



Vermont's Taxing Dilemma

Taxation and the Long-Term Economy

August 20, 2020

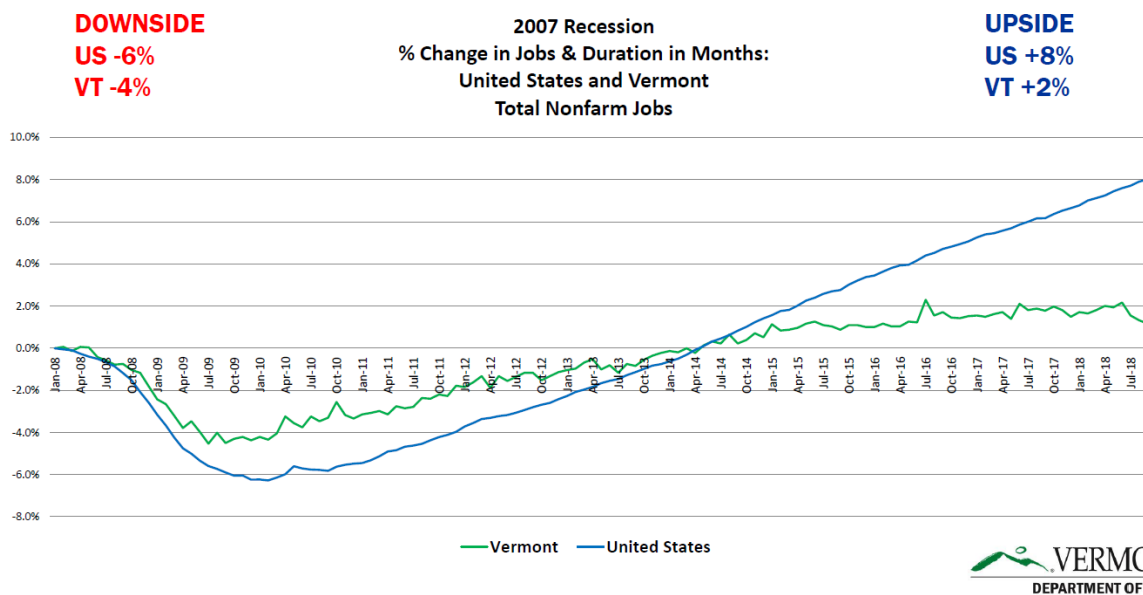
Table of Contents

Introduction	2
Data and Research: Telling the Story	3
Revenue Base and Taxation	5
The Best Path Forward	7
Conclusion	10
About the Authors	11
About The Vermont Futures Project	11

Introduction

The Vermont Futures Project promotes the long-term economic health of Vermont through leadership, research, and education. We aim to have an informed conversation around how a healthy economy contributes to Vermont's vibrant communities and unique quality of life. Since its inception four years ago, the project has closely monitored Vermont's modest economic rebound as it slowly recovered from the 2008 recession. Unfortunately, much of Vermont saw business activity never fully recovered to pre-recession levels. Vermont, like many rural states, had been experiencing the dual challenges of "rural flight" and an "aging demographic". Attractive lifestyles and urban job opportunities have previously drawn many workers away from rural areas while a generation of people are retiring from the workforce.

The Great Recession: US & VT



Source: Economic & Labor Market Information Division of the Vermont Department of Labor in cooperation with the U.S. Bureau of Labor

Today, with the onset of a global pandemic, new paradigms may change these long-established patterns in unexpected ways that could renew interest in a more rural lifestyle. This phenomenon may be great news for reimagining Vermont's future. Times dictate that Vermont's singular focus must be on repairing and rebuilding our economy. All states are experiencing severe economic impacts from COVID-19. While the full financial impact is still uncertain, as of 8/1/20 the [projected state revenues](#)¹ in fiscal year 2021 are estimated to fall across all state funds creating an estimated budget deficit close to \$200 million. As a result of this stark reality, tough choices lay ahead when planning state budgets going forward.

