



# A TAX CODE FOR THE 21ST CENTURY

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Joint Fiscal Office

# Blue Ribbon Tax Structure Commission

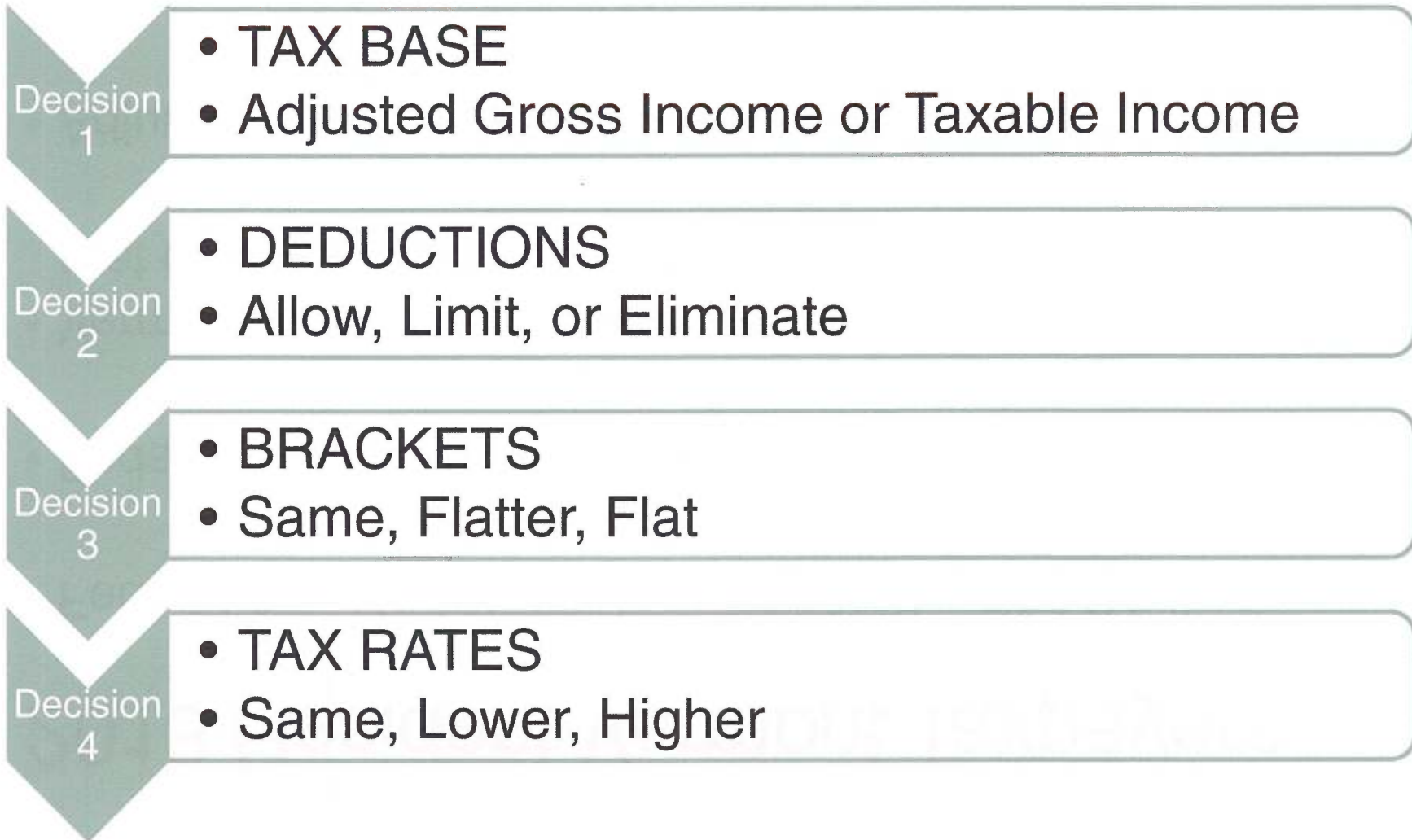
## **Income Tax Reform Proposals**

- 1A: Shift tax base from federal Taxable Income to federal Adjusted Gross Income
- 1B: Eliminate standardized and itemized deductions
- 1C: Implement a lower, flatter rate and bracket structure
- 1D: Implement a residential credit as a transparent alternative to deductions
- 1E: Evaluate all remaining personal income tax expenditures for opportunities for removal
- 1F: Reduce the number of filing statuses from four to two, single and joint

