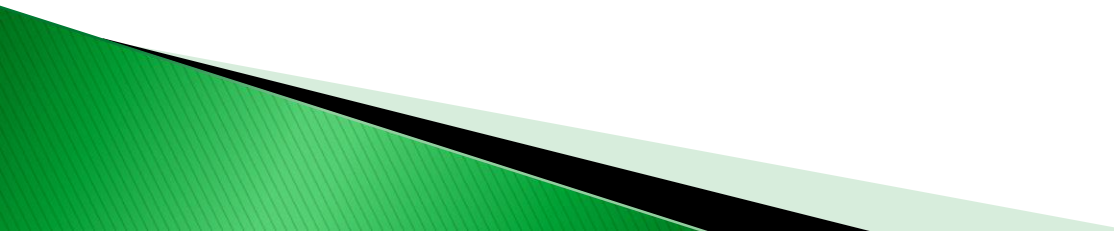


Capital Gains 40% Percentage Exclusion

Graham Campbell
Joint Fiscal Office
February 27, 2018

Background–Capital Gains

- ▶ Defined as the profits resulting from the sale of a capital asset
 - Stocks, bonds
 - Business or real estate
 - Works of art or collectibles
 - ▶ Classified as long or short term
 - Long term= asset held for one year or longer
 - ▶ Subject to personal income tax rates in Vermont because they are a part of Adjusted Gross Income
 - ▶ Also applies to estates and trusts
- 

CG Exclusion: What is it?

- ▶ Vermont-specific deduction, acts as a subtraction from VT Taxable Income (VTI)
- ▶ Taxpayers have two options
 - Flat exclusion of \$5,000 on total capital gains, short or long-term
 - Exclusion equal to 40% of capital gains from the sale of assets held for more than 3 years.
 - Limited to sales of primarily businesses, farms, investment properties
- ▶ Amount cannot exceed 40% of more of FTI

