include the value of any trade in in the taxable amount in order to avoid double taxation. Notable exceptions include California, Washington DC, and Michigan (for any trade-in value over $7,000).

10,000 Exemption from the Property Value of Disabled Veterans – Expedited Review

Tax Expenditure	**Statutory Purpose**	**Estimated Revenue Impact**	**Recommendations**
Up to $10,000 of appraised value (except any part used for business or rental) is exempt from both the statewide education and municipal property taxes if the property is owned by someone receiving disability compensation for at least 50 percent disability, death compensation, dependence and indemnity compensation, or pension for disability paid through any military department or the Veterans Administration. Applicants must annually file with the Office of Veteran's Affairs.	The statutory purpose of the exemption for $10,000 of appraised value of a residence for a veteran in subdivision 3802(11) of this title is to recognize disabled veterans' service to Vermont and to the country.	$0.5M	Clarify whether "established residence" in §3802 (11)(A) has the same meaning as homestead under §5401 (7)(A). In FY22 and FY23, properties receiving the exemption were homesteads roughly 86% of the time Clarify whether the income-based property tax credit received by a household receiving a Veterans' exemption should be based on the housesite taxes *before* the exemption is applied, or after. Currently the credit is based on the full (before exemption) housesite taxes. Consider making the state veterans' exemption a uniform $40,000 across all towns. There are only 19 towns that have not voted the exemption up to $40,000, and 96% of all instances of the exemption being applied in FY23 were for $40,000.

Public Policy Objectives

The policy objective of this exemption is to recognize the service of disabled veterans to Vermont and the country.

Estimates and Analysis

According to the Grand List, roughly 3,000 parcels have this $10,000 exemption applied each property tax year and the cost to the Education Fund is roughly $0.5M per fiscal year. Towns are allowed to increase the exemption to $40,000 under § 3802(11), but they need to make up the difference to the education fund between the state-authorized exemption amount and whatever they have voted. The mechanism for raising that additional revenue is the "Local Agreement Tax Rate."

Legal History

This exemption was enacted prior to 1910 and amended in 2011 to require the Office of Veterans Affairs to track application instead of local listers.

State Comparisons

Many states provide targeted property tax relief to veterans. Some states provide the relief through an exemption of a portion of the property value (like Vermont) and some states reduce the taxes by a specific amount. This article summarizes the program parameters of the other states that exempt a portion of the property value: https://www.thebalancemoney.com/property-tax-exemptions-for-veterans-5208601. So does this website: Disabled Veteran Property Tax Exemptions By State and Disability Rating (veteransunited.com)

Energy Purchases for Farming – Expedited Review Prepared by the Vermont Department of Taxes

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	Recommendations
Sales of electricity, oil, gas, and other fuels used directly and exclusively for farming purposes are exempt from the 6% sales and use tax. (32 V.S.A. § 9741(27))	To promote Vermont's agricultural economy. 32 V.S.A. § 9706(n)	$2,480,000 in 2024	Expenditure is in line with nearby states. Consider creating a targeted statutory purpose or redirecting expenditure for better impact.

Public Policy Objectives

The statutory purpose of "promot[ing] Vermont's agricultural economy" is very broad, which makes the impact difficult to evaluate. A specific and measurable purpose, such as "to reduce agricultural heating costs by 5% over 5 years," would provide clear targets against which to evaluate the effectiveness of the tax expenditure.

Estimates and Analysis

As indicated in the accompanying Tax Expenditure Report, current estimates for the revenue impact of this tax expenditure are:

Fiscal Year	Expenditure
2020	$1,990,000
2022	$2,490,000
2024	$2,480,000

According to data from the most recent US Census of Agriculture, purchases of gasoline, fuels, and oils constituted 5.4% of total farm production expenses for Vermont farmers in 2017 and 6.4% of total farm production expenses in 2012[44]. This is the sixth largest expense category of the 22 categories listed in the report for 2017, indicating that there may be opportunity to better target this $2.48m tax expenditure. The largest expense category in the Census of Agriculture report was feed purchased (26.6% of total farm production expenses), followed by hired farm labor; repairs, supplies, and maintenance costs; depreciation expenses; and "all other production expenses."[45]

