

# HIGHLIGHTS OF 2002 TAX LEGISLATION

## INDIVIDUAL INCOME TAX

The calculation of Vermont income tax based federal taxable income is now permanent. Federal taxable income is increased by nonVermont state and municipal bond income and dividends or other distributions to the extent they are attributable to nonVermont state or local obligations; and decreased by income from federal obligations and by forty percent of net long term capital gain income to arrive at **Vermont taxable income**. Vermont taxable income is subject to Vermont tax rates from 3.6 percent to 9.5 percent. However, the marginal rates for the middle three income brackets have changed.<sup>1</sup> The pass-through of federal credits for retirement income, investment tax, child care and dependent care and, for 2 years, alternative minimum tax credit is continued. The pass-through of the federal tax on early withdrawals from pensions and IRAs is continued. The pass-through of the recapture of investment tax credit and lump-sum pension averaging is continued. The farm income averaging tax is no longer passed through, but a farm income averaging credit is available on the Vermont return. The pass-through of alternative minimum tax and tax on investment income of children under 14 is eliminated. These changes are effective for taxable years beginning on or after January 1, 2002. H. 753.

Effective January 1, 2002, the **penalty** for underpayment of quarterly estimated taxes is reduced from two percent to one percent per month. The threshold for estimated tax liability is increased from \$250 to \$500 for tax years 2003 and after. The penalty for failure to pay income tax is reduced from 5 percent to 2 percent for taxable years beginning on or after January 1, 2002 (and further reduced to 1 percent for taxable years beginning on or after January 1, 2005). H. 753.

Income tax exemption for **National Guard** pay is expanded to include **U.S. Reserve** pay and the exempt amount is increased from the first \$1500 to the first \$2000. The income eligibility for this exclusion is increased from adjusted gross income of less than \$47,000 to adjusted gross income of less than \$50,000. Effective for taxable years beginning on or after January 1, 2003. H. 771.

A new **child care or dependent care credit** is available to filers with adjusted gross income below \$30,000 for a single taxpayer and below \$40,000 for married taxpayers. The credit is 50% of the federal credit amount and is available in lieu of the existing credit (24% of the federal credit amount) that can be claimed on the Vermont return. Effective for taxable years beginning on or after January 1, 2003. H. 771.

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<sup>1</sup> The effect of the changes for most taxpayers is minimal, but for those who want to change their withholding, see the Department's website for New Withholding Tables.

## **BUSINESS INCOME TAXES**

The use of the **federal 30 percent bonus depreciation** is disallowed on the Vermont corporate income tax return for C corporations and thus a separate depreciation schedule for Vermont is required. Effective for taxable years beginning on or after January 1, 2001. H. 753.

The **penalty** for failure to pay income tax is reduced from 5 percent to 2 percent for taxable years beginning on or after January 1, 2002 (and further reduced to 1 percent for taxable years beginning on or after January 1, 2005). H. 753.

A business whose only contact with Vermont is ownership of data or software being used in Vermont, or ownership of computers servers in the state or receipt of computer processing or web hosting services from a Vermont provider will not be considered a Vermont business for tax purposes. This makes explicit current practice of the Department. Effective for taxable years beginning on or after January 1, 2002. H. 771.

The definition of “charitable threshold rate” applicable to tax credits for **charitable investments in housing** is updated. Prior law pegged the rate to two points below the one-year U.S. Treasury note. The U.S. Treasury no longer issues one-year notes. Now the rate is pegged to two points below the bank prime loan rate. This credit is available against individual income tax, corporate income tax, bank franchise tax and insurance premiums tax. The amendment takes effect upon passage (not yet signed) and shall apply to loans made after that date. H.771.

The law that made an **export tax credit** available to C corporations has been expanded to any type of business entity. Effective upon passage (not yet signed). H. 239.

The **financial services tax credit** that was due to sunset is extended through tax years beginning prior to January 1, 2007. H. 239.

The investment credit is expanded to allow the credit to be claimed on **capital leases** as well as purchases. Effective upon passage and applicable to leases entered into after that date (not yet signed). H. 239.

**High-tech businesses** (defined as those involved in Vermont in design, development and manufacture of computer hardware and software; electronic devices; energy technology; or electric vehicles) may be entitled to a new range of tax incentives. Most of the incentives mirror existing VEPC-granted incentives, but high-tech businesses may obtain approval for more of these credits than granted to any one company under current law. Effective for taxable years

beginning on or after January 1, 2002. H. 239. (Also see high tech exemption under "Sales Tax" below.)