## **Sales Tax Reform Proposals**

- 2A: Levy the general sales tax on all consumer-purchased services with limited exceptions for certain health and education services and business-to-business service transactions
- 2B: Eliminate all consumer-based sales tax expenditures retaining only the exemptions for food and prescription drugs
- 2C: Cut the sales tax rate from 6 percent to 4.5 percent
- 2D: Move as aggressively as possible with other states to collect tax revenue due on Internet purchases
- 2E: Levy the sales tax on soda by removing its tax exemption as a food product

# Income Tax Reform Decision Points



# 2013 Resident Vermont Taxpayers

- Federal Adjusted Gross Income (AGI) = \$17.6 billion
- Federal Taxable Income (TI) = \$12.2 billion (69% of AGI)
- Vermont Adjustments to federal TI = \$148.5 million (net of all additions and subtractions)
- Adjusted VT Tax = \$622.6 million (3.5% of AGI)
- Credits = \$63.9 million (10% of tax)
- Actual Tax Paid = \$558.7 million (3.2% effective rate)

# Recommendation 1A

## Shift Tax Base from federal TI to federal AGI

- Vermont is out of step with most states regarding choice of tax base (30 states AGI, 7 states TI, 9 no tax, 4 other)
- Taxes smaller base and leaves deduction choices largely to federal government
- Creates gap between marginal and effective rates (perception issues)

# AGI to TI (\$5.4 billion value)

- Personal Exemption  
2013 Value = \$2.2 billion
- Standard Deduction
- 2013 Value = \$2.7 billion
- Itemized Deductions
- 2013 Value = \$0.5 billion – difference with Standard

# Insulating Tax Filers from Paying Tax on First Dollar

Do nothing – shifts tax incidence on lowest income classes

Zero percent bracket – simple to understand

- Makes policy choice to shield income explicit
- Treats taxpayers the same
- Needs to be large to cover current standard deduction/exemptions
- Expensive because all taxpayers transition through bracket

Deductions and exemptions (dominant paradigm)

- Flat standard deduction (same amount for each tax filer)
- Family sized based deduction/exemption (based on household size)
- Itemized deductions (corresponds with specific incentive goals)
- Combination of deductions (current system)

Credits

- A tax credit lowers your tax bill dollar for dollar
- A deduction shaves money off your taxable income, so the value depends on your tax bracket

# Recommendations 1B and 1D

**1B Eliminate Standard and Itemized Deductions**

**1D Implement a Residential Credit as a Transparent Alternative to Deductions**

Current Law 2015 (and Exemption)

Filing Status	Standard Deduction	2015 Value at Vermont Marginal Rates				
		3.55%	6.80%	7.80%	8.80%	8.95%
MFJ	12,600	447	857	983	1,109	1,128
HOH	9,250	328	629	722	814	828
Single/MFS	9,300	330	632	725	818	832
Personal Exemption	4,000	142	272	312	352	358

Proposal (developed on TY08 data)

<b>BRTSC Recommendations</b>	
Credits in Lieu of Deductions	
Residential Credit	350
Per Exemption	150
Capped Credit Amount*	800
Phase-out (AGI)	\$125,000

\*Equivalent to 1 return with 3 exemptions



# Rate and Bracket Structure Examples (MFJ) 2013

## Connecticut (AGI + No Itemized Deductions)

- 3.5% \$0-\$20,000
- 5.0% \$20,001-\$100,000
- 5.5% \$10,001 - \$200,000
- 6.0% \$20,001 - \$400,000
- 6.5% \$400,001 - \$500,000
- 6.7% \$500,001 and over

## Maine (AGI + Capped Itemized Deductions)

- 0.00% \$0 - \$10,449
- 6.50% \$10,450 - \$41,849
- 7.95% \$41,850 and over

## Massachusetts (AGI – personal exemption + No Itemized Deductions)

- Flat 5.3%

## New Hampshire

- No Income Tax

## Rhode Island (one bracket) (AGI + No itemized Deductions)

- 3.75% Under \$58,600
- 4.75% \$58,601 - \$133,250
- 5.99% \$133,251 and over

## Vermont (TI + Permissive Deductions)

- 3.55%: Under \$60,550
- 6.80%: \$60,551 – \$146,400
- 7.80%: \$146,401 – \$223,050
- 8.80% : \$223,051 – \$398,350
- 8.95%: \$398,350 and over

