

Income Surcharge or New Bracket?

House Committee on Ways and Means

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Outline of talk

- \$500K+ Vermont Taxpayers Overview
- How does a surcharge on AGI differ compared to a new top marginal bracket?
- Considerations
- Revenue
- Appendix: Potential Behavioral Responses



Vermont \$500K+ taxpayers



Overview

- H.828 would place a 3% surcharge on adjusted gross income (AGI) above \$500,000.
- The surcharge would be adjusted for inflation each year.
- The surcharge would be effective retroactively for tax year 2024.
- <https://legislature.vermont.gov/Documents/2024/Docs/BILLS/H-0828/H-0828%20As%20Introduced.pdf>



Personal income tax data, 2022

- 1,059 returns with AGI of \$1 million or more represented 2,752 exemptions or individuals
- 1,059 returns with AGI of \$1 million or more accounted for:
 - 0.32% of all VT tax returns
 - 11.3% of all VT AGI
 - 20.0% of all net VT personal income tax paid



Personal income tax data, 2022

- 3,560 returns with AGI of \$500,000 or more represented 9,347 exemptions or individuals
- 3,560 returns with AGI of \$500,000 or more accounted for:
 - 1.1% of all VT tax returns
 - 16.7% of all VT AGI
 - 34.8% of all net VT personal income tax paid



Table 1. Personal Income Tax Returns for \$500,000+ and Millionaires, Tax Year 2022

All Vermont Resident Returns				
# returns	% returns	% VT AGI	% net VT tax	
\$500,000+				
3,560	1.1%	16.7%	30.4%	
\$1,000,000+				
1,059	0.3%	10.6%	20.0%	
Ages 65+ Only				
\$500,000+				
989	0.3%	4.8%	8.7%	
\$1,000,000+				
324	0.1%	3.2%	5.9%	
Source: Vermont Department of Taxes, Income Tax data.				



