

Estate Tax Reform

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Overview

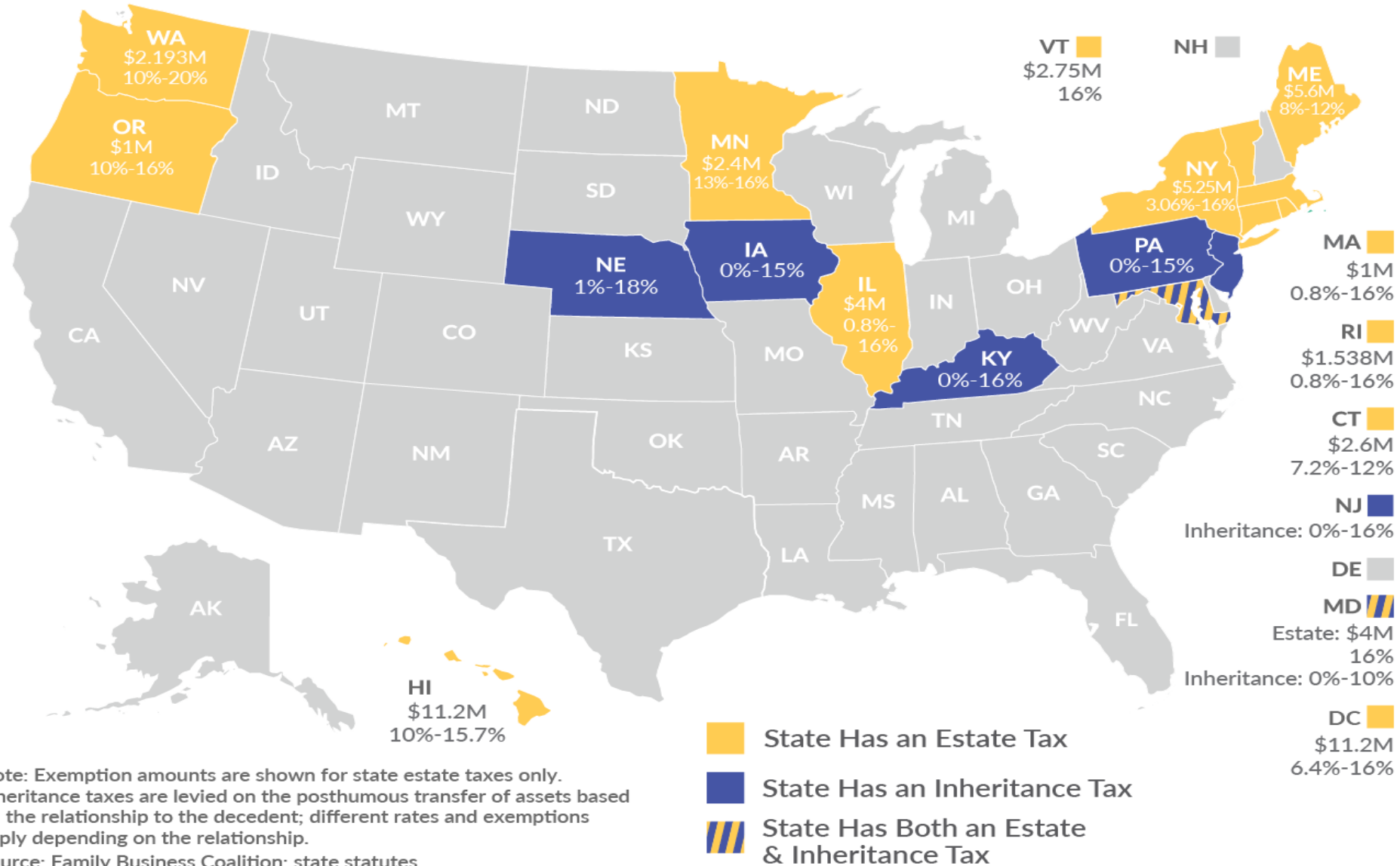
- Source of Data: Institute on Taxation and Economic Policy
 - “ITEP is a non-profit, non-partisan tax policy organization”
- History of federal estate tax
- Tax progressivity in Vermont and throughout the United States
- Income distribution in Vermont and throughout the United States
- Economic/tax impact of high income Vermonters