As Vermont struggles to create the 2021 state budget, many discussions will be around taxation with a focus on immediate policy and adjustments to address this current crisis. The Vermont Futures Project is looking beyond the immediate circumstance to understand how taxation structures can either drive or inhibit long-term economic recovery and growth. The observations will be used to inform and provide guidance for today's economic situation while recommending future goals to establish a tax structure that is acceptable, fair, and sustainable.

¹ Source: <https://lifo.vermont.gov/assets/Subjects/Revenue-Fund-Updates-and-Issue-Briefs/020559acda/Revised-May-19-Detailed-Forecast-Tables-v2.pdf>

Data and Research: Telling the Story

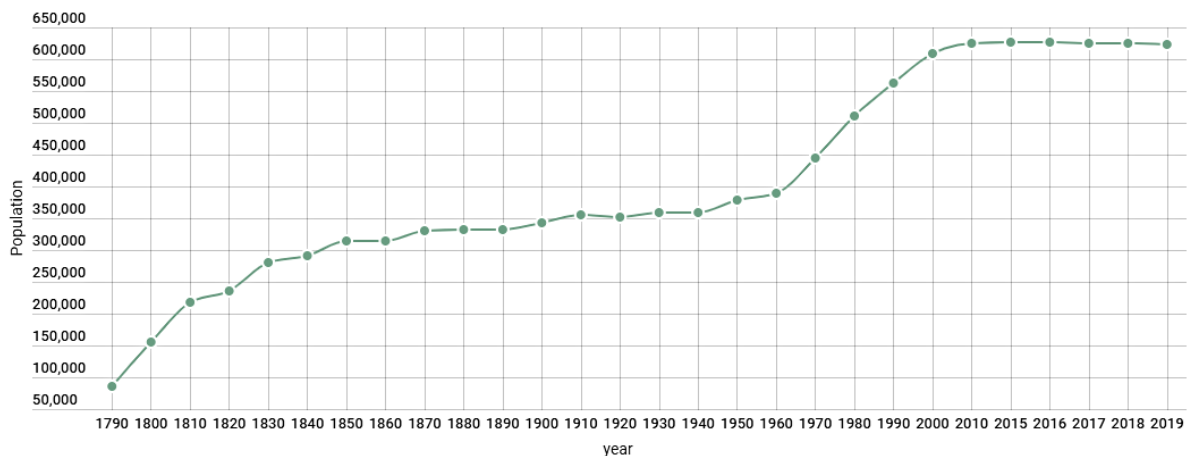
As we look ahead and plan for a secure economic future, lessons can be learned from the Vermont Futures Project studies of Vermont's economy prior to the pandemic. Vermont has been at an economic tipping point that started well before the current pandemic-caused economic crisis. What we know is that the pre-COVID Vermont economy featured low unemployment, aging population impacts, rural economic challenges, and a skilled workforce crisis. This all created a modest and uneven recovery throughout the state.

Additional research within The Vermont Futures Project's *Economic Activity Pillar* shows Vermont's [population](#)² has been stagnant for over a decade, but more troubling is that the [composition](#)³ is rapidly changing with a larger share of Vermonters over 50 and fewer Vermonters in early career stages. Research has also shown that tax revenues increase with population growth but decrease with an aging population. When combined with increased needs for services and resources, the outlook for balancing future budgets presents significant challenges. Simply put, Vermont needs to maintain careful taxation discipline so younger people will migrate here to build their lives and careers, helping the economy grow out of the pandemic downturn.

Vermont's Historic Population Growth

Source: ACS 1-year estimates, Table S0101

Vermont grew rapidly in the late 1700s and early 1800s. From the mid 1800s to 1900s the population remained relatively flat, then grew again from the 1960s to 1990s. Growth was fueled by baby boomers and facilitated by developments like the interstate highway system. Since the 1990s Vermont's population has flattened out. From 2010 to 2019, Vermont's population has remained relatively flat according to Census estimates. Although people move in and out of Vermont all the time, net gains are mainly in older cohorts.



