Vermont's State Income Tax in 2002: A Decisionmaking Framework

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The Vermont Business Roundtable is a non-profit, non-partisan organization of 110 chief executive officers representing geographic diversity and all major sectors of the Vermont economy. The Roundtable is committed to sustaining a sound economy and preserving Vermont's unique quality of life by studying and making recommendations on statewide public policy issues.

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Executive Summary

The 2002 Vermont Legislature will facing a number of important fiscal matters, including dealing with funding for education, a general fund revenue shortfall resulting from the economic downturn, and how to deal with the fiscal impact of federal tax law changes. This report focuses on how Vermont can deal with revenue shortfall arising from federal income tax law changes since the Vermont personal income tax is computed based on 24% of the federal income tax liability.

The report briefly describes Vermont's overall tax structure and how the personal income tax fits into it by comparing Vermont's taxes to the national average for state and local governments. It lays out four possible options for the Legislature to consider, then discusses what characteristics should be examined when looking at these options.

Rather than focusing on those options and characteristics here, this summary presents a matrix with which to consider any planned changes to the Vermont income tax.

Decisionmaking Framework for 2002 Tax Changes

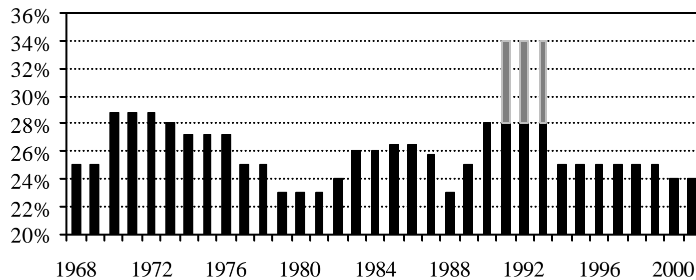
Options	**1. Keep state tax rate at 24% of federal liability.**	**2. Keep current income tax structure and raise state rate from current 24%.**	**3. Continue 2001 solution.**	**4. Set tax rates based on federal adjusted gross income or taxable income.**
Summary	Keep Vermont tax at 24% of federal liability and pass on federal tax cuts to Vermonters.	Current Vermont piggyback tax structure would be maintained. For revenue neutrality, Vermont rate would have to rise as additional tax cuts take effect in future years.	Vermont taxpayers recalculate federal income taxes as if federal tax law had not changed, then pay 24% of that hypothetical amount of federal tax.	Vermont would set its own tax rates, number of brackets, and exemptions/deductions, and would have to decide whether to base a tax on adjusted gross income or taxable income.
Goals				
Adequacy of Revenues	Does not raise sufficient revenues to fund existing programs.	State tax rate can be easily adjusted to offset impact of federal tax cuts to bring in expected revenues.	Revenues would be the same as if federal tax law had not changed; they would still fluctuate with economic conditions.	Revenue base would grow with economy so revenues should be sufficient to fund programs; revenues would fluctuate with economic conditions.
Equity	New federal tax law creates new loopholes and distortions of horizontal equity. Big controversy over impact on vertical equity at national level; new 10% rate benefits low income workers proportionately more than high income earners, but high income earners get a bigger dollar tax cut.	Equity would be identical to current level.	Existing equity would be preserved, but over time, it would be increasingly difficult to do this as different provisions of the federal tax law are implemented.	Legislature could set rates to obtain any level of vertical progressivity it desires. Horizontal equity would differ if income base is AGI or taxable income. Legislature could change brackets or rates annually without much problem.
Neutrality and Competitiveness	Vermont's high marginal tax rates would fall and be closer to other states but federal changes mean more tax-induced changes in behavior.	High state marginal tax rate would continue so existing competitive issues would not change; tax-induced behavioral changes are encouraged.	Tax-induced behavioral changes are encouraged and it would be increasingly difficult for Vermont to design a tax which compensates for these.	Impact on competitiveness of Vermont economy and tax-induced behavior depends on rates and number of brackets; if they are changed frequently, uncertainty over tax environment is increased.
Low Cost	No new costs for Tax Department or taxpayers.	No new costs for Tax Department or taxpayers.	Very costly to Tax Department and taxpayers; major changes would have to be made each year as new deductions and exemptions appear and then disappear from federal tax code.	Major one-time cost to Tax Department. If Vermont's definition of income deviates from simply using federal definitions, cost is higher for taxpayers. If changes are made frequently, higher cost especially for tax planning.
Simplicity and Transparency	Same as status quo.	Same as status quo.	Vermont tax code will become increasingly complex and hard to understand for an increasing number of taxpayers.	Can be made simple, but it will be easy to add complexity to tax structure; AGI-based tax is easier for taxpayers to understand than is taxable income-based tax.
Stability	No change from current level of stability; tax revenues fluctuate with economy and federal tax law changes.	No change from status quo.	Vermont tax code should not be any less stable than current structure.	AGI fluctuates less than taxable income so AGI base would be more stable.
Notes	The state would forego increasing amounts of revenues over time; Vermonters would benefit from higher disposable income.	As federal tax code becomes more complicated, with new tax law changes, it becomes more difficult to calculate hypothetical revenue loss to Vermont and set appropriate new state tax rate.	In future years, this option wou be very difficult to implement a more confusing to taxpayers, especially if Congress changes.	Legislature would have to make many major decisions with far reaching impacts. This should entail a major study of options, which will probably not happen if the Legislature wants to pass something during the 2002 session.

I. Introduction

The U.S. Congress recently passed the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). That law dramatically changes a number of parts of the U.S. tax code, especially the federal income tax. The immediate impact was to provide a tax rebate to most American families and many individuals during the summer of 2001. That rebate was actually part of a reduction in marginal income tax rates that will continue to occur on a phased-in basis over the next ten years. Other parts of the EGTRRA affect definitions of income, credits, and deductions, but the most significant impact is on the reduction in income tax rates.

Rate reductions are important to all states because of their economic impact, but have a particularly important effect in Vermont because of the unique structure of Vermont's individual income tax. Vermont is the only state that levies state income tax as a percent of federal tax liability. All other states with a broad-based income tax levy the tax as a percent of federal adjusted gross income or federal taxable income.[1] In those states, the impacts of federal tax law changes are felt only when the definitions and measures of income are changed, not when rates change. Thus, a change in federal income tax rates directly affects the revenue-raising potential of the Vermont income tax.

Figure 1.
Vermont Income Tax Rates



Note: Between 1991 and 1993, there were two tax rates; the top rate was 34% for upper income taxpayers and 28% for all others.

The Vermont income tax rate is currently pegged at 24% of the federal income tax liability. Figure 1 shows that Vermont's income tax rate has fluctuated over the past two decades as economic conditions have changed and as the state's need for revenues led to tax rate increases or the collection of surplus revenues prompted tax rate cuts.

The lowest state rate was a 23% rate between 1979 and 1982 and again in 1988. The highest rates were in the late 1960s, early 1970s, and in the early 1990s. In the early 1990's, higher income Vermonters paid a higher percentage of their federal tax liability than did other Vermont taxpayers.[2]

The most recent Vermont income tax rate change was on January 1, 2000, when the state reduced the income tax rate from 25% of the federal liability (where it had stood since January 1, 1994) to 24%. The reduction was enacted due to surplus income tax revenues generated from an expanding economy and especially from significant capital gains tax revenues resulting from a booming stock market.

