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Fiscal Note

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H.510 – An Act Relating to Tax Reductions and Other Aid for Vermonters Committee of Conference Report

URL for bill: LINK TO BE UPDATED

Bill Summary

This bill makes several alterations and additions to Vermont's revenue sources. It makes changes within the Personal Income Tax, the Affordable Housing tax credit, and fees paid to the Department of Financial Regulation. It also includes two appropriations.

Within the Personal Income Tax:

- It creates a new refundable tax credit for families with young children. The tax credit is equal to $1,000 per child aged five and under. For both single and married tax filers, this credit is phased out beginning at $125,000 in Adjusted Gross Income (AGI), until $175,000 when it is completely phased out.
- It expands Vermont's existing Child and Dependent Care tax credit by amending the current credit of 24% of the Federal equivalent tax credit to 72% and making the credit fully refundable.
- It expands Vermont's existing Earned Income tax credit (EITC) from 36% to 38% of the Federal credit.
- It creates a new Vermont Student Loan Interest deduction, allowing single taxpayers with AGI below $120,000 and married taxpayers below $200,000 to fully deduct student loan interest paid from their Vermont taxable income.
- It expands the income thresholds for Vermont's Social Security exemption by $5,000. With the expansion, single taxpayers with AGI below $50,000 and married taxpayers with AGI below $65,000 would receive a full Vermont tax exemption on their Social Security benefits.
- It creates a new $10,000 retirement income exemption for Civil Service Retirement System (CSRS) annuitants and military retirees, subject to the same expanded income thresholds as the Social Security exemption listed in the previous bullet.

The bill makes two other changes to revenues not related to the Personal Income Tax:

- It expands the cap on first year credit allocations for manufactured homes within the Affordable Housing tax credit from $425,000 to $675,000.
- It increases the renewal fee paid by securities dealers to the Department of Financial Regulation for selling their products in the state from $1,500 to $1,650.

Finally, it contains two appropriations from the General Fund in FY 2023:

- $750,000 in additional State funding to the Aid to the Aged, Blind and Disabled (AABD) program, and
- $1 million in additional funds to be used for the childcare retention payments.

Fiscal Impact

JFO estimates this bill will result in a net fiscal impact of $39.72 million in FY 2023 on the General Fund. $37.97 million of this is from net reductions in State General Fund revenues while $1.75 million is from appropriations from the General Fund. As of result of the bill, individuals will see their Personal income taxes decrease by over $41 million in FY 2023.

The appropriations in this bill are for FY 2023 only, so the future fiscal impacts of this bill are limited to the tax changes. In FY2024, the bill is expected to reduce revenues by $36.90 million (Table 1).

Table 1: Fiscal Impacts of H.510, Committee of Conference (in millions of dollars)			
Tax Changes (General Fund)			
Section	**Description**	**FY2023**	**FY2024**
1	Child Tax Credit	-$31.80	-$31.80
2,3	Child and Dependent Care Credit	-$3.44	-$3.44
4	Earned Income Tax Credit	-$1.50	-$1.50
5	Student Loan Interest Deduction	-$2.20	-$2.20
6,7	Social Security Exemption Threshold Increase	-$1.67	-$1.77
6,7	CSRS and military retirement threshold increase	-$0.71	$0.71
9	Affordable Housing tax credit: manufactured homes	-$0.25	-$0.50
12	Increase in Securities Registration renewal fee	$3.60	$3.60
	Total State Revenue Impact	**-$37.97**	**-$36.90**
Appropriations (General Fund)			
Section	**Description**	**FY2023**	**FY2024**
10	Aid for the Aged, Blind and Disabled	-$0.75	
11	Child Care Worker Retention Grant Program	-$1.00	
	Total Appropriations	**-$1.75**	

Details and analysis

<u>Section 1: Child Tax Credit</u>

Section 1 of the bill creates a new Child Tax Credit for personal income taxes equal to $1,000 per child aged five and under. The credit is fully refundable. It phases out beginning at $125,000 in AGI and is completely phased out by $175,000 for single and married taxpayers alike.

JFO estimates that the Child Tax Credit in Section 1 will reduce State General Fund revenues by $31.8 million in FY 2023. The cost of this tax credit is not expected to grow in the short-term reflecting Vermont's declining birth rates. It is estimated this credit will be provided to just under 34,400 children and be reflected on over 27,000 tax returns.