Source: Vermont Futures Project, <https://vtfuturesproject.org/vermonters-visitors/forces-of-change/>

Additional pre-COVID economic challenges in Vermont included:

- A severe need for more skilled workers
- Substantial increases to unemployment and workers' comp costs
- Payroll tax hikes of 2%
- A growing property tax burden with overly complex calculations
- Increased health care and energy expenses

² Source: <https://vtfuturesproject.org/vermonters-visitors/forces-of-change/>

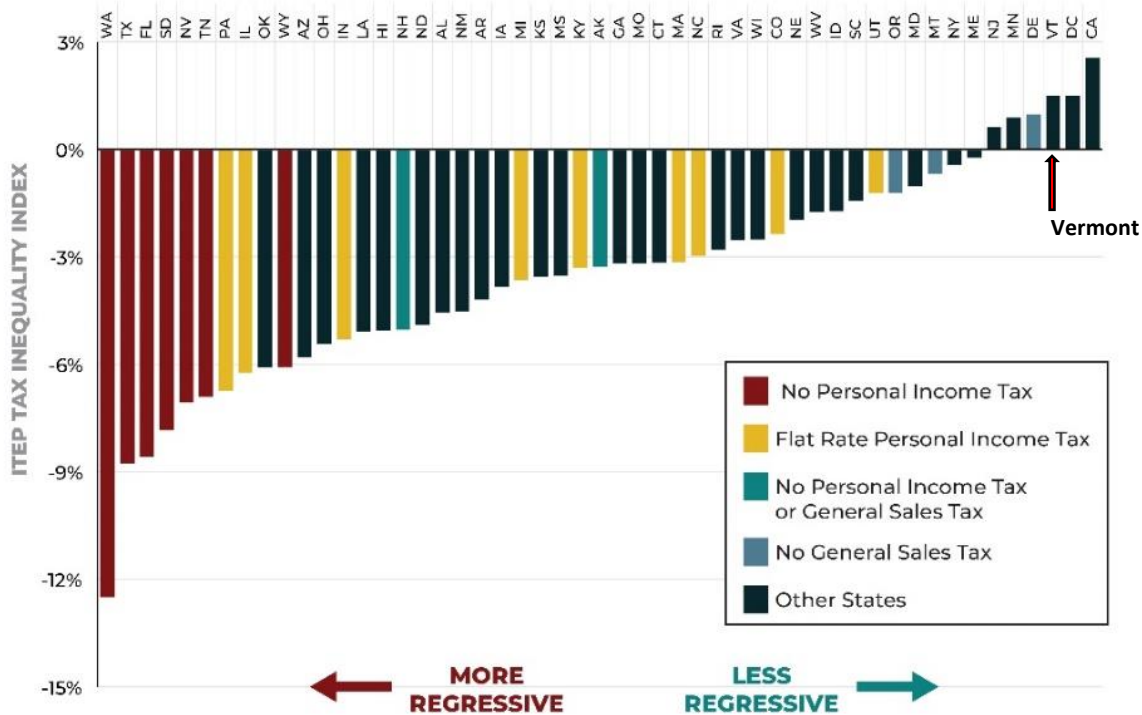
³ Source: <https://vtfuturesproject.org/vermonters-visitors/forces-of-change/>

- Deficient housing stock for low- and middle-income earners

Challenging times require focus on a future that leverages Vermont’s strength for a talented workforce, unparalleled quality of life, and economic opportunity for all. But improving economic conditions requires more than research and policy; it also demands shifting attitudes and developing a culture of support for new business, innovation, and workforce opportunity.