It is unclear whether this reduction of energy spending effectively promotes Vermont's agricultural economy. One possible interpretation of the statutory purpose is that the expenditure is intended to reduce energy costs to allow agricultural producers to stay in business. The National Agricultural

[44] Table 4: Farm Production Expenses: 2017 and 2012 from National Agricultural Statistics Service (NASS), *Census of Agriculture: 2017 Census Volume 1, Chapter 1: State Level Data: Vermont*. (2018). https://www.nass.usda.gov/Publications/AgCensus/2017/Full_Report/Volume_1,_Chapter_1_State_Level/Vermont/

[45] ibid

Statistics Service provides an estimate of number of farms in service that has remained at a consistent 6,800 farms between 2017 and 2020[46]. The Vermont Department of Labor shows that the number of establishments in the category "agriculture, forestry, fishing and hunting" that are subject to the unemployment insurance program (including but not exclusive to farms employing ten or more workers) has increased from 492 in 2018 to 535 in 2021.[47] These numbers do not provide detail on how fuel costs contributed to the business decisions of the establishments in question, but do indicate that the number of players in Vermont's agricultural economy overall has not declined in the recent past.

<u>Legal History</u>

1977	Exemption added
2013	Statutory purpose added (Act 200 of 2013)

[46] Note that the data in this report include the same value each year for multiple categories, indicating that the estimate is updated infrequently. National Agricultural Statistics Service. (2021 September). *2020-2021 Agricultural Statistics Annual Bulletin: New England*. United States Department of Agriculture. https://www.nass.usda.gov/Statistics_by_State/New_England_includes/Publications/Annual_Statistical_Bulletin/2020/NewEng_Annual_Bulletin_2020.2021.pdf

[47] Vermont Department of Labor. (2018 to 2021). *U.I. Covered Employment & Wages (QCEW) Annual & Quarterly Averages: Year to Date Table: State & County*. http://www.vtlmi.info/indnaics.htm#mqa

State Comparisons

The following table shows the taxability of residential energy purchases in nearby states. Energy purchases for farms are exempt in all these states.

State	Taxability	Reference
Connecticut	Exempt	Conn. Gen. Stat. § 12-412(3)(A) https://cga.ct.gov/current/pub/chap_219.htm#sec_12-412
Maine	Exempt for commercial farmers	36 M.R.S. § 1760(9-B) https://www.mainelegislature.org/legis/statutes/36/title36sec1760.html Instructional Bulletin no. 13 https://www.maine.gov/revenue/sites/maine.gov.revenue/files/inline-files/IB13%20FINAL%20Sales%20of%20Fuel%20and%20Utilities%202022_11_15.pdf
Massachusetts	Exempt	G.L. c. 64H, § 6(r) https://malegislature.gov/Laws/GeneralLaws/PartI/TitleIX/Chapter64H/Section6
New Hampshire	No state sales tax	
New York	Exempt	TAX § 1115(c)(2) Legislation | NY State Senate (nysenate.gov)
Rhode Island	Exempt	R.I. Gen. Laws § 44-18-30(20) http://webserver.rilegislature.gov//Statutes/TITLE44/44-18/44-18-30.HTM
Vermont	Exempt	32 V.S.A. § 9741(27) https://legislature.vermont.gov/statutes/section/32/233/09741

Energy Purchases for a Residence – Expedited Review Prepared by the Vermont Department of Taxes

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	Recommendations
Sales of electricity, oil, gas, and other fuels used in a residence for all domestic use including heating are exempt from the 6% sales tax on tangible personal property. Wood pellets are specifically included in this exemption. 32 V.S.A. § 9741(26)	To limit the cost of goods that are necessary for the health and welfare of Vermonters. 32 V.S.A. § 9706(m)	$49,400,000 in 2024	Periodically review exemption to ensure it continues to align with intended purpose. Is this the best use of funds to achieve that purpose?

Public Policy Objectives

The public policy objective is, broadly, to ensure that Vermonters can continue to afford to meet their needs for food and shelter.