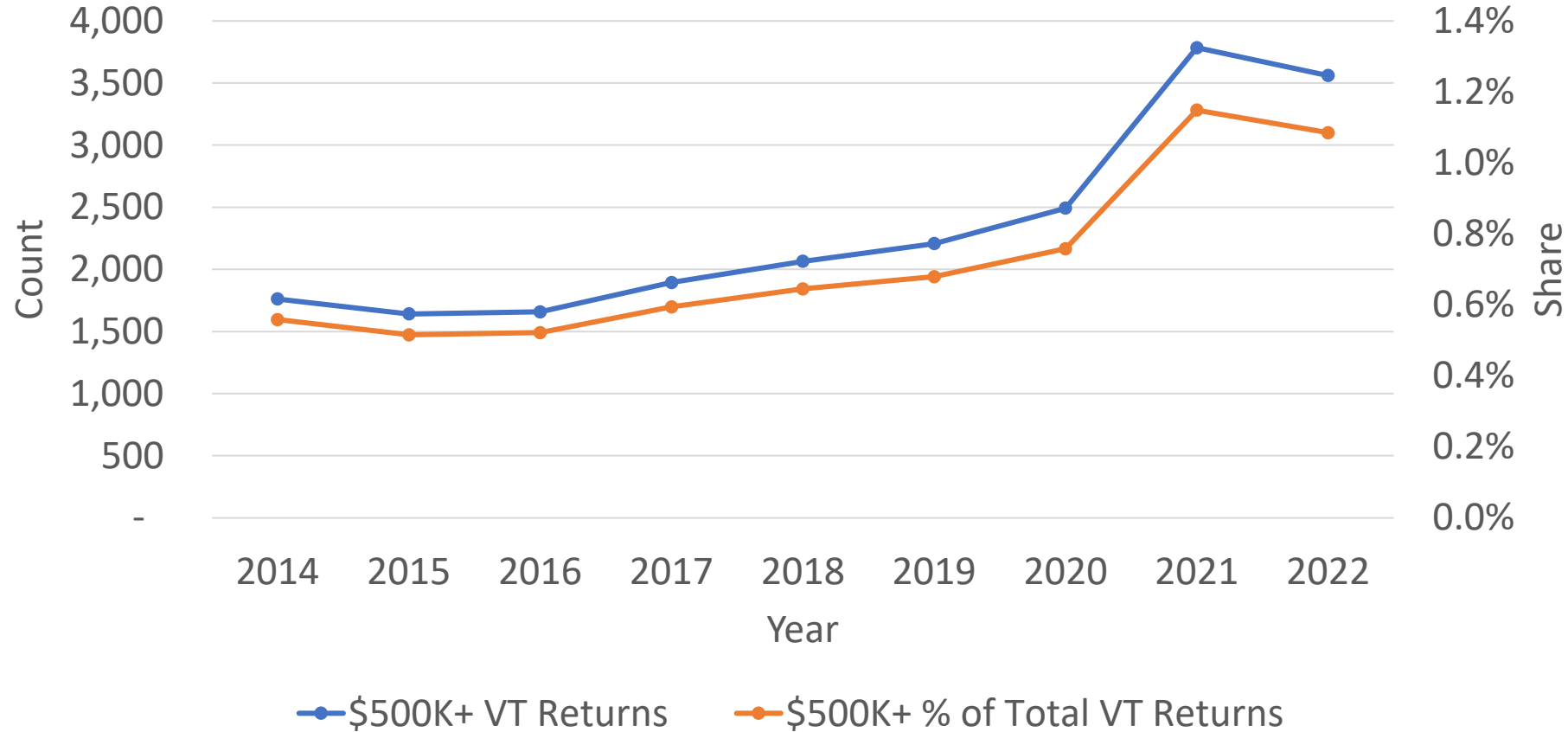
\$500K+ Returns - 2013 to 2022

Vermont Resident Filers with AGI over \$500,000*: 2013-2022			
Year	Count	YoY Change	YoY % Change
2013	2,340		
2014	2,744	404	17%
2015	2,632	(112)	-4%
2016	2,567	(65)	-2%
2017	2,772	205	8%
2018	2,952	180	6%
2019	2,983	31	1%
2020	3,284	301	10%
2021	4,308	1,024	31%
2022	3,592	(716)	-17%

