

# Overview of H127

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At a high level, the bill proposes to make the following changes to Vermont's K-12 education finance system:

1. Replace the current *variable* residential education property tax rate with a much lower *fixed* residential property tax rate that would be uniform across the state;
2. Allow residential rental units to be taxed at the lower residential property tax rate, rather than the non-residential tax rate;
3. Implement an education income tax structure that would vary according to local school spending; and
4. Eliminate the income sensitivity, property tax rebate, and renter rebate programs (no longer necessary due to the lower residential property tax rate).

Before I go into detail about this proposal, I would like to take a step back and provide some background for how we arrived at the proposal in H127.

Two fundamental problems with Act 60/68 are the lack of transparency and accountability that stem from the inherent complexity of the system. Very few legislators truly understand how the system works, let alone average citizens voting on school budgets.

Under the current system, there are no less than six different types of voters who are impacted in different ways by the school spending decisions we ask them to make on Town Meeting Day:

1. Voters who own their own home, but are ineligible for income sensitivity assistance - they pay the full residential property tax rate;
2. Voters who own their own home, and are eligible for income sensitivity assistance (i.e. those with household income up to \$90,000) - in a roundabout, convoluted way, they pay a tax that is based on their household income;
3. Voters who own their own home, and are eligible for partial income sensitivity assistance, but are limited by a cap on income sensitivity payment (capped at \$8,000), own more than 2 acres of land, earn more than a certain amount of income through interest and dividends, and/or have a home that is valued over \$500,000 - these folks pay a hybrid property/income tax;
4. Voters who own their own home, but have less than \$47,000 in household income - they are guaranteed to pay no more than 5% of their household income in education taxes, regardless of local school spending decisions;
5. Voters who rent their home - they don't pay property taxes, and although their landlord pays property taxes, those taxes are at the fixed non-residential rate, which does not vary based on local school spending;
6. Voters who live rent-free in another person's home (e.g. parent, child, partner, friend, etc.) - they don't pay property taxes.

This gives you a sense of the challenge that school boards face when posed with the obvious question on Town Meeting Day: "How will this budget affect my bottom line tax bill?"

The problem is that there is never a clear answer to that very straightforward question.

The first objective of H127 is to make the impact of school spending decisions much more transparent, so the voters have a clear understanding of how a proposed school budget will translate into their individual tax obligation.

Currently, about 64% of Vermont homeowners participate in the income sensitivity program; in a roundabout way, they are effectively paying an income tax based on their local school spending. However, this is far from evident to the average taxpayer - it involves a tax credit applied to a property tax bill based on the prior year's income and property tax liability.

So, if 64% of homeowners are already paying based on income, why not short-circuit this convoluted system and have everyone pay an education income tax with a system that is much more transparent?

This is what H127 proposes to do.

Under H127, there would be an income tax structure that would vary based on local spending decisions. Every income-earning Vermont resident would be subject to the tax, regardless of whether or not they own property: local spending decisions would drive income tax rates up or down for local residents, proportionately to per-pupil spending in that community.

When posed with the question of "how will this budget affect my bottom line tax bill", a school board would have one answer that would apply to all voters: "these are the income tax rates that you will all pay..." No more prebates, rebates, exceptions, and other machinations to complicate the picture.

The second objective of H127 is to provide greater accountability for local spending decisions. One of the problems with the current system is that we have folks voting for school budgets who don't have to pay for those decisions. That just isn't fair. With H127, virtually everyone eligible to vote on school budgets would pay into the system. Everyone would have skin in the game.

Education funding is a rather dense subject; the complexity of the current system makes it challenging to compare and contrast alternatives - even those (such as this one) that would simplify the system. I hope that my outline of the proposed legislation makes sense, but I would invite you to ask questions. I would also ask you to share your comments and criticisms. No proposal is perfect, but unless people are willing to put ideas on the table and invite feedback, we will never have the opportunity to move forward.

In the meantime, here answers to some of the questions you might have about H127:

**Wasn't there a proposal a few years ago to pay for education with an income tax?**

Yes, there was, but that bill called for a uniform, fixed education income tax, with a property tax that would still vary based on local school spending. The challenge with that approach is that we would still have voters making budget decisions that would only impact property owners. H127 proposes the reverse - an income tax for education that would vary according to local spending, coupled with a lower fixed residential property tax rate for education.

### **Why put forward a proposal; why not commission a study first?**

Since the passage of Act 60, there have literally been dozens of studies on education and education funding in Vermont. Studies are a useful way to examine complex issues that are not well understood, but there comes a point when they just become a political tool to delay action and avoid taking a stand. In the case of education finance, we have studied the issue to death: we know what the problems are, and have examined many alternatives over the years. We don't need any more studies. The time has come for real proposals.

### **What would the tax rates be under this proposal?**

Actually tax rates would be set in separate legislative action. Because this proposal includes a fixed residential property tax rate and three marginal education income tax rates, there are many different combinations that could be used. The goal would be to develop a combination that would allow for a transition from the current system in a way that does not disproportionately impact different taxpayers. This modeling is underway, and hypothetical scenarios will be available at a later date.

### **Would education income taxes collected from local residents be retained by the local school district?**

No. Although the rates applied to residents in each town would vary according to local school spending, this would be a state tax that would be collected by the state and remitted to the state education fund. Communities with different average income levels would have equal ability to raise money for their schools. For example, a poor community with per pupil spending of \$12,000 would have the same tax rates as a wealthy community with per pupil spending of \$12,000.

### **How would this affect the non-residential property tax?**

Under this proposal, there would be no change to the non-residential property tax (which applies to business property, open land, second homes, hunting camps, etc.). Those properties would continue to be taxed at the same rate they are today. It is important to note that this rate is fixed, and is insulated from local spending decisions.

### **Why not just eliminate the residential property tax rate altogether? Can't we just move entirely over to an income tax?**

One of the advantages of the property tax is the relative stability of the tax base. While property values have declined in Vermont, the impact on revenues has been relatively minor, compared to the erosion of income tax revenues. Income is inherently more volatile, so shifting all of our education revenues to an income tax would lead to wild shifts in tax rates and/or drastic variations in school spending. By retaining the non-residential property tax and using a low fixed residential property tax, we would preserve the relative stability of our revenue mix.

**Wouldn't this be a new tax for renters and others who don't pay the education property tax?**

Because the non-residential property tax is applied to rental units and paid by landlords, it is a cost of business that influences rents, so renters contribute to the property tax in an indirect way. H127 proposes to tax residential rental units at the new, lower, fixed residential rate, with the expectation that the savings would reduce the market cost of rentals, pressuring rents downward. We may need to look at some interim mechanisms to ensure that tax reductions were passed along to renters.

Technically, anyone living rent-free in a household should be reported as part of the household income for purposes of determining income sensitivity payments under the current funding system. We know from tax preparers that this often does not happen, and as a consequence, many people are not paying their fair share under the current system. Since everyone would pay the income tax under H127, and the need for calculating property tax income sensitivity payments would go away, this would no longer be an issue.