

# OVERVIEW OF POTENTIAL REVENUE SOURCES

Pension Benefits, Design, and Funding Task Force

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**JOINT FISCAL OFFICE**

# Overview

- Cannabis tax revenues
- Sports gambling
- High-income tax surcharges
- Elimination of the Capital Gains Exclusion



# Cannabis Tax Revenues

- Passed in S.53 of 2020
- Total state tax rate on retail sales: 20% (plus 1% in LOT towns)
  - *14% state excise tax on the retail sale of cannabis*
  - *6% sales and use tax*
  - *Local option sales tax municipalities would receive extra 1%*
- Revenues from 14% tax dedicated to two funds:
  - *70% to the General Fund*
  - *30% to the Substance Misuse and Prevention Fund*
    - Capped at \$10 million per year
- Fee revenue TBD



# JFO Estimates

- Note: these are different from S.53 Fiscal Note because underlying data has been updated, but not assumptions
- Year 3 mature market: Between \$71 and \$131 million in total sales
  - *JFO high: \$210 per capita*
- Heavily dependent upon when market gets up and running, timelines may shift

<b>JFO Estimates: Total Excise Revenues (in millions)</b>				
<b>State 14% Excise Tax</b>				
	<b>FY22</b>	<b>FY23</b>	<b>FY24</b>	<b>FY25</b>
Low	\$0.0	\$3.6	\$7.6	\$10.0
Mid	\$0.0	\$4.9	\$10.5	\$13.7
High	\$0.0	\$6.5	\$14.0	\$18.3

<b>JFO Estimates: Total Sales Tax Revenues (in millions)</b>				
<b>6% Sales and Use Tax</b>				
	<b>FY22</b>	<b>FY23</b>	<b>FY24</b>	<b>FY25</b>
Low	\$0.0	\$1.6	\$3.3	\$4.3
Mid	\$0.0	\$2.1	\$4.5	\$5.9
High	\$0.0	\$2.8	\$6.0	\$7.9



# JFO Estimates

- Unspoken-for available GF revenue

<b>General Fund Revenue (in millions)</b>				
<b>70% of Excise Tax Revenue</b>				
	<b>FY22</b>	<b>FY23</b>	<b>FY24</b>	<b>FY25</b>
Low	\$0.0	\$2.5	\$5.3	\$7.0
Mid	\$0.0	\$3.4	\$7.3	\$9.6
High	\$0.0	\$4.5	\$9.8	\$12.8



# Cannabis Control Board Estimates

- Consultant estimated total market demand for cannabis in Vermont.
- Total Market Size (in millions):

Year	2021	2022	2023	2024	2025	2026
Total Non-Medical Retail Sales	\$0	\$10.1	\$103.7	\$221.9	\$231.3	\$209.4

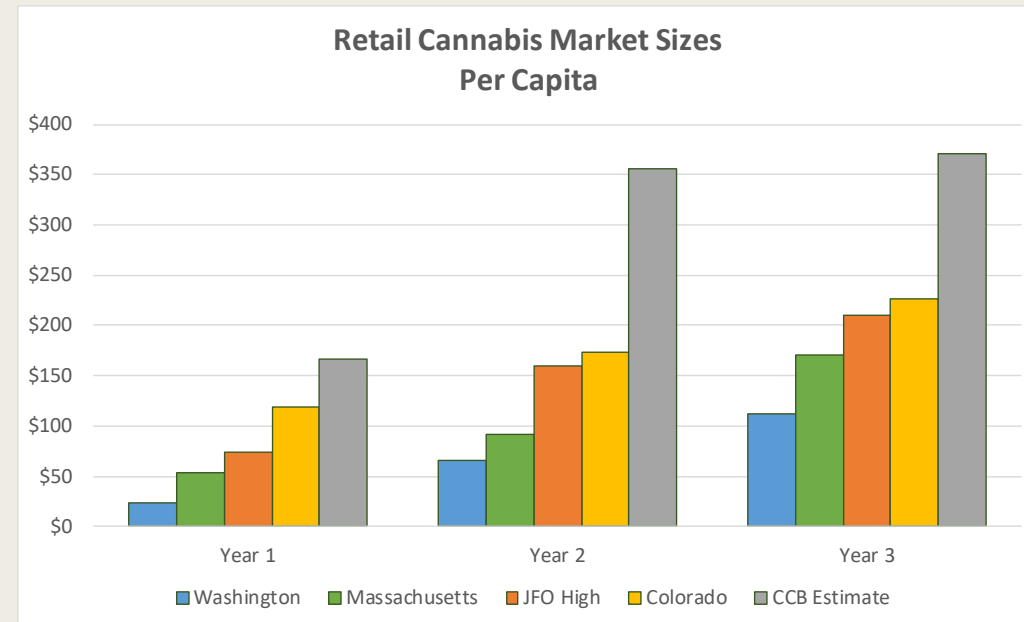
- Total Revenues (in millions)

