



H.541 Revenue Bill Follow-Up



Graham Campbell, Joint Fiscal Office
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Capital Gains Exclusion



Background-Capital Gains

- ▶ Defined as the profits resulting from the sale of a capital asset
 - ▶ Stocks, bonds
 - ▶ Business or real estate
 - ▶ Works of art or collectibles
- ▶ Classified as long or short term
 - ▶ Long term= asset held for one year or longer
- ▶ Subject to personal income tax rates in Vermont because they are a part of Adjusted Gross Income



Capital Gains at the Federal Level

- ▶ Taxed at lower rates than ordinary income
- ▶ Brackets correspond to regular income brackets

2018 Federal Tax Rates (Married Filing Jointly)			
Federal Taxable Income		Tax Rates	
Over	But Not Over	Ordinary Income Rate	Capital Gains Rate
\$0	\$19,050	10.0%	0%
\$19,050	\$77,400	12.0%	0%
\$77,400	\$165,000	22.0%	15%
\$165,000	\$315,000	24.0%	15%
\$315,000	\$400,000	32.0%	15%
\$400,000	\$600,000	35.0%	15%
\$600,000	-	37.0%	20%

← Notice the growing gap



Who has capital gains?

- ▶ Largely high income taxpayers, and therefore, account for the majority of the capital gains exclusion

Table 1: Taxable Capital Gains and Exclusions by Filers in Various Income Groups in CY2016

Adjusted Gross Income	Accounts Reporting Capital Gains	Total Taxable Capital Gains	Average Taxable Capital Gain	Total Capital Gains Excluded From Income	Percent of Total Capital Gains Exclusions	Average Capital Gains Exclusion
Less than \$40,000	8,236	\$17,043,548	\$2,069	\$13,099,367	4%	\$1,591
\$40,000 to \$60,000	5,321	\$17,296,454	\$3,251	\$13,106,240	4%	\$2,463
\$60,000 to \$100,000	9,484	\$53,310,460	\$5,621	\$28,139,032	9%	\$2,967
Below \$100,000	23,041	\$87,650,462	\$3,804	\$54,344,639	18%	\$2,359
\$100,000 to \$300,000	14,595	\$227,328,649	\$15,576	\$67,006,896	22%	\$4,591
\$300,000 and above	4,229	\$698,636,678	\$165,201	\$182,148,940	60%	\$43,071
Total	41,865	\$1,013,615,789	\$24,212	\$303,500,475		\$7,250



Why do we even have an exclusion?

- ▶ In theory, capital gains should get preferential treatment because it encourages savings and investment
- ▶ **However, it is unlikely that the Vermont capital gains exclusion is encouraging savings and investment.**
 - ▶ Nationwide research on the effect of capital gains on savings and investment is mixed at best, although most studies show little to no effect
 - ▶ Tax benefits of Vermont's capital gains exclusion are significantly smaller than Federal tax benefits
 - ▶ Unlikely the Vermont exclusion is enough to drive savings and investment behavior



Who takes the 40% Exclusion?

95% of exclusion-takers use the \$5,000 exclusion. The remaining 5% use the 40% exclusion

Table 4: Capital Gains Exclusions by Type and Income Group in CY2016

AGI Group	40% Exclusion			\$5,000 Exclusion		
	Returns Taking	Total Amount Excluded Under 40% Exclusion	Under 40% Exclusion	Returns Taking \$5,000 Exclusion	Excluded Under \$5,000 Exclusion	Average Exclusion Under \$5,000 Exclusion
Less than \$40,000	66	\$455,957	\$6,908	8170	\$12,643,410	\$1,548
\$40,000 to \$60,000	157	\$1,452,702	\$9,253	5164	\$11,653,538	\$2,257
\$60,000 to \$100,000	416	\$4,982,877	\$11,978	9068	\$23,156,155	\$2,554
\$100,000 to \$300,000	1040	\$25,380,023	\$24,404	13555	\$41,626,873	\$3,071
\$300,000 and above	552	\$167,000,704	\$302,538	3677	\$15,148,236	\$4,120
Total	2231	\$199,272,263	\$89,320	39,634	\$104,228,212	\$2,630



Who Takes the 40% Exclusion?

