VERMONT

2019 Tax Expenditure Reviews

As part of the:

2019 Biennial Tax Expenditure Report

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Legislative Joint Fiscal Office
Vermont Department of Taxes

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2019 Vermont Tax Expenditure Reviews

Introduction

The 2019 Vermont Tax Expenditure Report is 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 fourteenth year in Vermont and is improved to reflect more recent research and recommended best practices.[1]

As part of the 2019 Tax Expenditure Report, the Joint Fiscal Office, with assistance from the Vermont Department of Taxes, have completed reviews of certain tax expenditures as required by Sec. 40 of Act 134 of 2016. These reviews were classified as "expedited" and "full".

An expedited review analyzes the purpose of a tax expenditure, delineates its cost 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 of 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 year. The full review of the Capital Gains Exclusion within this report represents the first full review undertaken using this approach.

Act 134 of 2016 also established a schedule for the expedited and full reviews. For the 2019 Tax Expenditure Report, the tax expenditures scheduled for review were those related to incentivizing a specific desirable outcome, including agriculture, and related to excluding charitable and public service organizations from taxation.

The Joint Fiscal Office completed these reviews with data assistance and legal analyses as needed from the Tax Department.

[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

Capital Gains Exclusion
Full Review
Prepared by the Joint Fiscal Office

I. Executive Summary

The Vermont income tax exclusion for capital gains allows taxpayers to exclude a portion of their realized capital gains each year from taxation. Capital gains are defined as the profits resulting from the sale of a capital asset, such as shares of stock, a business, real estate, or a work of art.

The capital gains exclusion acts as a subtraction from Vermont taxable income. Taxpayers can choose one of two options for the exclusion:

- An exclusion of $5,000 or less based on total (either short-or-long term) capital gains; or
- A percentage exclusion equal to 40% of their adjusted net capital gains from the sale of assets held for more than three years or 40% of their Federal Taxable Income (whichever is less). Restrictions on the types of assets limit the use of this exclusion to the sales of non-publicly traded businesses, farms, investment property, and timber.

In CY2016, the most recent and complete year of data, 41,865 Vermont taxpayers excluded approximately $303.5 million in capital gains from their income. These numbers fluctuate with the overall volatility in capital gains year-to-year. This tax expenditure cost the State roughly $15 million in forgone tax revenue in FY2017. Vermont is one of nine states that offer some sort of specific preferential tax treatment for capital gains within their tax code.[3]

Key Findings

JFO's review of the capital gains exclusion made the following key findings:

1) Similar to the distribution of personal income tax receipts overall, higher-income, older taxpayers account for the majority of capital gains and capital gains exclusions.

- Of the $303.5 million of capital gains exempted through the exclusion in CY2016, almost 60% went to filers with Adjusted Gross Income (AGI) over $300,000, despite representing 1% of tax returns and 10% of returns with taxable capital gains.
- Filers with AGI below $100,000 represented only 18% of total capital gains exclusions, despite representing over 85% of Vermont tax returns and 55% of returns with taxable capital gains.
  - In CY2016, the average exclusion for those with AGI above $300,000 was roughly $43,000, almost ten times greater than the average exclusion for those with incomes between $100,000 and $300,000 ($4,600).
  - 65% of total capital gains excluded from taxation came from taxpayers age 55 and older.

[3] Other states choose to tax capital gains at regular income tax rates, which can sometimes provide a greater tax benefit than a specific capital gains exclusion, if marginal income tax rates are low enough.

2) For the vast majority of taxpayers, the exclusion's tax benefit declines as income rises. For those who can take the 40% exclusion (business owners, farmers, property investors), higher-income taxpayers receive a greater tax benefit.

- 95% of capital gains filers took the capped $5,000 exclusion in CY2016, which limits the amount of capital gains high-income filers can exclude from their income. For this reason, as incomes rise, the tax benefit as a percentage of income declines.
- For the remaining 5% of capital gains filers who were eligible to take the 40% exclusion, larger capital gains, on average, for high-income filers mean they benefit from the capital gains exclusion more than lower-income filers.
- At the federal level, the tax benefit from preferential capital gains rates increases with income.

3) The capital gains exclusion helps Vermont remain tax competitive with neighboring states that do not have special tax treatment for capital gains but have lower top marginal tax rates.

- The $5,000 exclusion provides a much greater tax benefit to taxpayers with income below $100,000 than is provided in other states in the region.
- For taxpayers with income above $100,000 who are not eligible for the 40% exclusion, the lower marginal tax rates in other states near Vermont provide a significantly greater tax benefit than the $5,000 exclusion.
- For taxpayers with income above $100,000 who are eligible for the 40% exclusion, Vermont's tax treatment of capital gains is the most favorable in the region[4], aside from those of Massachusetts and New Hampshire.

4) It is unlikely that the Vermont capital gains exclusion is encouraging savings and investment.

- Nationwide research on the effect of capital gains taxes on savings and investment is somewhat mixed, although the empirical evidence suggests that there is little to no effect.
- The tax benefit of the Vermont capital gains exclusion is significantly smaller than the federal tax incentive for capital gains. It is unlikely the Vermont exclusion is large enough to drive savings and investment behavior.

5) Exempting a portion of capital gains from taxation creates an inconsistency in the Vermont tax code.

- Other forms of capital income associated with savings and investment, such as dividends, interest, and rent, do not receive any preferential tax treatment in Vermont.

Areas for Legislative Consideration

Should the General Assembly wish to make any changes to the capital gains exclusion, it could consider reviewing the following aspects of the tax expenditure:

1) Review or reassess the statutory purpose, particularly around the goals of increasing savings or investment.

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[4] Defined as the New England states (Vermont, New Hampshire, Maine, Massachusetts, Connecticut, and Rhode Island), and New York.

- Notwithstanding the weak link between lower capital gains taxes and savings and investment, particularly at the State level, the current statutory purpose's lack of clarity makes it difficult to evaluate whether the tax expenditure is meeting its goals:
    - The statutory purpose does not specify whether the exclusion's purpose is to incentivize savings for savings' sake or whether it is to increase investment through increased savings.
    - It is also unclear whether the desired increase in investment is intended for investment nationwide or for investment in Vermont-specific companies.

2) Review the reasoning behind giving preferential tax treatment to capital gains. This includes exploring the following questions:

- Whether the Vermont capital gains exclusion is needed to encourage savings and investment, especially when compared to the federal tax treatment of capital gains:
    - Is the tax expenditure large enough to change savings and investment behavior?
    - Would removing the exclusion, especially the 40% exclusion for large capital gains, incentivize taxpayers to hold on to their assets, rather than selling them? What types of issues would arise if they did?
- Given the stated goal of increasing savings, and the fact that higher-income taxpayers generally already have high savings rates, are capital investments the type of savings the State wants to encourage?
- How important is it for Vermont to be tax competitive with other states for capital gains?
    - Would lowering income tax rates for all or only higher-income taxpayers achieve the same tax competitiveness goals as the capital gains exclusion?

3) Reconfigure either the $5,000 or 40% exclusion.

- Possible policy changes could include:
    - Lowering the 40% exclusion amount but extending the exclusion to dividends and interest.
    - Lowering the 40% exclusion to bring Vermont's taxation of capital gains at higher incomes more in line with other states.
    - Making the exclusion applicable only to capital gains from Vermont-domiciled assets.
    - Eliminating the capital gains exclusion entirely and lowering tax rates for all or only high-income taxpayers in a revenue neutral way.

II. Overview

a) State and Federal Taxation of Capital Gains

Capital gains are defined as the profits resulting from the sale of a capital asset, such as shares of stock, a business, real estate, or a work of art. Capital gains are realized when the capital asset is sold at a higher price than its purchase price (also known as its basis). Conversely, a capital loss occurs when the asset is sold for less than the purchase price.

Capital gains are classified as either long-term or short-term. Long-term capital gains result from assets held for more than one year, while short-term gains are from assets held for a year or less.

Vermont taxpayers are subject to personal income tax rates on the net gain from the sale of a capital asset less the capital gains exclusion. Gross realized capital gains are reported as part of Federal Adjusted Gross Income.

The Vermont capital gains exclusion allows taxpayers to exclude a portion of their realized capital gains each year from taxation. The capital gains exclusion acts as a subtraction from Vermont taxable income. Taxpayers have two options for the exclusion:

- A flat exclusion of $5,000 on total capital gains. This can be used for both short- and long-term capital gains.
- A percentage exclusion equal to 40% of their adjusted net capital gain from the sale of assets held for more than three years. Under this option, filers are not entitled to include the realized gains on the following assets: real estate for primary or secondary residences, depreciable personal property, publicly traded stocks and bonds, and other publicly traded financial instruments. Therefore, the percentage exclusion is limited largely to sales of private businesses, farms, or investment properties.

Once the capital gains exclusion is applied, the remaining taxable income is subject to Vermont's personal income tax rates minus other subtractions and credits.

At the federal level, rather being eligible for an exclusion or deduction, capital gains are taxed at lower tax rates than other types of income (also known as ordinary income), such as wages, business income, or retirement income. Capital gains at the federal level are taxed at 0% for the first two income tax brackets, 15% for the next four brackets, and 20% for the highest bracket. In addition, high-income taxpayers pay another 3.8% tax, imposed as a provision in the Affordable Care Act.

2018 Federal Tax Rates (Married Filing Jointly)

Federal Taxable Income		Tax Rates	
Over	But Not Over	Ordinary Income Rate	Capital Gains Rate
$0	$19,050	10.0%	0%
$19,050	$77,400	12.0%	0%
$77,400	$165,000	22.0%	15%
$165,000	$315,000	24.0%	15%
$315,000	$400,000	32.0%	15%
$400,000	$600,000	35.0%	15%
$600,000	-	37.0%	20%

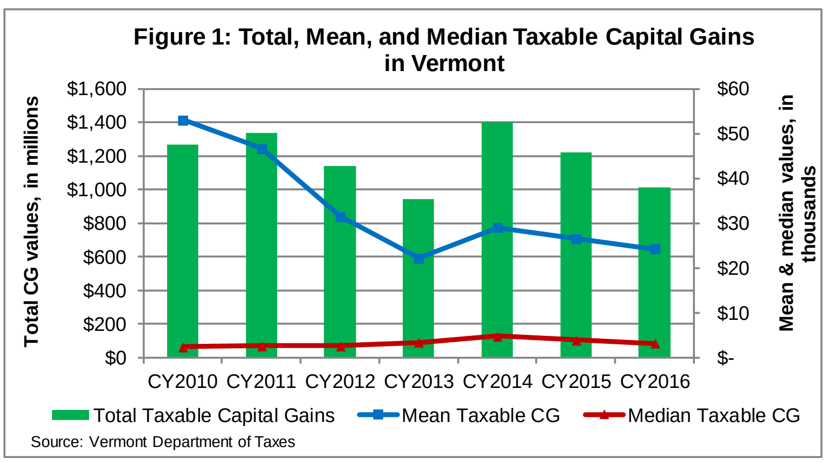
b) Overview of Capital Gains in Vermont[5]

Generally, realized capital gains are primarily driven by the following factors:

- Asset market conditions: Demand for certain assets, market expectations, and financial needs of investors can all drive asset prices, which are directly linked to capital gains.
- One-time sales of businesses or assets: A sale of a large business with Vermont resident ownership can have an important impact on capital gains receipts, even if the business is not large by national standards. This is particularly important in Vermont, which has a relatively small absolute number of high-income taxpayers, who are often not the same people each year.
- Tax policy changes: Taxpayers may choose to defer or not realize capital gains until subsequent years to take advantage of potentially lower rates or other policy changes. Typically, policy-related capital gains realizations are associated with changes in federal tax policy, although a sizeable change to Vermont tax policy could also influence capital gains realizations for Vermont taxpayers.

In calendar year (CY) 2016 (mainly FY2017 revenues), the most recent calendar year with complete data, 41,865, or roughly 11%, of Vermont taxpayers filed income tax returns that included realized capital gains, with a median taxable gain of $3,170 and an average gain of $24,212. Since CY2010, the number of returns with taxable gains has grown significantly, as filers increasingly realize gains after the trough of the Great Recession[6].

Over the past seven calendar years, capital gains reported by Vermont taxpayers have been volatile. The value of taxable capital gains fluctuates significantly from year to year, with swings of +/-15% or more are not uncommon (Figure 1).



Note: Data for CY2010 and CY2011 may be less reliable than other years due to changes in Department of Taxes' data systems in those years.

It is estimated that capital gains have accounted for between 8% and 14% of total personal income tax revenues between CY2010 and CY2016 ($60 to $84 million) (Figure 2).

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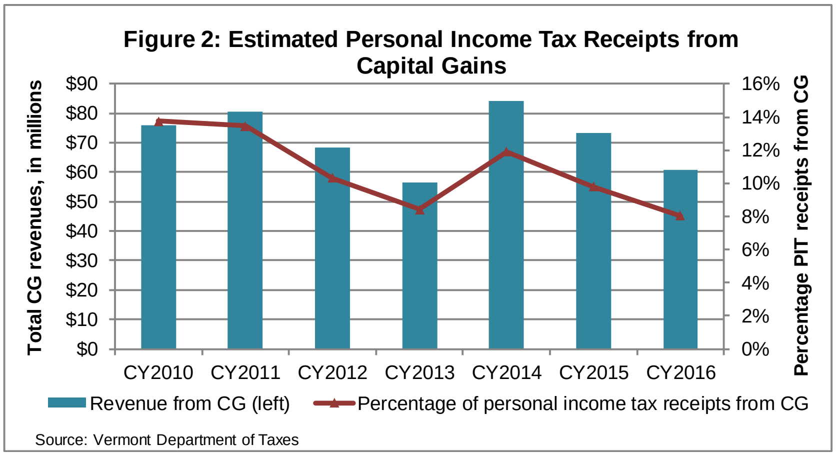
[5] For more information, please see JFO's Issue Brief on Capital Gains Receipts, July 2018 http://www.leg.state.vt.us/jfo/issue_briefs_and_memos/JFO%20CG%20Issue%20Brief%20Final.pdf.

