

Economic Effects of an Income Tax Surcharge

Senate Finance Committee

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Outline of talk

- What is an income tax surcharge?
 - Why consider a surcharge on taxpayers with high incomes?
 - How does income inequality look for the United States?
 - What is the distribution of income tax filers in Vermont?
- How do high tax rates on high-income taxpayers affect the economy?
 - Would there be special concerns for Vermont?



What is an income tax surcharge, and how might it affect the economy?

An income tax surcharge imposes an additional income tax on certain taxpayers, on top of the usual tax rate structure.



What is the income tax surcharge in H.828?

H.828 would place a 3% surcharge on federal adjusted gross income at or above \$500,000.

- The threshold level of \$500,000 would be adjusted for inflation each year
- The tax would be effective retroactively for tax year 2024
- <https://legislature.vermont.gov/Documents/2024/Docs/BILLS/H-0828/H-0828%20As%20Introduced.pdf>

That surcharge would be in addition to the “usual” personal income taxes

- The top marginal rate is now 8.75%
 - Single: Vermont taxable income over \$229,550
 - Head of Household: over 254,500
 - Married Filing Jointly: over \$279,450



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
 - 30.4% 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% ⁵	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.



How does federal AGI differ from VT taxable income?

- Vermont income taxes start with federal Adjusted Gross Income (AGI)
- Vermont AGI “apportions” income derived from activity in Vermont
- Vermont taxable income makes further adjustments for personal exemptions, the standard deduction, charitable contributions, etc.
 - For all tax filers, VT taxable income is 80% of federal AGI
 - For tax filers with \$500,000+, VT taxable income is 97% of federal AGI



Why consider an income tax surcharge?

- Advocates of an income tax surcharge argue that it would
 - raise revenues in an effective and progressive way,
 - address income inequality,
 - affect only a small fraction of households, and
 - likely have only a small effect on efficiency.
- Critics counter that an income tax surcharge would
 - negatively affect efficiency and innovation,
 - invite behavioral changes and tax evasion, including tax flight.



Possible economic effects

Economists generally agree that the tax system is a useful vehicle for addressing the nation's income and wealth inequality, but they disagree on an optimal approach.

- Efficiency
 - Resources are allocated in a way that maximizes the production of goods and services
 - An ideal tax system does not distort that allocation
- Equity
 - Taxes paid are a greater share of income for those with greater ability to pay



Possible effects on efficiency

Would a tax surcharge of 3 percent on federal AGI affect decisions regarding the allocation of resources?

- Could discourage high-income individuals to work, save, and invest
 - Possibly offset by better opportunities for lower-income individuals to work, save, and invest
- Could incentivize high-income individuals to shift how they receive returns to labor, saving, and investment
 - E.g., shift wage income to deferred compensation or wait longer to realize capital gains from investments
- Could be a factor in decisions about where to live (encourage tax flight or discourage in-migrants)

