STATE OF VERMONT

MEMORANDUM

To: Rep. Kornheiser, Chair, House Committee on Ways and Means

From: Kirby Keeton

Date: January 23, 2024

Subject: H.827; application of personal income tax to unrealized gains

Bill Summary of H.827

Eligible Taxpayers

Tax is imposed on resident individuals with net assets worth more than $10,000,000.00. There is no regard for filing status and the bill excludes most retirement accounts. The total taxable gains cannot exceed 10 percent of an individual's net wealth in excess of $10,000,000.00. Taxpayers may exclude up to $1,000,000.00 in specific asset categories: personal and intellectual property, interests in business entities, real estate, and property held in trust. The amounts excluded reduce the gains counted toward the threshold $10,000,000.00 amount that triggers tax liability and are also excluded from the amount to which tax is applied.

Functionality

Taxpayers are required to pay personal income tax on 50 percent of the unrealized gain or loss of a taxpayer's assets. An "unrealized gain" is an increase in value, but the owner has not yet received the income for that gain. Taxpayers receive an offset for losses in value but cannot receive a refund. Unused losses can be carried forward to later years. The value is normally calculated by determining the amount received if the property was sold for fair market value.

Residential Status

The full tax liability phases in over four years of residency. For new residents, taxpayers receive credit for gains that accrued and were taxed prior to Vermont residency and their gains will be apportioned based on years of residency. Part year residents and temporary residents with a substantial presence are subject to the tax. Full-time students are exempt.

Valuation

- Publicly traded assets (e.g., stocks and bonds): fair market value.

- Private businesses: book assets and 7.5 times the book earnings. Alternatively, a taxpayer may submit an appraisal if the taxpayer can show that the value is incorrect.
- Real Estate: equalized grand list value.
- Private and intellectual property: the purchase price if within 10 years (adjusted for inflation) or by appraisal within the last 10 years (adjusted for inflation).

Optional Deferral Accounts

For any nontraded asset, a taxpayer may elect to use an ODA instead of the other valuation methods. An ODA defers tax until an asset is sold but imposes interest. Taxpayers owe tax when taking distributions from ODA assets, such as taking dividends from a private business or when borrowing. The amounts paid for this are credited against tax due when the asset is sold. Taxpayers may also resolve the ODA prior to the sale of an asset.

Special Rules for Trusts

Vermont resident trusts are subject to tax and have no exemption amounts unless an individual who funded the trust applies part of their personal exemption to the trust. Vested Vermont beneficiaries of nonresident trusts must treat trust assets as their own assets.

Retirement Plans

Pensions and IRAs are exempt. Roth balances in excess of $1,000,000.00 are taxable. Executive pensions, deferred compensation, and carried interest are taxable unless precluded by federal law.

Some Needed Adjustments to the Bill

I ran out of time when drafting this, which resulted in some needed adjustments to make it function correctly:

- Some provisions that are in the apportionment section should be moved to the enacting section.
- Some language relating to what counts toward the threshold amount should be clarified. Specifically, language related to debt or liabilities subject to events that are uncertain to occur.
- Some added clarification to the provisions defining fair market value. As drafted, it is unclear how an asset could be valued when not sold to the public.
- Clarify how exemption amounts can be contributed to trusts. Currently, it could be interpreted so that any person can contribute an exclusion to a trust. It is also possible that a person could exempt more from a trust than the person contributed.
- The equation for determining tax when closing an ODA needs to be adjusted because an exponent is currently characterized as a minus.