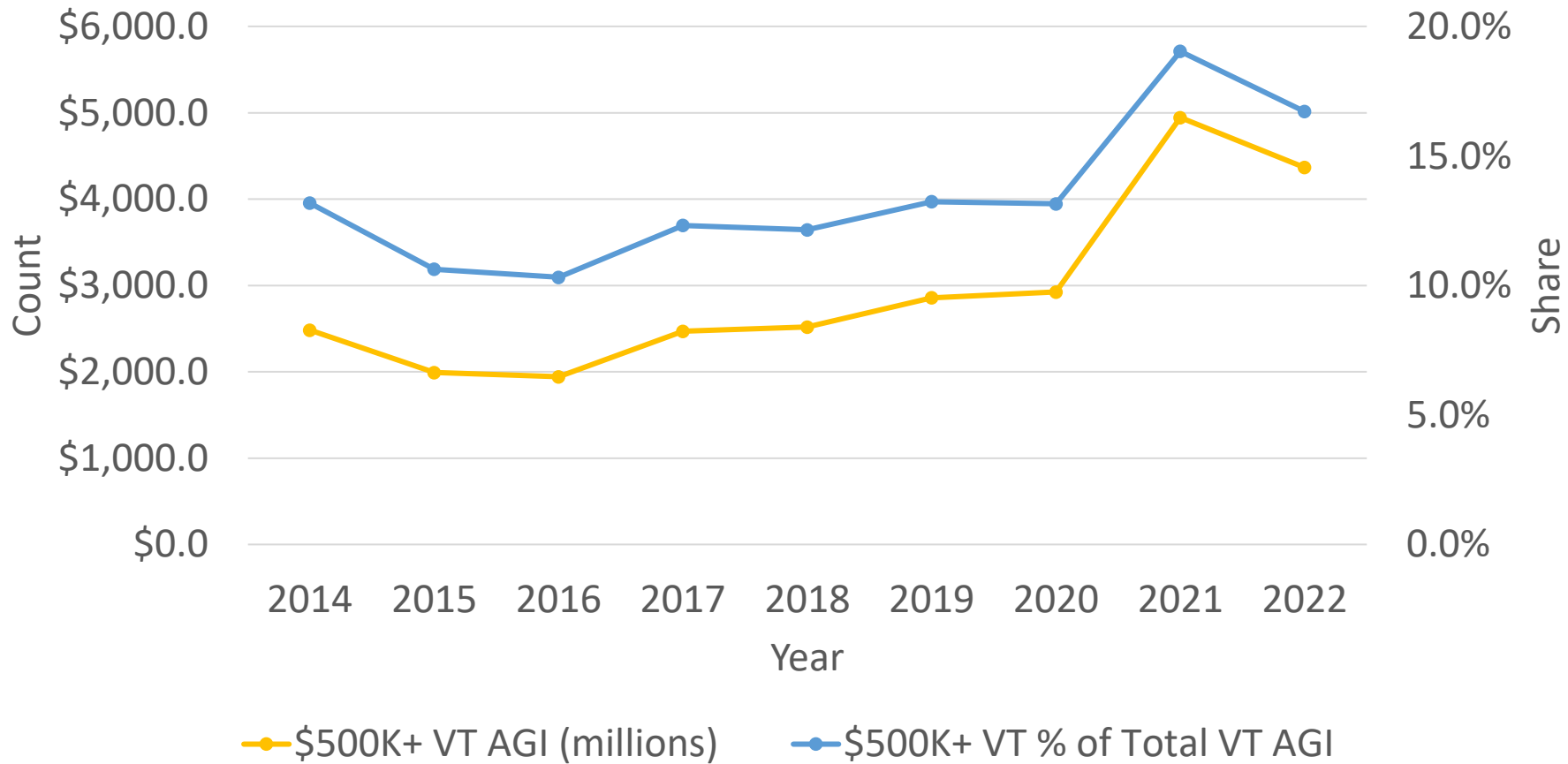
**AGIs inflation-adjusted to 2022 dollars*