JFO expects this tax credit to significantly reduce tax liabilities and effective tax rates on average for lower- and middle-income groups in Vermont. According to the Department of Taxes, in 2020, the average tax paid by income group is $1,000 or less for taxpayers with AGI less than $50,000. This means that for most families with children aged 5 and under with incomes below this level, this tax credit will likely reduce their Vermont tax liability to zero or result in refund payments from the State. In many cases, this credit will augment further payments from the State because many of these taxpayers claim the State's refundable Earned Income Tax Credit.

Section 2: Child and Dependent Care Tax Credit

This section expands the existing Vermont Child and Dependent care tax credit.

Under current law, Vermonters with out-of-pocket childcare expenses can claim a tax credit against expenses paid. Single taxpayers with AGI below $30,000 and married taxpayers with incomes below $40,000 receive a credit equal to 50% of the Federal Child and Dependent Care tax credit that it is fully refundable. For taxpayers above those thresholds, the tax credit is 24% of the Federal credit and is not refundable.

This bill expands the existing Vermont credit making it 72% of the Federal equivalent and fully refundable for all taxpayer regardless of income.

JFO estimates this section will reduce State General Fund revenues by $3.44 million in FY 2023. Based upon modeling by JFO, over 13,000 tax returns will benefit from this expansion, with an average tax credit of $261 (Table 2):

Table 2: Estimated Impacts of Section 2
Child and Dependent Care Tax Credit Expansion

AGI Group		Number of Returns Impacted	Total Tax Change (in millions)	Average Tax Decrease
Negative	$25,000	311	-$0.06	-$188
$25,000	$50,000	2,143	-$0.55	-$255
$50,000	$75,000	1,779	-$0.45	-$252
$75,000	$100,000	2,103	-$0.57	-$269
$100,000	$150,000	3,764	-$1.03	-$274
$150,000	$200,000	1,653	-$0.43	-$259
$200,000	$300,000	910	-$0.22	-$246
$300,000	Infinity	493	-$0.14	-$277
Total		**13,156**	**-$3.44**	**-$261**

Many of the taxpayers benefitting from the Child Tax Credit in Section 1 would also benefit from the expansion of the Child and Dependent Care tax credit if they had a child five and under and childcare expenses. The exact number of these taxpayers is unknown due to lack of data.

Section 3: Earned Income Tax Credit

Section 3 of the bill expands Vermont's Earned Income Tax Credit (EITC). Under current law, Vermont's EITC is equivalent to 36% of the Federal Earned Income Credit and is fully refundable. This bill makes Vermont's EITC equal to 38% of the Federal credit, and it will remain fully refundable.

JFO estimates that this will reduce State General Fund tax revenues by $1.55 million in FY2023 and by similar amounts beyond FY2023.

The taxpayers benefitting from this change are those with below $60,000 in AGI. This is because the Federal credit is limited by a taxpayer's income. The Federal credit generally reaches zero by $60,000. Table 3 shows the impact of Section 3's changes. In all, roughly 38,600 EITC recipients will benefit from the change for an average annual benefit of $40.

Table 3: Tax Impacts of EITC Expansion, Section 3				
Income Group		Number of Returns Benefitting	Total Tax Change (in millions)	Average Tax Change
$0	$25,000	24,399	-$0.86	-$35.2
$25,000	$35,000	6,384	-$0.41	-$64.2
$35,000	$45,000	5,239	-$0.20	-$38.2
$45,000	$55,000	2,056	-$0.06	-$29.2
$55,000	Infinity	509	-$0.02	-$39.3
Total		**38,587**	**-$1.55**	**-$40.2**

For context, under current law, the average EITC is $690 per year, so this change represents a roughly 5% increase in the average EITC.

Section 4: Student Loan Interest Deduction

This section of the bill creates a new deduction for student loan interest paid by a taxpayer, subject to income limits.

Under current law, since the starting point for Vermont income taxes is AGI, the Federal student loan interest deduction flows through to Vermont because it is a pre-AGI deduction. The Federal deduction is limited to $2,500 and has income limits of $70,000 for single filers and $140,000 for married couples.

This section of the bill creates a Vermont deduction on top of that Federal deduction. Vermonters will be able to deduct their student loan interest beyond $2,500 for their Vermont taxes. The deduction in this section is also limited by income to $120,000 for a single filer and $200,000 for a married couple. This credit is sunset on January 1, 2025.

JFO estimates this section will reduce State General Fund revenues by $2.2 million in FY2023 and in future years.

