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Prioritizing Revenues Can Help Vermont, Other States Build Forward in Wake of Federal Megabill

Testimony of Wesley Tharpe, Senior Advisor for State Tax Policy, Center on Budget and Policy Priorities, Before the Vermont House Ways and Means Committee

Chair Kornheiser, distinguished members – good afternoon. My name is Wesley Tharpe, and I'm Senior Advisor for State Tax Policy at the Center on Budget and Policy Priorities (CBPP) in Washington, D.C. Thank you for the invitation and opportunity to share some perspective here today, and I look forward to any questions and conversation to follow.

Allow me to start with a quick introduction. CBPP is an independent, nonpartisan research institute in Washington, D.C., that since 1981 has advanced both federal and state policies aimed at building a nation where everyone has the resources they need to thrive. I've been with the Center for the past seven years, and in this general line of work for nearly 15 years overall, focused primarily on the critical importance of state tax and budget choices for people's everyday well-being.

As part of that work, over the course of the past year I have been focused intently on the implications of recent federal policy changes, especially last summer's federal reconciliation package (what some call the One Big Beautiful Bill Act or H.R. 1), on states, local communities, and the people who call them home. So, I'm eager to share some thoughts here today on the challenges, and in turn opportunities, Vermont faces in those policies' wake and help contribute to a conversation about the most promising policies to pursue.

I plan to focus my time today primarily on two things: first, I'll concisely summarize the nuanced fiscal challenges stemming from the passage of H.R. 1, such as those related to "conformity" with federal tax cuts and new spending responsibilities for health care and food assistance. And second, with my remaining time, I'll briefly present a framework for how despite these significant challenges, the passage of the federal megabill *also* presents Vermont – and all states – with an enormous opportunity: specifically, a chance to pursue a thoughtful yet forceful response that centers the needs of the state's people and communities — namely by protecting and raising the revenues needed to support bold public investment, mitigate harm, and build forward stronger than ever before.

Vermont and Other States Face Considerable Challenges From Recent Federal Tax and Spending Cuts

To do so, allow me to begin with a high-level summary of last summer's federal reconciliation package. In short, the plan includes tax cuts of about $4.5 trillion over a decade, tilted significantly toward the nation's wealthiest households and corporations. Just in Vermont, the law is expected to save households with incomes in the top 1 percent nearly $60,000 on average each year, over 500 times more than the expected annual savings for households with incomes in the bottom 20 percent (about $110) and about 37 times as much as the households with incomes in the middle 20 percent (about $1,500). Overall, more than 70 percent of all benefits — $730 million in 2026 — from this tax proposal are directed to Vermonters with incomes in the top 20 percent.[1]

To partially finance those tax reductions, the federal package also imposes a sweeping set of cuts to programs designed to either fight climate change or help people with low and moderate incomes afford health care and groceries, implemented in part by shifting significant new responsibilities to the state and local level. Meanwhile, the rest of the tax cuts are financed by adding $3.4 trillion to our deficits over ten years and $4.1 trillion to our debt, once accounting for interest payments on the additional borrowing.

Independent analyses have found that, combined, the new law's program cuts and tax cuts are likely to make households in the bottom 20 percent of the income scale worse off: they will lose more from the cuts in health coverage, food assistance, and other programs than they will gain in tax cuts. [2] Average household incomes will rise by about 3 percent for those with incomes in the top 10 percent of the income scale, while *falling* by about 3 percent for those with incomes in the bottom 10 percent, according to the Congressional Budget Office.

Together, these federal policy choices are expected to create considerable new challenges for state and local budgets and the people and communities they serve. Those challenges can be concisely characterized into three main buckets:

1. First, immediate fiscal implications from recent federal tax cuts, due to various "conformity" linkages between Vermont's tax system and the federal tax code;
2. Second, a suite of short- to medium-term direct fiscal implications of recent federal actions, namely historic spending cuts and new state responsibilities for Medicaid and food benefits (provided through the Supplemental Nutrition Assistance Program, or SNAP); and
3. Third, the specter of additional longer-term, indirect costs that could accumulate on both the state and local level over time, as the harm from people losing access to health care and other vital services begins to show up downstream across communities statewide.

