Federal Tax and Budget Bill: Impacts on Vermont

Presented to the Vermont House Ways and Means Committee

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About ITEP

The Institute on Taxation and Economic Policy (ITEP)

- Non-profit, non-partisan
- Federal, state, and local tax policy issues
- Research and data focused
- ITEP Microsimulation Tax Model

Select Major Features of H.R. 1
One Big Beautiful Bill Act (OBBBA)

Tax Cuts

Rate reductions

QBI pass-through deduction

Estate tax cuts

Alternative Minimum Tax cuts

Standard deduction increase

Child Tax Credit expansion

Deductions for tips, overtime, car loans, seniors

Various business tax breaks

And more

Tax Increases

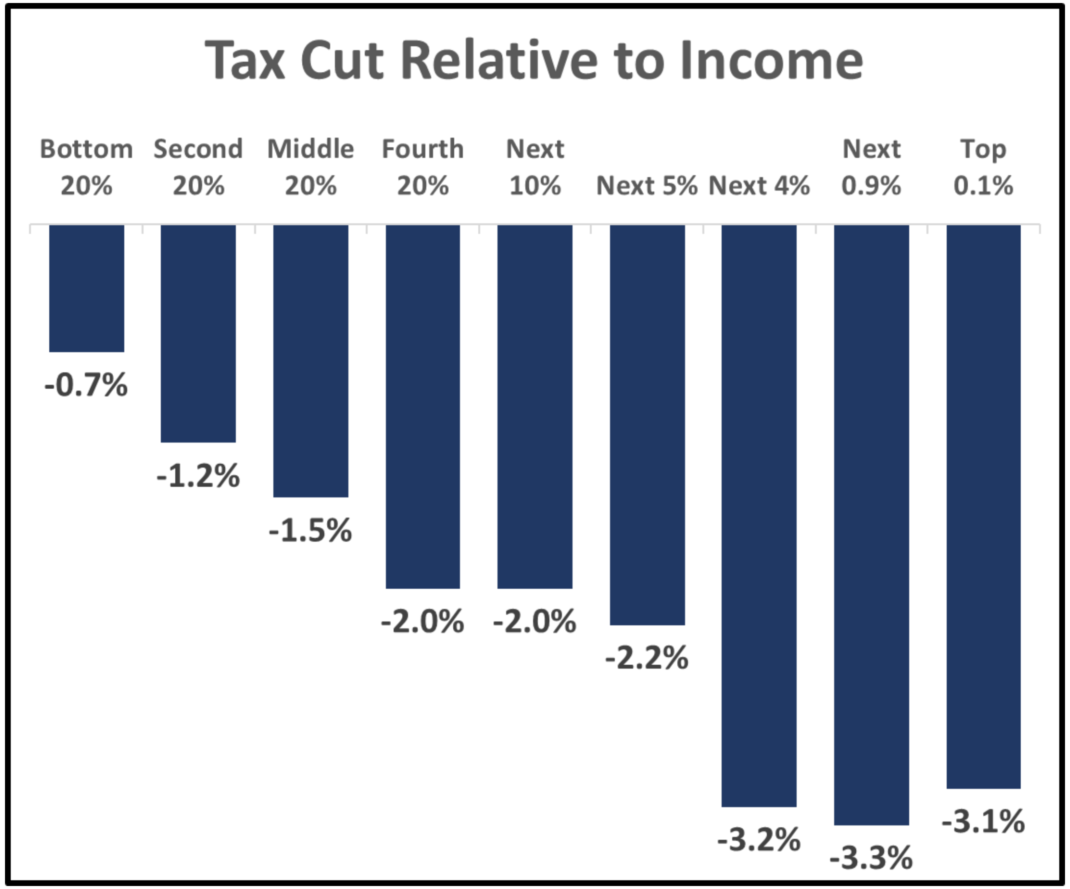
Personal exemptions repealed