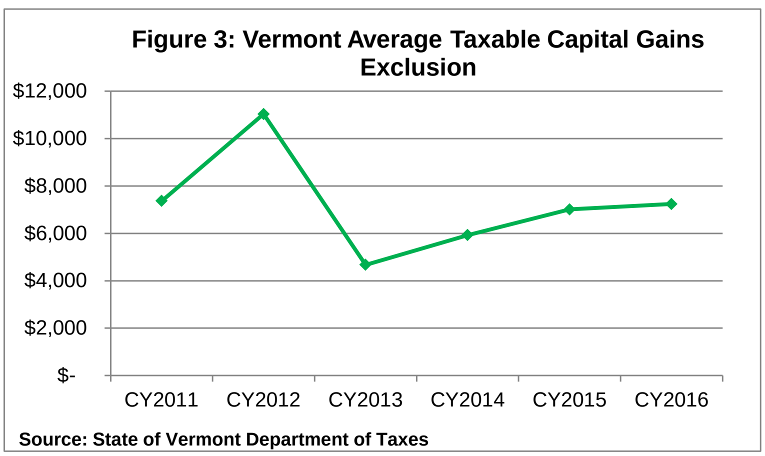
6 This number has grown significantly since 2010, but not necessarily consistently upward. For instance, the number of filers with capital gains decreased between calendar years 2014 and 2016.



Note: Data for CY2010 and CY2011 may be less reliable than other years due to changes in Department of Taxes' data systems in those years.

c) Overview of the Vermont Capital Gains Exclusion

In CY2016, 41,865 Vermont taxpayers excluded approximately $303.5 million in capital gains from their income. This corresponds to nearly 30% of total taxable capital gains. The average capital gain exclusion in CY2016 was $7,250. This number fluctuates over time depending, on the amount of capital gains taxpayers report in a given year (Figure 3).



The capital gains exclusion is estimated to have cost the State roughly $14.8 million[7] in forgone personal income tax revenue in FY2017. This cost also fluctuates, depending on the amount of capital gains realized in a given year. The tax expenditure was as high as $17.4 million in FY2015 and as low as $11.8 million in FY2014.

[7] The total cost of the tax expenditure depends upon how dollars from capital gains are taxed. This number could be higher or lower, depending on whether the gains are taxed at effective tax rates or marginal tax rates.

d) Legislative History of the Capital Gains Exclusion

2002, Act 140: Established an exclusion from a taxpayer's Vermont taxable income equal to 40% of the net capital gains income. No revenue estimate was found for the specific capital gains exclusion.[8]

2009, Act 2 of the Special Session: Repealed the 40% exclusion for all capital gains except farms or timber sales and replaced it with a flat $2,500 exclusion for tax years 2009 and 2010. For every year thereafter, the flat exclusion would be $5,000. Individuals over the age of 70 would have the choice of taking the 40% exclusion on any capital gains or the $5,000 exclusion (sunset in tax year 2011).

At the time, JFO estimated that repealing the 40% exclusion for all taxpayers and replacing it with a flat amount for all but businesses and farms would increase revenues by $15.5 million for FY2010. In FY2009, before this Act was passed, the capital gains exclusion cost the state $31.04 million. In FY2010, after the Act was passed, the exclusion cost the state $13.53 million, a revenue increase of $17.51 million.

2010, Act 160: Established the current capital gains exclusion framework. Taxpayers would have the choice of either taking an exclusion of a flat $5,000 or 40% of the net capital gain from the sale of assets held more than 3 years or 40% of Federal Taxable Income. However, the 40% exclusion could not include real estate, personal property (except farms and timber), or publicly traded financial instruments.

At the time, JFO estimated that the bill would reduce personal income tax revenues by $3.3 million in FY2011 and $10.9 million in FY2012. The actual revenue loss was $8.5 million in FY2011 and $11.55 million in FY2012. It should be noted that in CY2012 (which affects receipts in the final six months of FY2012and the first six months of FY2013), there was a large increase in capital gains realizations due to anticipated increases in federal capital gains rates in CY2013.

III. Public Policy Objectives

a) Statutory purposes

The statutory purpose of the capital gains exclusion (32 V.S.A. § 5813(b)) contains three specific provisions:

- **". . . increase savings and investment by making the effective tax rate on capital gains income lower than the effective tax rate on earned income."** The theory behind this purpose is that increasing the after-tax rate of return on investments and savings will increase taxpayers' willingness to save and the savings will, in turn, be used to make investments in businesses to spur economic growth.

- **". . .exempting a portion of the capital gain that may represent inflation."** Under the current Federal and Vermont tax systems, income from investments is not adjusted for inflation. The reasoning behind excluding a portion of capital gains from taxation is that even though an investor may see no

[8] Act 140 as a whole was a significant tax code overhaul for the State. Prior to the Act, Vermont taxpayers' personal income tax liability was determined as a percentage of the federal tax liability. The Act established a new Vermont taxable income with new Vermont-specific tax rates.

real increase in wealth, he or she would have to pay capital gains taxes if the gains are strictly from inflation. In real terms, the investor is worse off if their investment performs worse than inflation.

- **"The 40 percent business capital gains exclusion mitigates the impact of one-time realizations in a progressive tax structure."** Some capital gains realizations come in the form of large, one-time sales of businesses or property. One-time large capital gains create a large windfall for the taxpayer and push them into higher tax brackets for the year in which the gain occurred. The proceeds from the sales of large assets are usually on top of ordinary income, meaning that they are taxed at the marginal rate.

  Relatedly, the exclusion helps prevent a potential "lock-in" effect where investors or business owners become less likely to sell because they are likely to face the highest marginal tax rates on the capital gain.[9]

b) Other Public Policy Objectives

Though not listed in the statutory charge, there are potentially two other public policy objectives to giving special tax treatment to capital gains:

- **Encourage risk-taking for entrepreneurship and venture capital:** Taxing the return of an investment lowers its rate of return. Riskier investments are those that offer a higher rate of return. Taxing this rate of return could potentially act as a disincentive to making the investment. In addition to this, the lock-in effect could prevent investors from realizing their gains and using the returns to invest in new ventures.[10]

- **Double taxation of income:** Some argue[11] that taxing capital gains is double taxing income on two levels:
  - Capital assets include corporate stocks. When corporations make a profit, they pay the corporate tax. If those profits are reinvested or retained, it increases the value of the company's stock. When the stock is sold, capital gains taxes are assessed. The profits, therefore, are taxed twice.
  - When individuals earn ordinary (non-capital gains) income, they are assessed income taxes. They use this after-tax money to purchase capital assets. When they sell an asset and are assessed tax on the capital gains, income is taxed again.

- **Tax competitiveness with other states:** Most states tax capital gains at the same rates as ordinary income. While most do not have an exclusion for capital gains like Vermont, many have lower marginal

[9] Slemrod, Joel B. and Feldstein, Martin S., The Lock-In Effect of the Capital Gains Tax: Some Time Series Evidence (July 1978). NBER Working Paper No. w0257.
[10] Hungerford, Thomas. "The Economic Effects of Capital Gains Taxation." Congressional Research Service. 18 June 2010.
[11] Six Reasons to Keep Capital Gains Tax Rates Low. (2012). Cato Institute. https://www.cato.org/publications/commentary/six-reasons-keep-capital-gains-tax-rates-low.

income tax rates. Even with the exclusion, Vermont could be taxing capital gains at higher effective rates than other states. If Vermont taxed capital gains at a significantly higher effective rate than its peers, it may depress savings and investment or impact the decisions of higher-income taxpayers who rely heavily on capital gains for their income.[12]

IV. Estimates and Analysis

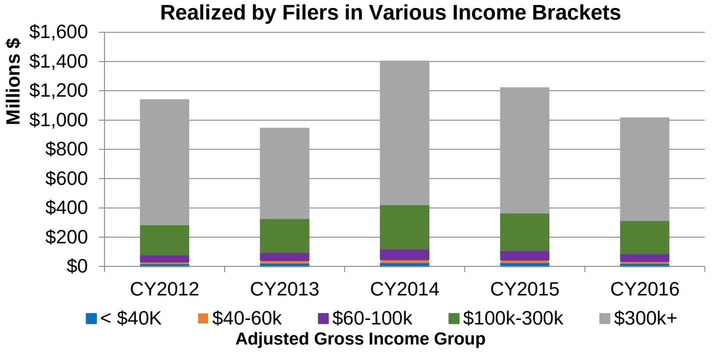
a) Who Benefits From the Capital Gains Exclusion?

The filers who take the bulk of the capital gains exclusion are those who have the greatest amount of capital gains. Higher-income taxpayers pay a significant majority of capital gains taxes, despite representing a relatively small number of tax returns:[13]

- In CY2016, returns with a federal Adjusted Gross Income (AGI) of $300,000 or more accounted for 70% of total taxable capital gains, despite representing only 1% of total Vermont taxpayers (and 10% of Vermont returns with realized capital gains) (Figure 4).
- Their average taxable capital gain[14] of about $165,800 was more than 10 times the average taxable capital gain of those earning between $100,000 and $300,000, roughly $15,000 (Figure 5).
- Over the past five calendar years, around 200 taxpayers (though not necessarily the same 200 each year) have been responsible for nearly 50% of Vermont's taxable capital gains. Their average taxable capital gain was between $2 and $3 million per taxpayer.

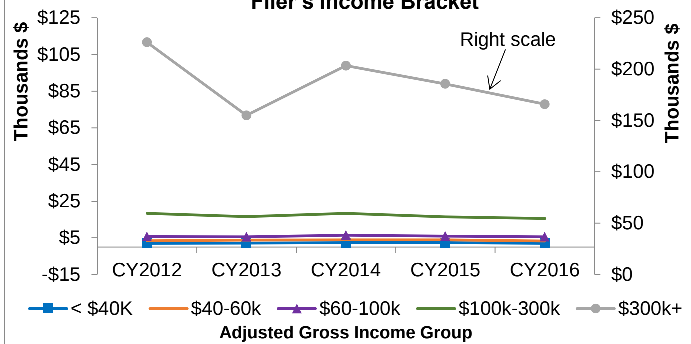
Individuals and households with AGI below $100,000 represent approximately 55% of all returns reporting some capital gains. However, their average taxable capital gain is lower, at about $4,000 since 2012. In a typical year, this group accounts for only 9% of total taxable capital gains.

Figure 4: Share of Vermont Total Taxable Capital Gains Realized by Filers in Various Income Brackets



Source: State of Vermont Department of Taxes

Figure 5: Vermont Average Taxable Capital Gain by Filer's Income Bracket



Source: State of Vermont Department of Taxes

High-income taxpayers account for the majority of the capital gains exclusion. Of the $303.5 million of capital gains excluded from income taxes in CY2016, 60% of it went to filers with AGI over $300,000. Filers with AGI below $100,000 accounted for only 18% of total capital gains exclusions (Table 1).

12 At present, these outcomes are theoretical and the degree to which they could happen is unknown.

13 This highly skewed distribution is similar to personal income tax receipts in general. In CY2016, resident taxpayers with AGI over $300,000 paid 28% of Vermont personal income taxes, despite representing 1% of returns.

14 Defined as reported capital gains multiplied by the percentage of a taxpayer's income that is apportionable to Vermont, less the capital gains exclusion.

Table 1: Taxable Capital Gains and Exclusions by Filers in Various Income Groups in CY2016						
Adjusted Gross Income	**Accounts Reporting Capital Gains**	**Total Taxable Capital Gains**	**Average Taxable Capital Gain**	**Total Capital Gains Excluded From Income**	**Percent of Total Capital Gains Exclusions**	**Average Capital Gains Exclusion**
Less than $40,000	8,236	$17,043,548	$2,069	$13,099,367	4%	$1,591
$40,000 to $60,000	5,321	$17,296,454	$3,251	$13,106,240	4%	$2,463
$60,000 to $100,000	9,484	$53,310,460	$5,621	$28,139,032	9%	$2,967
Below $100,000	23,041	$87,650,462	$3,804	$54,344,639	18%	$2,359
$100,000 to $300,000	14,595	$227,328,649	$15,576	$67,006,896	22%	$4,591
$300,000 and above	4,229	$698,636,678	$165,201	$182,148,940	60%	$43,071
Total	**41,865**	**$1,013,615,789**	**$24,212**	**$303,500,475**		**$7,250**

Even though high-income taxpayers[15] account for the bulk of total capital gains exclusions, as a percentage of their income, whether they benefit more than other taxpayers from the exclusion depends on the type of exclusion they take. For many high-income taxpayers, a significant amount of their total capital gains receive no exclusion.

Table 2 shows hypothetical examples of taxpayers throughout the income distribution. The amount of capital gains they earn is typical of what taxpayers with these incomes realize on average. Each taxpayer is eligible to exempt a certain portion of capital gains from taxation, through either the $5,000 flat exclusion or the 40% exclusion.

Of the taxpayers who claimed capital gains in CY2016, 95% took the $5,000 flat exclusion. Because the exclusion is capped, the benefit of the exclusion declines as incomes rise. As the first shaded column in Table 2 indicates, the hypothetical high-income taxpayers shown see hardly any benefit from the $5,000 exclusion. The $5,000 exclusion benefits lower-and-middle-income taxpayers most because they are less likely to be affected by the cap.