History of Estate Tax

- In 1916 the federal government introduced the Estate Tax, to “break up the swollen fortunes of the rich,” every state enacted a similar tax of its own.
- Between 1926 and 2001, the federal estate tax allowed a dollar-for-dollar tax credit against the estate taxes levied by states, effectively making state estate taxes a transfer of liability from federal tax to state tax.
- Key Point: Until 2001, all states had an estate tax and there was essentially no inter-state competition issue, since an estate’s total tax liability was the same, any amount not taxed at the state level was picked up at the federal level.
- Federal estate tax reform in 2001 shattered this model, and states rapidly backed away from the estate tax
- Prior to 2001-50 states had an estate tax
- By 2012:16 states had an estate tax
- By 2014:15 states had an estate tax
- In 2018: 12 states + D.C. have an estate tax

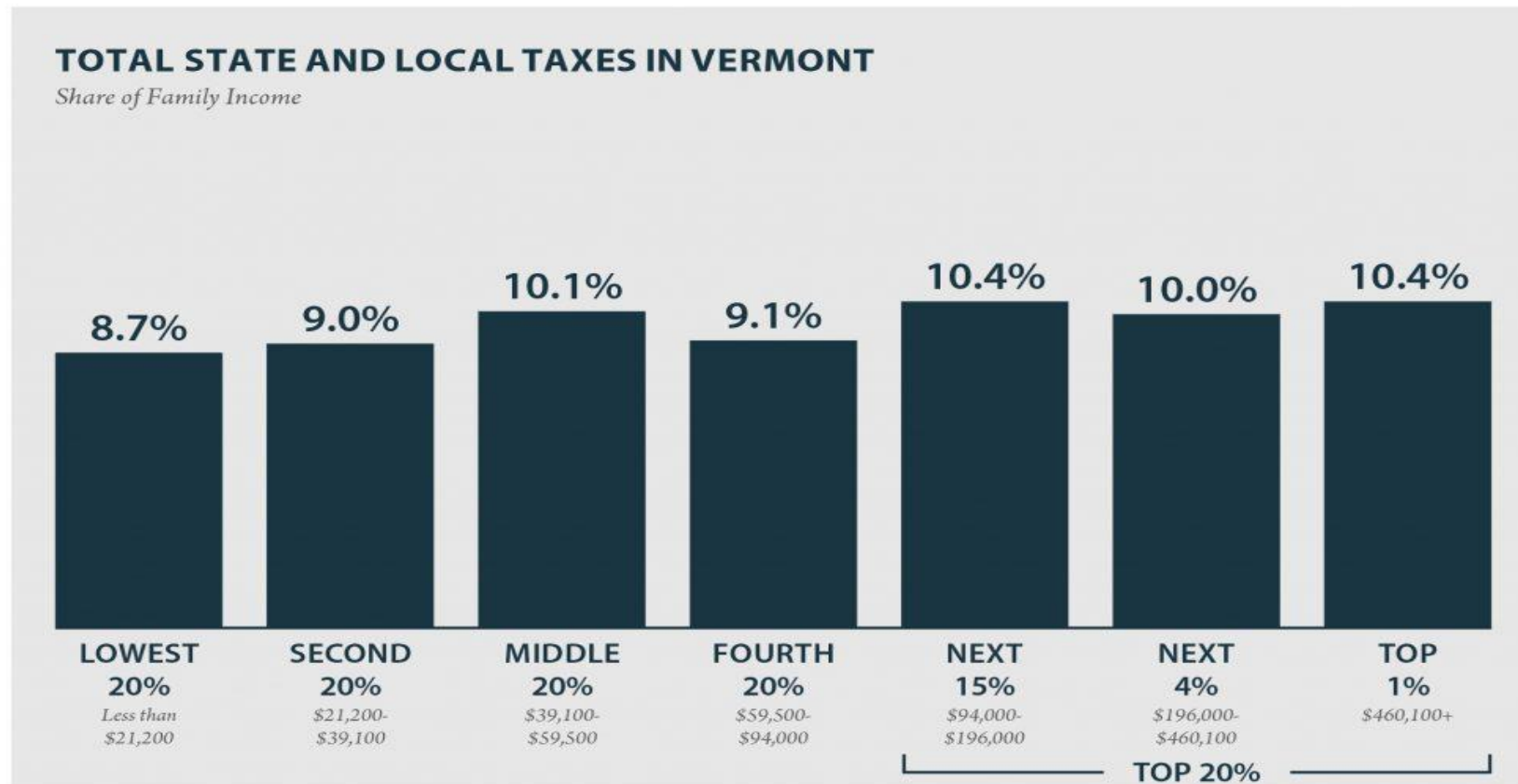
Does Your State Have An Estate or Inheritance Tax?