Sections 6 and 7: Retirement Exemptions

Social Security Exemption

This section of the bill increases the income thresholds for the Vermont Social Security income exemption.

Under current law, Vermont exempts Social Security income from taxation for single taxpayers with AGI below $45,000 and married filers with AGI below $60,000. Over the next $10,000 of AGI, the exemption is phased out. This bill would increase those thresholds by $5,000: $50,000 for single filers and $65,000 for married filers. The phase out over the next $10,000 of AGI remains.

JFO estimates that this will reduce State General Fund revenues by $1.67 million in FY 2023, growing by approximately $100,000 in reductions each year thereafter. The beneficiaries of this tax change are heavily concentrated among Social Security recipients with AGI above $50,000 and below $70,000. About 7,800 tax returns are expected to be impacted, and the average tax change is expected to be a tax cut of $215 (Table 4)

Table 4: Tax Impacts of Social Security Threshold Change, FY2023					
AGI Group		Tax Returns Impacted	Total Tax Impact (in millions)	Average Tax Cut
Negative	$40,000	0	$0.00	$0
$40,000	$50,000	1,170	-$0.14	-$123
$50,000	$60,000	2,312	-$0.56	-$241
$60,000	$70,000	2,848	-$0.70	-$247
$70,000	$80,000	1,472	-$0.27	-$184
$80,000	Infinity	0	$0.00	$0
Total		**7,802**	**-$1.67**	**-$215**

Military Retirement and Civil Service Retirement System Exemptions

These sections create two new retirement exemptions. The first is for recipients of military pensions and the second is for individuals who receive pensions from the Civil Service Retirement System (CSRS) or any other retirement system that does not receive Social Security.

For military retirees, the bill creates a new personal income tax exemption for the first $10,000 in military retirement pay. The individuals who take this exemption will be subject to the same income thresholds as Vermont's Social Security Exemption. Military retirees with adjusted gross income (AGI) below $50,000 for a single filer and $65,000 for a married couple will receive the full $10,000 exemption. Over the next $10,000 of AGI, the $10,000 retirement exemption is phased out.

Under this bill, military retirees who are receiving Social Security benefits will need to choose to take the existing Vermont Social Security exemption or the new military retirement pay exemption. For those military retirees not receiving Social Security, they will receive the $10,000 exemption.

JFO estimates that roughly 1,150 of Vermont's 3,900 military retirees will benefit in some way from this exemption.

- Just under 300 of the military retirees are estimated to be those who are receiving military retirement but not receiving Social Security. These are estimated to be military retirees who are still of working age. The average tax benefit is about $210 per year.
- JFO estimates about 870 military retirees will opt to take the military retirement exemption instead of the existing Vermont Social Security exemption because the $10,000 military retirement exemption provides a better tax benefit. However, because these taxpayers were already benefiting from the Social Security exemption under current law, the net new tax benefit for them is approximately $189 per year.

The second retirement exemption in the bill is a new exemption for individuals receiving a pension from the CSRS or from another pension system that makes them ineligible for Social Security. Individuals who were hired into the Federal government prior to 1983 are members of the CSRS. Under this system, retirees receive a pension payment from the Federal government each month. However, these retirees are not eligible to receive Social Security because they did not make Social Security contributions during their careers in the civil service. Under current law, between 90-95% of the pension payment is taxable at the Federal and Vermont level.

This section of the bill also exempts the first $10,000 of pension income received from the CSRS. The bill also offers the same treatment for individuals who are receiving pension payments but are ineligible for Social Security, such as some other state employees or teacher pension systems. This exemption would also be subject to the taxpayer having AGI below $50,000 for a single filer and $65,000 for a married couple.

Like the military retirement pay exemption in the bill, the individuals receiving this exemption and Social

Security will need to choose either this exemption or the existing Social Security exemption. While these individuals did not pay into Social Security when they were employed with the civil service, some retirees in this group may have paid into Social Security if they left the civil service and took another job (and therefore receive Social Security for that portion of their working experience) or that their spouse receives Social Security.

JFO estimates that between 1,500 and 1,800 taxpayers will benefit from this new exemption. The estimated average tax benefit of this exemption is approximately $240.

In total, JFO estimates that the new military and CSRS exemptions will reduce State General Fund revenues by $710,000 in FY2023 and declining modestly thereafter, as the number of individuals receiving CSRS payments declines.

