Fight Back! Draft 1.2

Vermont State Employees Association

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The Problem: Joint Fiscal Office currently projects a budget deficit of $100 million in FY16.

Context: Vermont legislators have faced annual budget deficits since the beginning of the recession. These gaps are primarily the result of a drastically increased demand for human services, coupled with a decrease in revenue collection. The main remedy to address Vermont's budget deficit—and one supported by both the current and previous Administration—has been to decrease spending by implementing service and position cuts. Revenue increases have generally been limited to increased fees and cigarette taxes, both of which have minor revenue return and lack the sufficient growth potential needed to sustain state spending. Anticipating the economy (and revenue) will rebound in the near future; recent state budgets have relied on approximately $50 million in one-time funds to avoid additional politically controversial cuts. In FY16, overly optimistic economic forecasts, combined with a historically high concentration of income and other spending pressures have resulted in an unexpectedly high budget deficit.

While it may be true that our state's General Fund revenues have now rebounded to above pre-recession levels, it's concerning that an anemic state workforce continues to struggle with ballooning caseloads—and with no relief in sight. Making it worse, Commissioners and Secretaries have been instructed to draft FY16 budgets with 5% actual cuts, and only after they have absorbed the 2015 Pay Act provisions[1]. If the Administration accepted 5% across the board cuts from each department after absorbing the Pay Act, this would eliminate roughly $80 million in general fund expenditures. Depending on where the cuts are targeted and whether or not the programs have a federal match, cutting $80 million in state funding could result in $150 million in reduced funding for services.

VSEA Fight-Back Plan Highlights:

- Raises $99.5 million to cover the budget shortfall
- Raises the minimum wage to $10 by July 1, 2015, saving taxpayers $3 million, while increasing the aggregate income of 31,000 low-wage workers by $30 million;
- Closes tax loopholes and eliminates tax breaks for Vermont's wealthiest citizens, while providing a $23 tax cut for the average Vermonter by increasing the standard deduction;
- Penalizes large employers who do not provide health insurance or employ workers covered by Medicaid; and
- Imposes a two-cent-per-fluid-ounce excise tax on sugar-sweetened beverages, which addresses the Medicaid budget gap and produces long-term taxpayer savings by decreasing consumption and combatting obesity.

[1] Department of Finance and Management, FY 2016 Budget Instructions, Pg. 3

Fiscal Year 2016 Budget Pressures:

FY16 General Fund	
Spending Pressure	**Projected Cost**
Medicaid	**$35,800,000**
State Employee/ Teacher Related	**$28,200,000**
FY15 Rescission One-time Backfill	**$8,400,000**
IT Projects	**$10,000,000**
DoC Caseload/ One-time Backfill	**$13,700,000**
Education Fund Base Transfer	**$7,500,000**
Veteran's Home	**$1,000,000**
Capital Debt Service	**$5,100,000**
Public Safety TF Reduction	**$2,500,000**
Budget Pressure	**$112,200,000**
Available Revenue	**$12,700,000**
FY16 Budget Gap	**$99,500,000**

The Solution: Raise Revenue to ensure vital services and reduce Income Inequality

Revenue Package:	**FY 16 Revenue Est.**
Eliminate Income Tax Itemized Deduction Increase Standard Deduction*	**$25,000,000**
Treat Capital Gains as ordinary Income	**$11,500,000**
"Water's Edge" Offshore Loophole	**$4,800,000**
Eliminate QPAI Deduction (Domestic production)	**$5,000,000**
Financial Institutions Pay Corporate Income Tax*	**$5,000,000**
Minimum Wage $10.00	**$3,000,000**
Tiered Catamount Assessment	**$16,600,000**
2-Cent per OZ Soda Tax	**$34,856,000**
Bottle Bill Escheat	**$2,085,000**
Hotel Occupancy Fee $2/Night	**$11,000,000**
* Indicates FY13 or older Revenue Estimate	
Total:	**$118,841,000**

Close Income Tax Loopholes that disproportionally benefit the Wealthiest Vermonters