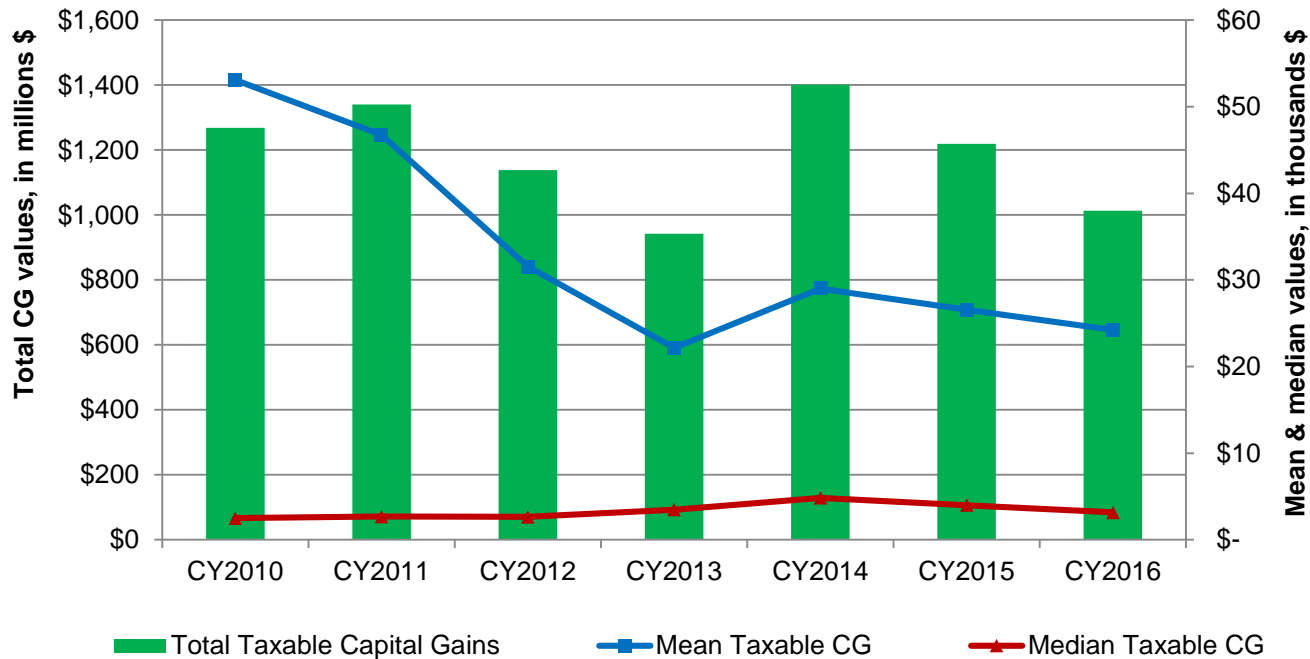
Quick Facts

- ▶ CY2016:
 - 41,865 taxpayers claimed the exclusion
 - \$303.5 million in capital gains excluded
 - Roughly \$15 million tax expenditure, although fluctuates depending on the year

Quick Facts

Capital gains tend to fluctuate from year to year but are always heavily skewed towards large capital gains

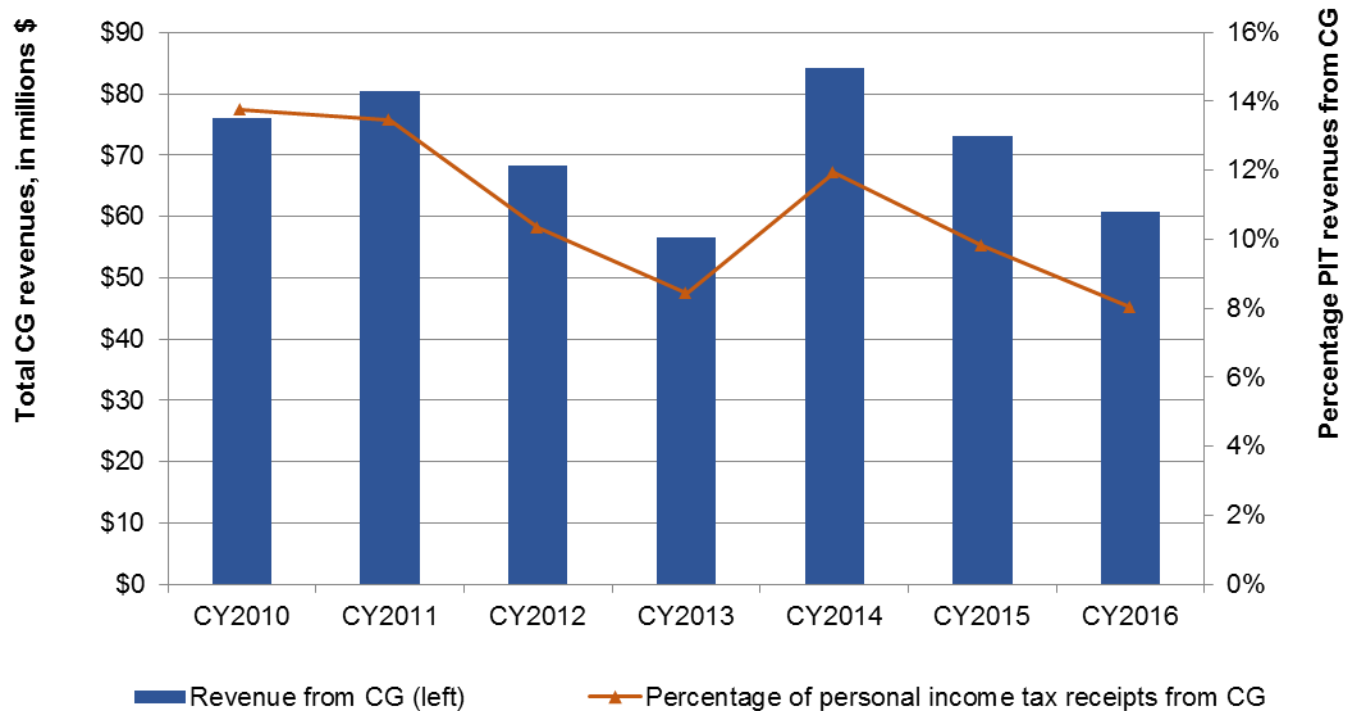
Figure 1: Total, mean, and median taxable capital gains in Vermont



