State of Vermont
Department of Taxes
133 State Street
Montpelier, VT 05633-1401

Agency of Administration

TESTIMONY

TO: Honorable Emilie Kornheiser, Chair, House Committee on Ways and Means
FROM: Craig Bolio, Commissioner, Vermont Department of Taxes
DATE: May 3rd, 2023
SUBJECT: S.56 An act relating to childcare and early childhood education

---

Chair Kornheiser and members of the House Committee on Ways and Means, thank you for the opportunity to offer comments on S.56 – *An act relating to childcare and early childhood education.*

Governor Scott has made it clear that his Administration and the Legislature have shared values, and that he supports significant investments in childcare and early childhood education. This included a $56 million investment in the Childcare Financial Assistance Program (CCFAP) in the Governor's recommended budget. The Governor has also made it clear that he cannot support new or increased taxes at a time when average Vermonters are already struggling to make ends meet and the potential for a more challenging fiscal landscape looms large.

Tax Capacity of Vermont

Vermont is the 2nd least populated state in the country; we're a small state with a small tax base. Using data from the 2020 Census, roughly 650,000 people live in Vermont. If Vermont were a city, our entire state population would make us only the 25th most populated *city* in the country, smaller than Boston. Vermont's small tax base already results in considerable pressure on taxpayers. Based on the 2022 State and Local Tax Burden analysis by the Tax Foundation, Vermonters currently pay 13.6% of their income in state and local taxes, higher than any other state except New York, Connecticut, and Hawaii.[1]

This year, on top of a more than $80 million property tax increase that Vermont taxpayers are expected to pay, the Legislature is considering over $285 million in additional taxes, including an unprecedented $178 million income tax increase under consideration in this Committee that raises both personal income tax and corporate income tax rates, and a $107.4 million payroll tax in H.66. Altogether, this more than $365 million tax increase would increase the share of Vermont income paid in state and local taxes to 14.57%, moving us up to the 3rd most taxed state in the country. At a time when Vermonters are paying more than ever for basic necessities, like food and housing, the Administration remains concerned about the impacts of these tax increases on Vermonters who are trying to get by, and the overall tax burden in the state.

[1] State-Local Tax Burden Rankings | Tax Foundation

A Potential Economic Downturn:

When the Governor was constructing his recommended budget, he was mindful of the consensus revenue forecast predicting a more than 7% general fund revenue reduction in FY24. Since then, we have more news of economic uncertainty including multiple bank failures around the country, concern about the national debt ceiling, and lower than expected personal income tax receipts from the month of April. This April's personal income tax receipts were nearly $43 million below the consensus forecast (and over $100 million below last April's). While we don't want to overreact to a single month, we were also nearly $6 million below April's forecast for personal income tax estimated payments, a "leading indicator" of economic health. We're fortunate that other revenues have been running strong so far this fiscal year to help offset these results, but this is a major underperformance for our most significant revenue source and policymakers should be mindful that Vermont may already be experiencing some of the same fiscal trends impacting other states. In March and April respectively, the Tax Policy Center and the Pew Charitable Trusts each published articles about the challenging revenue picture around the country, including two of the highest taxed states, New York and California, projecting significant budget deficits.[2][3]

The combined $365 million in tax increases that could come to pass this year are more than two times the projected General Fund revenue drop from FY23 to FY24. With Vermonters already facing such a large tax burden, where is the tax capacity going to come from in the next economic downturn?

Reliability and Volatility

Vermont has one of the most progressive tax systems in the country; the 2nd most progressive state tax system according to the Institute on Taxation and Economic Policy.[4] The Administration and Legislature agree that a progressive income tax system which protects the lowest income taxpayers is a Vermont value. However, in this proposal, according to the Joint Fiscal Office, 63% of the tax increase would be paid by the 8.5% of Vermont income tax filers who have an adjusted gross income (AGI) over $200,000. This layers a very "top heavy" revenue stream onto Vermont's famously progressive tax system, and would tie more of the health of Vermont General Fund revenues to the often one-time events of a small group of taxpayers. For comparison, over the last five tax years the average share of Vermont's income taxes paid by those over $200,000 of AGI has been 40%. Additionally, we must always be mindful that when you tax something more, you get less of it – whether the thing you tax is cigarettes, vaping devices, candy, or income. With such a significant tax increase, we may experience larger than normal effects of tax avoidance strategies that will also increase volatility to the General Fund. Again, the Administration and Legislature share the Vermont value of a progressive income tax structure, and those who earn the

[2] State Revenue Forecasts Look Bleak as Revenue Boom Subsides | Tax Policy Center
[3] States Feel Budget Pinch Amid Darkening Revenue Projections | The Pew Charitable Trusts (pewtrusts.org)
[4] Who Pays? 6th Edition – ITEP

State of Vermont
Department of Taxes
133 State Street
Montpelier, VT 05633-1401

most should pay the most, but we must also be mindful of how changes in tax policy and the economic landscape might impact our tax base.