For the remaining 5% of taxpayers who are eligible to take the 40% exclusion (business owners, farmers, and property investors), the exclusion benefits higher-income taxpayers more than lower-income taxpayers. This is largely because higher-income taxpayers derive a greater percentage of their income from capital gains, and they are more likely to take the 40% exclusion (see Table 4). Those high-income taxpayers who take the 40% exclusion could also be one-time high-income taxpayers; a large, one-time capital gain could make them high-income in one year, but middle-income in any other year.

In the federal tax system, capital gains are taxed at lower rates than other income. Because the gap between the capital gains and ordinary income rates grows with a taxpayer's income, the benefit of the lower capital gains tax rate is greater for higher-income taxpayers, as noted in the third shaded column of Table 2.

[15] Some, but not all, of these high-income taxpayers may only be high income in a single year, due in large part, to the one-time sale of a capital asset. As JFO's 2017 Tax Study explored, high-income taxpayers are rarely the same group year after year.

Table 2: Hypothetical Examples of Capital Gains Incentives (2017 Tax Year)							
		$5,000 Exclusion (95% of CG filers)		40% Exclusion (5% of CG filers)		Federal Tax Benefit	
		Vermont Taxes		Vermont Taxes		Federal Taxes	
Adjusted Gross Income	Long-Term Capital Gains (based on observed data)	Tax Benefit of Exclusion	Tax Benefit of Exclusion as Percent of AGI	Tax Benefit of Exclusion	Tax Benefit of Exclusion as Percent of AGI	Federal Tax Benefit	Tax Benefit of Lower Rates as Percent of AGI
$40,000	$2,000	$71	0.2%	$71	0.2%	$228	0.6%
$60,000	$3,500	$125	0.2%	$125	0.2%	$525	0.9%
$100,000	$5,600	$340	0.3%	$340	0.3%	$675	0.7%
$300,000	$15,000	$440	0.1%	$528	0.2%	$2,700	0.9%
$500,000	$65,000	$440	0.1%	$2,288	0.5%	$11,704	2.3%
$1,000,000	$150,000	$447	0.0%	$5,370	0.5%	$29,400	2.9%
$2,000,000	$300,000	$447	0.0%	$10,740	0.5%	$58,800	2.9%

Note: The higher income examples assume various levels of itemized deductions:
$300,000 Example: $34,000 in itemized deductions
$500,000 Example: $75,000 in itemized deductions
$1,000,000 Example: $105,000 in itemized deductions
$2,000,000 Example: $135,000 in itemized deductions

b) Capital Gains Exclusions by Age Group

Capital gains are highly concentrated among older taxpayers, both in terms of the number of returns and the total amount of capital gains excluded (Table 3):

- In CY2016, 60% of returns reporting capital gains were by filers aged 55 years or older, while only 23% were from taxpayers under the age of 45. Older taxpayers also had almost three times the average capital gains of younger taxpayers.
- In that same year, 66% of the State's total taxable capital gains were from filers aged 55 years or older, while only 9% were from taxpayers under the age of 45.
- Of the $303.5 million in capital gains excluded from taxation, 65% of it came from taxpayers age 55 or older.
    - This group also has higher average exclusions than taxpayers under the age of 45 ($7,814 vs. $4,204), although the $5,000 cap on exclusions prevents this gap from being as large as the difference between the respective age groups' average taxable capital gains.

Older taxpayers' disproportionate share of capital gains is in contrast to personal income tax receipts in general, where in 2016, taxpayers over age 65 accounted for 20% of resident tax returns and 21% of personal income tax revenue.

Table 3: Distribution of Capital Gains and Exclusions by Age Group in CY2016					
Age Group	Number of Returns Filing Capital Gains	Total Taxable Capital Gains	Average Taxable Capital Gain	Total Capital Gains Excluded from Taxation	Average Capital Gains Exclusion
< 18	468	$1,962,738	$4,194	$787,723	$1,683
18-35	5,499	$25,047,656	$4,555	$19,345,486	$3,518
35-45	3,870	$64,985,412	$16,792	$21,224,154	$5,484
Under 45	**9,837**	**$91,995,806**	**$9,352**	**$41,357,363**	**$4,204**
45-55	6,636	$247,879,694	$37,354	$61,926,394	$9,332
55-65	10,199	$299,475,558	$29,363	$73,375,822	$7,194
65+	15,085	$371,030,288	$24,596	$124,191,560	$8,233
55 and older	**25,284**	**$670,505,846**	**$26,519**	**$197,567,382**	**$7,814**
Unreported	108	$3,234,444	$29,949	$2,649,336	$24,531
Total	**41,865**	**$1,013,615,789**	**$24,212**	**$303,500,475**	**$7,250**

c) $5,000 Flat Exclusion Versus 40% Exclusion

The capital gains exclusion allows filers to take either a $5,000 exclusion on most types of capital gains or a 40% exclusion on the sale of particular assets, mainly farms, businesses or investment properties.

In CY2016, of the 41,865 taxpayers who took the capital gains exclusion, 2,231 took the 40% exclusion.[16] The remaining 33,634 taxpayers took the $5,000 exclusion. Of the $303.5 million in total capital gains excluded, about two-thirds are from the 40% exclusion, while the remaining one-third are from taxpayers who took the $5,000 exclusion (Table 4).

Table 4: Capital Gains Exclusions by Type and Income Group in CY2016							
	40% Exclusion				$5,000 Exclusion		
AGI Group	Returns Taking	Total Amount Excluded Under 40% Exclusion	Under 40% Exclusion		Returns Taking $5,000 Exclusion	Excluded Under $5,000 Exclusion	Average Exclusion Under $5,000 Exclusion
Less than $40,000	66	$455,957	$6,908		8170	$12,643,410	$1,548
$40,000 to $60,000	157	$1,452,702	$9,253		5164	$11,653,538	$2,257
$60,000 to $100,000	416	$4,982,877	$11,978		9068	$23,156,155	$2,554
$100,000 to $300,000	1040	$25,380,023	$24,404		13555	$41,626,873	$3,071
$300,000 and above	552	$167,000,704	$302,538		3677	$15,148,236	$4,120
Total	**2231**	**$199,272,263**	**$89,320**		**39,634**	**$104,228,212**	**$2,630**

High-income taxpayers are more likely to take the 40% exclusion.[17] In CY2016, 13% of capital gains filers with AGI above $300,000 took the 40% exclusion, almost twice the rate of those taxpayers with income between $100,000 and $300,000. High-income taxpayers also use the 40% exclusion to exclude significant amounts of capital gains from taxation; the total amount excluded by 552 taxpayers with over $300,000 in income is over 5 times the amount excluded by all other income groups combined (Table 4).

The 40% exclusion is only available to those selling businesses, farms, or investment properties. This would imply that its use by a taxpayer would be limited; unless a taxpayer owns multiple businesses, farms, or investment properties or sells off pieces of these assets over time, it would be uncommon to see the same taxpayer take the 40% exclusion multiple times, especially over a short time period. Research by JFO and the Tax Department has determined that this not as uncommon as might have been expected. Of the 2,231 taxpayers who took the 40% exclusion in CY2016:

- 1,110 (about 50%) claimed it in at least one other year between CY2012 and CY2015.
- 470 claimed it 3 or more times.

There is some evidence that the 40% exclusion is being used to lessen the tax impact for business owners or farmers using their main asset as retirement savings. In CY2016, 72% of taxpayers who took the 40% exclusion were over the age of 55 (Table 5). However, almost 35% of the total amount of capital gains excluded using the 40% exclusion ($68 million) came from taxpayers under the age of 45.

Table 5: Age Distribution of Filers Who Took the 40% Exclusion: CY2016			
Age Group	Number of Returns	Average Capital Gains Exclusion	Total Taxable Capital Gains Excluded
< 18	Less than 10	…	…
18-35	86	$122,100	$10,500,614
35-45	166	$77,623	$12,885,453
45-55	361	$127,412	$45,995,694
55-65	612	$76,330	$46,713,719
65+	999	$80,880	$80,798,722
Unreported	Less than 10	…	…
Total	**2,231**	**$89,320**	**$199,272,263**

Table 6: Taxpayers Effected by $5,000 Exclusion Cap in CY2016		
AGI Group	Returns that Maxed Out $5,000 Exclusion	Percent of $5,000 Exclusion Returns that Maxed Out
Less than $40,000	561	7%
$40,000 to $60,000	1,236	24%
$60,000 to $100,000	2,985	33%
$100,000 to $300,000	6,288	46%
$300,000 and above	2,691	73%
Total	**13,761**	**35%**

[16] This group is defined as taxpayers who took a capital gains exclusion greater than $5,000 and filled out line 18 on the VT-153.
[17] Many of these high-income taxpayers could be one-time high income taxpayers due to a large sale of a capital asset.

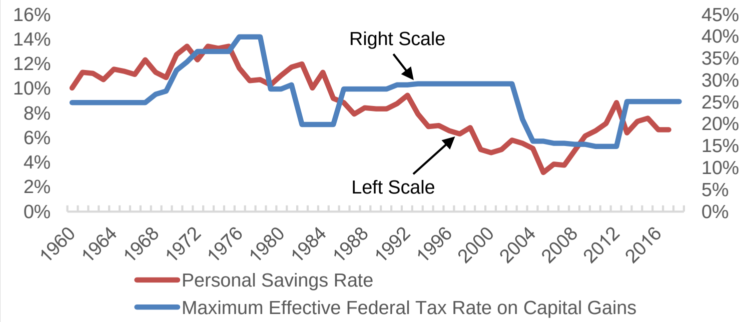
Though significantly more taxpayers take the $5,000 exclusion than take the 40% exclusion, the cap greatly limits the amount of gains that can be excluded. However, despite the cap being $5,000, only 35% of taxpayers who took the $5,000 exclusion were affected by the cap, meaning they had taxable capital gains equal to or greater than $5,000. Taxpayers with over $300,000 in AGI and who took the $5,000 exclusion are much more affected by the cap than any other income group; 73% of them maxed out their $5,000 exclusion (Table 6).

d) Impact on Savings, Investment and Economic Growth

The economic theory behind providing tax incentives to capital gains is that it will encourage saving and therefore investment. Because an economy's growth is dependent upon investment, lower capital gains taxes are beneficial for economic growth.

In practice, however, the link between lower capital gains taxes and increased savings is tenuous. The nationwide savings rate has fallen over the past 50 years, despite cuts in the federal tax rate on capital gains (Figure 6). While other factors affect the savings rate, the connection between savings and lower capital gains taxes is not immediately clear.

Figure 6: Federal Capital Gains Rates and Savings Rates



Sources: Tax Policy Center, Bureau of Economic Analysis

Research has also examined economic effects due to lower capital gains taxes. The results are somewhat mixed, although, on balance, they appear to indicate that capital gains taxes are unlikely to reduce savings and investment.

Table 7: Summary of Research on Capital Gains and Savings

Paper	Do CG Taxes Affect Savings?	Summary
Gravelle and Marples, Congressional Research Service (2014)	No	Eliminating capital income taxes would increase economic activity by less than 1% over 10 years.
Sanchirico (2013)	No	Capital gains taxes may actually increase savings as people save more to counteract the increased taxes.
Hungerford, Congressional Research Service (2010)	No	Lower CG taxes do increase incentive to save but also reduce the need to save because after-tax returns are higher.
Sinai (2010)	Yes	Removing capital gains taxes would increase GDP growth by 0.23 percentage points per year.
Hederman, Nell and Beach, Heritage Foundation (2008)	Yes	Capital gains taxes cause a lock-in effect; savings very sensitive to after-tax rate of return.
Aron-Dine, Center on Budget and Policy Priorities (2007)	No	2002 capital gains tax-rate cut had minimal effect on economic growth but resulted in significant revenue loss.
Gale and Burman, The Brookings Institute (1997)	No	Cuts in capital gains taxes would impact savings very little because most investments are held by pension funds, nonprofit institutions, and foreigners, who are not subject to capital gains taxes.
Congressional Budget Office (1990)	Unclear, but unlikely	Private savings unlikely to be very sensitive to the after-tax rate of return. Government savings also likely to decrease, with lower capital gains taxes lowering overall savings.

With respect to Vermont's capital gains exclusion, it is unlikely that the exclusion is a needed incentive to promote savings and investment, especially when compared to the federal preferential tax treatment for capital gains.

Table 2 on page 11 showed the relative size of the preferential tax treatment for capital gains for various income groups. For typical taxpayers, depending upon what type of exclusion they took, the tax benefit was between 0% and 0.5% of total income. This small reduction in tax liability is likely not meaningful enough to drive savings and investment behavior.

Lower capital gains tax rates at the federal level are a much greater incentive, mainly because federal income tax rates are higher. For example, for a taxpayer earning $2,000,000 with $300,000 in capital gains, the benefit of lower capital gains rates at the federal level is 2.9% of income, over five times the benefit of the Vermont 40% capital gains exclusion (0.5%).

e) Exempting a Portion of Capital Gains from Inflation

Capital gains are not indexed for inflation. One of the statutory purposes for the Vermont capital gains exclusion is to exempt a portion of the capital gains that may represent inflation, so that taxpayers are closer to paying taxes on the *real* change in their wealth, rather than nominal.

Vermont, however, does not provide any preferential inflation treatment to other forms of capital income that are more affected by inflation. These include bond interest and dividends.

To illustrate how other types of capital income are more affected by inflation, suppose there are two investments: a $100 bond that pays a 4% coupon per year and $100 worth of stock that appreciates 4% annually. Inflation is 2%. For the bond, half of the $4 annual interest payment is inflation (4% interest minus 2% inflation). Using compound interest, the stock is worth $219 in 20 years. Of that $119 gain, $48.60 or 41% is due to inflation, compared to 50% for the bond.

An exemption for inflation for part of capital gains income but not for other types of capital income creates an inconsistency in the Vermont income tax code.

