INTERACTIVE TAX REFORM: Proposals to Address Imbalance, Inefficiency, and Inequity in the Property Tax & the Income Tax.

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GOALS:

To achieve a better balance of rights and responsibilities within the Education Fund and the General Fund in terms of the tax revenue raised and how it is spent. The intended result would be to have simpler, more efficient, and more equitable tax codes raising revenue that is spent in a fully transparent and accountable way.

PROPOSALS:

***** Take the Current Use property tax subsidy and the Income Sensitivity property tax subsidy out of the Education Fund and finance them in the General Fund. These are state policy programs that are not education and should not be financed using state education property tax revenues. Together they cost around $180 million. (Note: I am using approximate numbers from recent years – they would have to be updated for further development of the proposal.) Their financing in the EF forces property tax rates up, which then makes the subsidies in these programs cost more.**

***** Lower the base property tax rates by 18 cents since costs within the EF are down by $180. This could be done equally across the homestead and nonresident rates or asymmetrically by reducing the homestead rate more than the nonresident rate. These lower property tax rates will mean that the Current Use program and the Income Sensitivity Program will now cost much less in the GF since the tax payments that are to be subsidized are so much lower and some participants may no longer be eligible for as much assistance.**

***** Set a limit on the allowed increase in education spending either by altering the excess spending threshold system to increase the penalty for an increase over a base amount, by mandating that school budgets cannot grow by more than some amount – perhaps 1.5% or 2% -- for the next three years, at which time the situation would be re-evaluated, or by some other mechanism. The reduction in education property tax rates cannot be used as an opportunity to increase spending and increase property tax rates again, or for districts to continue to export their increases to other towns whose spending has not increased. Districts would have to make difficult decisions about staffing and compensation within the limits. The tuition rates charged to towns by private or independent schools could also only grow by 1.5%. There could be exceptions to the growth rate limit in extraordinary circumstances, for instance if a choice district has a significant increase in the number of tuitioned students.**

***** Change the Vermont Income Tax Code so that we apply tax rates to Adjusted Gross Income rather than Taxable Income. Lower all tax rates by one, two, or three percentage rates each bracket in a way that preserves progressivity with most of the extra revenue that would be available. Take some of the extra revenue and use it to finance the Current Use and the Income Sensitivity Programs, along with the Earned Income Tax Credit, which would be one special provision that should be preserved. Those funds can be combined with existing GF spending on CU and IS to cover their new lower costs.**

[This can be done because switching from TI to AGI eliminates all special state and federal tax provisions that are used to reduce tax payments through credits, deductions, and exemptions. Such provisions often

benefit higher income Vermonters disproportionately, it is difficult to control their costs in lost tax revenue, they may not actually achieve the intended policy goal effectively, and they can cause violations of the principles of horizontal and vertical equity. People with similar levels of income can end up paying very different amounts of taxes and people with higher incomes can end up with less tax liability than those at lower levels. There would be about $300 million from the tax reform dividend of eliminating the special provisions – about $200 million could go to reducing the tax rates and $100 million would go to financing the CU & IS programs and the EITC.]

RESULTS?

The intended results of these proposals are as follows:

***** Lower property tax rates & lower income tax rates with progressivity, equity, simplicity, and effectiveness.**

***** Individuals cannot use special tax provisions to reduce their income tax liability disproportionately but must pay a reasonable share.**

***** The state is taking responsibility for its own policy goals rather than putting them in the Education Fund and on the education property tax and those goals can be achieved at less cost.**

***** The school districts must take responsibility for moderating the increases in education spending because the increase is capped and they cannot shift costs onto the rest of the state.**

***** The volatility of state General Fund revenues MIGHT be lessened since revenue flows would no longer be affected by variations in the size and number of deductions, credits, and exemptions used by taxpayers from year to year & by interactions between property & income tax systems.**

WARNINGS: 1) I have not checked whether the limit on increases in school budgets is consistent with the Brigham decision, but I expect it could be designed in an acceptable way, and 2) many of the special tax deductions, credits, and exemptions are extremely popular, and it may be a hard case politically to argue that the reductions in both income and property tax rates can compensate for their loss, (high income taxpayers who took tens of thousands of dollars in such reductions in taxable income or taxes owed might end up paying more income taxes but their property tax rates would have come down to offset that) & 3) timing these tax changes might be hard to manage in the transition.