State Estate & Inheritance Tax Rates & Exemptions in 2018



Tax Progressivity in Vermont

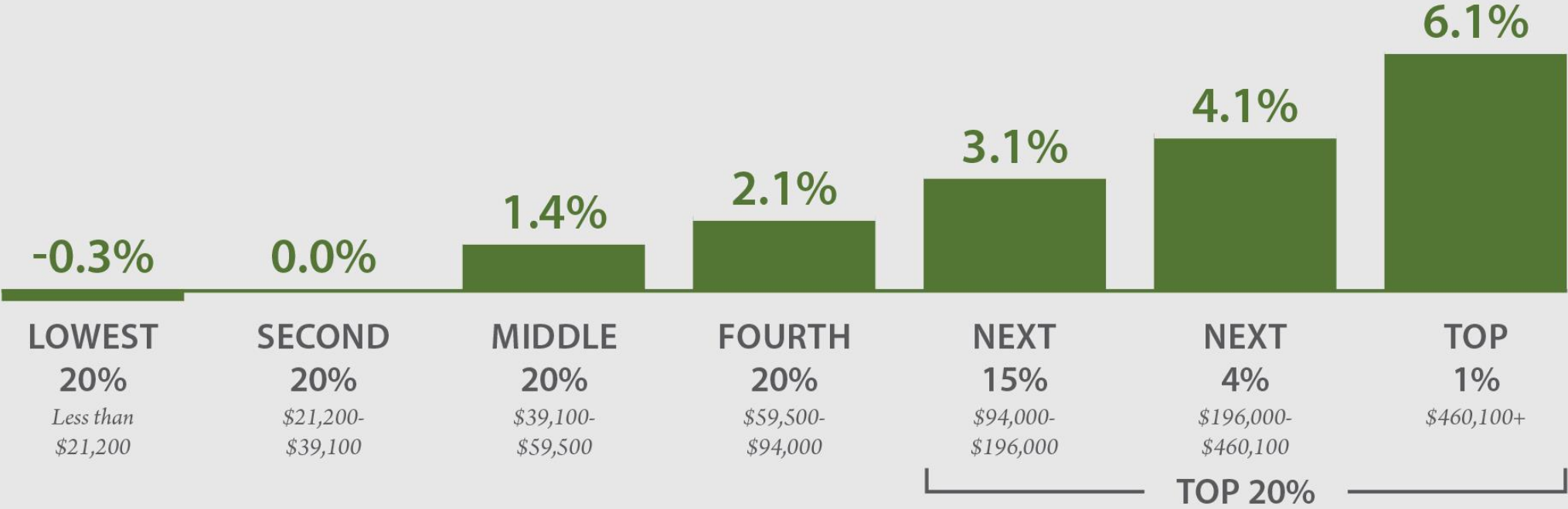
- ▶ Vermont ranks as the second most progressive tax state in the country: According to ITEP's Tax Inequality Index, Vermont's state and local tax system ranks 49th on the index (2nd best state). Vermont is one of only 6 states in the US with a positive score on ITEP's Tax Inequality Index, where the large income gap between lower- and middle-income taxpayers, as compared to the wealthy, is made narrower after state and local taxes.