Quick Facts

Capital gains represent between 8–14% of Personal Income Tax revenues

Figure 2: Estimated personal income tax revenues from capital gains



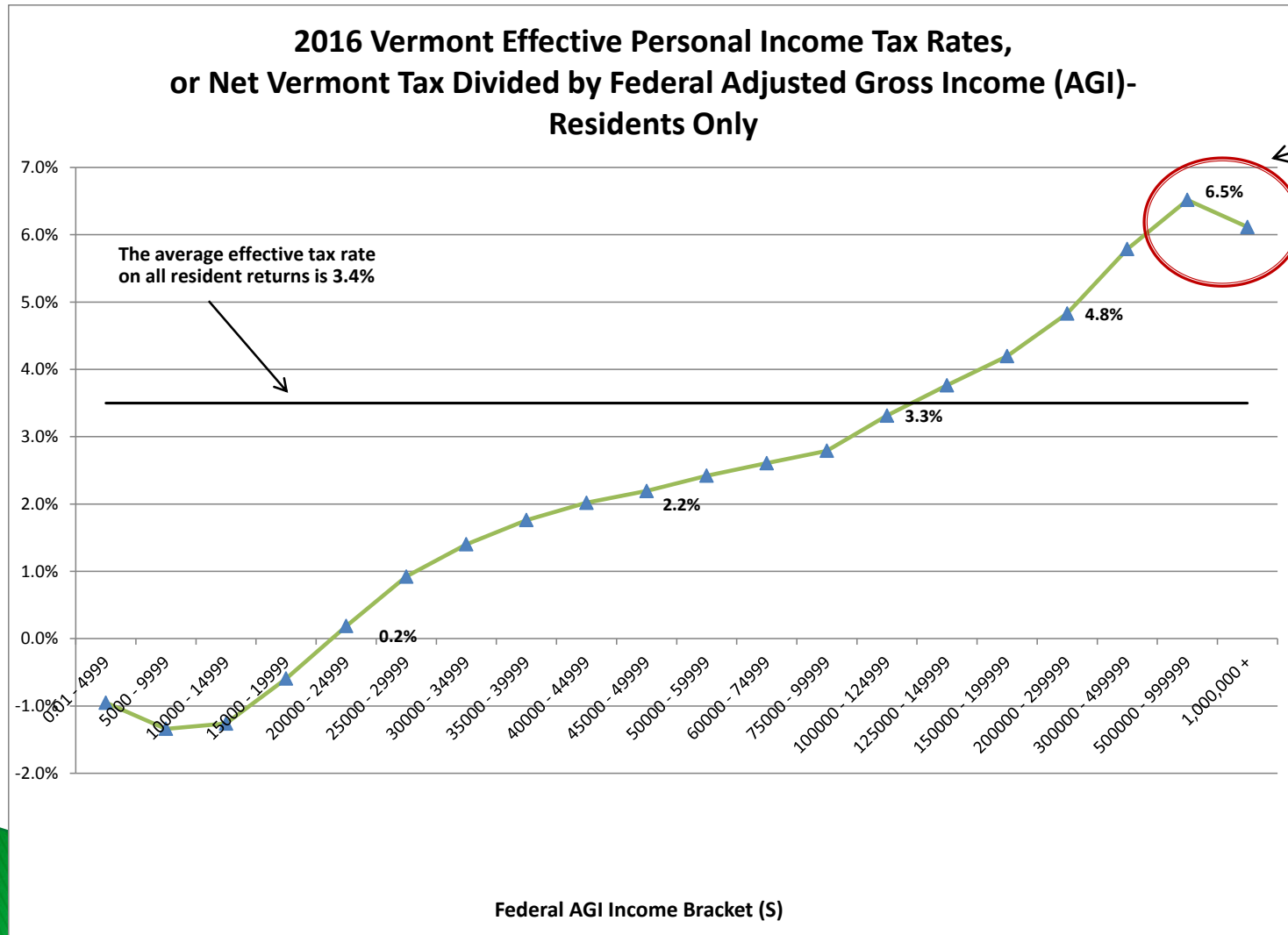
Percentage vs \$5,000 Exclusion

95% of exclusion-takers use the \$5,000 exclusion. The remaining 5% use the 40% exclusion

Table 4: Capital Gains Exclusions by Type and Income Group in CY2016

AGI Group	40% Exclusion			\$5,000 Exclusion		
	Returns Taking	Total Amount Excluded Under 40% Exclusion	Under 40% Exclusion	Returns Taking \$5,000 Exclusion	Excluded Under \$5,000 Exclusion	Average Exclusion Under \$5,000 Exclusion
Less than \$40,000	66	\$455,957	\$6,908	8170	\$12,643,410	\$1,548
\$40,000 to \$60,000	157	\$1,452,702	\$9,253	5164	\$11,653,538	\$2,257
\$60,000 to \$100,000	416	\$4,982,877	\$11,978	9068	\$23,156,155	\$2,554
\$100,000 to \$300,000	1040	\$25,380,023	\$24,404	13555	\$41,626,873	\$3,071
\$300,000 and above	552	\$167,000,704	\$302,538	3677	\$15,148,236	\$4,120
Total	2231	\$199,272,263	\$89,320	39,634	\$104,228,212	\$2,630

Impact on Vermont's progressivity



40% capital gains exclusion

Who takes the 40% Exclusion?

- Is it people who have one-time, large sales of capital assets like farms or businesses?
 - In CY2016, 2,231 taxpayers took the 40% exclusion
 - 1,110 of them claimed it in at least one other year between CY2012 and CY2015
 - 470 claimed it 3 or more times
- Is it farmers selling off their assets?
 - Less than 200 of the 2,231 taxpayers who took 40% reported any farm income
 - Less than \$8 million in capital gains exclusions, out of the total \$199 million excluded under the 40% exclusion

Who takes the 40% Exclusion?

- Is it people who are selling an asset for use as a next egg?

Table 5: Age Distribution of Filers Who Took the 40% Exclusion: CY2016

Age Group	Number of Returns	Average Capital Gains Exclusion	Total Taxable Capital Gains Excluded
< 18	Less than 10
18-35	86	\$122,100	\$10,500,614
35-45	166	\$77,623	\$12,885,453
45-55	361	\$127,412	\$45,995,694
55-65	612	\$76,330	\$46,713,719
65+	999	\$80,880	\$80,798,722
Unreported	Less than 10
Total	2,231	\$89,320	\$199,272,263

Percentage Exclusion: Other States

40% exclusion is tax-advantageous for high-income filers compared to other states

