To: Income-Based Education Tax Study Committee
From: Stephanie Yu, Public Assets Institute
Date: December 21, 2022
Re: Committee's draft report

Overview

The main elements of the Committee's proposed design of an income-based education tax appear to us to advance several important recommendations of the Vermont Tax Structure Commission report:

• moving to an income-based school tax for all Vermont taxpayers,
• preserving the link between school tax rates and local, democratic, education-spending decisions, and
• giving renters a direct stake in the education funding system while recognizing their indirect contribution to school taxes.

While the proposal reduces complexity in some areas, it increases complexity in other ways. The central problem identified by the Tax Structure Commission was the complexity of the current funding system, which has left many voters feeling disconnected from their school budgets and the process of local democracy. We offer some ideas, all within the framework of the Committee's draft proposal, that could go a long way toward reconnecting voters to budgets and strengthening democratic participation at a time when our democracy is under threat.

Vermonters need to know the consequences of their votes

The draft proposal calls for continuing to set education tax rates after local voters have voted on their school budgets. This is the default pattern the Legislature has fallen into in the last decade or so, but it was not the original design. The purpose of the December 1st letter was to give local school boards timely tax information as they were developing their school budgets. The early projections of school spending and education revenues were prepared so that the Legislature could act in January to set tax rates before school boards finalized their budgets and published their annual reports. (Initially, the Legislature determined homestead base rates and base per pupil amounts, and later it set the income-based and property-based homestead yields.)

It undermines the democratic intent of the process to ask Vermont residents to vote on school budgets without knowing the tax consequences of their decisions. The goal is for voters to weigh the needs of the schools against the tax contributions and decide what to do. But currently they only have half the information. Vermonters may feel frustrated that they have no control over school finances because they don't know what their tax rates will be when they're asked to decide how much to spend on their schools. We believe the best way to reconnect voters to the school budgets is to let them see that the tax rate they approved at Town Meeting is the same one they pay. It may take time for that to become meaningful to voters, in part because of the mistrust engendered by the current disconnect. But the goal should be for the choice to be as clear as possible to encourage participation and trust in the democratic process.

Virtually all state fiscal decisions are based on spending and revenue estimates and forecasts. By mid- to late-January, the Legislature can have as much information as it needs to set education tax rates for the coming fiscal year. If some projections are off, the difference can be made up the following year, as is currently the case. In the draft proposal, the committee has recommended expanding the Education Fund reserve to accommodate more volatility in the fund. Such a change would give the Legislature the tool it needs to make a commitment on school tax rates in January so that voters will know what their votes will mean on Town Meeting Day.

Tax base: prior year versus current year

There are pros and cons to either choice: prior-year adjusted gross income would reduce uncertainty over revenue projections, but current-year income would be better for taxpayers who experience an unexpected loss of income because their tax bill would be immediately responsive to that drop. The drawback to using current-year income is that revenues are vulnerable to economic shifts and voters may not know what their current year income will be when they vote on the budget. The Legislature can weigh the trade-offs.

Complexity versus simplicity

We support the committee's goal to create a progressive income-based education tax. The question is whether it's worth the resulting complexity that multiple tax brackets, all subject to local adjustments, will create. This could make it harder for voters to understand the tax consequences of their votes, and the disconnect they feel would persist.

If the Legislature decides to move forward with multiple tax brackets and local adjustments, we would recommend the Tax Department and Agency of Education publish Town Meeting Day handouts similar to the ones prepared in the early years of Act 60. The original Act 60 tax calculations were complicated, too. But the state prepared tables for each town that allowed voters to look up their approximate home value and approximate income and see the taxes due. Something similar could be done with town-specific income tables. Voters could look up their approximate income and see the amount of the tax. But for that system to work, the Legislature would need to avoid changing the tax rates it set in January.

