Report to the House Committee on Ways & Means
Vermont's Renter Rebate Program

January 15, 2014

Findings and Recommendations

- Vermont's renter rebate program is a type of property tax circuit breaker intended to promote tax equity at a minimum cost by targeting relief to renters with the greatest property tax burdens measure in relation to income.

- The total cost of the renter rebate was $8.7 million in 2012. There were 13,541 claimants who received an average renter rebate of $641. The average monthly rent of claimants was $636. The average household income of claimants was $20,802.

- More than 29% of occupied housing units in Vermont were occupied by renters in 2012; however, the percent of renter-occupied housing units varies widely across the State. Almost 26% of residents were members of renter-occupied households.

- Although there are renters at all income levels, nearly three-quarters of renter-occupied housing units had household income under $50,000 in 2012. The median household income of renter-occupied households is less than one-half that of homeowners.

- The conventional indicator of housing affordability is the percent of household income spent on housing. By this measure, nearly one-half of renter-occupied households are overburdened and nearly one-quarter are severely overburdened.

- The problem of unaffordable housing is heavily concentrated among very low-income renters. Over 84% of overburdened renter-occupied units have annual household incomes under $35,000.

- On average, Vermont's renter rebate program reduces gross rent as a percent of household income from 36.7% to 33.6% of household income. Gross rent, which excludes the cost of utilities, remains above 30% for most claimants.

- Rental housing assistance is available to low-income households through programs funded primarily by the US Department of Housing and Urban Development. However, there are long waiting lists for assistance and program funding has been eroding.

- The design of property tax circuit breakers involves a number of policy choices. The committee may want to review the following issues, which are discussed in the body of this report:
    - Allocation of program costs between the Education and General Funds
    - Household income brackets and notch effects
    - Benefit limits
    - Adjustments for inflation
    - Adverse incentives
    - Percentage of rent deemed property taxes
    - Delivery of benefits to renters
    - Administrative costs

Vermont's renter rebate program, which was established in 1970, is a type of property tax circuit breaker. Circuit breakers are intended to promote tax equity at a minimum cost by targeting relief to taxpayers with the greatest property tax burdens measured in relation to income. The term derives its name from an electrical circuit breaker that shuts off the electrical current when a system is overloaded. This report reviews issues with the State's current-law renter rebate program[1] and examines other ways Vermont provides assistance to renters coping with high rents and low incomes. The statutory charge is included in the appendix.

1. Vermont's Renter Rebate Program

To be eligible for the renter rebate program, a claimant must meet all of the following requirements:

- Domiciled in Vermont for the entire calendar year
- Rented in Vermont for the entire calendar year
- Not claimed as a dependent of another taxpayer
- Household income does not exceed $47,000
- Only one claim per household

Vermont uses a multiple threshold circuit breaker with three income brackets. Property taxes are limited to between 2% and 5% of household income as follows:

Under $9,999	2.0%
$10,000 to $24,999	4.5%
$25,000 to $47,000	5.0%

However, the maximum rebate is limited to $3,000 per claimant regardless of the amount of property taxes paid in excess of these household income thresholds.

To avoid providing different tax relief to households with similar property tax burdens, circuit breaker programs generally define income broadly to include Social Security, pensions, and cash public assistance. In Vermont, household income is defined as federal adjusted gross income for all members of the household with a number of modifications. Household income is reported to the Vermont Department of Taxes (VDT) on the Household Income Schedule, which is reproduced in the appendix to this report.

Since renters do not pay property taxes directly, property taxes are assumed to be 21% of rent paid. For this purpose, rent includes only the amount actually paid for the right to occupancy; payments for heat, electricity, and other services are excluded. In addition, any federal or state

[1] The focus of this report is the renter rebate; however, Vermont's renter rebate is part of a circuit breaker program that applies to homeowners as well as renters. With the exception of the maximum benefit and the need to estimate property taxes paid by renters, the parameters of the two parts of the program are identical.

rental subsidies are excluded. Rent, items included in rent, and any rental subsidy are reported to the VDT on the Landlord's Certificate, which is reproduced in the appendix to this report.

In addition, claimants must timely file the Renter Rebate Claim, which is also reproduced in the appendix to this report. Normally, claimants file this form annually with the VDT by April 15th with their Vermont Income Tax Return; however, claimants not otherwise required to file an income tax return may file separately. For more than three-quarters of claimants, the rebate is treated as a refundable personal income tax credit.

The number of claimants, average monthly rent, average household income, and average rebate by income class for 2012 are presented below.