The new federal income tax rates would have reduced Vermont's income tax revenues if Vermont had not changed its tax law. In 2001, the Legislature changed the state income tax law to attempt to hold the state harmless from any reduction in revenues caused by federal income tax rate changes, although it did not exempt the state from revenue reductions caused by declining economic activity. As a result of the state tax law change, all Vermonters will essentially have to recalculate their 2001 federal income tax liability

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[1] Nine states levy no broad-based state income tax.

[2] Between 1991 and 1993, two higher rates were imposed on higher income tax payers: a 31% rate for anyone with a federal tax liability of between $3,400 and $13,100, and a 34% rate on anyone with a federal tax liability of more than $13,100.

based on the federal tax code as of December 31, 2000 and then take 24% of that amount as their 2001 state income tax liability. This complexity will be reflected in additional lines on the state income tax forms and new tax forms for taxpayers with unusual or special circumstances.

The 2001 legislative fix was a one-year solution to the problem. The Legislature that meets in 2002 is expected to enact a permanent response to the federal income tax law changes. The Legislature has a number of options. Among the most likely to be considered are the following:

1. It can do nothing and forego the revenues that the state would have received at higher federal tax rates, essentially giving Vermonters a state income tax cut.
2. It can increase the Vermont income tax rate (currently 24% of the federal tax liability) to make up for the revenue lost due to federal rate cuts, essentially preserving the existing piggyback tax structure with a revenue neutral tax rate increase.
3. It can continue the solution that it enacted in 2001.
4. It can decouple the Vermont income tax rate from the federal tax liability and have taxpayers calculate their state income tax liability as a percentage of federal adjusted gross income or federal taxable income.

The entire federal tax law passed last June sunsets in ten years. Therefore, whatever changes the Legislature decides to make in Vermont's tax structure, it also might want to sunset those changes with the federal sunset. That would mean any legislative changes enacted in 2002 would end in 2011 and Vermont would then go back to the tax structure Vermont has had in place for the past three decades.

This report does not analyze the impact of these alternatives in terms of revenues or many other issues that will be important to the Legislature and to Vermonters as they consider what, if any, changes should be made to the Vermont tax code. Rather, the report looks at some of the fundamental tax policy issues that should be considered as these changes are considered.

II. Vermont's Overall Tax Structure

In fiscal year 1999, Vermont's state and local governments combined raised $1.78 billion in tax revenues and the 50 states combined raised $816 billion in state and local taxes. A comparison between Vermont and the 50-state average is best done in two ways. One is by looking at the total taxes Vermont raises compared to other states and the second compares the distribution of tax revenue sources to the average state.

Although this study focuses on the state income tax, it is best to put that in perspective by first focusing on all state and local government tax revenue combined. Vermont is a small state and many state level government functions in Vermont are handled by local and county governments elsewhere in the nation. Therefore, focusing only on state tax burdens would not accurately capture the true nature of Vermont's tax system.

Table 1.

Taxes per $1,000 of Personal Income in FY99

	Vermont	U.S.
All taxes	$122.82	$109.96
Property tax	$52.70	$32.36
Sales taxes	30.86	39.22
Personal income tax	26.39	25.52
Corporate income tax	3.42	4.57
Vehicle taxes	2.32	2.07
Other taxes	7.13	6.21

Source: *Survey of Government Finances 1999*, U.S. Commerce Department.

Table 1 shows that Vermont's combined state and local tax burden on income, relative to the 50-state total, is about 12% above the national average. Our property tax burden is well above the national average, while our total sales tax burden (which includes the general sales tax, meals and rooms tax, and taxes on beer, wine, and alcohol, among others), is about 20% below the national average. Vermont's personal income tax is nearly identical, relative to total personal income, as the national total for all state and local governments.

Table 2 shows how Vermont ranks in terms of total state and local tax collections as a share of total personal income earned in the state. Vermont ranks sixth in the nation by this measure of tax burden. Within New England, only Maine is higher than Vermont and neighboring New Hampshire is second lowest in the nation. Connecticut and Rhode Island rank just below Vermont, and Massachusetts is the only New England state other than New Hampshire to rank below the national average.

Table 2.

State and Local Taxes as a Percent of State Personal Income FY99

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New York	14.03%	18	Arkansas	11.26%	34	Illinois	10.50%
2	Maine	13.91%	19	Delaware	11.23%	35	Oklahoma	10.48%
3	Wisconsin	12.71%	20	Washington	11.13%	36	South Carolina	10.48%
4	Minnesota	12.33%	21	Kentucky	11.10%	37	Indiana	10.47%
5	Hawaii	12.30%	22	Mississippi	11.05%	38	Maryland	10.46%
6	**Vermont**	**12.18%**		U.S.	11.05%	39	Alaska	10.26%
7	New Mexico	12.17%	23	Ohio	10.99%	40	Colorado	10.22%
8	Connecticut	12.15%	24	Montana	10.88%	41	Nevada	10.18%
9	Utah	11.68%	25	Arizona	10.87%	42	Virginia	10.16%
10	West Virginia	11.67%	26	Massachusetts	10.85%	43	Missouri	10.16%
11	Rhode Island	11.56%	27	Louisiana	10.80%	44	Florida	10.02%
12	North Dakota	11.49%	28	Iowa	10.80%	45	Oregon	10.02%
13	New Jersey	11.37%	29	Georgia	10.77%	46	Texas	9.68%
14	Michigan	11.36%	30	Nebraska	10.77%	47	South Dakota	9.51%
15	California	11.36%	31	Kansas	10.76%	48	Alabama	9.11%
16	Wyoming	11.34%	32	Pennsylvania	10.72%	49	New Hampshire	8.84%
17	Idaho	11.26%	33	North Carolina	10.55%	50	Tennessee	8.80%

Source: U.S. Census Bureau 2001.

Table 3 shows the structure of tax collections in Vermont compared to the U.S. Vermont raises a significantly larger share of its state and local taxes from property taxes and a lower share from sales and consumption taxes than do other states. Vermont's sales tax raises slightly over one fifth of all the taxes, slightly below the national average.

Table 3.
Distribution of Taxes Raised in FY99

	Vermont	U.S.
Property Taxes	43%	29%
All sales taxes	25%	36%
Personal income taxes	21%	23%
Corporate income taxes	3%	4%
Motor vehicle taxes	2%	2%
Other taxes	6%	6%

Source: *Survey of Government Finances 1999*, U.S. Commerce Department.

The tables show Vermont's overall tax burden is higher than the national average and that we rank sixth in the nation in our total tax burden on income. Vermont's income tax provides generally the same relative share of taxes to Vermont government as the national average and the income tax burden, measured as a share of income earned in the state, is also close to the national average. What the tables do not show is that Vermont's income tax raises a far larger share of revenues from upper income taxpayers compared to most states with an income tax. This study looks at this in more detail.

