Tax Renewal Bill Brief for H.538 1/10/18 **House Ways & Means Committee**
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There are three key ways in which the Vermont tax code does not work as well as it might for Vermonters. It is complex, it is inequitable, and it is ineffective in achieving some policy goals

(1.) The tax code is quite complex, especially the property tax adjustment assistance process (income sensitivity), and this can make it hard for taxpayers to fulfill their obligations properly; it can also make it hard for citizens to have confidence that all are paying their fair share.

(2.) The tax code violates the principles of horizontal and vertical equity in several ways, because people in similar situations can pay different amounts of taxes and people with more resources do not necessarily pay more in taxes than those with less. This problem arises because the use of itemized deductions can reduce tax liability below the level of the standard deduction for taxpayers with the same level of income, and the functioning of the property tax adjustment system with different permutations of payment based on income and/or property value and the lack of incorporation of consideration of the value of other assets, can mean that people in similar situations pay different amounts of taxes and people with more resources may not pay more in taxes than those with less.

(3.) One policy goal of the tax system is to support access to housing through homeownership, yet a substantial portion of the resources used for income tax deductions and property tax assistance go to taxpayers who clearly have the ability to afford housing. The mortgage interest deduction is widely considered an upside down subsidy because it disproportionately benefits those who can afford housing, and can even be used to on second homes. Since we suffer from an ongoing shortage of affordable housing for renters and first time homeowners, it seems inefficient to allocate scarce housing funds in such a way. The current property tax adjustment income sensitivity program can result in assistance for people with valuable property, and also for substantial monetary wealth, if there income meets the criteria.

[Note: this proposal was prepared before the passage of the recent federal tax legislation, which would complicate or alter some of this, but the basic patterns and possibilities remain.]

PROPOSAL:

The aim of this proposal is to renew the tax code for the income tax and the property tax in a way that is simpler, more transparent, more equitable, and more effective in achieving certain policy goals. This is done by:

(1) broadening the income tax base by using as the tax base Adjusted Gross Income instead of Taxable Income – this means removing most pass through Federal deductions -- and by including the value of employer paid health insurance premiums in the tax base; together these will result in a "tax renewal dividend" to be used mostly to lower tax obligations with tax credits;
(2) removing the costs of the income sensitivity and current use programs from the Education Fund, which will mean that property tax rates can be reduced <u>significantly</u>; these programs are not education and should not be funded on the education property tax;
(3) using almost all of the "tax renewal dividend" from broadening the tax base to fund a standard tax credit for ALL Vermont filers, which will be supplemented at the lower income levels by an additional refundable housing credit to replace Income Sensitivity property tax assistance and the renters rebate, and using a small part of it to fund the Current Use program in the General Fund;

(4) to prevent a surge in property tax rates after the reduction in the base rates some kind of cap on the rate of growth would be imposed on either per pupil spending or total spending or both, and/or the total cost of teacher and staff compensation. This could be done in a way that is linked to the growth rate of Vermont gross domestic product or some other appropriate measure. Alternatively, a mechanism using base spending payments and greater local responsibility for increases in spending above a certain per pupil level could be used.

[Note: this proposal addresses the pass-through Federal income tax deductions only, along with the question of including employer paid health insurance premiums in income; it does not alter Vermont specific income tax exemptions, deductions, or credits.]

BENEFICIAL RESULTS:

The results of this approach are illustrated in examples below, and although due to limitations of skill, time, and access to updated and sorted numbers there is a lot of estimation and extrapolation, the basic pattern is clear. It looks as if it would be possible to do the maneuvers described above. The results show that it may be possible to:

(1) Base property tax rates come down significantly, all taxpayers get the same standard credit, and then housing support credits are awarded based on income up to a certain level, and those credits would also go to renters;
(2) Ensure that people in similar situations in terms of income or property value will pay similar amounts in taxes (allowing for variations in local school tax rates) – this improves horizontal and vertical equity;
(3) Award assistance with housing based on income alone rather than also according to home value or having a mortgage – in this way support for housing is targeted on lower and middle income Vermonters rather than also supporting higher income taxpayers through the availability of the mortgage interest deduction and the real estate property tax deduction along with the upper reaches of Income Sensitivity;
(4) Re-connects school budget votes to property tax rates again, because since housing assistance is through an income tax credit so that the expected rate for school budgets will be paid by all;
(5) Tax obligations will shift around in this approach: anyone with relatively high income who used a lot of itemized deductions will likely pay more in income taxes, but if they own a homestead or nonresident property they will pay less in property taxes – there is no intent to make those changes even out;
(6) By removing Current Use and Income Sensitivity from the Education Fund this shifts some of the costs into the General Fund and onto the Income Tax system respectively, and this in effect means that part of the burden that had been on the property tax has been shifted onto the income tax, which has long been a policy goal of some.

***** RESULTS OF ILLUSTRATIVE NUMERICAL EXAMPLES *** (see longer paper for analysis)**

Using a number of sources I have developed a numerical analysis to endeavor to illustrate what might be possible in this general approach. Since I did this myself, it involved a good deal of interpretation and sometimes extrapolation, so the exact numbers should be taken with a large grain of salt. If this approach is of interest, a more professional analysis must be done. However, the examples I have developed to illustrate the basic approach below lead to the following conclusions:

***Total Education Fund costs are reduced by $225 million because of the removal of Current Use, Income Sensitivity, and Renter Rebate costs.**
***Base Homestead Education Property tax rates will be reduced by 34 cents.**
***Base Non Resident Education Property tax rates will be reduced by 5 cents.**
***Total Property Taxes are reduced by $225 million.**

***The Net Increase in Total Income Taxes is $25 million through broadening the tax base by eliminating the Federal itemized and standard deduction and ending the exemption for the value of employer provided benefits.**
***The Net increase in Total General Fund spending is $25 million to partially fund Current Use in GF.**
***The broadening of the income tax base in this way will generate $300 million in additional revenue, which will be used to partially fund Current Use with $25 million, and then $275 million is used to fund a standard tax credit and a housing tax credit to replace the Income Sensitivity.**
***A standard tax credit will go to all Vermont filers – this would vary from $300 to $600 for different filing statuses (i.e. single or married filing jointly, etc.).**
***A housing credit will go to low and middle income Vermont filers to replace the Income Sensitivity property tax assistance and renter rebate programs – given the decrease in Homestead property tax rate the size of this subsidy can be smaller, and its size is based on income not property value as well. This additional housing tax credit would vary from $275 to $630 depending on filing status and income levels and it would go to renters as well as homeowners.**
*** The standard and housing credits will be funded with the $275 million of the additional funding from the broadening of the tax base.**
*** Some kind of circuit breaker program to support very low income Vermonters with housing may still be advisable, otherwise people with low income but high property values will pay more.**
***The overall tax burden will be shifted from the Property Tax to the Income Tax.**
***The overall tax burden will be shifted towards higher income filers who lost itemized deductions and exemption of employer provided benefits, but the reduction in property taxes will mitigate this for many high earners who also own Vermont property.**
***Since Education Fund costs and property taxes both decline by $225 million, and General Fund spending and income taxes both rise by $25 million, THE NET CHANGE OF BOTH TAXES AND SPENDING IS A DECREASE OF $200 MILLION.**