Taxes and Revenues: Pension Task Force
Bus Tour of Revenue/Tax World

1) Quick stop at Tax School

2) Major landmarks
   1) Personal Income Tax
   2) Sales and Use Tax
   3) Corporate Income Tax

3) Quick stop for other tax types and other potential revenue ideas

4) Tax Expenditures
Tax School
Anatomy of a tax

**Tax Base (x) Rate = Liability (minus credits)**

The bigger the base, the lower the rate
The higher the rate, the smaller the base
A **tax base** is defined by what is included by the statutory language, minus any **exemptions** and **deductions**.
Exemptions

• An **exemption** is a systemic exclusion from the tax, and is usually limited to a particular group of taxpayers.
  - Example: Vermont has a property tax, but most libraries are statutorily exempt from paying the tax, even if their property would otherwise be taxable.

• An exemption can be a **full exemption** or a **partial exemption**.
  - Full exemptions obviously cost more, while partial exemptions require more compliance work by the taxpayer and the Department of Taxes.
Deductions

A *deduction* is an amount that an individual taxpayer is permitted to subtract from his or her tax base, which typically has the effect of reducing his or her liability.

\[
\text{BASE} \ (x) \ \text{RATE} = \text{LIABILITY}
\]

Deduction lowers the base
Tax Rates

- Tax rates can be fixed or tiered.

- Vermont’s sales tax is an example of a fixed rate.
- Vermont’s income taxes are examples of tiered rates.
  - Tiered rates are typically structured as a series of brackets.
  - Most tiered rates are structured to be progressive: liability increases smoothly from bracket to bracket.
  - Taxpayer pays only the assigned rate for each dollar within that bracket.
**Tax Brackets: Terminology**

- For tiered rates, a taxpayer’s **marginal tax rate** is the tax paid on the last dollar in the base.
  - Example: a taxpayer with $20,000 in income
  - Marginal Rate = 10%

- A taxpayer’s **effective tax rate** is the actual rate of tax for the entire liability
  \[
  \text{Effective tax rate} = \frac{\text{Total tax liability}}{\text{Total base}} \times 100
  \]
  - Example: taxpayer with $20,000 in income
    - First $10,000 in income taxed at 5% = $500
    - Second $10,000 in income taxed at 10% = $1,000
    - \[
    \frac{500 + 1,000}{20,000} \times 100 = 7.5\%
    \]
Liability modifications - credits

- **A credit** is an amount that reduces a taxpayer’s tax liability. It does not reduce the base or the rate, but lowers the resulting liability.

- Credits can be either refundable or nonrefundable. A **refundable credit** means that the taxpayer receives a payment if the credit reduces his or her liability below zero.
  - $100 tax liability, but a $150 refundable credit = zero liability + $50

- A **nonrefundable credit** can reduce a liability to zero, but not any further.
  - $100 tax liability, but a $150 nonrefundable credit = zero liability + a possible carryforward against future liability
Structure of Briefing

- What is it?
- How much do we collect?
- Who pays it?
- What’s new? How is COVID-19 affecting this revenue stream?
Personal Income Tax

1. Federal Adjusted Gross Income (Federal Form 1040, Line 86) .................................................................
2. Net Modifications to Federal AGI (Schedule IN-112, Part I, Line 15) ...................................................
3. Federal AGI with Modifications (Add Lines 1 and 2) ..............................................................................
4. 2019 Vermont Standard Deduction from filing status section above. Please see instructions if you or your spouse checked any standard
Personal Income Tax - What is it?

![Image of 1040 tax form]

### Personal Income Tax Form 1040

#### Filing Status
- Single
- Married filing jointly
- Married filing separately
- Head of household
- Qualifying widow(er)

#### Home Address
- Street address
- City, town, or post office
- State, and ZIP code

#### Standard Deduction
- Someone can claim: [ ] You as a dependent
- [ ] Your spouse as a dependent
- [ ] Spouse itemizes on a separate return or you were a dual-status alien

#### Dependent
<table>
<thead>
<tr>
<th>First name</th>
<th>Last name</th>
<th>Social security number</th>
<th>Relationship to you</th>
<th>Child tax credit</th>
<th>Credit for other dependents</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</tbody>
</table>

#### Income Sources
- Wages, salaries, tips, etc. (Attach Form W-2)
- Tax-exempt interest
- Qualified dividends
- IRA distributions
- Social security benefits
- Capital gain or loss (Attach Schedule D if required, if not required, check here)

#### Adjustments to income
- Add lines 1, 2a, 2b, 3b, 4b, 5b, 6, and 7a. This is your total income
- Subtotal line 8a from line 7b. This is your adjusted gross income