III. Characteristics to Evaluate Tax Policy

Taxes bring in revenue, but they also have many other impacts on people's behavior and on government — the costs of operation, the degree to which government policies affect the private sector, and the size of government itself. In order to assess the impact of a tax, or of a change in tax policy, the tax needs to be evaluated against a number of criteria, not simply how much revenue the tax will generate in the coming fiscal year. These criteria include:

- **Adequacy of Revenues:** The tax must raise the revenues needed to finance the requirements of state government. More broadly, the entire range of taxes needs to be able to finance the expenditures desired. The expenditures are developed by the political process, reflecting the views of the electorate through their elected representatives. A tax which meets all the other criteria listed below and has public support, but does not raise sufficient revenues to finance the desired government programs, either in the short run or in the longer run, will fail to meet this test. Here we consider the income tax in isolation rather than examining its place in the overall state tax structure. We assume that any newly structured state income tax will raise the same amount of revenue as the past structure would have.

- **Equity:** The overall tax structure should be fair. Again, the focus of this report is to compare likely alternatives to the current structure of the state income tax and examine fairness in a comparative context. Equity has the following two components: vertical equity and horizontal equity.

  Equity in Vermont is usually discussed in terms of the progressivity of the tax structure. This means that those with higher incomes are taxed at a higher percentage of their income than are those with lower incomes. A family earning $30,000 and paying $600 in taxes spends 2% of its income on taxes. A family earning $60,000 and paying $3,000 in taxes pays 5% of its income. This tax would be considered progressive since the higher income family pays a larger share of its income than does the lower income family.

  If the $60,000 income family paid $900 in taxes, this would not pass the test of vertical equity, since the $900 in taxes represents 1.5% of its income. Even though the higher income family pays more in taxes than the family earning $30,000, the percentage of its income needed to pay the tax bill is

higher for the lower income family (2% of income for the lower income family and 1.5% for the higher income family).

Horizontal equity means that people with the same incomes have the same tax liability; that is, the tax system does not discriminate against different types of income, or tax different types of income or spending differently. Nor does it give preference to different types of spending. Under horizontal equity, one family with $50,000 in wage income would pay identical taxes as a second family with $20,000 in wage income, $10,000 in municipal bond income, and $20,000 in social security income. Similarly, two families, each earning $50,000, would pay the same taxes if one spent $10,000 on rent and a second spent $10,000 on the principal and interest for a mortgage on their house.

Neutrality and Competitiveness: All taxes distort economic activity of businesses and households. It is a conscious design of public policy that taxes on cigarettes and alcoholic beverages are levied to discourage smoking and drinking, as well as to raise revenues. However, all taxes discourage the activity being taxed, whether it is drinking or smoking, or purchasing other products or services. A tax on telephone services will discourage people from using telephone services. A tax on income will discourage people from earning income or channel their income-earning activities into earning untaxed types of income. Sometimes, as with alcohol or tobacco, discouraging the activity is a major goal of the tax. At other times, a tax has the unintended consequence of discouraging an activity that society would like to encourage, such as entrepreneurship, job growth, or workforce participation. However, the higher the tax on any specific activity, the more likely it is to have significant disincentive effects.

Therefore, any specific tax on business and household activity should be as low as possible. Deviations from this principle can be considered where the tax-induced economic distortion encourages economic development or achieves some other public policy goals (i.e., a high cigarette tax discourages smoking).

- **Low Cost:** The tax should have a low cost for administration and compliance. Tax revenues used for administration of the tax by the Vermont Tax Department are not available to meet other public policy goals. The more complex and complicated the tax, the more difficult and costly it will be to administer and to enforce. Complexity adds to the cost of compliance not just for government but also for the taxpayers. For example, in Vermont, half of all federal income tax forms are prepared by paid tax preparers, no doubt in part due to the complexity of the federal tax code. This is not just a cost paid by high income tax filers. More than one-third of taxpayers earning under $10,000, for example, use paid tax preparers to fill out and calculate their federal income tax forms and presumably their state tax forms. Moreover, frequent changes in tax laws create additional costs for both the Tax Department and for taxpayers. An uncertain tax environment, or a frequently changing one, can create an environment that makes it difficult for businesses and individuals to plan their investment and savings decisions.

- **Exportability:** State residents benefit if taxes are paid by non-residents. The exportability is enhanced if the state has a unique product or service to tax. Alaska, for example, relies on oil taxes for a large share of its state revenue. States with large tourism sectors may have tax structures that attempt to extract revenues from tourists. This report does not discuss the issue of tax exportability in relationship to the income tax because it has limited applicability to the current debate over changes in the income tax structure.

- **Simplicity and Transparency:** Individuals and firms make optimal economic decisions to enhance their own well being when they understand the true costs and benefits of their actions and decisions. Vermonters should be able to easily understand what items are taxed, what the actual tax rate is, and

what programs the tax revenues fund. Taxes that are clearly labeled as taxes and are readily apparent enable people to make better purchasing decisions and give them valuable information about the extent of their government's role in the economy and how it affects the price of products and the cost of different types of economic activity. Taxes that make it difficult to calculate the true cost of some economic activity mean that individuals are unable to properly weigh alternatives and decide which actions to undertake.

The Vermont income tax has become increasingly complex in the recent past. One measure of this is simply the length of the state income tax form and instructions. In tax year 1995, the Vermont income tax book was 28 pages long, and included seven forms for a variety of taxes, tax relief programs, and other programs. For tax year 2000, the state income tax book was 64 pages long and included 11 different forms. The 2001 form will be more complicated than last year's. For example, a recent draft shows an additional 24 lines on the basic form as well as additional lines on supplemental forms including those to be completed by all taxpayers who report capital gains.

In 1995, the basic income tax form (Form 103) had 22 lines, and for most Vermonters, those were the only lines that had to be filled out. In 2000, the basic form (Form IN-111) had 19 lines. However, most taxpayers also had to file at least one other form (for Act 60), and that form had 16 lines. Taxpayers also had to determine which of the three Act 60-related forms was appropriate to their circumstances.

The Vermont income tax has become increasingly complex, in part because Act 60 partially transformed the local property tax into a state income tax. In large part, that was done in the name of vertical and horizontal equity, but the cost was a loss of simplicity and transparency as well as increased administrative costs to the state and compliance cost to the taxpayer.

- **Stability:** The tax should be a stable source of revenue, not varying a great deal each year. In addition, the revenue raised by the tax should grow over time with economic activity. Revenues which show a great deal of volatility year to year can cause unexpected surpluses and deficits which are difficult to accommodate and make it difficult to rely on for budgeted programming expenditures. If the tax does not grow with economic activity, either the tax rate will have to be raised or new taxes will have to come from some other source.

