

# Principles of a High-Quality Tax System

Senate Finance

Emily Byrne, Associate Fiscal Officer

January 12, 2023



# Six Key Principles to a High-Quality Tax System



# Six Principles of a High-Quality Tax System

Based on the “NCSL Tax Policy Handbook for State Legislators”  
3<sup>rd</sup> Edition 2010

- <http://www.ncsl.org/documents/fiscal/TaxPolicyHandbook3rdEdition.pdf>



# Six Principles

1. Sustainability/Reliability
2. Fairness
3. Simplicity
4. Economic Competitiveness
5. Tax Neutrality
6. Accountability

Source: <https://www.ncsl.org/research/fiscal-policy/principles-of-a-high-quality-state-revenue-system.aspx#principles>



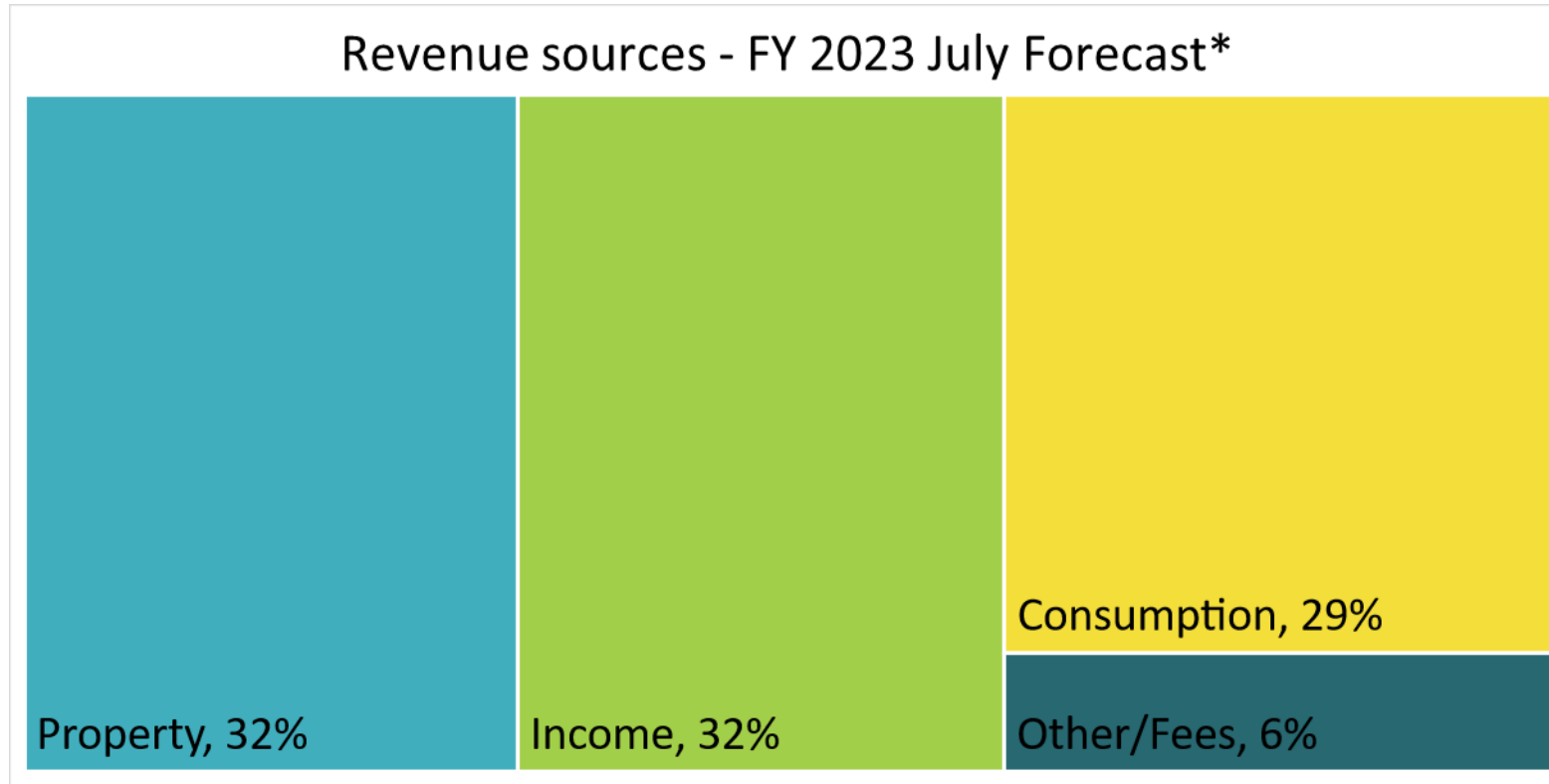
# Sustainability and Reliability

**Principle:** Maintain a reliable, sustainable, and diverse revenue stream

- Reliable – not one time, predictable, doesn't vary much from year to year
  - State Perspective:
    - Corporate and personal income tax tend to be the most volatile
    - Sales taxes tend to be more stable
  - Taxpayer
    - Tax changes are kept to a minimum to allow individuals and business to plan
- Sustainable – not one time, is enough to cover expenses over time
  - Match revenue growth with expenditure growth where possible
- Diverse – the tax base is broad enough to mitigate volatility and increase reliability
  - Goal is to have a balanced mix of taxes



# Vermont balance among tax types



Source	Amount (in Billions)
Property	\$1.43
Income	\$1.41
Consumption	\$1.31
Other/Fees	\$0.28
<b>Total</b>	<b>\$4.43</b>

\*Note – only includes revenues as part of the official state revenue forecast, does not include other non-consensus-forecasted revenues sources such as certain dedicated special fund fees and taxes, etc.