Estimates and Analysis

As indicated in the accompanying Tax Expenditure Report, current estimates for the revenue impact of this tax expenditure are:

Fiscal Year	Expenditure
2020	$42,350,000
2022	$38,810,000
2024	$49,400,000

Although Vermonters do not pay the 6% sales and use tax on the energy sources and fuels because of this exemption, other taxes do apply to the same products. These products are subject to the 0.5% fuel gross receipts tax in 33 V.S.A. § 2503, which is currently slated to end on June 30, 2024. Similarly, the gross operating revenue tax on utilities in 30 V.S.A. § 22 covers these products and is most likely passed on to consumers.

According to the US Energy Information Administration, Vermont ranks 44th in the nation on energy consumption per capita but 12th in the nation on energy expenditures per capita.[48] The rankings for neighboring states are provided below for context. Vermont has the 9th highest

[48] *U.S. Overview*. (2022). U.S. Energy Information Administration. https://www.eia.gov/state/

residential sector average electricity retail prices in the United States,[49] likely due in part to its renewable energy requirements.

State Total Energy Rankings, New England and New York

State	Consumption per Capita Million Btu	Rank	Expenditures per Capita Dollars	Rank
Connecticut	185	46	$3,205	25
Maine	268	28	$3,586	13
Massachusetts	182	47	$2,977	31
New Hampshire	215	39	$3,354	19
New York	166	49	$2,380	51
Rhode Island	160	50	$2,865	38
Vermont	196	44	$3,619	12

Source: https://www.eia.gov/state/

Vermont has the third-largest share of households heating with petroleum products (68%) and the largest share of households heating with wood (12%) in the nation.[50] The following table presents residential heating sources in Vermont vs. the country overall.[51] Vermont's mix is very different from the rest of the nation; the old housing stock, cold climate, and small market size contribute to this difference.

Residential Heating Sources, 2021

Energy Source Used for Home Heating	Vermont (share of households)	U.S. Average (share of households)
Natural gas	18.8%	46.5%
Fuel oil	38.9%	4.1%
Electricity	8.3%	41.0%
Propane	19.2%	5.0%
Other/None	14.8%	3.5%

Source: https://www.eia.gov/state/data.php?sid=VT#Prices

Vermonters' dependence on fuel oil makes its residents particularly sensitive to changes in fuel oil prices, which increased quickly at the beginning of 2022 in response to geopolitical conditions. The chart below shows that residential heating oil prices started the 2022-2023 winter heating season 65% higher in October of 2022 than they had been in October of 2021.[52] The U.S. Energy

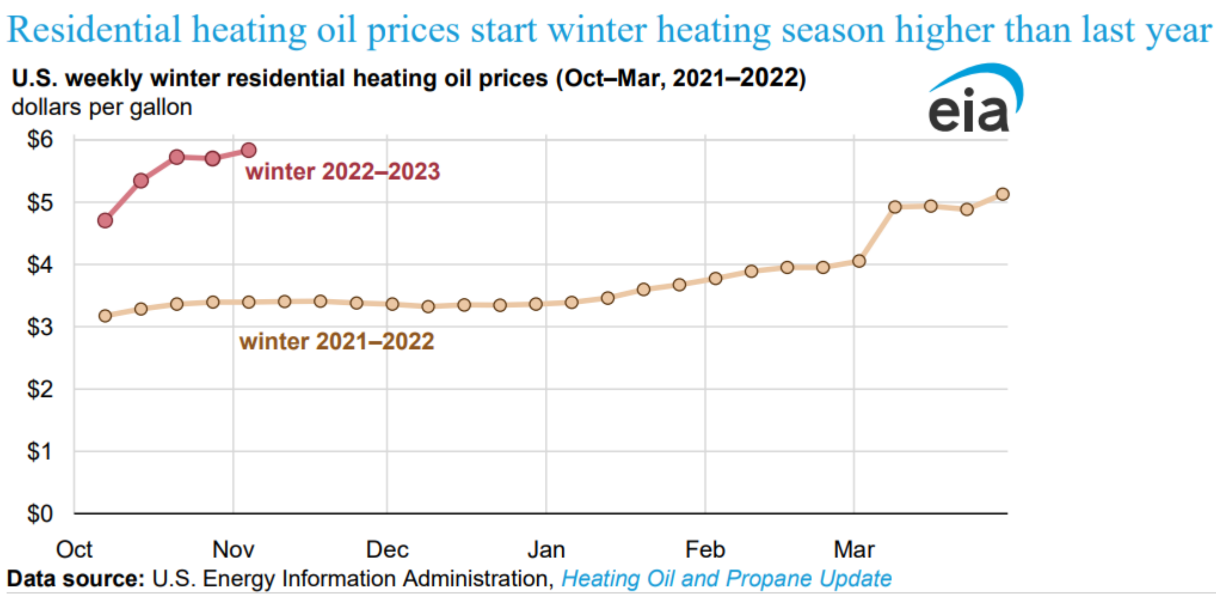
[49] *Vermont State Energy Profile*. (2022 October 20). U.S. Energy Information Administration. https://www.eia.gov/state/data.php?sid=VT#Prices