Each characteristic, while desirable if considered in isolation, often conflicts with other characteristics. For example, a high marginal income tax rate meets the goal of vertical equity but it does not meet the efficiency goal because it distorts work incentives. Similarly, the property tax is a very stable tax revenue source, but some question its equity features.[3]

How the Current Vermont Income Tax Works

Vermont's personal state income tax raised a net amount of $400 million in 1999. (About $34 million of that was raised from non-Vermont residents, or 8.5% of the total.) Vermont is unique in the way it levies its state income tax by calculating the state income tax liability by applying a fixed percentage to the

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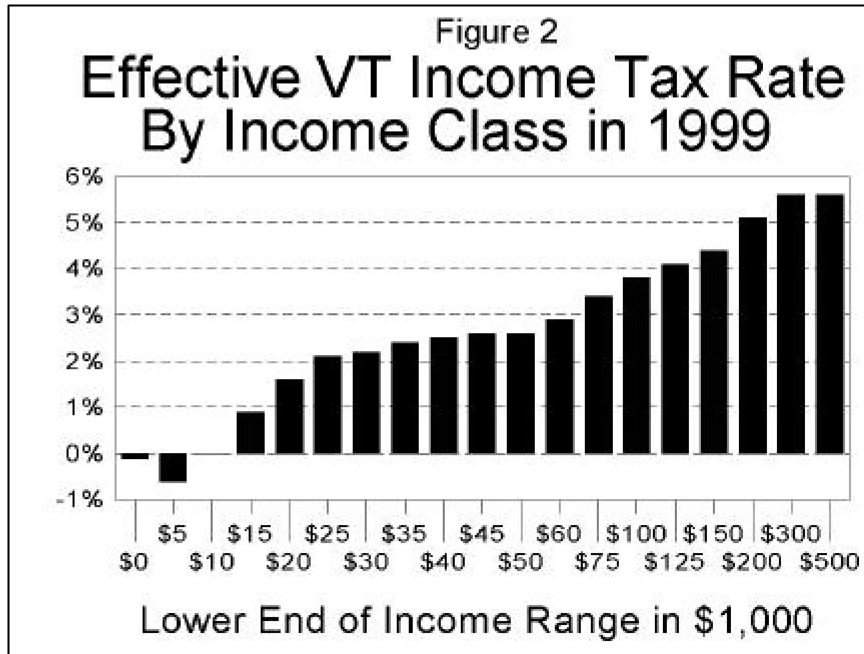
[3] Although the property tax is commonly thought to be regressive, current economic research casts serious doubts on this assertion. See George Zodrow, "Reflections on the New View and the Benefit View of the Property Tax," in *Property Taxation and Local Government Finance*, Wallace Oates (ed), Lincoln Institute of Land Policy, 2001, pp. 79-111.

federal income tax liability. The current rate is 24% of the federal tax liability but, as Figure 1 showed, the rate has varied widely over the past two decades.



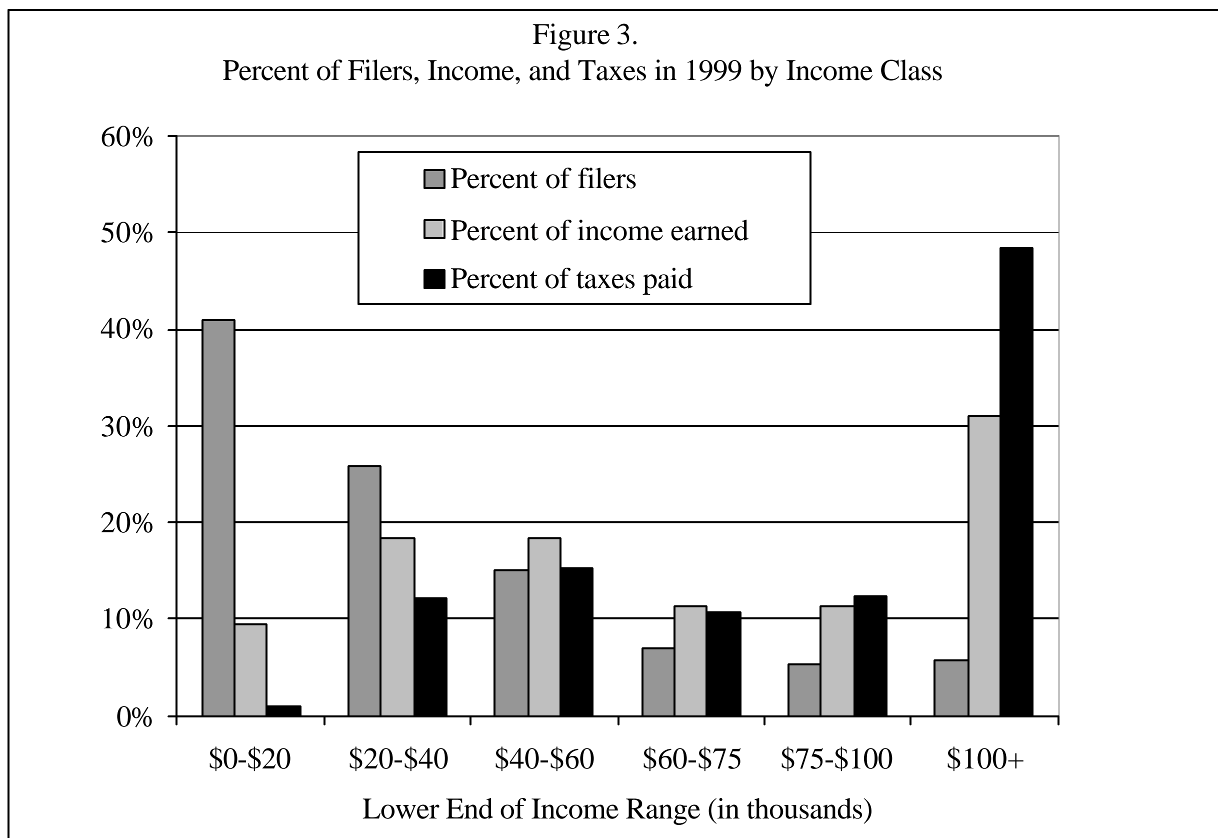
Although the state income tax is levied as a flat percentage of the federal tax liability, it does not mean that all Vermonters pay the same share of their income to the state for income taxes. Because the federal tax is progressive, higher income Vermonters pay a larger share of their income to the state for state income taxes than do lower income Vermonters, as Figure 2 shows. Very low income Vermonters pay no income tax or a negative income tax, as they take advantage of the state's refundable earned income tax credit. Middle-income taxpayers pay between 2% and 3% of their income as income tax payments. Taxpayers earning over $100,000 pay an effective tax rate of over 4%.

Figure 3 and Table 4 show these issues in more detail. Upper income Vermonters pay a disproportionate share of the state's income taxes. Taxpayers earning over $100,000 represent fewer than 6% of all the taxpayers in Vermont, earn slightly over 30% of all income, and they pay nearly half of all the income taxes. For every category of taxpayers earning under $75,000, the share of taxes paid is less than the share of income earned.

Table 4.
Number of Taxpayers and
Total Vermont Income Taxes Paid in 1999

Income Range	Number of Taxpayers	Total Income Taxes Paid ($millions)
$0 -$19,999	116,200	$ 3.1
$20,000-$39,999	73,400	43.3
$40,000-$59,999	43,000	54.5
$60,000-$74,999	19,600	38.0
$75,000-$99,999	15,300	44.4
$100,000+	16,500	172.1

This high reliance on upper income taxpayers gives Vermont's income tax a very different base than most states with an income tax. Most other states levy a tax as a percentage of income, with exemptions for the number of people in the family. Some states have high exemptions and others low, but in most other states with an income tax, middle income taxpayers pay a higher share of the total income tax package than in Vermont and they pay a higher effective income tax rate than they do in Vermont.



IV. What are the important considerations for each possible new income tax structure?

This section looks at four options and examines them in light of the characteristics for evaluating tax policy discussed earlier. The discussion assumes that any changes in the income tax structure are not designed to increase the amount of income taxes paid by Vermonters or the share of state revenues coming from the income tax. That is, the assumption underlying this report is that legislative action will be revenue neutral. Any change in Vermont's income tax law will be designed to bring in the same amount of revenues that would have been raised by the state income tax had there been no change in the federal income tax law.