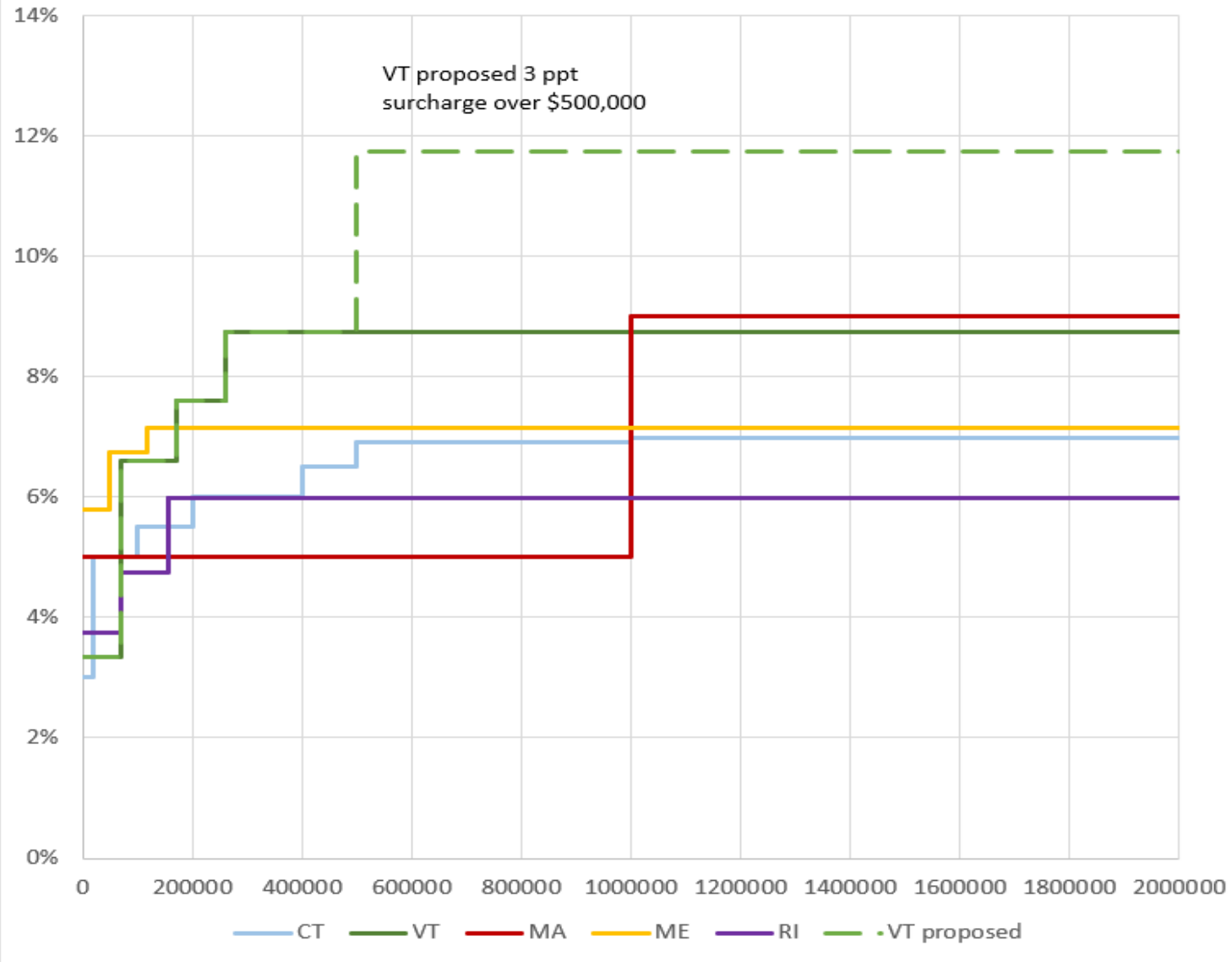


Is tax flight a concern for Vermont?

- Evidence on tax flight is a mixed bag, but caution is likely warranted
- One well-known academic paper finds little responsiveness after New Jersey increased its income tax rate on top earners by 2.6 percentage points to 8.97 percent
 - Young and Varner, National Tax Journal, 2011
 - However, “tax-induced migration is estimated to be higher among
 - people of retirement age,
 - people living on investment income rather than wages, and
 - people who work (and pay tax) entirely in-state.”