Household Income	Number of Claimants	Average Monthly Rent	Average Household Income	Average Renter Rebate
Under $9,999	2,441	$284	$8,203	$544
$10,000 to $19,999	4,501	$528	$15,101	$645
$20,000 to $29,999	3,944	$741	$24,549	$694
$30,000 to $39,999	2,015	$942	$34,424	$641
$40,000 to $47,000	640	$1,123	$42,971	$668
Total/Average	13,541	$636	$20,802	$641

The number of claimants, the total cost of the renter rebate program, and the average rebate for tax years 1999 to 2012 are presented below.

Tax Year	Number of Claimants	Amount of Rebate	Average Rebate
1999	11,620	$5,257,244	$452
2000	10,324	$4,704,796	$456
2001	10,406	$4,866,323	$468
2002	11,131	$5,636,205	$506
2003	11,525	$6,136,097	$532
2004	11,037	$5,913,113	$536
2005	11,251	$6,353,863	$565
2006	11,529	$6,924,340	$601
2007	12,408	$7,238621	$583
2008	13,150	$8,108,943	$617
2009	13,745	$8.811,700	$641
2010	13,859	$8,609,210	$621
2011	13,636	$8,748,066	$642
2012	13,541	$8,685,183	$641

Since the renter rebate is based on a claimant's education and municipal property taxes, the cost of the program is borne by both the State's Education Fund and General Fund. The

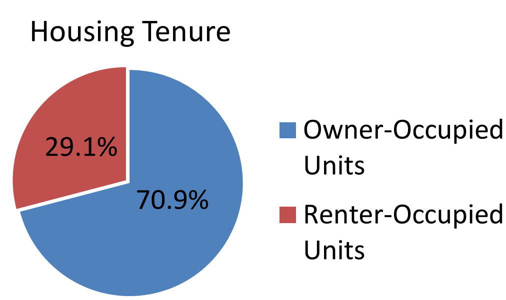
Education Fund has borne 70% of the total cost and the General Fund has borne 30% of the total cost. Although this allocation has been used since the implementation of Act 60 in FY1999, it does not reflect the portions of the total rebate attributable to the education and municipal property taxes.

2. Renters in Vermont

Information on renter-occupied households published by the VDT is limited to renters who have applied for a rebate. To gain a broader picture of renters in Vermont, US Census Bureau data[2] on housing tenure, income, rent, and rental housing affordability are presented below. Note that the definitions of both household income and gross rent for the purposes of Vermont's renter rebate differ from the US Census Bureau definitions.

Renter-Occupied Housing Units

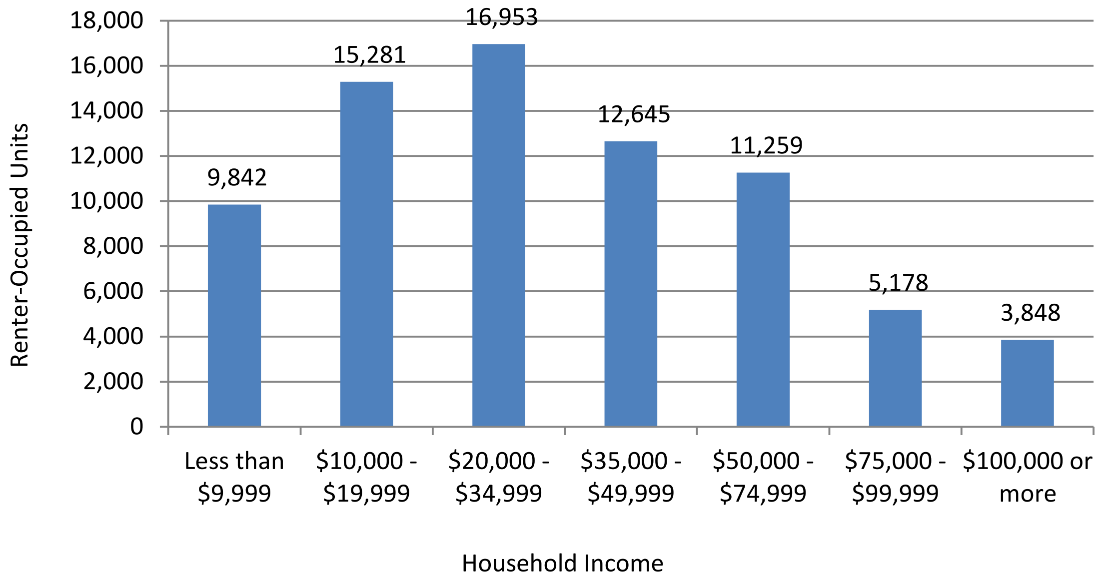
In 2012, 75,006 or more than 29% of total occupied housing units were occupied by renters. The percentage of total occupied housing units occupied by renters varies widely across the State from a high of 36% in Chittenden County to a low of 16% in Essex County. Renter-occupied households in Vermont are smaller on average than owner-occupied households. In 2012, there were 155,783 members of renter-occupied households accounting for almost 26% of the state's total population.