Option 1: Do nothing and keep the Vermont income tax at 24% of the federal liability.

- **Adequacy:** Vermont will forego revenues as lower federal tax liabilities for most Vermonters translate into lower state income tax revenues. Without a corresponding increase in some other tax, revenues will not be available for ongoing or new programs and corresponding budget decisions will have to be made.

- **Equity:** The progressivity of the state income tax will remain. It is difficult to determine whether progressivity will be reduced because of the new federal tax law. Lower income Vermonters will pay a larger share of their income at the new, lower, 10% tax rate rather than the 15% rate that prevailed before the tax cut, so proportionately, their taxes will be reduced more than upper income Vermonters. However, the absolute magnitude of the dollar

reduction in taxes will be larger for upper income Vermonters, especially given that they pay a larger share of the income tax bill in Vermont.

There are also horizontal equity issues. The new federal tax bill creates many new tax loopholes and ways to shelter income from taxes. For example, income can be sheltered from taxes if it used for specified retirement savings or for education. In addition, families with children are treated differently than families with identical incomes that have no children. If Vermont continues to piggyback to the federal tax liability, horizontal equity will be worsened.

- **Neutrality and competitiveness:** Vermont has one of the highest marginal tax rates in the nation, and it will remain among the highest if this option is taken, with corresponding impacts on economic behavior. Federal marginal tax rates are scheduled to decline, which will reduce the tax rates the highest income Vermonters pay. However, Vermont's top marginal tax rates will still be higher than in most other states. High marginal tax rates reduce the returns to business activity and entrepreneurial innovation, which, all other things being equal, has a negative impact on economic activity and growth in Vermont.

- **Low Cost:** Continuing to peg Vermont's income tax as a flat percent of the federal liability would be the cheapest alternative for both the state and for taxpayers. The Vermont Tax Department would not have to change any of its forms nor would there be any increase in compliance costs for the Tax Department. For taxpayers, multiplying the federal liability by a flat 24% does not involve any significant increase in their own tax preparation time or cost if they hire a tax preparer.

- **Simplicity and Transparency:** The Vermont income tax is simple to calculate and it is easy for Vermonters to understand how much they owe and why they owe that much. The only drawback to this option is that many Vermonters think that the Vermont income tax is not progressive since everyone pays the same flat state tax rate, even though this flat rate is a percent of a progressive federal liability. This is true not only for average Vermonters, but for key policymakers as well.[4]

- **Stability:** The Vermont income tax is one of the least stable taxes the state levies, since incomes fluctuate over the business cycle. When the economy grows, tax revenues grow faster than economic growth, and the Legislature must make tough choices about whether to spend the additional revenues, cut taxes, or bank the surplus revenues in a rainy day account. When the economy declines, income tax revenues decline faster since not only the base of the tax (income) falls, but also the federal tax rates decline as well. In part, that is due to the nature of an income tax, but it is intensified by the progressivity of the Vermont income tax.

- **Other Considerations:** One might question why Vermont would want to reduce its income tax level simply because the federal government decided to reduce income taxes. After all, most other states that levy a state income tax will suffer little or no decline in their income tax collections because of federal income tax changes. Most states levy their income tax by collecting a certain percent of income, rather than Vermont's method of levying the state income tax as a share of the federal tax liability.

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[4] Ralph Wright, former Speaker of the Vermont House, did not understand the progressive structure of the Vermont income tax, as he makes clear in his autobiography, *All Politics is Personal*, p. 135.

One reason for this is that in the past Vermont has not reduced its tax rate to insure revenue neutrality when the federal government raised taxes. In 1990, under President Bush, and then again in 1993 under President Clinton, the top marginal tax rates were increased in order to help balance the federal budget. Vermont received windfalls since the new, higher federal taxes in upper income taxpayers meant Vermont also received higher state income taxes. If the state did not lower its tax rate when the federal government raised its rate to offset the impact, one might ask why the state should raise its rate when the federal government lowered federal tax rates.

Option 2: Keep the Vermont income tax piggybacked to the federal tax liability.

For revenue neutrality, raise the Vermont tax rate to a higher percent of the federal liability. This would keep revenues equal to what they would have been had there been no federal tax change. The issues and characteristics of good tax policy in this case are very similar to the previous option.

- **Adequacy:** Raising the Vermont tax rate to a level that would generate the same level of income as the 24% rate without federal tax reform would preserve the status quo in terms of adequacy. The tax could be structured relatively easily to raise the identical amount to what would have been expected under the old tax law calculation. Since spending plans are based on the anticipated level of the tax revenues from the income tax, and the tax would raise the same as it would have in the status quo situation, the tax would raise an adequate amount of revenues.

- **Equity:** The vertical equity, or progressivity, of the Vermont state income tax would also be essentially preserved if the state tax rate were increased. The new federal tax law has not substantially changed the progressivity of the federal tax code, which means that a flat percent of the federal tax liability would not significantly change the progressivity of the Vermont income tax.

  Horizontal equity would change, however, because of the new deductions and credits put into the federal tax code. The horizontal equity impacts would be identical to the discussion in Option 1.

- **Neutrality and competitiveness:** Raising the state income tax rate would continue to give high income Vermonters a higher marginal tax rate than if the state did nothing, which means there would be more reason for taxes to affect behavior. That means a greater distortion of economic activity, either by promoting illegal behavior to earn income off of official books, less entrepreneurial activity, and more opportunities and reasons for firms to look elsewhere in New England or in other states to locate their businesses. However, the marginal tax rates would not be much different from what they would have been had the federal government not changed the tax code and had Vermont maintained its 24% state income tax rate.

- **Low Cost:** Similar to the discussion in Option 1, pegging the state tax rate to a fixed percent of the federal rate means a low administrative and compliance cost for the Vermont Tax Department and a low cost of calculating the Vermont income tax for personal income tax filers.

- **Simplicity and Transparency:** Just like Option 1, the Vermont income tax is simple to calculate and it is easy for Vermonters to understand how much they owe and why they owe

what they do. There would be no change in this if the state merely increases the state tax rate as a share of the federal income tax liability. Continuing with an easy to understand tax structure fits in well with this goal of tax policy.

- **Stability:** A Vermont income tax that was calculated as a higher share of the federal tax liability than the current rate would not change the stability of the state income tax from its past level of stability.

Option 3: Continue the legislative solution imposed at the end of the 2001 legislative session.

The legislative solution was designed to be a temporary, one-year fix to the problem. The state Tax Department will have new tax forms and new lines on the 2001 state tax form so that Vermonters will recalculate their federal tax liability in order to hold the state harmless from the 2001 impacts of the tax law change.

- **Adequacy:** Recalculating the tax to essentially hold Vermont harmless from the 2001 federal tax law changes maintains the same tax revenues to the state. If this method continues, state income tax revenues will still fluctuate with the changing economy, and the fluctuations will be the same as they would have been with the Vermont tax code that existed prior to 2001.

- **Equity:** The vertical and horizontal equity of the Vermont state income tax would probably be preserved. Because different provisions of the federal tax law changes take effect at different times, it would be increasingly difficult for the state Tax Department to calculate how much taxes would have been owed under the old tax law and to preserve the existing levels of horizontal and vertical equity in Vermont.

