TO THE HOUSE OF REPRESENTATIVES:

The Committee on Ways and Means to which was referred House Bill No. 827 entitled "An act relating to applying personal income tax to unrealized gains" respectfully reports that it has considered the same and recommends that the bill be amended by striking out all after the enacting clause and inserting in lieu thereof the following:

Sec. 1. 32 V.S.A. chapter 149 is added to read:

CHAPTER 149. UNREALIZED GAINS

§ 5601. DEFINITIONS

As used in this chapter:

(1) "Commissioner" means the Commissioner of Taxes.

(2) "Incremental ODA withholding percentage" means, for the prior tax year, the product of the estimated economy-wide normal rate of return for that prior tax year and the highest marginal Vermont income tax rate for that prior tax year.

(3) "Optional deferral account" or "ODA" means an unliquidated tax reserve account governed by section 5605 of this title.

(4) "Phase-in cap amount" means an amount equal to 10 percent of the worth of a taxpayer's net assets in excess of $10,000,000.00 at the end of the day on the last day of an applicable tax year.

(5) "Related person" means any person that is related to the taxpayer under 26 U.S.C. § 267 or § 318, as well as any other person so specified by rules adopted by the Department of Taxes.

(6) "Resident individual" means all Vermont residents as determined by subdivision 5811(13) of this title, any Vermont part-year residents as determined by subdivision 5811(10) of this title, and any person who was either a Vermont resident or part-year resident in any of the previous four years.

(7) "Taxable income" has the same meaning as in subdivision 5811(21) of this title.

(8) "Temporary resident" means a taxpayer who does not qualify as a resident or part-year resident under subdivisions 5811(10) and (13) of this title but who has substantial presence in this State. An individual has substantial presence in this State if the individual satisfies the criteria of 26 U.S.C. § 7701(b)(3) as modified by substituting "this State" for "the United States."

§ 5602. TAXATION OF UNREALIZED GAINS

(a) Tax is imposed for each taxable year on resident individuals with net assets worth more than $10,000,000.00 at the end of the day on December 31 of the taxable year. A taxpayer shall be deemed to realize 50 percent of the gain or loss as though each asset owned was sold for fair market value at the end of the day on that date. A proper adjustment shall be made for assets previously subject to taxation under this section in prior years, pursuant to subsection (b) of this section. All other adjustments to the basis of a taxpayer's assets shall be made prior to a partial deemed sale under this section. Any resulting net gains from a partial deemed sale, up to the phase-in cap amount, after accounting for losses carried forward, shall be recognized and included in the taxpayer's taxable income for that taxable year. To the extent that a taxpayer realizes net losses from these partial deemed sales in any tax year, such net losses shall not be recognized in that tax year and shall instead carry forward indefinitely. However, if a taxpayer has net losses carried forward for more than two consecutive years and if the taxpayer previously included in the taxpayer's income for any prior year net gains from any partial deemed sales under this chapter, the taxpayer may file to claim a refund in the amount of the lesser of either the amount of the taxpayer's net losses that have been carried forward for more than two years or the amount of tax the taxpayer paid in prior years as a result of any net gains included in the taxpayer's income from partial deemed sales. Any additional tax payable as a result of this subsection for any tax year shall be payable along with any other income tax owed for that tax year.

(b) Proper adjustments shall be made to the basis of assets subject to taxation under this section, to reflect all losses deemed to be realized and all gains actually recognized.

(1) For assets having any built-in gains recognized at the end of a tax year, basis shall be increased for each asset by its pro rata share of the total gains recognized. A pro rata share is determined based on each asset's built-in gains as a share of the total built-in gains of all assets for which any built-in gain was recognized. For any taxable assets having any built-in gains deemed as realized under subsection (a) of this section, the total gains recognized is the lesser of:

(A) 50 percent times the total built-in gains summed across all taxable assets having any built-in gains deemed as realized under subsection (a) of this section; or

(B) the phase-in cap amount.

(2) For taxable assets without built-in gains at the end of the tax year, basis shall be decreased by 50 percent of the amount of any built-in losses of the property at the end of the tax year.

(3) There shall be further basis adjustments if any of the built-in gains that are deemed to be realized in any tax year are unrecognized due to the phase-in cap amount and are also offset by recognized losses. If the phase-in cap amount is less than 50 percent times the total built-in gains summed across all taxable assets having any built-in gains deemed as realized under subsection (a) of this section, the basis in the built-in gain asset shall be further increased by the basis adjustment amount. For any tax year, the basis adjustment amount

is the total built-in losses deemed to be realized in the tax year under subsection (a) of this section, but excluding any unrecognized losses carried forward or backward from other tax years, that are used to offset the total built-in gains deemed to be realized in the tax year for purposes of determining net gains from the partial deemed sales, but only to the extent that the resulting net gains from the partial deemed sales exceed the phase-in cap amount. The basis adjustment amount shall be allocated pro rata to all taxable built-in gain assets, where the pro rata share is determined based on each asset's built-in gains as a share of the total built-in gains of all assets for which any built-in gain was recognized under subsection (a) of this section.

(c) At the time a return is filed pursuant to section 5861 of this title, every Vermont resident individual required to file shall:

(1) declare that the individual's net assets were worth less than or equal to $10,000,000.00 at the end of the day on the last day of the applicable tax year; or

(2) submit forms created by the Vermont Department of Taxes for calculating whether any additional tax is owed under this chapter and the amount of any such additional tax owed.

