VERMONT

2021 Tax Expenditure Reviews

As part of the:

2021 Biennial Tax Expenditure Report

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Legislative Joint Fiscal Office
Vermont Department of Taxes

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2021 Vermont Tax Expenditure Reviews

Introduction

The 2021 Vermont Tax Expenditure Report is a continuing effort to catalogue all exemptions, exclusions, deductions, credits, preferential rates or deferral of liability as defined in 32 V.S.A. § 312 (a) applicable to the state's major tax sources and provide an estimate of the fiscal effect for each. Tax expenditure reporting is now in its fourteenth year in Vermont and is improved to reflect more recent research and recommended best practices.[1]

As part of the 2021 Tax Expenditure Report, the Joint Fiscal Office, with assistance from the Vermont Department of Taxes, have completed reviews of certain tax expenditures as required by Sec. 40 of Act 134 of 2016. These reviews were classified as "expedited" and "full".

An expedited review analyzes the purpose of a tax expenditure, delineates its cost and benefits, and considers whether it meets its policy goal.

A full review includes the elements of an expedited review but also includes a quantitative analysis of the economic impact of the tax expenditure, consideration of the direct and indirect economic and social benefits of the tax expenditure, and a comparison of the effectiveness of the tax expenditure with alternate policies.

Act 134 of 2016 tasked the Joint Fiscal Office with developing recommendations for the standards and processes to conduct full reviews of tax expenditures.[2] One of the recommendations of the report was for the Joint Fiscal Office to conduct ad-hoc full reviews of one to three tax expenditures per year. The full review of the Capital Gains Exclusion within this report represents the first full review undertaken using this approach.

The same act also established a schedule for the expedited and full reviews. For the 2021 Tax Expenditure Report, tax expenditures related to enhancing community development, including housing and historic revitalization were reviewed. The 2023 report will include reviews of tax expenditures related to promoting income security and encouraging work, as well exempting the necessities of life, and implementing State tax policy and other priorities. This report includes a review of the Clothing and Footwear sales tax exemption which was slated for 2023, but was completed this cycle to allow staff to review other several significant tax expenditures in 2023.

The Joint Fiscal Office completed these reviews with data assistance and legal analyses as needed from the Tax Department.

[1] NCSL Tax Expenditure Budgets and Reports: Best Practices http://www.ncsl.org/documents/task_forces/Tax_Expenditure_Report.pdf

[2] "2016 Act No. 134 Sec. 40. Evaluation of Tax Expenditures." Prepared by the Joint Fiscal Office. 14 January 2017. https://ljfo.vermont.gov/assets/docs/reports/d58aecb7c7/2017-Evaluation-of-Tax-Expenditures.pdf

TAX EXPENDITURE
FULL REVIEWS

Downtown and Village Center Tax Credit Program
Full Review[3]

Executive Summary

The Downtown and Village Center tax credit program provides tax credits to assist individuals and developers rehabilitate and modernize older and historic buildings in Vermont's designated downtowns and village centers.[4] The program is made up of three separate credits (Code Improvement, Façade Improvement, and Historic Rehabilitation), claimable either on the individual's personal income tax or sold to banks and insurance companies who can claim it against their Bank Franchise Tax or Insurance Premiums Tax liabilities. In FY 2020, these credits resulted in $1.72 million in foregone State tax revenue, most which was taken against the Bank Franchise Tax.

Since its creation in 1999, the Downtown and Village Center tax credit program has awarded approximately $29.5 million worth of tax credits.[5] A statutory cap limits the amount of credits issued each year. In the past 20 years, the legislature gradually increased the cap from $300,000 to $3 million today to respond to demand.

JFO conducted a full review of these credits as part of the 2021 Tax Expenditure Report and made the following major findings:

1) Operationally, the Downtown and Village Center tax credit program appears to be achieving its statutory purpose of simply and effectively channeling public funds into projects that improve and revitalize Vermont's historic centers with the greatest economic development needs.

- The program, particularly in more recent years, targets a diverse set of projects that are "shovel ready" and are more likely to have a wider potential economic impact in their communities, such as housing, mixed-use, and commercial projects.
- Of the roughly $28 million in credits awarded since 2005, $18.3 million, or 65%, has been awarded to projects in municipalities located in counties with below-average GDP growth. According to data from personal income tax claimants, the credits also do not disproportionately benefit high-income taxpayers and developers, although those credits sold to banks could potentially provide more to benefit high-income taxpayers indirectly.
- Compared to other economic development programs in the State, the simplicity and flexibility of the program allows program recipients to quickly and easily obtain cash for projects.

While not a part of the statutory purpose, JFO also analyzed whether the program was generating economic and fiscal impacts for the state. In these areas, JFO made the following conclusions:

2) While the economic benefits of the Downtown and Village Center tax credits are likely positive in aggregate, they vary significantly based on the unique circumstances of the project and could be offset by the cost of the credits.

- Based upon an analysis of property values of unfunded applications from 2016 and 2017, it appears as though many projects moved forward without State tax credits. Almost one-third of the unfunded properties saw property value growth of 25% or more, indicating some improvements and subsequent economic impacts do occur without tax credits.

[3] JFO would like to thank Chris Cochran and Caitlin Corkins from the Department of Housing and Community Development for all their assistance on this review.

[4] As of December 2020, there are 23 designated downtowns and over 208 designated village centers.

[5] Although the program was created in 1999, the current version of the program was codified in statute in 2005, and earlier statutes were repealed. This review covers the time period of 2005 to the present.

- The program helps finance many smaller projects where the tax credit is a significant portion of the funding stack (greater than 35% of the project's total cost). Based upon an analysis of grand list growth for these smaller projects from 2012 through 2019, property value growth was negligible. While property value growth is not a complete measure of economic impacts, the limited grand list growth for the building itself is suggestive of limited widespread economic impact elsewhere.
- The tax credits regularly help finance large, community-impactful developments (greater than $2 million in project size) that, based upon grand list analyses, generate greater property value growth and potential economic impact. However, these projects only rely on the credits for a very small portion (often less than 10%) of their total cost, which raises questions about whether the project could have occurred without them.
- The program does drive development to downtown, denser areas, which leads other positive benefits such as increased community vitality, lower transportation costs for residents, greater access to housing, and environmental benefits.

3) Based upon an analysis of property value growth, the Downtown and Village Center Tax Credit program is unlikely to be generating a positive fiscal return on investment for the State, at least in the near and medium term.

- Based upon analysis from the 2016 and 2017 award years, projects funded by the tax credits do appear to generate modestly higher grand list growth than their unfunded peers, but the tax benefit is not enough to justify the expense: the annual property tax benefit resulting from the $4.6 million spent in tax credits during this period is approximately $100,000 per year.
- Awardees from 2014 through 2017 experienced an increase in value of $27.4 million from 2012 through 2019, generating about $400,000 in new education property tax per year. Based on this sample, this means it will take over 20 years (even before adjusting for inflation) to recoup the State's $8.9 million in credits and sales tax allocations issued over that time period.
- This analysis does not quantify additional fiscal returns from other tax streams, although it seems implausible that their inclusion would make the fiscal return positive in the medium term. It is also possible that absent credits, buildings would fall into disrepair and the associated revenue streams would decline over time, though JFO did not confirm the extent to which this is true of the properties that received the credits.

JFO highlighted three minor areas for legislators to consider should they decide to alter the program.

- Clarifying the statutory purpose to include measurable goals.
- If a State short-term fiscal return is a goal of the tax credits, legislators could consider ways to improve the return on investment. Possible solutions could include:
    - Requiring projects to be reappraised upon completion. Many of the projects that receive Code Improvement tax credits feature upgrades to systems that, while beneficial to the health and safety of occupants and undoubtedly improving the building, do not trigger a reappraisal by the town.
    - Limiting the eligibility of the credits for tax-exempt entities. Examples of nonprofits that have used these credits include museums, grange halls, and affordable housing entities. Because these entities are exempt from most taxes, the fiscal return on investment is limited to the indirect benefits of the project. Some states have either limited (Rhode Island) or made nonprofits ineligible (Mississippi) for the credits.
- Review the age requirement for buildings eligible for the credits. The requirement that a building be at least 30 years old does not, with some exceptions, reflect the higher costs of improving a building built 100 years ago versus one from 35 years ago. Related to this, the legislature could also consider the following:
    - Whether more modern buildings built in the 1980s and 1990s reflect the initial intent of the program, or whether it should focus on significantly older buildings.
    - Whether the State should consider providing tax credits to improve other aspects of buildings aside from health and safety, such as energy efficiency.

I. Overview

The Vermont Downtown and Village Center tax credit program, as laid out in 32 V.S.A. § 5930(cc) Subchapter 11J, are tax credits designed to assist owners or lessees of a qualified building with the costs of rehabilitating older and historic buildings around the State.

Unlike the Federal and other states' historic rehabilitation tax credits, Vermont's program stipulates that the credit is only available to restoring or modernizing buildings located in a designated downtown or village center as defined by 24 V.S.A. chapter 76A. In general, Vermont municipalities that have downtown or village center designation from the Downtown Development Board have made financial and policy commitments to promote the health, economic vitality, and livability of their communities. Being designated as a downtown or village center enables a municipality to have access to not only the Downtown and Village Center tax credit program but also resources, loans, and grants from the State's Downtown Transportation Fund, priority consideration for State grants, and Act 250 exemptions for qualifying developments that create affordable housing.

Many projects that qualify for the Downtown and Village Center tax credit program use these credits to supplement the Federal Historic Rehabilitation Tax Credit. That federal credit is equal to 20% of qualifying expenditures incurred towards the rehabilitation of a historic building that is both income-producing and certified as historic by the National Park Service. Qualifying expenditures for this credit are generally those expenses related to the improvement or restoration of building structures including walls, floors, ceiling, electrical and plumbing systems, and elevators. Claimants take the credit against their Federal personal or corporate income tax liability.

The Downtown and Village Center tax credit program consists of three separate credits, all with the purpose of improving and restoring older and historic[6] buildings in designated downtowns and village centers:

- *Code Improvement Tax Credit:* a 50% credit for qualified code improvements with certain maximums depending on the type of code improvement:
  - $12,000 for the installation of a platform lift
  - $60,000 for the installation of a limited use, limited application elevator
  - $75,000 for the installation of an elevator
  - $50,000 for the installation of a sprinkler system
  - $50,000 for the combined cost of all other code improvements
- *Façade Improvement Tax Credit:* a 25% credit for qualified façade improvements- with a maximum credit equal to $25,000. A qualified façade improvement is defined as the rehabilitation of the façade of a qualified building that "contributes to the integrity of the designated downtown or designated village center."
- *Historic Rehabilitation Tax Credit:* a 10% credit for qualified rehabilitation expenses as defined by Internal Revenue Code, 26 U.S.C. § 47(c), which is the Federal statute for the Federal Historic Rehabilitation Tax Credit. The building must either be listed or eligible for listing in the National Register of Historic Places to qualify.

For all three credits, a building is considered qualified if it is greater than 30 years old at the time of application and, like the Federal credit, is income-producing, although some nonprofit buildings are eligible

[6] Note that the Federal Historic Rehabilitation Tax credit requires a building to be on the National Register of Historic Places to qualify. The Downtown and Village Center tax credit program has no such requirement, only that the building be at least 30 years old.

for the credits. Those entities sell the credits to banks for up-front cash rather than claiming against a tax liability. Rehabilitations to personal residences or single-family homes and municipal buildings are not eligible for the credits.

The total amount of credits that can be awarded is limited by statute at $3 million per year, increased in 2020 from $2.6 million.

II. Legislative History

The Downtown and Village Center tax credit program is 20 years old but has seen multiple changes throughout its history. Below is a summary of major legislative changes to the program:

1997, Act 120: Two tax credits for the rehabilitation of historic buildings are created. One credit added an additional 5% tax credit to projects that received the Federal Historic Tax Credit (HTC). A second credit was created for those who did not receive the Federal HTC, which was 25% of qualified expenses up to $100,000. The total annual statutory cap for both credits was $300,000. Only projects in downtowns were eligible to receive the credits.

2005, Act 183: The prior credits from Act 120 of 1997 were repealed and replaced with the current the Downtown and Village Center tax credit program, with the three separate credits. The program was passed into law in 2005 and the first credits were claimed in 2006. This act also created the downtown and village center designation in parallel with the tax credit program. The total annual limit on the credits was set at $1.5 million and was available to buildings built prior to 1983.

2007, Act 81: The annual limit on the tax credits was increased to $1.6 million.

2009, Act 54: The annual limit on the tax credits was increased to $1.7 million.

2011, Act 45: Any recaptured credits are made eligible to the State Board to award in the subsequent year.

2013, Acts 174 and 199: The Code Improvement Credit is expanded to include technological improvements, such as networking and wiring with a separate $30,000 limit. The annual limit on the tax credits was increased to $2.2 million.

2015, Act 57: The Code Improvement Credit is expanded to include limited-use elevators with a $40,000 credit limit. The limit for all other code improvements is increased from $25,000 to $50,000.

2017, Act 69: The annual limit on the tax credits is increased to $2.4 million.

2019, Act 71: The annual limit on the tax credits is increased to $2.6 million. The definition of a qualified building is changed to any building built within 30 years of application, rather than being built prior to 1983. The technological improvements credits passed in 2013 as part of the Code Improvement Credit were repealed.

2020, Act 154: The annual limit on the tax credits is increased to $3 million.

III. Statutory Purpose

The statutory purposes for the three credits that make up the Downtown and Village Center tax credit program can be found in 32 V.S.A. § 5813 (m), (n), and (o) and are largely iterations of the same wording. All include the following main purpose:

"to provide incentives to improve and rehabilitate historic properties in designated downtowns and village centers."

While this is the statutory purpose of the tax credit themselves, 24 V.S.A. § 2790 provides the statutory purpose for historic downtown development and the downtown/village center designation upon which these tax credits rely. This section of statute lists out numerous goals including:

- Supporting downtowns by providing funding, training and resources to increase economic growth and diversity.
- Attractring new and existing residents to downtown by enhancing livability through increased access to jobs, housing, education, and other services.
- Removing barriers for collaboration between local downtown organizations, developers, businesses, nonprofits, and municipal government.
- Encouraging mixed use development in downtowns.
- Building public transportation options in downtowns.
- Minimizing strip development and development in outlying countryside and farmland.