Fiscal Fallout From "Conformity" With Federal Tax Cuts

Starting with the first, as you all know, Vermont – like most other states with personal or corporate income taxes – uses the federal tax code as a starting point for calculations of their own income taxes. Changes to the federal code can therefore affect state tax revenues enormously, especially when those changes are wide-ranging, such as after the initial enactment of the Tax Cuts and Jobs Act back in 2017.[3]

In the case of the most recent federal tax changes, there are a series of provisions that will have noteworthy implications on states' ability to adequately raise revenues. At a high level these most prominently include a series of significant corporate income tax changes, most of which involve expansions to existing business tax breaks and making them permanent. The federal plan also enacts several new personal income tax carveouts for income from tips and overtime, as well as a potentially costly new deduction for auto loans. A growing number of states – about 20 by last count – have in recent months been publishing official estimates of what these various conformity provisions might cost, and those analyses suggest that the megabill's conformity impact on states could be substantial.

In Vermont's case, initial estimates released earlier this month suggest that – relative to many other states – the immediate impact of these conformity linkages may be relatively modest: rising to about $5 million in fiscal year 2027. This is likely due to a few factors, including the fact that Vermont policymakers in 2017 wisely moved the state's starting point for calculating income taxes from federal taxable income (FTI) to federal adjusted gross income, which provides an important initial layer of protection from some of the sharpest impacts of federal tax changes that a small handful of states still using FTI are now grappling with.

That said, the reconciliation bill's conformity impacts – especially from interactions with the bill's expansive business tax provisions – could rise substantially over the long run.[4] And in any case, most of the costs stemming from federal tax changes are due to provisions which – to be clear – are completely optional for states to take on in their own tax codes. I will return to some of these choice conformity points near the conclusion of my remarks.

Short- to Mid-Term State Costs From Federal Cuts to Medicaid and SNAP

Turning to the second bucket of challenges, there are also a series of ways that this summer's federal reconciliation bill could impact Vermont's finances directly over the next few years. Moreover, while I will not detail them at length today, I would be remiss not to mention that Vermont and other states could very well face a series of additional threats to current and future federal funding as well, due to various congressional or Administration proposals that seriously threaten federal support for services including housing, childcare, education, and others.

Focusing on the reconciliation package, because the implementation schedule for several of these provisions is staggered over the coming years, I will walk through these from the standpoint of their respective timing.[5]

First, Vermont, along with other states, will be compelled to invest the funds necessary to stand up and operate a new set of administrative requirements in Medicaid and SNAP. In some cases, these will be one-time expenditures, such as investments in new IT systems, and in others they will be ongoing; for example, in Arizona, the health care agency is requesting about 300 new full-time equivalent employees to implement the law's Medicaid requirements. Because these new administrative requirements are either already in effect (such as with expanded SNAP work requirements) or are required to be online no later than January 2027 (in the case of new Medicaid work requirements), even with limited federal support, Vermont and other states will still have to accommodate these new spending needs during the current 2026 session.

Another new cost that states will have to account for as they work this year to craft their fiscal year 2027 budgets is an increase to the share of SNAP administrative expenses that states are required to cover. Until now, states covered 50 percent of the cost of administering SNAP, with the federal government paying the other 50 percent. H.R. 1 increases the state share to 75 percent, which in the case of Vermont is expected to cost an extra $8.4 million annually, according to the state's Department for Children and Families.

Then, beginning in their fiscal year 2028 budgets, states including Vermont will face two of the most significant fiscal implications from the megabill: (1) an unprecedented new funding requirement for SNAP food benefits; and (2) new limits on "provider taxes" that every state other than Alaska uses to help fund their share of Medicaid.

On SNAP, most states will be required to pay 5 to 15 percent of food benefits starting in October 2027, based on their payment "error rates," which is a measure of the under- and over-payments states made in their SNAP programs. Depending on Vermont's payment error rate, the increased cost to the state could range from $7 million to $22 million annually. At the moment, Vermont is one of a small handful of states with an error rate low enough (5.13 percent) so as to not trigger this cost-sharing requirement; however, if the state's rate were to rise even slightly, namely to 6 percent or higher, this cost-share requirement would then kick in.[6]