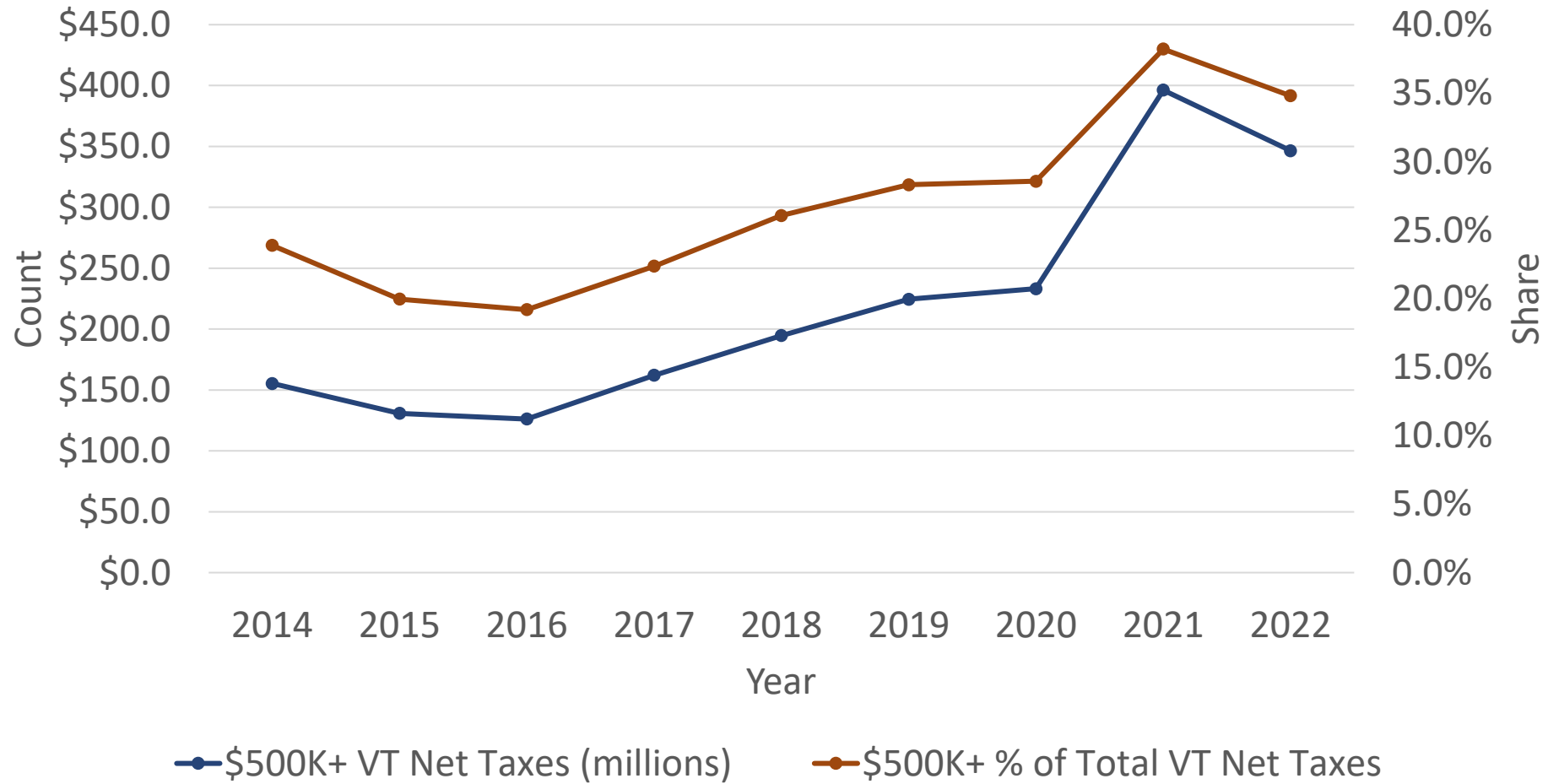
\$500K+ Returns



\$500K+ VT AGI



\$500K+ Net Taxes



2022 Vermont Personal Income Tax Returns - Dollars

AGI Income Bracket	Returns	Adjusted Gross Income (AGI)	Vermont AGI	Vermont Taxable Income	Vermont Tax	Adjusted Vermont Tax	NonRef Credits	Ref Credits	Net Vermont Tax	ETR
Negative	2,500	-146,222,620	-146,222,620	4,879,939	351,619	351,619	10,747	157,774	183,098	NA
0 - 4999	21,916	46,429,682	46,229,284	299,864	14,223	14,218	3,613	1,377,369	-1,366,764	-3.0%
5000 - 9999	18,857	141,216,959	139,995,093	7,024,075	246,966	245,110	27,887	2,791,696	-2,574,473	-1.8%
10000 - 14999	17,439	216,860,576	213,930,638	31,541,960	1,049,003	1,030,475	35,755	4,395,055	-3,400,335	-1.6%
15000 - 19999	14,781	258,187,116	253,836,077	69,989,626	2,301,518	2,251,663	66,239	5,181,857	-2,996,433	-1.2%
20000 - 24999	13,713	308,295,702	302,030,823	109,388,624	3,619,216	3,521,125	83,761	4,678,547	-1,241,183	-0.4%
25000 - 29999	14,195	390,586,725	382,313,346	170,760,649	5,747,522	5,601,535	154,248	4,525,581	921,706	0.2%
30000 - 34999	15,121	491,461,291	481,105,413	250,197,737	8,305,381	8,098,182	164,651	4,047,996	3,885,535	0.8%
35000 - 39999	16,214	608,161,910	597,383,548	342,196,458	11,384,568	11,160,080	216,659	3,611,560	7,331,861	1.2%
40000 - 44999	15,931	676,699,132	665,530,919	409,180,249	13,603,377	13,353,084	244,465	2,566,768	10,541,851	1.6%
45000 - 49999	14,435	684,915,541	672,614,579	434,441,334	14,451,625	14,177,078	674,154	1,649,385	11,853,539	1.8%
50000 - 59999	25,253	1,383,696,977	1,361,535,968	922,135,093	31,756,262	31,203,638	634,354	2,488,838	28,080,446	2.1%
60000 - 74999	28,825	1,931,922,793	1,901,234,124	1,373,432,696	52,464,382	51,554,227	1,199,254	3,001,763	47,353,210	2.5%
75000 - 99999	32,932	2,854,794,233	2,800,047,805	2,171,846,858	85,655,289	83,846,238	2,589,744	4,605,946	76,650,548	2.7%
100000 - 124999	23,460	2,620,856,679	2,572,597,010	2,075,737,832	88,056,128	86,276,768	2,743,475	4,206,985	79,326,308	3.1%