Household Income of Renters

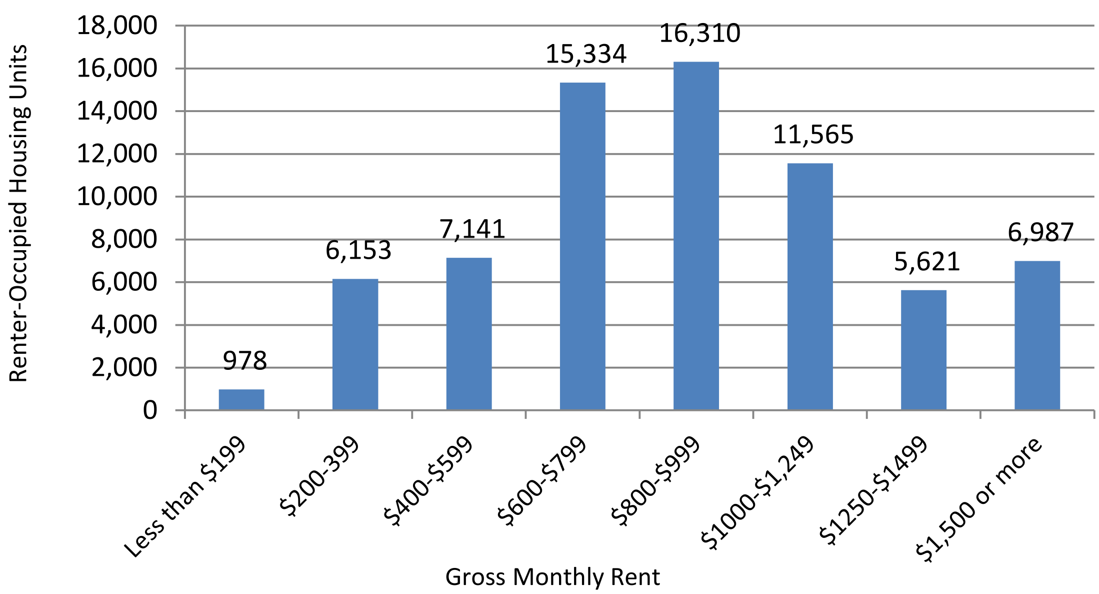
Although renter-occupied units account for more than 29% of all occupied housing units in Vermont, renter-occupied households account for only about 16% of total household income. In 2012, the median household income for renter-occupied households was $30,943 compared to $64,771 for owner-occupied households. Nearly three-quarters of renter-occupied housing units had household income under $50,000.

[2] All US Census Bureau data used in this section of the report is from the 2010-2012 American Community Survey - 3-year estimates.