- **Neutrality and Competitiveness:** The federal tax code is becoming increasingly complex under the new tax bill, which means the tax law encourages certain types of behavior and activity, and discourages other types. It will be increasingly difficult for the state to design a state tax law that gets around these changes. As a result, behaviors will be encouraged not based on economic fundamentals but simply in response to the tax law.

- **Low Cost:** The administrative cost will rise as the federal tax code changes each year. The Tax Department each year will have to redesign its state income tax form in order to insure that it is not losing revenues from the tax cuts and tax law changes. It will become increasingly complicated for Vermonters, especially those with complex federal tax calculations, to comply with the new and ever-changing Vermont tax forms and tax code. In 2001, the Vermont Tax Department had a great deal of difficulty implementing a new computer system.[5] This type of change may be very difficult, costly, and time consuming for the Tax Department to make each year.

- **Simplicity and Transparency:** The Vermont tax code will become increasingly complex if it attempts to estimate how much a taxpayer would have paid in federal income taxes in the absence of the federal tax law changes of 2001. Moreover, Vermonters will not have a good sense of exactly why they are paying what they do, since the underlying calculations to arrive

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[5] See "Review of Income Tax Return Processing Vermont Department of Taxes," by the State Technical Assistance Team, Federation of Tax Administrators, September 7, 2001 for a discussion of the problem and its causes.

at that number will not be obvious or clear. Therefore, over time, the tax code will become more complex, and less easily understood by Vermonters.

- **Stability:** The stability of income tax revenues received would probably not be any different that it was under the previous tax structure.

Option 4: Decouple the Vermont income tax from the federal tax liability and instead levy a tax based on federal adjusted gross income (AGI) or federal taxable income.

If Vermont decouples by applying a certain percentage tax rate to AGI or taxable income, there are a number of options, and the option chosen will influence many of the characteristics we examine. The AGI option means that Vermont will tax a broad measure of total income earned, including all income derived from wages and salaries, taxable dividends and interest, business income (or losses), and other types of income. It does not include other types of income, including tax-exempt municipal bond income, most social security income, or child support payments. AGI also includes deductions for expenses such as IRA contributions, self-employment taxes, and health insurance premiums, among others. Of the 41 states that levy a state income tax (nine states have no broad-based income tax[6]), 25 base their tax on the federal AGI.

Ten states levy their state income tax as a percentage of the federal taxable income.[7] Federal taxable income differs from adjusted gross income and is calculated by subtracting a number of exemptions and deductions from AGI. These include the standard deduction or itemized deductions. The standard deduction is a fixed dollar amount based on filing status.

The first option is to have a flat tax on income with no deductions or exemptions. This is unlikely to be considered in Vermont because of our concern over vertical progressivity. No other states levy an income tax this way.

Most of the states that levy a tax on AGI or taxable income have a sliding percentage tax rate that rises with income, and most also grant exemptions based on the number of dependents claimed on the tax form. It is this option that we will consider, although we will not specify either the rates themselves, at what income level the rates change, or the level of personal exemptions allowed to be deducted from income. The Legislature will have to make these decisions and they are important. It will be difficult to calculate revenue impact resulting from the mix of rates, deductions, and exemptions that would make the new income tax revenues identical to the existing Vermont income tax. It will be tempting for the Legislature to raise more revenues to fund desired state programs, especially given that the 2002 Legislature will be dealing with falling revenues caused by the recession.

It will also be important to consider whether to index the dollar values of exemptions for inflation and at what income level different rates are applied. Vermont would not want to emulate Alabama, which has income tax rates ranging from 2% of AGI to 5% of AGI. This seems like a progressive structure, but the highest tax bracket hits taxpayers with incomes of only $3,000. Moreover, the exemptions granted are modest, with an exemption of only $3,000 for married filers and $300 per dependent. Most likely, these were legislatively set some time ago and were not indexed for inflation. There will also be a temptation not to index these for inflation, since not indexing would automatically give the state a revenue windfall.

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[6] They are Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming.
[7] The states are Colorado, Hawaii, Idaho, Minnesota, North Carolina, North Dakota, Oregon, Rhode Island, South Carolina, and Utah.

The U.S. Congress indexed exemptions and tax brackets for inflation decades ago. Since Vermont's income tax is essentially piggybacked to these indexed deductions, the Vermont tax code today is implicitly indexed for inflation as well.

Most states with an income tax use either the adjusted gross income or taxable income as the base for their tax. They then apply exemptions and deductions and set the number of brackets, the cutoff points for bracket changes, and the rates prevailing in each bracket. The Appendix to this report gives a brief overview of the income tax structure of all the states.

- **Adequacy:** A state income tax levied as a share of adjusted gross income or taxable income could be structured to bring in the level of income needed to fund existing state requirements. The tax would be elastic, meaning that it would grow with the economy and therefore be able to meet the future revenue needs of existing state programs.

- **Equity:** The extent of vertical equity, or progressivity, would be a choice that the Legislature will have to make with a combination of rates, income brackets, and personal exemptions. The vertical equity could be very similar to the existing state income tax structure or it could be made more or less progressive. The tax rates could increase with income, as many states now do. The determination over how many rates to have and at what income level the rates would take effect would have to be made by the Legislature in the design of the new tax structure. The Legislature would have to decide the level of personal exemptions. The higher the dollar value of exemptions, the more revenue will be foregone.

  In more general terms, the Legislature will have to decide how much of the income tax should be levied on low income Vermonters, on middle, and on upper income Vermont taxpayers. As was shown in Figure 3 and Table 4, upper income Vermonters pay a larger share of the total income tax bill in the state as well as higher rates than middle or upper middle income Vermonters.

  If the state used the federal definition of adjusted gross income, taxpayers with the same incomes but from different sources would generally pay the same taxes, with a few notable differences. First, there would be a difference based on the number of people in the family if exemptions were given for family size. Second, some types of income are treated differently in the calculation of AGI, including the exemption of certain types of dividend and interest income, a portion of social security income, and the treatment of business income and losses. The latter especially has a great potential for loopholes and creative tax accounting and hence equity issues. But, in general, this method of taxation does a fairly good job at preserving horizontal equity.

  If the state elected to levy a state income tax based on federal taxable income, more of the loopholes, complications, and problems of the federal tax code would be brought into the Vermont tax structure.

- **Neutrality and Competitiveness:** Like any other income tax, the more progressive an income tax, the more likelihood there is of taxes influencing economic behavior, including the attractiveness of Vermont as a place in which to locate a business or to earn a high income. The more tax rates that are imposed, especially higher rates for high income taxpayers, the more competitive impacts the tax would have.
- **Low Cost:** Although there will be transition costs for the Vermont Tax Department to move to a tax based on AGI or taxable income, it will be a one-time cost. The ongoing

administrative costs for this alternative should not be onerous for the Tax Department, assuming the state adopts the same definitions of income as the federal government. The more the state deviates from the federal definitions and calculations, the higher the cost will be to the state and to Vermont taxpayers. And if the Legislature elects to change rates, add new tax brackets, and make other changes, the more costly the new structure will be to the Tax Department and to taxpayers. However, if the Legislature makes frequent changes in rates or brackets, the Tax Department may also have problems with implementation, just as was discussed in Option 3.

