Vermont Legislative Joint Fiscal Office

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ISSUE BRIEF

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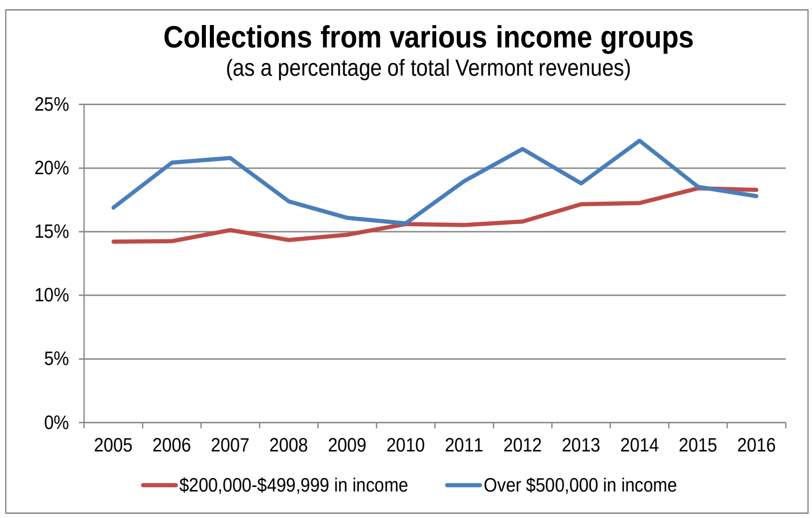
Key Facts regarding the Distribution of Income and Income Tax Returns in Vermont

Five key facts describe the distribution of income in Vermont and the contribution of high-income tax filers to Vermont's personal income tax revenues:

- Tax filers with incomes of $500,000 or more contributed roughly one-fifth of net personal income taxes in Vermont in 2016 while those with incomes from $200,000 to $499,999 contributed 18 percent.
- Tax filers with incomes of $500,000 or more represented 0.5 percent of all tax returns, while those with incomes from $200,000 to $499,999 were roughly 3 percent. The number of high-income filers fluctuates with the economy but shows no signs of shrinking.
- The number of taxpayers with incomes of $500,000 or more is determined largely by overall economic conditions and stock market returns. They are not always the same people year to year.
- The income and wages of the highest-income taxpayers have grown faster than middle- and lower-income taxpayers in recent decades. Since 2004, wages have grown 10.7 percent at the 90th percentile of wage earners, 6.8 percent at the median, and 4.5 percent at the 10th percentile.
- Slowing Vermont revenue growth is likely the result of on-going trends such as demographic change and sluggish wage and income growth for the majority of taxpayers.

1) Income taxes paid by high-income tax filers in Vermont are an important contribution to the State's revenues.

Data provided by the Department of Taxes provide useful snapshots of income taxes paid by Vermonters by income group.[1] In 2016, resident tax filers with adjusted gross income of $500,000 or more paid 18 percent of all net income taxes in Vermont. The percentage of total revenues contributed by this income group has fluctuated over time. It fell to around 16 percent of revenues during the recession and was as high as 22 percent in 2014.[2]



Furthermore, resident tax filers with incomes between $200,000 and $500,000 contributed