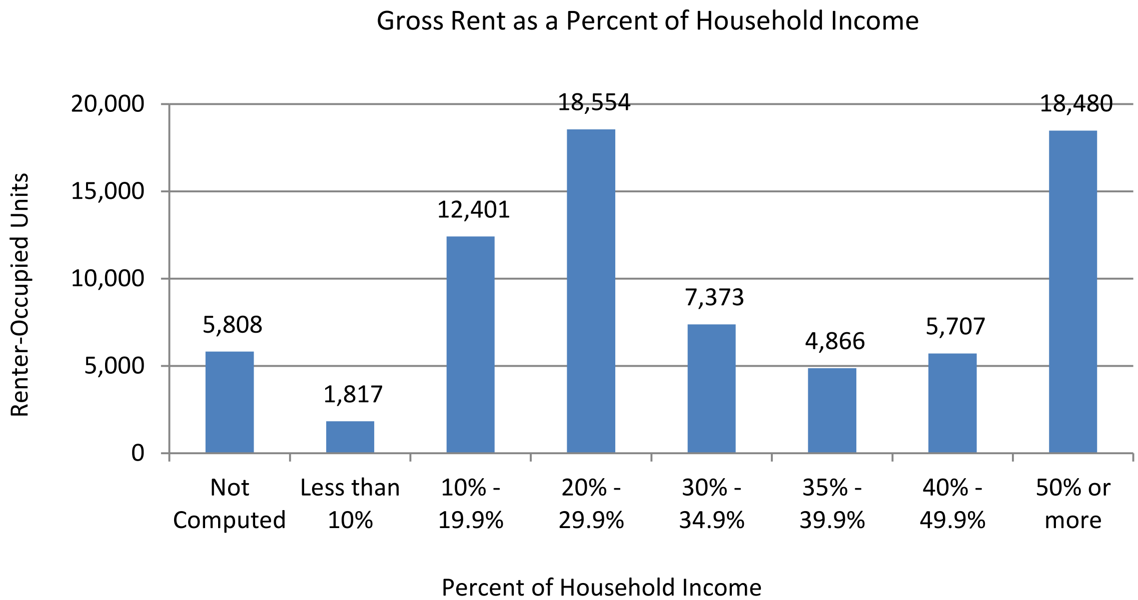
Gross Rent

Contract rent is the monthly rent agreed to or contracted for, regardless of any furnishings, utilities, fees, meals, or services that may be included. Gross rent is contract rent plus the estimated average monthly cost of utilities and fuels. Median gross rent in 2012 was $859 per month. Median rent varies widely across the State from a high of $991 per month in Chittenden County to a low of $629 per month in Essex County.

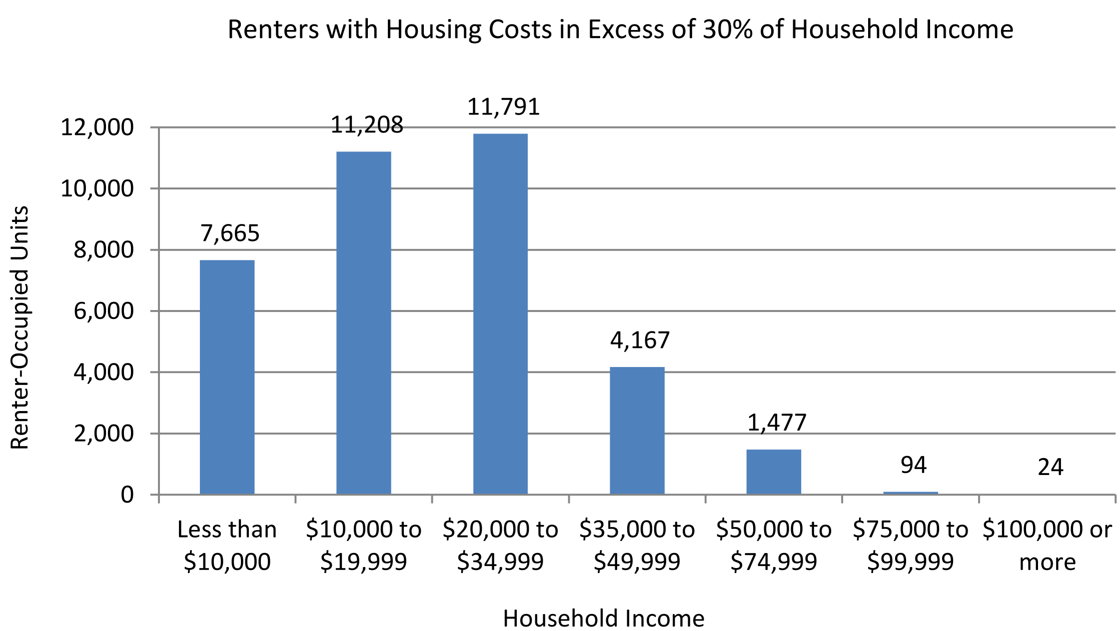


Rental Housing Affordability

The conventional public policy indicator of housing affordability is the percent of household income spent on housing. Housing expenditures that exceed 30% of household income have historically been viewed as an indicator of a housing affordability problem. By this measure, nearly half of renter-occupied households are overburdened and nearly one-quarter of renter-occupied households are severely overburdened.



The problem of unaffordable housing is heavily concentrated among very low-income renters. Over 84% of renter-occupied units, or 30,664 units, with housing costs in excess of 30% of household income have annual household incomes under $35,000. The percentage of renters with housing costs in excess of the 30% threshold varies widely across the state, but nearly one-third of all overburdened renter-occupied households are in located in Chittenden County.