Table 9: Marginal Capital Gains Taxes of New England States

		Vermont				Massachusetts	New Hampshire	Maine	Connecticut	Rhode Island	New York
		40% Exclusion		\$5000 Flat Exclusion		5.2% tax rate on capital gains	0% tax rate all income except dividends and interest	Individual income tax rates on capital gains	Individual income tax rates on capital gains	Individual income tax rates on capital gains	Individual income tax rates on capital gains
Adjusted Gross Income	Long-Term Capital Gains <small>(based on observed data)</small>	40% Exclusion	Marginal Tax on Capital Gains	\$5000 Exclusion	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains
\$40,000	\$2,000	N/A	\$0	\$2,000	\$0	\$104	\$0	\$116	\$60	\$75	\$90
\$60,000	\$3,500	N/A	\$0	\$3,500	\$0	\$182	\$0	\$236	\$175	\$131	\$207
\$100,000	\$5,600	N/A	\$40	\$5,000	\$40	\$291	\$0	\$400	\$280	\$266	\$361
\$300,000	\$15,000	\$6,000	\$788	\$5,000	\$875	\$780	\$0	\$1,073	\$900	\$899	\$998
\$500,000	\$65,000	\$26,000	\$3,413	\$5,000	\$5,250	\$3,380	\$0	\$4,648	\$4,225	\$3,894	\$4,453
\$1,000,000	\$150,000	\$60,000	\$7,875	\$5,000	\$12,688	\$7,800	\$0	\$10,725	\$10,350	\$8,985	\$10,275
\$2,000,000	\$300,000	\$120,000	\$15,750	\$5,000	\$25,813	\$15,600	\$0	\$21,450	\$20,970	\$17,970	\$20,550

Note: The higher income examples assume various levels of itemized deductions

Other state income tax rates do not include local income taxes

What do other states do?

State	Tax Treatment of Capital Gains
Vermont	Capital gains exclusion: \$5,000 of long-term capital gains or 40% of capital gain from sale of business, farm, or investment property.
Arizona	25% deduction of capital gains from taxable income
Arkansas	50% exclusion of net capital gains from taxable income
Hawaii	Capital gains taxed at lower rates than ordinary income
Montana	Credit equal to up to 2% of net capital gains
New Mexico	50% exclusion of net capital gains from taxable income
North Dakota	40% exclusion of net capital gains from taxable income
South Carolina	44% exclusion of net capital gains from taxable income
Wisconsin	30% exclusion of net capital gains from taxable income, 60% exclusion for farm assets

- ▶ Most do not have special tax treatment for capital gains
- ▶ Some have exclusions related to sales of in-state assets (Colorado, Louisiana, Oklahoma, Idaho)

Proposal: Lower the 40% Exclusion to 20%

Revenue Impacts of Changing Percentage Exclusion to 20% from 40% (Based upon 2016 Tax Year Data)						
Income Group (AGI)		Number of Returns Impacted	Percent of Total Returns	Total Tax Raised (millions)	Average Tax Increase	Overall Change in Effective Tax Rates
-infinity	\$35,000	2,056	1.24%	\$0.06	\$31	0.00%
\$35,000	\$40,000	249	1.33%	\$0.01	\$33	0.00%
\$40,000	\$45,000	169	1.01%	\$0.01	\$51	0.00%
\$45,000	\$50,000	126	0.87%	\$0.00	\$37	0.00%
\$50,000	\$60,000	133	0.54%	\$0.01	\$78	0.00%
\$60,000	\$75,000	156	0.54%	\$0.03	\$195	0.00%
\$75,000	\$100,000	256	0.71%	\$0.06	\$257	0.00%
\$100,000	\$125,000	235	0.94%	\$0.09	\$417	0.00%
\$125,000	\$150,000	201	1.33%	\$0.09	\$491	0.01%
\$150,000	\$200,000	272	1.80%	\$0.14	\$554	0.01%
\$200,000	\$300,000	355	3.37%	\$0.37	\$1,112	0.02%
\$300,000	\$500,000	282	4.99%	\$0.50	\$1,882	0.04%
\$500,000	\$1,000,000	173	5.48%	\$0.57	\$3,454	0.06%
\$1,000,000	Infinity	184	6.93%	\$3.09	\$17,684	0.09%
Totals		4,847	1.27%	\$5.05	\$1,097	0.02%

Note: Overall revenue impacts include 5% model adjustment

Based on a low year for capital gains.