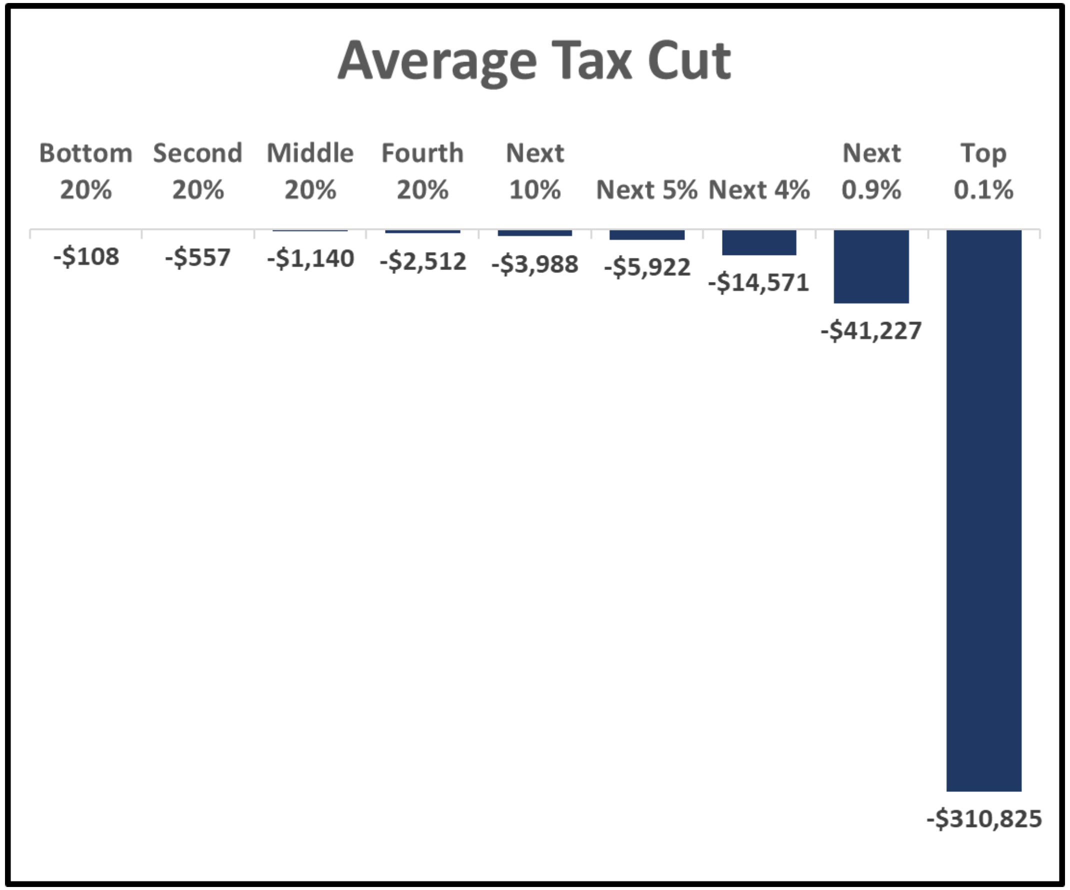
SALT cap extended

Repeal/limit green tax provisions

And more

OBBBA Impacts by Income Level





Source: Joint Committee on Taxation, JCX-37-25, data for Calendar Year 2027

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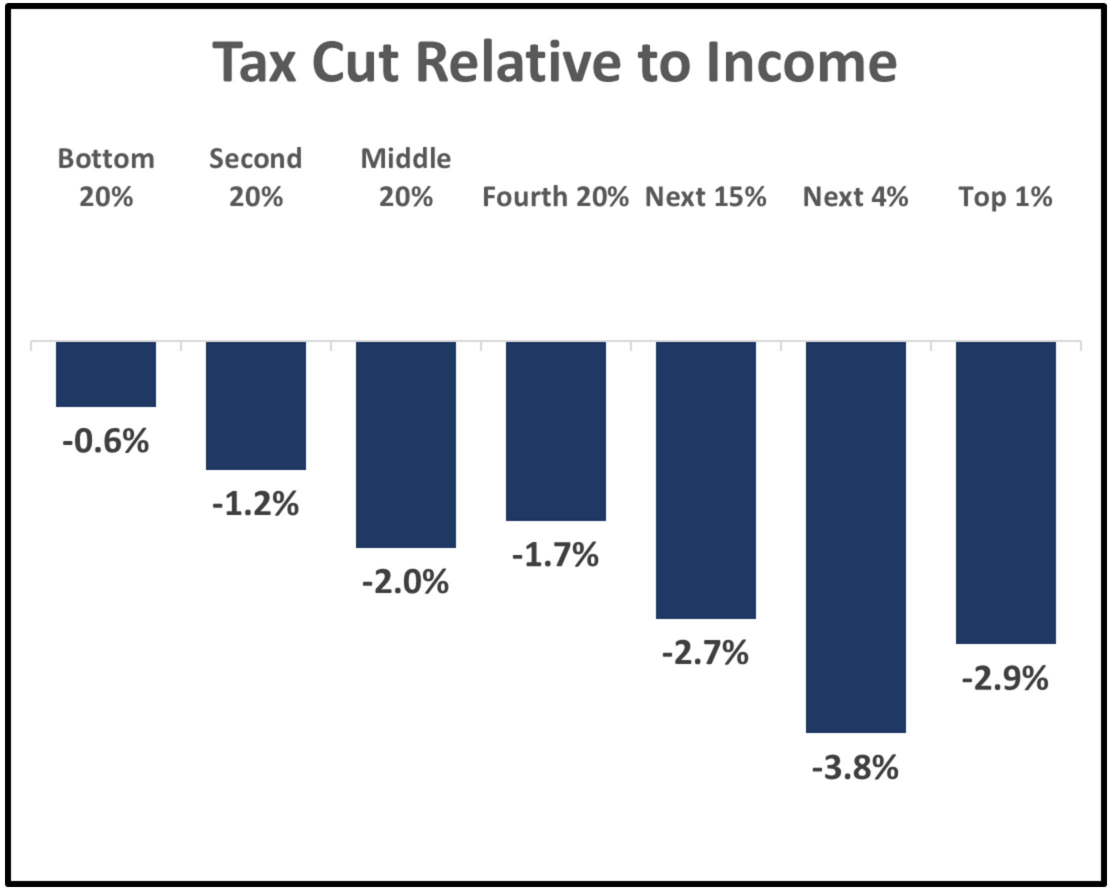
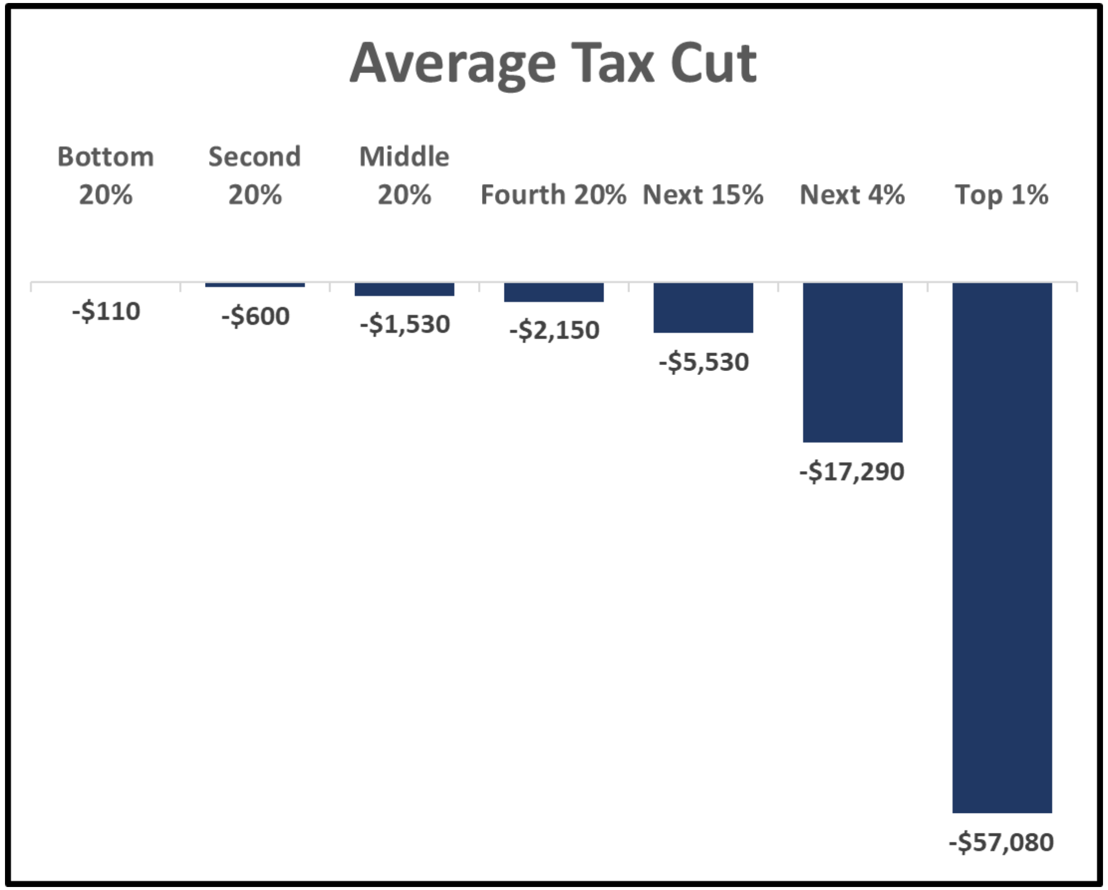
OBBBA Impacts in Vermont, Current Law Baseline