3. Evaluation of Vermont's Renter Rebate Program

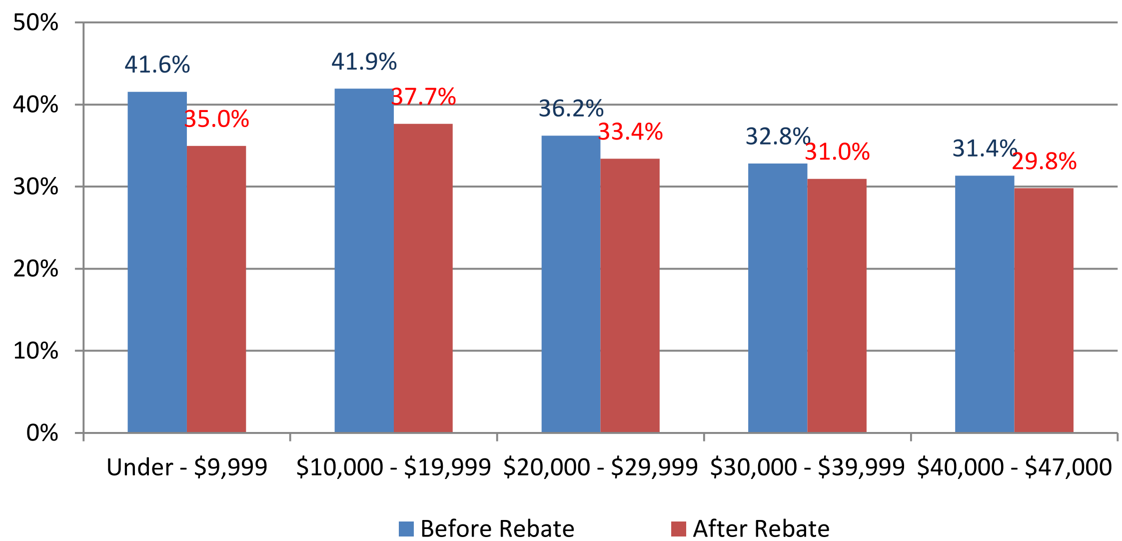
The design of a circuit breaker program involves a number of policy choices. This section provides an evaluation of Vermont's current renter rebate program that relies on a report on property tax circuit breakers published by the Lincoln Institute of Land Policy in 2009.[3]

Adequate Relief

Some states calculate circuit breakers according to a prescribed formula, but may not fully fund their program. In Vermont, the Legislature has generally chosen to fund the full cost of the renter rebate program through the annual State budget. In FY1992 and FY1993, claimants under 65 years of age were paid 90% and 96%, respectively, of the amount prescribed by the renter rebate formula.

The following table compares gross rent as a percent of household income before and after the renter rebate is deducted from gross rent. On average, the rebate reduces gross rent from 36.7% to 33.6% of household income. However, gross rent as a percentage of household income, which excludes the cost of utilities and fuels, remains above 30% for all but the highest income class.

Gross Rent as a Percent of Household Income



Treatment of the Elderly

Most states limit their circuit breaker programs to the elderly, viewing age as a proxy for low income and an indication of financial need. However, the elderly are actually less likely to live in poverty than other taxpayers. Vermont's renter rebate program was initially available to residents 65 years of age or older only; however, the program was expanded to include taxpayers under the age of 65 in 1974. Although the poverty rate is generally higher among non-elderly, some states target relief to the elderly to reduce resistance to property tax

[3] Bowman, John H., Daphne A. Kenyon, Adam Langley, and Bethany P. Paquin. 2009. *Property Tax Circuit Breakers: Fair and Effective Relief for Taxpayers*, Cambridge, MA: Lincoln Institute for Land Policy.

increases. In Vermont, the elderly in Vermont do receive special treatment under an asset test, which is discussed below.

Definition of Household Income

Most states, including Vermont, define household income broadly to include Social Security, private pensions, and public cash assistance. Defining household income too narrowly distorts property tax relief and may result in different relief to households paying identical shares of their income in property taxes. Over time, more types of income have been excluded from the definition of household income in Vermont. Although intended to make the circuit breaker program more equitable, excluding some types of income complicates both compliance and administration of the program.

Net Worth

Although two households may have identical annual household income, they may not be equally well-off if one household has significantly higher net worth. However, reporting net worth would require claimants to list and value their assets and obligations, which may present problems of discovery and valuation. Even if discovery is not a problem, valuation may be problematic since the value of assets may fluctuate significantly.

In 2011, Vermont introduced a proxy for net worth into its definition of household income definition that double-counts interest and dividend income over $10,000 annually. This avoids valuation and discovery issues, but it counts only realized income produced by certain assets. Subsequent legislation applied the asset test to non-elderly taxpayers only, which may result in similarly situated taxpayers paying different amounts in property tax.