- ▶ Is it people who have one-time, large sales of capital assets like farms or businesses?
 - ▶ In CY2016, 2,231 taxpayers took the 40% exclusion
 - 1,110 of them claimed it in at least one other year between CY2012 and CY2015
 - 470 claimed it 3 or more times

- ▶ Is it farmers selling off their assets?
 - Less than 200 of the 2,231 taxpayers who took 40% reported any farm income
 - Less than \$8 million in capital gains exclusions, out of the total \$199 million excluded under the 40% exclusion



Who takes the 40% Exclusion?

- ▶ Is it people who are selling an asset for use as a next egg?

Table 5: Age Distribution of Filers Who Took the 40% Exclusion: CY2016

Age Group	Number of Returns	Average Capital Gains Exclusion	Total Taxable Capital Gains Excluded
< 18	Less than 10
18-35	86	\$122,100	\$10,500,614
35-45	166	\$77,623	\$12,885,453
45-55	361	\$127,412	\$45,995,694
55-65	612	\$76,330	\$46,713,719
65+	999	\$80,880	\$80,798,722
Unreported	Less than 10
Total	2,231	\$89,320	\$199,272,263



Current law: Very tax competitive

40% exclusion is tax-advantageous for high-income filers compared to other states

Table 9: Marginal Capital Gains Taxes of New England States

		Vermont				Massachusetts	New Hampshire	Maine	Connecticut	Rhode Island	New York
		40% Exclusion		\$5000 Flat Exclusion		5.2% tax rate on capital gains	0% tax rate all income except dividends and interest	Individual income tax rates on capital gains			
Adjusted Gross Income	Long-Term Capital Gains <small>(based on observed data)</small>	40% Exclusion	Marginal Tax on Capital Gains	\$5000 Exclusion	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains
\$40,000	\$2,000	N/A	\$0	\$2,000	\$0	\$104	\$0	\$116	\$60	\$75	\$90
\$60,000	\$3,500	N/A	\$0	\$3,500	\$0	\$182	\$0	\$236	\$175	\$131	\$207
\$100,000	\$5,600	N/A	\$40	\$5,000	\$40	\$291	\$0	\$400	\$280	\$266	\$361
\$300,000	\$15,000	\$6,000	\$788	\$5,000	\$875	\$780	\$0	\$1,073	\$900	\$899	\$998
\$500,000	\$65,000	\$26,000	\$3,413	\$5,000	\$5,250	\$3,380	\$0	\$4,648	\$4,225	\$3,894	\$4,453
\$1,000,000	\$150,000	\$60,000	\$7,875	\$5,000	\$12,688	\$7,800	\$0	\$10,725	\$10,350	\$8,985	\$10,275
\$2,000,000	\$300,000	\$120,000	\$15,750	\$5,000	\$25,813	\$15,600	\$0	\$21,450	\$20,970	\$17,970	\$20,550