Source: Institute on Taxation and Economic Policy data for Tax Year 2026, released July 2025

Before OBBBA, Americans said that _____ pay:

		"Middle-Income People"		
"Too little"		5%		
"Fair share"		40%		
"Too much"		54%		

Source: Gallup poll conducted March 3-16 of 2025

Before OBBBA, Americans said that _____ pay:

	"Lower-Income People"	"Middle-Income People"		
"Too little"	10%	5%		
"Fair share"	30%	40%		
"Too much"	58%	54%		

Source: Gallup poll conducted March 3-16 of 2025

Before OBBBA, Americans said that _____ pay:

	"Lower-Income People"	"Middle-Income People"	"Upper-Income People"	"Corporations"
"Too little"	10%	5%	58%	70%
"Fair share"	30%	40%	28%	21%
"Too much"	58%	54%	12%	7%

Source: Gallup poll conducted March 3-16 of 2025

Before OBBBA, Americans said that _____ pay:

	"Lower-Income People"	"Middle-Income People"	"Upper-Income People"	"Corporations"
"Too little"	10%	5%	58%	70%
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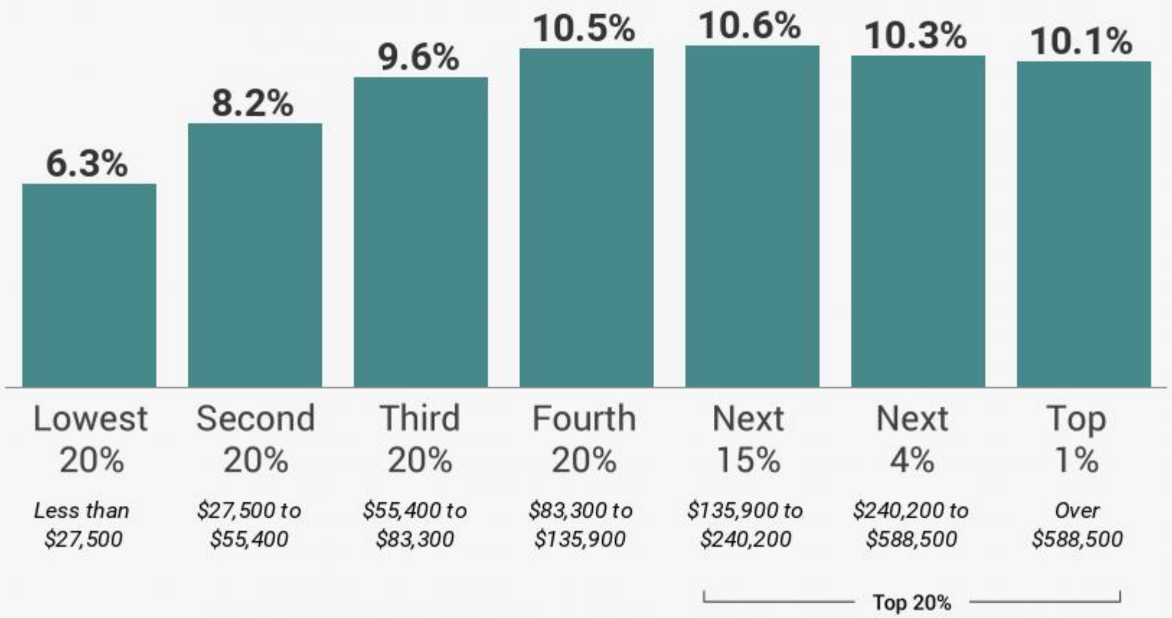
Share of OBBBA tax cuts:	Bottom 40%	Next 40%	Next 15%	Top 5%
	Under $53k	$53k-154k	$154k-$361k	$361k or More
	4%	25%	26%	50%