[50] ibid

[51] Ibid

[52] *Residential Heating Oil Prices Start Winter Heating Season Higher than Last Year*. (2022 November 17). Today in Energy. U.S. Energy Information Administration. https://www.eia.gov/todayinenergy/detail.php?id=54699

Information Administration expects that households will spend an average of 45% more for heating during the winter of 2022-2023 than the previous winter due to this price increase and expectations of increased consumption.[53]



Graphic source: U.S. Energy Information Administration
https://www.eia.gov/todayinenergy/detail.php?id=54699

The energy purchases for a residence tax exemption applies to "sales of electricity, oil, gas, and other fuels used in a residence for all domestic use, including heating…" (32 V.S.A. § 9741(26)). This provision has been in place since 1977. Energy technology is changing as people focus on the role that traditional technologies, such as fossil fuels, play in climate change. The existing statutory language may or may not continue to be relevant as newer technologies gain prominence. Does the Legislature want to defray costs for these newer technologies, or only for the older ones? The Legislature should periodically review whether this exemption, in combination with other statutes and programs, continues to adequately address the policy objective.

Legal History

1977	Exemption added
2013	Specified that fuel sold at retail in free-standing containers is not included in exemption (Act 174 of 2013)
	Statutory purpose added (Act 200 of 2013)
2021	Wood pellets sold to individual on vendor's premises or delivered to a residence are presumed to be purchased for residential use and are included in this exemption (Act 54 of 2021). This means that individuals need not obtain and present an exemption certificate when purchasing wood pellets.

[53] ibid

State Comparisons

The following table shows the taxability of residential energy purchases in nearby states.

State	Taxability	Reference
Connecticut	Exempt	Conn. Gen. Stat. § 12-412(3)(A) https://cga.ct.gov/current/pub/chap_219.htm#sec_12-412
Maine	Residential electricity first 750 kwh per month exempt, gas for residential heating and cooking exempt, wood exempt, small volumes of kerosene exempt, some other exemptions	Title 36, § 1760(9-B) https://www.mainelegislature.org/legis/statutes/36/title36sec1760.html Instructional Bulletin no. 13 https://www.maine.gov/revenue/sites/maine.gov.revenue/files/inline-files/IB13%20FINAL%20Sales%20of%20Fuel%20and%20Utilities%202022_11_15.pdf
Massachusetts	Exempt	G.L. c. 64H, § 6(i) https://malegislature.gov/Laws/GeneralLaws/PartI/TitleIX/Chapter64H/Section6
New Hampshire	No state sales tax	
New York	State exempt, local taxable	https://www.tax.ny.gov/pubs_and_bulls/tg_bulletins/st/residential_energy.htm https://www.tax.ny.gov/pdf/publications/sales/pub718r.pdf
Rhode Island	Exempt	R.I. Gen. Laws § 44-18-30(20) http://webserver.rilegislature.gov//Statutes/TITLE44/44-18/44-18-30.HTM
Vermont	Exempt	32 V.S.A. § 9741(26) https://legislature.vermont.gov/statutes/section/32/233/09741