Currently, Vermont allows taxpayers two options to subtract certain kinds of expenses from their income. They can take a standard, lump-sum deduction that covers things like health care, state and local taxes, and mortgage interest. Or they can list each of these expenses and take a larger deduction if the itemized expenses are greater than the standard deduction. Itemized deductions reduce taxable income, providing disproportionate benefit to wealthy taxpayers, who pay higher marginal tax rates[2]. Unlike tax credits, the benefit taxpayers receive from reducing taxable income with itemized deductions depend on their top marginal tax rate. For instance, when a middle income taxpayer with a top marginal rate of 15% contributes $100 to a charity, they receive a $15 deduction, while a millionaire with a top marginal tax rate of 39.6% who contributes $100 to charity receives a $39.60 deduction[3].

Itemized Tax Deductions cost Vermont roughly $67 million in 2014, while providing little benefit to low- and middle-income taxpayers[4]. Vermont is currently one of 26 states which generally follow federal rules for itemized tax deductions[5]. In New England, Vermont and Maine are the only two states that mirror federal rules for itemized tax deductions, while New York limits itemized deductions. Nearly every state allowing itemized deduction utilize federal itemized deductions rules for simplicity, however most states require itemizers to add back state income taxes paid when calculating their state income tax itemized deductions. Vermont is one of half a dozen states that allow taxpayers to itemize and deduct state income taxes paid from their state income tax[6]. Vermont could raise $16 million while making its income tax code simpler and more progressive by eliminating the itemized deduction for state income taxes[7].

Vermont can raise $25 million by eliminating itemized tax deductions and coupling the move with an increase in the standard deduction. This would provide income tax relief to a majority of Vermonters. Raising revenue through the state income tax is also supported by the federal deduction for state income taxes, or federal offset. Essentially the federal government will cover 25%-39.6% of the tax increase for itemizers through federal itemized deductions for state income taxes[8]. Increasing the standard deduction will in fact cut taxes for 60% of Vermonters, while increasing taxes on merely 4% of Vermonters[9]. An average Vermont tax filer with an income of $49,000 would receive a tax cut of $23, while a tax filer with an income of $30,000 would get a $32 tax cut[10].

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[2] ITEP, Writing Off Tax Giveaways, 2010 Pg. 3
[3] ITEP, Leaving Money on the Table, 2010, Pg. 2
[4] Public Assets Institute, Vermont has Options to Raise Revenue for Smart Investments, Option 1 2013
[5] ITEP, State Treatment of Itemized Tax Deductions, 2011
[6] ITEP, Writing Off Tax Giveaways, 2010 Pg. 8
[7] Public Assets Institute, Vermont has Options to Raise Revenue for Smart Investments, Option 2 2013
[8] ITEP, Writing Off Tax Giveaways, 2010 Pg. 11
[9] ITEP, Writing Off Tax Giveaways, 2010 Pg. 42
[10] Public Assets Institute, Vermont has Options to Raise Revenue for Smart Investments, Option 1 2013

Option 1: Increase the standard deduction and eliminate itemized deductions			Additional revenue: $25 million
Change to standard deduction			
Filer	Current	New	
Married filing jointly	$12,200	$15,000	
Single	$6,100	$7,500	
Head of household	$8,950	$12,000	

Filers in upper income brackets tend to claim itemized deductions more than filers in the lower brackets, who tend to use the standard deduction. Increasing the standard deduction and eliminating the itemized deduction would generally reduce taxes on those with lower incomes and increase taxes for those in the upper brackets.

Effect of change by income group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $22k	$22k –$39k	$39k –$61k	$61k –$94k	$94k- $179k	$179k –$371k	$371k+
Average Income	$13,000	$30,000	$49,000	$75,000	$124,000	$246,000	$942,000
Average tax change	–$21	–$32	–$23	–$7	+$165	+$853	+$4,099

Tax Capital Gains Income like Wages

Capital gains are profits from the sale of assets, such as stocks, bonds, investment real estate and antiques. Income tax on capital gains is paid only when the asset is sold. For instance, a stockholder who owns a stock over many years doesn't pay any tax as it increases in value each year. When the capital gain is sold, the "realized" capital gain is calculated by subtracting the purchase price from the selling price.