To date, Vermont has been guided by attitudes forged in an era of rapid change (1970s – 1990s). During that time, several regulations and budgets were passed to control growth and downplay the importance of businesses and jobs that impacted our future tax base to draw on over time. Our current tax structure evolved to one of the least regressive (most equalized) in the country. This progressive tax structure reflects Vermont’s long-standing values that include caring for both the vulnerable and the environment. An overview of Vermont’s current tax structure in terms of “progressivity” was reviewed by the Vermont Tax Structure Commission in May of this year. The Vermont Tax Structure Commission was established to prepare a structural analysis of the State’s revenue system and offer recommendations for improvements and modernization and provide a long-term vision for the tax structure. The research from several comprehensive national studies proves that Vermont has one of the most progressive state tax structures in the United States and is a leader in reducing the tax burden on its lowest-income families. The Institute on Taxation and Economic Policy (ITEP) [chart on tax inequality](https://itep.org/chart-on-tax-inequality/)⁴ indicates that the Vermont tax structure is already highly progressive.

Impact of Tax Systems on Inequality



Source: Institute on Taxation and Economic Policy.

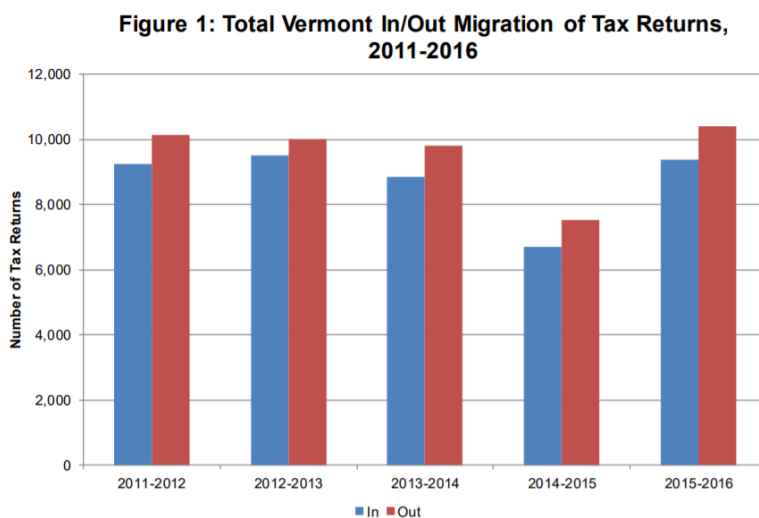
Source

⁴ Source: <https://itep.org/fairness-matters-a-chart-book-on-who-pays-state-and-local-taxes-2019/#11>

Revenue Base and Taxation

Each economic challenge drives adjustments to both spending and revenues to help pave the way for a better future. As we find ourselves amid our first downturn since the 2008 financial crisis, we now face a taxing dilemma around balancing a budget using revenue adjustments coupled with difficult spending reductions. At the same time, we are hitting the full effect of recent federal tax reforms capping key deductions for middle- to upper-income households and a wave of workforce retirements. Expanding our economic base through as moderate taxation as possible provides the best approach to improve long-term spending support. Our perceptions about the overall tax burden and distribution of tax costs will shape our long-term economic future to expand capacity and revenue base.

Even before the new federal tax law changes, there has been a growing trend of movement from higher-tax to lower-tax states. The [CATO Institute report](#)⁵ used IRS state migration flows to show that in just the year 2016 there was a net migration of almost 600,000 people moving from the 25 highest-tax states to the 25 lowest-tax states. IRS data shows that New Hampshire with no personal income and sales tax had a net in-migration in four of the past five years while adjoining higher-tax states suffered net out-migration. The report estimates that Vermont lost as many as 12,877 taxpayers between 2008 and 2017 while New Hampshire has had net in-migration from other New England states. The [Vermont JFO report](#)⁶ showed that over the 2011 to 2016 period, Vermont lost 4,167 taxpayers to migration. Overall trends show that people are moving from states that are fiscally unhealthy, economically stagnant, higher taxed and with fewer job opportunities, while moving to business-friendly, fiscally sound lower taxed states.