New England States' and Vermont Proposed Marginal Income Tax Rates, MFJ, 2023



Income Inequality: Vermont has less than the United States as a whole

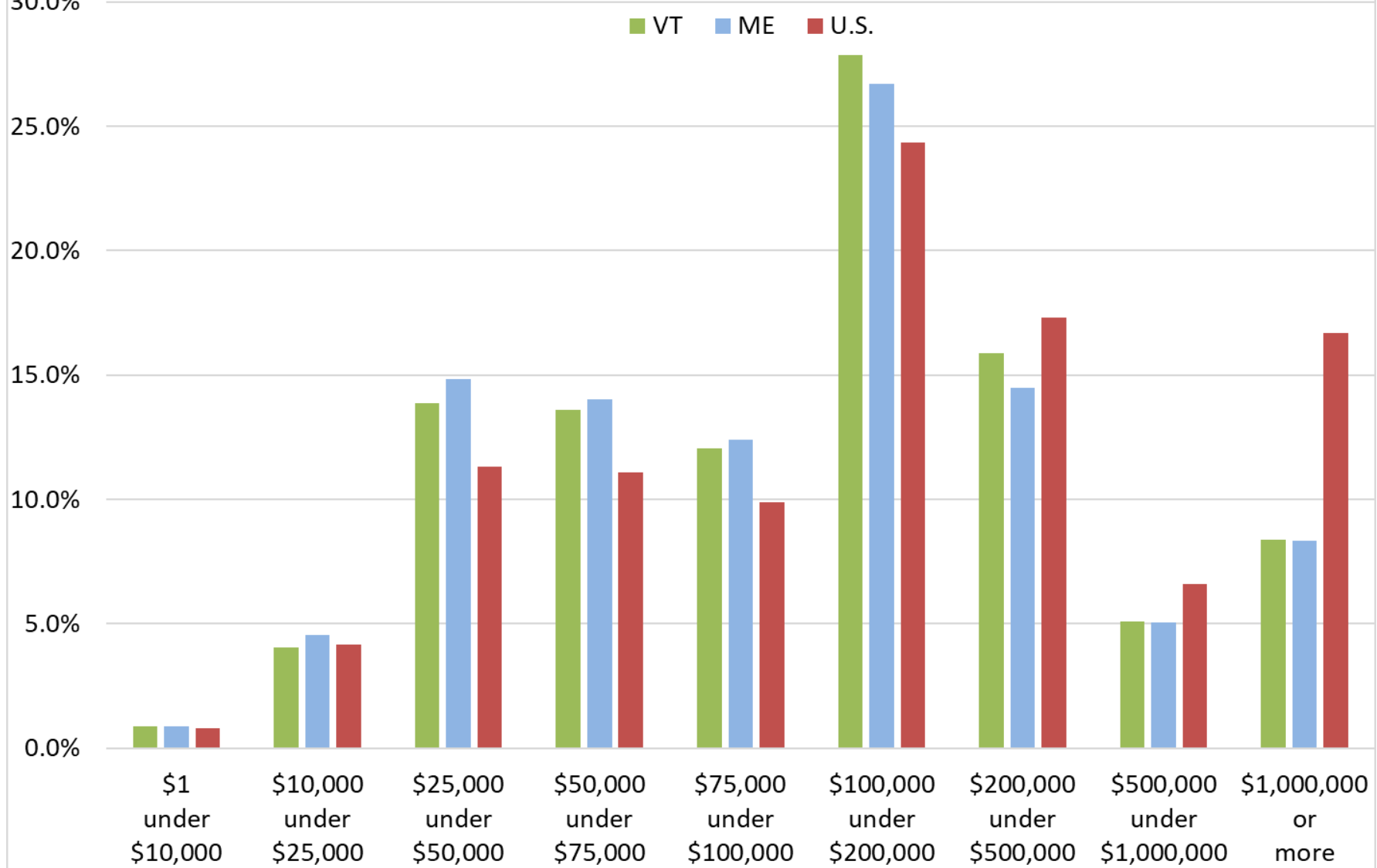
**Table 2. Distribution of income
at selected percentiles in 2022**

Percentile of income	Tax Policy Center	VT Dept of Taxes	VT to U.S.
	U.S. AGI	AGI	AGI Ratio
20	15,000	16,602	111%
40	37,500	38,920	104%
50	NA	49,615	NA
60	65,300	62,965	96%
80	135,600	109,942	81%
90	197,600	159,290	81%
95	289,400	223,506	77%
99	773,900	520,544	67%
99.9	4,061,800	??	NA

Tax Policy Center. <https://www.taxpolicycenter.org/model-estimates/income-breaks-distribution-tables-april-2023/t23-0051-income-breaks-2023-tax-model>; Vermont Department of Taxes, Data and Statistics.