Finally, this section of statute emphasizes the importance of future developments occurring in Vermont's historic downtowns by saying "a large percentage of future growth should occur within duly designated growth centers that have been planned by municipalities in accordance with smart growth principles and Vermont's planning and development goals."[7]

This report will evaluate against the purpose in 32 V.S.A. § 5813 (m), (n), and (o) but will also incorporate the intent listed in 24 V.S.A. § 2790 since the tax credits and the intent of the downtown and village center designation program are connected.

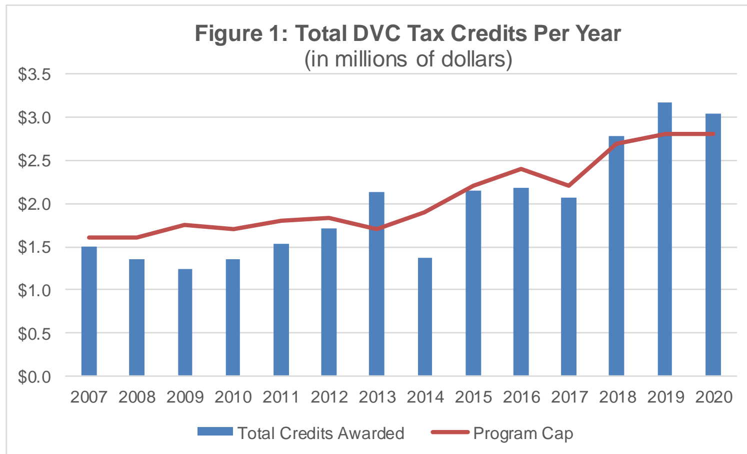
IV. Major Findings

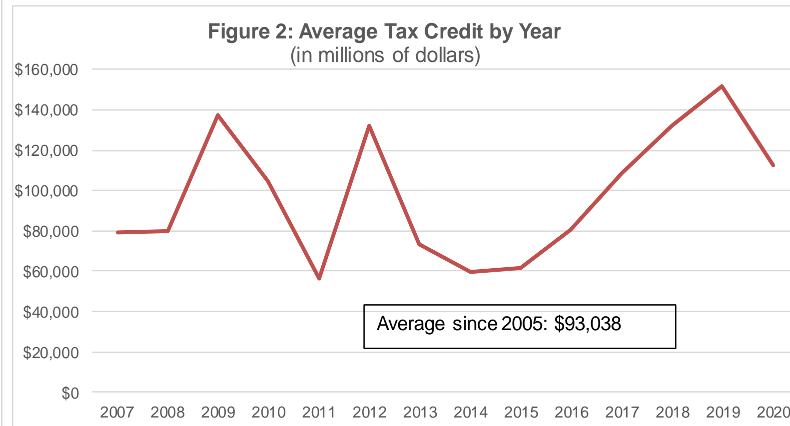
1) Operationally, the Downtown Tax and Village Center tax credit program appears to be achieving its statutory purpose of simply and effectively channeling public funds into projects that improve and revitalize Vermont's historic centers with the greatest economic development needs.

Since its creation in 1999, the Downtown and Village Center tax credit program has awarded over $29 million worth of tax credits. Most of this ($28 million) has been awarded since 2005 when the program was overhauled in statute. However, because some projects are ongoing, only $27.6 million has been paid out (Figure 1). In some years, actual credits awarded can exceed the statutory cap because recaptured credits from uncompleted projects in preceding years can be used. The average tax credit awarded to completed projects was $93,038 in nominal dollars,[8] although this figure changes from year to year. Since bottoming out in 2014 and 2015, the average credit by award year has exceeded its historical average (Figure 2). In

[7] 24 V.S.A. § 2790(d)(1)
[8] Approximately $84,599 in 2020 dollars

general, this up-and-down nature of the average credit mirrors the economic situation in Vermont, particularly in 2010, and the recovery years of 2014 through 2016.





Of the three credits that comprise the program (Code Improvement, Façade Improvement, and Historic Rehabilitation), Code Improvement tax credits account for nearly 60% of all credits awarded, which is unsurprising given it is arguably the most generous of the credits offered (50% of the expenses incurred, with certain limits depending on the improvement). Façade improvements and historic rehabilitations account for 25% and 17% of the remaining credits, respectively (Table 1).

Table 1: Total Credits Awarded by Credit Type, 2005-2020 (in millions of dollars)

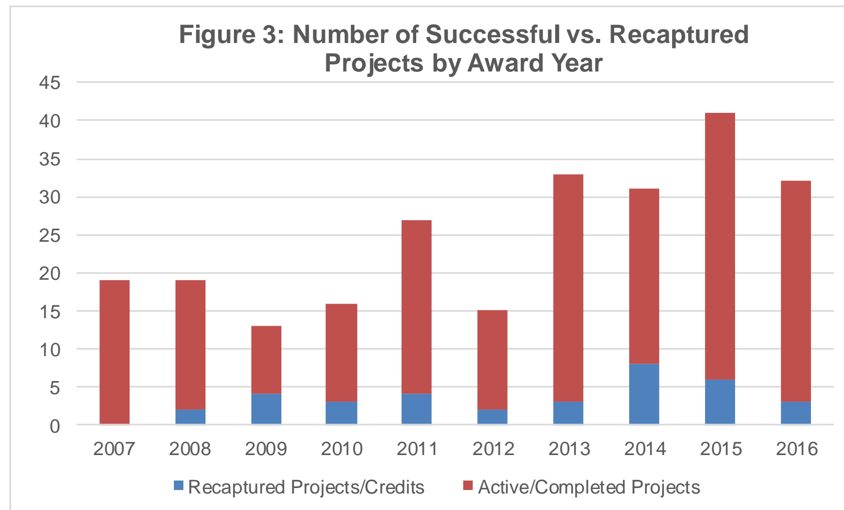
	Total Credits	Share
Code Improvement Credits	**$16.24**	**59%**
of which: Sprinkler systems	$4.70	17%
of which: Lifts	$0.41	1%
of which: Elevators	$2.95	11%
of which: Technology improvements	$0.94	3%
of which: other Code improvements	$7.22	26%
Façade Improvement Credits	**$6.79**	**25%**
Historic Rehabilitation Credits	**$4.58**	**17%**
Total	**$27.61**	

From an operational perspective, the tax credit program plays an important role in helping reach the goals laid out by the Downtown and Village center designation in 24 V.S.A. § 2790 (see statutory purpose section above for details on those goals). The program is also effective in the following ways:

- The program largely targets projects that are "shovel ready" and are more likely to have a wider potential economic impact.
- The tax credits are used to fund a wide variety of projects in downtowns.
- Compared to other economic development programs, the program has been successful in targeting projects in areas of the State with slower economic growth.
- The simplicity and flexibility of the program allows program recipients to quickly and easily obtain cash for projects.

i) The tax credits have been successful at targeting shovel ready projects with a wider potential economic impact on their communities.

Based upon data provided to JFO by the Department of Housing and Community Development, 226 projects have been awarded tax credits or sales tax allocations through this program between 2007 and 2016. Over that time period, 35 projects, or 14% have been subject to recapture because the project was not completed within three (or five)[9] years of the award (Figure 3). In some cases, projects that were not completed in one year reapplied and were completed in future years. By having a narrow recapture window, the program quickly turns around unused dollars to deserving projects.



The program, in general, appears to also award tax credits to projects that show more promise of wider economic growth in their communities. JFO compared the funded and unfunded applications from the FY 2016 and FY 2017 award years. In general, projects that were funded tended to have a wider public benefit than those that were not. For example, projects that were funded in the FY 2016 and FY 2017 award years included:

- The Craftsbury Public House, a historic inn and restaurant, a prominent community-gathering place in a small village center, and one of the few public gathering spaces in a small community.
- The Willey's Store in Greensboro, a neighborhood historic landmark and general store.
- A large renovation of the historic Clement Building in downtown Rutland to provide housing to Castleton University students.

Examples of projects that were not funded included:

- Renovation of the upper floors of a historic building to expand the office of an eye clinic.
- The remodeling of existing downtown spaces in Vergennes and Middlebury for restaurants despite both towns having multiple restaurant options.
- The renovation of a two-room bed and breakfast in Stowe.

By choosing projects with wider potential economic benefits, the Board is better adhering to the intent laid out in 24 V.S.A. § 2790, which speaks about the desire for community revitalization. JFO also spoke to town planners for municipalities that have benefitted from these tax credits and there was universal agreement that the projects chosen were instrumental helping revitalize their downtowns.

[9] Prior to 2019, projects had up to five years before being subject to credit recapture.

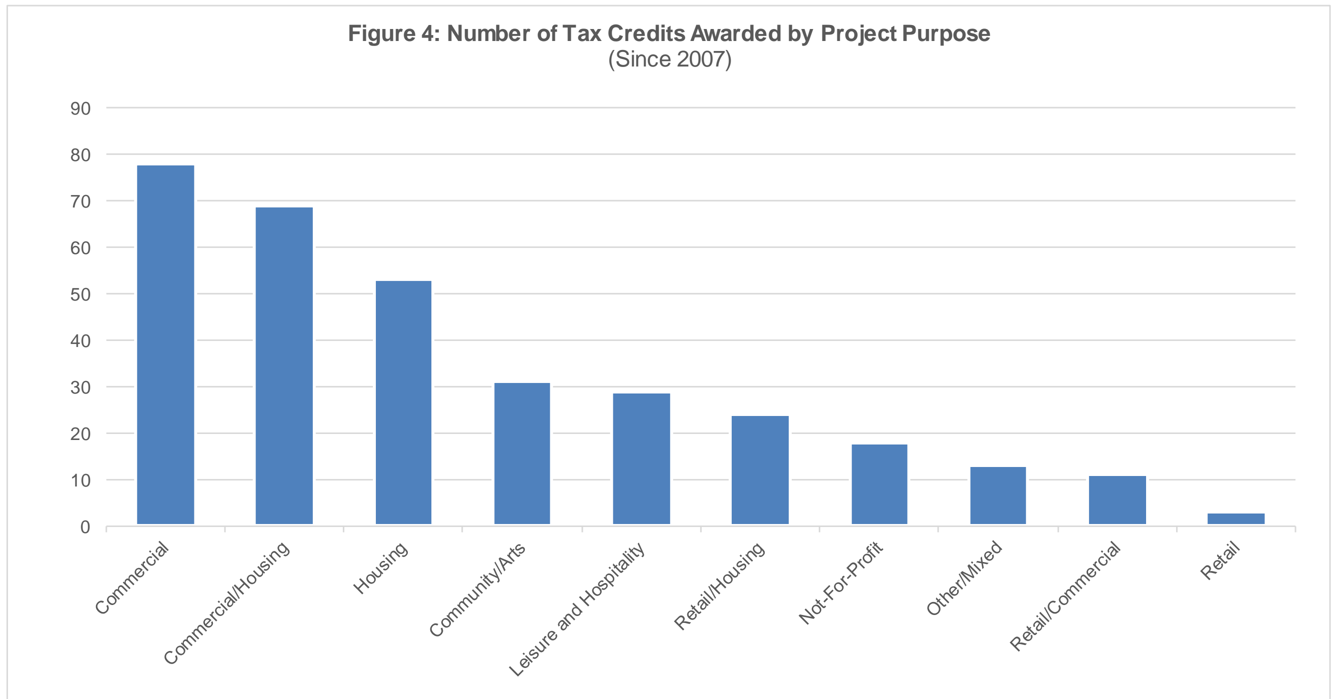
ii) The tax credit program funds a diverse range of projects that all meet the statute's purpose.

Though the Downtown and Village Center tax credit program is a single program, it almost operates as two separate programs:

- One set of tax credits is used to fund small code and safety improvements in downtowns. Out of the 335 projects approved since 2007, 99 had total project costs less than $200,000.
- Another set of tax credits is used to assist developers with significant projects designed to revitalize an entire building. Fifty of the 335 projects had total project costs of greater than $2 million.

Even though credits fund vastly different project types, all of them are in line with the program's goals laid out in 24 V.S.A. § 2790. Smaller code improvement projects tend to focus more on safety improvements while the larger projects rehabilitate city blocks and provide new housing, retail, office space or mixed-use developments.

Based upon the information provided to JFO by the Department of Housing and Community Development, the credits awarded have been focused on promoting economic activity and quality of life in downtowns, either through expanding the commercial base or improving the housing stock in downtowns. Since 2007, 66% of total awarded projects have some sort of retail or commercial purpose. 44% of the projects have stated an intention to either add or improve housing. About one in five projects have a purpose related to leisure/hospitality (restaurant, hotel) or community/arts (community centers, art gallery, theaters) (Figure 4).



iii) The tax credit program mostly provides funding to projects in areas of the State with slower economic growth.

Since 2007, the majority of credits have been awarded to projects located in parts of the State where economic growth has been at or below the average for the State as a whole. Of the roughly $28 million in credits awarded since the inception of the program, $18.3 million or 65%, has been awarded to projects in municipalities located in counties with below-average GDP growth. Of the top 18 municipalities who received the most total credits, 11 of them were located in counties that had slower GDP growth than Vermont overall over the 2001 to 2018 period (Table 2). This is compared to the State's Tax Increment Financing (TIF) program, the largest economic development program by dollars spent,[10] where only 8% of the total diverted State Education Tax dollars were directed to projects outside the Burlington metropolitan statistical area[11] and 6% of the dollars were diverted to municipalities in counties with below average GDP growth over the past 18 years.

Table 2: Credits Awarded by Municipality, 2007 to 2020

	Total Credits	Total Projects	County Real GDP Growth, 2001-2018
Brattleboro	$2,190,400	18	10%
St. Johnsbury	$1,986,392	20	15%
Bennington	$1,966,313	10	3%
Springfield	$1,689,258	11	15%
Winooski	$1,689,055	9	40%
Burlington	$1,517,025	10	40%
St. Albans	$1,491,894	14	33%
Montpelier	$1,300,686	14	22%
Barre	$1,178,835	19	22%
Bellows Falls	$684,173	11	10%
Vergennes	$676,544	10	37%
Middlebury	$668,330	6	37%
Wilmington	$636,287	15	10%
Hardwick	$624,319	7	15%
Newport	$601,914	8	41%
Morrisville	$583,794	14	40%
White River Junction	$557,393	6	15%
Windsor	$463,575	7	15%
Others	$7,489,777	127	
Total Vermont	**$27,995,964**	**336**	**25%**

While the Board has awarded credits to a diverse set of projects geographically, more credits appear to be awarded to larger projects. Almost a third of all active or completed projects that received credits were under $200,000 in total project costs; however, as a share of total dollars, they represented less than one-tenth. Projects with over $3 million in costs were only 12.5% of total recipients but received 38% of the total credits since 2007 (Table 3).