(d) Credit shall be provided in the amount of income tax paid another state or jurisdiction if a taxpayer subject to the tax imposed by this chapter can show that any portion of the net gains that would otherwise be subject to income tax as a result of this chapter was accumulated prior to the taxpayer becoming a resident individual of this State and if the taxpayer can also show that the portion of those gains was previously subject to income tax by any prior state or jurisdiction in which the taxpayer was a resident prior to becoming a resident or part-year resident of this State. Any credits provided by this subsection, however, shall not exceed the lesser of the total tax owed under this subsection on such gains and the income tax imposed on such gains by such other prior states or jurisdictions in which the taxpayer was a resident prior to becoming a resident or part-year resident of this State.

(e) A taxpayer shall demonstrate, using clear and convincing evidence, the taxpayer's basis in each asset subject to the partial deemed sales under subsection (a) of this section. The basis shall be deemed to be zero unless the taxpayer substantiates such basis by adequate records or by clear and convincing evidence corroborating the taxpayer's own statement.

(f) Debts and other liabilities owed by the taxpayer shall be taken into account for purposes of determining whether a Vermont resident individual has net assets worth more than $10,000,000.00 at the end of the day on the last day of a tax year. Debts and liabilities taken into account shall be genuine and subject to the following limitations:

(1) Recourse debts for which the taxpayer is fully personally liable, without any limitations other than those arising from bankruptcy law, shall be

fully taken into account for purposes of determining whether a Vermont resident individual has net assets worth more than the threshold exemption amount at the end of the day on the last day of a tax year.

(2) Nonrecourse debts and other liabilities for which the taxpayer is not fully personally liable without any limitations other than those arising from bankruptcy law may be taken into account for purposes of determining whether a Vermont resident individual has net assets worth more than $10,000,000.00 at the end of the day on the last day of a tax year. For each such debt or liability, the amounts that may be taken into account in any tax year shall not exceed the amounts included in the taxpayer's net assets in that tax year, for purposes of determining whether a Vermont resident individual has net assets worth more than the threshold exemption amount at the end of the day on the last day of a tax year, on account of the assets serving as collateral for the debt or liability. The amount of each debt or liability shall be reduced by the fair market value of any assets owned by another and also used to secure the debt or liability.

(3) No debt or liability described in subdivisions (1) and (2) of this subsection shall be taken into account, for purposes of determining whether a Vermont resident individual has net assets worth more than the threshold exemption amount at the end of the day on the last day of a tax year, if the debt or liability is owed to a related person or persons or was not negotiated for at

arm's length. Additionally, no amounts shall be taken into account for any such debt or liability unless market rates of interest are being charged to the taxpayer. No amounts shall be taken into account for any debt or liability for which payment of the liability itself or the interest thereon, or similar periodic payment charged in connection with the debt or liability, is contingent on future events that are uncertain to occur.

(4) Any debts or liabilities of a taxpayer for which a taxpayer is entitled to receive future benefits or future ownership rights, such as a contractual obligation to contribute to an entity at a future date, shall only be taken into account, for purposes of determining whether a Vermont resident individual has net assets worth more than the threshold exemption amount at the end of the day on the last day of a tax year, to the extent that:

(A) the value of those future benefits or ownerships rights is included in the taxpayer's net assets for such purposes; or

(B) the taxpayer can demonstrate that the amount owed under the debt or liability is in excess of any future benefits or ownership rights that are not included in the taxpayer's net assets for such purposes.

(g) Any change in basis effectuated pursuant to this chapter shall be incorporated when determining taxable income under subdivision 5811(21) of this title and shall be in addition to other adjustments made under that subdivision.

§ 5603. APPORTIONMENT

(a) Any resulting net gains from the partial deemed sales under subsection 5602(a) of this chapter shall be multiplied by a fraction, the numerator of which shall be years of residence in Vermont during the previous four years, and the denominator of which shall be four. The amount so calculated, up to the phase-in cap amount, shall be included in the taxpayer's income for the applicable tax year.

(b) For the purpose of calculating the numerator described in subsection (a) of this section:

(1) any part-year of residence, as determined under subdivision 5811(10) of this title, shall be included in the numerator; and

(2) any period as a temporary resident shall be included in the numerator.

(c) A taxpayer may request, and the Commissioner may require, the use of an alternative apportionment method if the method used pursuant to subsection (a) of this section does not fairly represent the extent of the gain that occurred while the taxpayer was a resident in this State. An alternative apportionment method may be used for all or part of a taxpayer's unrealized gains.

(1) When requesting alternative apportionment, a taxpayer shall demonstrate by clear and convincing evidence that the standard method is unfair and that a more fair and reasonable method is available.

(2) The Commissioner may develop and publish guidelines for determining alternative apportionment methods for recurring fact patterns.

(3) Full-time postsecondary students not engaged in more than de minimis employment shall not have any gains deemed as accumulated in Vermont while students.

(d) If any provision of this section is found to be invalid, unconstitutional, or otherwise unenforceable, that finding shall not affect the enforceability of any other provision of this section. If the sourcing rule of subsection (a) of this section is found by a court to be invalid, unconstitutional, or otherwise unenforceable, 100 percent of unrealized gains under subsection 5602(a) of this chapter are to be sourced to Vermont as to Vermont residents. A pro rata share of 100 percent of unrealized gains, based on the period of partial or temporary residency, are to be sourced to Vermont for part-year residents and temporary residents.