Note: The higher income examples assume various levels of itemized deductions

Other state income tax rates do not include local income taxes



30% Exclusion still makes us tax competitive

Table 9: Marginal Capital Gains Taxes of New England States

		Vermont		Massachusetts	New Hampshire	Maine	Connecticut	Rhode Island	New York
		30% Exclusion		5.2% tax rate on capital gains	0% tax rate all income except dividends and interest	Individual income tax rates on capital gains			
Adjusted Gross Income	Long-Term Capital Gains <small>(based on observed data)</small>	30% Exclusion	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains	Marginal Tax on Capital Gains
\$40,000	\$2,000	N/A	\$0	\$104	\$0	\$116	\$60	\$75	\$90
\$60,000	\$3,500	N/A	\$0	\$182	\$0	\$236	\$175	\$131	\$207
\$100,000	\$5,600	N/A	\$40	\$291	\$0	\$400	\$280	\$266	\$361
\$300,000	\$15,000	N/A	\$875	\$780	\$0	\$1,073	\$900	\$899	\$998
\$500,000	\$65,000	\$19,500	\$3,981	\$3,380	\$0	\$4,648	\$4,225	\$3,894	\$4,453
\$1,000,000	\$150,000	\$45,000	\$9,188	\$7,800	\$0	\$10,725	\$10,350	\$8,985	\$10,275
\$2,000,000	\$300,000	\$90,000	\$18,375	\$15,600	\$0	\$21,450	\$20,970	\$17,970	\$20,550

Note: The higher income examples assume various levels of itemized deductions

Other state income tax rates do not include local income taxes



States with special treatment for CG

State	Tax Treatment of Capital Gains
Vermont	Capital gains exclusion: \$5,000 of long-term capital gains or 40% of capital gain from sale of business, farm, or investment property.
Arizona	25% deduction of capital gains from taxable income
Arkansas	50% exclusion of net capital gains from taxable income
Hawaii	Capital gains taxed at lower rates than ordinary income
Montana	Credit equal to up to 2% of net capital gains
New Mexico	50% exclusion of net capital gains from taxable income
North Dakota	40% exclusion of net capital gains from taxable income
South Carolina	44% exclusion of net capital gains from taxable income
Wisconsin	30% exclusion of net capital gains from taxable income, 60% exclusion for farm assets

- ▶ Some states have exclusions related to sales of in-state assets (Colorado, Louisiana, Oklahoma, Idaho)
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Effects of 30% exclusion with 450k cap

Revenue Impacts of Changing Percentage Exclusion to 30%, \$450,000 cap (Based upon 2016 Tax Year Data)						
Income Group (AGI)		Number of Returns Impacted	Percent of Total Returns	Total Tax Raised (millions)	Average Tax Increase	Change in Effective Tax Rate
-infinity	\$35,000	1,502	0.90%	\$0.02	\$15	0.002%
\$35,000	\$40,000	73	0.39%	\$0.00	\$30	0.000%
\$40,000	\$45,000	70	0.42%	\$0.00	\$31	0.000%
\$45,000	\$50,000	29	0.20%	\$0.00	\$53	0.000%
\$50,000	\$60,000	79	0.32%	\$0.01	\$62	0.000%
\$60,000	\$75,000	150	0.52%	\$0.02	\$99	0.001%
\$75,000	\$100,000	249	0.69%	\$0.03	\$131	0.001%
\$100,000	\$125,000	230	0.92%	\$0.05	\$204	0.002%
\$125,000	\$150,000	195	1.29%	\$0.05	\$244	0.003%
\$150,000	\$200,000	244	1.62%	\$0.07	\$260	0.003%
\$200,000	\$300,000	350	3.32%	\$0.18	\$515	0.010%
\$300,000	\$500,000	282	4.99%	\$0.25	\$889	0.018%
\$500,000	\$1,000,000	173	5.48%	\$0.29	\$1,641	0.029%
\$1,000,000	Infinity	184	6.93%	\$3.90	\$21,193	0.109%
Totals		3,810	0.99%	\$4.97	\$1,273	0.018%

Note: Overall revenue impacts include 5% model adjustment and an additional \$125,000 for fiduciary income and trusts