# 1C Implement a lower, flatter rate and bracket structure

BRTSC Proposed Rates and Brackets

<b>Tax Rate</b>	<b>Single</b>	<b>Joint</b>
3.00%	Under \$30,000	Under \$50,000
4.50%	\$30,001 - \$90,000	\$50,001 - \$150,000
6.95%	\$90,001 and over	\$150,001 and over

# 1F Reduce the number of filing statuses from four to two (joint and single)

## Resident Taxpayer Statistics (2013)

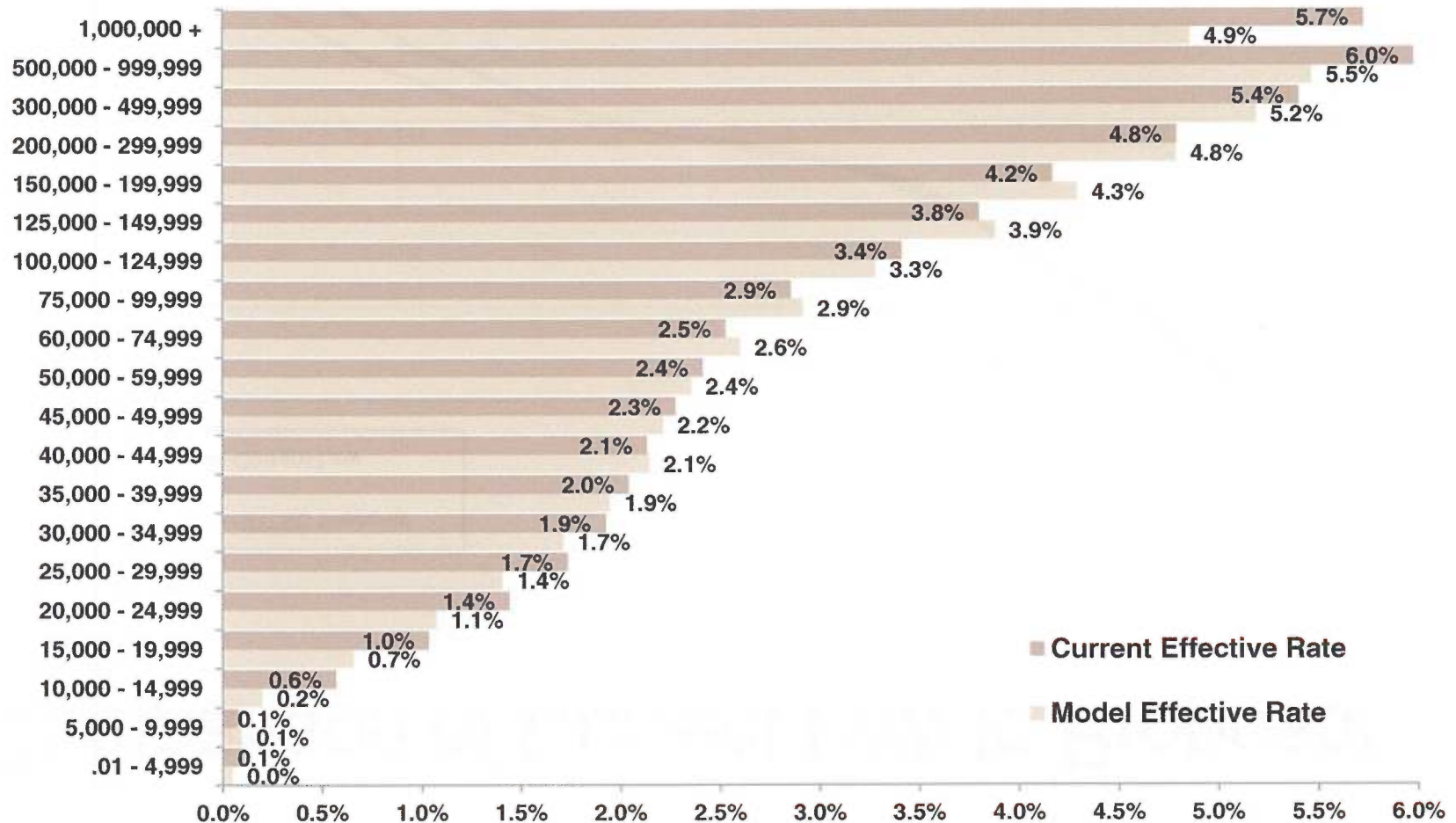
- 314,010 Tax Returns
- 560,067 Exemptions (1.78 people per return)
  
- 122,776 married filing joint - MFJ (39%)
- 159,084 single – Single (51%)
- 5,050 married filing separate - MFS (2%)
- 27,100 head of household - HOH (9%)