Table 3: Credits Received by Project Size, 2007-2020

Total Project Cost	Number of Projects	Total Credits Awarded
Less than $200,000	93	$2,407,695
$200,000-$500,000	67	$3,889,923
$500,000-$1 million	52	$4,962,782
$1 million-$3 million	48	$5,691,507
$3+ million	37	$10,268,712
Total	**297**	**$27,220,619**

Note: Includes only active and completed projects

The nature of the three separate credits helps ensure that the benefits of the tax credits are relatively broad-based across income groups. The Code Improvement tax credit is often awarded to smaller projects

[10] The TIF program generated a tax expenditure of approximately $6 million in FY 2021.
[11] Municipalities with TIF districts in this region include Burlington, South Burlington, St. Albans, Winooski, and Milton.

(less than $200,000 in project costs) that are less likely being financed by higher-income equity or debt investors.

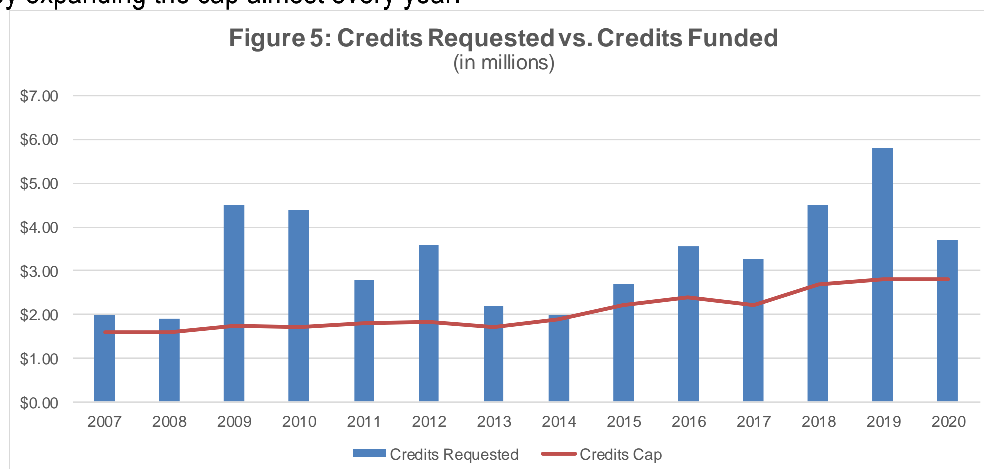
The fact that many of the awarded credits are going towards small projects spearheaded by non-higher income taxpayers is supported by the data. Credits claimed on personal income taxes show that these tax credits are not being claimed exclusively by high income taxpayers. Since 2012, 122 individuals have claimed a tax credit from the program on their Personal Income Tax. Seventy-one of those individuals have had Adjusted Gross Income (AGI) of greater than $150,000, while 51 have had less.
iv) The simplicity and flexibility of the program allows program recipients to quickly and easily obtain cash for projects.

Overall, one of the program's strength appears to lie in its simplicity and flexibility for awardees. The credits themselves can be claimed by the individual or corporate entity completing the historic rehabilitation. Despite the credits being nonrefundable, the awardees have a significant amount of flexibility in order to access the full amount of the credit:

- If the credit they are awarded exceeds their tax liability in any given year, they can carry forward unused credits for up to nine tax years.
- They can sell the credits to banks or insurance firms who can then use them to reduce either their Bank Franchise or Insurance Premium tax liability. Based upon information from ACCD, awardees typically receive between 85 and 95 cents on the dollar for their tax credits from a bank.

Credit awardees have generally preferred selling their credits to banks in order to gain immediate access to cash to assist with projects. In FY 2020, only $210,000 in credits were claimed against the Personal Income Tax, while at least $680,000 were claimed against the Bank Franchise Tax.

It is likely this simplicity that has made the program so popular. Developers JFO spoke to highlighted this as a major advantage to the credit. The program's credits have been oversubscribed every year since at least 2007 (Figure 5). While some projects may not have been funded for eligibility reasons, data from ACCD indicates that since 2007, the total amount of credits requested have exceeded the statutory cap by almost $18 million in nominal dollars.[12] Over the years, the legislature has taken action to reduce this pressure by expanding the cap almost every year.



[12] For instance, total requested credits in 2009 were $4.5 million against a cap of $1.75 million. That is the equivalent of $3.45 million requested credits against a $1.34 million cap in 2019 dollars.

2) While the economic benefits of the Downtown and Village Center tax credits are likely positive in aggregate, they vary significantly based on the unique circumstances of the project and could be offset by the cost of the credits.

This evaluation of the economic impacts of the Downtown and Village Center tax credit program is broken down into three sections:

- A brief review of the literature on economic impacts of historic tax credits.
- An analysis of whether these projects would have occurred if not for the use of tax credits.
- A discussion of the scope of economic impacts by project.

i) Literature review on the economic impacts of historic tax credits in other states.

The Downtown and Village Center tax credit program is in reality three separate credits with three separate goals that likely yield different economic impacts. The Code Improvement Credit focuses on making improvements to buildings in a way that may not be immediately evident to an outside observer, such as electrical and fire sprinkler system improvements. The Façade and Historic Rehabilitation credits are much more likely to yield visible and more tangible improvements to a building and its surroundings. As such, each one is likely to create different levels of economic benefit.

Academic literature on the impact of historic rehabilitation, but not code improvement credits, is plentiful. Almost every state has similar credits to Vermont's Historic Rehabilitation and Façade Improvement Credits (see Appendix) in addition to the Federal Historic Rehabilitation Tax Credit. Overall, most studies find a positive economic impact of these types of credits. Table 4 provides a sampling of this literature and their findings. Note that these economic impacts would be offset by the cost of the credits in these respective states.

Table 4: Literature Review Economic Impact of State Historic Tax Credits

State	Summary of Results
Minnesota (2018)	Historic rehabilitation credits have generated over $3 billion in economic impact since 2011.
Federal HTC (2017)	$131.8 billion in Federal Historic Tax Credit (HTC) expense has created over 2.4 million new jobs and $291 billion in economic output. However, only $41.7 billion in tax revenues were generated.
Georgia (2017)	State historic tax credits were effective in generating economic growth and a state return on investment.
West Virginia (2015)	$192 million in economic impact and 1,400 jobs were created or supported the state's historic tax credits
Indiana (2015)	Historic tax credits' effectiveness was limited by their cap, historic backlog, and inability to carryforward credits.
Maryland (2004)	Historic tax credits are self-financing and often generate positive fiscal impacts for the state.
Missouri (2010)	State historic tax credits were responsible for supporting over 43,000 jobs.
South Carolina (2000)	Home value appreciation is greater in areas designated in historic districts.

Note: References and links to articles can be found in the appendix.

While these studies mostly find positive economic impacts to historic preservation and tax credits, most of them largely take tax credits as a given input into the analysis and then forecast economic benefits associated with the project. Even if a tax credit is a very small portion of the project costs, it is implicitly assumed that projects would not go forward without them. Furthermore, the economic benefits are projections based upon spending multipliers for industries rather than based upon actual data.

A 2009 study by the Iowa Department of Revenue used a different methodology to determine the economic impacts of their Historic Preservation and Cultural and Entertainment District Tax Credit Program, instead relying on city case studies and analyzing the impacts to sales tax and property tax collections in areas around rehabilitated buildings. Their analysis found that the economic benefits of the credits were mixed depending upon the region in which they are located, indicating unrelated economic conditions likely determine the benefit of the tax credits.

ii) Would these projects have occurred without the tax credits?

In order to understand the potential economic benefits of the Downtown and Village Center tax credit program, JFO analyzed the likelihood that the project would not have occurred but for the awarding of the credits.

Before continuing any further, it should be noted that the statute does not require applicants to show that the project would not have occurred but for the use of the tax credits. Other State economic development programs, such as TIF and the Vermont Economic Growth Incentive do require some form of evaluative but-for criteria. Fully evaluating the economic impacts of the tax credits themselves requires understanding whether the projects would have occurred otherwise. If all the projects would have occurred without the use of the tax credits, the actual impact of the tax credits themselves is limited. Conversely, if none of the projects would have happened or happened at a significantly smaller scale without the tax credits, the economic benefits of the tax credits are significant.[13]

The first analysis that JFO undertook to answer this question was to examine the unfunded applications from FY 2016 and FY 2017. If it were true that all projects would not have occurred without a tax credit, the very act of applying for a tax credit is implicitly suggesting the project would not occur if not awarded tax credits. JFO found that based upon grand list values, many of the projects appeared to continue with an improvement despite not receiving tax credits:

- JFO found that of the 37 unfunded applications from the FY 2016 and 2017 cycles, 20 saw their grand lists grow from 2015 through 2019, indicating either an improvement went forward or there was a reappraisal during that time period.
- 10 of the 37 properties saw their property values increase by 25% or more, which would seem to indicate that an improvement was made even without the tax credit.

[13] It is worth noting that a project without credits might still go forward but in a less desirable area from a public benefit standpoint. Vermont's land-use and development policies encourage building in downtown areas. Not receiving a credit might drive an investor to build outside a downtown area where land and construction are cheaper. This analysis would not be able to determine the extent to which that occurs. Applications are linked to properties and individual SPANs. JFO does not have the data to determine if a rejected application resulted in a building owner selling the building and carrying out the project outside the downtown area.

- Of the 10 projects that appeared to have improvements from 2015 through 2019, the tax credit would have been 15% or less of the cost of the project in six of them, suggesting that the smaller the tax credit as a share of the project, the weaker the but-for argument.

- Eight properties saw their grand list increase by greater than $100,000.
- 12 of the 37 projects saw zero grand list growth from 2016 through 2019, which could either indicate that the project did not occur or that an improvement (such as a code improvement) was made but it did not trigger a reappraisal.

This analysis does not attempt to evaluate the Board's efficacy in rejecting applications that do not require the tax credits. Rather it is simply an examination of the premise that none of these historic or code improvement projects would be viable without the tax credits, a premise that does not appear to be accurate. The Board may have rejected these applications in part because it was clear that the tax credits were not integral to the projects, an outcome undoubtedly in the State's best interest. While a but-for test is not explicitly in the application as a criterion for approval, conversations with the Department of Housing and Community Development indicate that the Board's process for evaluating applications includes some qualitative review about project feasibility without the tax credit.[14]

Determining how many of these projects would have went forward without the tax credit is difficult to answer. For the 2007 through 2020 period, JFO also analyzed the size of the tax credit relative to the project's overall cost to get a sense of the importance of the credit in the overall funding stack.

- A quarter of completed projects with available data relied on the credit for greater than 25% of the cost of the project (Table 5). These projects tend to be small, with the average project cost of less than $150,000. In most cases, the project was limited to the credit itself; for example, the whole project is an electrical update to a historic building, rather than a complete rehabilitation of a building that also includes an electric system update.
- On the other end of the spectrum, 17% of the total awarded projects relied on the tax credits for less than 5% of their project financing. The median project cost for these projects was $3.7 million. Often these tax credits form one piece of a larger capital financing stack with many sources of funding. JFO's conversations with developers and the Department of Housing and Community Development indicated that the credits are often early, and therefore, more important sources of funding for a project.[15]

Table 5: Completed Projects by Share of Project Cost Paid by Tax Credits, 2007-2020

Share of Project Cost	Number of Projects	Share of Total Projects	Average Project Cost	Median Project Cost
Greater than 40%	29	10%	$83,514	$72,368
25% and 40%	45	15%	$147,850	$129,375
15% and 25%	74	25%	$472,952	$410,000
10% and 15%	48	16%	$581,519	$435,513
5% and 10%	52	17%	$1,850,671	$1,203,647
Less than 5%	50	17%	$11,581,798	$3,705,288

Also of note is the fact the applicants themselves do not often list the tax credits as an integral part of their funding stack. JFO analyzed tax credits awarded in FY 2020 and found many applications did not list the

[14] Each applicant is scored on three criteria with differing point scales. Cost Effectiveness (0-5 points), Community Need (0-5), and Community Impact (0-7).

[15] It is important to note that most of these recipients sell the tax credits to banks in return for up-front cash for projects. However, the sale of the credits returns between 85 and 95 cents on the dollar. As a result, share of total financing that these credits represent is modestly less than what is described here.

tax credits as a source of funding for the project. Any reliance on Vermont's tax credits was only listed by five of the 27 accepted applications and only accounted for 3% of the total $42 million in project costs. Of the roughly $42 million of project costs that year, outside private debt or equity accounted 43% of the total share of funding and 16% came from the owner's own money (Table 6). This, however, could largely be a function of the application. Improvements in the application over the years have allowed the Board to better review funding sources for each applicant. Applicants may not want to assume receipt of a tax credit in their budgets when presenting them to the Board for review.

Table 6: FY2020 Awards Composition of Funding

	Own Funding/Private	Grant	Commercial Loan	Private Debt/Equity	VT Tax Credits	Federal Tax Credit	Total
Total Funding	$6,621,128	$3,034,732	$8,453,383	$18,002,780	$1,450,431	$4,142,446	$41,704,900
Share of Total	16%	7%	20%	43%	3%	10%	100%

iii) Analyzing the scope of economic impacts of the Downtown and Village Center tax credit program

Notwithstanding whether these projects would have occurred without the tax credit, the Downtown and Village Center tax credit program offers tax credits to such a wide variety of project sizes that it is difficult to make overarching statements about the program's economic impacts. This is to say, the economic benefits likely vary significantly from one project to the next.

As stated earlier, nearly one-third of all projects awarded credits have a total project size of less than $200,000. These projects are largely limited to code improvements. The direct economic impacts of these smaller projects are likely limited. An improvement to a building's electrical or sprinkler system unquestionably makes a building more desirable for development. Bringing a building up to code also has unquantifiable safety benefits. Beyond these, however, the economic impacts to these projects are more limited to the direct employment benefits to complete them[16] without many spillover effects to other areas. Moreover, data from the statewide grand list indicate that few of these smaller projects result in further development of the building in the near term (see the following section).