Impact of Child Tax Credit on Costs for Early Childhood Education

In the version of S.56 as passed by the Senate, the Vermont Child Tax Credit (CTC) that was passed just last year would be fully repealed. It seems the impetus of that proposed repeal was a recognition that there is significant overlap between the Vermonters who enjoy the CTC and those who would benefit from the increase to the Child Care Financial Assistance Program (CCFAP). After all, the Vermont version of the Child Tax Credit is only available to those with children ages 5 or younger. However, a repeal of the CTC would increase taxes on the lowest income Vermonters who would not directly benefit from the changes in S.56. In my testimony to the Senate Finance Committee, I provided the following table that showed nearly 40% of the CTC paid out to Vermonters, as of March 22 of this year, went to those at or below 150% of federal poverty level, the level at which Vermonters today receive a full subsidy from CCFAP.

2022 Vermont Child Tax Credit Totals by Federal Poverty Level (Preliminary)

Federal Poverty Level	Return Count	Number of Eligible Children	CTC Claimed
Up to 150%	4,900	6,374	$ 6,310,298
150% to 175%	1,027	1,322	$ 1,301,645
175% to 200%	885	1,116	$ 1,096,645
200% to 225%	783	1,023	$ 1,004,985
225% to 250%	612	812	$ 805,171
250% to 275%	526	681	$ 669,277
275% to 300%	498	678	$ 671,622
300% to 325%	491	658	$ 642,860
325% to 350%	441	591	$ 584,188
Over 350%	3,120	3,946	$ 3,229,298
Grand Total	**13,283**	**17,201**	**16,315,989**

Wholesale repeal of the CTC in response to the partial overlap with CCFAP undeniably harms our most vulnerable families – a poor outcome. But the RAND study did not consider any of the $31.8 million projected CTC payments to families as funds available to pay for early childhood education, which also cannot be correct. It's important to recognize that there is public investment in the existing system not accounted for in the RAND study and that it would make sense to count a portion of the CTC. Consider that the RAND study *did* count a portion of the tax expenditure for the Child and Dependent Care Credit in their modeling. As per my March 22 stats above, 60% of this year's CTC payments went to families above 150% of FPL who shoulder some childcare costs. To be *extremely clear*, this is not a suggestion to scale back the CTC. After all, sometimes the best financial support a government can offer those it is trying to help is to keep the money in their pocket and trust them to make the best decisions on how to use it.

State of Vermont
Department of Taxes
133 State Street
Montpelier, VT 05633-1401

Agency of Administration

Other Provisions of S.56

There are other tax provisions in S.56 not discussed above. These include the Committee's proposal to increase the Vermont Earned Income Tax Credit (EITC) to 100% of the federal credit for those without children, and 55% of the federal credit for those with children. As the Committee knows, for two years the Administration has been proposing to increase the Vermont EITC to 45% of the federal credit, in recognition of its impact as an antipoverty tool, particularly for lifting children out of poverty, and a workforce development tool. The Administration is of course pleased the Committee is interested in increasing the Vermont EITC.

Additionally, the Committee seems poised to adjust both the Vermont Child Tax Credit and Earned Income Tax Credit to no longer require Social Security Numbers for recipients. The Administration accepts both of these adjustments as an equity initiative.

Lastly, I understand that the Pass-Through Entity (PTE) Tax/State and Local Tax (SALT) Cap Workaround that was part of S.45 is being added to S.56. It is no secret that the Administration is a strong supporter of the PTE tax and believes it makes all the sense in the world to offer some Vermonters a tax cut that actually raises state revenue. I hope the Committee will see fit to retain the corresponding personal income tax credit of 90%. As we've discussed this policy, one key element has been the lack of equity between resident and non-resident PTE owners in Vermont. While non-resident PTE owners can enjoy the SALT cap workaround today through composite filing, Vermont resident PTE owners cannot. Reducing the personal income tax credit for residents moves the policy further away from parity for residents and non-residents.

The Administration hopes the Committee is willing to consider these provisions separately from the significant income tax increase laid out in this bill.

Conclusion:

As stated at the top of this document, the Administration and Legislature have shared values, among them the need to invest in our childcare and early childhood education system. But the way we do it matters, and ensuring that we're responsive to the fiscal uncertainty ahead is critical. At a time when Vermonters are already experiencing the crunch of inflation and are expected to experience an $80+ million property tax increase, the Administration cannot support an additional $285 million in taxes, including a $178 million income tax increase. Thank you for your consideration.