#### Standard Deduction
- [ ] Standard deduction or itemized deductions (from Schedule A)
Personal Income Tax - What is it?
(based on Tax Year 2020)

Adjusted Gross Income

minus

Subtractions from Adjusted Gross Income

Standard Deduction
$6,250 for single filer, $12,500 for married filer

Personal Exemptions
$4,350 for you, your spouse, and any dependents

Other Subtractions
• Capital Gains Exclusion
• Social Security Exemption
• Interest income from U.S. bonds

plus

Additions to Adjusted Gross Income
Examples included: interest from VT state and local bonds, non-Vermont state and local bonds, bonus depreciation

equal

Vermont Taxable Income
How to calculate tax liability

Vermont Taxable Income (VTI) 
Multiplied by 
Income tax rates at various brackets of income 
Equals 
Initial Vermont Tax Liability (Before Credits)
How to calculate final tax liability

Initial Vermont Tax Liability (Before Credits)

minus

Non-Refundable Credits
Credit for child and dependent care expenses, credit for elderly and disabled, investment tax credit, Charitable Tax Credit

minus

Refundable Credits
Earned Income Tax Credit

Multiplied by

Vermont Apportionment Percentage
The percentage of income based in Vermont

Equals

Final Vermont Tax Liability (or Refund)
Personal Income Tax: How much do we collect?

As of end-June: $124m above forecast. 60% of available GF revenue.

48% of available GF revenue

Source: Legislative Economist’s January 2021 Forecast
Personal Income Tax - Who Pays?

Total Vermont Taxes Paid by Residents, TY2019

Percentages above bars are the number of returns in that AGI group divided by the total number of resident returns.

$284 million in taxes (approx. 36% of total) came from 2% of tax returns.

Source: Department of Taxes
Personal Income Tax- Who Pays?

2019 Vermont Effective Personal Income Tax Rates, or Net Vermont Tax Divided by Federal Adjusted Gross Income (AGI)- Residents Only

The average effective tax rate on all resident returns is 3.5%

Source: Department of Taxes
Personal Income Tax: Who Pays?

Source: JFO 10-Year Tax Study, 2017
Personal Income Tax - What’s New?

- **Act 11 of 2018 Special Session**
  - Major overhaul in Vermont Personal Income Tax system
  - Made the income tax system modestly more progressive

- **COVID-19, and the related Federal fiscal stimulus has led to significant revenues in PIT**
  - Estimated payments since March 2020 have smashed records
  - K-Shaped recovery - strong business income and capital income
  - Bonus unemployment in 2020 and 2021 likely also boosted withholding payments
  - People moving to Vermont and working remotely
    - Likely higher income taxpayers, but not enough data yet to show this has moved the needle.
Personal Income Taxes and the Pandemic

Figure 4: Personal Income Tax Forecasts versus Actuals (in millions)

As of end-June 2021 ($124.4m above Jan 2021 target)
Sales & Use Tax
Sales and Use Tax- What is it?

- 6% on the retail sales of tangible personal property unless exempted by law.
- Destination based
  - Applied where the buyer takes possession of the item or where it was delivered.
- Does not apply to most services
- Revenues dedicated exclusively to the Education Fund beginning in FY2019
- Exemptions aplenty! (more on that later)
Sales & Use Tax: How much do we collect?

Sales Tax Collections Since FY2005
(Not Adjusted for Inflation)

Source: Legislative Economist’s January 2021 Forecast
Sales & Use Tax - Who pays it?

- Remitted by the retailer, final point of sale. Everyone pays but...

- Exemptions for groups and goods
  - Organizations who don’t pay sales tax
    - 501(c)(3) organizations (up to a certain amount of sales)
    - Federal, state, local governments
  - Purposes and goods exempted-usually to make it more progressive
    - Clothing
    - Groceries
    - Medical products

- Sales taxes (and most consumption-based taxes) considered to be regressive:
  - Lower-income residents pay higher percentage of income in sales taxes
  - They spend a higher proportion of their income on taxable goods
Sales & Use Tax - What’s new?

- **Internet/Remote Sales**
  - Prior to June 2018, states could only collect sales tax if a vendor had a “nexus” in the state (Quill Decision)
  - Supreme Court overruled Quill in June 2018: Wayfair Decision
    - States can now legally collect sales tax from remote sellers
  - Act 46 of 2019: Marketplace Facilitators
    - Large “marketplace facilitators” (Amazon, Etsy, Ebay) are required to collect and remit sales tax on behalf of vendors on their platform.