# Fairness

**Principle:** Ensuring equality in taxes paid across similar ability to pay and circumstances

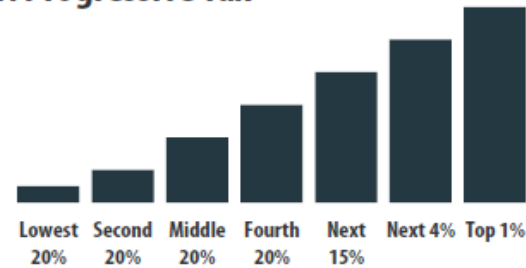
- Horizontal Equity – taxpayers with similar economic circumstances have similar tax burdens
  - 2 married couples with combined income of \$60,000; but one couple has a mortgage....
- Vertical equity or progressivity – how the distribution of tax burdens varies among taxpayers with different economic circumstances

Taxpayer	Income	Effective Tax Rate
Single - A	\$50,000	3.00%
Single - B	\$150,000	6.00%



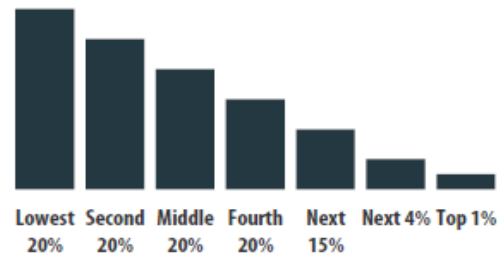
# Progressive vs Regressive vs Proportional Tax

## A Progressive Tax



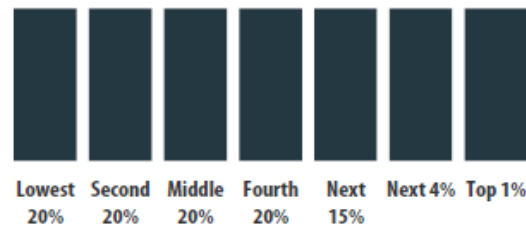
A **progressive tax** is one in which upper-income families pay a larger share of their incomes in tax than do those with lower incomes.

## A Regressive Tax



A **regressive tax** requires the poor and middle-income to pay a larger share of their incomes in taxes than the rich.

## A Proportional Tax



A **proportional tax** takes the same percentage of income from everyone, regardless of how much or how little they earn.





# ITEP: *Who Pays*, 6<sup>th</sup> Edition

- Per the Institute for Taxation and Economic Policy (ITEP), Vermont's state and local tax system does not worsen income inequality
  - Meaning that the income gap between lower- and middle- income taxpayers, as compared to the wealthy, is somewhat narrower after state and local taxes than before.
  - In 2018, Vermont Ranked #49 out of 51 (51 is best)
  - Looks at the whole state tax system – not just one component
    - When considering new tax policy consider the whole system

*Note – Published in October 2018, Vermont and other states have changed their tax codes*

[ITEP: Why Pays, 6<sup>th</sup> Edition](#)