Source: JFO Report <https://lifo.vermont.gov/assets/Publications/Issue-Briefs/3bed2c98d0/Age-and-Income-Issue-Brief-Final.pdf>

The Vermont Futures Project dashboard indicates that during the four-year period from 2012 to 2016, income tax rates increased so income tax revenue grew by 13.5%, the rooms and meals rooms tax rate stayed constant, but revenue increased by 23.3% due to increased sales.

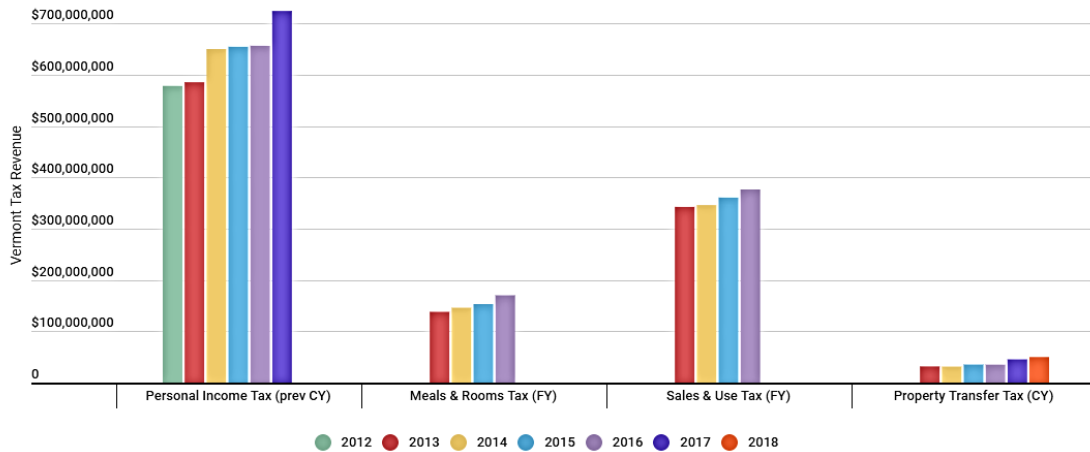
⁵ Source: <https://www.cato.org/publications/tax-budget-bulletin/tax-reform-interstate-migration>

⁶ Source: <https://lifo.vermont.gov/assets/Publications/Issue-Briefs/3bed2c98d0/Age-and-Income-Issue-Brief-Final.pdf>

Vermont Tax Revenues by Source

Source: Vermont Department of Labor 2014 data, 2015 data, 2016 data, 2017 data, 2018 data, 2019 data available soon. ^S

Four Principle Categories of Tax Revenue.



Source: Vermont Futures Project, <https://vtfuturesproject.org/vermonts-economy/revenue-base/>

The most recent [Institute on Taxation and Economic Policy \(ITEP\) tax inequality report⁷](#) ranks Vermont as having some of the highest taxes in the country in key tax areas. Vermont ranks 49th highest property tax, 45th highest corporate tax, and 39th highest income tax. The ITEP report calculates the effective tax burden per state (state & local taxes divided by income) as follows:

	Top 1% income	Middle 60% income	Bottom 20% income
VT	10.4%	9.4%	8.7%
NH	3%	7.1%	9.1%
ME	8.6%	9.3%	8.7%
MA	6.5%	9.3%	10%
CT	8.1%	11.6%	11.5%
RI	7.9%	9.3%	12.1%
USA avg.	7.4%	9.3%	12.1%

For middle-income and above, Vermont is positioned as the highest effective tax rate in New England. As we face the COVID-19 economic challenge, we are faced with the age-old decision between cutting spending or increasing taxes. The effect of additional taxes is basic “supply & demand” economic human behavior. Additional taxes raise the cost of business operations so tend to drive location decision making. In our highly mobile world, businesses and citizens pinched by higher costs first react by moving between locations, deferring investment, and taking on less risk. This creates a negative downward spiral of slowing business activity and lowering future tax revenues as tax increases result in less future revenue. Over long periods of time excessively high tax rates lower revenues and lower tax rates increase long-term revenue. Therefore, long-term tax policy should reflect a balanced rate that keeps Vermont competitive while gently increasing future revenues.