Source: Institute on Taxation and Economic Policy, July 2025

Vermont

Total Taxes

Share of family income



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Conformity

Checking in on a state that still conforms to federal taxable income (SC)

"We want to decouple from the feds... South Carolina doesn't need to depend on Congress"

- **Senate Finance Chairman Harvey Peeler "**

State tax collections should not be "dependent on the whims of the federal government... Let us decouple and put together a South Carolina-focused, South Carolina-centric tax policy that supports our budget"

- **Sen. Sean Bennett, chair of two of Senate Finance's regular subcommittees**

"It shows what happens when we give away the tax-making authority of the General Assembly to Washington... We can't be at the mercy of whatever D.C. does, whether it's President Trump or President AOC"

- **Rep. Brandon Newton, chairman of House Ways and Means' tax policy subcommittee**

One Path for Navigating New Federal Context

OBBBA Conformity Response:

Leave out

- Tips
- Overtime
- Car loan interest
- Senior deduction
- QBI/199A deduction

Other Responses:

One Path for Navigating New Federal Context

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- Dependent care credit
- Dependent care FSAs
- Trump account deferral
- NCTI QBAI change
- Executive pay change

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OBBBA Conformity Response:

Decouple

- QSBS
- Depreciation / Expensing
- FDDEI 250 deduction
- NCTI 250 deduction
- Relaxed biz interest limit

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Other Responses:

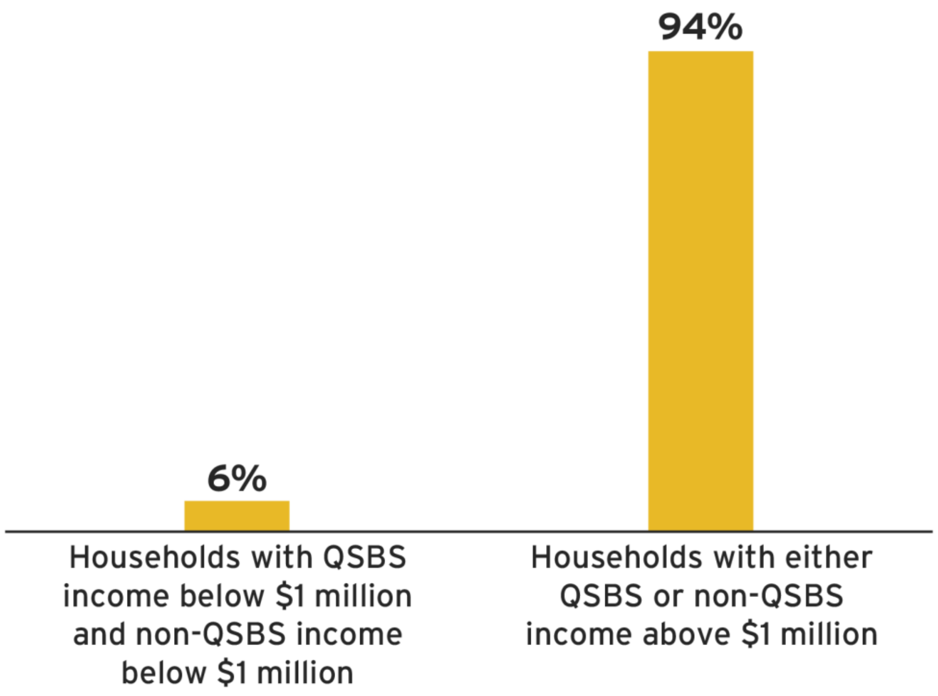
- Pursue tax compliance measures in the wake of IRS cuts (e.g., ING trust reform)
- Claw back least popular parts of top-heavy federal tax cuts

Qualified Small Business Stock (QSBS)

- Geared toward venture capitalists investing in C corporate tech companies
- Does not translate to state level well: companies largely outside VT
- VT revenue: -$2.6M in 2026; -$4.4M by 2031 (ITEP est.)
- AL, CA, MS, PA, and now DC have decoupled

Which Households Benefit From the Qualified Small Business Stock Exclusion?