§ 5604. VALUATION; EXCLUSIONS

(a) Unless otherwise specified by the Commissioner, and except as otherwise specified in in this section, the fair market value of each asset owned by a taxpayer is the price at which the asset would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts. The location of an asset shall be taken into account wherever appropriate. For an asset that is generally obtained by the public in the retail market, the fair market value of the asset is the price at which the item or a comparable item would be sold at retail. The fair market value of an asset shall not be:

(1) the price that a forced sale of the property would produce; or

(2) for property generally offered for sale to the public, the sales price in a market other than that in which the property is most commonly sold to the public.

(b) Any feature of an asset, such as a shareholder rights plan, shall be disregarded where a significant purpose and effect of adding the feature was to reduce the appraised value of the asset. No valuation or other discount shall be taken into account if it would have the effect of reducing the value of a pro rata economic interest in an asset below the pro rata portion of the value of the entire asset.

(c) The following valuation methods, exclusions, and reporting requirements shall apply to the following specific asset types:

(1) For all publicly traded assets, the fair market value of the asset shall be presumed to be the asset's market trading value at the end of the tax year.

(2) For all sole proprietorships, all assets owned by or held through a sole proprietorship shall be reported and valued as though they were directly owned and held by the taxpayer and not through a sole proprietorship.

(3) Except assets and entities governed by subdivisions (1) and (2) of this subsection, for all interests in any business entities, including all equity and ownership interests, all debt interests, and all other contractual or noncontractual interests, valuation shall be conducted as follows.

(A) A taxpayer may exclude up to $1,000,000.00 of total asset value of such interests from all taxation under this chapter from the calculation of whether the taxpayer has net assets worth more than the $10,000,000.00 for purposes of this chapter and from the reporting requirements of this section. After excluding those assets, the taxpayer shall report the following annually at the time when forms are filed pursuant to this chapter:

(i) the percentage of the business entity owned by the taxpayer;

(ii) the book value of the business entity according to generally accepted accounting principles; and

(iii) the book profits of the business entity in the tax year according to generally accepted accounting principles.

(B) If the reporting required under subdivision (A) of this subdivision (3) is impossible because the taxpayer lacks information on the book value or the book profits of the business entity and also lacks the right to obtain that information, the taxpayer must either submit a certified appraisal of all of the taxpayer's interests in the business entity or attach all of the taxpayer's interests in the business entity to an optional deferral account pursuant to section 5605 of this chapter. In all cases, a taxpayer may opt to attach all of the taxpayer's interests in a business entity to an ODA in lieu of paying any tax due on those interests under this chapter.

(C) For any interests that confer voting or other direct control rights, the percentage of the business entity owned by the taxpayer shall be presumed to be not less than the taxpayer's percentage of the overall voting or other direct control rights. However, if the taxpayer can demonstrate with clear and convincing evidence that such a presumption would substantially overstate the actual percentage of the business entity owned by the taxpayer for any year or set of years, the taxpayer may instead submit a certified appraisal of the percentage of the business entity owned by the taxpayer for that year or set of years and then use the certified appraisal value in place of the presumed percentage.

(D) Except for assets and entities governed by subdivisions (1) and (2) of this subsection (c), assets excluded under subdivision (A) of this subdivision (3), and assets attached to an ODA, for all other interests in any business entities including all equity and other ownership interests, all debt interests, and all other contractual or noncontractual interests, the fair market value of those interests at the end of any tax year shall be presumed to be the sum of the book value of the business entity according to generally accepted accounting principles for the tax year plus a present-value multiplier of 7.5

times the book profits of the business entity for the tax year according to generally accepted accounting principles, with this entire sum then multiplied by the percentage of the business entity owned by the taxpayer as of the end of the tax year. However, if the taxpayer can demonstrate with clear and convincing evidence that such a presumption would substantially overstate the fair market value, the taxpayer may instead submit a certified appraisal and then use the certified appraisal value as the fair market value.

(4) For all interests in any real estate assets held directly by a taxpayer, and not held through a business entity other than a sole proprietorship, valuation shall be conducted as set forth in subdivisions (5)(A)–(G) of this subsection.

(A) A taxpayer may exclude up to $1,000,000.00 of total asset value of interests in real estate assets held directly by the taxpayer from all taxation under this chapter from the calculation of whether the taxpayer has net assets worth more than the $10,000,000.00 for purposes of this chapter and from the reporting requirements of this section. After excluding those assets, the taxpayer shall report the following annually at the time when forms are filed pursuant to this chapter:

(i) the address of each distinct real estate asset;

(ii) the acreage of each distinct real estate asset;

(iii) the square footage of any buildings or structures on each distinct real estate asset;

(iv) the number of bedrooms and bathrooms in any buildings or structures on each distinct real estate asset; and

(v) any other information required as specified by the Commissioner.

(B) Using the most recent equalized grand list, the Commissioner shall publish the values of real estate assets in this State for use by taxpayers under this section. For each distinct real estate asset, a taxpayer must opt either to use the valuations provided by the Commissioner or attach the real estate asset to an ODA. However, if the Commissioner does not provide a valuation for a real estate asset, or if the taxpayer can demonstrate with clear and convincing evidence that any such valuations provided by the Commissioner would substantially overstate the fair market value, the taxpayer may instead submit a certified appraisal and use that value as the fair market value. In all cases, a taxpayer may opt to attach all of the taxpayer's interests in a real estate asset to an ODA in lieu of paying any tax due on those interests under this chapter.