The existing 5 percent credit for **substantial rehabilitation of historic buildings** is expanded to qualified projects in a "village center" and the credit for qualified rehabilitation projects in a downtown development district is increased to 10 percent. The requirement that the credit be applied for prior to commencement of work has been eliminated. The amount authorized to be awarded in historic credits is increased from \$300,000 to \$750,000, but the \$750,000 (\$1,000,000 effective July 1, 2003) must include the total awarded for certain other new credits and the amount of reallocated sales tax. No more than forty percent of the total may be awarded in one community. This credit is available against income tax, bank franchise tax and insurance premiums tax. Effective May 28, 2002. H. 208.

A new credit is available against income tax, bank franchise tax or insurance premiums tax in the amount of 50 percent of expenditures up to a maximum of \$25,000 spent to install or improve **platform lifts, elevators or sprinkler systems** in an existing building within a downtown district in order to comply with certain safety and admissibility rules. The credit may be carried forward for 14 years. It is subject to the \$750,000 limit on total credits and reallocated sales tax. Effective May 28, 2002. H.208.

### **ESTATE TAX**

Current law imposes a Vermont estate tax equal to the amount of state death tax credit allowed by federal estate tax law. Under federal law, the **federal credit amount** is being phased out to zero over four years, beginning in 2002. To prevent the decreases from passing through to the Vermont estate tax, the Vermont law was amended to make the Vermont tax equal to the amount of the credit which was allowed under federal law in effect on January 1, 2001. When the federal credit reaches zero, a federal deduction for state estate tax is created. However, the Vermont estate tax will continue to be imposed in the amount of the 2001 federal credit without any deduction. Current federal law exempts estates of \$1,000,000 or less from federal estate tax. The **exclusion amount** increases until the federal estate tax is repealed in 2010. Vermont passes through the exclusion and will continue to do so as it increases. This legislation also maintains the current Vermont tax rates on generation-skipping transfers. Effective as to estates of decedents with a date of death on or after January 1, 2002. H. 753.

The Vermont estate tax on the portion of a farmer's estate which is the **farm business** is eliminated. Effective upon passage (not yet signed). H. 753.

### **SALES AND USE TAX**

The Tax Commissioner is authorized to participate in the **Streamlined Sales and Use Tax Agreement** - a multistate agreement on how states will uniformly streamline and simplify their sales and use tax laws. Once the agreement is created, state legislatures will have the option of amending their laws to adopt the uniform provisions. Effective upon passage (not yet signed). H. 771.

Effective January 1, 2003, **steel-toed and Kevlar-toed work shoes** are exempt from sales tax regardless of price. H. 771.

**Building materials and supplies** that are purchased out-of-state and used in a job in a state that has no sales or use tax, but are stored for up to 180 days in Vermont are exempt from Vermont use tax. Effective with respect to material and supplies not stored in Vermont before July 1, 2004. H. 771.

The **Mobile Telecommunications Act** is adopted. This Act provides a uniform, national method for taxing mobile telecommunications based on the customer's place of primary use. Effective with respect to bills issued after August 1, 2002. H. 771.

The law with respect to **trade-ins** is clarified, providing that "receipt" excludes the amount allowed for trade-in of like kind property and that a credit is given after the sale when an old part is returned (so-called "core charges"). Effective upon passage (not yet signed). H.771.

**High tech businesses** that have received VEPC approval may qualify for an exemption for personal computers and included software packages purchased for use exclusively in the Vermont business and directly in the high tech activity. Effective with respect to purchases on or after July 1, 2002. H.239.

Effective July 1, 2002, **fertilizers and pesticides** are exempt from sales tax *only* if purchased for use directly in the production for sale of tangible personal property on farms. Formerly the exemption was available to anyone purchasing pesticides and fertilizers for any purpose. H. 753.

Effective July 1, 2002, the exemption for property to be incorporated into a net metering system is expanded to include property incorporated into (1) an off-the-grid **energy system** that meets all other requirements of the net metering system and (2) a **hot water system** that convert solar energy into thermal energy used to heat water (the property must be directly necessary for and used to capture, convert, or store solar energy for this purpose). Effective July 1, 2002. S.138.

## **CIGARETTE TAX**

The cigarette tax is **increased** by 49 cents per pack on July 1, 2002 (to 93 cents per pack). It increases another 26 cents per pack on July 1, 2003 (to \$1.19 per pack). H. 753.

A **floor stock tax** is imposed on wholesale and retail dealers of cigarettes who, on July 1, 2002, possess more than 10,000 cigarettes for retail sale. The tax is 49 cents per pack (of twenty cigarettes) or stamp in the wholesaler's or retailer's possession on July 1, 2002. Payment is due September 25, 2002. A floor stock tax will be imposed on wholesale and retail dealers of cigarettes who, on July 1, 2003, possess more than 10,000 cigarettes for retail sale. The tax is 26 cents per pack or stamp in the wholesaler's or retailer's possession on July 1, 2003. Payment is due September 25, 2003. H. 753.

