Andrew Wilford
Director of State Policy
National Taxpayers Union Foundation
andrew.wilford@ntu.org

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Thank you Madam Chairwoman, Mr. Vice Chairman, and distinguished members of the Committee. My name is Andrew Wilford, and I am the Director of State Policy here at the National Taxpayers Union Foundation. I also run our Center for State Competitiveness, which aims to help states position themselves to attract economic opportunities and strengthen their tax bases through pro-taxpayer policies.

I am here today to testify on the proposed changes to Vermont's income tax, which include introducing a new top income tax bracket, as well as introducing a new 4 percent investment proceeds tax that mirrors the federal-level Net Investment Income Tax, or NIIT.

Harming Vermont's Economic Competitiveness

Making Vermont Into a High-Tax Outlier

Under the proposed language, the current top income tax bracket of 8.75 percent would remain, but a new 13.3 percent top income tax bracket would apply to income above a threshold of $481,825 for single filers and $586,625 for married couples filing jointly. This would tie Vermont for the highest individual income tax bracket in the nation, though California's top rate kicks in at nearly $1.5 million in taxable income for married filers.

At these thresholds, the new top individual income tax rate would fall upon more than just the CEOs one might picture. It would affect doctors, tech and research specialists, and lawyers. Most importantly, it would affect thousands of Vermont small business owners whose business income through S corporations or LLCs or partnerships passes through to the individual income tax code. Vermont small businesses would also face significantly higher tax rates than C corporations, which would remain subject to a top rate of 8.5 percent.

Such a rapid and drastic increase would take Vermont from a position where its top income tax rate is roughly similar to most other states in the region (besides New Hampshire) and immediately make it an outlier. What's more, it would signal to high-income earners that future budget shortfalls in Vermont will be addressed via their tax burden alone.

Targeting Investment Harms Vermont's Economy and Future Tax Base

On top of this, a new 4 percent Vermont Investment Proceeds Tax would be introduced, applying to single taxpayers with federal modified adjusted gross income (AGI) above $125,000 or married taxpayers filing jointly with modified AGIs above $250,000. As with the federal-level NIIT, it would apply to the lesser of investment income or modified AGI above the threshold.

High-income Vermonters would therefore face punishing tax rates for engaging in one of the most pro-growth activities: investment. Vermonters' investment income would be subject to a 41.1 all-in tax rate, including the 20 percent federal capital gains rate, a 3.8 percent federal NIIT, a 13.3 percent Vermont income tax, and a 4 percent Vermont Investment Proceeds Tax.

Contrast this to New Hampshire, where investment income faces no state tax, and would max out at the 23.8 federal rate. Even New York, a state that Vermont traditionally compares favorably against in terms of tax burdens, would appear relatively affordable.

Discussion of rates and reduced investment may seem abstract, but the consequences are tangible and reach beyond high-income earners themselves. Investment is what powers growth, allowing Vermont businesses to expand their operations, hire new workers, purchase new equipment, and develop new products. Investment is also directly tied to the productivity improvements that allow wage earners to command higher salaries from their employers.

All of this means that targeting investment with high tax rates is a problem for Vermont's tax base in the future. Investment contributes to the growth of every other form of tax revenue, from income taxes to sales taxes and even property taxes. Discouraging investment in Vermont through higher tax burdens shrinks the tax base in other areas, limiting the state's options for the future.

Migration in the Wrong Direction

Tax-Based Outmigration is Real and Tangible

There's another way that these high tax burdens would shrink Vermont's tax base: outmigration. Vermont currently comes close to breaking even in interstate migration, with a net gain of just 84 new residents according to the latest IRS data from 2022.

Here at NTUF, our research has consistently found that tax rates, and particularly income tax rates, are the most predictive metric explaining interstate migration trends.[1] To be sure, many factors can prove decisive at the individual level, but on aggregate, taxpayers leave high-tax states and head to more competitive ones.

States that have eliminated or recently cut their income taxes, such as Texas, Florida, North and South Carolina, and Tennessee, are the hottest destinations for new residents. Meanwhile, the biggest interstate migration "losers" are all states with reputations for high taxes: California, New York, Illinois, New Jersey, and Massachusetts.

Outmigration Means a Smaller Tax Base

In a state the size of Vermont, even seemingly minor shifts in migration patterns, either in or out, would have a profound impact on the state's tax base and budget. Despite gaining just 84 new residents overall, Vermont added a net of about $93 million in AGI to its tax base in 2022, driven largely by a surge from Massachusetts as the state abandoned its much lower flat rate via a new millionaire surtax that drove its top rate above Vermont's. We estimate that migration added about $12.7 million in additional revenue at the state and local level.

That might not have broken the proverbial bank, but once again, even small shifts can prove significant. New Hampshire, a state with about double Vermont's population but facing many of the same geographic and demographic challenges, gained about 4,200 new residents and an estimated $72.6 million in combined state/local tax revenue from interstate migration that same year, despite notably lower tax burdens.

This works both ways. Even a few thousand higher-income Vermonters leaving for Florida or Texas would represent a substantial drain on the state's finances, particularly considering that the problem often leads to a vicious cycle: departing high-income earners lead to budget shortfalls, leading to tax increases on remaining high-income earners, in turn leading to an acceleration of the ongoing exodus. The proposed increases to high-earner tax burdens being discussed today are drastic enough that a scenario involving the departure of only a few thousand Vermonters may well prove optimistic.

An Unstable Revenue Source

One last factor to consider when relying on tax revenue from high-income earners is that these are some of the least stable revenue sources available. Individual income taxes, and capital gains

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1 https://www.ntu.org/foundation/detail/migration-in-minutes-latest-irs-data-on-interstate-migration-shows-taxpayers-continuing-to-flee-california-and-new-york

income taxes in particular, are consistently more volatile than revenue sources such as sales taxes or property taxes.

Within the individual income tax lie a few different subcategories of income. According to the Pew Research Center, by far the most volatile of these is capital gains income, followed by pass-through business income.[2] Wage income is the least volatile of these. Similarly, the California Legislative Analyst's Office has found that capital gains tax revenue is about three times more volatile than revenue from the general income tax.[3]

Unfortunately, revenues raised from the proposal being discussed today would fall disproportionately upon capital gains and pass-through business income. This means that revenues generated by these tax increases would hew more closely to the booms and busts of the business cycle, increasing instability and making it harder for legislators and policymakers to plan for the future.

Conclusion

In conclusion, I would like to thank the members of the committee for the opportunity to testify before you today. I am happy to answer any questions you may have and hope to work with you in the future to make Vermont prosperous and competitive.

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[2] https://archive.legmt.gov/content/publications/fiscal/2023-Interim/September%202022/Pew-Volatility-Study-June-2022.pdf

[3] https://lao.ca.gov/Publications/Report/3703