(5) For all interests in trusts, valuation shall be conducted as follows:

(A) In the case of any resident trust in Vermont, the trust shall be taxable under this chapter as if it were an individual, without respect to any phase-in cap amount, except that the applicable fraction under section 5603 of this chapter shall always be 1/1 with respect to the trust.

(B) At the election of any trust, whether resident in Vermont or otherwise, the trust may be taxable under this chapter as if it were an individual, without respect to any phase-in cap amount, except that the applicable fraction under section 5603 of this chapter shall always be 1/1 with respect to such trust.

(C) In the case of a trust taxed as an individual under subdivision (A) or (B) of this subdivision (5), the threshold exemption amount of $10,000,000.00 shall instead be $0.00, and all exclusion amounts under this subsection (c) shall also be $0.00, except to the extent that an individual taxpayer may assign a fraction of that individual's threshold exemption amount and exclusion amounts to the trust pursuant to subdivision (D) of this subdivision (5). In the event that more than one individual assigns such fractional amount to a given trust, the applicable threshold exemption and exclusion amounts for the trust shall be the smallest such amounts assigned by any individual.

(D) An individual, other than a trust, meeting the requirements to be subject to tax under this chapter may assign a fraction of the individual's $10,000,000.00 threshold exemption amount and exclusion amounts under this subsection (c) to any trust to which the individual transfers or has transferred substantial property, but any such assignment shall reduce the exemption and exclusion amounts of the transferring individual by the same fraction as that assigned to such trust. The exemption and exclusion amounts assigned to a trust under this subdivision (D) shall not exceed the value of the property contributed by the individual.

(E) In the case of the beneficiary of a trust, whether or not the trust is resident in Vermont, the beneficiary shall be deemed the owner of the trust's assets to the extent that the assets are distributable to the beneficiary, whether distributed or not. However, a trust beneficiary shall not be deemed the owner of any trust asset in a given year if the trust is taxable as an individual under subdivision (A) or (B) of this subdivision (5).

(F) For any year in which a beneficiary is deemed to own any trust assets under subdivision (E) of this subdivision (5), and those assets were not previously deemed to be owned by the beneficiary because the assets were not yet distributable to the beneficiary, the beneficiary shall attach the assets to the beneficiary's optional deferral account, if not already so attached.

(G) Notwithstanding any other provisions of this section to the contrary, a taxpayer who would otherwise be subject to taxation as a result of this chapter on any nondistributed interest in a trust pursuant to this subdivision (5) may opt to exclude up to $1,000,000.00 of total asset value of those interests from all taxation under this chapter from the calculation of whether the taxpayer has net assets worth more than the $10,000,000.00 for purposes of this chapter and from the reporting requirements of this section. Additionally, a taxpayer may opt to attach all of the taxpayer's interests in a trust to an ODA in lieu of paying any tax due on those interests under this chapter.

(6) The following categories of assets shall be exempt from all taxation under this chapter from the calculation of whether the taxpayer has net assets worth more than the $10,000,000.00 for purposes of this chapter and from the reporting requirements of this section:

(A) Except as described in subdivision (B) of this subdivision (6), qualified pensions and individual retirement arrangements, including those described by 26 U.S.C. § 219(g)(5), or foreign pension arrangements similar in nature to those described in that section and exempted from U.S. taxation by a treaty obligation of the United States.

(B) Amounts held in designated Roth accounts, Roth IRA accounts, or any substantially similar accounts, except to the extent that the aggregate value in all such accounts in which the taxpayer holds a beneficial interest, either directly or indirectly, exceeds $1,000,000.00 in present value. In the case that the aggregate value exceeds $1,000,000.00, the $1,000,000.00 exemption shall be applied to each such account in the same proportion as the ratio of that account's fair market value to the total fair market value of all such accounts in which taxpayer has a beneficial interest.

(C) Nonqualified deferred compensation, and any other promises of future payments specified by the Commissioner, except that any pension, deferred compensation amount, or other payment for goods or services, not described in subdivisions (A) and (B) of this subdivision (6), shall be treated as a taxable asset of the taxpayer if:

(i) under the terms of a compensation arrangement, plan, contract, or other arrangement providing for payment, the taxpayer has a legally binding right as of the end of the tax year to such payment;

(ii) the compensation has not been actually or constructively received on or before the end of the year; and

(iii) pursuant to the compensation arrangement, the payment is payable to, or on behalf of, the taxpayer on or after the end of the year.

(d) Except assets exempted or excluded, a taxpayer must opt either to treat assets described in subdivision (c)(6) of this section as though they were held directly, and not in a tax-favored account, or to attach all such assets to an ODA in lieu of paying any tax due on those interests under this chapter.

(e) In the case of a defined benefit plan, in the event that the taxpayer opts to treat the asset as held directly, an amount equal to the present value of the taxpayer's accrued benefit is treated as included by the taxpayer in the taxpayer's taxable assets on the last day of the tax year. In making appropriate adjustments to basis with respect to a plan, the amount allocable to the plan as a basis adjustment under subsection 5602(b) of this chapter will be treated as investment in the contract, as the term is used in 26 U.S.C. § 72, in cases where that section would apply to the amounts and by another reasonably similar method where that section does not apply.