On the other end of the spectrum, 88 of the 335 projects were over $1 million in size. These types of projects are more likely to generate direct and indirect economic benefits. A major revitalization of a historic block in a downtown area requires more direct spending on contractors, architects, consultants, and construction to complete, generating direct benefits to the municipality's residents' disposable incomes to the extent the labor and services are locally sourced. The revitalization also creates greater spillover effects as a more inviting downtown is more likely to spur more consumer spending and rentals at nearby establishments. At the same time, it is still more difficult to say that the tax credits are leading to these economic benefits, as they usually represent less than 10% of the project's overall cost, unless it is true that these projects in their entirety would not happen without the credits.

Based upon funded and unfunded applications from 2016 and 2017, larger projects are more likely to be funded. During this period, 76 projects requested funding. 39 of them were funded and 37 were unfunded. For projects that had total costs of less than $500,000, there were 52 applications. 21 of them were funded

[16] For instance, an example of the economic impact of an electrical system update would include the wages of the electrician and the supplies they purchase for the project.

(40%) and 31% were unfunded (60%). However, for larger projects with greater than $1 million in costs, of the 13 projects for those two years, only two were rejected (15%) (Table 7). This could be a reflection of the Board believing that larger projects are more likely to spur greater economic impacts through community revitalization and better meet the statutory goals. It could also mean that larger projects have better and more convincing applications overall; many of these projects likely hire development consultants to assist with the application process.

Table 7: Unfunded vs. Funded Applications by Project Size 2016 and 2017

	Funded	Unfunded	**Total**
All Projects	39	37	**76**
Less than $500,000 in project costs	21	31	**52**
Greater than $1 million in project costs	11	2	**13**

The Downtown and Village Center tax credit program likely also creates economic benefits by driving development to denser, downtown areas. Denser development is one of the tenets of "Smart Growth" for urban centers. Smart Growth, which is promoted by the American Planning Association[17] and the Environmental Protection Agency,[18] as well as the State's Land Use Goals and Comprehensive Energy Plan[19] advocates for compact urban development, reducing sprawl, varying housing choices, increasing transportation options, and creating walkable communities.[20] Advocates of Smart Growth point to numerous benefits that could result from building more compact communities. These include:

- Increased housing options for residents: in sprawling communities, zoning restrictions may be putting restrictions on the types of multi-family housing.
- Transportation benefits: these include less money spent on transportation by residents, improved fitness, and reduced traffic incidents.
- More efficient provision of public services: utilities, roads, and emergency services cheaper to provide in denser communities.
- Environmental benefits: less need for cars results in fewer vehicles emitting pollution and fewer impervious surfaces. [21,22]

There is also a body of academic literature that has found that increased density leads to increases in productivity, wages, and innovation.[23]

[17] https://www.planning.org/policy/guides/adopted/smartgrowth.htm
[18] https://www.epa.gov/smartgrowth/about-smart-growth
[19] 24 V.S.A. § 4302
[20] APA Policy Guide on Smart Growth. Updated April 14, 2012. https://www.planning.org/policy/guides/adopted/smartgrowth.htm
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[22] Littman, Todd. Understanding Smart Growth Savings: What We Know About Public Infrastructure and Service Cost Savings, And How They are Misrepresented By Critics. Victoria Transport Policy Institute. 2008. (www.vtpi.org/sg_save.pdf).
[23] Glaeser, Edward L., José A Scheinkman, and Andrei Shleifer. "Economic growth in a cross-section of cities." Journal of Monetary Economics. 36. No.1 (1995): 117-143.

JFO spoke with municipal officials who believed these credits were critical to the revitalization of their downtowns. Other developers and consultants JFO spoke to expressed the sentiment that the financial returns on these projects do not justify the expense without the tax credits.

3) Based upon an analysis of property value growth, the Downtown Tax and Village Center tax credit program is unlikely to be generating a positive fiscal return on investment for the State, at least in the near and medium term.

The statutory purpose for the Downtown and Village Center tax credit program does not require that they return a positive fiscal return on investment for the State. Often government programs and incentives are specifically designed to solve issues where an investment might have a worthwhile public benefit but the private benefits of completing the project do not yield a profit for any single individual.

JFO analyzed this area of impact for the following reasons:

- Evaluation of fiscal impacts on the state of various tax expenditures is in line with the goals of the biennial Tax Expenditure Report and is part of the framework for evaluation that JFO has used for previous evaluations, such as those for the Tax Increment Financing[24] program and the Capital Gains Exclusion.[25]
- Some economic development programs are promoted as being self-financing because the public investment in the project might generate new tax revenues that offset or exceed the State's investment. Materials from the Department of Housing and Community Development highlight the increase in certain projects grand lists.[26] JFO wanted to examine the extent to which this was true.

From 2007 onward, the program has awarded over $28 million in tax credits. For the State to receive a positive fiscal return on investment, tax revenues generated by the projects incented by these tax credits must equal or exceed this amount, after accounting for the time value of money. These new tax revenues could result primarily from increased property taxes, but also, depending on the project, consumption (sales and meals and rooms taxes) and personal income taxes.

New tax revenues could also be generated indirectly from the project itself. If a rehabilitated city block makes a downtown more desirable and more retail businesses establish themselves downtown because of it, the state could see increased tax revenue. JFO did not analyze this potential growth although new indirect tax revenues could plausibly improve the State's fiscal return on investment on these credits.[27]

JFO analyzed the question about the fiscal return in two parts. First, JFO examined the changes in the grand lists of the 107 projects approved from FY 2014 through FY 2017 for the period FY 2012 through FY 2019. Next, JFO compared the grand list growth for approved projects approved in the FY 2016 and FY 2017 award years to the grand list growth to the rejected projects for those same two years.

[24] https://ljfo.vermont.gov/assets/docs/reports/79f1f110da/Final-TIF-Report-January-24-2018.pdf

[25] https://ljfo.vermont.gov/assets/Subjects/Tax-Expenditure-Reports/88d0b85215/2019-Tax-Expenditure-Reviews-FINAL.pdf

[26] https://accd.vermont.gov/sites/accdnew/files/documents/CD/CPR/CPR-TaxCredits_2020-Annual-Report.pdf

[27] While in theory it is possible to estimate these, project by project speculative assumptions would be required about the geographic area where there might be fiscal spillover benefits. Any analysis would also require an unknown counterfactual.

i) Grand list growth for the 2014 through 2017 approved projects

To determine the extent of the new property tax revenues generated, JFO examined projects that applied for tax credits from FY 2014 through FY 2017.[28] This included 107 projects with verifiable grand list parcels. JFO tracked the value of these properties from FY 2012 through FY 2019 to see if the property values of the projects increased after the projects received tax credits and were completed.

Overall, these projects did not generate enough grand list growth, and therefore, new property tax revenue, to cover the cost of the tax credits in the short term. From FY2012 through FY2019, these 107 properties experienced an increase in value of $27.4 million (Table 8). Using adjusted tax rates from those years, it is estimated that these properties are generating just over $500,000 a year in new property tax revenue. Assuming tax rates stay the same, if these properties do not further increase in value, it would take between 17 and 20 years for the State to recoup its investment.

Table 8: Change in Grand List Growth
FY2012 through FY2017 Tax Credit Awardees

Tax Credit Award Year	Total Grand List Change	For Only Projects with Less than 10% Cost Share	For Only Projects with Greater Than 35% Cost Share
2014	$7,996,375	$1,016,900	$877,090
2015	$6,788,910	$6,243,640	$271,300
2016	$5,517,200	$3,016,830	$23,120
2017	$4,437,100	$1,902,500	$0
Total	**$24,739,585**	**$12,179,870**	**$1,171,510**

Note: Analysis of Grand List Growth covered the years FY2012 through FY2019

Many of the projects experienced no grand list change at all over the entire 2012 through 2019 period. 26 of the 107 projects did not experience any growth and another 23 experienced decreases in value.

The primary reason for the lack of grand list growth is likely due to the fact that many of the tax credit projects are smaller Code Improvement Tax credits that may not trigger a reappraisal by a municipality. If a building receives a credit for an electrical system upgrade, the property is undoubtedly improved, but it is not reappraised by the town in the near term solely because of the upgrade. This seems to be supported by the data; as Table 8 shows, projects where the tax credit was greater than 35% of the total cost, which are more likely smaller projects, only generated $1.171 million in grand list growth over the entire 2012 through 2019 period.

The larger projects show more growth in Grand List in the short term in part because they are more likely to trigger a reappraisal but also because the improvements are likely to be of greater consequence. For projects where the tax credit was less than 10% of the cost, $12.2 million of grand list growth was generated.

ii) Grand list and tax revenue growth in funded versus unfunded projects

Another way of examining the fiscal impact of the tax credits is to compare the property value growth of projects that received the tax credits to those that applied but ultimately did not receive them.

[28] Some properties were excluded because JFO was unable to locate a property SPAN number for them.

The Department of Housing and Community Development provided JFO with applications for unfunded applications for the FY 2016 and FY 2017 award years. JFO pulled the grand list values for these properties and compared them to the grand list values for the properties that received awards in those same years.

Overall, it appears as though those projects that received tax credits generated modestly higher grand list growth than those that did not. For the 39 projects that received awards in the FY2016 and FY2017 award years, the total grand list growth experienced by these properties from 2012 through 2019 was almost $10 million. For the 37 projects that were not funded, their grand list grew by $6.6 million. The average grand list growth for the funded projects was $236,920 while the unfunded projects saw average grand list growth of $178,712 (Table 9).

Table 9: Grand List Growth for 2016 and 2017 Funded vs Unfunded Applications

	Funded Projects		Unfunded Projects	
Tax Credit Award Year	Grand List Growth	Tax Revenue Growth	Grand List Growth	Tax Revenue Growth
2016	$5,753,030	$112,331	$2,475,590	$74,023
2017	$4,197,600	$93,219	$4,136,740	$97,600
Total	**$9,950,630**	**$205,550**	**$6,612,330**	**$105,401**
Average Per Project	**$236,920**	**$4,894**	**$178,712**	**$2,849**

From a return on investment standpoint, the higher property value growth in the tax credit properties alone is not enough to generate enough education property tax revenue to make up for the expense of the tax credits. During these two years, the State awarded $4.6 million in tax credits to the 39 funded projects, for an average tax credit of $117,948. The average annual education property tax growth for the funded projects over these two years is $4,894, or about $205,550 across all projects per year. The average new education property tax revenue generated by 37 unfunded projects was $2,849, for total new revenues of $105,401 per year.[29]

To summarize, for these two award years, relative to those properties that did not receive a tax credit, the annual property tax benefit resulting from the $4.6 million spent in tax credits is approximately $100,149 per year (the difference between the $205,550 from the funded projects and the $105,401 from the unfunded projects). Put another way, for the average project, the State's $117,948 average credit is generating approximately $2,045 in new education property tax per year relative to the projects that did not receive any credit.

There are caveats to these analyses. The first is that the time period analyzed could be too short to show the grand list benefit of the property improvements. For some of these projects, any improvement in the project might not be reflected on the grand list until the property is sold or reappraised as part of a town-wide reappraisal. This is likely true to some extent but the longer the time between the project's completion and the increase in the grand list, the more outside factors (recessions, loss of a major downtown anchor tenant, for example) could obscure the link between the credits and the grand list growth.

The second is that other revenue streams (sales, meals and rooms, income taxes) aside from property taxes could increase to offset the cost of the credits. While it is certainly true that a project could have a

[29] Note that for this analysis, CLA adjusted tax rates were applied to town grand list values.

positive impact on these, it seems implausible that they would be significant enough to make up the short-term difference in fiscal cost. The third is that unfunded applications were rejected because the Board determined that they did not need the credit. If the rejected applications were largely rejected on the grounds that their improvements would have occurred anyway relative to the funded applications, the actual fiscal impact of the funded applications may be higher.

In the end, even after accounting for these caveats, if the tax credits do indeed generate an identifiable positive fiscal return on investment, they are most likely over a much longer time horizon, likely beyond 15 or 20 years.

V. Considerations for Legislators

This review has found that the Downtown and Village Center tax credit program is largely meeting its statutory purposes by providing public funding for a wide variety of public beneficial and community-revitalizing projects. JFO also finds that a key virtue of the program is its simplicity for applicants. The program also appears to be generating some level of economic benefits in aggregate, although that value varies significantly by project.

JFO's review also found that the program is unlikely to be providing a fiscal return on investment to the State in the near or medium term.

After speaking to many different stakeholders, reviewing the information and data provided by ACCD and, examining similar tax credits in other states, JFO identified some smaller areas for the legislature to consider to further define the program.

1) Clarify the program's statutory purpose

The statutory purpose of the tax credits themselves is found in 32 V.S.A. § 5813 (m), (n), and (o), stating the intent of the credits is to "to provide incentives to improve and rehabilitate historic properties in designated downtowns and village centers." It is relatively vague without any measurable goals.

24 V.S.A. § 2790 also provides the statutory purpose for historic downtown development and the downtown/village center designation upon which these tax credits rely. They are much clearer, but largely normative in nature:

- Supporting downtowns by providing funding, training, and resources to increase economic growth and diversity.
- Attracting new and existing residents to downtown by enhancing livability through increased access to jobs, housing, education, and other services.
- Removing barriers for collaboration between local downtown organizations, developers, businesses, nonprofits, and municipal government.
- Encouraging mixed use development in downtowns.
- Building public transportation options in downtowns.
- Minimizing strip development in outlying countryside and farmland.

Questions for the legislature to consider in further defining the statutory purpose could include the following, noting the mutually exclusivity in these goals:

- Should the credits mostly focus on improving historic buildings in areas of the State with slower economic growth?
    - If this is the case, Chittenden County would likely not be eligible for the credits.
- Should the Board only award tax credits that will maximize potential economic benefits?
    - Again, larger projects are more likely to maximize absolute potential economic benefits, although the legislature may deem smaller projects like rehabilitating a small general store to be equally beneficial in proportion to the size of the community.
- Is it a purpose of the tax credits to generate a positive fiscal return on investment for the State?
    - If this is the case, then larger, more expansive projects are probably more advantageous than smaller code improvements.
- Are there more efficient ways of achieving the goals laid out in 24 V.S.A. § 2790?

Another possible consideration is to leave the statutory purpose relatively vague, thereby giving the Board flexibility in awarding tax credits to different projects but establish various concrete areas for evaluation for future reviews, like those listed for the Tax Increment Financing report,[30] which include:

- A recommendation for a sustainable statewide capacity of TIFs.
- The positive and negative impacts on the State's fiscal health.
- The economic development impacts of the program.
- The mechanics for ensuring geographic diversity.
- A review of other programs used in other states.