While politicians have accepted the theory that capital gains tax cuts will be rewarded with increased economic growth, the evidence does not support this assertion. In 2002, the Congressional Budget Office found that capital gains tax cuts "would provide little fiscal stimulus," because the wealthy individuals who disproportionately benefit from the tax break are more likely to save than spend.[11]Mark Zandi of Moody's investor service came to a similar conclusion when analyzing the capital gains tax cuts passed by the George H.W. Bush administration. Zandi found that each dollar of capital gains tax cuts produced a mere 38 cents of economic activity, while a dollar invested into Unemployment Insurance or improving infrastructure would increase economic activity by $1.50.[12]

Vermont is one of eight states that currently offer a substantial tax break for capital gains income. The 67% of Vermont tax filers with incomes below $50,000 earned merely 4% of capital gains income in 2008, while the wealthiest 2% of tax filers with income above $200,000 earned 77% of capital gains income[13]. In 2014, eliminating the capital gains exclusion was projected to raise $13 million[14]. This estimate should be updated to reflect the unprecedented growth in the stock market in recent years.

[11] Congressional Budget Office, Economic Stimulus: Evaluating Proposed Changes in Tax Policy, 2002.
[12] Zandi, Mark. Testimony before U.S. House of Representatives Committee on the Budget, 2009.
[13] ITEP, A Capital Idea, 2011 Pg. 4
[14] Vermont Department of Taxes, Tax Expenditure Report, 2013, Pg 18

Vermont Capital Gains Income[15]	Income Group (AGI)	Vermont
Share of all returns filed	Under $50,000	67%
	$200,000 Plus	2%
Share of all Returns with Capital Gains	Under $50,000	13%
	$200,000 Plus	74%
Share of total Capital Gains	Under $50,000	4%
	$200,000 Plus	77%
Capital Gains Income as Share of AGI	Under $50,000	1%
	$200,000 Plus	21%

Share of Capital Gains	
Preferences by Income Group[16]	
Bottom 80%	**4%**
Top 20%	**96%**
Top 5%	**88%**
Top 1 %	**69%**

Eliminate Corporate Tax Loopholes

The corporate income tax, or an income tax on corporate profits, is another policy option available to raise revenue. Most Vermont small businesses are currently classified as "S-Corporations", "Limited Liability Corporations" or partnerships that pay state income tax on their profits, rather than pay a corporate income tax. Today, roughly 38% of Vermont Businesses are registered as "C-Corporations", and, of those, 76% pay the minimum tax of $250. Within the C-Corporations, 55% are mulit-state or multi-national[17]. There are ineffecient and costly loopholes in Vermont's corporate tax code which could be eliminated to incentivize investment in Vermont and ensure profitable mutlinational corporations aren't utiziling offshore tax havens to avoid contributing their fair share.

To even the playing field a little, first close the "water's edge" loophole by mandating that when companies are calculating their taxes, they must include their U.S. profits held in offshore tax havens. In many states, companies calculate their tax liability based on their income held in subsidiaries

[15] Source: IRS, 2008 Statistics of Income: Historical Table 2
[16] ITEP, A Capital Idea, 2011 Pg. 5
[17] Vermont 2007 Tax Study, supra note 31, at 3

incorporated within the “water’s edge” (that is, within the United States). By declaring a statutory list of tax havens, states can tax corporate profits held in tax havens that lie past the “water’s edge”[18].

