

# INTRODUCTION TO VERMONT'S EDUCATION FINANCE SYSTEM

JANUARY 2019

MARK PERRAULT AND CHLOE WEXLER  
LEGISLATIVE JOINT FISCAL OFFICE

# TAKEAWAYS

1. Vermont has a unique education finance system – a statewide funding formula coupled with local property tax administration.
2. School boards set budgets and submit them to voters for their approval, maintaining local control over education spending.
3. The Legislature sets education property tax rates annually at the level necessary to fund voter-approved school budgets.
4. To comply with the *Brigham* decision, the homestead property tax rate is a function of district per-pupil spending rather than property wealth.
5. The tax bills of homeowners who are eligible for a property tax adjustment also vary in proportion to per-pupil spending.
6. Since the enactment of Act 68, the nonresidential tax rate has been uniform statewide – the tax rate is not directly related to per-pupil spending.

# WHY WAS ACT 60 NECESSARY?

1. Prior to the Brigham decision, Vermont relied on a foundation program\* to fund its education system.
2. Fluctuations in the state's fiscal status led the Legislature to underfund the foundation formula to reduce state costs.\*\*
3. Property wealthy districts benefitted from low tax rates and high per-pupil spending while property poor districts faced high tax rates and low per-pupil spending.
4. This combination of reduced state share and property tax rate inequities across towns led to the *Brigham* decision; the Legislature responded with the passage of Act 60 in 1997.
5. Under Act 60, towns with the same per-pupil spending have the same homestead tax rate regardless of their property wealth.
6. Now if the Legislature reduces state funds for education all school districts, regardless of their property wealth, are adversely affected.

*\* A foundation formula relies on a base level of revenue for each school district. To ensure that all districts have equal access to this level of resources, a fixed property tax rate is established, and state aid is provided to districts unable to raise the full foundation amount on their own.*

*\*\* The state's share of education expenditures ranged from 20% to 37% and was falling in the period immediately preceding the Brigham ruling.*

# RESPONSIBILITIES BY LEVEL OF GOVERNMENT

- State Agencies\* and the Legislature
  - ❑ Set education tax rates
  - ❑ Calculate property tax adjustments
  - ❑ Estimate the fair market value of real property
- School Boards and Towns
  - ❑ Administer the education property tax
  - ❑ Prepare school district budgets
- Voters and Taxpayers
  - ❑ Approve school district budgets
  - ❑ Pay education taxes

*\* The Agency of Education and the State Board of Education; the Agency of Administration: Department of Taxes, Division of Property Valuation & Review, and the Department of Finance & Management.*

# EDUCATION FINANCE TIMELINE

1. On or before December 1st, the Tax Commissioner recommends education tax rates for the next fiscal year.\*
2. School boards develop budgets and submit them to voters for their approval in March at town meeting or by Australian Ballot.
3. The Legislature sets base education tax rates at the level necessary to fund voter-approved school budgets before adjournment.
4. The Tax Department sets spending-adjusted homestead tax rate for each town on or before June 30<sup>th</sup>.
5. Towns send tax bills to property owners on local schedules (typically in the late summer and early fall).
6. School districts receive three equal education payments on September 10th, December 10th, and April 30th.

*\* This is largely a ministerial task because of statutory constraints on the Commissioner's recommendation; however, the recommendation is based on a consensus Education Fund Outlook and provides timely guidance for school board budget deliberations.*

# HOW IS THE AMOUNT TO RAISE ON THE EDUCATION PROPERTY TAX DETERMINED?

- The amount to be raised statewide on the education property tax is determined by subtracting available non-property tax revenues from total uses:

Total Education Fund appropriations and transfers

- Recurring non-property tax revenue

- Reversions\*

-/+ Prior-year surplus or deficit

Amount to be raised on the education property tax

- Reversions and prior-year surpluses are nonrecurring revenue sources. The use of nonrecurring revenues for this purpose can contribute to year-to-year fluctuations in education tax rates.