⁷ Source: <https://itep.org/whopays-map/>

The Best Path Forward

Rebuilding and growing the economy is the only long-term answer to meeting our future budgetary challenges. Many Vermonters believe the tax burden has become so high that there is little capacity for further increases and further hikes will result in diminishing returns. It is likely that the downward cycle of revenue shortfalls Vermont has experienced over the past few years will be even further magnified during this severe economic slowdown. Raising taxes during difficult economic times is akin to putting more weight on an overburdened backpacker; it just slows them down even more. The current state of the economy calls for **tax restraint not additional taxes**. The cumulative impact of repeated tax increases weigh on Vermont business' ability to reinvest in future business growth, additional jobs, increased wages, and boosting capital investments. The exercise of restraint, for both additional taxes and new services, will create a sustainable business climate with steady future revenue for critical programs and services.

Goals and Recommendations:

Goal 1: Commission a Tax Incidence Study

Occasional *Blue Ribbon* tax commissions are helpful but not enough. A [Tax Incidence Study](#)⁸ would be used to evaluate Vermont's current tax system as valuable analysis for considering future changes in Vermont's tax structure paid by both individuals and businesses. This study would highlight the burden of state and local taxes across various income and demographic groups. The study would address the important question: "Who pays Vermont's taxes?" The report can also estimate tax incidence across income groups for state and local taxes. Establishing a standing tax committee would help to continually refine and simplify Vermont taxes and articulate how our tax structure drives long-term economic activity.

Recommendation:

The work of past and current tax commissions to recommend structural changes to Vermont's taxes has been a step in the right direction but the effort needs to be ongoing, deeper, and broader. A *Tax Incidence Study* would work to continue to make Vermont taxes more competitive, transparent, and acceptable for all demographic cohorts.

Areas to explore:

- Revised land use taxes for people with high wealth
- Income tax adjustments for retired military and social security
- Lower property transfer taxes for first home buyers
- Inequalities and non-competitive taxes for retirees and young workers
- Inequalities and non-competitive taxes for Black, Indigenous and People of Color (BIPOC)
- "Benefit cliffs" and "tax mountains" for specific cohorts
- Simplify complex systems of credits and special exceptions
- Smooth tax receipt instability from higher income brackets
- Improve coordination between the legislative budget and taxation committees
- Communicate Vermont taxes to the general public and Legislature

Goal 2: Establish a Goal for Vermont's Tax Structure to Be in the Middle of Surrounding States

Establish a goal to shift the Vermont tax structure over time to the middle of the surrounding states for the percentage of taxes per average Vermonter's income. Bend the curve on the growing tax burden

⁸ Source: https://www.investopedia.com/terms/t/tax_incidence.asp

Vermonters have been experiencing by setting a 10-year goal for Vermont to rank in the middle of this key indicator or 6.8% of the average Vermonter's income down from the current 10.1%.

Recommendation:

The Federation of Tax Administrators [2019 tax burden per capita report](#)⁹ (Table 2) for Vermont and the surrounding states indicates Vermont's per capita tax as a percentage of personal income is excessive. These comparisons may not fully consider the progressivity of Vermont's current tax system, but it is important to note in our small state, the tax burden is felt by a relatively small cohort of high-income earners as noted in Table 3 below. Table 3 indicates only 15% of Vermonters make over \$100,00 income compared to 25% in the New England region.