Section 9: Affordable Housing Tax Credit for manufactured homes

This section of the bill increases the first-year allocation for the manufactured homes credit within the Affordable Housing Tax Credit.

Under current law, the Affordable Housing Tax Credit program under 32 V.S.A. § 5930u allocates tax credits to individuals or businesses who construct affordable rental housing or affordable owner-occupied housing as defined by 26 U.S.C. § 42 or 26 U.S.C. § 143. These credits can be taken against the personal income tax, the corporate income tax, the bank franchise tax, or the insurance premiums tax. The credits awarded are 5-year credits. Within the Affordable Housing Tax credit, a certain amount is allocated to the construction of new manufactured homes.

Section 9 of the bill increases the first-year allocation for the manufactured homes tax credit within the Affordable Housing Tax Credit from $425,000 to $675,000. These tax credits reduce available General Fund revenues. They are five-year credits. As such, the total revenue impact of the state increases by $250,000 each year for five years, with the maximum revenue impact occurring in FY2027 of $1.25 million in reduction of General Fund revenues (see table below).

Overall Flow of Revenue Impact, Manufactured Housing Credit Expansion							
	FY23	FY24	FY25	FY26	FY27	FY28	FY29
Credits Issued Year 1	-$250,000	-$250,000	-$250,000	-$250,000	-$250,000	$0	$0
Credits Issued Year 2	$0	-$250,000	-$250,000	-$250,000	-$250,000	-$250,000	$0
Credits Issued Year 3	$0	$0	-$250,000	-$250,000	-$250,000	-$250,000	-$250,000
Credits Issued Year 4	$0	$0	$0	-$250,000	-$250,000	-$250,000	-$250,000
Credits Issued Year 5	$0	$0	$0	$0	-$250,000	-$250,000	-$250,000
Credits Issued Year 6	$0	$0	$0	$0	$0	-$250,000	-$250,000
Credits Issued Year 7	$0	$0	$0	$0	$0	$0	-$250,000
Total Revenue Impact	**-$250,000**	**-$500,000**	**-$750,000**	**-$1,000,000**	**-$1,250,000**	**-$1,250,000**	**-$1,250,000**

In FY 2023, this expansion will reduce General Fund revenues by $250,000, growing by $250,000 per year through FY 2027. After FY2027, the impact of the increase in the manufactured housing allocation of the Affordable Housing Tax Credit will total $1.25 million annually.

Section 12: Department of Financial Regulation Securities Registration Fee

Under current law, mutual fund managers who sell products in Vermont are required to pay fees to the Department of Financial Regulation (DFR) each year. These fees are called Securities Registration Fees. The current initial fee is $2,000 and the annual renewal fee is $1,500. There are approximately 3,000 filers per year who pay the initial fee and 24,000 filers who pay the renewal fee. The last time these fees were changed was 2016.

This section of the bill proposes raising the renewal fee to $1,650 per year and leaving the initial fee at $2,000.

This is projected to raise approximately $3.6 million per year in General Fund revenues beginning in FY2023

Section 10: Appropriation for the Aid to the Aged, Blind, and Disabled (AABD) program

Section 10 appropriates an additional $750,000 in General Funds to the AABD program operated out of the Department of Children and Families. This appropriation will be matched with $950,000 in funds from the Global Commitment fund, for a total increase to the program of $1.7 million.

This increase in funding is expected to benefit each individual in the program by approximately $110 per year on average

Section 11: Appropriation for the Childcare Worker Retention Grant Program

This section appropriates an additional $1 million in FY 2023 General Funds to the Department of Children and Families to be used as childcare worker retention grants.

This program was created under Section G.300 of Act 74 of 2021 (FY2022 budget), amended by Act 83 of 2022 (FY 2022 Budget Adjustment). The Department is authorized to establish the parameters for employees in the childcare sector to receive these retention bonuses in Act 83 of 2022.

JFO estimates that there are approximately 5,500 childcare workers in Vermont who could benefit from these bonuses, although the exact number of beneficiaries will be determined by the parameters of the program created by the Department.

Appendix: Resources

The following sources were used in the analysis and estimates for this bill:

- State economists' consensus state population forecast by single year of age. December 2021.
- United States Census Bureau, American Community Survey, 2019
- Taxpayer data from the Department of Taxes
- Chainbridge Income Tax Model
- Correspondence with the Department of Children and Families
- Information provided by the Department of Financial Regulation