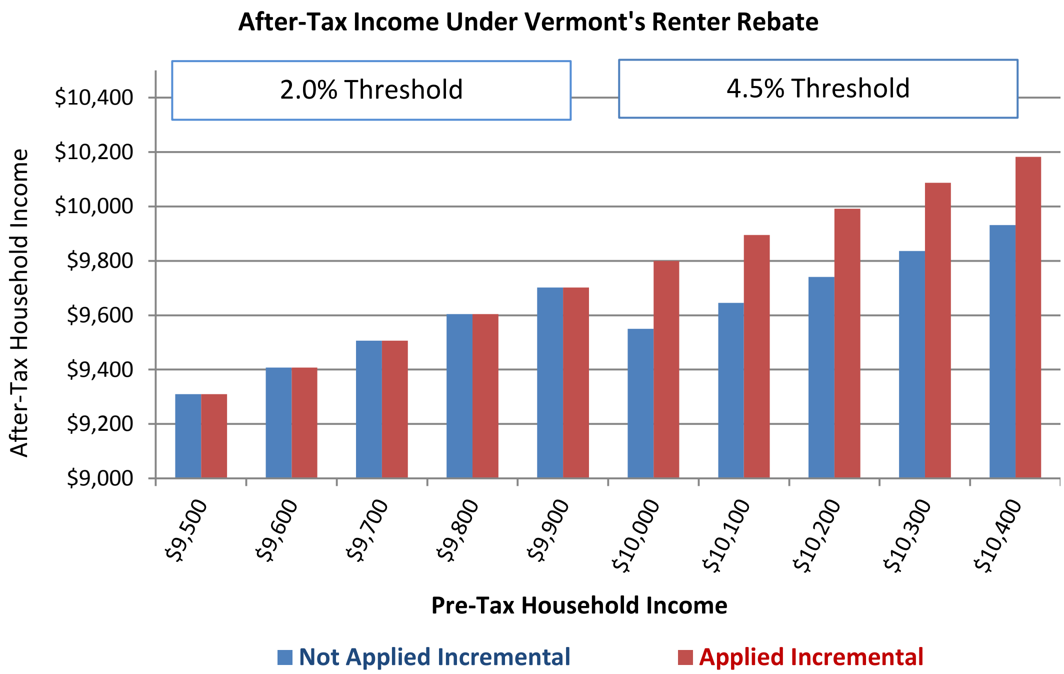
Income Limits

Almost all states with circuit breaker programs incorporate income limits; however, they are not always comparable since states define income differently. The argument in favor of income limits is that they restrict tax relief to renters who most need assistance and may hold down the total cost of the program. However, even without an income limit, relief is targeted toward renters with lower income because rent is generally a smaller percentage of household income at higher income levels. In past years, Vermont's income limit has varied widely, ranging from a low of $25,000 to no limit.

Notch Effects

Income limits and income brackets may create notch effects - a situation in which a small change in income causes a larger change in property tax relief. Income limits produce a notch effect when benefits are entirely eliminated above a limit as opposed to being reduced gradually. Vermont's rebate program currently provides full benefits to renters with household income up to $47,000, but eliminates them entirely above that threshold.

Income brackets may also produce a notch effect when the thresholds are not applied incrementally. The following graph illustrates the notch effect in Vermont's rebate program between the first and second household income tiers. The maximum impact of this notch effect on individual claimants is $250. A much smaller notch effect also exists between the second and third household income tiers.



Benefit Limits

Most states set a maximum benefit between the poverty line and median income; however, some states have much higher limits. A few states have multiple benefit limits where the maximum benefit declines with income. Vermont's maximum benefit is currently the highest nationally, but it has varied widely over the years from a low of $500 to an unlimited amount. Most recently, the benefit limit was reduced from $8,000 to $3,000 beginning in 2012.

The following table shows the total cost of the rebate under current law and with lower benefit limits in 2012. Since the number of claimants in the highest rebate amount classes is small, the savings attributable to a reduction in the maximum benefit is also small. For example, reducing the maximum to $2,000 would affect only 178 claimants and reduce the cost of the rebate by about $192,000.

Rebate Amount Class	Number of Claimants	Total Cost of Rebate		
		$3,000 Cap	$2,000 Cap	$1,000 Cap
Under $999	10,741	$4,521,745	$4,521,745	$4,521,745
$1,000 to $1,499	1,842	$2,227,177	$2,227,177	$1,842,000
$1,500 to $1,999	578	$980,556	$980,556	$578,000
$2,000 to $2,499	204	$448,393	$408,000	$204,000
$2,500 to $2,999	93	$252,527	$186,000	$93,000
$3,000	85	$255,000	$170,000	$85,000
Total	13,543	$8,685,398	$8,493,478	$7,323,745

Adjusting for Inflation

All circuit breaker programs include parameters setting specific dollar amounts. Unless these parameters are increased with inflation, the benefits lose their value over time and fewer taxpayers will qualify for relief. Vermont has made a number of changes to these parameters over the years; however, they have not been systematic. Many states, including Vermont, do not have automatic indexation for their circuit breaker programs. For example, the current household income eligibility limit was last increased to $47,000 in 1995 and the household income brackets were last revised in 2005.