PERSONAL INCOME TAX IN VERMONT

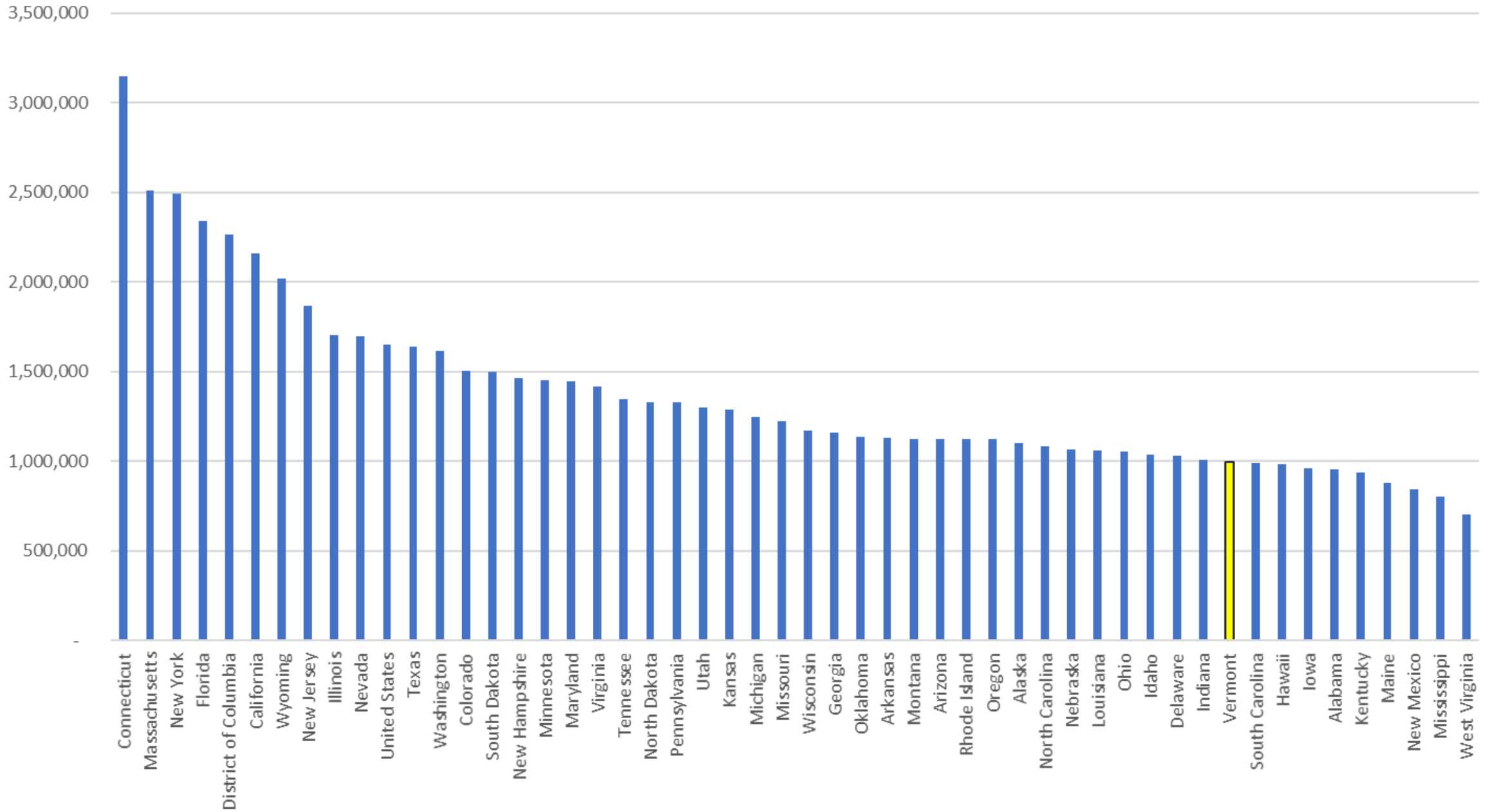
Share of Family Income



Progressivity and Revenue

- ▶ Our tax structure is very progressive, what is the impact on revenue?
- ▶ Do we collect more from our high income population than other states?
- ▶ How does Vermont compare with other states in terms of our distribution of earners? Do we have a lot of high income people?