*\* A reversion is the return of the unused portion of a prior-year appropriation to the fund from which the appropriation was made. Reversions are included in the annual Budget Adjustment Bill.*

# HOW IS THE EDUCATION TAX ALLOCATED AMONG PROPERTY CLASSES?

Subject to the following constraints,\* education tax rates are *initially* set so that the Education Fund is in balance:

- The stabilization reserve is funded at 5% of prior-year net appropriations.
- The percent change in the *average* tax bill on nonresidential and homestead taxpayers is the same.
- This allocation of the tax burden takes into account the rate of growth of the respective tax bases.
- Many individual taxpayers belong to more than one class.

*\* The Legislature is not bound by these constraints. The education tax rates recommended by the Tax Commissioner are the starting point for annual deliberations.*

# PROPERTY TAX BASES SUBJECT TO THE STATEWIDE EDUCATION TAX

## Nonresidential Property

- All taxable real property that does not qualify as a “homestead” – for example, commercial & industrial property, rental housing, second homes, open land etc.
- The nonresidential property tax rate is uniform across towns.

## Homesteads

- A resident’s home and all contiguous land.
- The homestead property tax rate in each town varies directly in proportion to per-pupil education spending.

# HOW ARE HOMESTEAD PROPERTY TAX RATES ADJUSTED TO ACCOUNT FOR PER-PUPIL SPENDING?

- By statute, the base homestead tax rate is \$1.00 for homestead property.
- The base tax rate effectively creates a floor on per-pupil education spending.
- After voters approve the school budget, the base homestead property tax rate is adjusted by per-pupil education spending.
- Spending-adjusted tax rate =  $\$1.00 \times \frac{\text{per-pupil spending}}{\text{property yield}}$
- If a town belongs to more than one school district, the homestead tax rate is weighted by enrollment in each district.

## WHAT IS THE “PROPERTY YIELD”?

- The property yield can be thought of as the per-pupil amount of spending that the fund can support with a uniform homestead tax rate of \$1.00 on homestead value.
- In FY2019, the property yield was \$10,220 per pupil.
- The homestead property tax rate in any district spending more than the yield is increased proportionally.
- For example, in any district spending \$15,330 per pupil, or 150% of the yield, the homestead property tax rate is \$1.50.\*

*\* Per-pupil spending / yield x \$1.00 = spending-adjusted homestead tax rate  
\$1.00 x ( \$15,330 / \$10,220 ) = \$1.50*

# IS THE HOMESTEAD TAX AN INCOME TAX OR A PROPERTY TAX?

Vermont's education system may be viewed as an income tax system; in this presentation, it is described as a property tax system with adjustments for income.\*

- The homestead tax is property tax with an adjustment based on income:
  - ❑ Adjustment is applied to tax bills in the following tax year.
  - ❑ Adjustment is limited to the first \$400,000 of housesite value and capped at \$5,600 (\$8,000 with homeowner rebate).
  - ❑ Adjustment is limited to taxpayers with income under \$90,000
  - ❑ Renters do not pay a tax based on their income.
- The homestead tax is an income tax:
  - ❑ Adjustment is simply a means used to arrive at a tax bill based on income within a system that uses local billing and collection of the homestead property tax.
  - ❑ Most resident homeowners ultimately pay on the basis of their income.
  - ❑ The difference between homestead and housesite is not significant for most taxpayers.

“[M]any Vermont policy makers . . . view the State’s funding system . . . as an income tax based system . . . . However, documents and legislation describing the system describe it more in terms of a property tax based system with adjustments for income.” Picus & Associates, 2012.

# HOW IS THE TAX RATE ON HOUSEHOLD INCOME ADJUSTED TO ACCOUNT FOR PER-PUPIL SPENDING?

- By statute, the base tax rate on household income is 2%.
- The base tax rate effectively creates a floor on per-pupil education spending.
- After voters approve the school budget, the base tax rate on household income is adjusted by per-pupil education spending.
- Spending-adjusted tax rate on income =  $2\% \times \frac{\text{per-pupil spending}}{\text{income yield}}$
- If a town belongs to more than one school district, the homestead tax rate is weighted by enrollment in each district.