125000 - 149999	15,504	2,117,518,179	2,078,427,332	1,734,416,539	81,561,352	79,919,036	2,917,897	2,451,992	74,549,147	3.6%
150000 - 199999	16,508	2,829,266,091	2,763,671,786	2,406,947,218	124,306,019	121,266,795	5,000,469	1,095,493	115,170,833	4.2%
200000 - 299999	11,285	2,701,340,388	2,617,795,239	2,400,168,595	139,782,001	135,331,965	6,600,049	473,278	128,258,638	4.9%
300000 - 499999	5,672	2,133,069,983	2,053,765,532	1,966,896,539	133,705,491	128,625,155	8,436,684	205,071	119,983,400	5.8%
500000 - 999999	2,501	1,664,479,734	1,594,869,768	1,574,777,015	120,380,547	115,269,108	11,219,075	77,622	103,972,411	6.5%
1,000,000 +	1,059	3,039,937,189	2,771,795,340	2,996,575,373	254,351,426	231,214,745	32,226,973	17,540	198,970,232	7.2%
State Total	328,101	26,953,474,260	26,124,487,004	21,452,834,273	1,173,093,915	1,124,311,844	75,250,153	53,608,116	995,453,575	3.8%
Out of State	53,890	27,818,102,036	2,116,095,973	27,304,804,708	2,240,216,120	108,452,977	1,045,995	569,423	106,879,815	NA
All Returns	381,991	54,771,576,296	28,240,582,978	48,757,638,981	3,413,310,035	1,232,764,821	76,296,148	54,177,539	1,102,333,390	3.9%



How does a surcharge on AGI differ compared to a new top marginal bracket?



Tax Base – Income Tax Brackets

- Vermont allows exemptions and deductions including:
 - Social security, military retirement, civil service, and other retirement income
 - Standard deduction and personal exemptions
 - Medical deduction
 - Capital gains exclusion
 - Student loan interest
 - Bonus depreciation
 - Recapture of state and local income tax deductions not taken in VT
 - Federal deductions or credits not allowed for cannabis



Tax Treatment – Income Tax Brackets TY2024

- Vermont has different tax brackets based on filing status:

Filing Status: Single		
AGI		Existing Marginal Tax Rate
\$0	\$47,900	3.35%
\$47,900	\$116,000	6.60%
\$116,000	\$242,000	7.60%
\$242,000	and up	8.75%

Filing Status: Married Filing Jointly		
AGI		Existing Marginal Tax Rate
\$0	\$79,950	3.35%
\$79,950	\$193,350	6.60%
\$193,350	\$294,650	7.60%
\$294,650	and up	8.75%