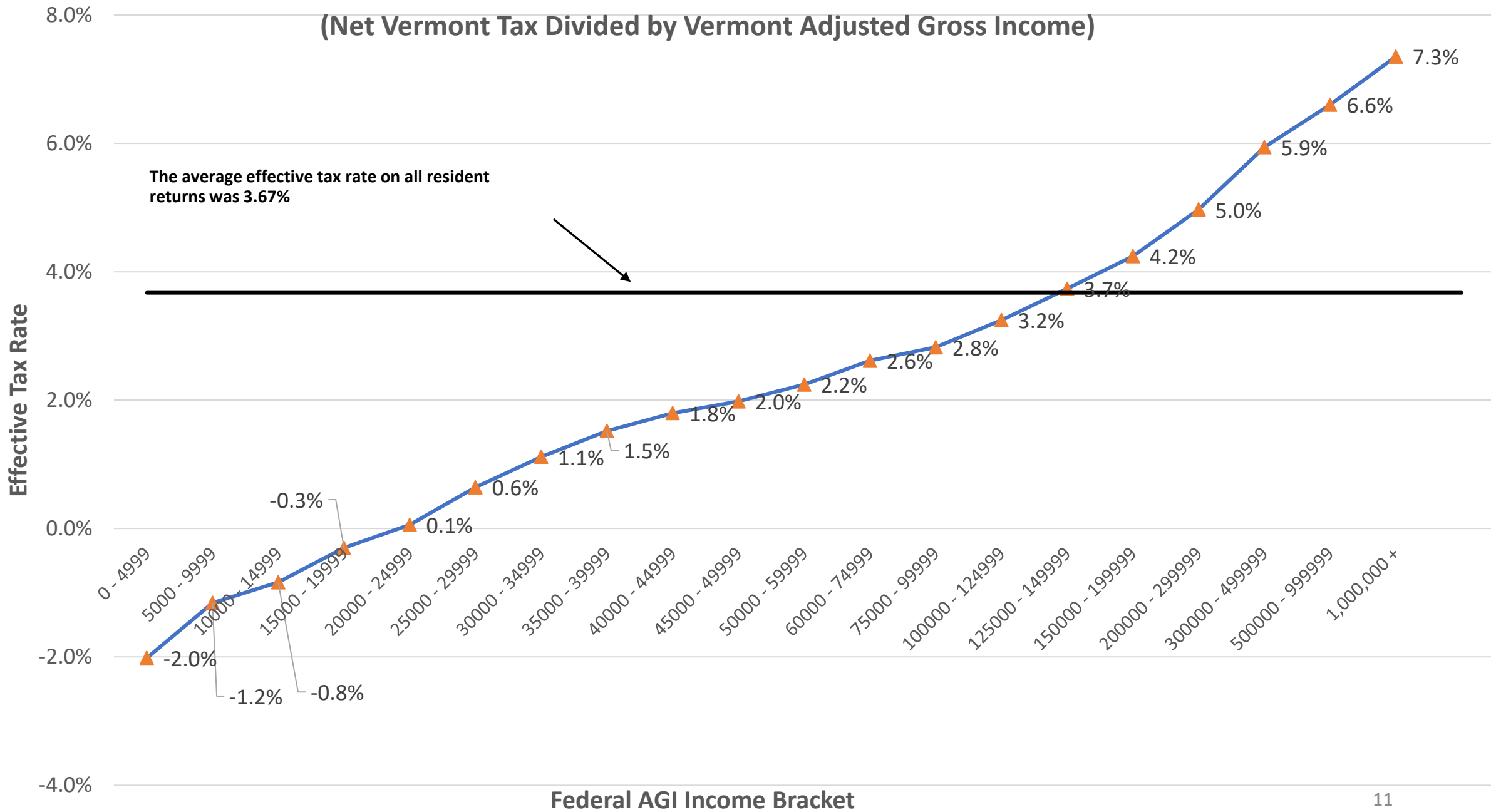


# ITEP: *Who Pays, 6<sup>th</sup> Edition*

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	Top 1%
Income Range	Less than \$21,200	\$21,200 to \$39,100	\$39,100 to \$59,500	\$59,500 to \$94,000	\$94,000 to \$196,000	\$196,000 to \$460,100	over \$460,100
Average Income	\$11,500	\$29,200	\$49,200	\$74,800	\$131,100	\$279,700	\$993,600
<b>TOTAL TAXES</b>	8.7%	9.0%	10.1%	9.1%	10.4%	10.0%	10.4%