V. State Comparisons

Vermont is one of nine states that provide some sort of preferential state tax treatment to capital gains:

Table 8: State Tax Breaks for Capital Gains

State	Tax Treatment of Capital Gains
Vermont	Capital gains exclusion: $5,000 of long-term capital gains or 40% of capital gain from sale of business, farm, or investment property.
Arizona	25% deduction of capital gains from taxable income
Arkansas	50% exclusion of net capital gains from taxable income
Hawaii	Capital gains taxed at lower rates than ordinary income
Montana	Credit equal to up to 2% of net capital gains
New Mexico	50% exclusion of net capital gains from taxable income
North Dakota	40% exclusion of net capital gains from taxable income
South Carolina	44% exclusion of net capital gains from taxable income
Wisconsin	30% exclusion of net capital gains from taxable income, 60% exclusion for farm assets

Some other states provide tax benefits to capital gains for assets held and sold within state boundaries:

- Colorado, Louisiana, Oklahoma: full exclusion of all the capital gains for the sale of tangible property located in the state.
- Idaho: 60% exclusion of all the capital gains for the sale of property located in the state.

Although many states do not have preferential tax treatment for capital gains, lower income tax rates overall may mean that their taxation of capital gains is more favorable than Vermont's.
For example, New York does not have any preferential tax treatment for capital gains; however, New York has lower marginal income tax rates. Consider the following example between New York and Vermont for a taxpayer with $500,000 in income, of which $65,000 is from capital gains:

- At this income level, New York's marginal tax rate is 6.85%. Capital gains in New York are taxed the same as ordinary income.
- Vermont's marginal tax rate is 8.75% but the State provides a $5,000 exclusion (assuming the $50,000 in gains is not from the sale of a business).

New York's lower tax rate means this taxpayer will pay less income taxes on capital gains than he or she would pay in Vermont. Vermont's $5,000 exclusion is not sufficient to offset the benefit from New York's lower income tax rates (see Table 9).

Table 9 lists several taxpayer examples, with the corresponding marginal taxes on capital gains for Vermont, other New England states, and New York. Capital gains income in these examples are typical capital gains incomes for Vermont taxpayers, on average.

- Relative to other state's lower income tax rates, the $5,000 exclusion makes Vermont's treatment of capital gains better for taxpayers with income under $100,000.
- For those with income above $100,000, the $5,000 exclusion provides significantly less of a tax benefit than the lower marginal tax rates in other states.
- For those higher-income Vermont taxpayers who can use the 40% exclusion, Vermont's tax treatment is considerably more advantageous than that of other states in the region, except for Massachusetts and New Hampshire.

Table 9: Marginal Capital Gains Taxes of New England States							
		Vermont				Massachusetts	New Hampshire
		40% Exclusion		$5000 Flat Exclusion		5.2% tax rate on capital gains	0% tax rate all income except dividends and interest
Adjusted Gross Income	Long-Term Capital Gains (based on observed data)	40% Exclusion	Marginal Tax on Capital Gains	$5000 Exclusion	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains
$40,000	$2,000	N/A	$0	$2,000	$0	$104	$0
$60,000	$3,500	N/A	$0	$3,500	$0	$182	$0
$100,000	$5,600	N/A	$40	$5,000	$40	$291	$0
$300,000	$15,000	$6,000	$788	$5,000	$875	$780	$0
$500,000	$65,000	$26,000	$3,413	$5,000	$5,250	$3,380	$0
$1,000,000	$150,000	$60,000	$7,875	$5,000	$12,688	$7,800	$0
$2,000,000	$300,000	$120,000	$15,750	$5,000	$25,813	$15,600	$0

Note: The higher income examples assume various levels of itemized deductions
Other state income tax rates do not include local income taxes

Table 9 (continued)					
		Maine	Connecticut	Rhode Island	New York
		Individual income tax rates on capital gains	Individual income tax rates on capital gains	Individual income tax rates on capital gains	Individual income tax rates on capital gains
Adjusted Gross Income	Long-Term Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains
$40,000	$2,000	$116	$60	$75	$90
$60,000	$3,500	$236	$175	$131	$207
$100,000	$5,600	$400	$280	$266	$361
$300,000	$15,000	$1,073	$900	$899	$998
$500,000	$65,000	$4,648	$4,225	$3,894	$4,453
$1,000,000	$150,000	$10,725	$10,350	$8,985	$10,275
$2,000,000	$300,000	$21,450	$20,970	$17,970	$20,550

Note: The higher income examples assume various levels of itemized deductions
Other state income tax rates do not include local income taxes

VI. Areas for Legislative Consideration

Should the General Assembly wish to make any changes to the capital gains exclusion, it could consider reviewing the following aspects of the tax expenditure:

1) Review or reassess the statutory purpose, particularly the purpose of increasing savings and investment. JFO's research and analysis of this tax expenditure found the link between the capital gains exclusion and increased savings to be unsubstantiated by data or outside research.

Notwithstanding these findings, the current statutory purpose could be improved by clarifying the definitions of the current exclusion's savings and investment objectives. The current statutory purpose states that the capital gains exclusion's purpose is to encourage savings and investment. However, these objectives lack specific goals such as:

- Who is the intended beneficiary for these increased savings or investment?
- Is the capital gains exclusion designed to boost overall, nationwide savings and investment or only Vermont-specific savings and investment?

Improving the statutory purpose will allow for better evaluation of the tax expenditure. A clear and specific purpose is important to determine whether the tax expenditure is achieving the Legislature's goals.

2) Review the reasoning behind giving preferential tax treatment to capital gains. Possible questions legislators could review include:

- Whether the Vermont capital gains exclusion is needed to encourage savings and investment, especially when compared to the federal tax treatment of capital gains:
    - Is the tax expenditure large enough to change savings and investment behavior?
    - Would removing the exclusion, especially the 40% for large capital gains, produce a lock-in effect?
- Given the goal of increasing savings, and the fact that higher-income taxpayers generally already have high savings rates, are capital investments the type of savings the State wants to encourage?
- How important is it for Vermont to be tax competitive with other states for capital gains?
    - Would lowering income tax rates for all taxpayers achieve the same tax competitiveness goals as the capital gains exclusion?

Addressing these questions might help in establishing clearer goals for the tax expenditure, as well as determining whether the exclusion is meeting any goals not stated in the statutory purpose.

3) Reconfigure either the $5,000 or 40% exclusion
The General Assembly could explore possible changes to the capital gains exclusion. These include:

a) Lowering the exclusion amount but extending the exclusion to dividends and interest: This would mitigate the tax inconsistency between capital gains and other forms of capital income in Vermont's personal income tax code. To make the change revenue-neutral, the $5,000 or 40% exclusion would need to be reduced.

b) Lowering the percentage exclusion: Vermont's treatment of large capital gains windfalls is better than that of almost all neighboring states. A large percentage of the forgone tax revenue from the capital gains exclusion comes from the 40% exclusion. Lowering the percentage would raise additional revenue for other policy objectives, such as expanding the exclusion to other capital income, or raising the $5,000 exclusion.

c) *Making the exclusion only available to Vermont-domiciled assets:* Because the capital gains exclusion can be applied to realized gains on non-Vermont assets, the State is incentivizing investment outside of Vermont's borders. Legislators might consider whether it is the role or goal of Vermont's tax code to incentivize investments outside of Vermont or investments by non-Vermont companies. A handful of states (Colorado, Idaho, Oklahoma, Louisiana) have taken this approach to capital gains taxes.

d) *Eliminating the capital gains exclusion entirely and lowering tax rates for all or only high-income taxpayers in a revenue neutral way:* If one of the policy objectives of the capital gains exclusion is to make Vermont tax-competitive for high-income filers, lowering overall tax rates or just those for high-income filers could achieve the same objective, without giving preferential treatment to a particular income source.

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TAX EXPENDITURE EXPEDITED REVIEWS

Tax Expenditures Relating to Incentivizing a Specific Desirable Outcome
Sales Tax Exemption for Veterinary Supplies – Expedited Review
Prepared by the Joint Fiscal Office

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	Legislative Considerations
Exemption of veterinary supplies from the Sales and Use Tax (32 V.S.A. § 9741(3)).	The statutory purpose of the exemption is to lessen the cost of veterinary services in order to support the health and welfare of Vermont animals. (32 V.S.A. § 9706(c)).	$4,228,000 in FY18	• Clarify statutory purpose • Repealing exemption for nonagricultural veterinarians.

Public Policy Objectives

The statutory purpose of the veterinary supplies exemption from the sales tax is to support the health and welfare of animals in Vermont by lowering the cost of medication and supplies.

The exemption, which is codified in (32 V.S.A. §9741(3), is included as one exemption amongst a group of goods associated with agricultural purposes. Because of its grouping with a number of agricultural goods, another public policy objective of the exemption is to prevent the taxation of agricultural inputs. Exempting veterinary supplies from the sales tax is a way of preventing tax pyramiding for final agricultural products.

However, this exemption also applies to veterinary supplies used in the treatment of non-agricultural animals, such as household pets. The exemption reduces the cost of veterinary supplies for domestic pet owners, which could support the welfare of animals in Vermont. At the same time, unlike agriculture, in most cases the veterinary supplies are not an input used for a final product or good. Therefore, tax pyramiding is not an objective for the exemption for non-agricultural veterinary supplies.

The statutory purpose of supporting the welfare of animals is broad. It is unclear why other products that support animal welfare would not be exempted, particularly in the case of non-agricultural animals. For instance, animal feed for agricultural animals is exempt under the same subsection as the veterinary supplies exemption. However, pet food for non-agricultural animals is not exempt despite plausibly being important for the welfare of non-agricultural animals.

The definition of veterinary supplies is also somewhat unclear. The Department of Taxes Sales and Use Tax Regulations only clarify that veterinary supplies do not include pet food sold by a veterinarian. Generally, the Department of Taxes defines "supply" as tangible personal property that cannot be consumed multiple times. Under this definition, supplies such as medicine and one-time use first aid supplies would be exempt.

Estimates and Analysis

JFO estimates that the sales tax exemption for veterinary supplies cost the State approximately $4.2 million in FY2018. About $1.9 million of this is from non-agricultural veterinary supplies, while the remaining $2.3 million is from veterinary supplies sold for agricultural purposes.

The Department of Taxes does not collect data on the amount of sales tax exemptions claimed by veterinarians. As such, estimates for this tax expenditure rely on data from many different sources, including industry trade groups, the U.S. Department of Agriculture, and academic literature.

According to the American Veterinary Medical Association, about 45% of total U.S. veterinary income is from small animal veterinary practices, which focus mainly on non-agricultural animals and domestic pets. The remaining 55% of veterinary income comes from veterinarians that serve other types of animals: equine, food animal, and mixed large and small animals[18].

Non-Agricultural Veterinary Supplies

The $1.9 million estimate for non-agricultural veterinary supplies is based upon data from the American Pet Products Association, which reports that U.S. pet owners spent about $15.1 billion in veterinary supplies for their pets in 2017. Scaling this estimate based upon Vermont's population yields roughly $32 million in spending on veterinary supplies in Vermont.

The same organization reports that about 68% of household own a domestic pet. In Vermont, this translates to about 175,000 of Vermont's 257,107 households. Using the spending numbers above, JFO estimates that the average pet-owning household in Vermont spent roughly $182 on veterinary supplies in 2017. This figure is similar to data from the U.S. Census Consumer Expenditure Survey, which found that the average American spent about $155 per year between 2007 and 2011 on pet supplies and medicine[19].

If the veterinarians are passing the savings onto their clients, the sales tax exemption for non-agricultural animals equates to $10.89 in annual savings per pet-owning household in Vermont. By not paying the sales tax, pet-owners are saving 6% on the total price of veterinary supplies. Based upon one study[20] which found the price elasticity of veterinary care to be -0.12[21], this implies that the sales tax exemption is incentivizing pet owners to spend 0.72% more on

[18] Ouegraogo, F., Dicks, M. "Veterinary practice and the U.S. economy: What's the impact?" *dvm360.* January 13, 2017. http://veterinarynews.dvm360.com/veterinary-practice-and-us-economy-what-s-impact

[19] Henderson, Steven. "Spending on pets: 'Tails' from the Consumer Expenditure Survey" *Beyond the Numbers.* Bureau of Labor Statistics. May 2013. https://www.bls.gov/opub/btn/volume-2/pdf/spending-on-pets.pdf

[20] Daneshvary N, Schwer RK. The Nature Of Demand For Companion Pet Health Care. Journal of Applied Business Research 1993; 9 (4): 24–32

[21] For every 1% increase/decrease in price, quantity of veterinary services decreases/increases by 0.12%.

veterinary supplies. If the average Vermont pet owner is currently spending $182 on veterinary supplies for their pet, if the sales tax exemption were repealed, this elasticity implies they would decrease spending by roughly $1.31.

Agricultural Veterinary Supplies

The agricultural veterinary supplies exemption totaled $2.3 million in FY2018.

According to the Vermont Association of Veterinary Medicine, there were 30 veterinarians serving exclusively large animals such as livestock. 17 veterinarians served both large and small animals. This is compared to 232 veterinarians who serve small animals such as domestic pets.

Calculating the tax benefit per Vermont veterinarian is difficult for data reasons. Farmers who need veterinary supplies for their animals have the option of purchasing these supplies online, which means that on the retailer side, the tax benefit cannot be attributed only to Vermont-based large animal vets.

It is also difficult to calculate the benefit on a per-farm basis. While the 2012 Agriculture Census listed 7,338 farms in Vermont and various information on the number of farms with livestock and poultry, this data does not delineate between farms with multiple animal types[22]. For example, in 2012, there were 2,784 farms with cattle in Vermont and 450 farms with hogs. JFO is unable to calculate the number of farms that have both cattle and hog to eliminate double-counting.