## 1E Evaluate all remaining income tax expenditures for opportunities for removal

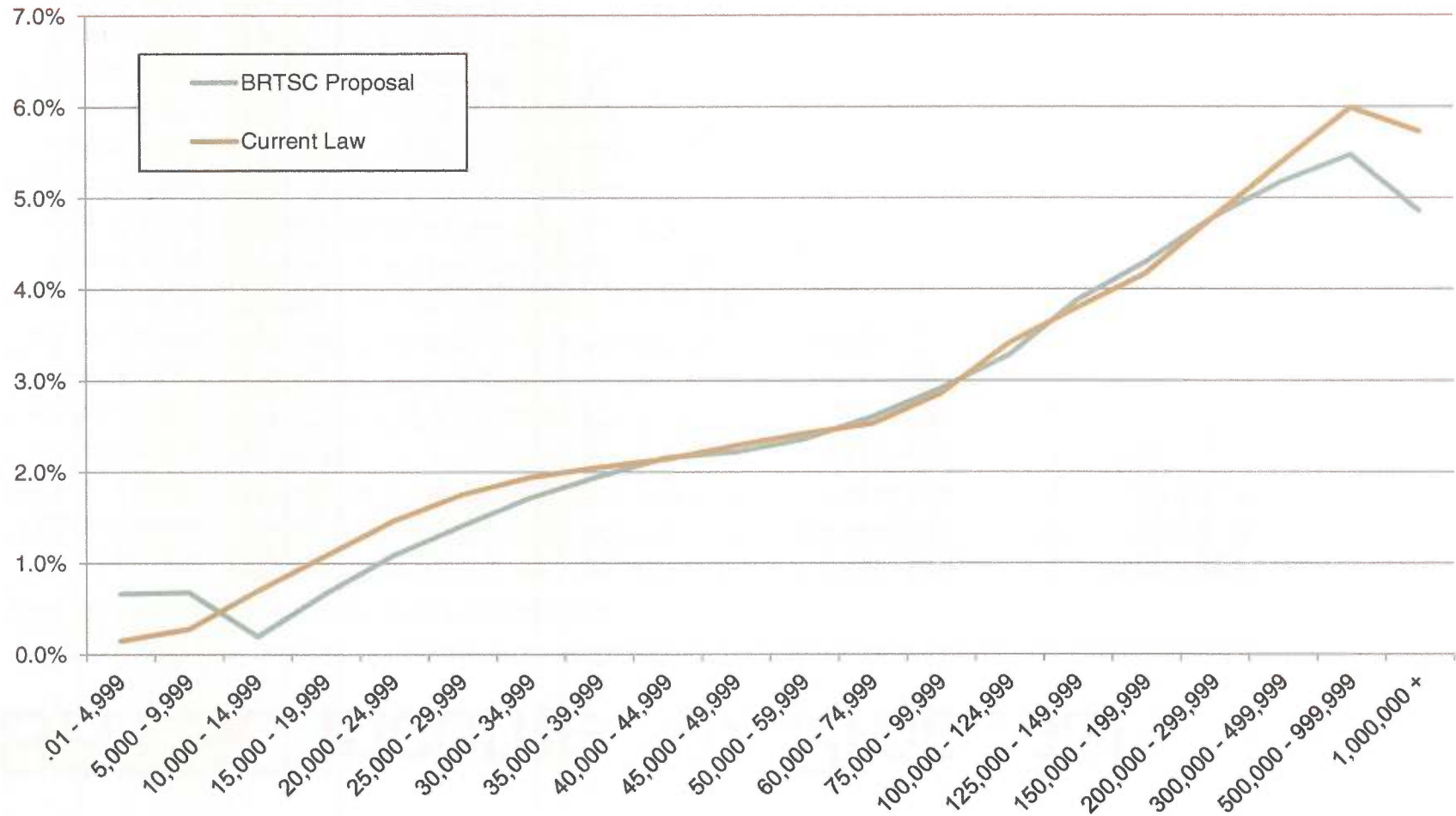
- VT EITC – 44,000 taxpayers receive \$27.0 million
- Average of \$609 per taxpayer
  
- All other credits – 15,000 taxpayers receive \$36.9 million
- Average of \$2,390 per taxpayer

# BRTSC Income Tax Proposal

Model 13: AGI Base with No Exemptions or Deductions. Resident Credit Capped at \$800 for Taxpayers up to \$125,000 AGI. Lower, Flatter Rates and Brackets



# Comparison of Current Law to Proposal



# Sales Tax Reform Proposals

Tax all consumer services

- Exemptions for B2B services
- Exemption for specified health services
- Exemption for specified education services


Remove all tax expenditures except food and prescription drugs.

