

How to Close the Budget Gap—Fiscal 2016 and Beyond

Vermont's elected leaders face another projected budget gap as they work to fund state services for fiscal 2016. They blame the gap on structural problems: a mismatch between the growth in revenues and the growth in spending. The prevailing response has been more budget cuts, which is mostly how they've addressed budget gaps for the past decade.

But cutting the budget year after year does not address the underlying causes. It simply shifts costs—onto property taxes or health insurance premiums, for example—and leaves more and more Vermonters without needed state services. But there are two things the Legislature can do this year both to close the projected budget gap and begin to address the underlying structural problems.

1. Adopt the governor's payroll tax

The governor's proposed 0.7 percent payroll tax would begin to create a rational way to pay for health care for the increasing number of Vermonters who rely on the state rather than private insurance coverage. This will reduce the upward pressure on the property tax and private health insurance premiums and stem the continuing cuts to state services.

2. Reform income taxes

Vermont is one of six states in the country that uses federal taxable income rather than adjusted gross income as the base for the state income tax. Because this base is lower, the state must set its top marginal rate higher than necessary to raise the needed revenues. Additionally, tax breaks that primarily benefit upper-income taxpayers unfairly burden lower-income taxpayers, while also reducing the amount the entire tax system raises. The state can lower marginal rates, increase revenue, and improve the progressivity of the tax system by eliminating itemized deductions and replacing personal exemptions with a refundable tax credit.

**Additional revenue:
\$80 million**

Income tax: Eliminate itemized deductions and lower tax rates

This reform uses federal adjusted gross income to calculate Vermont taxable income, replacing itemized deductions with a higher standard deduction and converting personal exemptions to a refundable credit. Both the standard deduction and the personal exemption credit phase out at higher incomes. All income for filers of \$400,000 or more is taxed at the top rate.

Effect of change by income group

	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	< \$24k	\$24k –\$43k	\$43k –\$65k	\$65k –\$105k	\$105k –\$195k	\$195k –\$435k	\$435k+
Average Income	\$14,000	\$33,000	\$53,000	\$81,000	\$134,000	\$269,000	\$1,081,000
Change: average tax	–\$191	–\$159	–\$29	+\$122	+\$710	+\$2,922	+\$9,575
Change: % of income	-1.3%	-0.5%	-0.1%	+0.2%	+0.5%	+1.1%	+0.9%

Vermont Income Tax Brackets by Filer Type

	CURRENT					PROPOSED				
	Married Filing Jointly	Single	Married Filing Separately	Head of Household	Tax Rate	Married Filing Jointly	Single	Married Filing Separately	Head of Household	Tax Rate
	-	-	-	-	3.55%	-	-	-	-	3.50%
	\$61,600	\$36,900	\$30,800	\$49,400	6.80%	\$50,000	\$25,000	\$25,000	\$40,000	4.75%
	\$148,850	\$89,350	\$74,425	\$127,550	7.80%	\$100,000	\$50,000	\$50,000	\$80,000	7.25%
	\$226,850	\$186,350	\$113,425	\$206,600	8.80%	\$250,000	\$125,000	\$125,000	\$200,000	8.75%
	\$405,100	\$405,100	\$202,550	\$405,100	8.95%					

The Institute on Taxation and Economic Policy (www.itep.org) in Washington, D.C., prepared the analysis and revenue estimate of the tax reform plan for Public Assets Institute. The revenue projection and estimated tax effects for taxpayers in various income brackets are for calendar year 2015.

Vermont Can Balance the Budget without More Cuts to State Services

FY2016 General Fund Budget Gap Analysis (in millions)¹

	Governor's Proposal	One Vermont Proposal ²
Initial FY2015 gap projection	(\$94.61)	(\$94.61)
Revenue downgrade (January 2015 Revenue Forecast)	(\$18.60)	(\$18.60)
TOTAL GAP	(\$113.21)	(\$113.21)
Anticipated FY2015 surplus	\$2.00	\$2.00
Proposed new revenue (details below)	\$49.86	\$114.36
Proposed budget cuts (details below)	\$44.75	\$0.00
(Gap)/Surplus after new revenue and budget cuts	(\$16.60)³	\$3.15

PROPOSED NEW REVENUE DETAILS

	GOV	ONE VT
Eliminate state income tax deduction for state income taxes	\$15.50	incl. below
Portion of 0.7% payroll tax (to cover Medicaid caseload increase)	\$15.87	\$15.87
Miscellaneous fees and revenue	\$3.79	\$3.79
One-time transfers		
Property transfer tax	\$2.80	\$2.80
Rainy Day Fund	\$5.00	\$5.00
Other one-time transfers and reversions	\$6.90	\$6.90
Income tax reform: Lower rates/eliminate itemized deductions	\$0.00	\$80.00
Total new revenue	\$49.86	\$114.36

PROPOSED BUDGET CUTS DETAILS

	GOV	ONE VT
Education Fund cuts used to reduce General Fund		
Current Use	\$1.20	\$0.00
Community High School of Vermont	\$1.74	\$0.00
Lottery revenue used to fund Veterans' Home	\$1.00	\$0.00
Cuts other than human services		
Current Use	\$0.40	\$0.00
Libraries, Judiciary, Natural Resources Board, etc.	\$2.90	\$0.00
Miscellaneous	\$2.84	\$0.00
Labor reductions		
Across-the-board savings (to be determined)	\$10.79	\$0.00
Human Services		
LIHEAP, Reach Up, general assistance, Legal Aid, etc.)	\$21.15	\$0.00
Offset reductions in federal funds	\$2.73	\$0.00
Total budget cuts	\$44.75	\$0.00

1 Data source for governor's budget gap proposal is a Joint Fiscal Office document dated February 11, 2015: [http://www.leg.state.vt.us/jfo/appropriations/fy_2016/Major%20Components%20of%20Gov's%20\\$94M%20Gap%20Close.pdf](http://www.leg.state.vt.us/jfo/appropriations/fy_2016/Major%20Components%20of%20Gov's%20$94M%20Gap%20Close.pdf)

2 Public Assets Institute is a member of the One Vermont coalition and prepared this analysis for the coalition (onevt.org).

3 Revenue projections for fiscal 2016 were lowered a week after the governor presented his budget recommendations in January. The administration and legislative committees are working to close the remaining gap.

© 2015 by Public Assets Institute

This research was funded in part by the Annie E. Casey Foundation. We thank them for their support but acknowledge that the findings presented in this report are those of the Public Assets Institute and do not necessarily reflect the opinions of the Foundation.

PO Box 942, Montpelier, Vermont 05601 | 802-223-6677 | publicassets.org
The Public Assets Institute supports democracy by helping Vermonters understand and keep informed about how their government is raising and spending money and using other public assets.