Adverse Incentives

Circuit breakers may lead to higher spending because some taxpayers may vote for additional services knowing that higher taxes will be entirely offset by circuit breaker benefits. Threshold programs, such as Vermont's, that offset 100% of property taxes above a certain threshold level result in a marginal property tax liability of zero. To diminish adverse incentives in threshold programs, the program may include a co-payment requirement. Under a co-payment requirement, taxpayers are required to pay a percent of the property tax above the threshold.

Property Taxes Paid by Renters

Circuit breaker programs that include renters generally assume that the entire property tax on rental units is passed through to tenants in the form of higher rents. This is unlikely since the ability of landlords to shift the tax burden to their tenants largely depends on whether renters are able to move to similar municipalities in the area with lower property tax rates. If renters are able to choose where to rent, landlords may be compelled to pay at least part of the property tax themselves.

In Vermont, the nonresidential property tax that is applied to rental properties is uniform, so the total property tax rate on rental units varies only by the municipal property tax rate, which accounts for about one-third of total property taxes statewide. Consequently, in Vermont it may be possible for landlords to pass on more of the property tax liability to tenants through higher rents than in states where property tax rates vary more widely between municipalities.

Nevertheless, all states assume that the entire property tax on rental units is passed through to tenants. The actual property tax on individual rental housing units is then estimated by specifying a percent of gross rent that is assumed to be property tax. The most common percentage used is 20%, but the range is currently 6% to 35%. In Vermont, the percentage of rent deemed property taxes has varied over the years from a high of 24% to a low of 20%. Prior to 2012, a claimant could use the higher of the actual property tax paid on the rental unit or a fixed percentage of rent, but this option was repealed to make it easier for landlords to comply with the law.

Data on actual rents and property taxes for individual rental properties are not readily available; however, in 2005 the Minnesota Department of Revenue surveyed landlords to collect such information. Their study concluded that the property tax as a percentage of rent averaged 11.7% with over 90% of rental units falling below 15%. Generally, urban renters paid more than suburban renters and those in the nonmetropolitan area. Also, renters in buildings with one to three units paid much higher taxes on average than tenants in larger apartment buildings.

If a circuit breaker program assumes that renters pay more of the property tax on their apartments than they actual pay, a rent subsidy is effectively added to the renter rebate program. While a subsidy may be justified given the rental housing affordability problem in Vermont, a rental subsidy is not an explicit goal of a property tax relief program. Rental housing assistance programs or anti-poverty programs more generally may be better alternatives suited to providing assistance to low-income renters.

Lowering the percentage of rent assumed to be property taxes would significantly reduce the cost of the Vermont's renter rebate program by reducing the number of claimants and the average benefit received by those who still qualify. For example, the following table shows the impact of assuming only 15% of rent is property taxes.

	Allocable Rent at 21%			Allocable Rent at 15%		
Household Income	Cost of Rebate	Number of Claimants	Average Rebate	Cost of Rebate	Number of Claimants	Average Rebate
Under $10,000	$1,326,216	2,523	$526	$830,999	2,463	$337
$10,000-$19,999	$3,025,436	4,657	$650	$1,398,498	3,260	$429
$20,000-$29,999	$2,827,895	4,039	$700	$966,053	2,386	$405
$30,000-$39,999	$1,204,933	1,869	$645	$271,635	648	$419
$40,000-$47,000	$363,586	548	$663	$65,737	149	$441
Total	$8,748,066	13,636	$642	$3,532,923	8,906	$397

4. Administration

<u>Delivery of Property Tax Relief to Renters</u>

Since renters do not receive property tax bills, states use one of two methods to deliver property tax relief to renters: a direct rebate check or a refundable personal income tax credit. Vermont uses a refundable personal income tax credit. Either the taxpayer's personal income tax bill is reduced by the amount of the credit when the annual income tax return is filed or, if the credit results in a negative tax bill, the difference is refunded to the taxpayer.

The advantage of this approach is that a separate tax relief program does not need to be established so administrative and compliance costs are reduced. However, claimants must wait for relief until filing their income tax returns. In most states, renters who would not otherwise be required to file an income tax return are required to do so and they may not perceive the credit as property tax relief since it is so closely linked to the personal income tax. There is also a longer delay in receiving benefits.