Distribution of total dollars excluded on individual tax returns by annual income and exclusion amount, 2012-2022



Source: U.S. Department of Treasury Office of Tax Analysis, January 2025

Institute on Taxation and Economic Policy | ITEP.org

Criticism of QSBS is Widespread

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"State lawmakers now have the chance to separate themselves from this deeply problematic provision."

Washington Center for Equitable Growth

AEI

"particularly troubling… inefficient, complex, and unfair."

TAX FOUNDATION

"Policymakers should consider scaling back or even repealing the QSBS exclusion."

Depreciation / expensing

- Largest VT revenue loss of all conformity provisions
  - -$2.8M in FY26; -$6.4M in FY27 per JFO
- Core rationale does not translate to state level:
  - Federally, this was proposed to boost investment
  - For Vermont, it affects pre-apportionment profit so VT would be cutting taxes on investments occurring in other states
- "Retroactive incentive" is an oxymoron
- Recent decoupling actions show feasibility (per Bloomberg, 1/6/26):
  - DE, IL, MI, PA, RI, DC

How to think about OBBBA's international provisions and their relevance to VT

1. **Something OBBBA got right:** Administering CIT with a blind spot for foreign profits does not work. Open highway for tax avoidance.
    - e.g., GILTI now expanded and solidified into NCTI.
    - This general lesson is applicable to Vermont.

2. **But** differences in foundational structure of federal vs. state CIT systems mean that conformity needs to be done selectively to achieve a logical, principled result.
    - Fed CIT leans heavily on partial income inclusions and foreign tax credits.
    - Vermont uses sales factor formulary apportionment.

Sales Factor Illustration: Simplified Example for Hypothetical Company that is Not Shifting Profits

Water's Edge View (blinders on)

- $100M U.S. profit on $1B U.S. sales
- 5% of sales ($50M) into Vermont
- VT tax base is 5% of the $100M profit, or $5M

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Worldwide View (blinders off)

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WW scenario: Company expands its overseas sales

- $250M WW profit on $2.5B WW sales
- 2% of sales (still $50M) into Vermont
- VT tax base is 2% of the $250M profit, still $5M

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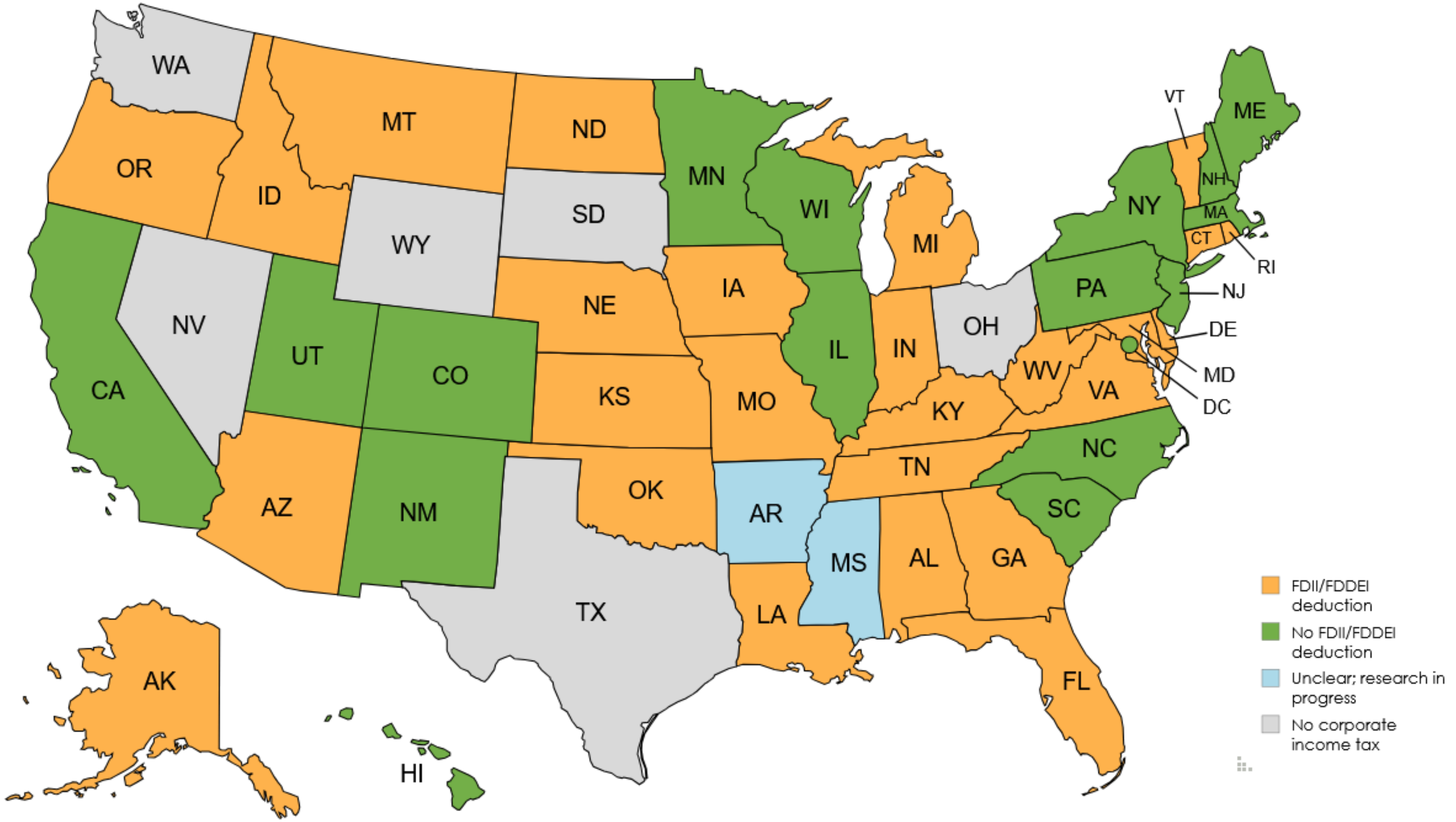
Key OBBBA Concept:

- **Foreign-Derived Deduction Eligible Income (FDDEI)** *(formerly FDII)*
  - Certain profits earned on exports by U.S. companies and U.S. subsidiaries.
  - Federal CIT lets companies deduct about one-third of these profits via Section 250 deduction, effectively taxing these profits at a reduced rate.
    - FDII/FDDEI deduction = 37.5% for 2018-2025; 33.34% for 2026 and later
  - Foundational element of Vermont CIT (single sales factor apportionment) ***already*** strives to forgo taxing export profits (see previous slide).
  - FDDEI deduction is unnecessary and serves no legitimate state policy purpose. No reason to expect in-state economic benefits.
  - Many states have decoupled (most recently, Colorado in August).

Many states have decoupled from FDII/FDEII



Approximately **3/4ths** of CIT revenue is collected by states not allowing a FDII/FDDEI deduction

Source: Fort, Bruce. "State Taxation of MNEs Under the TCJA: It's Time for a Policy Reassessment." *Tax Notes State*. June 2024. Supplemented with ITEP research.

Another Key OBBBA Concept:

- **Net CFC Tested Income (NCTI)** *(formerly GILTI)*
  - Certain profits booked abroad by foreign subsidiaries of U.S. companies. Mix of legitimate foreign profits and those artificially shifted to avoid tax.
  - Federal CIT lets companies deduct 40% of these profits via Section 250 deduction. And then foreign tax credits are applied to mitigate double taxation.
    - GILTI/NCTI deduction = 50% for 2018-2025; 40% for 2026 and later
  - Under Vermont law, single sales factor (SSF) apportionment can do the work needed to identify the appropriate share of profit to tax. SSF helps to forgo taxation of legitimate (as opposed to shifted) foreign income, and to mitigate double taxation.
  - Under the VT CIT, with SSF apportionment, the NCTI 250 deduction is unnecessary and serves no policy purpose. OBBBA's haircut to the deduction (from 50% to 40%) moves in the right direction, but decoupling from the deduction altogether is more compatible with the structure of VT tax code.

Two major ways that 2026 state tax debates are shaping up to look different

- **Tax conformity.**
  - Technically can do this anytime, but in practice issues that don't get dealt with in the first session following a large federal bill tend to linger.
- **Increased interest in taxing high-income and wealthy people.**
  - State budget outlooks less rosy due to OBBBA, tariffs, declining tax enforcement, end of pandemic aid, etc.
  - Large federal tax cuts for wealthy people are unpopular. Some states may want to distance themselves from that.
  - Widening inequality.
    - At the high-end: Stock market records and robust consumer spending.
    - Everyone else: Affordability concerns and uncertainty/anxiety about future.

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