PUBLIC ASSETS INSTITUTE

Issue Brief
April 2017

Meeting Vermonters' needs in Fiscal 2018 and beyond

The purpose of the state budget is "to address the needs of the people of Vermont." Yet each year Montpelier focuses its attention on closing the General Fund budget gap.

Elected leaders acknowledge investments are needed to clean up Lake Champlain, provide families with child care financial assistance, and make higher education more affordable. But progress has been slow in making these investments. And to balance the budget they make cuts—to Reach Up benefits for the poorest families, to affordable housing programs, to key policy staff.

Despite the cuts, however, the budget gap reappears year after year, thanks to persistent structural problems: anemic state revenues even in a growing economy, and rising health care costs that demand an increasing share of state spending.

Vermont's elected leaders are facing a projected budget gap of about $70 million for fiscal 2018. They have an opportunity to balance the budget, begin to make smart investments that address Vermonters' needs, and modernize the tax system to better respond to Vermont's 21st century economy.

The plan described in this report would do three things:

Vermont can balance the budget without more cuts to state services

FY2018 General Fund budget gap analysis (in millions)

	Governor's proposal	House as passed	One Vermont proposal
FY2018 Projected General Fund Gap	($72.9)	($70.0)	($70.0)
Cuts/Savings/Transfers (details below)	$92.3	$71.1	$105.9
New investments (details below)	($21.5)	($1.1)	($35.9)
Remaining gap/surplus	**($2.1)**	**($0.1)**	**$0.0**
Cuts/Savings/Transfers			
S-CHIP & Medicaid savings	$28.0	$35.0	$35.0
IT projects transferred out of General Fund		$12.5	$12.5
Net expense transfer to Education Fund	$49.9		
Corrections cuts	$5.2	$3.1	
Management/position cuts	$4.5	$4.5	
Miscellaneous cuts	$4.7	$11.0	
Savings from reduced tax violations		$5.0	$5.0
Savings from closing income tax loopholes			$53.4
Subtotal Cuts/Savings/Transfers	**$92.3**	**$71.1**	**$105.9**
New Investments			
Early education	($9.6)		($9.6)
Education innovation	($1.6)		($1.6)
Higher education	($6.1)		($6.1)
Other investments	($4.2)	($1.1)	($18.6)
Subtotal New Investments	**($21.5)**	**($1.1)**	**($35.9)**

1. Fund the governor's proposed investments without reducing funding for public education. Gov. Phil Scott's budget includes investments in child care and an expanded vision of public education that includes both early education and higher education. That's a good idea. But Scott would cut pre-K-to-12 public education to fund his plan—not a good idea.

The state can invest in child care and all levels of education—pre-K to 12, and higher ed—without cuts to any. There are numerous other state services that also need funding—Reach Up, mental health care, programs that support homeless Vermonters, initiatives that move Vermont families out of poverty permanently. What's important is that we start now to invest in Vermont's future.

2. Solve the budget gap without additional harmful cuts. The budget adopted by the Vermont House correctly rejected the governor's proposed public education cuts, but it resolved the gap with some savings and transfers, as well as General Fund reductions. This worsens already inadequate state services weakened by previous years' cuts.

3. Eliminate income tax loopholes for upper-income Vermonters while lowering tax rates for everyone. While elected officials have cut services to vulnerable families, tens of millions of dollars are spent annually on income tax expenditures that primarily benefit upper-income residents. Vermont is one of only seven states that use federal taxable income rather than adjusted gross income (AGI) to calculate state taxes. Shifting to AGI would lower rates for all brackets, ease taxes on a majority of Vermonters, make Vermont more competitive with other states, and create savings that can support smart investments.

With these recommendations, the state budget would take an important step toward achieving its purpose by addressing the needs of Vermonters and allow the state to make smart investments for a thriving future.

INCOME TAX: **Close tax loopholes for high income filers and lower rates for everyone**

Total savings: $53.4 MILLION

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 $350,000 or more is taxed at the top rate. The number of brackets is reduced from five to four and rates are reduced.

EFFECT OF CHANGE BY INCOME GROUP:

	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Tax change as a % of Income	-0.7%	-0.2%	-0.2%	-0.1%	0.1%	1.0%	0.8%
Average tax change	-$96	-$82	-$87	-$41	+$152	+$2,816	+$9,402
% receiving tax cut	67%	63%	89%	77%	53%	4%	2%
% facing tax increase	0%	1%	2%	17%	47%	96%	98%

Vermont Income Tax Brackets by Filer Type

CURRENT

Married Filing Jointly	Single	Head of Household	Married Filing Separately	Tax Rate
-	-	-	-	3.55%
$62,100	$37,850	$50,600	$31,550	6.80%
$153,100	$91,900	$131,200	$76,550	7.80%
$233,350	$191,650	$212,500	$116,675	8.80%
$416,700	$416,700	$416,700	$208,350	8.95%

PROPOSED

Married Filing Jointly	Single	Head of Household	Married Filing Separately	Tax Rate
-	-	-	-	3.50%
$62,100	$37,850	$50,600	$31,550	5.50%
$153,100	$91,900	$131,200	$76,550	7.25%
$233,350	$191,650	$212,500	$116,675	8.75%

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 2017. Income tax bracket thresholds are updated each year; this analysis uses 2017 projections.

 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.

Public Assets Institute | PO Box 942, Montpelier, Vermont 05601 | 802-223-6677 | publicassets.org