(f) No assets described in subdivision (c)(6) of this section shall be taxable under this chapter to the extent that such tax would be contrary to 4 U.S.C. § 114. The State of Vermont considers all individuals subject to taxation under this chapter to be residents of the State for the purposes of 4 U.S.C. § 114.

(g) The Commissioner shall adopt rules regarding the taxability of receivables and similar assets under this chapter and all receivables shall be taxable assets under this chapter until the Commissioner has adopted those rules. Pursuant to the requirements of this subsection, the Commissioner may exempt those assets from all taxation under this chapter from the calculation of whether the taxpayer has net assets worth more than the $10,000,000.00 for purposes of this chapter and from the reporting requirements of this section. In adopting rules on the taxability of receivables under this chapter, the Commissioner shall consider:

(1) whether a taxpayer is reasonably likely to receive payment from a particular type of receivable;

(2) whether gains relating to a particular type of receivable are reasonably likely to be taxed as income in the next two tax years; and

(3) whether a particular type of receivable is reasonably likely to result in an unrealized gain.

(h) For all other assets not governed by subsections (c) and (g) of this section, including art and collectibles, non-publicly traded financial instruments, intellectual property rights, debts and other liabilities owed to the taxpayer, and vehicles and other personal property, the taxpayer may exclude up to $1,000,000.00 of total asset value of those assets from all taxation under this chapter from the calculation of whether the taxpayer has net assets worth more than the $10,000,000.00 for purposes of this chapter and from the reporting requirements of this section. With the exception of assets so excluded, a taxpayer must opt either to attach all such assets to an ODA in lieu of paying any tax due on those assets under this chapter or else the taxpayer must report the fair market value of those assets. For any such assets that were purchased or produced through an arm's length transaction that was completed within the prior 10 years, the fair market value of those assets shall be deemed to be the valuation derived from those arm's length transaction and then adjusted by the annual published estimated economy-wide normal rates of return for each year or partial year since the transaction took place, after also making any proper adjustments for withdrawals, contributions, improvements, or depreciation of the assets. For any such assets that were not purchased or produced through an arm's length transaction completed within the prior 10 years, the taxpayer shall submit a certified appraisal of the collective value of all such assets at least once every 10-year period and then, for years subsequent to the appraisal, may deem the fair market value of such assets to be the appraisal value as then adjusted by the annual published estimated economy-wide normal rates of return for each year or partial year since the appraisal took place, after also making any proper adjustments for withdrawals, contributions, improvements, or depreciation of the assets. In all cases, a taxpayer may opt to attach all of the taxpayer's interests in any such asset or group of such assets to an ODA in lieu of paying any tax due on such interests under this chapter.

§ 5605. OPTIONAL DEFERRAL ACCOUNTS

(a) The Commissioner shall develop an optional deferral account contract and related forms for an optional deferral account in order to create a binding contractual agreement between a taxpayer and the State. A taxpayer may sign the contract to initiate an ODA under this chapter. As part of this contract, the taxpayer shall agree to:

(1) file all annual informational returns and forms as described and specified in this section;

(2) reconcile and pay all tax liabilities that may arise as a result of the ODA; and

(3) be subject to personal jurisdiction in this State for purposes of the collection of any tax imposed by this section and of satisfying any reporting requirements imposed by this section, together with any related interest or penalties imposed on the taxpayer by this State, with respect to the ODA.

(b) The contract shall be legally binding on the taxpayer, and also on the taxpayer's estate and assigns, until such time as either the taxpayer or the taxpayer's estate reconciles and appropriately closes the ODA by fully liquidating the accumulated tax claims and then paying all tax due on the liquidated tax claims.

(c) A taxpayer may maintain only one ODA, and so a taxpayer who is already maintaining an ODA may not initiate another separate ODA until after such time as the first ODA has been reconciled and closed so as to fully liquidate the accumulated tax claims.

(d) In order to attach any assets or groups of assets to an ODA, a taxpayer must first sign forms provided by the Department of Taxes for reporting:

(1) the year in which the ODA was initiated;

(2) a list of all assets or groups of assets to which the ODA was attached in any prior years;

(3) a list of all assets or groups of assets to which the ODA is to be attached for the current year;

(4) the basis the taxpayer had in each asset or group of assets at the time the asset or group of assets was attached to the ODA; and

(5) the total basis the taxpayer had in all assets to which the ODA is currently attached or to which the ODA has ever been attached at the time each such asset or group of assets was initially attached to the ODA.

(e) If a taxpayer has initiated an ODA in any prior year, until that ODA has been reconciled and closed, the taxpayer shall annually complete and file any forms provided by the Department of Taxes for the purposes of reporting any material distribution transactions made with regard to the ODA. The taxpayer shall continue to annually file such forms until the taxpayer has reconciled the ODA so as to fully liquidate the accumulated tax claims and to then pay all tax owed on such liquidated tax claims. As a component of the legal contract signed by the taxpayer upon initiating an ODA, such reporting requirements shall continue even if and after the taxpayer is no longer a resident of Vermont and shall then be enforced as a legally binding contract with the State. Failure to file the annual forms shall be treated as a breach of contract and shall also be subject to the same penalties as a failure to file income tax forms for Vermont residents who are required to file income tax forms. Upon the death of any taxpayer who has initiated an ODA that has not been fully reconciled and closed, that taxpayer's estate and assigns shall be required to reconcile the ODA so as to fully liquidate the accumulated tax claims and to then pay all tax owed on such liquidated tax claims, treating these claims as an unpaid tax liability of the taxpayer owed to the State.