	FY2022	FY2023	FY2024	FY2025	FY2026
<b>Sales Tax</b>	\$0.59	\$6.95	\$13.23	\$13.88	\$12.56
<b>Excise Tax</b>	\$1.37	\$16.22	\$30.87	\$32.38	\$29.32
<b>of which: Prevention Fund</b>	\$0.41	\$4.87	\$9.26	\$9.71	\$8.79
<b>of which: General Fund</b>	\$0.96	\$11.35	\$21.61	\$22.66	\$20.52



# Cannabis Control Board Estimates

- Estimates of cannabis markets are highly sensitive to model inputs and assumptions.
- Two big ones: number of cannabis users, and how much they will consume.
- Differences between JFO and CCB estimates largely boil down to different assumptions on these two parameters.
- JFO is reviewing the CCB model to see whether to incorporate changes.
- Benchmarking:
  - *On a per capita basis, CCB estimates of market size is large.*
  - *On a per-user basis, it is in line with states like Colorado.*
  - *Actual market may be somewhere in between.*



# Sports Gambling

- As of September 2021, 26 states and DC have legalized sports gambling
  - *Other than Nevada, the experience of states with legal sports betting markets is relatively young (since 2018).*
- The potential amount of revenue raised is dependent upon three factors:
  - *Maturity of the market: how long has it been up and running?*
  - *Regulatory structure: how competitive is the market? How easy is it for bettors to place bets?*
  - *Revenue split: how high is the tax rate? Is there a large revenue share with sportsbook?*
- Act 70 report explores the various regulatory structures, and revenues will be heavily dependent on what type of market is proposed.





# Sports Gambling

- Revenues generated will depend highly upon the ultimate structure of the market.
- Could be as low as \$1-2 million or as high as \$10 million per year.
- NCSL report: “States looking to close budget gaps with sports betting revenue may be disappointed, especially as more and more states legalize and take their slice of the market. “



# High Income Tax Surcharges

- Generally, an AGI-based surcharge that applies to any dollars over a certain amount
- Preliminary JFO estimates:
  - *3% tax rate on AGI over \$300,000: \$60 to \$70 million per year*
  - *1.5% tax rate on AGI over \$150,000: \$30 to \$40 million per year*
  - *3% tax rate on AGI over \$500,000: \$40-50 million per year*