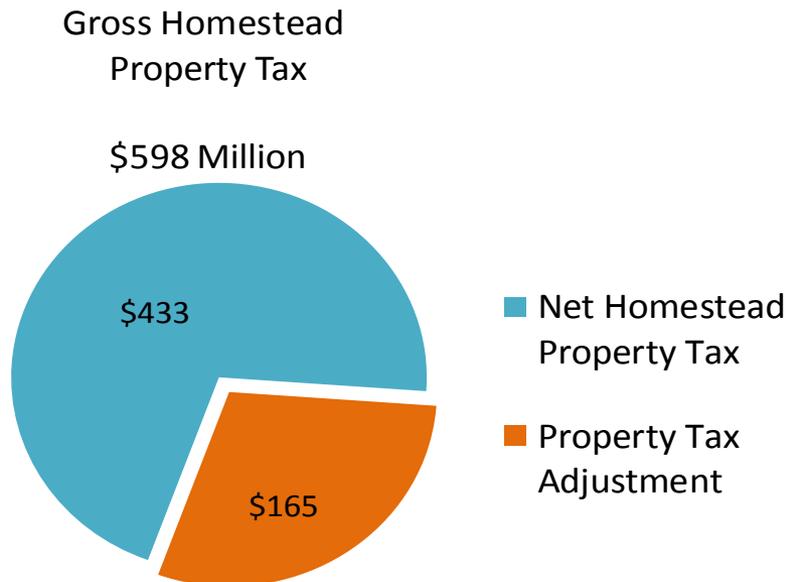
## WHAT IS THE “INCOME YIELD”?

- The income yield can be thought of as the per-pupil amount of spending that the fund can support with a uniform tax rate on income.
- In FY2019, the income yield was \$12,380 per pupil.
- The tax rate on income in any district spending more than the yield is increased proportionally.
- For example, in a school district spending \$18,570 per pupil, or 150% of the yield, the tax rate on income is 3.0%.\*
- Whether a resident homeowner pays the education tax on homestead value or income, the homestead tax rate increases in proportion to per-pupil spending.

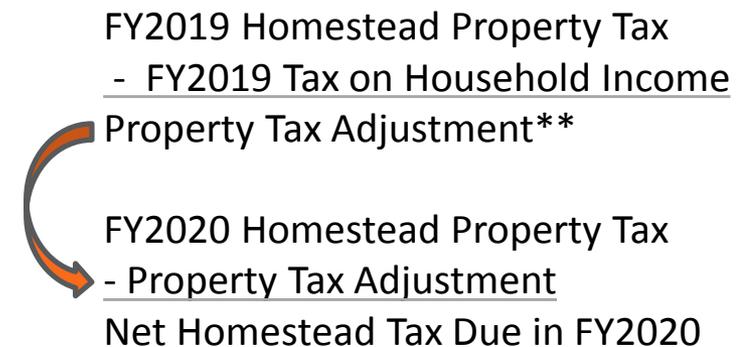
*\* Per-pupil spending / yield x 2% = tax rate on household income  
2% x ( \$18,570 / \$12,380 ) = 3.0%*

# PROPERTY TAX ADJUSTMENT

- About 70% of resident homeowners are eligible for an income-based adjustment to their homestead property tax.\*
- The property tax adjustment includes income sensitivity and may also include the homeowner rebate, which is covered in the next slide.



Adjustments are applied to property tax bills in the *following* tax year:



\* Vermont's education finance system may be viewed as an income tax system; here the system is described as a property tax system with adjustments for income.

\*\* The property tax adjustment: (1) applies only to the "housesite", a residence and up to two acres of contiguous land; (2) is limited to the first \$400,000 of housesite value; and (3) is capped at \$5,600 per claimant.

# HOMEOWNER REBATE\*

- Resident homeowners with income under \$47,000 are entitled to additional tax relief if their net education tax exceeds a fixed percentage of household income.
- About 30% of homesteads eligible for income sensitivity are also eligible for a homeowner rebate.
- The cost of the municipal homeowner rebate is borne by the General Fund.
- The rebate existed prior to the passage of Act 60.