### **LOCAL OPTION TAXES**

Authority of qualifying municipalities<sup>2</sup> to impose local option taxes (sales, meals and alcohol, and rooms) was due to expire at the end of 2004. It has been extended through 2006. H. 771.

### **EDUCATION PROPERTY TAX**

**Property tax adjustment payments** are no longer subject to reconciliation. Eligible homeowners will file claims (Form HS -138) and receive an adjustments based on their prior year household income and prior year property value and their school district's current budget. To receive an adjustment, a claimant must own the homestead on April 1 of the year for which the claim is made. Property tax adjustment claims and homeowner and renter rebate claims may be filed until December 1. As in the past, eligibility for a homeowner rebate is based on owning the homestead on December 31. Effective January 1, 2003 and applicable to claims filed in 2003 and after. H.771; H. 766.

Effective fiscal year 2005 (2004 grand list), **ski lifts and snow-making equipment** will be exempt from education property tax. H. 771.

For purposes of determining household income for a property tax adjustment, **pension and annuity distributions** will continue to be included in household income but only to the extent that they are included in adjusted gross income in the year of distribution. Amounts contributed to a pension, annuity or Roth IRA that were included in adjusted gross income in the year of contribution are not included in household income in the year of distribution. Effective for claims filed in 2003 and after with respect to 2002 household income. H. 771.

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<sup>2</sup> Williston's local option tax goes into effect on July 1, 2002. See Technical Bulletin-14 on the Department's website ([www.state.vt.us/tax](http://www.state.vt.us/tax)) for guidance on local option taxes.

A claimant who filed a timely claim may file **amended property tax adjustment claim** within three years after the date for filing the claim to correct household income. Effective upon passage (not yet signed). H. 771.

Property tax adjustment payments will be subject to debt claims of other state agencies under the **Setoff Debt Collection** Program. Effective upon passage (not yet signed). H.771.

A school district may finance capital school construction projects voted after July 1, 2002 and begun in fiscal years 2003, 2004 or 2005 by raising taxes on its own grand list in lieu of receiving State school construction aid. A Vermont participant in an interstate school district, however, will receive State school construction aid in addition to being permitted to raise taxes for school construction outside of the sharing provisions of Act 60. There are two interstate school districts, Dresden (which includes Norwich, Vermont and Hanover, New Hampshire) and Rivendell (which includes Fairlee, West Fairlee and Vershire, Vermont and Orford, New Hampshire). The benefit applies retroactively to towns that voted a capital school construction project after April 1999 and began construction before July 1, 2002. The tax rate of a member of a union district that does not vote to finance construction on its own grand list will not be higher than it otherwise would be due to another member town's vote. However, members that finance school construction outside of the sharing pool will have a lower tax rate for the construction than the other members of the same district. Effective upon passage (not yet signed). H. 771.

### **PROPERTY TRANSFER TAX**

Property transfer tax returns will include a certification indicating whether the transfer is in compliance with or is exempt from regulations governing potable water supplies and wastewater systems under chapter 64 of Title 10; and that the seller has advised the purchaser that potable water supply and wastewater system requirements pertaining to the property may significantly limit the use of the property<sup>3</sup>. This replaces the certification requirement relative to the subdivision of lands under section 1218 of Title 18. Effective upon passage (not yet signed). S.27.

The first \$100,000 of value of a principal residence purchased with financing from the **Vermont Housing Finance Agency** is exempt from property transfer tax. This exemption, due to expire on July 1, 2002, will continue in effect until July 1, 2006. H. 767.

### **CURRENT USE**

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<sup>3</sup> This certification will be part of the property transfer tax return in its next iteration. Until the new return is available, filers should complete the subdivision certification section of the return as provided in temporary instructions available from the Department (call 828-2777).

The land use change tax is reduced from 20 percent to 10 percent for parcels that have been enrolled in the use value appraisal program for more than 10 years. Effective upon passage (not yet signed). H. 753.

Conformance reports formerly were required to be filed annually. Now they are required only when management activity has occurred. The report is due on or before February 1 of the year following the year in which the management activity occurred. Effective upon passage (not yet signed). H. 753.

### **MISCELLANEOUS CHANGES**

The per transaction fee that the Internal Revenue Service charges for participation in the **federal debt offset program** may be charged against the tax account. Effective upon passage (not yet signed). H. 771.

A tax refund owed to an offender who is under a **restitution** order will be offset to the Department of Corrections for payment to the victim under the Setoff Debt Collection Program. Effective July 1, 2002. S. 222.

The Department may provide **tax return information** to the Department of Corrections or the Center for Crime Victims for the purpose of verifying a defendant's assets and income in setting a restitution amount. Effective July 1, 2002. S.222.