## 2020 Vermont Resident Effective Personal Income Tax Rate (Net Vermont Tax Divided by Vermont Adjusted Gross Income)



# Simplicity

**Principle:** The tax system is easy for a taxpayer to understand and comply with, and it is easy to administer

- It is easy to understand so that compliance costs and the time it takes to comply with the law are minimized
- It is easy to administer and raises revenue efficiently
- Need informed taxpayers who understands how tax assessment, collection, and compliance work



# Vermont's Personal Income Tax

From federal  
form 1040

Adjusted gross income

plus

Additions to adjusted gross income

Bonus depreciation, interest from non-Vermont state and local bonds

minus

Subtractions from adjusted gross income

Standard deduction\*

\$6,350 for single filer,  
\$12,700 for married filer

Personal exemptions\*

\$4,350 for taxpayer,  
spouse, and any  
dependents

Other subtractions

- Interest income from U.S. bonds
- Capital gains exclusion
- Social Security exemption
- Medical expenses

equals

Vermont taxable income

*Note: Amounts for Tax year 2021; indexed  
annually for inflation*



# Economic Competitiveness

**Principle:** A tax system is responsive to interstate and international economic competition

- Provides a level playing field devoid of unnecessarily high rates and compliance burdens
- Discourage tax liability-shopping and interstate migration



# State by State Comparison of Top PI rates

Top Tax Rate Comparison - Married Filing Jointly NE States - Tax Year 2019*		
State	Top Rate %	On Taxable Income (\$) Above:
Vermont	8.75	243,750
Connecticut	6.99	1,000,000
Maine	7.15	105,200
Massachusetts	5.00	-
New York	8.82	2,155,350
Rhode Island	5.99	148,350

\* Does not account for changes to Income Tax Structures that have occurred since 2019.

Note: New Hampshire does not tax individual's earned income (W-2 wages). The state currently taxes income from dividends and interest but is scheduled to start phasing it out starting in 2023.



# State by State Comparison of State Sales, Rooms, and Meals Tax Rates

Comparison of State Sales, Rooms, & Meals Taxes			
NE States - Tax Year 2022			
State	Sales Tax Rate	Rooms Tax	Meals Tax
Vermont	6.00%	9.00%	9.00%
Connecticut	6.35%	15.00%	7.35%
Maine	5.50%	9.00%	8.00%
Massachusetts	6.25%	5.70%	6.25%
New Hampshire	None	9.00%	8.50%
New York	4.00%	4.00%	4.00%
Rhode Island	7.00%	5.00%	7.00%

*Note: VT charges 10% meals tax on alcohol*

*This doesn't include any local taxes – New York has significant local taxes, Vermont has Local Option Taxes*





# Tax Neutrality

**Principle:** The tax system tries to minimize the unintended consequences

- Encourage or discourage consumption/production of good and services
    - “Sin” taxes
  - Change the allocation of resources
    - Influence decision to invest in land and a house or other types of wealth
  - Impact business decisions
- 
- When Policy makers use the tax system to drive behavior changes, those choices should be explicit and evaluated frequently
    - E.g., Using the cigarette tax to discourage smoking



# Accountability

**Principle:** The tax system should include taxes that are explicit, minimize credits and exemptions, and limit the amount of tax flow through

- Tax systems and individual taxes should be evaluated regularly to ensure consistency with intended policy goals
  - Tax Expenditure Report and Tax Expenditure Reviews
- Does the policy unfairly benefit some taxpayers at the expense of others?



# Is it Possible to Design a Perfect Tax System?

- Policy Makers need to decide what is most important to them
- Trade-offs Frequently Occur...
  - Tax Neutrality vs Influencing Behavior
    - Cigarette tax
    - Soda Tax
    - Gasoline Tax
  - Simplicity vs Fairness
    - Sales Tax



# Is it Possible to Design a Perfect Tax System?

## Sales Tax

- Sales tax rate is 6%
  - Regressive because blind to Vertical Equity (ability to Pay)
  - Enter Sales Tax Exemptions:



- Enter Complexities



# Conclusion

Lawmakers need to consider, balance, and prioritize these principles when developing Tax Policy

1. Sustainability/Reliability
2. Fairness
3. Simplicity
4. Economic Competitiveness
5. Tax Neutrality
6. Accountability



# Questions?