# High Income Tax Surcharges

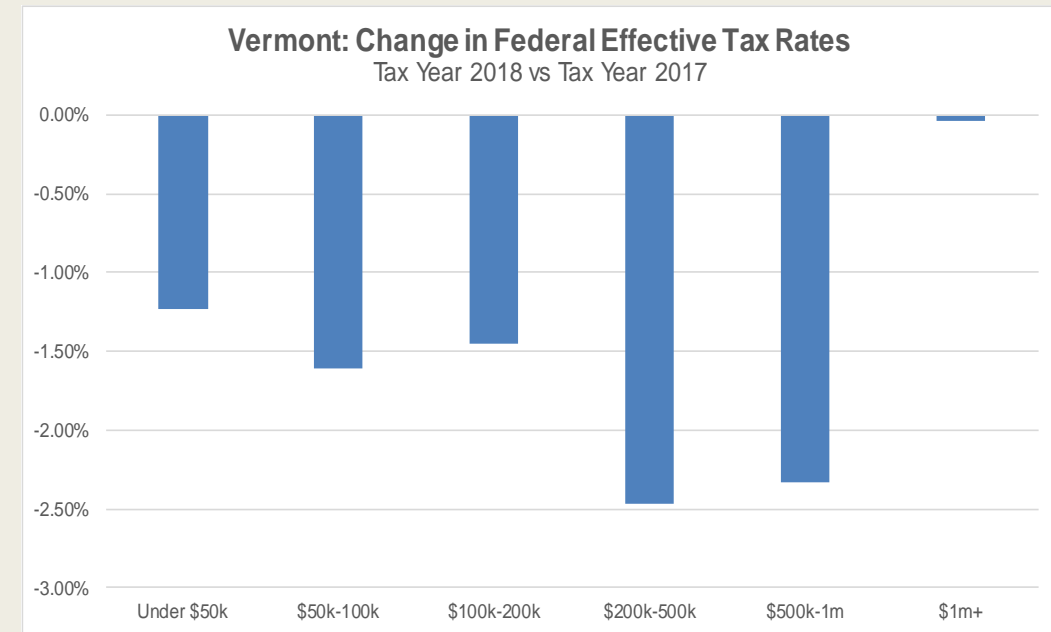
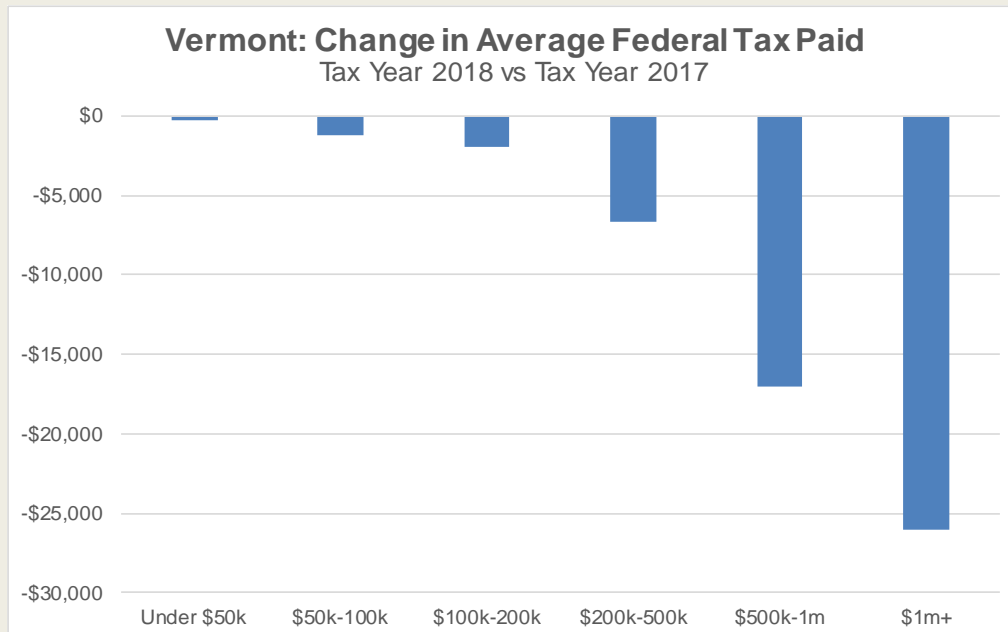
## ■ Considerations:

- Personal Income Tax already quite top heavy
- Very progressive systems are more vulnerable to volatility.
- Make up of high-income taxpayers changes every year. High income is often a one- or two-time event
- Adding a surcharge would make Vermont's PIT one of the highest in the country (Hawaii, California, Oregon)
- This group of taxpayers is very sensitive to fiscal or monetary policy



# High Income Tax Surcharges

- Over the past five years, Vermont tax policy has generally become more progressive:
  - Cap on capital gains exclusion (2019)
  - Repeal of all itemized deductions (2018)
  - Cap on charitable contributions (2018)
- Federally, tax code has generally become more regressive, especially in 2018 Tax Cuts and Jobs Act:
  - Policy question: how should Vermont react to Federal tax changes?



# Capital Gains Exclusion

- Taxpayers can exclude from income one of the following:
  - \$5,000 for any type of capital gain
  - 40% of sale of business assets, farms, timber
- History:
  - Prior to 2002, Vermont tax liability was calculated as a percentage of the Federal tax liability. Federal taxes had preferential treatment for capital gains.
  - Post-2002, Vermont created its own income tax system, but chose to preserve the preferential treatment for capital gains.
  - Exclusion has been narrowed over time:
    - 40% for all gains was narrowed to \$2500 for TY2009 and TY2010, and 40% was only available to farms and timber. For taxpayers over 70, they could use the 40% on anything.
    - 2010: current framework: \$5000, or 40% for certain assets
    - 2019: 40% exclusion capped at \$350,000



# Statutory Purpose

- 32 V.S.A. § 5813(b)
- Three parts:
  - “. . . increase savings and investment by making the effective tax rate on capital gains income lower than the effective tax rate on earned income.”
  - “. . . exempting a portion of the capital gain that may represent inflation.”
  - “The 40 percent business capital gains exclusion mitigates the impact of one-time realizations in a progressive tax structure.”