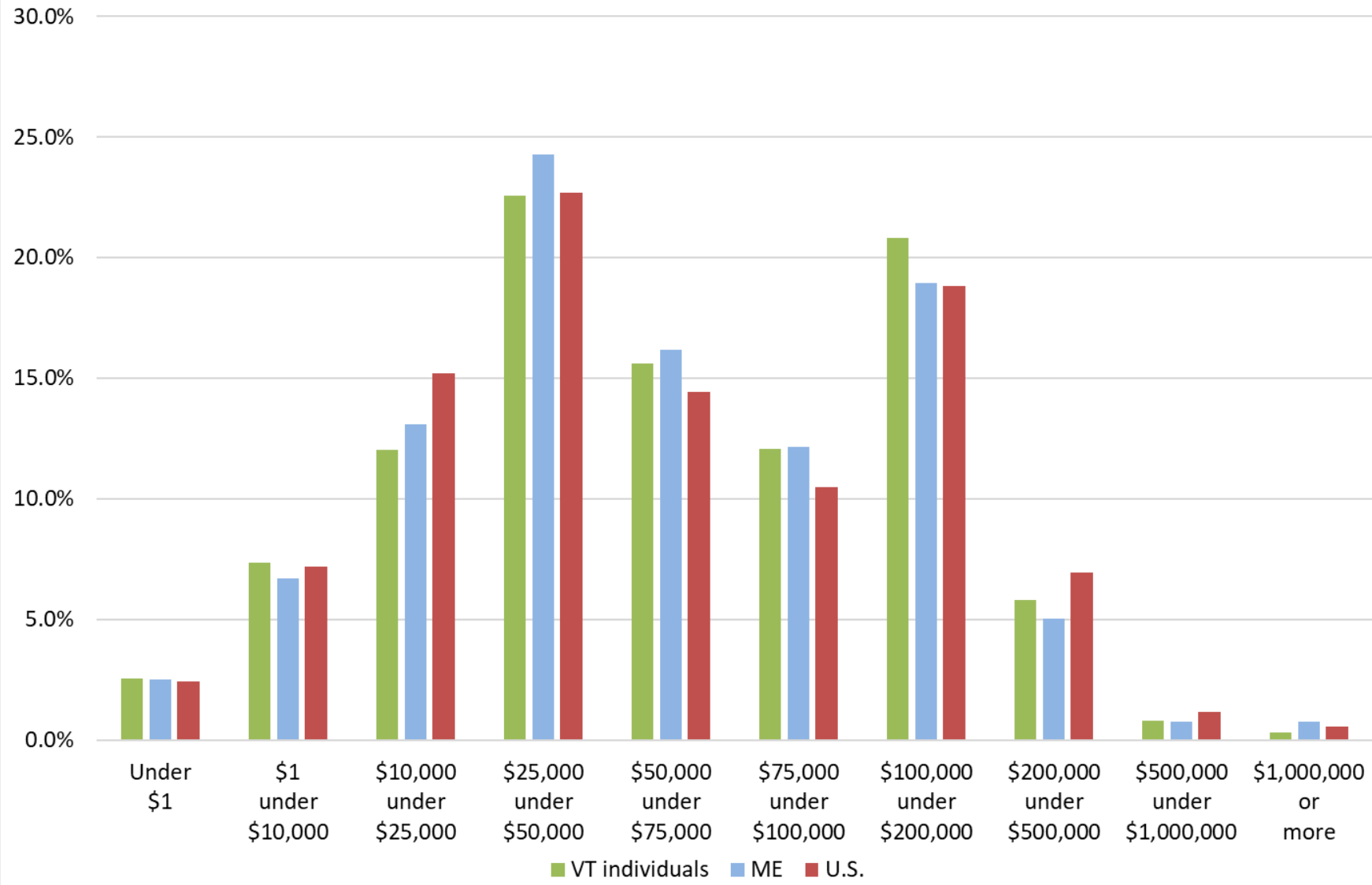
Distribution of AGI in Vermont, Maine, and the United States; 2020



Source: Internal Revenue Service, Statistics of Income, 2020. Historic Table 2 State Data Tax Year 2020.



Distribution of Individuals by AGI category: VT, ME, and the U.S., 2020



Source: Internal Revenue Service, Statistics of Income, 2020. Historic Table 2 State Data Tax Year 2020.



Resources

- Federal Reserve Board of Governors, 2020 Statistics of Income, released October 2023.
 - <https://www.irs.gov/statistics/soi-tax-stats-historic-table-2>
- Vermont Department of Taxes, Data and Statistics on the Income Tax, 2022 Tax Year
 - <https://tax.vermont.gov/data-and-statistics/income-tax>



Appendix – Additional Information

2022 Vermont Personal Income Tax Returns by AGI Percentile, Vermont Residents

Federal AGI Percentile	Returns	Exempt	AGI Start for Percentile	Vermont AGI	Net Vermont Tax
Bottom 10%	32,812	32,331	NA	-49,111,264	-2,154,745
10% - 20%	32,813	36,282	7,214	379,292,524	-6,050,183
20% - 30%	32,809	45,287	16,602	720,183,146	-2,959,266
30% - 40%	32,809	48,187	28,284	1,084,598,357	10,064,483
40% - 50%	32,810	48,748	38,920	1,422,357,145	23,640,980
50% - 60%	32,810	51,662	49,615	1,806,174,757	37,982,308
60% - 70%	32,810	58,951	62,965	2,315,182,159	59,982,923
70% - 80%	32,809	70,432	81,920	3,060,502,549	86,054,505
80% - 90%	32,809	80,746	109,942	4,219,918,466	147,347,686
90% - 95%	16,405	41,988	159,290	2,969,985,566	129,425,853
95% - 99%	13,124	34,161	223,506	3,964,861,458	217,534,828
Top 1%	3,281	8,625	520,544	4,230,542,140	294,584,203
Totals	328,101	557,400	NA	26,124,487,004	995,453,575

Source: Vermont Department of Taxes, 2022 Income Tax Statistics