It is also worth highlighting here that delayed and incomplete guidance from the U.S. Department of Agriculture (USDA), along with the chaotic few weeks of government shutdown, are making errors more likely, such that even states like Vermont that have previously been below 6 percent could very well have a hard time maintaining a low error rate. Vermont, for instance, recently noted in court filings that it incorrectly terminated benefits for some legal permanent residents who should have remained eligible based on USDA's initial guidance and then had to reinstate people after the agency later issued a clarification.[7]

Now as a practical matter, if states prove either unable or unwilling to cover new federally imposed costs, they will have to either shrink their SNAP program, such as by restricting eligibility or making it harder for people to enroll; or opt out of the program *entirely*, in effect terminating food assistance in the state. Assuming Vermont policymakers do not intend to take either of those harmful paths, there will have to be thoughtful choices made about how to account for these additional costs without harming other essential parts of the state's budget.

Moving to provider taxes, the bottom-line is the federal megabill imposes a strict set of new limits on this revenue-raising tool, which are expected to have a meaningful impact on its effectiveness over time. Indeed, here in Vermont, the Joint Fiscal Office recently estimated that the new provider tax limits could reduce revenue from the state's hospital fee by about $15 million starting in fiscal year 2028, rising to an estimated $133 million by fiscal year 2033.[8] Compounding these losses, H.R. 1 also makes changes that appear likely to impact renewal of Vermont's current 1115 Medicaid waiver, possibly forcing the state to make hard trade-offs about continuing key coverage provided through that demonstration.

Long-Term Fiscal Risk Due to Spillover Costs from Megabill's Expected Harm

Now I will briefly highlight the third important challenge facing Vermont's finances and communities stemming from recent federal policies. Simply put, the reality is that the significant disruptions to health coverage, food assistance, and likely additional public services caused by recent federal cuts are likely to also carry a series of long-term implications for state and local finances, which while difficult to fully foresee, could prove substantial.

Most prominently, the surge of people who stand to lose Medicaid or Affordable Care Act (ACA) marketplace coverage and become newly uninsured — about 15 million nationwide, including as many as 16,000 Vermonters — will likely translate over time into more people showing up at local emergency rooms and clinics without the ability to pay. The costs for such uncompensated care can be sizable and put significant strain on hospitals and other providers, especially those that serve high levels of low-income and vulnerable populations. These uncompensated care costs could rise by about $280 billion nationwide over the next decade due to a combination of Medicaid cuts and the ACA premium tax credits expiring, including by about $200 million over that span of time in Vermont.[9]

Over the long term, widespread losses to affordable health coverage — paired with potentially significant harm to people's ability to afford enough to eat, including an estimated 6,000 here in Vermont that could lose at least some of their food benefits — will also, according to decades of research, likely make people less healthy, create barriers to employment, dampen people's ability to fully participate in local economies, and generate further indirect costs for state and local health systems and budgets.

At the same time, it is important to note there are actions Vermont policymakers can take to limit some of this long-term fallout. States have options for reducing administrative hassle and mistakes that can lead eligible people to lose their health coverage or food assistance. By working to ensure that as many Vermonters as possible still receive the benefits for which they are eligible, policymakers would in turn likely limit increases in uncompensated care and other indirect spillover costs to communities. To strive for that end, it is critical that states invest in human service agencies' staffing and technology and make programmatic choices to make it as simple and free of red tape as possible when determining who is eligible under the now-expanded federal requirements.

Vermont and Other States Have Golden Opportunity to Mitigate Harm, Build Forward

With my remaining time, I'd like to briefly present a framework for how despite these significant challenges, the passage of the federal megabill *also* presents Vermont – and states generally – with an enormous opportunity: specifically, a chance to pursue a thoughtful yet bold response that centers the needs of the state's people and communities by prioritizing revenue.

Because states and localities must balance their budgets, absent a policy response that centers and prioritizes revenue, the fiscal implications of the federal megabill risk potentially significant harm to not *only* states' new responsibilities for health care and food assistance but also their full constellation of public services. Centering revenues is also vital for states to continue advancing policies that address more long-standing needs such as supporting quality education or proactively investing in good infrastructure, which would be sorely needed even in the absence of recent federal actions. Such public investments – both today and in the long-run – are essential ingredients for states to build and maintain prosperous economies rich with broad-based opportunities for all residents.[10]

Both protecting the state's existing revenue system and, ideally, further strengthening it by raising new revenues from those most able to pay will be essential for an adequate state response in this moment. To advance such a revenue-focused approach, we suggest Vermont devotes attention to three areas:

- **Preserve revenues the state would otherwise lose due to federal tax cuts**. A first order of business for Vermont tax-writers in 2026 will be to carefully consider the revenue impact of federal tax cuts that H.R. 1 either enacted or expanded and to delink from as many of the costliest "conformity" impacts as possible.