- **COVID-19 impacts**
  - Goods consumption has exploded during the pandemic, in particular, e-commerce
  - Federal fiscal stimulus led to record high levels of consumer disposable income, which was spent on durable goods, which are usually taxable
  - $507.6 million was collected in FY2021, which is $75 million more than the previous fiscal year.
  - Uncertainty remains- with reopening, will consumers continue to purchase goods or will the pivot back to services?
Corporate Income Tax
Corporate Income Tax - What is it?

Background: Types of Businesses

- **C-Corporation**: Larger business, profits accrue to corporation, 100+ shareholders
- **Pass-throughs**: Profits get “passed through” to owners who pay tax on their own personal income taxes
  - S-Corporations and LLCs: Usually smaller businesses, profits dispersed to smaller number of shareholders, limited liability
  - Sole Proprietors: Profits go to a single owner on their income

Corporate Income Tax is a tax on the net income of a C-Corporation

- **Most businesses do not pay the corporate income tax because they are pass-throughs!**

What about multi-state businesses?

- Taxable income determined by formula using property, payroll and sales
- Vermont requires unitary combined reporting
  - **Two types of business**:
    - **Unitary Combined**: Those that file a VT return but are part of a larger company (13% of returns).
    - **Not Combined**: Those businesses that are not part of a larger company (87% of returns)
# Corporate Income Tax – What is it?

<table>
<thead>
<tr>
<th>Taxable Income Bracket</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$3,751 up to $10,000</td>
<td>6.00%</td>
</tr>
<tr>
<td>$10,000 up to $25,000</td>
<td>7.00%</td>
</tr>
<tr>
<td>$25,000 and over</td>
<td>8.50%</td>
</tr>
</tbody>
</table>
Corporate Income Tax - How much do we collect?

Corporate Income Tax Collections since FY2005
(Not Adjusted for Inflation)

As of end-June, $51 above forecast. 7.2% of GF Revenue

5.8% of GF Revenue
Corporate Income Tax – Who pays it?

- Only C Corporations
- Most revenue comes from a minority of larger unitary combined returns

Figure 22. Corporate Income Tax by Type of Return: Unitary Combined or Not Combined, Tax Year 2014

- **Not Combined**
  - $11.3 Million, 16%
  - 6,300 Filers, 87%

- **Combined**
  - $59.0 Million, 84%
  - 972 Filers, 13%
Corporate Income Tax - Who pays?

In 2019:

- 13,236 corporate tax filers
- ~3,000 had positive taxable income and therefore, paid corporate income tax from the brackets

### Minimum Tax Payers by Gross Receipts

<table>
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<tbody>
<tr>
<td>Less than $100,000</td>
<td>7,246</td>
<td>7,345</td>
<td>91.3%</td>
<td>90.4%</td>
</tr>
<tr>
<td>$100,000-$200,000</td>
<td>654</td>
<td>621</td>
<td>73.3%</td>
<td>70.6%</td>
</tr>
<tr>
<td>$200,000-$500,000</td>
<td>778</td>
<td>718</td>
<td>64.6%</td>
<td>59.6%</td>
</tr>
<tr>
<td>$500,000-$1 million</td>
<td>468</td>
<td>457</td>
<td>55.3%</td>
<td>53.1%</td>
</tr>
<tr>
<td>$1 million-$1.5 million</td>
<td>181</td>
<td>182</td>
<td>47.6%</td>
<td>45.7%</td>
</tr>
<tr>
<td>$1.5 million to $3 million</td>
<td>314</td>
<td>283</td>
<td>49.4%</td>
<td>46.5%</td>
</tr>
<tr>
<td>$3 million to $5 million</td>
<td>154</td>
<td>150</td>
<td>43.1%</td>
<td>41.8%</td>
</tr>
<tr>
<td>$5 million+</td>
<td>309</td>
<td>288</td>
<td>42.3%</td>
<td>40.6%</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>10,104</strong></td>
<td><strong>10,044</strong></td>
<td><strong>77.8%</strong></td>
<td><strong>76.4%</strong></td>
</tr>
</tbody>
</table>

Source: VT Department of Taxes
Corporate Income Tax – What’s New

- **Tax Cuts and Jobs Act of 2017**
  - Changed the rules around treatment of foreign profits which could lead to one-spikes in Corporate Taxable Income
  - Vermont received a lot of foreign repatriated money in FY2018 through FY2020.