# Capital Gains Exclusion

- What does it cost us?
  - \$20.6 million in FY2019, 46,220 taxpayers
  - Rises and falls with capital gains performance
- Who benefits from the exclusion?
  - Higher income, older taxpayers
    - In TY2016, 60% of exclusions went to taxpayers with AGI above \$300,000
    - 65% of total gains excluded were from taxpayers older than 55.

**Table 1: Taxable Capital Gains and Exclusions by Filers in Various Income Groups in CY2016**

Adjusted Gross Income	Accounts Reporting Capital Gains	Total Taxable Capital Gains	Average Taxable Capital Gain	Total Capital Gains Excluded From Income	Percent of Total Capital Gains Exclusions	Average Capital Gains Exclusion
Less than \$40,000	8,236	\$17,043,548	\$2,069	\$13,099,367	4%	\$1,591
\$40,000 to \$60,000	5,321	\$17,296,454	\$3,251	\$13,106,240	4%	\$2,463
\$60,000 to \$100,000	9,484	\$53,310,460	\$5,621	\$28,139,032	9%	\$2,967
Below \$100,000	23,041	\$87,650,462	\$3,804	\$54,344,639	18%	\$2,359
\$100,000 to \$300,000	14,595	\$227,328,649	\$15,576	\$67,006,896	22%	\$4,591
\$300,000 and above	4,229	\$698,636,678	\$165,201	\$182,148,940	60%	\$43,071
<b>Total</b>	<b>41,865</b>	<b>\$1,013,615,789</b>	<b>\$24,212</b>	<b>\$303,500,475</b>		<b>\$7,250</b>



# Capital Gains Exclusion

- 40% vs \$5000 exclusion

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

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





# Capital Gains Exclusion

## ■ Who takes the 40% Exclusion?

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



# Capital Gains Exclusion

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

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

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



# Capital Gains Exclusion

- The capital gains exclusion helps Vermont remain tax competitive with neighboring states that do not have special tax treatment for capital gains but have lower top marginal tax rates.
  - *Compared to other states:*
    - VT's \$5,000 exclusion provides a much greater tax benefit for taxpayers below \$100,000 AGI
    - For taxpayers above \$100,000 who can't take 40% exclusion, lower marginal tax rates in other states are better
    - For taxpayers above \$100,000 who can take 40% exclusion, VT's tax on capital gains is among most favorable in region



# Capital Gains Exclusion

- JFO determined it is unlikely that the Vermont capital gains exclusion is encouraging savings and investment.
  - *Nationwide research on the effect of capital gains on savings and investment is mixed at best, although most studies show little to no effect*
  - *Tax benefits of Vermont’s capital gains exclusion are significantly smaller than Federal tax benefits*
    - Unlikely the Vermont exclusion is enough to drive savings and investment behavior

**Table 2: Hypothetical Examples of Capital Gains Incentives (2017 Tax Year)**

		\$5,000 Exclusion (95% of CG filers)		40% Exclusion (5% of CG filers)		Federal Tax Benefit	
		Vermont Taxes		Vermont Taxes		Federal Taxes	
Adjusted Gross Income	Long-Term Capital Gains (based on observed data)	Tax Benefit of Exclusion	Tax Benefit of Exclusion as Percent of AGI	Tax Benefit of Exclusion	Tax Benefit of Exclusion as Percent of AGI	Federal Tax Benefit	Tax Benefit of Lower Rates as Percent of AGI
\$40,000	\$2,000	\$71	0.2%	\$71	0.2%	\$228	0.6%
\$60,000	\$3,500	\$125	0.2%	\$125	0.2%	\$525	0.9%
\$100,000	\$5,600	\$340	0.3%	\$340	0.3%	\$675	0.7%
\$300,000	\$15,000	\$440	0.1%	\$528	0.2%	\$2,700	0.9%
\$500,000	\$65,000	\$440	0.1%	\$2,288	0.5%	\$11,704	2.3%
\$1,000,000	\$150,000	\$447	0.0%	\$5,370	0.5%	\$29,400	2.9%
\$2,000,000	\$300,000	\$447	0.0%	\$10,740	0.5%	\$58,800	2.9%

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

\$300,000 Example: \$34,000 in itemized deductions

\$500,000 Example: \$75,000 in itemized deductions

\$1,000,000 Example: \$105,000 in itemized deductions

\$2,000,000 Example: \$135,000 in itemized deductions



# Follow up questions?

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