Filing Status: Head of Household		
AGI		Existing Marginal Tax Rate
\$0	\$64,150	3.35%
\$64,150	\$165,700	6.60%
\$165,700	\$268,350	7.60%
\$268,350	and up	8.75%

Filing Status: Married Filing Separately		
AGI		Existing Marginal Tax Rate
\$0	\$39,975	3.35%
\$39,975	\$96,675	6.60%
\$96,675	\$147,325	7.60%
\$147,325	and up	8.75%



Tax Base and Treatment – Surcharge

- The surcharge would not allow the same exemptions and deductions that are allowed to adjust AGI for personal income tax in Vermont.
- A surcharge does not differentiate between filing status.
- A surcharge is not imposed on estates or trusts.

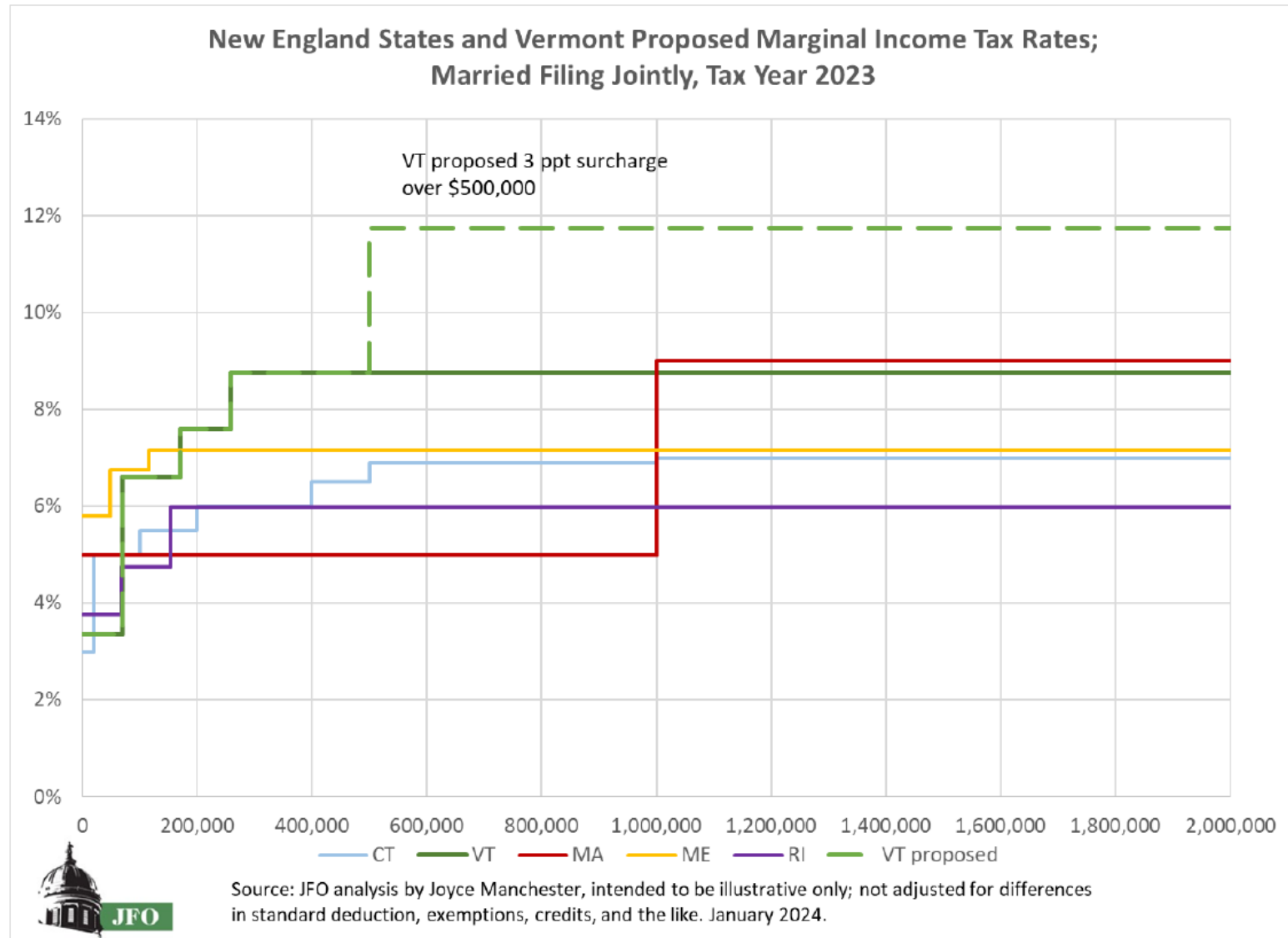


Tax Base and Treatment – Both

- Both taxes would require credit for taxes paid to another state or allocated to another jurisdiction.
 - This is a constitutional requirement.
- Interest income from U.S. obligations and any other items Vermont is precluded from taxing cannot be included in the taxable amount.



Tax Rate Schedules Regionally



Considerations



Considerations

1. Vermont has implemented income surcharges in the past, but only on a temporary basis.
2. A surcharge would be a little more administratively complex than adding a new bracket and top marginal rate to the existing personal income tax structure.
3. Currently Vermont accounts for differences in household sizes and composition with brackets that differ by filing status, standard deduction amount and personal exemptions. The surcharge would treat all filers the same regardless of household composition.



Considerations

4. Because the surcharge does not allow for exemptions and deductions it has a broader base than a new bracket and top marginal rate would.
5. If the committee were to implement new top marginal brackets rather than a surcharge, to what extent should the top marginal threshold differ by filing status?



Revenue



Revenue

- A surcharge would be expected to generate more revenue than a new tax bracket and top marginal rate.