Top 1% Avg. Income (source: ITEP, Oct. 2018)



Tax Competitiveness

- ▶ TCJA delivered a serious blow to many states, including Vermont, on tax competitiveness
- ▶ Because of the \$10,000 deduction cap on state and local taxes (SALT) in the TCJA, every state tax dollar over \$10,000 actually costs Vermonters 25-35% more.
 - ▶ A “top 1%’er” in VT paid on average over \$50k in annual VT personal income tax
 - ▶ Prior to TCJA, that \$50k was an itemized deduction on their federal return, reducing their federal tax by at least \$15k (30% X \$50k).
 - ▶ Their actual, after tax cost of Vermont’s income tax was $\$50k - \$15k = \underline{\$35K}$
 - ▶ Today, their actual cost is $\$50k - \$3k$ (30% x \$10K cap): \$47K
 - ▶ With no other changes in law, and no changes in what they paid to Vermont, their VT income taxes essentially went up by 34%
- ▶ The effect above is real, not hypothetical, and puts VT and other high tax states at an additional and significant disadvantage to low or zero income tax states.

High Income Migration

- ▶ I requested the following query of the most recent complete tax year (2017)
 - ▶ Taxpayer is over 60, filing a non-resident return
 - ▶ Taxpayer has over \$200k in AGI
 - ▶ Taxpayer used to file as a Vermont resident (10 year look-back)
- ▶ 422 former Vermonters changed their tax domicile
 - ▶ 200/422 are now in estate and income tax free states. Top two destinations are Florida (136), and New Hampshire (45)
 - ▶ Because they still have VT apportioned income, I presume some tangible connection to the state, and therefore moving was not a slam-dunk decision
 - ▶ Note: This sample is just a portion of the total population that could be potentially influenced.

Estate Tax Payers, What do we know

- ▶ Annual median AGI prior to passing: \$216k (\$327k avg AGI)
- ▶ Average PIT contribution is approx. \$1M/yr total (prior to passing)
- ▶ Median taxable estate in VT: \$4.36M
- ▶ Average taxable estate in VT: \$8.11M
- ▶ Larger estates are associated with higher income. For every \$1M increase in estate size you would expect an additional \$20,700 in annual AGI
- ▶ On average (using 5 year period), we lose approximately 250 Vermont taxpayers with AGI > \$300K. On average, 28% of them are over 65, meaning approximately 70 very high income retirees leave the state annually.

Total Tax Impact - typical estate tax payer/high income Vermonter

| Vermont Tax Type | Average Contribution Per Year | Source |
|---------------------------------|-------------------------------|------------------------|
| Personal Income Tax | 20,753 | Tax Return Data |
| Corporate Income Tax (Indirect) | 359 | ITEP share of income |
| Sales and Excise Taxes | 4,668 | ITEP share of income |
| Meals and Rooms Taxes | 664 | Based on ACCD analysis |
| Property Taxes | 13,286 | ITEP share of income |
| Total | 39,729 | |

Cost of increasing exemption to \$5.75M?

- Updated policy change cost using 7 (not 1) years of data (shared with JFO 2/13/19):

| Revenue Impacts by Fiscal Year (Millions) | | | | |
|--|--------------------|----------|--------|--------|
| Fiscal Year | Forecasted Revenue | Loss PCT | Impact | |
| FY2020 | 20.9 | -4% | \$ | (0.8) |
| FY2021 | 21.8 | -24% | \$ | (5.3) |
| FY2022 | 22.7 | -34% | \$ | (7.6) |
| FY2023 | 23.5 | -40% | \$ | (9.3) |
| FY2024 | 24.3 | -41% | \$ | (10.0) |
| Forecasted Revenue Amounts are from Conensus Forecasts | | | | |
| Loss Percentages are based on effective dates of exclusion, with assumed nine month filing lag | | | | |

Why do this?

To best leverage our progressive tax structure, we need to do a better job retaining our high income taxpayers, and the associated positive tax and economic impact they provide.

- ▶ Given all the forces at play (TCJA, our robust progressivity, and the changing estate tax competitive environment), Vermont is increasingly standing out as hostile to high income and high wealth taxpayers. We need to take tax migration seriously to protect Vermont revenues. This policy is an important step.
- ▶ If the average VT tax impact of a typical taxpayer who might be influenced by an estate tax policy change is \$40k/year,
- ▶ and the average tax motivated emigrant moves 15 years prior to death,
- ▶ How many people's behavior would need to change for PIT and other taxes to offset the potential estate tax revenue loss?
- ▶ If we can sustain 250 additional high income taxpayers over current trends, their total tax impact would roughly equal the projected estate tax revenue loss,
- ▶ This means retaining approximately 17 high income taxpayers annually.