

Ruling 95-02

Vermont Department of Taxes

Date: January 11, 1995

Written By: Mary Bachman, General Counsel

Approved By: Betsy Anderson, Commissioner of Taxes

You have requested a formal ruling on the application of the Vermont income tax. This ruling relies on the facts represented in your letter to Emily Tartter, dated August 5, 1994.

Facts: [Taxpayer] (the "taxpayer"), a [State] resident, owns rental property located in [Town], Vermont. In 1993, the property generated annual rental income of \$20,000¹ which was reported on [Taxpayer's] federal income tax return. She also filed a Vermont nonresident income tax return to report this income.

In addition to the rental income, the taxpayer also had the following nonVermont income in 1993: (1) dividend income of \$10,000; (2) [State] municipal bond income of \$50,000; (3) miscellaneous income of \$20,000.

In calculating the taxpayer's Vermont tax, the starting point is his federal income tax liability. Federal taxable income does not include municipal bond income. Without adding back her municipal bond income, the taxpayer's federal taxable income (assuming deductions and personal exemptions of \$10,000) is \$40,000 and her federal tax liability is \$8,334.

When the taxpayer's municipal bond income is added back, the taxpayer's federal taxable income is \$90,000 and her federal tax liability is \$23,430. At the 1993 Vermont tax rate, her Vermont tax is \$7,471. The taxpayer's Vermont tax is then adjusted by reducing it by the percentage which her nonVermont income bears to her total income. The calculation reduces the taxpayer's Vermont tax liability to \$1,488 or 20% of \$7,441. If the taxpayer invested in Vermont municipal bonds, rather than [State] municipal bonds, the resulting tax liability would be \$993, computed by taking the federal tax liability of \$8,334, applying the Vermont rate schedule, and then adjusting the resulting tax by the appropriate ratio.

You request the commissioner to rule that this result violates the equal protection clause of the United States Constitution and the uniformity clause of the Vermont Constitution. Ruling: The Vermont income tax is imposed as a percentage of federal tax liability, reduced by a percentage equal to the percentage of the taxpayer's adjusted gross income for the taxable year which is not Vermont income. 32 V.S.A. § 5822. Federal tax liability is defined as: "[T]he federal income tax payable by the taxpayer for that taxable

year under the laws of the United States, or the federal income tax which would have been payable if amounts received by the taxpayer on and after July 1, 1987 as interest income from state and local obligation, other than obligations of the state of Vermont and its political subdivisions, and dividends or other distributions from a fund to the extent such dividend or distribution is attributable to such Vermont state or local obligations, were included in federal adjusted gross income...." 32 V.S.A. § 5811(4). The statutory scheme is clear. It requires that the taxpayer's Vermont tax be calculated by adding back [State] municipal bond income to arrive at the federal income tax which would have been payable if such bond income were federally taxable and then reducing the Vermont tax by the percentage of nonVermont income. Administrative agencies lack the power to declare invalid a law which it is charged with administering. *Alexander v. Barton*, 152 Vt. 148, 565 A.2d 1294 (1989); *Westover v. Village of Barton*, 149 Vt. 356, 543 A.2d 698 (1988). The correct amount of Vermont tax is based on the recalculated federal income tax liability.

Moreover, The Vermont Supreme Court has held that this method of calculating the Vermont income tax is not discriminatory. The Court held in *Wheeler v. State*, 127 Vt. 361, 249 A.2d 887 (1969), that taxpayers having similar Vermont source income may be taxed upon that income at different rates based upon differing ability to pay as reflected in their federal taxable income. In *Wheeler*, a nonresident taxpayer objected to the adjustment method described above because it resulted in a higher tax on him than on a resident with identical Vermont income. The Court rejected this comparison, observing that taxpayer limited his comparison to a taxpayer of lower total income than his. The taxpayer did not pay more tax than someone with the same total income.

The New York Court of Appeals recently rejected a constitutional challenge to New York's method of calculating nonresident income tax, which is similar to Vermont's. *Brady v. State of New York*, 80 N.Y. 2d 596 (1992), cert. denied, *Brady v. New York*, No. 921720 (U.S. June 21, 1993). New York first computes the nonresident's tax base as though the individual were a New York resident and then multiplies this amount by the ratio of the nonresident's New York adjusted gross income to the nonresident's federal adjusted gross income. This method typically pushed the nonresident into a higher tax bracket than a resident whose total income is the same as a nonresident's New York income.

Your claim that the taxpayer "pays a substantially higher tax on Vermont source income solely because of the type of municipal bond income earned..." is not correct. The taxpayer pays Vermont income tax on her Vermont income at a higher rate than someone who has identical Vermont income, but no other income. This is not due to the character of the taxpayer's nonVermont income. Income from any taxable source would produce the same result. The fact that some of the taxpayer's nonVermont income is derived from [State] municipal bonds as opposed to other types of taxable income is irrelevant. Your comparison is confined to [State] municipal bond income versus nontaxable types of income, but the true comparison is to someone with identical amounts of taxable income, from whatever source. Such taxpayers would pay the same amount of Vermont tax. The Vermont statutes do not discriminate against the taxpayer in an arbitrary or unreasonable way.

This ruling is issued solely to your firm and is limited to the facts presented as affected by current statutes and regulations. Other taxpayers may refer to this ruling to determine the Department's general approach, but the Department will not be bound by this ruling in the case of any other taxpayer or in the case of any change in the relevant statute or regulations.

¹ The numbers which you used in your letter are not the actual amounts, but are rounded for purposes of illustration]