Capital Gains: Taxpayer Examples

Married taxpayer, \$150,000 in AGI, of which \$10,000 is in capital gains

2019 Vermont Tax Liability Calculator			
	Current Law	Revenue Bill	No exclusion
Filing Status	Married	Married	Married
Adjusted Gross Income (AGI)	\$150,000	\$150,000	\$150,000
Kids	2	2	2
Exemptions	4	4	4
Capital Gains Exclusion	\$5,000	\$5,000	\$0
Total Capital Gains	\$10,000	\$10,000	\$10,000
of which: Short Term			
of which: Long Term	\$10,000	\$10,000	\$10,000
Taxable Social Security Benefits			
of which: Exempted	\$0	\$0	\$0
VT Taxable Income	\$115,700	\$115,700	\$120,700
VT Tax Liability	\$5,486	\$5,486	\$5,816
Difference from Current Law	...	\$0	\$330
Change in Effective Tax Rate		0.00%	0.22%



Capital Gains: Taxpayer Examples

Married taxpayer, \$150,000 in AGI, of which \$70,000 is in capital gains

2019 Vermont Tax Liability Calculator			
	Current Law	Revenue Bill	No exclusion
Filing Status	Married	Married	Married
Adjusted Gross Income (AGI)	\$150,000	\$150,000	\$150,000
Kids	2	2	2
Exemptions	4	4	4
Capital Gains Exclusion	\$28,000	\$21,000	\$0
Total Capital Gains	\$70,000	\$70,000	\$70,000
of which: Short Term			
of which: Long Term	\$70,000	\$70,000	\$70,000
Taxable Social Security Benefits			
of which: Exempted	\$0	\$0	\$0
VT Taxable Income	\$92,700	\$99,700	\$120,700
VT Tax Liability	\$3,968	\$4,430	\$5,816
Difference from Current Law	...	\$462	\$1,848
Change in Effective Tax Rate		0.31%	1.23%

About 1,600 returns had income roughly similar to this and capital gains above \$70,000 (0.4%)



Capital Gains: Taxpayer Examples

Married taxpayer, \$500,000 in AGI, of which \$200,000 is in capital gains

2019 Vermont Tax Liability Calculator			
	Current Law	Revenue Bill	No exclusion
Filing Status	Married	Married	Married
Adjusted Gross Income (AGI)	\$500,000	\$500,000	\$500,000
Kids	2	2	2
Exemptions	4	4	4
Capital Gains Exclusion	\$80,000	\$60,000	\$0
Total Capital Gains	\$200,000	\$200,000	\$200,000
of which: Short Term			
of which: Long Term	\$200,000	\$200,000	\$200,000
Taxable Social Security Benefits			
of which: Exempted	\$0	\$0	\$0
VT Taxable Income	\$390,700	\$410,700	\$470,700
VT Tax Liability	\$27,634	\$29,384	\$34,634
Difference from Current Law	...	\$1,750	\$7,000
Change in Effective Tax Rate		0.35%	1.40%



Capital Gains: Taxpayer Examples

Married taxpayer, \$2.5 million in AGI, of which \$1.5 million is in capital gains

2019 Vermont Tax Liability Calculator			
	Current Law	Revenue Bill	No exclusion
Filing Status	Married	Married	Married
Adjusted Gross Income (AGI)	\$2,500,000	\$2,500,000	\$2,500,000
Kids	2	2	2
Exemptions	4	4	4
Capital Gains Exclusion	\$600,000	\$450,000	\$0
Total Capital Gains	\$1,500,000	\$1,500,000	\$1,500,000
of which: Short Term			
of which: Long Term	\$1,500,000	\$1,500,000	\$1,500,000
Taxable Social Security Benefits			
of which: Exempted	\$0	\$0	\$0
VT Taxable Income	\$1,870,700	\$2,020,700	\$2,470,700
VT Tax Liability	\$157,134	\$170,259	\$209,634
Difference from Current Law	...	\$13,125	\$52,500
Change in Effective Tax Rate		0.53%	2.10%



Alternatives to the Capital Gains Exclusion in H.541

Alternatives for a Capital Gains Exclusion (in millions)				
	Estimate		Difference from Revenue Bill	
	FY20	FY21	FY20	FY21
Revenue Bill: 30% Exclusion with a 450k cap	\$2.49	\$4.97
30% exclusion raise with no cap	\$1.22	\$2.43	-\$1.27	-\$2.54
40% with a 450k cap (\$1.125 million capital gain)	\$2.00	\$4.01	-\$0.48	-\$0.96
40% with 250k cap (\$625,000 capital gain)	\$2.46	\$4.92	-\$0.03	-\$0.05



Could we tax CG like the Feds?

