**Memo: ENERGY/CARBON TAX SUBSIDY ISSUES** **4/10/18**
**Rep. Cynthia Browning**

**This memo is a brief exploration of issues with the Vermont Tax Code in connection to the policy goals of reducing emissions from fossil fuel use and increasing the use of renewables. The aim would be to explore the role of tax expenditures – exemptions, deductions, and credits – connected to fuel use which function to lower the after tax cost of using fossil fuels in certain circumstances. It would be useful to address this kind of issue before seriously considering the imposition of carbon taxes on top of such possible contradictory underlying provisions. Further work along the lines sketched below might be warranted.**

**There might be several policy goals that could be served by the identification and possible elimination of such fuel tax subsidies. One is that special tax treatment that may encourage the use of fossil fuels is contrary to the goals of reducing fossil fuel use and emissions connected to climate change and of encouraging renewables. Another is that volatile fuel prices may not provide useful guides to long term conservation and efficiency in fuel or heating for Vermonters. And a third is that by exempting fossil fuel use from taxation the need to finance state government overall falls on other taxes or taxpayers. There is also the burden of financing programs to mitigate the adverse effects of fossil fuels.**

---

## REVIEW TAX EXPENDITURES & OTHER RELEVANT PROVISIONS

**It would be useful to go through the current tax expenditures and other provisions for ways in which the Vermont Tax Code may actually subsidize the use of fossil fuels through tax exemptions, deductions, and credits. There may also be definitions and provisions in the Federal tax code that pass through to Vermont corporate income tax that have a supportive effect. Such provisions may be at cross purposes with other policy goals, and the prevailing price signals may fail to motivate internalization of the negative costs of fossil fuel use.**

**For instance, from the 2017 Biennial Tax Expenditure Report:**

**Fuels for Railroads & Off Road Uses (Boats)** **$4,080,000**
**Exemption from sales tax – not using transportation infrastructure**

**Energy Purchases for Residences** **$48,510,000**
**Exemption from sales tax – to avoid increasing Vermonters' heating costs – covers all homes whether primary or secondary**

**Energy Purchases for Farmers** **$3,180,000**
**Exemption from sales tax to promote agriculture**

**Diesel Fuel Tax, TIB Diesel Fuel Tax, License Fee FY18 $456,000**
**Exempted: Agriculture, Off Road vehicles, Farm Trucks --- not using the roads as much as other vehicles -- and state and municipal, nonprofit transit agencies.**

**Deductibility of fossil fuel energy costs from taxable business income for the Vermont Corporate Income Tax – these provisions may be passed through from the federal code. This would apply to all kinds of companies: if they are including their fossil fuel costs in the overall deductions that are used to reduce the taxable corporate income, that is a tax provision that in effect makes fossil fuel use cost less than it might if the cost of externalities like emissions were incorporated. What about purchases of business vehicles**

**that are not fuel efficient? Can Investment Tax Credits be obtained for purchasing machinery or engines that use fossil fuels? Accelerated depreciation? Do these provisions lower VT corporate tax liabilities? I have no information as to the possible dollar value of such subsidies.**

## POSSIBLE POLICY ALIGNMENT ACTIONS?

**Each of these tax provisions should be evaluated in terms of the original policy goals and whether the incentives provided do or do not conflict with other important policy goals. No action may be needed. Possible policy actions to consider in terms of correcting contradictions of policy goals might include the following, although it should be noted that each of these could also be done in part. And it would be advisable to defer implementation of such tax changes for several years, so that Vermonters have time to adjust their behavior and their patterns of investment in heating and vehicles. The goal of these changes would be to reduce the use of fossil fuels by eliminating certain cost subsidies. Extra revenue collected and how it might be used is a separate question.**

**( 1 ) End sales tax exemptions for Railroads and Off Road Uses – these are still polluting even if not using the roads.**

**( 2 ) Impose sales tax on all uses of fossil fuels in production processes whether manufacturing or agricultural? This could be done on some kind of delayed basis so that producers would have time to adjust? Retain exemption from sales tax for renewable energy uses?**

**( 3 ) Impose sales tax on residential fuels? This makes sense in that a slight increase in cost might provide an incentive to reduce use. But this may be problematic since there would have to be a way to return subsidies to low income or even middle income Vermonters with a portion of the tax revenues so as not to impose undue hardship.**

**( 4 ) Impose a Countercyclical Fuel Price Stabilization Tax to even out consumer costs to offset boom and bust price cycles? The idea would be to have a tax that will rise when gasoline prices or heating oil prices are low and fall to zero when they are high. This would moderate the fluctuations in energy prices that tend to contribute to consumer behavior that may be efficient in the short run but not in the long run. When fuel prices are low, people buy big inefficient vehicles and stop investing in renewables or weatherization. When fuel prices then go back up, people are caught flat footed with the wrong vehicles and heating systems. This might be an alternative to #3 above in that when prices go up the tax would vanish, so that it would not be imposing an added burden to Vermonters trying to stay warm or needing to drive to work. Additional revenue collected could be dedicated to investments weatherization, renewable energy, or electric cars.**

**( 4 ) End the exemption from the diesel taxes for all uses except state and municipal and nonprofit transit. The private uses are still polluting, even if they are not always using town or state roads.**

## ADDED REVENUES?

**Any additional revenue that could be identified as arising from any such changes as those listed above could be dedicated to funding investments in renewable energy or weatherization, and to encouraging investments in more efficient vehicles through grants or subsidies. Alternatively, some of it could be dedicated to lowering the sales tax or the property tax as appropriate.**

**But the main aim would be to eliminate the way in which as it stands now, uncollected tax revenue subsidizes the use of fossil fuels, so that in addition to the extra pollution that may stem from greater use**

**of such fuels due to the lower cost, other taxpayers in effect need to pay more in taxes to generate any particular amount of revenue. The intent is that this would mean reduced fossil fuel use.**

**As noted above, one way to approach the removal of favorable treatment for fossil fuel use would be to provide ample warning that the provisions would sunset at some point in the future. If there were several years' warning, this would give time for Vermonters to reduce their use of fossil fuels and actually avoid paying as much more in taxes as would otherwise be the case.**

---

**[ CLEAN WATER CONNECTION?**

**It should be noted that the exemption of the sales tax and the deduction from corporate income tax issues might also come into play from the perspective of tax subsidies for the use of agricultural chemical fertilizers, pesticides, and herbicides, and the for the use of toxic chemicals in manufacturing processes that can affect surface water quality and ground water quality. Why should Vermonters subsidize the use of materials that contribute to water pollution?]**