(f) For the year in which a taxpayer initiates an ODA and also in every subsequent year until after the ODA has been fully reconciled and closed, the taxpayer shall file forms provided by the Department of Taxes for purposes of calculating the taxpayer's accumulated unliquidated tax withholding percentage with respect to the ODA. For the initial year in which a taxpayer initiates an ODA, the taxpayer's accumulated unliquidated tax withholding percentage shall be equal to the highest marginal Vermont income tax rate in effect for that year. For each subsequent year after a taxpayer has initiated an ODA and prior to that ODA having been closed, the taxpayer's accumulated unliquidated tax withholding percentage for the year shall equal the taxpayer's accumulated unliquidated tax withholding percentage for the prior year plus the product of the published incremental ODA withholding percentage for the year and 100 percent minus the taxpayer's accumulated unliquidated tax withholding percentage for the prior year.

(g) The following withdrawals and transactions shall be deemed to be material distribution transactions that the taxpayer must report annually on forms provided by the Department of Taxes:

(1)(A) A withdrawal of money, property, or other value from any assets to which the ODA is attached;

(B) a transaction to the taxpayer, or a related person, that has the effect of transferring any assets or value of assets to which an ODA is attached without also transferring the attachments; and

(C) a transaction that has the effect of using any assets or value of assets for the benefit of the taxpayer or a related person.

(2) Notwithstanding subdivision (1) of this subsection, a material distribution transaction shall not include ordinary and necessary transactions for maintaining or increasing the value of assets to which an ODA is attached and that would not have the effect of distributing any profits, dividends, or other payments to owners for the use of capital, or similar transfers.

(3) The Commissioner shall provide guidance for specifying what sorts of transactions are to be treated as material distribution transactions and for specifying that transfers made in the ordinary course of a trade or business and exchanges of non-readily tradable assets shall not be treated as material distribution transactions. For any such material distribution transactions, the taxpayer shall report the fair market value withdrawn from the assets to which the ODA is attached or otherwise transferred or used for the benefit of the taxpayer or of a related person. The taxpayer shall then multiply the taxpayer’s accumulated unliquidated tax withholding percentage for the year of

<u>the material distribution transactions by the fair market value of all such material distribution transactions for the tax year. This product shall then be included in the taxpayer's income for that tax year. Any such amounts included in a taxpayer's income pursuant to this subdivision shall then also be added to the taxpayer's running total of accumulated prior withholding tax payments made with respect to the ODA, which shall be reported annually on forms provided by the Department of Taxes. Any additional tax payable as a result of this subdivision for any tax year shall be payable along with any other income tax owed for that tax year. The taxpayer's basis in any assets withdrawn as part of a material distribution transaction shall then equal their fair market value at the time so withdrawn.</u>

<u>(4) If any material distribution transaction is taxable to a taxpayer, whether in whole or in part, under Vermont's income tax as it would operate without this chapter, then the total amount to be included in the taxpayer's income from the material distribution transaction shall be the greater of either the amount that would be included under Vermont's income tax as it would operate without this chapter or the amount that would be included pursuant to subdivision (3) of this subsection.</u>

<u>(5) Any taxpayer maintaining an ODA who has had any material distribution transactions either in the current year or in any prior year shall</u>

annually file forms provided by the Department of Taxes for purposes of calculating and reporting all of:

(A) the taxpayer's running total of accumulated prior withholding tax payments made with respect to the ODA;

(B) the taxpayer's running total of additional tax paid as a result of all material distribution transactions made with respect to the ODA;

(C) the year in which the ODA was initiated;

(D) a list of all assets or groups of assets to which the ODA is currently attached or to which the ODA has ever been attached;

(E) the basis the taxpayer had in each such asset or group of assets at the time each such asset or group of assets was initially attached to the ODA;

(F) the total basis the taxpayer had in all such assets or groups of assets to which the ODA is currently attached or to which the ODA has ever been attached at the time such asset or group of assets was initially attached to the ODA; and

(G) the taxpayer's running total of the aggregate fair market value of all material distribution transactions made with respect to the ODA.

(h) Certain loans, borrowing, and indebtedness shall be treated as material distribution transactions in the following manner:

(1) If, prior to closing an ODA, a taxpayer who is maintaining an ODA borrows or takes out any loans or liabilities or increases the amount of any

prior borrowings or loans or liabilities, then the amount of any such increase in borrowings or loans or liabilities shall be treated as a material distribution transaction and so shall be subject to taxation and to the related guidance under subsection (g) of this section. However, a taxpayer may opt to exclude any qualified residence indebtedness as defined in 26 U.S.C. § 163(h)(3) from being treated as a material distribution transaction under this subsection and a taxpayer may additionally opt to exclude up to an aggregate total of $1,000,000.00 of other indebtedness from being treated as a material distribution transaction under this subsection. For purposes of this subsection, "aggregate total of $1,000,000.00 of other indebtedness" shall encompass all indebtedness so excluded over the lifespan of the ODA, except for any qualified residence indebtedness, and shall not be limited to only incremental annual indebtedness.