- ▶ **In theory, yes. But several wrinkles to iron out:**
 - ▶ Would we give special treatment to long-term assets like farms, business sales, or investment properties?
 - ▶ Federal treatment treats these sales and others (stocks, bonds, art) as the same
 - ▶ Would we do a percentage of the Federal benefit?
 - ▶ Would we create our own bracket structure with separate rates?
 - ▶ Would the gap between the ordinary income rate and capital gains rate be the same throughout the brackets?
 - ▶ Would we do a flat rate?
 - ▶ Lower income taxpayers would likely pay more, higher income would pay less
 - ▶ Preliminary estimate on a flat rate: 4.5-5%
 - Most people with AGI below \$200,00 who had capital gains would likely pay more.





Medical Deduction and How to Pay for It



Medical Deduction Proposal

- ▶ Allow a medical deduction on Vermont income taxes in excess of the Vermont standard deduction and personal exemptions
- ▶ Example: \$100,000 in AGI, \$50,000 in deductible expenses
 - ▶ 10% AGI floor: \$10,000
 - ▶ Federal deduction: \$50,000 minus \$10,000 = \$40,000
 - ▶ Vermont deduction:
 - ▶ VT Standard Deduction: \$12,300 (married)
 - ▶ VT Personal Exemptions: 2 exemptions @ \$4,250 each = \$8500
 - ▶ Total deduction: \$40,000 minus \$12,300 minus \$8500 = \$19,200



Income group impacts

Impacts of a Medical Deduction with a SD and PE Floor						
Income Group		Number of Returns	Percent of Total Returns	Total Tax Change (in millions)	Average Tax Change	Change in Effective Tax Rate
-infinity	\$35,000	360	0.22%	-\$0.1	-\$183	0.00%
\$35,000	\$40,000	85	0.45%	\$0.0	-\$303	0.00%
\$40,000	\$45,000	91	0.55%	\$0.0	-\$342	-0.01%
\$45,000	\$50,000	72	0.50%	\$0.0	-\$369	-0.01%
\$50,000	\$60,000	167	0.68%	-\$0.1	-\$683	-0.01%
\$60,000	\$75,000	213	0.73%	-\$0.2	-\$1,000	-0.01%
\$75,000	\$100,000	280	0.77%	-\$0.4	-\$1,355	-0.01%
\$100,000	\$125,000	199	0.80%	-\$0.3	-\$1,729	-0.02%
\$125,000	\$150,000	137	0.91%	-\$0.3	-\$2,070	-0.02%
\$150,000	\$200,000	119	0.79%	-\$0.2	-\$1,873	-0.01%
\$200,000	\$300,000	94	0.89%	-\$0.3	-\$2,841	-0.01%
\$300,000	\$500,000	41	0.73%	-\$0.2	-\$4,527	-0.01%
\$500,000	Infinity	26	0.45%	-\$0.1	-\$4,648	0.00%
Total		1,884	0.49%	-\$2.3	-\$1,210	-0.01%

Medical Deduction Proposal by School Code		
	Tax Change	Percent of Tax Cut
SHELBURNE	-\$0.28	12%
BURLINGTON	-\$0.13	6%
SOUTH BURLINGTON	-\$0.12	6%
MIDDLEBURY	-\$0.11	5%
BRATTLEBORO	-\$0.07	3%
DORSET	-\$0.06	3%
MANCHESTER	-\$0.06	3%
WOODSTOCK	-\$0.06	3%
OTHER	-\$1.32	60%
TOTAL (Residents Only)	-\$2.21	100%