[1] http://tax.vermont.gov/research-and-reports/statistical-data/income-tax

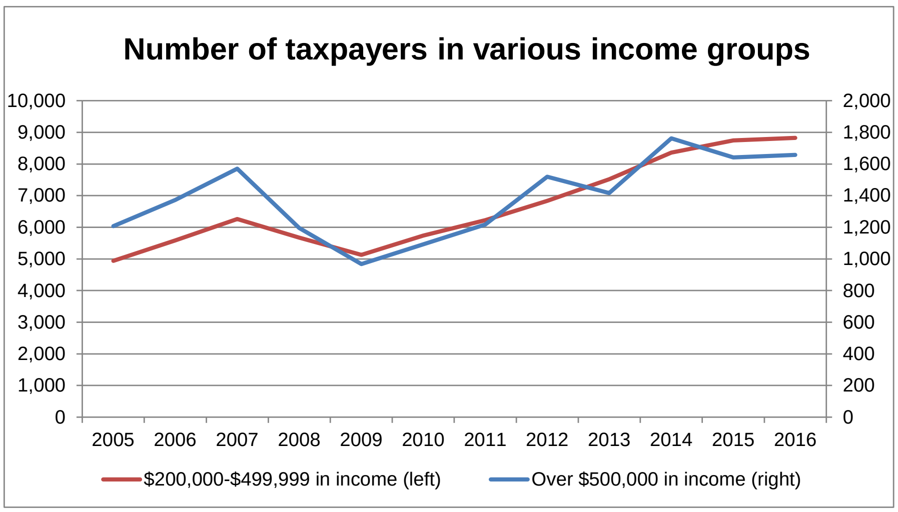
[2] Data are from the Department of Taxes. They are updated between November and February for the preceding tax year. For instance, the 2016 data were updated in February of 2018. However, high-income filers are more likely to file extensions on their tax returns that may not be processed until after these data are produced. As a result, the data here understate the numbers of high-income taxpayers and the percentage of total revenues they pay. Using the most complete data available, the number of resident taxpayers with $500,000 or more in 2014 was 1,805, accounting for roughly 22 percent of total revenues. Department of Taxes data reported 1,762, also accounting for 22 percent of total revenues. The strong stock market performance in 2017 might lead to higher numbers of high-income taxpayers again in 2017.

an additional 18 percent of total revenues. The percentage of total income taxes from this group has been growing steadily since 2005, with no drop during the recession. The fluctuations in contributions from the filers with $500,000 or more in income have been partly offset by growing contributions by those in the $200,000 to $499,999 income groups.

2) The number of high-income filers fluctuates with the economy but shows no signs of shrinking.

The number of taxpayers with incomes of $500,000 or more has fluctuated over time. In 2016, this group represented about 0.5 percent of all income tax filers. Large drops occurred in the recession years 2008 and 2009, but the number has recovered steadily since then. As of 2014, the number of taxpayers in this group has surpassed its pre-recession peak each year. It has grown about 37 percent since 2005, or about 4 percent per year on average.

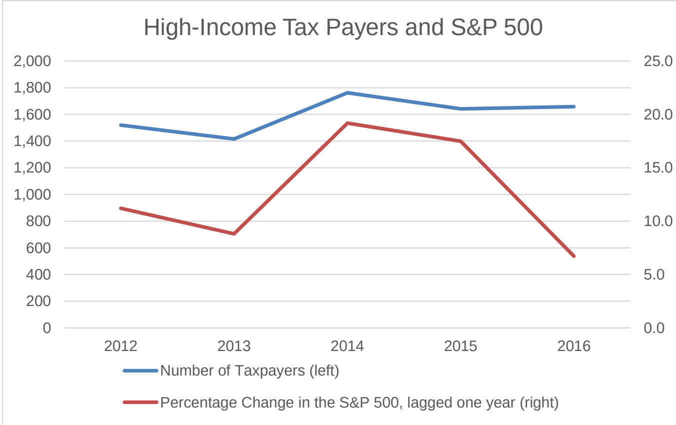
Furthermore, the number of taxpayers with incomes from $200,000 to $499,999 has nearly doubled since 2005. In 2016, this group was about 3 percent of total tax filers. Adding this group to the group with $500,000 or more, this expanded group of taxpayers has increased from just over 6,100 taxpayers in 2005 to almost 10,500 in 2016, an increase of over 4,000 taxpayers. Those with incomes of $200,000 or more accounted for 36 percent of Vermont's personal income tax revenues but represented just 3.5 percent of total resident tax returns in 2016.



3) The number of taxpayers with incomes of $500,000 or more is determined largely by overall economic conditions and stock market returns.