Reduce sales tax rate to 4.5%.

## Rationale for Broadening the Sales Tax Base

- Addresses perception problem that all sales tax roads lead to New Hampshire.
- Sustainability: broaden tax base to reflect 21<sup>st</sup> century with consumer services and most goods. Only exceptions to rule are Food, RX, and some education and health services.
- Competitiveness: Opportunity to lower sales tax rate to at least 4.5%
- Neutrality: move aggressively to tax internet sales to keep parity for brick and mortar stores.
- Transparency: Eliminate sale tax expenditure on soda.





2A Levy the sales tax on all consumer-purchased services with limited exceptions for health and education services and business to business transactions

# Sales Tax on Services

Sales Tax on Services	2007 Value not Taxed	1% Tax (\$ millions)	1% Tax excluding B-to-B
Construction	1,989,717,600	22.1	18.9
Transportation	228,310,000	2.5	1.1
Finance & Insurance	282,416,000	3.1	1.7
Real Estate	177,074,000	2.0	1.1
Professional Services	1,636,505,000	18.2	3.3
Administrative Services	517,084,000	5.7	1.1
<b>Educational Services</b>			
All educational services	137,900,000	1.5	1.5
Only those subject to federal income tax	82,454,000	0.9	0.9
<b>Health Care &amp; Social Services</b>			
All health care & social services	3,537,058,000	39.3	38.2
Only those subject to federal income tax	1,147,349,000	12.7	12.4
Personal Services	336,819,000	3.7	3.4
	<b>6,453,174,600</b>	<b>71.6</b>	<b>44.4</b>

# Health and Education Exemptions to Service Tax

**“healthcare services”** means: professional services that are delivered by licensed health care professionals such as physicians, registered nurses, and therapists, or by personal care aides under the supervision of health care professionals, for the diagnosis, prevention, treatment, cure or relief of a health condition, illness, injury or disease.

**“educational services”** means: services provided by an "educational institution" as the term is defined at 16 V.S.A. § 140a(1), or an employee, contractor, or agent of an “educational institution,” as that term is defined at 16 V.S.A. § 140a(1).

## B2B Exemption

- Violates principle of what sales tax is supposed to be – tax on consumption
- Often leads to —pyramiding— with possible negative economic and distributional effects
- Definition: imposing sales tax on inputs into production, passing cost of those inputs into cost of final product, then subjecting full price of product to sales tax all over again

# 2B Eliminate all consumer based expenditures retaining only the exemptions for food and prescription drugs

<b>Eliminate Sales Tax Exemptions</b>	<b>2007 Value not Taxed</b>	<b>1% Tax (\$ millions)</b>	<b>Exclude B2B</b>
Food	1,466,804,000	14.7	14.7
Clothing & Footwear	336,009,000	3.4	3.4
Prescription & Nonprescription Drugs & Medical Equip	843,333,333	8.4	8.4
Agricultural Inputs (feed, fertilizer etc.)	226,666,667	2.3	0.0
Agricultural M&E	21,666,667	0.2	0.0
Machinery & Equipment for manufacturing & newspapers	5,413,333,333	54.1	0.0
Packaging & Shipping Materials used by Manufacturers	20,000,000	0.2	0.2
Electricity, Oil, Gas and other fuels for Manufacturing	326,666,667	3.3	0.0
Electricity, Oil, Gas and other fuels for Residential Use	900,000,000	9.0	9.0
Electricity, Oil, Gas and other fuels for Farm Use	56,666,667	0.6	0.0
Aircraft and Depreciable Parts (all until 2018)	5,000,000	0.1	0.1
Rentals of Coin-Op Laundry Machines and Car Washes	20,000,000	0.2	0.2
Admissions to Nonprofit Museums	20,000,000	0.2	0.2
		<b>96.6</b>	<b>36.1</b>
		<b>Revenue Neutral Rate (rounded)</b>	
	All	4.50%	5.50%
	excluding food		5.75%

Prepared by JFO/st

## 2C Cut the tax rate from 6.0% to 4.5%

- Vermont's Rate is 6%
- USA Median is 6% & Mean is 5.1%
- Average Effective Rate in New England + NY is 6.375%

## 2E Levy the sales tax on soft drinks

- See attached sheet