Legal History

1969: Exemption enacted

State Comparisons

Vermont is one of eight states that does not charge sales taxes on veterinary services or products sold by a veterinarian.

49 states, including Vermont, exempt the sale of prescription drugs, vaccines, and medications sold by veterinarians.

A survey by the American Veterinary Medicine Association reported that 30 states charged sales taxes on non-prescription products[23].

[22] U.S. Department of Agriculture, National Agricultural Statistics Service. Census of Agriculture. https://www.nass.usda.gov/Publications/AgCensus/2012/Full_Report/Volume_1,_Chapter_2_US_State_Level/st99_2_001_001.pdf

[23] "State Taxes on Veterinary Sales and Services". American Veterinary Medicine Association. https://okvma.org/2018/04/27/1611/

Tax Expenditures Relating to Incentivizing a Specific Desirable Outcome
Sales and Use Tax Exemption for Railroad Rolling Stock and Depreciable Parts – Expedited Review
Prepared by the Joint Fiscal Office

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	JFO Recommendations
Sales tax exemption for railroad rolling stock, including depreciable parts, machinery, and equipment to be installed as a capital asset in such rolling stock… (32 V.S.A. § 9741 (30))	To increase the use of rail for transport. (32 V.S.A. § 9706(q))	Up to $200,000 annually	The Department of Taxes could consider a reporting form for purchases subject to this exemption to aid the State in tracking whether the statutory purpose is being met.

Public Policy Objectives

The statutory purpose of this sales tax exemption is to increase the use of rail for transport. The full language for the exemption is as follows: "railroad rolling stock, including depreciable parts, machinery, and equipment to be installed as a capital asset in such rolling stock, sold for use primarily in the carriage of persons and property. As used in this section, railroad rolling stock shall include locomotives, cabooses, boxcars, tank cars, flatbed cars, maintenance of way equipment, and all other wheeled vehicles used on rails or tracks."

Estimates and Analysis

Research indicates that companies in Vermont possessing equipment that meets the definition of railroad rolling stock are relatively small, privately held firms with little publicly available data concerning those holdings. The largest Vermont-based rail operator is Vermont Rail Systems, which possesses rolling stock that is housed in-state and is composed of several small subsidiary entities. Other freight rail operators are based out-of-state. Amtrak rolling stock is typically only housed in Vermont temporarily for cleaning at stations in St. Albans and Rutland.[24]

In the past couple of years, there have been a couple of significant transactions by Vermont entities that would've been exempt from the state sales and use tax. In 2015 Vermont Rail Systems purchased two used SD70M-2s locomotives from Florida East Coast Railway.[25] The price paid for the locomotives was not made available but a scan of used locomotive prices online indicated that the cost per unit was likely over $500,000. In 2017 allEarth Rail, a subsidiary of allEarth Renewables, purchased twelve Budd Rail diesel cars for a potential future

[24] Vermont State Rail Plan, "Technical Memo #2 – Vermont's Existing Rail System" March 28, 2014 https://vtrans.vermont.gov/sites/aot/files/rail/Tech%20Memo%202.pdf
[25] http://www.vermontrailway.com/news_pages/news_10_15_15.html

commuter rail service in Vermont. News reports indicated that the total purchase price was $4-5 million.[26] Additional funds could be spent to rehabilitate the cars in the future.

Previous tax expenditure reports from the Joint Fiscal Office have estimated the cost of the sales tax exemption for railroad rolling stock to be less than $100,000 annually.[27] Other northeastern states with similar exemptions have not previously given estimates for the cost of the exemption with the exception of Maine, which estimates an expenditure of $1 million - $3 million annually for an exemption that also includes any vehicle used for interstate or foreign commerce (i.e. trucks, aircraft, watercraft, RR rolling stock).[28] The VT Dept. of Taxes does not currently collect data regarding sales taxes foregone from this tax exemption. Due to the large recent rolling stock transactions, the cost for this tax expenditure could fluctuate year-to-year, but on average the annual cost is likely up to $200,000.

Legal History

1986	Sales tax exemption enacted
1987	Exemption amended
2013	Statutory purpose added

State Comparisons

Among New England states, Maine and Connecticut both have a similar exemption from sales tax for railroad "rolling stock." New Hampshire does not have a sales tax. Within the U.S. northeast, as defined by the U.S. Census Bureau[29], New Jersey is the only other state with a similar statutory exemption.

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[26] https://vtdigger.org/2017/04/23/blittersdorf-spends-5m-on-rail-cars-envisioning-commuter-train/; https://vermontbiz.com/news/2018/november/27/allearth-rail-moves-montpelier-wednesday

[27] 2017 Vermont Biennial Tax Expenditure Report, page 28: https://ljfo.vermont.gov/assets/docs/reports/0672c1318c/2017-Tax-Expenditure-Report-1-17-17.pdf

[28] 2017 Maine Tax Expenditure Report, page 107, "Certain Instrumentalities of Interstate and Foreign Commerce" https://www.maine.gov/revenue/research/tax_expenditure_report_17.pdf

[29] https://www2.census.gov/geo/pdfs/maps-data/maps/reference/us_regdiv.pdf

Tax Expenditures Relating to Incentivizing a Specific Desirable Outcome
Sales and Use Tax Exemption for Ferryboats and Depreciable Parts – Expedited Review
Prepared by the Joint Fiscal Office

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	JFO Recommendations
Sales tax exemption for ferryboats, including depreciable parts, machinery, and equipment to be installed as a capital asset in such ferryboat… (32 V.S.A. § 9741 (31))	The statutory purpose of the exemption for ferryboats and depreciable parts is to increase the use of ferries for transport. (32 V.S.A. § 9706(r))	Less than $100,000	The Tax Dept. could consider a reporting form for purchases subject to this exemption to aid the State in tracking whether the statutory purpose is being met.

Public Policy Objectives

The statutory purpose of this sales tax exemption is to increase the use of ferries for transport. The full language for the exemption is as follows: “ferryboats, including depreciable parts, machinery, and equipment to be installed as a capital asset in such ferryboat, sold to a person who holds himself or herself out to the general public as engaging in water commerce, for use primarily in the carriage of persons or property for compensation or hire.”

Estimates and Analysis

Research indicates that there is one firm in Vermont that operates a ferryboat network with machinery and equipment that would be covered under this sales tax exemption. Lake Champlain Transportation Company possesses a fleet of ten ships and operates three ferry routes across Lake Champlain between Vermont and New York.[30] The newest ship in the LCTC fleet was built in 2010. There is no publicly available information regarding the costs of the ships in the LCTC fleet and what is spent annually on maintenance. There is no other known operation that would have transactions meeting the definition of this exemption

Previous tax expenditure reports from the Joint Fiscal Office have estimated the cost of the sales tax exemption for ferryboats and related parts/equipment to be less than $100,000 annually. Other northeastern states with similar exemptions have either not previously given estimates for the cost of the expenditure, or have broader exemptions than Vermont’s and therefore have much higher expenditures, or have major shipbuilding operations. For example, Pennsylvania’s tax expenditure is approximately $20 million per year[31] but has major shipyards on the Delaware River and also has a sales tax exemption that is applicable to all vessels capable of hauling over 50 tons, regardless of whether they will be used exclusively for water commerce.

[30] http://ferries.com/about/history/
[31] Pennsylvania “2018-2019 Governor’s Executive Budget,” page D54: https://www.budget.pa.gov/PublicationsAndReports/CommonwealthBudget/Documents/2018-19%20Proposed%20Budget/2018-19%20Governor%27s%20Executive%20Budget%20-%20Web.pdf

Due mainly to the lack of relative state-level data, or comparable data from other states, this expedited review will maintain the previous tax expenditure estimate of less than $100,000 annually. The true annual cost could be greater, especially in a year when major repairs are undertaken, or if a new ship is purchased for the Lake Champlain Transportation Company fleet.

Legal History

1988	Sales tax exemption enacted
2013	Statutory purpose added

State Comparisons

A brief survey found that all New England states have some form of sales tax exemption relating to ferryboats, save for Connecticut, which does have a sales tax exemption for "vessels"[32] generally but only if they are docked in the state sixty or fewer days in a calendar year. New Hampshire does not have a sales tax. Within the greater U.S. northeast, as defined by the U.S. Census Bureau, [33] New York, New Jersey and Pennsylvania also have statutory sales tax exemptions that apply to ferryboats.

[32] Title 15 of Connecticut General Statutes, Sec. 15-127, defines a vessel to be "every description of watercraft, other than a seaplane on water, used or capable of being used as a means of transportation on water."

[33] https://www2.census.gov/geo/pdfs/maps-data/maps/reference/us_regdiv.pdf

Tax Expenditures Relating to Incentivizing a Specific Desirable Outcome
Sales and Use Tax Exemption for Tangible Personal Property Incorporated into a Rail Line – Expedited Review
Prepared by the Joint Fiscal Office

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	JFO Recommendations
Sales tax exemption for tangible personal property to be incorporated in a rail line… (32 V.S.A. § 9741 (44))	To increase the use of rail for transport by lowering the costs of materials. (32 V.S.A. § 9706(aa))	Not estimated	The Tax Dept. could consider a reporting form for purchases subject to this exemption to aid the State in tracking whether the statutory purpose is being met.

Public Policy Objectives

The statutory purpose of this sales tax exemption is to increase the use of rail for transport by lowering the costs of materials. The full language for the exemption is as follows: "tangible personal property to be incorporated in a rail line in connection with the construction, maintenance, repair, improvement, or reconstruction of the rail line."

Estimates and Analysis

According to the 2015 Vermont State Rail Plan, there are approximately 578 miles of active rail line in Vermont, with approximately 305 miles of that amount owned by the State.[34] Most of the privately owned rail line is possessed by one company, Genesee & Wyoming, Inc., through two subsidiaries: New England Central Railroad (NECR) and St. Lawrence & Atlantic Railroad (SLR). Vermont Rail Systems (VRS) provides freight service on State-owned rail lines, as well as on its own holdings, through several subsidiary rail operators.

At this time only the NECR mainline and the Clarendon & Pittsford Railroad (a subsidiary of VRS) are capable of accommodating 286,000 lb. railcars, the industry standard. Remaining rails in the State are only capable of accommodating up to 263,000 lbs. A priority of the State rail plan is to upgrade many tracks and bridges to the 286,000 lb. standard. The plan estimates that the cost of upgrading State-owned rail and bridges would be nearly $300 million (in 2015 dollars). If work is undertaken on privately-held track in future years, there could be significant costs and significant sales taxes forgone. These upgrades could potentially increase freight and passenger rail activity in the state in the future, but it is unclear if the benefits would outweigh the costs.

The most significant rail infrastructure project in recent years has been the ongoing upgrade of track and bridges along the Vermont western corridor, which is State-owned track operated by

[34] 2015 Vermont State Rail Plan: https://vtrans.vermont.gov/sites/aot/files/rail/VT%20State%20Rail%20Plan_Final.pdf

Vermont Railway, a subsidiary of VRS.[35] A recent announcement declared that $20 million in federal funds, from the U.S. Dept. of Transportation Better Utilizing Investments to Leverage Development (BUILD) grant program, will be paired with $11 million in State and private funds to continue western corridor improvements, namely upgrading bridges to 286,000 lb. capacity.[36] Because the Western Corridor track is State-owned any sales taxes forgone from this project would be limited to monies spent by VRS as the private-share of project costs.

Prior tax expenditure reports produced by the Joint Fiscal Office have not offered estimates for the cost of this particular expenditure. Reports filed by rail operators to the VT Dept. of Taxes include limited information regarding track improvements but the amounts are small and do not differentiate costs for personal property incorporated into the track, covered by the exemption, from other track improvement costs, such as labor. The State of Maine estimates that its tax expenditure for track improvements ranges from $1.1 million to $1.3 million annually.[37] There are approximately 1,162 miles of operational rail lines in Maine, of which the State owns approximately 407 miles of active rail.[38] If Maine's number were applied to Vermont, after adjusting for overall track mileage, State-owned mileage, and the different state sales tax rates, the amount would be approximately $480,000 per year. However, because the numbers reported by Vermont rail operators for track improvement costs are much smaller than the $8 million that would be necessary to generate $480,000 in annual tax expenditures, the Maine comparison is not appropriate. Due to the unreliability of data sources an estimate will not be given.

Legal History

1997	Sales tax exemption enacted as subdivision (38) in 32 V.S.A. § 9741
2008	Exemption renumbered to subdivision (44)
2013	Statutory purpose added

State Comparisons

Among New England states, Maine and Connecticut both have a similar exemption from sales tax for tangible personal property incorporated into a rail line. New Hampshire does not have a sales tax. Within the U.S. northeast, as defined by the U.S. Census Bureau[39], New Jersey is the only other state with a similar statutory exemption.

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[35] Western Corridor Tiger 7 Grant presentation, VT Agency of Transportation, January 2016: https://legislature.vermont.gov/assets/Documents/2016/WorkGroups/House%20Transportation/Rail%20Program%20and%20Budget/FY16%20Rail%20Program/W~Dan%20Delabruere~Western%20Corridor%20Rail%20TIGER%207%20%20Grant~1-6-2016.pdf

[36] https://vtdigger.org/2018/12/07/state-use-20-million-federal-funds-upgrade-rail-bridges/

[37] 2017 Maine Tax Expenditure Report, page 118, "Railroad Track Materials" https://www.maine.gov/revenue/research/tax_expenditure_report_17.pdf

[38] 2015 Maine State Rail Plan: https://www.maine.gov/mdot/ofbs/docs/Rail_Plan_7-9-2015.pdf

[39] https://www2.census.gov/geo/pdfs/maps-data/maps/reference/us_regdiv.pdf

Tax Expenditures Relating to Incentivizing a Specific Desirable Outcome
Sales and Use Tax Exemption for Net Metering System, Off-Grid Energy System, and Solar Hot Water System – Expedited Review
Prepared by the Joint Fiscal Office

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	JFO Recommendations
Sales tax exemption for tangible personal property to be incorporated into various renewable energy systems … (32 V.S.A. § 9741 (46))	To increase the deployment of solar technologies until the price of solar materials and installation decreases to the point it does not need state subsidization. (32 V.S.A. § 9706(cc))	$2,290,000 in FY2020	The Tax Dept. could consider a reporting form for purchases subject to this exemption to aid the State in tracking whether the statutory purpose is being met.