For the majority of taxpayers, the primary source of income is wages and salaries. For those earning $500,000 or more, income is much more likely to come from capital gains, dividends, and business income. In 2014, of the total income earned by this group, 39 percent came from capital gains, 12 percent from dividends, and 17 percent from some form of business income.

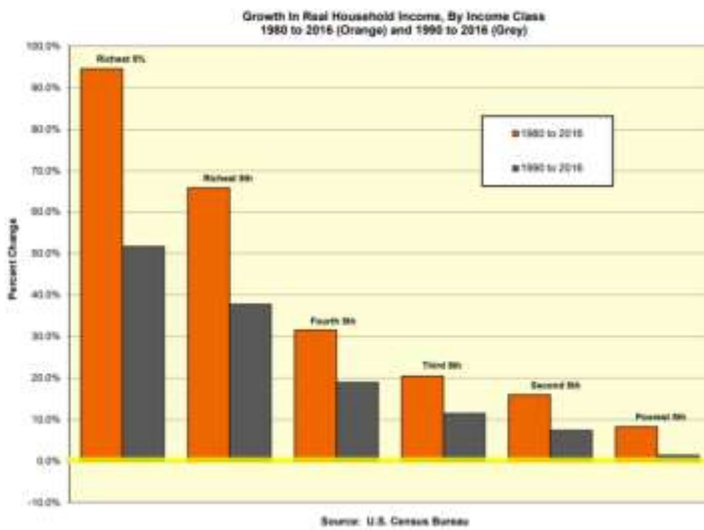
The extent of income coming from sources other than wages helps to explain why the group of taxpayers with income of $500,000 or more is rarely composed of the same individuals year after year; between 2006 and 2015, only 6 percent of tax filers in this group reported this level of income in all years. Non-wage income is more subject to fluctuations in the stock market and overall economic conditions. When conditions are good, the number of taxpayers in this group is likely to increase. Likewise, during recessions and stock market downturns, we would expect this group to shrink. As the chart below shows, since 2011, the number of taxpayers with $500,000 or more in income has roughly tracked the performance of the S&P 500 Index.

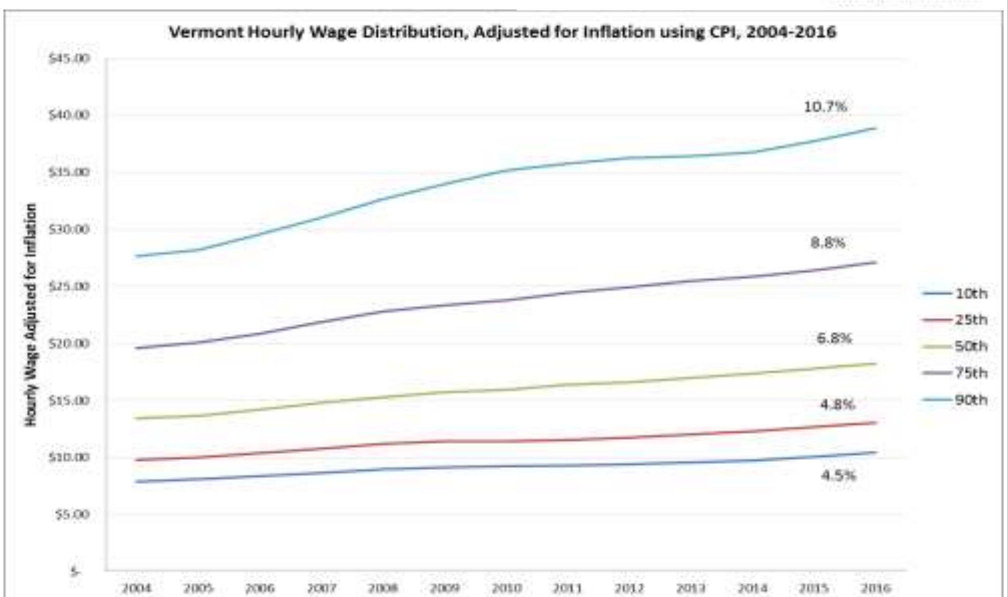


Source: Department of Taxes and Federal Reserve Bank of St. Louis, FRED

<u>4) State and national statistics of wage or income growth show faster growth in income for the highest income groups than for the middle or lowest income groups.</u>