Also in the name of simplicity and voter understanding, we suggest dropping the idea of basing education income tax liability on an average of two fiscal year tax rates. Again, the school tax that voters pay in a calendar year should be based on the tax rates they approved in the spring of that year to fund education for the coming school year. We don't average fiscal year tax rates now, and such a change would add unnecessary complication.

Miscellaneous

Homestead declaration. The report says the homestead declaration would no longer be required. But how else will the state know which properties are subject to the non-homestead tax rate? For example, the committee has not recommended that education taxes be filed by taxpayers who are not required to file personal income tax returns. Might those non-filers be taxed as non-homestead owners? It also may be necessary to continue the homestead declaration to insure that land beyond a two-acre housesite is taxed on its residual homestead value. That land would be taxed at the non-homestead rate. But it is important to retain the principle of residual valuation—that is, the value of the total homestead less the value of the housesite.

Technical questions: It wasn't clear from the draft report whether the EIT bracket rates would be expected to change every year (or frequently). If so, would that affect complexity and voter understanding?

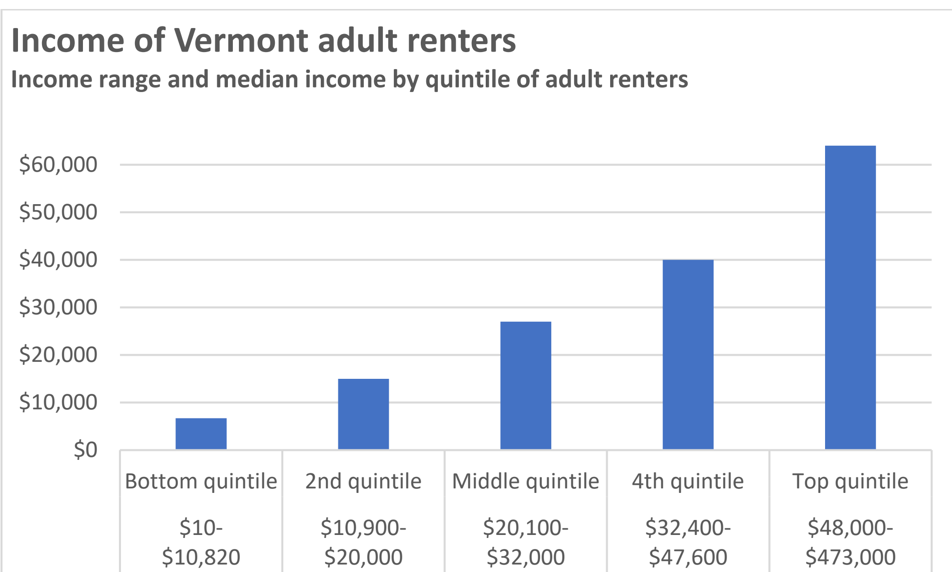
The income brackets don't correspond to the personal income tax brackets; how were the brackets derived? What is the relationship, if any, among the bracket rates? For example, if the rate for income up to $30,000 is 1.5 percent, do the rates on income over $100,000 or $300,000 or $500,000 bear some relationship to the 1.5 percent rate?

Typo. In the table on page 10, bottom row, third column, the formula for homeowners with income of $90,000 or more should be "(HS value - $225,000)." It's obviously just a typo copied from the row above, but in case you missed it.

Renter data (in case you're interested).

As a point of information, since renters have been an important of your discussion, perhaps the following from the 2021 American Community Survey 1-year microdata will be useful.[1]

Renter occupied households: 72,596.
Number of people in renter occupied housing: 144,807.
Number of people 18 and older in renter occupied housing: 117,714.
Number of people 18 and older with personal income in renter occupied housing: 108,347.
Income by quintile for 108,347 adult renters with personal income:



[1] The American Community Survey public use microdata are slightly different from the dataset used to create tables available at data.census.gov. For example, data.census.gov shows 73,872 renter occupied households. All of the data are estimates based on surveys, but they provide a good profile of Vermont renters.