2) Ways to improve the State fiscal return on investment in the near term

The statutory purpose of the tax credits does not identify a fiscal return on investment as a goal. As stated earlier, many state programs do not generate fiscal returns on investment but focus on solving public good problems where the private returns on investment do not match the public benefits. Notwithstanding this, JFO's analysis found that the new property taxes generated by many of the projects are insufficient to cover the cost of the credits in the near or medium term.

One reason this might be is that smaller improvements, such as code improvements, funded by the tax credits may not require a municipal permit and therefore, do not trigger a reappraisal. The legislature might consider ways to mitigate this timing issue by requiring projects to obtain a reappraisal after the project is completed so that any improvements are reflected on the statewide grand list sooner.

If a greater fiscal return on investment is a goal of these credits, the legislature might also want to consider whether nonprofit entities should remain eligible for the credits. With some exceptions, many of these entities do not pay property taxes or income taxes. The only fiscal benefit the State would see from credits awarded to nonprofit entities would be second-order effects; sales taxes paid to contractors for construction work or spillover effects. Some states, such as Mississippi or Rhode Island have excluded or limited their tax credits available to nonprofit entities for this reason.

[30] 24 V.S.A. § 1892

3) Clearer definitions of the type of building the program is intended to serve

Current statute states that a building must be at least 30 years old at the time of application to be eligible for tax credits, meaning any building built prior to 1990 would be eligible for these credits in 2020. This was a statutory change made in 2019. Prior to this change, the statute stated that any building built before 1983 was eligible. This date was chosen because prior to 1983, the State did not perform code inspections, so buildings built after 1983 were considered more likely to be constructed up to modern code standards[31] and therefore needed the credits less than older buildings.

Most of the credits go to building projects that were built before 1930. One issue with the current statute is that it does not account for the pace of change in code regulations and the costs necessary to make code improvements. For example, in the case of the Code Improvement credit, the legislature could investigate whether it is more cost prohibitive to update/install a sprinkler or new electrical system in a building constructed in 1905 or 1985 and adjust the age requirement accordingly. Relatedly, the legislature might study whether other goals, such as improving energy efficiency in older buildings, are as beneficial as the narrow health and safety purpose of the Code Improvement Credit.

The legislature could also consider whether financing improvements to more modern buildings is the original intent of the program, or whether they would prefer the program to focus more on older buildings built in a certain era or style. The fact that the projects need to be located in historic downtowns means that the majority of projects are likely to be late 19th and early 20th century buildings. There are also many modern buildings located in historic downtowns that will continually become eligible for these credits over time, and the legislature might decide that these buildings are not as valuable to preserve and rehabilitate as buildings from an earlier era.

[31] Building codes are continually updated so the building codes in 1984 are not the same as those today. This being said, the building codes in 1984 are more reflective of modern safety standards for building safety than the building standards of the early 20th century.

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Table A1: State Historic Rehabilitation Tax Credits					
	Tax Credit as a Percentage of Expenses				
State	Residential	Commercial	Per Project Credit Limit	Annual State Cap	Transferable?
Alabama	25%	25%	$50,000 for residential	$20 million	Yes, only once
Arkansas	25%	25%	$1.6 million for income producing, $100,000 for non-income producing	$4 million	No
California	No	20%	None	$50 million	
Colorado	No	25% for first $2 million in expenses, 20% after	$1 million	$10 million	No
Connecticut	25%	25%, 30% if an affordable housing project	$4 million	$31.7 million	Yes
Delaware	20%	20%	$30,000 for owner occupied property	$8 million	
Georgia	25%	25%	$5 million, $10 million if the project creates more than 200 jobs	$25 million	Yes
Hawaii	No	30%	None	$1 million	No
Indiana	20%	20%	$10,000	$250,000	No
Illinois	25%	25%	None	None	No
Iowa	25%	25%	None	$45 million	No
Kansas	25%	25%, 30% if a nonprofit	Expenses must exceed $500	None	No
Kentucky	30%	25%	$400,000	$5 million	No
Louisiana	20%	20%	None	$5 million	Yes
Maine	20%	20%	$5 million	None	No
Maryland	20%	20%	$50,000 for owner occupied, $3 million for commercial	None	No
Massachusetts	25%	20%	None	$55 million	No
Minnesota	No	25%	None	None	No
Mississippi	25%	25%	None	$12 million	No
Missouri	25%	25%	$250,000	$90 million	No
Montana	No	25%	None	None	No
Nebraska	No	20%	$1 million	$15 million	No
New Hampshire	Relief from property tax increase for 5 years		None	None	N/A
New Mexico	50%	50%	$25,000 or $50,000 depending on whether the building is in an arts district	None	No

Table A1: Continued					
	Tax Credit as a Percentage of Expenses				
State	Residential	Commercial	Per Project Credit Limit	Annual State Cap	Transferable?
New York	20%	20%	$50,000 for an owner occupied building	$5 million	No
North Carolina	15%	15%	$4.5 million, $22,500 for owner occupied	None	No
North Dakota	No	25%	$250,000	None	No
Ohio	25%	25%	$5 million	$60 million	No
Oklahoma	No	20%	None	None	Yes
Pennsylvania	No	25%	$500,000	$3 million	No
Rhode Island	No	20% for commerical properties, 25% if the first floor is used for a trade or business	$5 million	None	No
South Carolina	10%	10%	$1 million	None	No
Texas	25%	25%	None	None	No
Utah	20%	20%	None	None	No
Vermont	No	Varies by credit	Varies by credit	$2.6 million	Yes
Virginia	25%	25%	$5 million	None	No
West Virginia	No	25%	$10 million	$30 millon	No
Wisconsin	No	20%	$3.5 million	None	No

Source: Novogradac

Clothing and Footwear Sales Tax Exemption
Full Review

Executive Summary

Clothing and footwear have been exempted from Vermont's sales and use tax since 1999 and 2001, respectively. This exemption is estimated to cost the State just over $33 million in FY 2021 (8% of total sales tax collections), which represents annual tax savings of roughly $130 per Vermont household. Vermont is only one of seven states to offer preferential sales tax treatment to clothing and one of only three states with a full exemption without price thresholds or different rates.

As part of the 2021 Tax Expenditure Report, JFO reviewed the clothing and footwear exemption against its statutory purpose in 32 V.S.A. § 9706(bb), which is "to limit the tax burden on the purchase of goods that are necessary for the health and welfare of all people in Vermont."

When reviewed against this statutory purpose, JFO finds that:

- **The exemption is poorly targeted and costs the State significantly more than if it were narrowed to more closely reflect the statutory purpose.**
  - JFO estimates the exemption is costing between $11.2 and $16.1 million beyond the statutory purpose of providing tax relief on necessary clothing expenditures for Vermonters. A narrower exemption with a price threshold or a refundable income tax credit would likely better meet the goals of the statutory purpose.
- **The clothing and footwear exemption creates an inconsistency in the tax code as other items that are arguably necessary for health and welfare are not exempted.**
  - These include purchases of household supplies and appliances, both of which are considered necessary purchases in the Basic Needs Budget.
- **While not specifically goals laid out in statute, the exemption successfully reduces the regressivity of the sales tax and provides a benefit to Vermont apparel retailers on the border.**
  - Data from expenditure surveys indicate that lower-income families spend a greater share of their income on clothing and footwear than higher-income families. Therefore, exempting these items benefits the former greater than the latter.
  - Academic literature suggests that a full repeal of the clothing exemption would result in a reduction in sales for Vermont retailers on the border, particularly since all neighboring states either exempt clothing from their sales tax or have no sales tax.

With these findings in mind, the Legislature may want to consider narrowing or limiting the exemption to meet the statutory purpose. Potential options to consider include:

- Limiting the exemption using a price threshold like other states.
- Repealing the exemption in its entirety and replacing it with a more targeted income tax credit, such as:
  - A refundable personal income tax credit for low-income taxpayers, such as Maine's refundable Sales Tax Fairness credit, which provides up to $225 for lower- and middle-income taxpayers to offset the regressivity of the sales tax.
  - An expansion of the Earned Income tax credit, which would offset the regressivity of the sales tax by providing additional refundable credit to lower-income households.

In the event the Legislature decided to replace the clothing exemption with a personal income tax, it would need to consider not only the size of the credit but also how or whether to provide benefits to those who do not file tax returns. Additionally, since the cost of personal income tax credits is borne by the General Fund, the legislature would need to offset the loss in revenue in some way.

I. Overview

The sales and use tax exemption for clothing can be found in 32 V.S.A. § 9741(45). This subdivision of statute excludes clothing and footwear from the sales tax base. JFO estimates that the clothing and footwear exemption causes the State to forego over $33 million per year in sales tax in FY 2021.

32 V.S.A. § 9741(45) spells out that clothing is exempt but accessories, protective equipment, and sport or recreational equipment are not. The definitions of "clothing", "accessories," "protective equipment," and "sport or recreational equipment" are found in 32 V.S.A. § 9701. In general, clothing is defined as "all human wearing apparel suitable for general use."[32] 32 V.S.A. § 9701(24) lists examples of clothing but notes that it is not an exhaustive list:

- Aprons, household and shop
- Uniforms (athletic and non-athletic), athletic supporters
- Baby receiving blankets
- Bathing suits and caps
- Beach capes and coats
- Belts and suspenders
- Shoes, sneakers, boots, sandals, steel-toed shoes, shoelaces, and slippers
- Coats and jackets
- Costumes
- Diapers, child and adult, including disposable diapers
- Hats, caps, earmuffs, gloves, and mittens
- Formal wear, neckties and wedding apparel
- Garters and girdles
- Underwear, hosiery, pantyhose, socks, and stockings
- Lab coats

Clothing accessories are taxable and are defined in 32 V.S.A. § 9701 (25) as "incidental items worn on the person or in conjunction with clothing." Examples of clothing accessories listed in this section include:

- Briefcases and handbags
- Cosmetics and hair accessories such as barrettes, bows, wigs, and nets
- Handkerchiefs
- Jewelry and watches
- Nonprescription sunglasses
- Umbrellas
- Wallets

Other clothing accessories such as belt buckles, patches, masks, and sewing equipment are considered taxable.

"Protective Equipment" is taxable and is defined in 32 V.S.A. § 9701(36) as "items for human wear and designed as protection of the wearer against injury or disease or as protection against damage or injury of other persons or property but not suitable for general use." Examples listed in statute include:

- Breathing masks and respirators
- Cleaning apparel and equipment

[32] 32 V.S.A. § 9701(24).

- Ear and hearing protectors
- Face shields
- Hardhats and helmets
- Protective gloves
- Safety belts, glasses and goggles
- Tool belts
- Welders gloves and masks

"Sport or recreational equipment" is taxable and is generally defined as "items designed for human use and worn in conjunction with an athletic or recreational activity that are not suitable for general use."[33] Examples listed in statute include:

- Ballet and tap shoes
- Athletic shoes, cleated or spiked
- Gloves, including baseball, bowling, boxing, hockey and golf
- Goggles
- Hand, elbow, shoulder, and shin guards
- Life preservers and vests
- Mouth guards
- Ice skates and roller blades
- Ski boots
- Waders
- Wetsuits and fins

These definitions of clothing, protective equipment, accessories, and sports or recreational equipment are the same as those listed in the Streamlined Sales and Use Tax Agreement (SSUTA).[34] As a member of the SSUTA, Vermont can either exempt or fully tax clothing. If Vermont decided to tax clothing, it would need to tax all items listed as clothing in the definition above. For instance, it would not be allowed to tax boots but not sneakers.

The SSUTA also allows members to set a price threshold for taxability of clothing. A state may exempt an item of clothing below a certain price threshold provided that the threshold applies to each individual item (as opposed to the entire sale) and that the threshold is greater than $110. The threshold would need to apply to both State and local sales and use taxes.

Most states consider clothing to be a taxable item. Vermont is one of seven states that either fully exempt clothing from the sales tax base or exempt clothing up to a certain price threshold. Only three other states have a clothing exemption as broad as Vermont's (Table 1).

[33] 32 V.S.A. § 9701(37).

[34] See page 103-107: https://www.streamlinedsalestax.org/docs/default-source/agreement/ssuta/ssuta-as-amended-2019-12-31--clean.pdf?sfvrsn=fa67afa0_12.

Table 1: State Clothing Exemptions	
State	**Details of Exemption**
Vermont	Fully exempt. Accessories, protective equipment, and athletic apparel are taxable.
Massachusetts	Clothing under $175 is exempt.
Minnesota	Fully exempt. Accessories, protective equipment, and athletic apparel are taxable
New Jersey	Fully exempt. Fur clothing, accessories, and athletic apparel are taxable. Some protective equipment is exempt.
New York	Clothing under $110 is exempt.
Pennsylvania	Fully exempt. Fur clothing, accessories, and athletic apparel are taxable.
Rhode Island	Clothing under $250 is exempt. Accessories, protective clothing and athletic clothing are taxable.

The trend in the recent past is towards states limiting or ending the exemption. Rhode Island's exemption was changed to have a $250 limit in 2012. New York has changed its exemption from a full exemption to a $110 price threshold in 2012. Connecticut ended their exemption in 2011 and replaced it with a luxury goods tax, which is a 7.75% tax on items costing $1,000 or more. All other goods pay the 6% sales tax.

II. Statutory Purpose

32 V.S.A. § 9706(bb) states the statutory purpose of the clothing and footwear exemption as the following: "to limit the tax burden on the purchase of goods that are necessary for the health and welfare of all people in Vermont."

The statutory purpose does not make specific reference to limiting the tax burden on any group of people. Instead, as written, the purpose is intended to lower the tax burden on *all* Vermonters. A frequent argument made for exempting necessities from sales taxes is that the sales tax is regressive; lower-income individuals spend a greater share of their income on necessities. In order to reduce the regressivity of the tax, items that are necessities are exempted.[35]

Because the statutory purpose does not target any specific group, it is a blanket exemption for all types of clothing for general use, for any type of purchaser (residents and non-residents, high income and low income).

III. Statutory History

Act 49 of 1999 codified the clothing and footwear exemption.[36] Clothing was exempted from the sales tax effective December 1, 1999. In that same act, footwear was also to be added to the exemption, but that would only be effective beginning July 1, 2001. At that time, the exemption was limited to a clothing or footwear item costing less than $110. It did not exempt clothing or footwear used primarily for athletic activity or protective use. At passage, towns with local option sales taxes were ineligible to apply the exemption. However, since then, the exemption has extended to those towns.