Table 2

State	Tax per capita	Rank	% of average income
Vermont	\$5,495	#4	10.1%
NH	\$2,184	#51	3.6%
MA	\$4,614	#22	6.4%
NY	\$4,710	#13	6.8%
VT, MA, NY & NH Avg.	\$3,836		5.6%

The [Lincoln Institute of Land Policy](#)¹⁰ indicates that Vermont is unique in the degree to which the property tax provisions convert the property tax for some low- and moderate-income households into an income tax. Unlike other tax research organizations that present state to state comparisons, the Lincoln Institute of Land Policy is different. This organization [highlights](#)¹¹ Vermont's distinctive property tax structure. They reference Vermont's property tax system as one of the most complex systems in the United States and note that Vermont is one of only four states with no state-imposed limitation on property tax rates, levies, or assessments. In 2014, Vermont had the third-highest property tax burden in the nation as measured by percentage of personal income. Property taxes accounted for more than 22% of all state and local revenue, placing Vermont sixth from the top among all states in terms of total property taxation as a percentage of state and local revenue.

Table 3

	Vermont						New England (less VT)					
	Percent of Total VT Tax Returns in Cohort (2016)	In-Migration		Out-Migration		Percent of Total NE Tax Returns in Cohort	In-Migration		Out-Migration			
		Percent of Total	Number	Percent of Total	Number		Percent of Total	Number	Percent of Total	Number		
\$1-10k	10%	14%	5,933	14%	6,642	7%	12%	85,695	11%	93,082		
\$10k-25k	20%	29%	12,482	29%	13,697	17%	24%	173,367	23%	192,060		
\$25k-50k	28%	27%	11,863	28%	13,252	24%	26%	192,418	26%	214,527		
\$50k-75k	16%	12%	5,160	12%	5,676	16%	14%	103,477	14%	118,788		
\$75k-100k	11%	7%	2,847	7%	3,117	11%	8%	57,963	8%	69,745		
\$100k-200k	12%	9%	3,783	8%	3,977	18%	11%	78,481	12%	96,234		
\$200k+	3%	4%	1,646	3%	1,520	7%	5%	40,095	6%	46,638		
Total	100%	100%	43,714	100%	47,881	100%	100%	731,496	100%	831,074		

Source: JFO Report, <https://ljfo.vermont.gov/assets/Publications/Issue-Briefs/3bed2c98d0/Age-and-Income-Issue-Brief-Final.pdf>

⁹ Source: <https://www.taxadmin.org/2019-state-tax-revenue>

¹⁰ Source: <https://www.lincolnst.edu/research-data/data-toolkits/significant-features-property-tax/state-state-property-tax-glance>

¹¹ Source: https://www.lincolnst.edu/sites/default/files/vt_mar_2019_final.pdf

As most businesses in Vermont are smaller, about 80% of businesses pay pass-through taxation within the shareholder personal income tax. Only about 20% of Vermont businesses are subject to the Vermont corporate tax. The 8.5% Vermont marginal corporate tax rate is within the range of other regional states.

Table 4

State	Marginal corporate tax rate
New York	6.5%
New Hampshire	7.7%
Mass	8%
Vermont	8.5%
Maine	8.99%

Eleven states have a higher marginal corporate tax rate than Vermont. As the corporate tax is paid by some of the largest employers in Vermont, any further increases to this tax would be counter-productive to building a stronger economic base.

Moving Vermont taxation structures more to the regional middle ground is a long-term process. The cumulative impact of repeated tax increases weigh on Vermont business' ability to reinvest in future business growth, additional jobs, increased wages, and boosting capital investments.

Again, exercising restraint in the short-term by supporting tax policies that hold the line on new taxes for Vermonters and Vermont businesses would be the best path forward during these turbulent times. In the long-term, The Vermont Futures Project recommends creating a tax policy that grows the tax base but lowers the percentage of the average income Vermonter's pay. By developing a tax structure that is broad and deep across all sectors to grow the population, jobs, and economic sustainability would create a sustainable revenue stream for future long-term investments.

Goal 3: Grow Vermont's Tax Base

Change the perception of Vermont as a high tax state by creating an economic vision of a Vermont economy for our grandchildren. Grow Vermont's tax base by attracting and retaining Vermonters seeking a simpler more rural lifestyle. Position Vermont as the "work-from-home capital of the country" to grow our workforce and adapt to a new world of work.