- A surcharge does not allow the exemptions and deductions allowed under Vermont's personal income tax structure, which lower taxable income.
- Unlike the following two bracket scenarios, the surcharge proposal does not vary the \$500K threshold by filing status.
- JFO does anticipate some behavioral responses to increases in income tax paid by high income taxpayers and has incorporated those into the revenue estimates.



Revenue – Surcharge Estimate

- A 3% surcharge on AGI above \$500,000 is estimated to generate \$75.4 million annually.
- This estimate accounts for anticipated behavioral changes.



Revenue – New Bracket Estimate Option 1

Filing Status: Single		
AGI		Marginal Tax Rate
\$0	\$47,900	3.35%
\$47,900	\$116,000	6.60%
\$116,000	\$242,000	7.60%
\$242,000	\$500,000	8.75%
\$500,000	and up	11.75%

Filing Status: Married Filing Jointly		
AGI		Marginal Tax Rate
\$0	\$79,950	3.35%
\$79,950	\$193,350	6.60%
\$193,350	\$294,650	7.60%
\$294,650	\$500,000	8.75%
\$500,000	and up	11.75%

- This option for new top marginal tax brackets is estimated to generate approximately \$73.4 million in additional revenue.

Filing Status: Head of Household		
AGI		Marginal Tax Rate
\$0	\$64,150	3.35%
\$64,150	\$165,700	6.60%
\$165,700	\$268,350	7.60%
\$268,350	\$500,000	8.75%
\$500,000	and up	11.75%

Filing Status: Married Filing Separately		
AGI		Marginal Tax Rate
\$0	\$39,975	3.35%
\$39,975	\$96,675	6.60%
\$96,675	\$147,325	7.60%
\$147,325	\$250,000	8.75%
\$250,000	and up	11.75%



Revenue – New Bracket Estimate Option 2

Filing Status: Single		
AGI		Marginal Tax Rate
\$0	\$47,900	3.35%
\$47,900	\$116,000	6.60%
\$116,000	\$242,000	7.60%
\$242,000	\$410,650	8.75%
\$410,650	and up	11.75%

Filing Status: Married Filing Jointly		
AGI		Marginal Tax Rate
\$0	\$79,950	3.35%
\$79,950	\$193,350	6.60%
\$193,350	\$294,650	7.60%
\$294,650	\$500,000	8.75%
\$500,000	and up	11.75%

- This option for new top marginal tax brackets is estimated to generate approximately \$74.9 million in additional revenue.