Second, the QPAI deduction allows a broad category of manufacturing-related business activity, or “QPAI income,” to be partially deducted from a company’s profits. The federal government created this tax break in 2004, caling it the “domestic production deduction.” Since most states base their own tax codes on the federal tax code, this tax break was incorporated into many states without specific legislative scrutiny or a vote. As a result, the tax break is costing the federal government and 25 states a large amount of money. In addition, states are not required to allow this deduction, and since 2008, Connecticut, New York, Wisconsin, and the District of Columbia have joined 18 other states in prohibiting the deduction. This single move has reduced budget shortfalls and benefitted the states’ economies. But another 25 states, including Vermont continue to permit it[19].

The QPAI deduction has little value as an economic development strategy for individual states, because a corporation can use the QPAI deduction to reduce its taxable income for “domestic production” activities anywhere in the United States. This means that a multi-state company engaging in manufacturing activities in North Carolina is able to use the activities to claim the QPAI deduction—and thus cut it’s Vermont tax rate , even if the company does not have manufacturing facilities in Vermont[20].

Third, Vermont should end its preferential tax treatment of financial institutions. Vermont is just one of five states that taxes financial institutions based on a fractional percentage of their deposits, rather than the corporate income tax[21]. In recent years, Vermont has seen large, out-of-state banks consolidate ownership over the majority of Vermont’s market share[22]. Considering the profitiability and out-of-state ownership of Vermont major financial insutitutions, our elected representatives should replace the antiquated franchise tax with the corporate income tax, thereby ensuring that these large banks are paying their taxes like any other corporation.

Towards a Livable Wage

Lawmakers passed a minimum wage increase in the spring of 2014, but it was not sufficient to improve the lives of Vermont’s working poor. As comparison, in 1969[23], Vermont’s minimum wage was effectively $11, therefore an increase to $10.50 by 2018 does not approach restoring the minimum wage to it’s historical peak, nor does it come close to approaching the stuatory livable wage of $13.00[24]. Raising the minimum wage to $10 on July 1, 2015, would save the state of Vermont $3 million[25]. A $10

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[18]USPIRG, Closing the Billion Dollar Loophole, 2014 Pg. 3

[19] CBPP, Can States Opt Out of the Costly and Ineffective “Domestic Production Deduction” Corporate Tax Break. 2013, Pg. 1

[20] ITEP, the “QPAI” Corporate Tax Break: How it Works and How States can respond. 2011

[21] Federation of Tax Administrators, Range of State Corporate Tax Rates. 2014

[22] FDIC, Deposit Market Share, Accessed June 30, 2014.

[23] Kavet, Rockler and Associates, Vermont Mininmum Wage Study, 2014 Pg 4

[24] JFO, Basic Needs Budget and the Livable Wage, 2015

[25] Kavet, Rockler and Associates, Vermont Mininmum Wage Study, 2014

minimum wage would increase the aggregate income of 31,000[26] of Vermont's low-wage workers by $30 million, while have negligible impact on employment[27].

A Tiered Employer Assessment

The employer assessment is a successful targeted revenue source for the Vermont State Healthcare resources fund, which provides state funding and leverages federal matching funds for Medicaid. However an annual assessment of $485 is insufficient to incentivize businesses to provide health insurance. Furthermore, the annual assessment of $485 covers a mere 10.9% of state spending per adult Medicaid enrollee[28] . The employer assessment should be tiered to incentivize larger businesses to provide health insurance coverage to their employees. An effective employer assessment should be large enough to incentivize large employers to pay a livable wage, which would relieve the burden of Medicaid placed on taxpayers by unscrupulous employers. For instance, an analysis of public assistance eligibility of Wal-Mart employees in Wisconsin found that each job created by Wal-Mart cost taxpayers $3015 - $5815[29]. This study also found that roughly 28% of public assistance costs for Wal-Mart employees could be attributed to the cost of Medicaid[30].

Vermont should publish an annual list of employers whose employees are receiving public assistance. Moreover, this data should be utilized to craft a tax to penalize large, low-wage employers. This assessment should be tiered to correspond with federal penalties for businesses with more than 50 and 100 employees respectively. Another tier could be added to penalize the 100 largest Vermont employers with more than 250 employees. A tiered employer assessment could conceivably generate $10-$20 million to cover Vermont's budget shortfall[31], while incentivizing employers to insure their employees and pay them a livable wage.