## Net Education Tax

<u>Household Income Class</u>	<u>Tax Cap as % of Income</u>
Under \$9,999	0.5%
\$10,000 - \$24,999	1.5%
\$25,000 - \$47,000	2.0%

## Municipal Property Tax

<u>Household Income Class</u>	<u>Tax Cap as % of Income</u>
Under \$9,999	1.0%
\$10,000 - \$47,000	3.0%

*\* Beginning in FY2020, the homeowner rebate was split into its education and municipal property tax components. The maximum municipal property tax adjustment is \$2,400 per housesite. The maximum education tax adjustment remains at \$5,600 for both the property tax adjustment and homeowner rebate.*

# WHAT IS HOUSEHOLD INCOME?

- Household income is broadly defined to include the income of everyone who resided in a homestead at any time during the tax year, including children and unrelated individuals.
- Both taxable and nontaxable income are included in household income such as:
  - Social Security
  - Veterans' benefits
  - Some nontaxable pensions
  - Support money
- Since the enactment of Act 60 in 1997, the Legislature has made numerous modifications to the definition of household income - including an asset adjustment.
- These modifications were intended to make the definition of household income more equitable, but they have also made administration and compliance more complicated.

# HOMESTEAD EDUCATION TAXES BY HOUSEHOLD INCOME OF TAXPAYER

Household Income*	Homestead Tax	Notes
Under \$47,000	Pay a fixed percentage of household income for the net homestead tax and the municipal property tax	Beginning in FY2020, the homeowner rebate will be separated into its education and municipal components
\$47,001 to \$90,000	Pay the tax based on household income	Limited to housesite value up to \$400,000; pay education property tax on “excess” value
\$90,001 to \$136,277	Pay the tax based on household income plus the education property tax based on homestead value over \$225,000	This provision, often referred to as the “slope” provides a declining adjustment that begins at \$90,001 and ends at \$136,277**
Over \$136,277	Pay the education property tax	

*\*Household Income includes all income, taxable and nontaxable, of everyone who resided with you at any time during the tax year, including children and unrelated individuals.*

*\*\* This household income limit varies from year to year based on the relationship between the property and income yields and the \$225,000 housesite value limit.*

# THE EDUCATION FUND OUTLOOK

The Education Fund Outlook is a statement\* of sources and uses that allows legislators to:

- Determine the amount of revenue that must be raised through education taxes
- Set education tax rates
- Evaluate education finance policy changes