Taxpayer Examples

- ▶ Single taxpayer, \$50,000 in AGI, \$30,000 in Medical Expenses

2019 Vermont Tax Liability Calculator		
	Current Law	Proposal
Filing Status	Single	Single
Adjusted Gross Income (AGI)	\$50,000	\$50,000
Kids	0	0
Exemptions	1	1
Medical Expenses	\$30,000	\$30,000
Federal Deduction	\$25,000	\$25,000
Vermont Deduction		\$14,600
Charitable Contributions	\$0	\$0
Capital Gains Exclusion	\$0	\$0
Total Capital Gains	\$0	\$0
of which: Short Term		
of which: Long Term		
Taxable Social Security Benefits		
of which: Exempted	\$0	\$0
VT Taxable Income	\$39,600	\$25,000
VT Tax Liability	\$1,627	\$517
Difference from Current Law	...	-\$1,110
Change in Effective Tax Rate		-2.22%



Taxpayer Examples

- ▶ Married taxpayer, AGI of \$85,000, \$48,000 in Medical Expenses

2019 Vermont Tax Liability Calculator		
	Current Law	Proposal
Filing Status	Married	Married
Adjusted Gross Income (AGI)	\$85,000	\$85,000
Kids	0	0
Exemptions	2	2
Medical Expenses	\$65,000	\$48,000
Federal Deduction	\$56,500	\$39,500
Vermont Deduction		\$18,700
Charitable Contributions	\$0	\$0
Capital Gains Exclusion	\$0	\$0
Total Capital Gains	\$0	\$0
of which: Short Term		
of which: Long Term		
Taxable Social Security Benefits		
of which: Exempted	\$0	\$0
VT Taxable Income	\$64,200	\$45,500
VT Tax Liability	\$2,151	\$1,524
Difference from Current Law	...	-\$627
Change in Effective Tax Rate		-0.74%

Taxpayer Examples

- ▶ Married taxpayer, AGI of \$150,000, \$125,000 in Medical Expenses

2019 Vermont Tax Liability Calculator		
	Current Law	Proposal
Filing Status	Married	Married
Adjusted Gross Income (AGI)	\$150,000	\$150,000
Kids	0	0
Exemptions	2	2
Medical Expenses	\$125,000	\$125,000
Federal Deduction	\$110,000	\$110,000
Vermont Deduction		\$89,200
Charitable Contributions	\$0	\$0
Capital Gains Exclusion	\$0	\$0
Total Capital Gains	\$0	\$0
of which: Short Term		
of which: Long Term		
Taxable Social Security Benefits		
of which: Exempted	\$0	\$0
VT Taxable Income	\$129,200	\$40,000
VT Tax Liability	\$6,377	\$1,340
Difference from Current Law	...	-\$5,037
Change in Effective Tax Rate		-3.36%



How to pay for it?

- ▶ Recreate the old bracket with a new rate at 8.9%
- ▶ Generates \$2.6 million

Single		
Taxable Income		Rate
\$0	\$39,600	3.35%
\$39,600	\$96,000	6.60%
\$96,000	\$200,200	7.60%
\$200,200	\$435,200	8.75%
\$435,200	infinity	8.90%

Married Joint		
Taxable Income		Rate
\$0	\$66,150	3.35%
\$66,150	\$159,950	6.60%
\$159,950	\$243,750	7.60%
\$243,750	\$435,200	8.75%
\$435,200	infinity	8.90%

Married Separately		
Taxable Income		Rate
\$0	\$33,075	3.35%
\$33,075	\$79,975	6.60%
\$79,975	\$121,875	7.60%
\$121,875	\$217,600	8.75%
\$217,600	infinity	8.90%

Head of Household		
Taxable Income		Rate
\$0	\$53,100	3.35%
\$53,100	\$137,050	6.60%
\$137,050	\$221,950	7.60%
\$221,950	\$435,200	8.75%
\$435,200	infinity	8.90%