Vermont uses both methods to deliver property tax relief to renter-occupied households. About three-quarters of claimants are required to file personal income tax returns and receive their benefit as a refundable personal income tax credit. The remainder of those renter-occupied households eligible for a rebate may file a stand-alone renter rebate claim accompanied by the Landlord’s Certificate and the Household Income Schedule. These claimants receive a direct rebate check.

In a 2013 report to the Legislature, the VDT recommended delinking the renter rebate claim from the personal income tax form to prevent delays in processing income tax returns and refunds to many taxpayers. The report also recommends removing the existing option to apply the renter rebate claim to personal income tax liability. In 2011, only 943 of 13,640 claimants utilized this option. Under this scenario, the renter rebate claim form would stand alone and eligible renters would receive a check directly from the State.

<u>Administrative Costs</u>

The VDT has concerns about the high administrative cost of the renter rebate program. In FY2012, the DVT received between 6,000 and 7,000 telephone calls for 16,390 renter rebate claims. Of those claims, 77% required some form of individualized intervention by VDT. This was either a letter being sent automatically or an examiner reviewing the return and possibly sending a letter or a combination of both. Some of the claimants were sent follow-up letters. A total of 5,618 claims went to a work list for an examiner to review. Common reasons for this are rent that is much higher than the household income reported or the Landlord’s Certificate or Household Income Schedule contains errors or is missing.

The VDT also believes there are excessive administrative burdens placed on claimants in accessing the renter rebate program. Claimants are required to submit three separate forms (Renter Rebate Claim, Household Income Schedule, and Landlord’s Certificate) that rely upon the claimant to collect information from a third party, their landlords, in order to file their claim accurately.

To reduce the administrative and compliance costs that arise with the renter rebate program, the VDT believes it is worthwhile to explore both simplifying the filing process and putting mechanisms in place to focus more succinctly the property tax relief program on low-income renters.

Further, the VDT has recommended electronic administration of the program. This recommendation is a part of the Department’s goal to reduce paper transactions and manual data entry in order to improve taxpayer convenience, increase turnaround speeds, and decrease errors.

The VDT has also suggested that the Legislature set a fixed date for the mailing of renter rebate checks to reduce the number of telephone calls and e-mails the VDT receives during the tax season.

6. Alternative Ways Vermont Assists Low-Income Renters

Rental housing assistance is available to low-income households in one of two models: tenant-based assistance and project-based assistance. Funding for these programs is generally provided by the US Department of Housing and Urban Development. Depending on the program, the funding is directed to state government; nonprofit or private housing developers; public housing authorities, or other housing agencies. Each program has different income and eligibility rules.

Tenant-Based Assistance

Tenant-based assistance is a rental subsidy that is tied to an individual household that moves into any qualifying rental housing unit. The housing may be private housing that may not have been developed with the intention of accepting low-income tenants, but if the quality and the cost of the unit fall within a certain range, it may qualify for tenant-based assistance.

Under the Housing Choice Voucher program, a family or individual may apply for rental assistance that will enable them to afford a privately owned apartment. Eligibility is limited to applicants with incomes below 50% of the area median income. The unit must meet housing quality standards and have reasonable rent by local market standards. Households pay about 30% - but no more than 40% - of their income for rent and utilities. The remainder is paid for by the Public Housing Authority.

In addition to the Housing Choice Voucher program, there are several tenant-based rental assistance programs that are targeted to a specific population such as a family trying to reunite with children, people with disabilities, people who are homeless, and people who are elderly. Specific income eligibility varies by program.

Project-Based Assistance

Project-based assistance assigns a rental subsidy to a specific rental housing unit, and any eligible tenant that moves into that unit will receive assistance to cover that portion of rent that is otherwise unaffordable. Housing with project-based assistance is often developed with the purpose of accepting low-income tenants. Developers of affordable rental housing are able to access a variety of federal, state, and local housing programs to build a project. These include programs for rural development

In addition, a nonrefundable tax credit may be taken for an affordable rental housing project, provided that the project has been authorized by the Vermont Housing Finance Agency. The amount of the credit is based on a taxpayer's eligible cash contribution and the Agency's allocation plan. Total tax credits available to the taxpayer are the amount of the first-year allocation plus the succeeding four years' deemed allocation.

Appendix

Statutory Charge – Sec. 4 of Act 60 of 2013

RENTERS; STUDY

The Joint Fiscal Office shall report to the General Assembly on how the State can provide assistance to renters. The report shall review issues with the current renter rebate program and examine other ways to provide assistance to renters with high rents and low incomes. The report shall be due on or before January 15, 2014 and shall include specific findings and recommendations. The Joint Fiscal Office shall have the assistance of the Department of Taxes and the Office of Legislative Council.