- **Simplicity and Transparency:** Adopting a state tax based on federal definitions of income can be made simple to calculate and to understand. It can also be made more difficult depending on how much the state deviates from federal definitions and calculations of AGI or taxable income. A simple exemption for each person in the household would also not detract from the simplicity or transparency. Making the exemptions more complicated, for example, by having different exemptions based on AGI, would make it harder for Vermonters to understand how their taxes are calculated, why they are paying the amount they owe, and the reasons for the level of taxation they face.

  The concept of taxable income is not intuitive to most people, while the concept of AGI is much more intuitively understandable. When people are asked what their family income is, their answer will more closely approximate AGI than taxable income. Therefore, any tax based on taxable income will not be as easy for people to understand as would a tax based on AGI.

- **Stability:** The stability of this alternative would differ depending on the definition of income chosen. AGI tends to fluctuate less than taxable income, so an AGI-based tax would be more stable than one based on taxable income. However, the income tax is less stable than other taxes since an economic downturn will result in lower income and hence lower tax revenues to the state. Finally, a tax based on federal taxable income would exhibit less stability than a tax based on AGI since changes in the federal tax code are common, and more of these affect the calculation of taxable income than of AGI.[8]

V. Conclusion

Vermont's Legislature will be facing two very important fiscal decisions when it meets in January 2002. One will be how to deal with the revenue shortfall caused by the recession that began last summer. The second is how to deal with the revenue shortfall resulting from the significant changes in federal tax law enacted by Congress last summer. Our elected officials should address these two issues separately as they determine what specific actions to take in response to each of them.

The recession's impact on revenues is a short-run problem that legislatures have dealt with many times in the past. The impact of federal tax law changes is different. The Legislature's decisions will affect the Vermont economy and Vermont taxpayers for years to come. This report has laid out some of the basic issues surrounding changes in Vermont's personal income tax. By considering these issues, as they wrestle with tax levels and tax structures, our elected officials will hopefully be able to make more informed and thoughtful decisions.

[8] Any tax law change that affects AGI will automatically affect taxable income. The converse is not true.

Appendix

State Income Tax Rates, Brackets, and Federal Definition of Income Used

STATE INDIVIDUAL INCOME TAXES

(Tax rates for tax year 2001 -- as of January 1, 2001)

	TAX RATE RANGE (in percents)		Number of	INCOME BRACKETS		PERSONAL EXEMPTIONS			FEDERAL INCOME TAX
	Low	High	Brackets	Lowest	Highest	Single	Married	Dependents	DEDUCTIBLE
ALABAMA	2.0	5.0	3	500 (b)	3,000 (b)	1,500	3,000	300	*
ALASKA	No State Income Tax								
ARIZONA	2.87	5.04	5	10,000 (b)	150,000 (b)	2,100	4,200	2,300	
ARKANSAS	1.0	7.0 (e)	6	2,999	25,000	20 (c)	40 (c)	20 (c)	
CALIFORNIA (a)	1.0	9.3	6	5,454 (b)	35,792 (b)	72 (c)	142 (c)	227 (c)	
COLORADO	4.63		1	-----Flat rate-----			-----------None-----------		
CONNECTICUT	3.0	4.5	2	10,000 (b)	10,000 (b)	12,000 (f)	24,000 (f)	0	
DELAWARE	2.2	5.95	7	5,000	60,000	110 (c)	220 (c)	110 (c)	
FLORIDA	No State Income Tax								
GEORGIA	1.0	6.0	6	750 (g)	7,000 (g)	2,700	5,400	2,700	
HAWAII (h)	1.5	8.5	8	2,000 (b)	40,000 (b)	1,040	2,080	1,040	
IDAHO	2.0	8.2	8	1,000 (i)	20,000 (i)	2,900 (d)	5,800 (d)	2,900 (d)	
ILLINOIS	3.0		1	-----Flat rate-----		2,000	4,000	2,000	
INDIANA	3.4		1	-----Flat rate-----		1,000	2,000	1,000	
IOWA (a)	0.36	8.98	9	1,162	52,290	40 (c)	80 (c)	40 (c)	*
KANSAS	3.5	6.45	3	15,000 (b)	30,000 (b)	2,250	4,500	2,250	
KENTUCKY	2.0	6.0	5	3,000	8,000	20 (c)	40 (c)	20 (c)	
LOUISIANA	2.0	6.0	3	10,000 (b)	50,000 (b)	4,500 (j)	9,000 (j)	1,000 (j)	*
MAINE (a) (k)	2.0	8.5	4	4,150 (b)	16,500 (b)	2,850	5,700	2,850	
MARYLAND (aa)	2.0	4.8	4	1,000	3,000	2,100	4,200	2,100	
MASSACHUSETTS	5.6		1	-----Flat rate-----		4,400	8,800	1,000	
MICHIGAN (a)	4.2 (l)		1	-----Flat rate-----		2,800	5,600	2,800	
MINNESOTA (a)	5.35	7.85	3	17,570 (m	57,710 (m)	2,900 (d)	5,800 (d)	2,900 (d)	
MISSISSIPPI	3.0	5.0	3	5,000	10,000	6,000	12,000	1,500	
MISSOURI	1.5	6.0	10	1,000	9,000	2,100	4,200	2,100	* (u)
MONTANA (a)	2.0	11.0	10	2,100	73,000	1,610	3,220	1,610	*
NEBRASKA (a)	2.51	6.68	4	2,400 (n)	26,500 (n)	91 (c)	182 (c)	91 (c)	
NEVADA	No State Income Tax								
NEW HAMPSHIRE	State Income Tax is Limited to Dividends and Interest Income Only.								
NEW JERSEY	1.4	6.37	6	20,000 (o)	75,000 (o)	1,000	2,000	1,500	
NEW MEXICO	1.7	8.2	7	5,500 (p)	65,000 (p)	2,900 (d)	5,800 (d)	2,900 (d)	
NEW YORK	4.0	6.85	5	8,000 (b)	20,000 (b)	0	0	1,000	
NORTH CAROLINA	6.0	7.75	3	12,750 (q)	60,000 (q)	2,500 (q)	5,000 (q	2,500 (q)	
NORTH DAKOTA	2.67	12.0 (r)	8	3,000	50,000	2,900 (d)	5,800 (d)	2,900 (d)	* (r)
OHIO (a)	0.691	6.980 (s)	9	5,000	200,000	1,050 (s)	2,100 (s)	1,050 (s)	
OKLAHOMA	0.5	6.75 (t)	8	1,000	10,000	1,000	2,000	1,000	* (t)
OREGON (a)	5.0	9.0	3	2,350 (b)	5,850 (b)	132 (c)	264 (c)	132 (c)	* (u)
PENNSYLVANIA	2.8		1	-----Flat rate-----			-----------None-----------		
RHODE ISLAND	25.5% Federal tax liability (v)				---	---	---	---	
SOUTH CAROLINA (a)	2.5	7.0	6	2,310	11,550	2,900 (d)	5,800 (d)	2,900 (d)	
SOUTH DAKOTA	No State Income Tax								
TENNESSEE	State Income Tax is Limited to Dividends and Interest Income Only.								
TEXAS	No State Income Tax								
UTAH	2.30	7.0	6	750 (b)	3,750 (b)	2,175 (d)	4,350 (d)	2,175 (d)	* (w)
VERMONT	24.0% Federal tax liability (x)				---	---	---	---	
VIRGINIA	2.0	5.75	4	3,000	17,000	800	1,600	800	
WASHINGTON	No State Income Tax								
WEST VIRGINIA	3.0	6.5	5	10,000	60,000	2,000	4,000	2,000	
WISCONSIN	4.6	6.75 (y)	4	1,500	112,500	700	1,400	400	
WYOMING	No State Income Tax								
DIST. OF COLUMBIA	5.0	9.0 (z)	3	10,000	30,000	1,370	2,740	1,370	

FEDERATION OF TAX ADMINISTRATORS -- FEBRUARY 2001

Footnotes to Accompany State Individual Income Taxes

(a) Seven states have statutory provision for automatic adjustment of tax brackets, personal exemption or standard deductions to the rate of inflation. Michigan, Nebraska, and Ohio index the personal exemption amounts only.