Growth in hourly wages in Vermont has been faster at the top of the wage distribution than at the bottom. From 2004 to 2016 and after adjusting for inflation, cumulative wage growth at the 10th percentile (lower income groups) was 4.5 percent, that at the 50th percentile was 6.8 percent, and cumulative wage growth at the 90th percentile (higher income groups) was 10.7 percent. Looking at household income, U.S. households near the top of the income distribution have seen substantially faster growth in income than those near the bottom since 1980 or 1990.



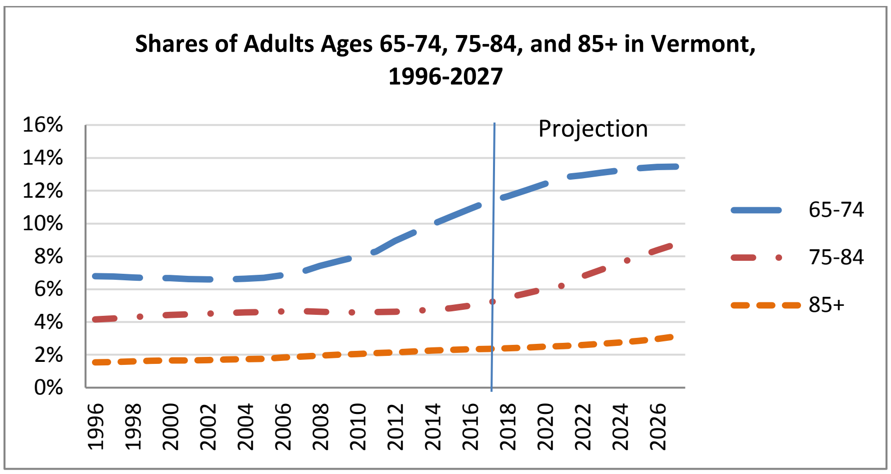


Source: Occupational Employment Statistics Survey. Data include salaried workers as well as workers paid by the hour. Number above each wage path is the cumulative growth in the inflation-adjusted hourly wage, 2004-2016.

<u>5) Slowing Vermont revenue growth is likely the result of other important factors, such as demographic change and sluggish wage and income growth for the majority of taxpayers.</u>

Two trends that may be difficult to reverse suggest that income tax revenues may continue to grow at only a moderate pace in the years to come. First, Vermont's aging population means that a large share of Vermont residents, as they retire, will have less income than when they were part of the workforce. That shift will likely cause downward pressure on income tax revenues in future years. In addition, the large majority of taxpayers in the lower 90 percent of the income distribution have seen only moderate growth in household incomes since 1990, as was shown in the figure above.

The share of Vermont's population that is age 65 or older is increasing notably now, and that trend will continue for a couple of decades. In 2005, people ages 65 and above made up 13 percent of the population. By 2015, that share was 17.5 percent. According to one set of population projections, the aging of the baby boomers — born from 1946 to 1964 — will cause the share of the population that is 65 years of age or older to expand to 24 percent in 2025 and to 27 percent in 2035.



During the last decade, Vermont enjoyed enhanced revenues from the large number of baby boomers in their 50s -- at or close to their peak earning and spending years. Revenues derived from personal income taxes, consumption taxes and property taxes generally peak during ages 45 to 64 and then decline as households move through their retirement years. According to detailed analysis of taxpayers for *The Vermont Tax Study, 2005-2015*, 56 percent of tax filers with income above $120,000 in 2014 (the top decile) were ages 45 to 64. About 26 percent were younger than age 45, and 18 percent were ages 65 and older. Looking ahead to 2020 or 2025, Vermont's tax revenues could grow at a slower rate or even decline as a consequence of the retirement of the baby boom cohort.