[35] "Options for a Less Regressive Sales Tax," *Institute for Taxation and Economic Policy*, (September 2016). https://itep.org/options-for-a-less-regressive-sales-tax/.

[36] Act 49 of 1999.

In 2007, when Vermont joined the SSUTA, the $110 price threshold was eliminated.

IV. Major Findings

i) The clothing exemption costs the State of Vermont just over $33 million per year in foregone tax revenue.

JFO estimates that repeal of the clothing exemption could generate up to $33 million in sales tax revenue. This could be done with minimal administration costs to the Department of Taxes since it does not require a change in forms or processing systems. This $33 million represents just over 8% of total sales tax collections in FY 2021.

A repeal of the exemption would increase administrative costs for clothing retailers as they comply with collection and remittance to the Department of Taxes. However, this could be less than it normally would be for a new tax:

- Many current Vermont retailers selling apparel also sell taxable goods. Adding an additional good should not represent a significant administrative burden.
- The exemption itself is not very old and many Vermont retailers that sell apparel could have been in business prior to 1999 and therefore have some experience collecting the sales tax on clothing.
- An estimated 35% of apparel purchases are from large, online retailers who sell nationwide.[37] Because only seven states provide some special treatment for clothing, these retailers would be accustomed to collecting and remitting sales taxes in other states.

It is estimated that the cost of this exemption has modestly declined over the past decade. According to the Consumer Expenditure Survey in 2010, households in the Northeast spent $2,084 a year on apparel and services, which is the equivalent of $2,443 in 2019 dollars. According to that same survey completed in 2019, households spent on average $2,282 a year. While the number of households in Vermont has increased modestly over that period (256,442 in 2010 versus 259,589 in 2019), the total spending on clothing in aggregate across Vermont has likely decreased. This reflects both the declining cost of clothing over the years[38] and the aging of Vermont's population as older households tend to spend less on clothing.

ii) The clothing and footwear exemption is a poorly targeted exemption that costs the State significantly more than if it were narrowed to more closely reflect the statutory purpose.

The statutory purpose of the clothing and footwear exemption is "to limit the tax burden on the purchase of goods that are necessary for the health and welfare of all people in Vermont." To evaluate its effectiveness, this analysis breaks that purpose down into two parts:

- Limit the tax burden on items that are *necessary* for health and welfare.
- Limit the tax burden on these purchases for *all people in Vermont.*

JFO concludes that the exemption is not meeting its statutory purpose on both areas. It exempts clothing purchases beyond what is necessary for health and welfare and it exempts a nontrivial amount of clothing

[37] https://www.digitalcommerce360.com/article/online-apparel-sales-us/

[38] https://www.aei.org/carpe-diem/chart-of-the-day-the-cpi-for-clothing-has-fallen-by-3-3-over-the-last-20-years-while-overall-prices-increased-by-63-5/

purchases made by non-resident tourists to Vermont. **JFO estimates that the exemption's breadth beyond its statutory purpose in these two areas costs the State between $11.2 to $16.1 million per year.** In other words, if the Legislature sought and was able to target reducing the tax burden for necessary clothing expenditures for Vermont residents only, the exemption would cost $17 to $20 million instead of the $33 million it currently does.

a) The clothing and footwear exemption does a poor job at targeting purchases that are necessary for health and welfare.

The first part of this analysis evaluates whether the exemption covers necessary clothing and footwear expenditures. While clothing and footwear are necessary for human health and welfare, not all clothing and footwear purchases are necessary.

To estimate the extent to which the clothing and footwear exemption is overly broad, JFO attempted to estimate the sales of clothing purchases that could reasonably be deemed necessary for the health and welfare of a person.

The first methodology uses the Joint Fiscal Office's 2019 Basis Needs Report.[39] The report estimates a set of necessary and common household expenses for several household configurations and determines a wage rate required to meet those expenses. The headline wage for the 2019 report was $13.34 an hour based upon a two-person household with no children and employer-sponsored health insurance, averaged for both urban and rural areas.

The expenses used to calculate the livable wage rate includes an estimate for apparel and services. For a two-adult household with no children, the report estimated $1,413 a year on apparel and services.[40] JFO adjusted this figure to more closely represent an average Vermont household, which was 2.3 people instead of 2, resulting in an average clothing expense of $1,624 per average Vermont household.[41]

Assuming that $1,624 is the average Vermont household expense on necessary apparel, total spending on *necessary* apparel to meet a household's basic needs would be about $421.8 million, translating to just over $25.3 million in sales tax exempted for necessary apparel expenses.[42] If the total clothing and footwear exemption is estimated to cost the State $33.1 million in foregone revenue, this would mean approximately $7.8 million of it is on *unnecessary* clothing purchases.

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[39] https://ljfo.vermont.gov/assets/Subjects/Basic-Needs-Budgets/2c974b591b/2019-Basic-Needs-Budget-and-Livable-Wage-report-FINAL-1-15-2019-v2.pdf

[40] This figure is determined using the Consumer Expenditure Survey based upon income groups similar to that of the livable wage determined by the Basic Needs Budget report.

[41] JFO divided the report's $1,413 listed clothing expense by two (two-person household) for an average of $706.50 per person and then multiplied it by 2.3. This methodology assumes that clothing expense is equal across all members of the household, which is likely not fully accurate. Children might require higher expense while older members of a family would likely require less.

[42] Many households will spend less than this, but many will also spend more. For instance, single-person households in Vermont, which are about 30% of the total, are estimated by the report to spend about $969 on apparel. Households with two adults and two children (four-person households represent about 11% of total Vermont households) are estimated to spend up to $2,287 a year on apparel.

However, Consumer Expenditure Survey asks respondents what they spent on clothing in the past year, rather than necessary expenditures on clothing. The $1,624 of annual clothing expenditure used in the above analysis likely contains some expenditures of unnecessary expenditure and therefore is modestly too high.

JFO's alternative methodology was to analyze the lower-income group responses from the Consumer Expenditure Survey as a proxy for necessary clothing expenses. The theory behind this methodology is that lower-income households' expenditure on clothing better reflects the necessary expenditures since these households have limited resources to spend on non-necessary clothing items.

Using the 2019 survey, JFO calculated the weighted average spending amount on apparel by households earning between $30,000 and $50,000. This resulted in an average necessary clothing expenditure of $1,289 a year. Across all Vermont households, this leads to a total necessary clothing expenditure of $334.6 million, translating to approximately $20 million in exempted necessary clothing expenditure. With the total clothing exemption costing $33.1 million, this implies the State is foregoing $13.1 million in sales tax revenue beyond the statutory purpose.

In sum, JFO estimates the State foregoes between $7.8 and $13.1 million in sales tax revenue from clothing and footwear purchases (almost one-third of all purchases) that are beyond what is necessary for human health and welfare.

b) The clothing exemption provides a significant tax incentive to tourists which is not in the statutory purpose.

The statutory purpose states that the goal of the clothing exemption is "to limit the tax burden on the purchase of goods that are necessary for the health and welfare of all people in Vermont." The blanket nature of the exemption means that non-residents are benefitting from the exemption.

Tourism is a significant part of Vermont's economy. As of 2018, the share of Vermont's gross domestic product attributable to the accommodation and food services sector (industries strongly driven by tourism) was 4.8%. That was the third highest in the country after Hawaii and Nevada.[43] According to the Agency of Commerce and Community Development's (ACCD) 2017 Tourism Benchmark Study[44] it is estimated that tourism accounts for 10% of Vermont's $2.5 billion retail sector, the sector most likely to be subject to sales taxes. The report also estimates that tourism is accountable for $30 million annually in sales taxes.

According to the Economic Census, clothing stores in Vermont sold over $325 million in merchandise in 2017.[45] Using data from Visa, JFO, with assistance of ACCD, estimates that between 15% and 20% of all these sales are to tourists. Using a midpoint of 17.5%, this would translate to approximately $57 million in apparel purchases by tourists that are not subject to the sales tax. This is equal to $3.4 million in foregone sales tax revenue.

[43] Bureau of Economic Analysis, "GDP by State."

[44] https://accd.vermont.gov/sites/accdnew/files/documents/VDTM/BenchmarkStudy/VDTM-Research-2017BenchmarkStudyFullReport.pdf

[45] About $320 million in 2020 dollars, adjusting for CPI for apparel.

This $3.4 million, which is about 10% of the total cost of the exemption, is revenue that the State forgoes that does not directly benefit Vermonters as desired by the statutory purpose. In effect, due to its poor targeting, the clothing exemption acts, in part, as a tax incentive for tourists. Of course, any indirect benefits of tax incentive, such as increased spending by tourists at local Vermont retailers, could benefit Vermonters. There is limited evidence to suggest that tourists partake in apparel shopping in Vermont due to the exemption.[46,47]

iii) The clothing and footwear exemption creates an inconsistency in the tax code as other items that are arguably necessary for health and welfare are not exempted.

The statutory purpose of the exemption makes specific reference to the health and welfare of individuals. The argument for exempting clothing and footwear from sales tax is that these items are necessities for human health and welfare and therefore should either not be subject to tax or receive some favorable tax treatment.

Notwithstanding the fact that the exemption covers tens-of-millions-of-dollars' worth of non-necessary clothing and footwear expenses (see section above), if the justification for exempting clothing is on the grounds of reducing the burden on the purchase of human necessities, it creates a significant inconsistency in the tax code as there are a multitude of items that could reasonably be called necessities but do not receive any favorable tax treatment.

Vermont does exempt many goods that could reasonably be deemed necessary for human health and welfare. These include medical and dental supplies, groceries, and energy purchases for residences (electricity, heating fuels, etc).

According to the Consumer Expenditure Survey, households in the Northeast spent an average of $2,282 a year on apparel and services. This translates to average household savings of $134 per year due to the exemption.

Again, the question of whether this exemption is fulfilling its statutory purpose relies on what the definition of a good that is necessary for human health and welfare. The Basic Needs Budget in the Livable Wage Report is perhaps the best proxy for what the Legislature considers a necessary expense.[48] It considers several other non-apparel household expenses from the Consumer Expenditure Survey in its determination of a livable wage. These items are currently subject to sales tax. These items include:

- Housekeeping supplies, which include laundry and cleaning supplies, other household products, and postage and stationery.

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[46] There is some evidence that sales tax holidays do affect consumer spending patterns, but it could largely be a function of timing. See "The Effect of Sales-Tax Holidays on Consumer Spending" by researchers at the Federal Reserve: https://www.federalreserve.gov/econres/notes/feds-notes/effect-of-sales-tax-holidays-on-consumer-spending-20170324.htm.

[47] There is also not much evidence on consumer elasticity with respect to clothing. A 2000 paper by Sheng-Shyr Cheng found that clothing purchases were inelastic in both the short and long term, meaning little response to price fluctuations. See: https://www.consumerinterests.org/assets/docs/CIA/CIA2000/cheng2.pdf.

[48] The legislature and the Joint Fiscal Committee approve the methodology of the report. The methodology for the report was recommended by the 2008 Basic Needs Technical Advisory Committee.

- Household furnishings and equipment, which include household textiles, furniture, floor coverings, major appliances,[49] small appliances, and miscellaneous household equipment.

Table 2: Selected Average Spending by Northeast Households on Necessary Items (as defined by the Basic Needs Budget)

Age Group	Apparel and Services	Housekeeping Supplies	Household Furnishings
Under 25	$1,470	$286	$946
25 to 34	$2,400	$490	$1,772
35 to 44	$2,500	$793	$2,324
45 to 54	$2,533	$858	$2,489
55 to 64	$1,804	$784	$2,801
65+	$1,560	$867	$1,845
Overall	**$2,282**	**$781**	**$2,250**

Source: Consumer Expenditure Survey, 2019

As Table 2 shows, on average, over $3,000 of annual spending on household furnishings and cleaning supplies are not exempted from sales tax despite arguably being necessary for human health and welfare. For some households, some of these expenditures might be less necessary than others (a household might use a laundromat instead of purchasing a washer and dryer, for instance).

Overall, while the clothing and footwear exemption does reduce the tax burden on necessary purchases for health and welfare, it is not clear why clothing and footwear are specifically singled out for a sales tax exemption when numerous other currently taxable items that have a reasonable claim of being necessary for human health and welfare do not receive the same treatment.

This inconsistency in the sales tax system violates the principle of equity, considered to be an important tenet of a high-quality tax system.[50] While the exemption does help ensure equity across taxpayers, it creates inequities within the tax base. If the Legislature's intent is to reduce the tax burden on goods necessary for human health and welfare, the principle states that it should follow that goal across the entire tax code and not just for select goods. Implementing a wide-ranging exemption for life's necessities would put the Legislature in a difficult position of determining which goods are necessary for human health and welfare.

iv) While not specifically goals laid out in statute, the exemption successfully reduces the regressivity of the sales tax and provides a benefit to Vermont apparel retailers on the border.

A frequent argument made for exempting necessities such as food and medical products from sales tax bases is that the sales tax is regressive; lower-income individuals spend a greater share of their income on these goods. By exempting them from the tax base, it is, in effect, a greater reduction in the tax burden as a proportion of income for lower-income groups.

[49] Major appliances are excluded from the budget because the household is assumed to be renting.
[50] Tax Policy Handbook for State Legislators, National Conference of State Legislatures, February 2010. https://www.ncsl.org/documents/fiscal/TaxPolicyHandbook3rdEdition.pdf.

Table 3: Annual Apparel Expense by Income Group, 2019			
Income Group	**Average Apparel Spending**	**Average Income**	**Average Share of Income Spend on Apparel**
Overall	**$1,883**	**$82,852**	**2.3%**
Less than $15,000	$862	$7,574	11.4%
$15,000 to $29,999	$912	$22,189	4.1%
$30,000 to $39,999	$1,193	$34,772	3.4%
$40,000 to $49,999	$1,400	$44,831	3.1%
$50,000 to $69,999	$1,586	$59,328	2.7%
$70,000 to $99,999	$1,899	$83,558	2.3%
$100,000 to $150,000	$2,565	$121,433	2.1%
$150,000 to $199,999	$3,437	$171,061	2.0%
$200,000+	$4,806	$343,498	1.4%

Source: Consumer Expenditure Survey, 2019

According to the Consumer Expenditure Survey, higher-income households tend to spend more money on clothing than lower income households (Table 3). Overall, the average U.S. household spent $1,883 a year on apparel and services, which equates to approximately 2.3% of average income before taxes.