- **COVID-19 Impacts**
  - Corporate Tax revenues significantly beat their forecast in FY2021.
  - Federal fiscal stimulus likely boosted corporate bottom lines
  - Potential revenue bump from Vermont change to method of sourcing services to “Market Based-Sourcing”
Other major revenue sources

- **Meals and Rooms Tax**
  - 9% on taxable meals and rented rooms, 10% on alcohol portion of meals
  - $143.5 million in FY21 ($173 million in FY18!)
  - Beginning FY20, 25% of revenues to EF, 69% to GF, 6% to the Clean Water Fund

- **Cigarette and Tobacco Products Tax**
  - $3.08 per pack for cigarettes, 92% of wholesale price for other tobacco products
  - 92% wholesale price tax added to e-cigarettes in 2019
  - $77.4 million in FY21
  - Revenues dedicated the General Fund

- **Insurance Premiums Tax**
  - 2% per year on the gross amount of premiums written in Vermont
  - Paid in lieu of corporate income tax
  - $60.3 million in FY21
  - Revenues dedicated to GF
Other major revenue sources

Source: Legislative Economist’s Forecast, January 2021
Hot Topic Revenue Ideas

- Cannabis excise tax
  - JFO Fiscal Note from 2020

<table>
<thead>
<tr>
<th></th>
<th>FY21</th>
<th>FY22</th>
<th>FY23</th>
<th>FY24</th>
<th>FY25</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>$0.0</td>
<td>$0.5</td>
<td>$5.3</td>
<td>$10.3</td>
<td>$13.3</td>
</tr>
<tr>
<td>Mid</td>
<td>$0.0</td>
<td>$0.5</td>
<td>$6.9</td>
<td>$14.0</td>
<td>$18.2</td>
</tr>
<tr>
<td>High</td>
<td>$0.0</td>
<td>$0.5</td>
<td>$9.0</td>
<td>$18.7</td>
<td>$24.2</td>
</tr>
</tbody>
</table>

Notes: State fee revenue totals $500,000 in FY22, and $650,000 thereafter

- Sports gambling
  - No formal JFO estimate, but Administration budget proposal estimated $2.5 million per year
  - Formal study to Legislature due in October 2021
Hot Revenue Ideas

- **High income tax surcharges**
  - Generally, an AGI based surcharge that applies to any dollars over a certain amount.
  - **Preliminary 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

- **Considerations:**
  - Personal income tax already quite top heavy
  - Very progressive systems are more vulnerable to volatility.
  - Only 2-3 states have income tax rates that would be near these levels (Hawaii, California, Oregon).
  - Fiscal and monetary policy play a huge impact on these groups
Tax Expenditures

VERMONT
Tax Expenditures
2021 Biennial Report

January 15, 2021
Pursuant to 32 V.S.A § 312.
Tax Expenditures

- Statutory provisions which reduce the amount of revenue that would otherwise be collected
- Done to encourage a particular activity or limit the amount of taxes collected from certain groups
- Examples:
  - Tax credits and deductions
    - Earned Income Tax Credit, Social Security deduction
  - Exemptions from the tax base
    - Clothing exempt from the sales tax
- JFO publishes a report every two years
FY2019 Personal Income Tax Expenditures: $313.5 million

- Vermont Standard Deduction, $129.67
- Vermont Personal Exemptions, $108.21
- Earned Income Tax Credit, $27.72
- Capital Gains Exclusion, $20.69
- Vermont Charitable Tax Credit, $9.28
- Social Security Exemption, $5.46
- Others, $12.44

FY2019 Personal Income Tax Expenditures: $313.5 million
Sales and Use Tax Expenditures

FY2019 Estimated Sales Tax Exemptions: $267.8 million

- Sales of food, $89.3m
- Energy purchases for a residence, $39.7m
- Clothing and footwear, $33.1m
- Medical products, $54.8m
- Agricultural inputs, $16.9m
- All others, $34.0m

FY2019 Estimated Sales Tax Exemptions: $267.8 million
FY2019 Property Tax Expenditures: $94.6 million

- VT State Colleges and UVM: $19.7
- Charitable Organizations: $6.7
- Private Colleges: $18.6
- Pious Organizations: $13.2
- Private/Public Schools: $6.7
- Hospitals: $15.0
- TIF Districts: $5.7
- Other: $9.1

Other information:
- Total property tax expenditures: $94.6 million
- Pie chart showing the distribution of expenditures among various categories.
Resources

- JFO Website, Revenue/Tax Page
  - Revenue Forecasts for information on revenues: https://ljfo.vermont.gov/subjects/revenue-and-tax/state-forecasts
  - Ten Year Tax Studies for overview of whole system: https://ljfo.vermont.gov/subjects/revenue-and-tax/ten-year-tax-studies
  - Tax Expenditure Reports: https://ljfo.vermont.gov/subjects/revenue-and-tax/tax-expenditure-reports
- Department of Taxes, Research and Reports: https://tax.vermont.gov/research-and-reports
- Contact me with any questions!
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  - 802-828-5768