Public Policy Objectives

The full language for the exemption is as follows:
"(46) Tangible personal property incorporated into:

(A) a net metering system as defined in 30 V.S.A. § 8002;

(B) a home or business energy system on a premises not connected to the electric distribution system of a utility regulated under Title 30 and that otherwise meets the requirements of 30 V.S.A. § 8002(16)(A), (C), and (D); or

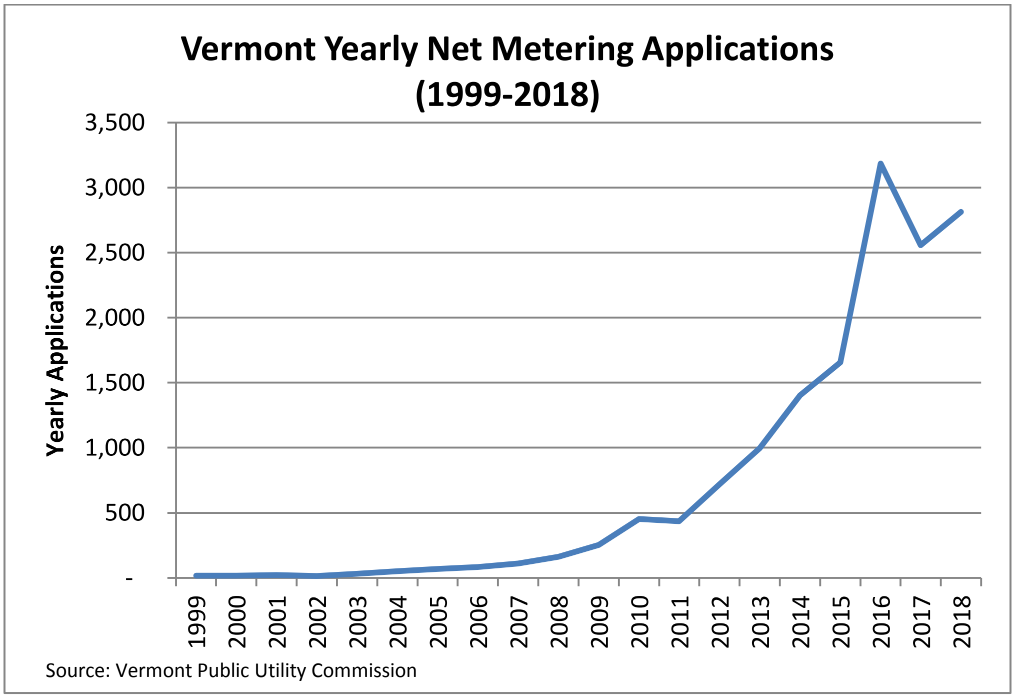
(C) a hot water heating system that converts solar energy into thermal energy used to heat water, but limited to that property directly necessary for and used to capture, convert, or store solar energy for this purpose."

The statutory purpose states that the exemption exists to increase the deployment of solar technologies until the price of materials and installation decreases beyond the need for State subsidization. The General Assembly enacted a state net metering law in 1998 to encourage growth in renewable energy systems. The sales tax exemption for net metering was enacted the following year to further encourage renewable energy. The exemption was expanded a few years later to include off-grid renewable energy systems as well as solar hot water systems, as a way of incentivizing systems that would not fully meet the definition of a "net metering system."

Estimates and Analysis

Following the adoption of this sales tax exemption, further provisions aimed at encouraging renewable energy growth have been established in law at the federal and State level. The most consequential provision has likely been at the federal level with the solar investment tax credit, established in 2006, which provides a 30% tax credit for investors in residential and commercial solar energy systems. Due to existing Vermont law that entitled taxpayers to a nonrefundable State tax credit equal to 24% of the federal investment tax credit, the new federal solar investment tax credit enabled Vermonters to utilize the existing State tax credit for solar projects. In 2012, the State exempted renewable solar energy systems with 10kW or less of plant capacity from the statewide education property tax, and in 2014 expanded the exemption to systems up to 50kW in capacity. Systems larger than 50kW are subject to a uniform capacity tax of $4.00 per kW of plant capacity per year.

The State previously had set limitations on the cumulative output capacity of net metering systems for each electrical distribution company. This “cap” began at 1% of a company’s peak demand during 1996 or the most recent calendar year, whichever was greater. The General Assembly raised the cap to 2% in 2008, 4% in 2011, and 15% in 2014 before finally removing the cap completely starting on January 1, 2017. The figure below shows the trend in net metering applications from 1999 through 2018.



As shown in the figure above, significant growth in net metering installations began in the years following enactment of the federal solar investment tax credit with higher bumps in years after the net metering caps were raised. There was a peak in 2016 due to a pending rules release by the Public Utility Commission (then the Public Service Board). 2017 saw a drop in applications due to the rush of activity in 2016, with a small rebound occurring in 2018. The relatively slow growth in net metering from 1999 through 2007-08, along with the correlation of growth in subsequent years with enactment of the federal tax credit and reductions in net metering caps, indicates that the sales tax exemption, in and of itself, likely does not impact consumer behavior a great deal in regards to the decision to purchase a net metering system.

Based on available data, solar hot water heater systems make up a small share of the total cost of this tax expenditure. Over ten years, the Clean Energy Development Fund (CEDF) has provided incentives for 1,180 solar hot water heater installations. Many of these incentives were provided between 2009 and 2013 with a steady annual drop-off over subsequent years until the incentive ended in 2017. Much of the drop-off in incentives leading up to 2017 could be due to the gradual reduction of available funding for CEDF incentives overall. However, in a peak year the CEDF provided incentives for 353 solar hot water projects, so the universe of annual solar hot water projects is likely well below 500. There is no available data for the number of off-grid renewable energy systems that are installed on an annual basis in Vermont. The number of systems is probably minimal but the cost per system would be much higher than for an average net metering system or solar hot water system, due to the need for larger systems to provide energy in all conditions and for on-site energy storage.

The annual tax expenditure for the exemption of net metering systems, off-grid renewable energy systems and solar hot water systems from the Vermont sales and use tax is estimated to be as follows:

FY2018	**$2,424,000**
FY2019	**$2,356,000**
FY2020	**$2,290,000**

Legal History

1999	Sales tax exemption enacted for net metering systems
2002	Exemption expanded to include off-grid home and business energy systems, as well as solar hot water systems.
2013	Statutory purpose added

State Comparisons

Among New England states, Massachusetts, Connecticut, and Rhode Island all have exemptions from sales tax for most renewable energy systems, not limited solely to net metered systems. New Hampshire does not have a sales tax. Within the U.S. northeast, as defined by the U.S. Census Bureau[40], New Jersey and New York both exempt residential and commercial solar installations from the sales tax.

[40] https://www2.census.gov/geo/pdfs/maps-data/maps/reference/us_regdiv.pdf

Tax Expenditures Relating to Incentivizing a Specific Desirable Outcome
Exemption for Property Owned by Public, Pious or Charitable Organizations – Expedited Review
Prepared by the Joint Fiscal Office

Tax Expenditure	Statutory Purpose	FY2018 Estimated Revenue Impact	Legislative Considerations
Property tax exemption for real and personal estate used for public, pious, or charitable uses. (32 V.S.A. §§3802(4), 3832, 3840, 5404(a))	The statutory purpose of the exemption for public, pious, and charitable property is to allow these organizations to dedicate more of their financial resources to furthering their public-service missions. (32 V.S.A. § 3800(b))	$56,127,000	None

Public Policy Objectives

The statutory purpose of these property tax exemptions is to allow charitable and non-profit organizations to dedicate more of their financial resources to furthering public service missions. The exemption encompasses property and real estate for organizations including but not limited to: churches, community centers, private primary, secondary and tertiary education institutions, museums or historic sites, granges or societal lodges, hospitals, and other health care facilities. Most public institutions and state colleges and universities are not included under this exemption. Public primary and secondary schools may be included in this exemption if the parcel is owned by the local school district, as opposed to the municipality.

Many of the properties taking this exemption are registered with the Vermont Secretary of State as a non-profit and with the Internal Revenue Service as tax exempt organization under 26 U.S.C. § 501(c).

The definition for what qualifies for this exemption is broad. 32 V.S.A. §§3802(4) is the main statutory language for the exemption and includes language on the following:

- Property and real estate owned by churches, church societies, or conferences and is used by ministers full time religious purposes, or land leased by towns for the support of the gospel.
- Property and real estate for non-for profit libraries.
- Lands leased by towns for educational purposes.
- Lands leased by towns for colleges, academies and other schools.
- Lands leased by towns for organizations that support the poor.

32 V.S.A. § 3832 provides some clarity by setting some restrictions on the exemption, including setting clearer definitions on exempt religious properties, and buildings and land used by health, recreation or fitness organizations. The language also puts restrictions on otherwise exempt property that is leased to a private entity for use of making profits.

Estimates and Analysis

JFO and the Department of Taxes have subdivided the FY2018 estimates for this tax expenditure into five groups:

- **Charitable**: $ 6,444,000; 519 parcels
- **College**: $17,296,000; 142 parcels
- **Pious**: $12,762,000; 1,162 parcels
- **Schools**: $5,550,000; 190 parcels
- **Hospitals**: $14,075,000; 132 parcels

Table 1: Charitable Organization Parcel Exclusions by Type: FY2018

General Charitable	125
Museum/Historical Society	117
Health Care	62
Lodge/Grange	57
Arts	29
Education	29
Religion	24
Miscellaneous	20
Environmental	19
Recreation	17
Community Center	14
Transportation	6
Total	**519**

1) Charitable

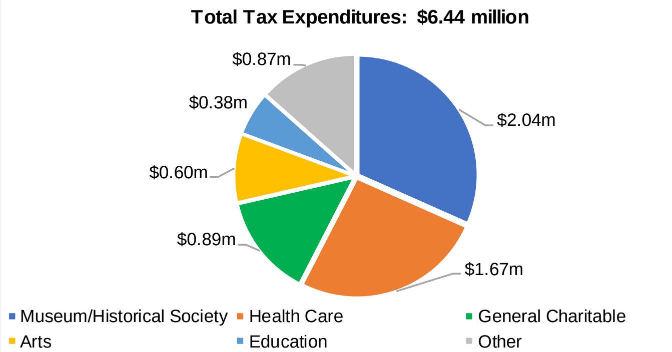
In FY2018, 519 parcels associated with a charitable organization claimed the public, pious, or charitable (PPC) exemption. The total value of the property exempted from the grand list was $409.8 million, resulting in a tax expenditure of $6.44 million.

Of the 519 parcels excluded, 125 of them belonged to general charitable organizations; organizations with missions aimed at assisting low-income, disadvantaged, or minority groups. 117 were from historical societies or museums. While hospitals are considered a different subdivision within the PPC exemption, other healthcare facilities, such as addiction or mental counseling organizations, accounted for 62 of the 519 parcels. Lodges and granges, such as masonic temples or Lyons clubs, account for more than 10% of charitable parcels exempted.

Exemptions for museums and health care organizations account for over half of the $6.44 million tax expenditure from this subdivision. A large percentage of the total dollars exempted from these museums and health care organizations come from a few large organizations that have large property holdings.

General charitable, arts and entertainment, and education organizations together account for roughly $1.87 million worth of tax expenditures. All others, despite representing roughly 157 parcels, only account for $870,000 worth of tax expenditures.

Figure 1: Property Tax Exemptions for Charitable Purposes by Type: FY2018



Source: Vermont Department of Taxes

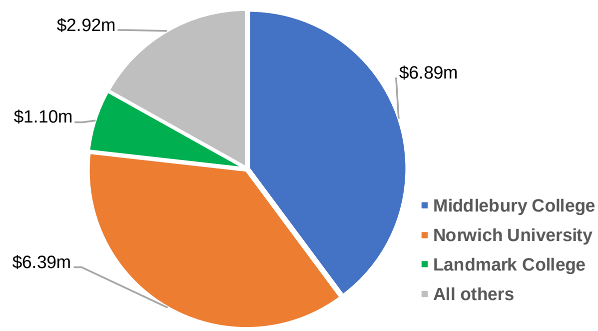
2) College

In FY2018, 142 parcels that belonged to private colleges claimed the PPC exemption. The total value of the property exempted from the grand list was $398.1 million, resulting in a tax expenditure of $17.3 million.

According to data provided by the Department of Taxes, 77% of the total tax expenditures ($13.2 million) for colleges come from two colleges: Middlebury College and Norwich University. Landmark College accounted for roughly $1.1 million in tax expenditures, while all other colleges combined for $2.92 million. Middlebury College and Norwich University also account for 67% (95) of the number of excluded parcels (142)[41].