(2) If, prior to closing an ODA, a taxpayer previously had any indebtedness treated as a material distribution transaction from that ODA, and if the taxpayer then pays off that indebtedness, whether in whole or in part, then the taxpayer may file for a refund of any additional tax paid as a result of that indebtedness having been treated as a material distribution transaction and with both the taxpayer's running total of accumulated prior withholding tax payments made with respect to the ODA and the taxpayer's running total of

additional tax paid as a result of all material distribution transactions made with respect to the ODA then to be adjusted to account for such refund.

(i) If, in any year, a taxpayer who has previously initiated an ODA sells, disposes of, or otherwise terminates all of the taxpayer's interests in the ODA and in all assets to which the ODA is attached, then after paying any tax owed as a result of any such transactions that are material distribution transactions, as specified in subsection (g) of this section, the ODA shall be deemed fully liquidated and closed. If, in any year, a taxpayer who has previously initiated an ODA liquidates the entire value of all assets to which the ODA is attached by converting the assets to cash or cash equivalents, then after paying any tax owed as a result of any such transactions that are material distribution transactions as specified in subsection (g) of this section, the ODA shall be deemed fully liquidated and closed. At the end of any tax year, a taxpayer who has previously initiated an ODA may elect to close that ODA by filing a form provided by the Department of Taxes. The taxpayer shall then reconcile the ODA pursuant to subsection (j) of this section.

(j) A taxpayer shall reconcile an ODA upon closing it, as follows:

(1) Prior to closing an ODA, a taxpayer shall withdraw any assets to which the ODA is attached and treat those withdrawals as material distribution transactions pursuant to subsection (g) of this section. For any such assets other than cash or cash equivalents, the taxpayer shall submit a certified

appraisal of the fair market value of those assets. The taxpayer shall then apply the ODA reconciliation guidance materials provided by the Department of Taxes for determining whether any additional tax is owed or whether the taxpayer is entitled to any refund of the accumulated prior withholding tax payments made with respect to the ODA.

(2) The Commissioner shall establish reconciliation guidance materials for determining whether, upon the closing and reconciliation of an ODA, any additional tax is owed or whether a taxpayer is entitled to any refund of the accumulated prior withholding tax payments made with respect to the ODA. To the extent practicable while maintaining ease of compliance and administration, the guidance materials shall aim to equalize the lifetime tax treatment of assets attached to an ODA with the total tax that would have been payable had such assets not been attached to an ODA and instead been subject to section 5602 of this chapter. However, such guidance materials shall also aim to ensure that taxpayers electing to attach assets to an ODA shall pay at least as much tax as would have been payable had the assets not been attached to an ODA and instead been subject to section 5602 of this chapter.

(A) Unless otherwise specified by the Commissioner, the default reconciliation tax calculation shall be made using the following formula, in which the reconciliation tax liability = $[MDTS - TAX](1 – ([MDTS - TAX]/BASIS)^{-t})$.

(i) For purposes of applying the formula, “MDTS” means the aggregate fair market value of all material distribution transactions made with respect to the ODA, “TAX” means the taxpayer’s running total of additional tax paid as a result of all material distribution transactions made with respect to the ODA, “BASIS” means the total basis the taxpayer had in all assets or groups of assets to which the ODA has ever been attached at the time each such asset or group of assets was initially attached to the ODA, and “t” means the absolute value of the applicable tax rate.

(ii) The applicable tax rate shall be the average of the highest marginal Vermont income tax rates for each year starting with the year in which the ODA was initiated and ending with the year in which the ODA is closed.

(iii) If the reconciliation tax liability exceeds the taxpayer’s running total of additional tax paid as a result of all material distribution transactions made with respect to the ODA, then this excess becomes an additional tax liability of the taxpayer owed to Vermont for the tax year in which the ODA was closed. Any additional tax payable as a result of this subdivision (iii) for any tax year shall be payable along with any other tax owed to Vermont for that tax year.

(iv) If a taxpayer’s running total of additional tax paid as a result of all material distribution transactions made with respect to the ODA exceeds the reconciliation tax liability, the taxpayer is entitled to file to claim this excess as a refund.

(B) This section shall have the goals of attempting to equalize the lifetime tax treatment of assets attached to an ODA with the total tax that would have been payable had such assets not been attached to an ODA and instead been subject to section 5602 of this chapter, and ensuring that taxpayers electing to attach assets to an ODA shall pay at least as much tax as would have been payable had such assets not been attached to an ODA and instead been subject to section 5602 of this chapter.

(i) If a taxpayer claims the default reconciliation tax calculation method would not reasonably satisfy the goals provided in this subdivision (2)(B), and if the taxpayer can demonstrate that some alternative reconciliation method would better satisfy the goals, then the taxpayer may petition for a hearing to determine the use of the alternative reconciliation method. After a hearing, the Commissioner shall determine whether an alternative reconciliation method would better satisfy the goals.

(ii) In any proceeding for an alternative reconciliation method, the burden shall be on the petitioning party to demonstrate by clear and convincing evidence that the default method is unfair and that the alternative method petitioned for would better satisfy the goals provided in this subdivision (2)(B).

(k) As used in this section, the term “taxpayer” shall also include any estate or assigns of a taxpayer made liable under this provision for satisfaction of the taxpayer’s ODA.