(b) For joint returns, the taxes are twice the tax imposed on half the income.

(c) Tax credits.

(d) These states allow personal exemption or standard deductions as provided in the IRC. Utah allows a personal exemption equal to three-fourths the federal exemptions.

(e) A special tax table is available for low-income taxpayers reducing their tax payments.

(f) Combined personal exemptions and standard deduction. An additional tax credit is allowed ranging from 75% to 0% based on state adjusted gross income. Exemption amounts are phased out for higher income taxpayers until they are eliminated for households earning over $52,500.

(g) The tax brackets reported are for single individuals. For married households filing separately, the same rates apply to income brackets ranging from $500 to $5,000; the income brackets range from $1,000 to $10,000 for joint filers.

(h) For tax years beginning after 2001, the tax rates range from 1.4% to 8.25% for the same tax brackets.

(i) For joint returns, the tax is twice the tax imposed on half the income. A $10 filing tax is charge for each return and a $15 credit is allowed for each exemption.

(j) Combined personal exemption and standard deduction.

(k) Income levels in each tax bracket with income for tax years 2002 and beyond.

(l) Tax rate scheduled to decrease to 4.1% for tax year 2002.

(m) The tax brackets reported are for single individuals. For married couples filing jointly, the same rates apply for income under $25,680 to over $102,030.

(n) The tax brackets reported are for single individuals. For married couples filing jointly, the same rates apply for income under $4,000 to over $46,750.

(o) The tax brackets reported are for single individuals. For married couples filing jointly, the same rates apply for income under $20,000 to over $150,000.

(p) The tax brackets reported are for single individuals. For married couples filing jointly, the same rates apply for income under $8,000 to over $100,000. Married households filing separately pay the tax imposed on half the income.

(q) The tax brackets reported are for single individuals. For married taxpayers, the same rates apply to income brackets ranging from $21,250 to $100,000. Lower exemption amounts allowed for high-income taxpayers.

(r) Taxpayers have the option of paying 14% of the adjusted federal income tax liability, without a deduction of federal taxes. An additional $300 personal exemption is allowed for joint returns or unmarried head of households.

(s) Plus an additional $20 per exemption tax credit. Rates reported are for tax year 2000; the 2001 rates will not be determined until July 2001.

(t) The rate range reported is for single persons not deducting federal income tax. For married persons filing jointly, the same rates apply to income brackets ranging from $2,000 to $21,000. Separate schedules, with rates ranging from 0.5% to 10%, apply to taxpayers deducting federal income taxes.

(u) Deduction is limited to $10,000 for joint returns and $5,000 for individuals in Missouri and to $3,000 in Oregon.

(v) Tax rate scheduled to decrease to 25% of Federal tax liability for tax years 2002.

(w) One-half of the federal income taxes are deductible.

(x) If Vermont income tax liability for any taxable year exceeds the tax liability determinable under federal tax law in effect on December 31, 1999, the taxpayer will be entitled to a credit of 106% of the excess tax.

(y) The tax brackets reported are for single individuals. For married taxpayers, the same rates apply to income brackets ranging from $10,000 to $150,000.

(z) Tax rate decreases are scheduled for tax years 2002 and 2003.

(aa) Top tax rate is scheduled to decrease to 4.75% for tax years beginning after 2001.

Source: The Federation of Tax Administrators Web site (*http://www.taxadmin.org/fta/rate/ind_inc.html*).

STATE PERSONAL INCOME TAXES: FEDERAL STARTING POINTS

STATE	Relation to Internal Revenue Code	Tax Base
ALABAMA	---	---
ALASKA	no state income tax	
ARIZONA	1/1/00	federal adjusted gross income
ARKANSAS	---	---
CALIFORNIA	1/1/98	federal adjusted gross income
COLORADO	Current	federal taxable income
CONNECTICUT	Current	federal adjusted gross income
DELAWARE	Current	federal adjusted gross income
FLORIDA	no state income tax	
GEORGIA	1/1/00	federal adjusted gross income
HAWAII	12/31/99	federal taxable income
IDAHO	1/1/99	federal taxable income
ILLINOIS	Current	federal adjusted gross income
INDIANA	1/1/98	federal adjusted gross income
IOWA	1/1/99	federal adjusted gross income
KANSAS	Current	federal adjusted gross income
KENTUCKY	12/31/99	federal adjusted gross income
LOUISIANA	Current	federal adjusted gross income
MAINE	12/31/99	federal adjusted gross income
MARYLAND	Current	federal adjusted gross income
MASSACHUSETTS	Current	federal adjusted gross income
MICHIGAN	Current (a)	federal adjusted gross income
MINNESOTA	Current	federal taxable income
MISSISSIPPI	---	---
MISSOURI	Current	federal adjusted gross income
MONTANA	Current	federal adjusted gross income
NEBRASKA	Current	federal adjusted gross income
NEVADA	no state income tax	
NEW HAMPSHIRE	on interest & dividends only	
NEW JERSEY	---	---
NEW MEXICO	Current	federal adjusted gross income
NEW YORK	Current	federal adjusted gross income
NORTH CAROLINA	6/1/99	federal taxable income
NORTH DAKOTA	Current	federal liability (b)
OHIO	Current	federal adjusted gross income
OKLAHOMA	Current	federal adjusted gross income
OREGON	Current	federal taxable income
PENNSYLVANIA	---	---
RHODE ISLAND	Current	federal liability
SOUTH CAROLINA	12/31/99	federal taxable income
SOUTH DAKOTA	no state income tax	
TENNESSEE	on interest & dividends only	
TEXAS	no state income tax	
UTAH	Current	federal taxable income
VERMONT	Current (c)	federal liability
VIRGINIA	Current	federal adjusted gross income
WASHINGTON	no state income tax	
WEST VIRGINIA	1/1/00	federal adjusted gross income
WISCONSIN	12/31/99	federal adjusted gross income
WYOMING	no state income tax	
DIST. OF COLUMBIA	Current	federal adjusted gross income

Source: Compiled by the Federation of Tax Administrators from various sources.
--- state does not employ a federal starting point. Current indicates state has adopted IRC as currently in effect. Dates indicate state has adopted IRC as ammended to that date.
(a) or 1/1/96, taxpayer's option.
(b) or federal taxable income based on current IRC
(c) not to exceed tax computed using IRC as of 12/31/99..

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