Higher-income households spend a greater amount of money on clothing in absolute dollar terms. However, lower-income households spend a greater share of their income on apparel than do higher-income households. For instance, while an average household earning between $15,000 and $39,999 spends about one-fifth the amount an average household earning $200,000 and above in absolute dollar terms, the share of household income the lower-income household spends on apparel is almost three times that of the higher-income household. The average household earning between $15,000 and $39,999 saves $55 a year in Vermont sales taxes on clothing purchases, which is about 0.25% of their income. An average household earning $200,000 and above saves $288 in sales taxes a year on clothing purchases, but that is the equivalent of about only 0.08% of their average income.

In addition to this, it is likely that Vermont apparel retailers close to the State's border are benefitting modestly from the exemption. New York and Massachusetts exempt clothing purchases up to a certain price, while New Hampshire does not have a sales tax. In the event of a full repeal of the clothing exemption, a given piece of clothing would cost 6% more at a Vermont retailer relative to its peer across the border, all things equal. While JFO could find no Vermont specific data to support the idea that Vermont clothing retailers on the border would suffer in the event of a repeal, recent academic literature has found that sales tax rate differentials do entice cross border shopping:

- A 2016 study by the Nebraska Department of Revenue[51] found that a one percentage point increase in a city's sales tax rate induced cross-border shopping by 4.81 percent. However, the effect disappears when the two cities are more than a 50-minutes' drive apart.
- A 2009 study from Washington found that for every 1% increase in the state sales tax, border county sales fell by 3.11%.[52]

[51] Cho, Iksoo, "Local Sales Tax, Cross-Border Shopping, and Travel Cost" (March 29, 2016). Available at SSRN: https://ssrn.com/abstract=2756208 or http://dx.doi.org/10.2139/ssrn.2756208.

[52] Wooster, R. B., & Lehner, J. W. Reexamining the Border Tax Effect: A case Study of Washington State. Contemporary Economic Policy, (2009): 511-523.

- A 2005 study from West Virginia found that the state's repeal of its groceries exemption (a 6% increase in price) led to a decrease in food sales in border counties of 4%. [53]

V. Considerations for Legislators

This review of the clothing and footwear exemption has found that the exemption, while helping reduce regressivity in the tax code, is poorly targeted. The Legislature may want to consider narrowing or limiting the exemption to better meet its statutory purpose.

One option for doing this is limiting the exemption using a price threshold. As noted earlier, this is a practice adopted by other states to limit the regressivity of the sales tax. Vermont used to have a price threshold in place, but it was repealed when Vermont joined the SSUTA because at the time, the agreement did not allow for them. However, states are now permitted to have a price threshold for their clothing exemptions.

Another option is repealing the exemption in its entirety and offsetting the regressivity of the sales tax through the personal income tax. Another advantage to using the personal income tax is that the benefit would be limited to Vermont residents, whereas even a price threshold would still benefit nonresidents.

One way to do this is by enacting a tax credit specifically designed to offset the sales tax's regressivity. An example of this is Maine's Sales Tax Fairness tax credit. This refundable credit is at least $100 and increasing depending on the number of personal exemptions the taxpayer claims. The credit phases out above $20,000 in adjusted gross income for single filers and $40,000 for married couples. [54]

Another way to mitigate the regressivity of the sales tax using the existing personal income tax framework would be to boost Vermont's Earned Income Tax Credit (EITC). That credit is fully refundable and is limited to lower-income families. Nearly 40,000 Vermont households benefit from the EITC, with an average credit of almost $700.

Should the legislature decide to provide some tax credit through the personal income tax, it would need to decide the appropriate amounts by household size and income thresholds. It would also need to consider how or whether to provide benefits to low-income households who do not file Vermont tax returns. Finally, since the costs of personal income tax credits are borne by the General Fund, the Legislature would need to find ways to replace the lost revenue due to new or expanded personal income tax credits.

[53] Tosun, Mehmet Serkan and Skidmore, Mark, "Cross-Border Shopping and the Sales Tax: A Reexamination of Food Purchases in West Virginia." Regional Research Institute Publications and Working Papers. (2005): 109.
[54] Maine Revised Statutes, Title 36, Chapter 822, §5213.

TAX EXPENDITURE EXPEDITED REVIEWS

Qualified Sale of Mobile Home Park Credit– Expedited Review
Prepared by the Department of Taxes

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	Recommendations
A credit of seven percent of the taxpayer's gain subject to federal income tax for the taxable year. The credit can be applied against personal or corporate income tax and unused credit amounts can be carried forward to the next three taxable years	The statutory purpose of the Vermont qualified sale of a mobile home park credit in section 5828 of this title is to encourage sales of mobile home parks to a group composed of a majority of the mobile home park leaseholders, or to a nonprofit organization that represents such a group, and, in doing so, to provide stability to the inhabitants of such mobile home parks	~$250,000 over prior five fiscal years	Provide reminders and resources regarding this credit. Potentially move this credit to pre-apportionment and make it a larger percentage than seven percent.

Public Policy Objectives
The Legislature stated that the public policy objective of the seven percent credit for the qualified sale of a mobile home park is to encourage the sale of mobile home parks to their leaseholders (or a nonprofit representing them) and in doing so, provide stability to those residents.

Estimates and Analysis
The number of filers claiming this credit against their personal income tax liability has been substantially fewer than ten over the past five fiscal years, although tax year 2019 saw more activity than usual. Generally, this credit costs less than $50,000 a year but the cost in 2019 was somewhat larger than that. The credit has almost never been used against corporate income tax, even though that is allowed in statute and captured on the applicable corporate form, the BA-404.

This credit is taken by the seller of the mobile home park on their tax return. It is unclear from tax department records how many sales of this nature have occurred, so the "utilization" of this credit is impossible to know. Periodically, credits such as this that are designed to encourage very specific transactions should be promoted or advertised to make sure they work as designed and succeed in their statutory purpose.

Legal History
This credit was created in Act 103 of 1997.

State Comparisons
Information about comparable credits to this one in other states is limited. It does appear that more than a dozen states offer a similar credit that is structured like Vermont's, where the credit come through as a percentage of the taxable gain[55]. A small number of other states appear to offer credits or exemptions to other tax types, such as real estate transfer taxes. The most

[55] https://prosperitynow.org/sites/default/files/PDFs/Promoting_Resident_Ownership_of_Communities.pdf

comprehensive resource for comparing the legal parameters of these sales, including tax treatment, is the one footnoted from the National Consumer Law Center.

Affordable Housing Tax Credit – Expedited Review
Prepared by the Vermont Department of Taxes

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	Legislative Considerations
Credit of 25% of the qualified basis of an affordable housing project; credit may be sold to raise capital. Taxpayer may claim the credit in five consecutive tax years and carry forward unused credits for 14 tax years. Credit may be claimed against bank franchise tax, personal income tax, corporate income tax, captive insurance premium tax, or insurance premium tax.	"The statutory purpose of the Vermont affordable housing credit in section 5930u of this title is to increase the capital available to certain affordable housing projects for construction or rehabilitation by attracting up-front private investment." 32 V.S.A. §5813(i)	$3.1 million in FY 2022	Statutory purpose could be improved by adding specific, quantifiable goals against which to collect data and track progress. Affordable housing credit should be considered in broader context of all policy that affects affordable housing in Vermont – how do the various initiatives support each other or create overlapping incentives?

Public Policy Objectives

The objective of the Affordable Housing Tax Credit is to increase capital for affordable housing construction and rehabilitation projects. The statute uses the federal definition of affordable rental housing from 26 U.S.C. § 42(g) and of owner-occupied housing from 26 U.S.C. § 143 (c)(1) or Vermont Housing Finance Agency (VHFA) criteria. VHFA has specific knowledge of the project applications and is responsible for ensuring that credits are awarded for projects that meet affordability criteria. Neither the statute nor the statutory purpose use specific or quantifiable language around "increase[ing] the capital available" for affordable housing projects. It is unclear whether the amount of capital should increase relative to the previous year, relative to a baseline year, or relative to a counterfactual in the absence of affordable housing credits (the last is notoriously difficult to evaluate).

The credit provides 1) rental housing tax credits for the construction or rehabilitation of affordable rental housing, 2) home ownership tax credits for the development of affordable owner homes and purchase of mobile homes, and 3) down payment assistance tax credits to provide down payment assistance loans to first-time home buyers.56 The Vermont Housing Finance Agency (VHFA) administers both the Vermont Affordable Housing Tax Credit and the similarly-constructed federal Low-Income Housing Tax Credit (LIHTC) that is used to finance affordable rental housing. The credits are typically awarded to developers and then sold to raise capital for project construction; the purchasers claim the credits against their bank franchise tax, personal income tax, corporate income tax, captive insurance premium tax, or insurance premium tax liabilities.

[56] Vermont Housing Finance Agency Affordable Housing Credit Summary, Vermont Housing Finance Agency, 2021.

Both the Affordable Housing Tax Credit and the federal LIHTC are allocated according to a Qualified Action Plan (QAP) that, among other things, explains allocation priorities for the credits; states have leeway to set their own priorities that align with federal priorities. In the most recent 2020-2021 QAP, Vermont's guiding principles are:

- "Achieving the perpetual affordability of housing resources and investments.
- Promoting development in State Designated Downtowns, Village Centers, Neighborhood Development Areas and other areas that are consistent with the State's Historic Settlement Pattern and 'Smart Growth'.
- Linking the State's homeless assistance activities with permanent housing through systems, practices and initiatives that are informed by data and proven approaches."[57]

Estimates and Analysis

The Affordable Housing Tax Credit is claimed by around 50 filers every year. The majority of the credit is claimed against bank franchise tax, followed by captive insurance and insurance premium tax, personal income tax, and corporate income tax (Table 1).

Table 1: Actual VT Affordable Housing Tax Credit Expenditures, 2010-2020

	BFT	IPT and CPT	CIT	PIT	TOTAL
FY 2010 Amount	1,229,100	364,300	0	0	**1,593,400**
FY 2011 Amount	1,377,300	440,000	144,800	0	**1,962,100**
FY 2012 Amount	1,221,700	447,000	0	0	**1,668,700**
FY 2013 Amount	1,231,500	436,200	*	0	**1,667,700**
FY 2014 Amount	1,860,000	*	0	*	**1,860,000**
FY 2015 Amount	1,910,000	*	0	*	**1,910,000**
FY 2016 Amount	1,970,000	*	0	*	**1,970,000**
FY 2017 Amount	2,250,000	*	*	*	**2,250,000**
FY 2018 Amount	2,680,000	*	0		**2,680,000**
FY 2019 Amount	2,190,000	*	0	9,764	**2,199,764**
FY 2020 Preliminary	2,570,000	*	0	*	**2,570,000**
FY 2022 Projected	3,090,000	*	0	20,000	**3,110,000**

Source: Vermont Department of Taxes; published Tax Expenditure Reports 2013-2019

* Data suppressed to protect taxpayer confidentiality

The total allocations for any given fiscal year have been capped in statute since 2005 – see Legislative History for values over time. When suppressed data are included, the annual expenditure on affordable housing tax credits consistently approaches this cap.

The VHFA estimates that the Affordable Housing Tax Credit is used to build or renovate an average of 131 apartments, 19 "perpetually affordable owner-occupied homes", and 32 "energy-

[57] State of Vermont Qualified Allocation Plan, Vermont Housing Finance Agency, 2019: p4. https://www.vhfa.org/documents/developers/2020_qap_final.pdf.

efficient mobile homes" annually.58 Additionally, the down payment assistance portion of the program supports an average of 300 first-time home buyers each year.59 The down payment assistance program has been used in 1,361 purchases since its inception in 2015.60 Per the VHFA, "The Affordable Housing Credit is a highly leveraged resource, drawing private equity investment into affordable housing that would not occur otherwise. In terms of rental development, for every $1 in Affordable Housing Credit equity raised in 2021 about $16 is expected to be leveraged in private and public capital from other sources."61

The availability and utilization of affordable housing is a critical issue in Vermont. The most recently available 2019 Census data show that 26% of homeowners with a mortgage, 17.8% of homeowners without a mortgage, and 54.4% of renters spend 30% or more of household income on housing expenditures (Table 2).

Table 2: VT Owners and Renters with Housing Expenditures of 30% or More of Income

Category	Estimated # Households	Margin of Error	Percent	% Margin of Error
Monthly owner costs as a percentage of household income				
Housing units with mortgage				
Less than 30 percent	84,505		74.00%	
30.0 to 34.9 percent	7,692	±988	6.70%	±0.9
35.0 percent or more	22,045	±1,831	19.30%	±1.5
Housing units without mortgage				
Less than 30 percent	58,369		82.20%	
30.0 to 34.9 percent	3,324	±759	4.70%	±1.1
35.0 percent or more	9,269	±1,212	13.10%	±1.5
Gross rent as a percentage of household income				
Less than 30 percent	32,393	0	45.60%	
30.0 to 34.9 percent	7,924	±1,365	11.10%	±1.9
35.0 percent or more	30,814	±2,698	43.30%	±3.2

Source: U.S. Census Bureau, 2019 American Community Survey 1-Year Estimates. Table DP04.

This is a large gap to address with tax expenditures alone. The affordable housing tax credit is one piece of the puzzle when addressing housing affordability in Vermont. It should be considered carefully in the broader context of policy that touches on the issue, including but not limited to the federal low-income housing tax credit (LIHTC), Act 250, zoning requirements, and development initiatives. It is possible that adjustment to these policy levers could catalyze investment in affordable housing beyond what is possible through increasing tax expenditures alone.

[58] Vermont Housing Finance Agency Affordable Housing Credit Summary, Vermont Housing Finance Agency, 2021.

[59] ibid

[60] ibid

[61] Vermont Housing Finance Agency Affordable Housing Credit Summary, Vermont Housing Finance Agency, 2021: p2.

Although it is not entirely within the scope of this review, the COVID-19 pandemic is likely to increase the importance of affordable housing in Vermont as it simultaneously creates conditions that make construction and maintenance of such housing less likely.[62]

- Households with lower incomes are more likely to spend a higher proportion of their income on housing.[63]
- Households facing high housing cost burdens may not be able to spend adequately in other areas such as food or health care.[64]
- Local housing market conditions may restrict the ability of households to move to more affordable housing if the supply of affordable housing in the market is limited, if housing prices in the area have risen faster than incomes, or if construction costs are high.