§ 5606. CERTIFIED APPRAISALS

(a) For purposes of this chapter, in any instance in which a taxpayer is required to report or submit a certified appraisal, if the taxpayer has previously submitted within the prior 10 years a certified appraisal for an asset or for a set of assets or for the taxpayer’s interests in an entity and if the taxpayer declares that the taxpayer has not entered into any transactions since that prior certified appraisal that would substantially alter either the valuation or the percentage of the asset or assets or entity owned by the taxpayer, then the taxpayer may choose to:

(1) submit a new certified appraisal for the value and the percentage owned by the taxpayer as of the end of the last day of the tax year; or

(2) instead submit the prior certified appraisal with all valuations adjusted by the annual published estimated economy-wide normal rates of return for each year or partial year since the prior certified appraisal, after also making any proper adjustments for withdrawals, contributions, improvements, or depreciation with respect to the relevant asset or assets or entity.

(b) Any appraiser making a certified appraisal for the purposes of this chapter shall send a copy of that certified appraisal to the Department of Taxes, along with information sufficient for identifying the taxpayer for whom the certified appraisal was prepared, and shall follow any applicable rules or other relevant instructions adopted by the Commissioner.

(c) The Commissioner shall adopt rules, or publish guidance, further detailing the requirements for certified appraisals and for appraisers qualified to make certified appraisals for purposes of this chapter. Rules and guidance shall be based on the qualified appraisal and qualified appraiser rules of 26 C.F.R. § 1.170A-17.

§ 5607. ADMINISTRATION

(a) The threshold exemption amount and all other exclusion amounts provided in this chapter shall be indexed for inflation and updated in the same manner as subdivision 5822(b)(2) of this title.

(b) Following the beginning of each tax year, the Commissioner shall publish the estimated economy-wide normal rate of return for the prior tax year, based on the best available methodology. Unless the Commissioner determines that some other methodology is more appropriate for a year or for a set of years, the estimated economy-wide normal rate of return for each year shall be determined by adding 300 basis points to the rate of return on the one-year U.S. Treasury Bill for that year that the Commissioner deems most appropriate.

(c) Following the beginning of each tax year, the Commissioner shall publish the incremental ODA withholding percentage for the prior tax year, which shall be the product of the estimated economy-wide normal rate of return for that prior tax year and the highest marginal Vermont income tax rate for that prior tax year.

(d) The Commissioner may adopt rules in accordance with 3 V.S.A. chapter 25 to implement, administer, and enforce this chapter. Through rules, the Commissioner may specify additional reporting requirements to be applied to taxpayers or third parties, or both.

(e) To the extent not inconsistent with this chapter, the provisions for the administration, assessment, collection, enforcement, and appeals of the income tax in chapter 151 of this title shall apply to the taxation of unrealized gains imposed by this chapter.

Sec. 2. 32 V.S.A. § 5811(21) is amended to read:

(21) "Taxable income" means, in the case of an individual, federal adjusted gross income determined without regard to 26 U.S.C. § 168(k) and:

(A) increased by the following items of income (to the extent such income is excluded from federal adjusted gross income):

(i) interest income from non-Vermont state and local obligations; ~~and~~

(ii) dividends or other distributions from any fund to the extent they are attributable to non-Vermont state or local obligations; and

(iii) unrealized gains recognized and made taxable under chapter 149 of this title; and

* * *

Sec. 3. 32 V.S.A. § 5811(28) is amended to read:

(28) "Taxable income" means, in the case of an estate or a trust, federal taxable income determined without regard to 26 U.S.C. § 168(k) and:

(A) increased by the following items of income:

(i) interest income from non-Vermont state and local obligations;

(ii) dividends or other distributions from any fund to the extent they are attributable to non-Vermont state or local obligations; ~~and~~

(iii) the amount of State and local income taxes deducted from federal gross income for the taxable year; and

(iv) unrealized gains of trusts recognized and made taxable under chapter 149 of this title; and

* * *

Sec. 4. TRANSITION PERIOD FOR TAXATION OF UNREALIZED GAINS

(a) In tax year 2025, a taxpayer shall have the option to pay any additional tax imposed under 32 V.S.A. § 5602(a):

(1) along with any other income tax owed for the 2025 tax year; or

(2) annually in three equal installments beginning with the date on which income tax is payable for tax year 2025 and with each subsequent annual installment payment also being subject to an annual nondeductible deferral charge of 7.5 percent annually.

(b) In tax year 2025, for the purpose of 32 V.S.A. chapter 149, in the case of any trust that, on the effective date of this act, is a Vermont resident, an irrevocable trust, and has no living individual who has, directly or indirectly, contributed property to the trust, the threshold exemption amount for the trust shall be $10,000,000.00 and the exclusion amounts available for the trust under 32 V.S.A. § 5604(c) shall be $1,000,000.00.

(c) For tax year 2025, the Commissioner of Taxes shall publish the incremental ODA withholding percentage for tax year 2023 for purposes of 32 V.S.A. chapter 149.

(d) For taxable year 2025, the Commissioner of Taxes shall publish the estimated economy-wide normal rate of return for each of the prior 10 tax years for purposes of 32 V.S.A. chapter 149.

Sec. 5. EFFECTIVE DATE

This act shall take effect on January 1, 2025 and apply to taxable years beginning on and after January 1, 2025.

(Committee vote: ___________)

_______________________

Representative ___________

FOR THE COMMITTEE