Filing Status: Head of Household		
AGI		Marginal Tax Rate
\$0	\$64,150	3.35%
\$64,150	\$165,700	6.60%
\$165,700	\$268,350	7.60%
\$268,350	\$455,350	8.75%
\$455,350	and up	11.75%

Filing Status: Married Filing Separately		
AGI		Marginal Tax Rate
\$0	\$39,975	3.35%
\$39,975	\$96,675	6.60%
\$96,675	\$147,325	7.60%
\$147,325	\$250,000	8.75%
\$250,000	and up	11.75%



Appendix: Potential Behavioral Responses



Potential Behavioral Responses - Massachusetts

- Massachusetts implemented a 4% surcharge on taxable income over \$1 million starting in tax year 2023.
- Initial estimates projected an additional \$2 billion in annual revenue.
 - This estimate was a “static” analysis which did not account for potential changes in taxpayer behavior.
- The Tufts Center for State Policy Analysis estimated that with behavioral changes the surcharge would raise \$1.3 billion.
- Preliminary results indicate the surcharge generated approximately \$1.5 billion in revenue in 2023.



Potential Behavioral Responses - Massachusetts

- The Tufts Center for State Policy Analysis considered behavioral factors including:
 - Some high-income residents may relocate to other states, but indicated the number of movers was likely to be small.
 - This factor was estimated to reduce the expected revenue by 5%.
 - A drop in reported incomes due to tax avoidance strategies like curtailing stock trading, financial restructuring that shifts economic activity out of state.
 - Unlike the question about relocation, estimates of the relationship between tax rates, tax avoidance, and state collections vary widely.
 - Tufts ultimately estimated that 30% of estimated revenue would be lost to tax avoidance, although noted there is research indicating it could be less and also evidence from California that it could be higher.



Potential Behavioral Responses - Massachusetts

- Combined, Tufts estimated behavioral responses would reduce the “static” analysis estimates by 35%, from \$2 billion to \$1.3 billion.
- Preliminary return data suggests the effect may have been less, around 25%.
- For context, MA appropriated \$1 billion in anticipation of surcharge revenue in their last budget, well below the initial estimates.
- Resources:
 - https://cspa.tufts.edu/sites/g/files/lrezom361/files/2022-01/cSPA_Evaluating_MA_Millionaires_Tax.pdf
 - <https://www.masslive.com/politics/2023/12/no-the-millionaires-tax-has-not-been-a-disaster-in-mass-analysis.html>
 - <https://massbudget.org/2022/08/18/fair-share-tax-on-incomes-over-1-million-would-generate-at-least-2-billion-a-year/>



Potential Behavioral Responses - California

- In 2012 California increased marginal tax rates by up to 3 percentage points for high-income households.
- A 2021 paper studied the effect of this increase in tax rates and estimated that behavioral responses eroded 45.2% of state windfall tax revenues.
- There were two effects the paper studied:
 - Extensive Margin: Out migration due to tax increase.
 - Intensive Margin: Decrease in reported taxable income due to tax increase.



Potential Behavioral Responses - California

- The combined extensive and intensive responses were estimated to have resulted in an approximately 45.2% decrease in new tax revenue.
 - The extensive margin is estimated to have accounted for 9.5% of the total behavioral response.
 - The decrease in reported taxable income was estimated to account for the majority of the 45.2% decrease.
- Note: 45.2% decrease *does not* mean a decrease in overall revenue. It is the decrease in potential revenue without any behavioral responses.
- https://www.nber.org/system/files/working_papers/w26349/w26349.pdf