Figure 2: College Property Tax Expenditures: FY2018

Total Tax Expenditures: $17.3 million



Source: Vermont Department of Taxes

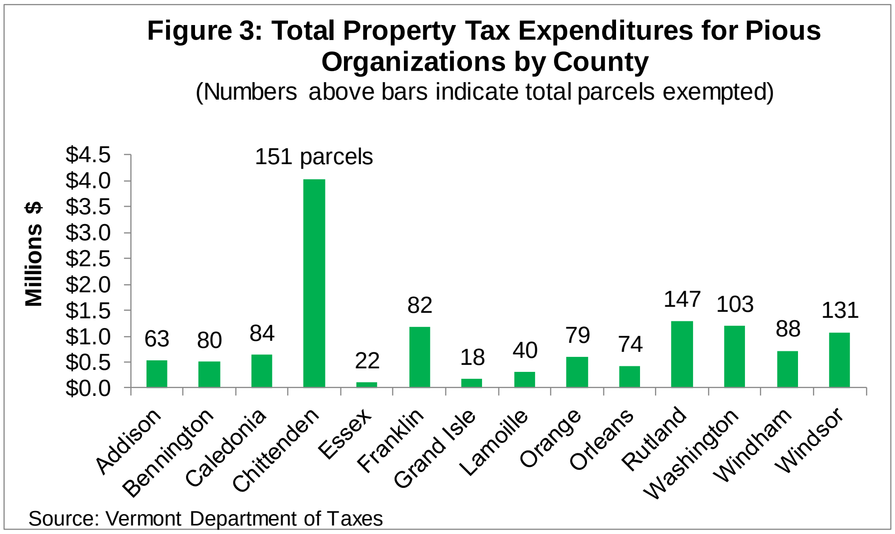
Table 2: College Property Tax Exemptions by Parcel: FY2018	
Middlebury College	53
Norwich University	42
Landmark College	2
All others	45
Total	**142**

3) Pious

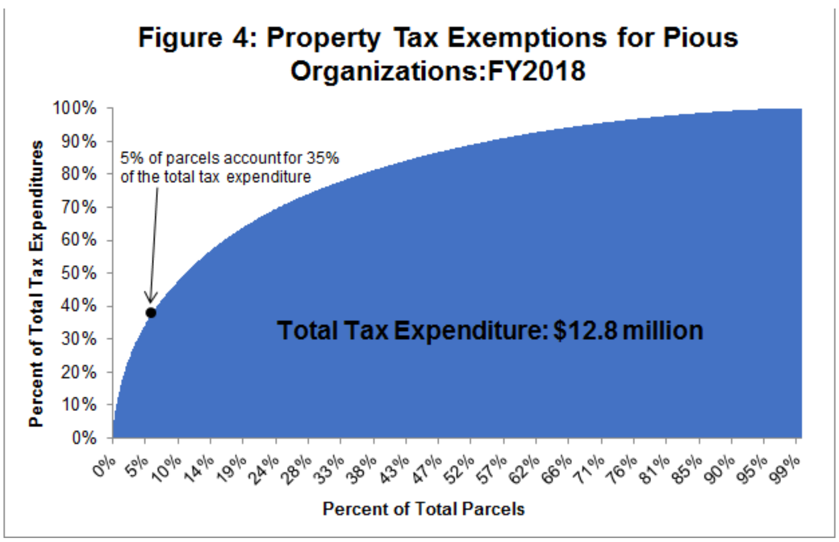
In FY2018, 1,162 parcels that belonged to pious organizations claimed the PPC exemption. The total value of the property exempted from the statewide grand list was $815.7 million, resulting a tax expenditure of $12.8 million.

Pious properties in Chittenden County account for nearly a third of the total state property tax expenditure for pious organizations. Of the 50 largest pious properties by value exempted from the property tax, 24 of them are from Chittenden County. While Chittenden County contains the most pious parcels, others such as Windsor and Rutland counties exempt similar numbers of pious parcels. However, for these counties, the total value of these pious parcels is significantly lower.

[41] The number of parcel excluded depends upon how the town assessor divides the parcels of the college. For instance, the main campus of Middlebury College is counted as one parcel, while Norwich University's main campus is divided into many parcels, with each building counted as a parcel.



The distribution of the property tax expenditure for pious organizations is skewed towards a relatively small number of properties. 62 or 5% of the parcels account for over a third ($4.6 million total) of the total amount of exemptions ($12.8 million). As ordered by the size of their tax expenditure, the bottom 576 parcels account for only 12% of the total exemptions ($1.5 million).

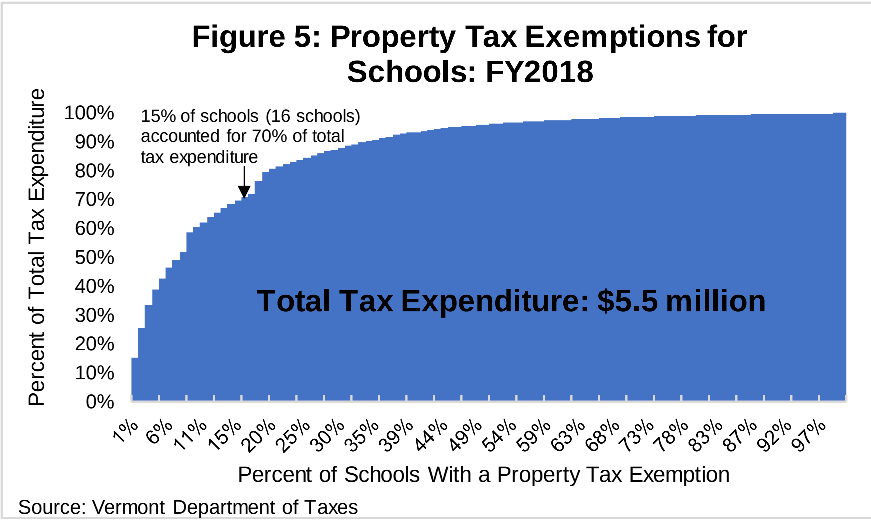


4) Schools

In FY2018, 190 parcels that belonged to mostly private schools claimed the PPC exemption. The total value of the property exempted from the statewide grand list was $384.6 million, resulting a tax expenditure of $5.5 million. A total of 104 schools took advantage of this exemption.

This exemption largely affects private primary and secondary schools. Some public schools use this exemption, although most public schools are excluded under 32 V.S.A. § 5401(10)(F), which exempts municipally-owned property from taxation. The public schools that claimed this exemption are those where the owner is a school district and not the municipality.

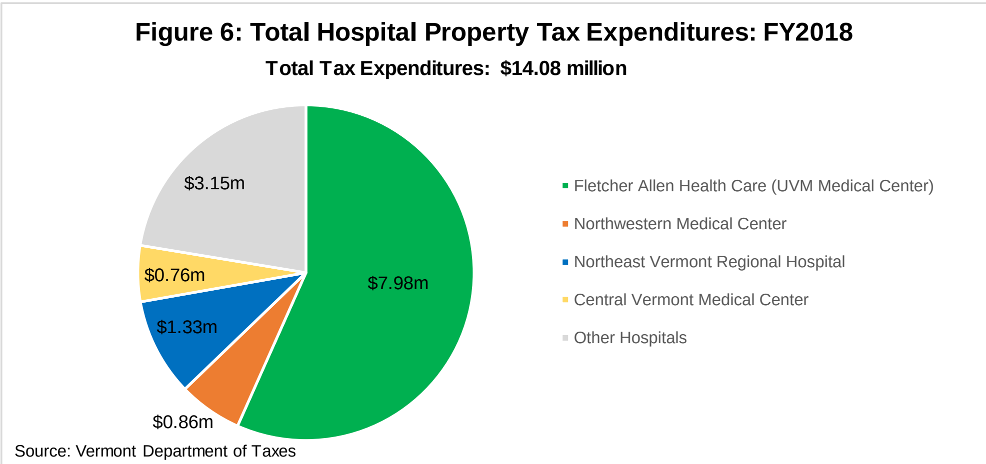
Like pious organizations, the distribution of the tax expenditure for schools is heavily skewed towards a few schools. Out of a total of 104 schools, 16 accounted for $3.9 million of the total $5.5 million in tax expenditures. Listed in the order of the size of their tax expenditure, the bottom 50 schools accounted for only $200,000 or 3% of the total tax expenditure.



5) Hospitals

In FY2018, 132 parcels that belonged to hospitals claimed the PPC exemption. The total value of the property exempted from the statewide grand list was $843 million, resulting a tax expenditure of $14.08 million.

Parcels associated with the Fletcher Allen (University of Vermont Medical Center) health system account for over half of the total State tax expenditure: $433.5 million worth of property is exempted from the property tax, equivalent to almost $8 million in foregone tax each year. The remaining exempted parcels are mostly from smaller regional hospitals, with Northeast Vermont Regional Hospital representing the largest tax expenditure of this group ($1.33 million).



Legal History

Some version of V.S.A. § 3802(4) existed when Vermont became a State in 1791. 32 V.S.A. § 3832, which more clearly defines the exemption for these organizations, was enacted in 1880.

State Comparisons

Every state has property tax exemptions for charitable organizations. Many even have the exemption written into their constitutions[42].

Pious organizations and hospitals are exempt from property taxes in all states[43][44].

[42] E.Brody, M. Marquez, K.Toran. “The Charitable Property-Tax Exemption and PILOTs.” The Urban Institute, Center on Nonprofits and Philanthropy. August 29, 2012.
[43] 26 U.S.C. § 501
[44] Martha H. Somerville et al., Hospital Community Benefits After the ACA: The State Law Landscape, The Hilltop Institute (Mar. 2013),

Tax Expenditures Relating to Incentivizing a Specific Desirable Outcome
Exemption for Property Owned by Agricultural Societies – Expedited Review
Prepared by the Joint Fiscal Office

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	Legislative Considerations
Property tax exemption for grounds and property owned and occupied by agricultural societies that are used annually for agricultural fairs. (32 V.S.A. § 3802 (9))	The statutory purpose of the exemption for property owned by agricultural societies is to lower the cost of public access to agricultural events. (32 V.S.A. § 3800(f))	$503,000 in FY2018	Limiting exemption to properties that exclusively or whose primary use is holding agricultural events.

Public Policy Objectives

The statutory purpose of this property tax exemption is to lower the cost of public access to agricultural events. The exemption lowers expenses for agricultural societies that host agricultural fairs. By lowering expenses, the societies can pass savings onto attendees by lowering admission prices.

The statute requires the agricultural societies to use the property annually for agricultural fairs.

Examples of events that take advantage of this exemption include:

- Addison County Field Days
- Caledonia County Fair
- Champlain Valley Exposition
- Franklin County Field Days
- Lamoille County Field Days
- Bradford Fair
- Vermont State Fair

Estimates and Analysis

In FY2018, there were 13 parcels that were excluded from the grand lists as a result of the agricultural societies exemption. The full grand list value of the property and land was approximately $32.7 million.

The statutory purpose of this exemption is to lower the cost for public access to agricultural events. This implies that the exemption lowers the admission cost to the events to the public. The exemption lowers the expenses for the non-profit agricultural society, which allows them to pass the savings onto lower admission prices.

JFO researched the IRS Form 990[45] returns from the agricultural societies who benefit from this exemption[46]. An analysis of these organizations' revenues, expenses, assets, and liabilities found that, for the latest available year of data (usually 2016 or 2015), 7 of the 13 had enough revenue after accounting for expenses to pay the property tax liability. However, the revenue and expenses for these organizations was very volatile; just because they made a profit in one year did not mean they profited in the next. This volatility often has much to do with the weather in a given year.

JFO also examined the extent to which this exemption theoretically lowers ticket prices. Using estimates from attendances gleaned from local newspapers and fair websites, as well as information on the admission prices to these events, JFO calculated the average savings for a member of the public from each of these fairs that claimed the exemption. Put another way, JFO calculated the additional amount the fair would need to charge attendees to cover the property tax obligation.

Estimates for the savings varied by fair. The median savings was $0.68 on an average ticket price of $11. This corresponds to savings of about 6% on the average ticket price. For some fairs, the savings was less than $0.50 on a $10-12 ticket, and for others, it was over $2. These estimates were calculated on the latest available years of data and could vary depending upon the attendance in a given year.

These estimates would vary significantly

These organizations also generate revenue from other sources, such as vendor fees, ride tickets, or sponsorships. If the State were to remove the property tax exemption, some or all of these organization could spread the additional cost throughout these streams, rather than solely the ticket price.

It's important to note that some of the properties that claim this exemption do not exclusively use them for agricultural events. For example, the Champlain Valley Exposition in Essex Junction hosts many events such as auto shows and flea markets in addition the Champlain Valley Fair (the main agricultural fair).

Legal History

1904	Property tax exemption enacted
2013	Statutory purpose added

State Comparisons

A brief survey found that at least 13 states have some form of property tax exemption for agricultural societies, 4-H clubs, or for property used for agricultural events in their state statutes. These include: Minnesota, Connecticut, Nebraska, New York, Montana, South Dakota, Iowa, Wisconsin, Illinois, Pennsylvania, Ohio, North Dakota, and Michigan.

[45] The federal income tax returns filed by non-profit or tax exempt organizations.
[46] *Seven Days* Non-Profit Navigator: https://nonprofits.sevendaysvt.com/

Tax Expenditures Relating to Incentivizing a Specific Desirable Outcome
Water Pollution Abatement Property – Expedited Review
Prepared by the Department of Taxes

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	Legislative Considerations
Exempts real and personal property exclusively installed and operated for the abatement of pollution of the waters of the State of Vermont or waters within the purview of the New England Interstate Water Pollution Control Compact in accordance with engineering principles approved by the Vermont Water Resources Board. This type of property shall be exempt as long as its operation meets with the approval of the Secretary of Natural Resources..	The statutory purpose of the exemption for property exclusively installed and operated for the abatement of water pollution in subdivision 3802(12) of this title is to encourage real property improvements that abate water pollution by nonpublic entities that would not qualify for an exemption as a government entity.	$1,000 in FY 2018	Require Vermont government entities to annually submit to the Department of Taxes a list of exempt properties under this exemption.

Public Policy Objectives
The Legislature stated that the public policy objective of the exemption for property exclusively installed and operated for the abatement of water pollution is to encourage real property improvements that abate water pollution by nonpublic entities that would not qualify for an exemption as a government entity.