A detailed analysis of housing affordability in Vermont is outside the scope of this report but interested parties should explore sources such as the U.S. Department of Housing and Urban Development,[65] the Low-Income Housing Coalition,[66] the Federal Reserve,[67] the Vermont Affordable Housing Coalition,[68] and the Vermont Agency of Commerce and Community Development's Vermont Housing Needs Assessment.[69]

Should the Legislature choose to refine the statutory purpose to include both increasing capital and increasing the availability of affordable housing itself, subsequent evaluations would focus more on the credit-funded projects. Legislators may find analyses of the similar federal LIHTC helpful in determining which criteria to include in the statutory purpose.[70] Data on outcomes of

[62] Sisson, Patrick. Covid-19 is Killing Affordable Housing Just as it's Needed the Most, Bloomberg City Lab, 2020. https://www.bloomberg.com/news/articles/2020-07-30/the-u-s-affordable-housing-gap-is-getting-worse.

[63] Data on housing expenditure as a proportion of income are available at: Monthly Housing Costs as a Percentage of Household Income in the Past 12 Months, 2019 American Community Survey 1-Year Estimates Table S2503, U.S. Census Bureau, 2020. https://data.census.gov/cedsci/table?q=housing%20expenditure%20Vermont&tid=ACSST1Y2019.S2503&hidePreview=true.

[64] Scally et al. The Low-Income Housing Tax Credit: Past Achievements, Future Challenges, Urban Institute, 2018. https://www.urban.org/research/publication/low-income-housing-tax-credit-past-achievements-future-challenges.

[65] U.S. Department of Housing and Urban Development. https://data.hud.gov/.

[66] Out of Reach 2020: Vermont, National Low Income Housing Coalition. https://reports.nlihc.org/oor/vermont.

[67] All-Transactions House Price Index for Vermont, St. Louis Federal Reserve FRED Economic Data. https://fred.stlouisfed.org/series/VTSTHPI. See also Monthly Economic Update – State of Vermont, Federal Reserve Bank of Boston, 2021. https://www.bostonfed.org/publications-and-data.aspx#/browse/series.

[68] Vermont Affordable Housing Coalition. https://www.vtaffordablehousing.org/.

[69] Vermont Housing Needs Assessment, Vermont Agency of Commerce and Community Development, 2020. https://accd.vermont.gov/housing/plans-data-rules/needs-assessment.

[70] See, for example: Scally, Gold, and DuBois. The Low-Income Housing Tax Credit: How it Works and Who it Serves, Urban Institute, 2018. https://www.urban.org/research/publication/low-income-housing-tax-credit-how-it-works-and-who-it-serves/view/full_report; Low Income Housing Tax Credit Policy Issues, Congressional Research Service In Focus 11335, 2019. https://fas.org/sgp/crs/misc/IF11335.pdf; Fischer. Low-Income Housing Tax Credit Could Do More to Expand Opportunity for Poor Families, Center on Budget and Policy Priorities, 2018. https://www.cbpp.org/research/housing/low-income-housing-tax-credit-could-do-more-to-expand-opportunity-for-poor-families; Stamm and LaJoie. An Overview of the Low-Income Housing Tax Credit, Tax Foundation Fiscal Fact, 2020. https://taxfoundation.org/low-income-housing-tax-credit-lihtc/.

projects financed with affordable housing tax credits are difficult to find – if they exist, they are dispersed rather than consolidated in a single, accessible location. The usefulness of data collection must be balanced against the burden it creates. Additional data that would be helpful in evaluating the effectiveness of the affordable housing tax credit include:
Data on capital availability for these projects and similar projects that are not financed with the affordable housing tax credit to assess relative quality and whether capital availability is still a key constraint in affordable housing construction and rehabilitation
Consistent granular housing data such as rent charged over time, market price over time, and financing options used for project homes and other area homes; this may be partially accomplished by linking project data to other existing data sources
Data about households who live in projects financed with the affordable housing tax credit such as income, demographic characteristics, and other kinds of assistance used to make housing affordable
Location information on projects financed with the affordable housing tax credit, including neighborhood characteristics[71,72,73]

Legal History

<table>
<tr><td>1999</td><td>Credit added for building owners. Credit can be claimed against taxpayers' individual income, corporate income, or franchise tax. Total annual award capped at $100k to all applicants.</td></tr>
<tr><td>2001</td><td>Total annual award increased to $150k to all applicants.</td></tr>
<tr><td>2003</td><td>Credit certificates introduced and credit may be claimed by taxpayers making eligible cash contributions.</td></tr>
<tr><td>2005</td><td>Credit may be claimed against insurance premium tax. Clarified that amount on credit certificate may be claimed each year for five consecutive years. Total annual first-year allocation award increased to $400k to all applicants. Total first year plus succeeding year allocations capped at $2m for any fiscal year.</td></tr>
<tr><td>2007</td><td>Eligibility extended to rental housing and owner-occupied housing. Allocation plans required. Limits changed to:
<table>
<tr><th>Type</th><th>Total first-year credit allocation award</th></tr>
<tr><td>Rental housing</td><td>$400k</td></tr>
<tr><td>Owner-occupied housing</td><td>$100k</td></tr>
</table>
Total first year plus succeeding year allocations capped at $2.5m for any fiscal year.</td></tr>
<tr><td>2012</td><td>Limits changed to:
<table>
<tr><th>Type</th><th>Total first-year credit allocation award</th></tr>
<tr><td>Rental housing</td><td>$400k</td></tr>
<tr><td>Owner-occupied housing</td><td>$300k</td></tr>
</table>
Total first year plus succeeding year allocations capped at $3.5m for any fiscal year.</td></tr>
<tr><td>2015</td><td>Definition of eligible applicants extended. Affordable housing credits may be allocated to finance down payment assistance loans. Limits changed to:</td></tr>
</table>

[71] Scally, Gold, and DuBoi., The Low-Income Housing Tax Credit: How it Works and Who it Serves, Urban Institute, 2018. https://www.urban.org/research/publication/low-income-housing-tax-credit-how-it-works-and-who-it-serves/view/full_report.
[72] Low Income Housing Tax Credit Policy Issues, Congressional Research Service In Focus 11335, 2019. https://fas.org/sgp/crs/misc/IF11335.pdf.
[73] Fischer. Low-Income Housing Tax Credit Could Do More to Expand Opportunity for Poor Families, Center on Budget and Policy Priorities, 2018. https://www.cbpp.org/research/housing/low-income-housing-tax-credit-could-do-more-to-expand-opportunity-for-poor-families.

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<tr><td></td><td>
<table>
<tr><th>Type</th><th>Total first-year credit allocation award</th><th>Aggregate limit</th></tr>
<tr><td>Rental housing</td><td>$400k</td><td>$2m over five-year period</td></tr>
<tr><td>Owner-occupied housing or down payment loans</td><td>$300k</td><td>$1.5m over five-year period</td></tr>
<tr><td>Down Payment Assistance Program loans, 2016-2018</td><td>$125k</td><td>$375k over five-year period</td></tr>
<tr><td>Down Payment Assistance Program loans, 2020-2026</td><td>$250k</td><td></td></tr>
</table>
Aggregate limit for all credit allocations in section is $3.875m in any fiscal year.</td></tr>
<tr><td>2016</td><td>Award allocation limit language clarified.</td></tr>
<tr><td>2017</td><td>Credit may be claimed against captive insurance premium tax.</td></tr>
<tr><td>2019</td><td>Vermont Housing Finance Agency can allocate affordable housing tax credits to provide funds for loans or grants for owner-occupied housing. If full amount of authorized first-year credits is not allocated to a taxpayer, the Agency may reclaim and re-award those allocations to other applicants. Limits changed to:
<table>
<tr><th>Type</th><th>Total first-year credit allocation award</th><th>Aggregate limit</th></tr>
<tr><td>Rental housing</td><td>$400k</td><td>$2m over five-year period</td></tr>
<tr><td>Owner-occupied housing or down payment loans</td><td>$425k</td><td>$2.125m over five-year period</td></tr>
<tr><td>Down Payment Assistance Program loans, 2016-2019</td><td>$125k</td><td></td></tr>
<tr><td>Down Payment Assistance Program loans, 2020-2026</td><td>$250k</td><td></td></tr>
</table></td></tr>
</table>

State Comparisons

Vermont is one of 16 states that currently provide a state-based affordable housing credit for the construction and operation of affordable housing. The other states are Arkansas, California, Colorado, Connecticut, Georgia, Hawaii, Illinois, Missouri, Nebraska, Nevada, New Mexico, New York, Oklahoma, Utah, and Wisconsin.

In addition to Vermont's state-based credits, Vermont developers have access to the federal low-income housing tax credit. In Vermont, the federal and state credits are requested in the same application. Every state determines for itself how credit funds are to be allocated and what projects are eligible. Vermont's estimated 2020 LIHTC contribution is $3,198,139.[74]

[74] NOVOGRADAC Affordable Housing Resource Center. Available: https://www.novoco.com/resource-centers/affordable-housing-tax-credits/2020-federal-lihtc-information-state. This link also contains more information about federal low-income housing tax credits by state.

Charitable Housing Investment Tax Credit – Expedited Review
Prepared by the Vermont Department of Taxes

Tax Expenditure	Statutory Purpose	Estimated Revenue Impact	Legislative Considerations
Credit of difference between interest income that would have been received at charitable threshold rate and actual interest income received by investors in eligible housing charities. Credit amount is not to exceed 3% of average outstanding principal balance of investment during taxable year. Aggregate of charitable investment allowed outstanding in any year is limited to $5 million.	"The statutory purpose of the Vermont charitable housing credit in section 5830c of this title is to enable lower capital cost to certain affordable housing charities by restoring some of the forgone investment income through a tax credit to the investor." 32 V.S.A. §5813(h)	$75,000 in FY 2022	Statutory purpose describes cost of capital but sets no goals for use of capital. Is this sufficient to evaluate the true success of the program? Tax credit has not been claimed against bank franchise tax, insurance premium tax, or corporate income tax in the past ten years.

Public Policy Objectives

The Charitable Housing Investment Tax Credit exists to encourage investment in eligible housing charities by crediting the taxpayer with the difference between interest income actually earned by investors in the housing charities and interest income that would have been earned at the charitable threshold rate (which is currently the greater of one percent or two percentage points below the most recent bank prime loan rate). The credit is nonrefundable but unused credits may be carried forward for three years. The credit cannot exceed 3% of the average outstanding principal balance of the investment during the taxable year. The eligible housing charities enjoy lower capital costs because they can pay lower interest rates.

Estimates and Analysis

The Charitable Housing Investment Tax Credit is claimed by around 50 filers every year. In practice, the credit is claimed against personal income tax. It has not recently been claimed against bank franchise tax, insurance premium tax, or corporate income tax, although all are eligible tax types (Table 3).

Table 3: Actual VT Charitable Housing Investment Tax Credit Expenditures, 2010-2020

	BFT	IPT	CIT	PIT	TOTAL
FY 2010 Amount	0		0	37,000	**37,000**
FY 2011 Amount	0		0	18,360	**18,360**
FY 2012 Amount	0		0	30,000	**30,000**
FY 2013 Amount	0		0	24,000	**24,000**
FY 2014 Amount	0		0	23,000	**23,000**
FY 2015 Amount	0		0	27,000	**27,000**
FY 2016 Amount	0		0	28,000	**28,000**
FY 2017 Amount	0		0	35,000	**35,000**
FY 2018 Amount	0	0	0		
FY 2019 Amount	0	0	0	61,105	**61,105**
FY 2020 Preliminary Amount	0	0	0	76,388	**76,388**
FY 2022 Projected	0	0	0	75,000	**75,000**

Source: Vermont Department of Taxes; published Tax Expenditure Reports 2013-2019

To evaluate whether the Charitable Housing Investment Tax Credit meets the policy objective of providing lower-cost capital, the actual interest rates from the eligible housing charities should be compared to the rate those charities would be charged to secure a loan in the same amount from a bank. The charity would likely get a loan at a rate greater than or equal to the bank prime rate. For fiscal year 2020, the Federal Reserve bank prime rate had a minimum value of 3.25%, a maximum value of 5.5%, and an average value of 4.45%.[75]

The Agency of Commerce and Community Development, which determines which housing charities are eligible, currently directs all interested investors to the Vermont Community Loan Fund (VCLF).[76] The VCLF website does not list historical rates but does list the current rates in the table below (Table 4). According to the "Tax Benefits" portion of the VCLF website, their investors may choose either to earn the rates listed in the table OR to receive the Vermont Charitable Housing Investment Tax Credit of 1.78%.[77] If the investor chooses the charitable housing credit, they earn no interest on VCLF accounts; about 25% of the fund's investors choose to take the credit.[78] All rates listed by the VCLF, including the tax credit rate of 1.78%, are below the prime rate. This indicates that the VCLF is able to secure lower-cost capital using the Charitable Housing Investment Tax Credit.

[75] Federal Reserve series H.15 Average majority prime rate charged by banks on short-term loans to businesses, Federal Reserve Data Download Program, downloaded 01/23/21. https://www.federalreserve.gov/datadownload/Choose.aspx?rel=H15.

[76] Vermont Agency of Commerce and Community Development, Charitable Housing Investment Tax Credit, 2021. https://accd.vermont.gov/housing/funding/tax-credit.

[77] Tax Benefits, Vermont Community Loan Fund, 2021. https://www.investinvermont.org/invest/vermont-investment-tax-benefits.html.

[78] ibid

Table 4: Vermont Community Loan Fund Products	
Product	**Interest Rate**
VCLF Social Investment Term Account	
1-2 Years	0.75%
3-4 Years	1.25%
5-6 Years	2.00%
7-9 Years	2.25%
10+ Years	2.50%
VCLF Social Investment Cash Account	0.50%
VCLF Social Investment Graduating Account	0.50%

Source: Vermont Community Loan Fund website, 2021[79]

Legal History

1989	Credit added.
2001	Changed definition of charitable rate to be at or below bank prime loan rate
2005	Changed definition of affordable housing. Shortened affordability protection from 40 years to 15 years or term of loan. Allowed charitable rate to be two points above bank prime loan rate. Expanded eligibility of borrowers to 100 percent of greater of state or area median income.

State Comparisons

A few other states provide tax credits for investments in support of affordable housing. Both Illinois and Missouri have similar credits available. Eligibility requirements vary by state.

[79] Products, Rates, and Terms, Vermont Community Loan Fund, 2021. https://www.investinvermont.org/invest/products-rates-and-terms.html.