  This will be especially important in the case of H.R. 1's expansive tax benefits for multinational corporations, which policymakers in Colorado, Delaware, Maine, Pennsylvania, and others have already chosen to largely decouple from. For example, the District of Columbia council recently voted to decouple from a now-expanded exemption for certain business stock, known as the Qualified Small Business Exemption, which in practice helps very few small businesses and mostly benefits people with incomes above $1 million. In Vermont's case, decoupling from the exemption could protect an estimated $2.6 million each year.[11] Meanwhile, Vermont should also follow the lead of Colorado in decoupling from a special deduction for profits attributable to foreign sales of goods and services that incorporate U.S.-held intellectual property like patents and trademarks. This provision taxes this income well below the standard corporate rate and, since its original enactment in 2017, has proven far more costly than anticipated.[12]

  Lastly, on conformity, Vermont policymakers should also avoid the possible temptation to proactively conform to new personal income tax deductions, such as those for income earned from tips and overtime. These provisions are expected to provide only a modest benefit to a small subset of workers, create opportunities for unscrupulous employers to game the system, and cost states a noteworthy amount of revenue in the process. In the case of Vermont, linking to the new federal deductions for tips and overtime could cost an estimated $23 million in lost revenue annually, while only benefiting about 1 out of every 20 workers.[13] There is also a risk that the true impact of these policies could prove larger. In Alabama, for example, lawmakers in 2023 enacted a temporary exemption for overtime income but later chose to let that exemption expire when it became apparent that the resulting revenue loss was much larger than anticipated.

- **Raise new revenues, ideally through targeted solutions geared toward wealthy households and corporations**. To both fill emerging gaps stemming from harmful federal budget cuts and continue investing in its own needs, Vermont can pursue targeted tax measures designed to reinforce and enhance their existing revenues. Wherever possible, these efforts should focus on the same wealthy households and corporations that will reap the lion's share of benefits from tax cuts either enacted or extended through the recent federal plan.[14] Over the past few months, elected leaders in a growing number of states – including Colorado, Rhode Island, and Washington – have already begun moving earnestly in this direction, by proposing bold, progressive, revenue-raising policies heading into their 2026 sessions.

  While there is no one right policy to pursue, some ripe potential options would include: enhancing the state's personal income tax to apply higher marginal rates to higher levels of income (commonly referred to as "millionaires' taxes"[15]); tightening the state's corporate income tax to more effectively block offshore tax avoidance (such as through a policy known as "worldwide combined reporting"[16]); or exploring ways to more robustly tax income earned passively through the holding of accumulated wealth (such as by bolstering the state's capital gains tax or enacting an innovative new measure known as the "wealth proceeds tax"[17]). Such measures could enable Vermont to raise hundreds of millions of additional dollars each year to support vital investments.

- **Sensibly draw on the state's strategic savings**. In addition to preserving and growing annual revenue streams, policymakers can also consider tapping their Rainy Day Funds. While to be clear, states cannot and should not look to their strategic reserves to adequately solve for new *ongoing* costs from the federal megabill, leveraging strategic savings to help cover various startup costs and soften the initial blow from federal cuts is a sensible approach. In fiscal year 2025, Vermont's Rainy Day Fund stood at about 19 percent of general fund spending, which puts it well above both the national median (13 percent) and the generally accepted best practice of holding about 10-15 percent of regular state spending in reserves.[18] That means Vermont policymakers are in a strong position to consider sensibly tapping those strategic savings.

To close, in the wake of recent harmful federal policy choices and increasingly sharp fiscal pressure, policymakers in every state have a significant opportunity to meet the moment and build forward in ways that better serve their communities' needs. Through ambitious yet thoughtful revenue choices now and in the years to come, state and local policymakers – in Vermont and elsewhere – hold real potential to mitigate harm for millions of people and raise the revenues needed to lay the foundation for a more equitable and prosperous future.

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