Vermont Business
ROUNDTABLE

# Vermont Business Roundtable
# Policy Statement

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

**December 2001**

**The complete text of this document is available at *www.vtroundtable.org*.**

# Vermont Business Roundtable Policy Recommendations

The accompanying report, *Vermont's State Income Tax in 2002: A Decisionmaking Framework,* describes the tax policy options and characteristics to evaluate tax policy. It lays out the framework that interested Vermonters as well as the Vermont Legislature and governor should consider as they debate what kind of changes to make, if any, in Vermont's income tax structure.

Taxes do not just raise revenues. They have many impacts on taxpayers and on the overall economy. The Vermont Business Roundtable views the revenue loss associated with federal tax law changes as a challenge to Vermont legislators and elected officials. The Roundtable members believe that the best solution to this challenge is also the simplest and revenue neutral: The state should set the state tax rate at a percent of the federal tax liability required to replace any net revenue loss resulting from the federal tax law changes.

However, the Roundtable members also strongly support the view that any tax rate increase, or any other kind of tax increase, should clearly be revenue neutral. Any changes should not be a back door increase in permanent taxes for Vermonters. The Legislature should clearly state the specific tax increases needed to simply offset the impact of federal tax changes. As a separate matter, the governor and the Legislature need to clarify which tax increases, if any, they are considering in order to balance the state's budget due to the impact of the economic downturn.

We support the simple solution to the state's state income tax design problems because it fits into the framework described in the report. It will provide an adequate amount of revenues and it preserves the vertical equity, or progressivity, of the Vermont income tax code. Discussions about whether the Vermont income tax should be more or less progressive should not be part of the discussion of how to hold state government harmless from federal tax law changes.

We also believe that the simple solution is most easily understood by Vermont taxpayers. It would impose the lowest cost burden on them and on the Tax Department. The Tax Department has been burdened by administrative and technical problems and this has affected many Vermont taxpayers. Adding another layer of complications to a state tax code which has already become more complex imposes more costs than it delivers in benefits.

We recognize that the ten-year phase in of the federal tax changes may require periodic adjustments in the Vermont rate throughout the ten-year period. We further acknowledge that there is concern about the political impact of possible periodic rate changes. However, elected leaders and interested organizations such as ours can clearly inform Vermont taxpayers that changing the percent rate for computing Vermont State Income Tax is not an increase in the actual dollars being collected and that the burden for individual tax payers will remain relatively constant.

We strongly believe that continuing to calculate the Vermont State Income Tax as a percent of the federal tax liability is the best solution. The Roundtable is not endorsing raising taxes. This recommendation and its endorsement are intended to assure simplicity and state income tax revenue neutrality based solely on the federal tax law changes.

# 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. |
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| ***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 would be very difficult to implement an 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. |

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