An Example of a tiered Catamount Assessment:

Employees	Employers	FTE's	Daily	Assesment	Tiered	Assessment	Cur.Revenue	New Revenue
1--9	556	1586	1.33	$485.45	$1.33	$485.45	$769,924	$0
10--19	691	3556	1.33	$485.45	$1.33	$485.20	$1,726,260	$0
20--49	606	6623	1.33	$485.45	$2.00	$730.00	$3,215,135	$1,619,655
50--249	413	10136	1.33	$485.45	$3.00	$1,095.00	$4,920,521	$6,178,399
250+	100	9072	1.33	$485.45	$4.00	$1,460.00	$4,404,002	$8,841,118
							$15,035,843	$16,639,171

[26] Ibid, Pg 6
[27] Ibid, Pg 14
[28] Kaiser Family Foundation, Medicaid Spending per Enrollee, 2011
[29] U.S. House Committee on Education and the Workforce, The Low-Wage Drag on Our Economy: Walmart's low wages and their effect on taxpayers and economic growth. 2013, Pg. 1
[30] Ibid, Pg. 12
[31] JFO, Senate Finance Committee, SFY '15 Employer Assessment Scenarios, 2014

The Sugar-Sweetened Beverage Tax

The "Soda Tax" or "Sugar-Sweetened Beverage Tax" would add a two-cent-per-fluid-ounce excise tax on sugar-sweetened beverages. Sugar-sweetened beverages have been targeted for an excise tax, like cigarettes, because their market price does not adequately represent the negative externalities of the product. For instance, sugar-added drinks account for at least one-fifth of the U.S. population's weight gain between 1977 and 2007[32]. The soda tax could be an important policy tool to decrease the consumption of sugar-sweetened beverages, as well as address obesity. Reducing obesity could save taxpayers money by lowering the estimated $57 million in obesity-related medical claims Medicaid covers annually[33]. The sugar-sweetened beverage tax is a well-targeted revenue source to fund Vermont's FY2016 budget gap, which includes nearly $36 million in pressure attributable to Medicaid[34].

Escheat Bottle Deposits

Finally, escheat would reclaim uncollected bottle deposits from Vermont's beverage distributors. Currently seven of ten states with bottle deposit laws keep unclaimed deposits, while Vermont, Iowa and Oregon allow beverage distributors to keep unclaimed deposits[35]. While not a large revenue source, Vermont should reclaim these deposits to fund Vermont's environmental conservation and recycling programs. An escheat of Vermont's bottle deposits it estimated to raise slightly over $2 million[36].

Hotel Occupancy Fee

Lawmakers should capitalize on Vermont's natural beauty and implement a $2 nightly occupancy fee on hotel stays. Unprecedented income equality is threatening to turn Vermont into a playground for the wealthy. This small fee would generate $11 million in new revenue to support vital public services; including Vermont's grossly underfunded state colleges as well as understaffed agencies throughout state government. And it would be barely noticeable to the skiers and leaf-peepers who continue to flock to Vermont. Unlike Vermont, most states assess hotel taxes at the state, county and municipal level, therefore additional hotel occupancy fee above the 9% Rooms tax will not harm Vermont's competitiveness as a tourist destination. In fact, if this fee was implemented, Vermont's total room's tax would still exceed the forty destinations imposing the highest hotel taxes, ranging from 9.5%-17%[37].

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[32] Public Health Nutrition, to what extent has sweetened beverages contributed to the obesity epidemic? 2010

[33] Journal of Occupational and Environmental Medicine, State-level estimates of annual medical expenditures attributable to obesity. 2014

[34] JFO, FY16 Budget Gap. 2014

[35] http://www.bottlebill.org/about/unclaimed.htm

[36] DSM Environmental Services, The Cost of Beverage Container Redemption in Vermont, 2007 Pg. 9

[37] Indianapolis Convention and Visitors Association, Hotel Room Tax Comparison, 2009.