Recommendation:

Create and communicate a vision for the economic future of Vermont to:

- Invest in universal broadband as the post-COVID economy depends on this resource to attract and retain workers, support education, improve health care access, and broaden business innovation.
- Develop policies that support a healthy mix of industries, improved focus on rural business, and high-speed communications in every corner of Vermont.
- Foster a vibrant and welcoming economy with a rising base of diverse and innovative businesses providing competitive compensation and benefits, including accessible and affordable child care.
- Increase new and retrofitted housing units across Vermont to improve inventory and reduce the cost of housing.
- Focus on the quality of Vermont's economic growth where high-paid jobs are plentiful, the environment is preserved, and people of all races experience higher income levels.

- Communicate a sense of shared destiny and a common commitment to economic opportunity and fairness with an economic system that builds trust while increasing productivity and improving individual health and well-being.

Conclusion

Like so many private businesses and non-profit organizations, the State of Vermont currently faces a deep budget deficit due to the onset of a global pandemic. The response to revenue losses due to COVID-19 will be long-lasting. The Vermont Futures Project believes that the time is now to take a broader look at our current tax structure and how it impacts Vermont's economic performance for our long-term economic security and sustainability. This is necessary ongoing work that must be broad and deep across all sectors.

The Vermont Futures Project recommends engaging the greater Vermont community (business, government, and not-for-profit) to take a new look at our long-term taxation dynamic to discover and implement meaningful improvements. The future success of Vermont depends on prioritizing the importance of economic development while also fostering policies and attitudes that help overcome the increasing pandemic-created challenges. Growing Vermont's future tax base, and not just the current tax rates, must be foremost in our dialog and actions. A focus on increasing our tax base and slowing or eliminating tax increases will allow Vermont to strengthen the quality of life we hold dear and affirm our commitment to the future generations of Vermonters. This change will be crucial to creating a climate that supports vibrant economic activity, affordability, and opportunity while focusing public spending on essential needs. Now more than ever is the time to refrain from burdening our economy in ways that will short-change our future.

In the months ahead, The Vermont Futures Project will continue to monitor the current economic impact and revenue losses due to COVID-19. We will partner in research and exploration of migration patterns, real estate transactions, and other additional revenue sources that could grow our tax base. We welcome you to join us in this conversation.

About the Authors



Lori Smith is the Executive Director of The Vermont Futures Project, a data-driven initiative working to secure Vermont’s economic future and provide opportunity for all Vermonters. Lori has over 30 years of health care knowledge and how it relates to wellbeing, behavior change, and organizational impact. In 2017, Lori discovered her “encore career” with The Vermont Futures Project as the Business Development Partner. Her passion and commitment led to the Executive Director role in September 2019 joining a great team and a dedicated Board of Directors.



John Burton is the President of Stormseye Associates, a Vermont-based consulting firm working with business leaders and communities around issues related to economic development. He has worked with The Vermont Futures Project to gather insights and create recommendations for the future of Innovation and entrepreneurship in Vermont. Recently his role was expanded to include the remaining four pillars of the six-pillar plan. John also consults with the Distributed Ledger Governance Association around distributed ledger application pilots, project planning and legislation. He is the former President of NPI Technology Management in South Burlington Vermont where he consulted with business executives about their technology planning, budgeting, and project management.

About the Vermont Futures Project

The Vermont Futures Project is an independent non-partisan organization with a goal of providing a vision that supports and encourages long-term economic growth for Vermont, providing data and recommendations to achieve this goal. The Vermont Futures Project will position the economy in the center of a statewide discussion about Vermont’s future, enriching that discussion with data, benchmarks, and research – demonstrating how a healthy economy provides opportunities for people and contributes to Vermont’s unique quality of life.

Contact: Lori A. Smith, Executive Director, Vermont Futures Project,
smith@vtfuturesproject.org, www.vtfuturesproject.org

A special thank you to our Donor Partner, [Gallagher Flynn, and Company, LLC](#) and [Sara Teachout](#) for their time, expertise, and advisement.