Estimates and Analysis
The Agency of Natural Resources was unable to provide a list of properties exempt from property tax under this provision. The tax department identified one property that was potentially exempt under this provision and it does appear (based on a letter sent by the Department of Environmental Conservation's Wastewater Management Division to the property owner) that the property may have been installed for the purposes described in statute. There may be other properties exempt under this provision, but the town grand lists submitted to the tax department lack the necessary detail to definitively identify them.

Legal History
1961 Exempted from property taxes the real and personal property exclusively installed and operated for the abatement of pollution of the waters of the State of Vermont

State Comparisons

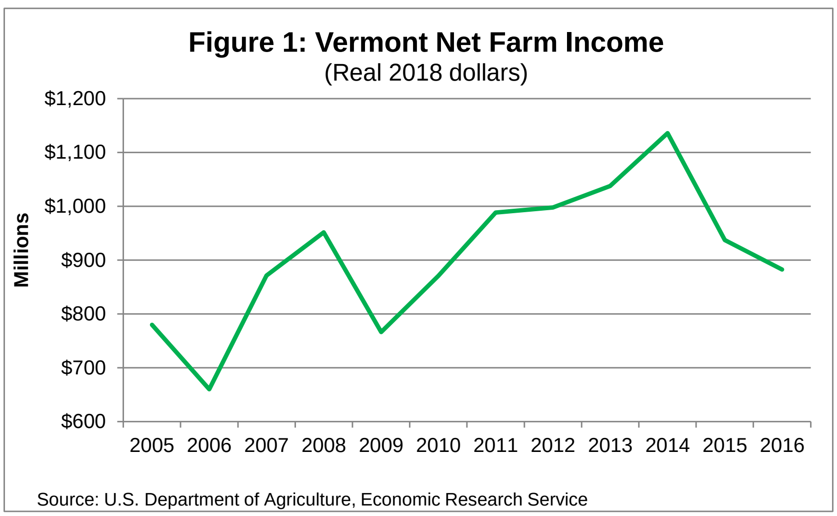
It is unclear if other states have a similar exemption to this one. In most states, exemptions from property tax are determined at the municipal or county level.

Tax Expenditures Relating to Incentivizing a Specific Desirable Outcome
Vermont Farm Income Averaging Credit – Expedited Review
Prepared by the Joint Fiscal Office

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	Legislative Considerations
Tax credit equal to 24% of the Federal Farm Income Averaging Credit (32 V.S.A. § 5822 (c(1)))	The statutory purpose of the Vermont farm income averaging credit is to mitigate the adverse tax consequences of fluctuating farm incomes under a progressive tax structure and to provide stability to farm operations. (32 V.S.A. § 5813 (f))	$76,000 in FY2017	Possible modifications could include: • Phasing out the credit after a certain level of income. • Limiting the number of times a filer can take the credit within a given time period.

Public Policy Objectives

The statutory purpose of this credit is to mitigate the consequences of fluctuating farm incomes and provide stability for farm operations. Historically, farm income in Vermont and nationwide has been volatile (Figure 1). The credit is in place to alleviate the tax implications of this volatility.



The Vermont credit is linked to the Federal tax code. On the Federal level, farmers are eligible to use the average of their past three years of income as their income in a given tax year. Typically, this is used to lower their income in a given tax year that was high due to any number of factors particular to the profession, including volatility in food prices and large sales of land or farm assets. Farmers may choose to do this if their income in the current year is higher than usual.

Using the average allows farmers to lower their federal taxable liability on their Federal return (line 44 on the IRS 1040). In addition to this, Vermont allows farmers to subtract 24% of the Federal reduction in tax liability from their Vermont tax liability.

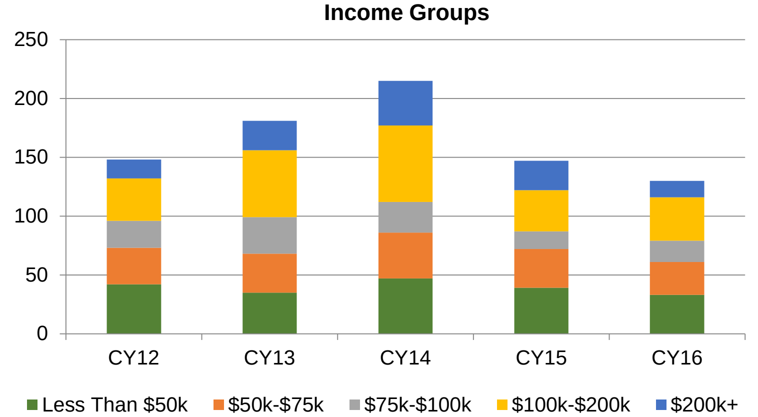
Eligibility for the credit extends to anyone involved in the trade or business of cultivating land or raising or harvesting an agricultural or horticultural commodity. This includes farmers, ranchers, and fisherman, but also extends to those leasing land to a tenant who is a farmer.

Estimates and Analysis

In CY2016, 130 taxpayers took the Farm Income Averaging Credit. This resulted in a total of approximately $76,000 in reduced Vermont income taxes for these claimants. This is the lowest amount of claimants and credits since CY2012.

The number of claimants and the total cost of the credit varies each year but tends to be higher when farm income in Vermont is highest. This is because farmers take the credit more when incomes are highest in order to lower their tax liability. In 2014, when Vermont farm income was high, 215 taxpayers took the credit (Figure 2).

Figure 2: Total Number of Claims by Filers in Various Income Groups



Over the past five years, no particular income group disproportionally takes the credit more than another (Figure 2).

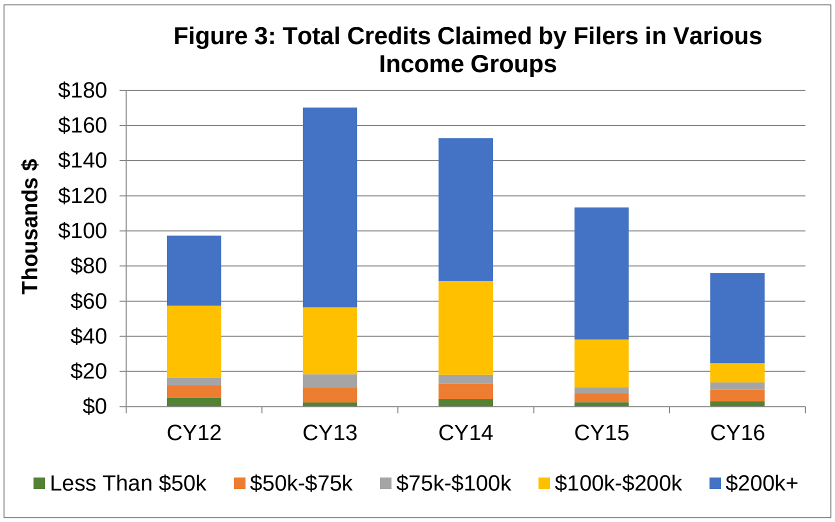
- Between 20% and 28% of the total number of credits were claimed by taxpayers with less than $50,000 in Adjusted Gross Income (AGI)
- Those with incomes between $50,000 and $100,000 claimed between 30% and 35% of credits
- Those over $200,000 in AGI claimed between 11% and 18% of the total credits.

Over the same time period, higher income taxpayers have accounted for the majority of the total dollar amount of credit claimed (Figure 3).

- Taxpayers with over $200,000 in income have, on average, claimed about 60% of the total amount of credits.

- Taxpayers with incomes between $100,000 and $200,000 claimed an additional 28% of the credit on average.
- Taxpayers with less than $50,000 in income have claimed about 3% of the total dollar amount of credit on average.

This distribution is to be expected as higher-income taxpayers have the largest tax liabilities. A credit used to smooth their liability would be larger than a lower-income taxpayers'.



The credit does not appear to be used by farmers for solely one-time spikes in their incomes. Rather, it may be used to smooth incomes across many years. For the claimants who took the credit in CY2016:

- Only 37% had never taken the credit from CY2012 to CY2015.
- 45% of them had taken the credit at least once or twice between CY2012 and CY2015
- 18% of them had taken the credit three or more times between CY2012 and CY2015

<u>Legal History</u>

2002 Farm income averaging credit enacted

<u>State Comparisons</u>

A survey of other states found that at least six other states had some form of farm income averaging for income tax purposes: Oklahoma, Kentucky, Oregon, Hawaii, North Dakota, and Rhode Island. Like Vermont, these states offer a credit against either corporate or personal income tax liability, depending on how the state treats farms as businesses. These credits lower the individuals' or business' income tax liability.

Tax Expenditures Relating to Incentivizing a Specific Desirable Outcome
Vermont Municipal Bond Income Exemption – Expedited Review
Prepared by the Department of Taxes

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	Legislative Considerations
Exempts the interest income earned from Vermont state and local government bonds.	The statutory purpose of the exemption for Vermont municipal bond income in subdivision 5811(21)(A)(i) of this title is to lower the cost of borrowing in order to finance State and municipal projects.	$2,274,000 in FY 2017	None

Public Policy Objectives

The Legislature stated that the public policy objective of the exemption for Vermont municipal bond income (collectively referred to as "muni" bonds) is to lower the cost of borrowing in order to finance State and municipal projects. Vermont and its municipalities will often sell bonds to finance public projects. Investors purchase these local government bonds because they are generally regarded as a safe investment and the interest earned is tax-free at both the federal and state levels (if the investor is filing in the state where the bond was issued). If interest income from these bonds was taxed, the yield would have to be higher to attract investors which would increase the cost of borrowing for the government entity issuing them. For this reason, exempting the interest from income reduces the cost of borrowing for the State and its municipalities.

Estimates and Analysis

For FY17 (tax year 2016), the number of filers claiming interest income from State and local bonds was 5,915. The total value of the expenditure in FY17 is calculated to be $2,274,000. The number of filers claiming this expenditure has remained steady at around 6,000 filers a year between tax year 2010 and 2016 while the value of the expenditure has gradually decreased over that period. The consistent number of filers claiming this type of exemption suggests a stable interest on the part of investors toward muni bonds as an investment option. The decrease in the value of the expenditure is likely related to interest rate fluctuations or other macroeconomic factors.

Legal History

2001 Vermont taxable income is defined, specifically *including* interest income from **non**-Vermont state and local obligations that is excluded from federal adjusted gross income but not including the analogous income from Vermont state and local obligations.

State Comparisons

Vermont's tax treatment of interest income from Vermont state and local bonds is consistent with how this type of income is treated in almost all other states with an income tax. And like the majority of these other states, Vermont does tax bond income from *non*-Vermont state and local bonds. Some states only allow residents to exempt muni bond income, while Vermont allows all filers to exempt the income. There are a few states that tax the interest income from state and local bonds if the bond was issued before a certain date or if the bond was issued for a certain purpose, but these exceptions are rare. It should be noted that when bonds are sold at a profit before they have matured the result is a capital gain, which is generally taxed both federally and at the state level. Interest income from state and local bonds is fully exempt from taxation at the federal level. Interest income from *federally* issues bonds is taxed at the federal level but exempt from state taxation by federal law.

Tax Expenditures Relating to Incentivizing a Specific Desirable Outcome
Qualified Bond Interest Income Exemption – Expedited Review
Prepared by the Department of Taxes

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	Legislative Considerations
Included in this expenditure is the interest income from bonds and notes issued by the Vermont Student Assistance Corp. (VSAC) 16 V.S.A. § 2825, the Vermont Telecom Authority (VTA) 30 V.S.A. § 8074, Build America (possibly under 32 V.S.A. § 5811(21)(A)(i)), and the Vermont Public Power Supply Authority (VPPSA) 30 V.S.A. § 5015.	The statutory purpose of the exemption for interest income from VSAC is to lower the cost of borrowing to finance education loan programs. The statutory purpose of the exemption for VTA bonds is to lower the cost of borrowing to finance the expansion of broadband access across the State. The Build America bond exemption does not have its own purpose but may possibly be considered state and local bonds. The VPPSA exemption does not currently have a statutory purpose.	$51,000 in FY 2017	*There are four types of bond interest income included in this exemption, not two. It is difficult to determine from statute how the legislature intended these income types to be treated. Currently, the Department of Taxes treats these as subtractions from Vermont income (apportionment), but that treatment may not be what was intended. All relevant statute for each bond type should be reviewed and clarified wherever possible.*

Public Policy Objectives
The Legislature stated that the public policy objective of the exemption for interest income from VSAC is to lower the cost of borrowing to help finance education loan programs. The Legislature stated that the public policy objective of the exemption for VTA bonds is to lower the cost of borrowing to help finance the expansion of broadband access across the State. It is unclear what the exact public policy objective of the Build America bond exemption is for, but it would likely be similar to the exemption for state and local bond income. Build America was a federal program that allowed state and local governments to issue taxable bonds for capital projects and to receive a direct federal subsidy payment from the Treasury Department for a portion of their borrowing costs. The VPPSA exemption does not have a clear statutory purpose, although that income, possibly including capital gains from the sale of these bonds, is clearly exempt from taxation. 30 V.S.A. § 5015.

Estimates and Analysis
In the most recent tax year (2017), there were approximately 435 filers claiming exempt interest income from one of these four sources. For roughly one hundred of these filers, it is impossible to tell which source the income is coming from because they did not check any of the boxes on the form corresponding to the bond type. Generally, it looks like the VSAC bonds are the most commonly claimed income source (around 250 filers), followed by Build America (around 50), VPPSA (around 20), and VTA (fewer than 10). Roughly $1,000,000 of total interest income was claimed from these four sources in tax year 2017.

Legal History
VSAC: 1982 VTA: 2007 VPPSA: 1979 Build America: possibly 2001

State Comparisons

States have varying treatments of interest income or capital gains income from bonds issued by entities within the state.