

Vermont Blue Ribbon Tax Structure Commission

The following comments and suggestions are offered to the Blue Ribbon Tax Structure Commission in connection with the hearing held on September 29, 2009 in Montpelier, VT. This paper was prepared by Marge McDonnell, Tax Director of Green Mountain Coffee Roasters, Inc., (GMCR) and does not necessarily reflect the opinions of GMCR or its employees.

1. Use Tax on Manufacturing Equipment. Vermont makes a distinction between "initial packaging" and "secondary packaging". Regulation §9741(14)-2 H defines "initial packaging". Regulation §9741(14)-8 defines "post-production activities", or secondary packaging, and says "equipment that loads packaged products into cases or cartons for ease of handling in delivery is subject to tax". This distinction is vague, subjective and punitive to the manufacturing industry in Vermont.

During a recent sales & use tax audit of GMCR, there was considerable disagreement, even among members of the Vermont tax department, on the interpretation of (14)-8. This section of the law could be simplified and more easily enforced (and complied with) if Vermont adopted language similar to other states. The two below are ones with which Green Mountain is familiar:

- a. Tennessee:
"...Exempt qualified machinery generally includes the machines that transfer raw materials from inventory and begin the processing cycle, process the product through various phases of manufacture, and transfer the finished product from the final processing step to inventory. Any device that powers this machinery and the oils and lubricants used in the machinery are also tax exempt." (Tenn. Code Ann. Sections 67-6-102,206)
- b. Washington State:
"A manufacturing operation begins at the point where the raw materials enter the manufacturing site and ends at the point where the processed material leaves the manufacturing site." (Washington Title 82.08.02565(2)(d))

Manufacturing equipment has a relatively short useful life and is constantly being replaced and upgraded. Assessing use tax on machinery and equipment costing thousands of dollars will help Vermont in the short term but hurt it when these taxpayers make capital investment decisions in the future. In addition, property (fixed assets) is one of the elements in Vermont's allocation formula and will result in lost tax revenue if capital is invested elsewhere.

2. Capital Gains Tax Change. The 40% exclusion for capital gains tax should not be considered a "loophole" to be closed. Between 1968 and 2000 Vermont was "piggybacked" to the federal personal income tax. Vermont tax liability was a percentage of federal liability, and all of the provisions of the federal tax code, including the preferential treatment of capital gains, was passed through to Vermont taxpayers. In 2002, as part of the restructuring of the personal income tax, the 40% exclusion of capital gains was enacted. This was an attempt to approximate the capital gains benefit received under the piggyback system.

Vermont's widely publicized change to the capital gains tax law in 2009 will drive a significant amount of capital gain property out of state, especially when the markets begin to rebound and investors cash out. Exclusion of the first \$5,000 of gain from tax (years 2010 and beyond) is insignificant (\$470 savings at a 9.4% personal tax rate) and represents a thin disguise for completely disallowing any tax break for capital gains.

Capital gains are also frequently used by entrepreneurs to reinvest in their companies or as venture capital for new projects. Reinstating favorable capital gains treatment will provide more capital investment within Vermont, translating to more jobs, more innovation, and higher economic output.

At GMCR, every full-time employee is entitled to participate in the Employee Stock Purchase Plan (ESPP). Under ESPP, employees purchase GMCR stock at a discount with after-tax dollars. With the new tax laws, this benefit is much less attractive, and the Company expects a reduction in employee participation. Vermont benefits from the ESPP program with capital gains tax revenue as well as the tax on ordinary income generated if the stock is not held for at least two years after purchase. I mention this particular company benefit to demonstrate that it is not only the affluent who are affected by a change in the capital gains tax law.

The federal government recognizes capital gains tax as a reward to those taxpayers willing to invest on a long-term basis. The more successful or affluent a taxpayer, the easier it is to move capital assets out of the state. When the tax burden on individuals and businesses is increased, the most affluent will find a way to divert these income streams away from Vermont.

3. Throwback Rule. The throwback rule requires a Vermont company to pay tax on sales to states in which the company does not have nexus. Although many states have a throwback rule, their tax rates are generally lower. In addition, and unlike Vermont, some of these states do not include foreign sales in the throwback rule. States with a throwback rule are usually at a competitive disadvantage in attracting manufacturing and wholesale/distribution businesses

with customers outside of their home state. To address this issue, some states, such as New York, do not have a throwback rule.

3. VEGI (Vermont Employment Growth Incentive). Most people agree that states offering investment and payroll incentives are more successful in attracting business. However, if those programs are difficult or time-consuming to administer, they lose their appeal.

GMCR successfully participated in the EATI (Economic Advancement Tax Incentive) program several years ago. We projected our capital investment and additional headcount for the next 5 years and received a Vermont tax credit when those goals were achieved. We are grateful for the program and enjoyed the benefits of the tax credit.

Since then, the VEGI program was redesigned from a tax credit (dollar for dollar against Vermont tax owed) to a cash incentive. Most profitable Vermont companies would prefer a straight tax credit, while a cash incentive is more attractive to companies with insufficient cash flow and/or minimum taxable income.

In either case, the redesigned VEGI program is very difficult to administer and involves a long tracking period. After a 5-year period of earning the incentive, there is a 6-year lookback period. A company must meet at least two of three objectives (number of qualified employees, payroll dollars and capital investment) each year in order to receive an incentive. Payroll dollars must be one of the two. The application process and calculation of the potential incentive are complex and time consuming. What's more, the Vermont tax law is unclear whether the incentive should be recognized as taxable income or as a non-shareholder contribution of capital. If a contribution of capital, the underlying assets' cost basis must be reduced to reflect the capital contribution, and depreciation expense recalculated.

GMCR is a manufacturer. A manufacturing environment includes many routine, repetitive jobs, and turnover is not unusual. It would be much easier for larger companies to track job titles and payroll dollars rather than the particular employees who fill those job. Using number of qualifying jobs (by position) and total payroll dollars should be enough to confirm that a business is increasing its number of good jobs and capital investment. In addition, the application/tracking forms require a considerable amount of personal information (i.e. name, social security number and Medicare wages) to be transmitted for each qualified employee each year.

The cost to administer this program could be considerably less if the program were simpler. Washington state comes to mind as a good example: It offers a

simple \$2,000-\$4,000 credit for each new qualified employee, provided qualified employment positions increase by at least 15% over the next four quarters (one year). The dollar amount of the credit is significantly lower, but it's easy to calculate the savings and offers a quick incentive for new or expanding businesses. Tennessee has a similar program, including a special Headquarters Relocation credit. Under the VEGI program, if a company receives cash incentives for 5 years, and in the 11th year leaves the state or goes out of business, does Vermont expect to recoup that incentive?

There are a lot of good things about Vermont's tax structure, and GMCR is appreciative of the incentives it provides. However, simplification of the state's tax code in some key areas can significantly lower administrative costs while still generating a sustainable level of both individual and business tax revenue.

Thank you for the opportunity to address the Commission.

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