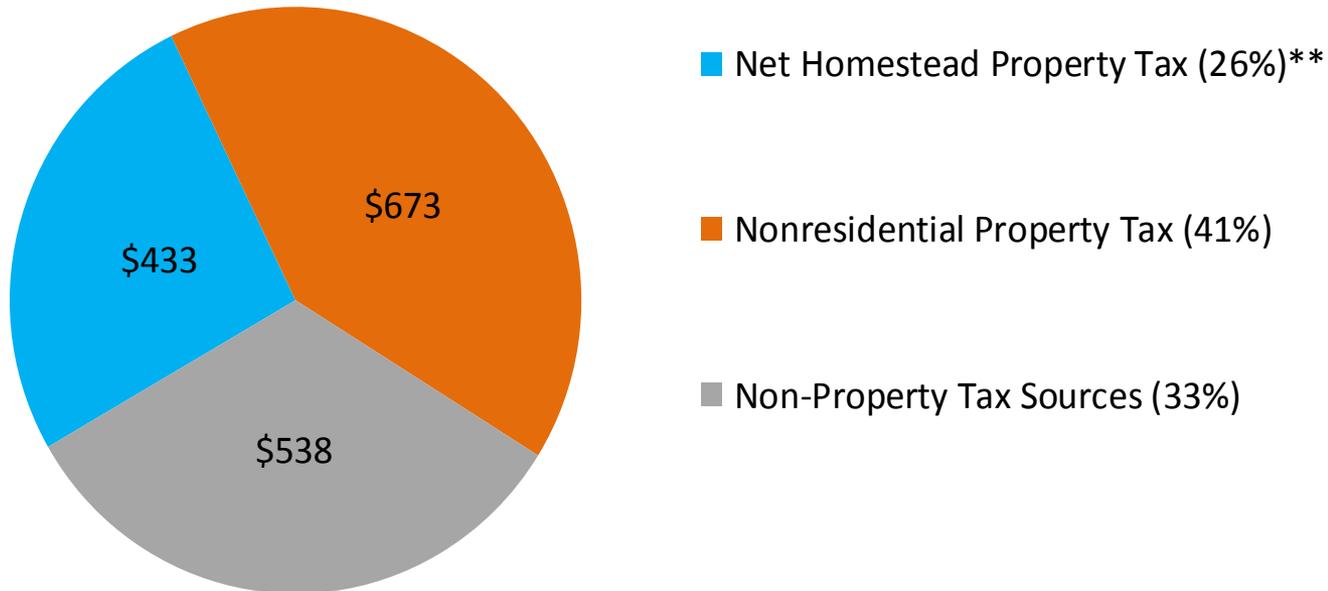
	FY2018 Actual	FY2019 Anticipated BAA	FY2020 Projections
a Average Homestead Property Tax Rate	\$1,500	\$1,499	\$1,507
b Average Tax Rate on Household Income	2.55%	2.48%	2.46%
c Uniform Non-Homestead Property Tax Rate	\$1,535	\$1,580	\$1,588
d Property Yield Per Equalized Pupil	\$10,160	\$10,220	\$10,604
e Income Yield Per Equalized Pupil	\$11,990	\$12,380	\$13,022
f Total Equalized Pupil Count	87,745	88,359	87,621
g Statewide Education Grand List Growth Rate	1.40%	1.40%	2.26%
h Statewide Education Spending Growth Rate	3.40%	1.70%	3.55%
<b>Sources</b>			
1a Homestead Education Tax	586.7	597.8	614.8
1b Property Tax Adjustment	(172.2)	(165.3)	(168.0)
2 Non-Homestead Education Tax	644.4	672.8	691.0
3 Sales & Use Tax	139.2	415.1	429.5
4 Purchase & Use Tax	36.5	38.0	38.5
5 Meals & Rooms Tax - 25%		45.4	46.9
6 Base General Fund Transfer	314.7		
6a Additional GF Transfer - 2017 Act 85	3.3		
6b Additional GF Transfers - 2018 Act 11*	30.2		
7 Lottery Transfer	27.1	28.2	28.5
8 Medicaid Transfer	10.2	9.6	9.2
9 Other Sources (Wind & Solar Taxes, Fund Interest)	2.7	2.7	2.7
10 <b>Total Sources</b>	<b>1,622.9</b>	<b>1,644.3</b>	<b>1,693.1</b>
<b>Appropriations</b>			
11 Education Payment	1,352.2	1,372.9	1,421.7
12 Special Education Aid	188.7	198.5	213.0
13 State-Placed Students	14.7	15.7	16.5
14 Transportation Aid	18.7	19.2	19.8
15 Technical Education Aid	13.6	13.9	14.2
16 Small School Support	7.6	7.6	8.2
17 Essential Early Education Aid	6.4	6.6	6.8
18 Flexible Pathways	7.2	7.3	7.7
19 Teachers' Pensions (Normal Cost Only)	7.9	7.7	7.1
20 Other Uses (Accounting & Auditing, Other)	1.4	1.0	1.1
21 Adult Education & Literacy	2.7		
22 Community HS of Vermont	3.2		
23 Renter Rebate	7.7		
24 Reappraisal & Listing	3.5		
25 <b>Total Uses</b>	<b>1,635.4</b>	<b>1,650.5</b>	<b>1,716.0</b>
<b>Allocation of Revenue Surplus/(Deficit)</b>			
26 Revenue Surplus/(Deficit)	(12.6)	(6.2)	(23.0)
27 Prior-Year Reversions (adjusted)	(8.5)	(10.9)	
28 Transfer to/(from) Stabilization Reserve	1.2	2.4	0.50
29 Transfer to/(from) Unreserved/Unallocated	(5.2)	2.3	(23.5)
<b>Stabilization Reserve</b>			
30 Prior-Year Stabilization Reserve	33.5	34.6	37.0
31 Current-Year Stabilization Reserve	34.6	37.0	37.5
32 Percent of Prior-Year Net Appropriations	5.0%	5.0%	5.0%
33 Reserve Target	34.6	37.0	37.5
<b>Available Funds</b>			
34 Prior-Year Unreserved/Unallocated	26.5	21.2	23.6
35 Current-Year Unreserved/Unallocated	21.2	23.6	0.1

\* The Education Fund Outlook is not a fund statement. Education Fund uses are appropriations rather than actual expenditures and unused appropriations that are designated by the Administration for continuing appropriation are not included.

# EDUCATION FUND SOURCES\*

Two-thirds of total recurring sources are raised on the education property tax.

\$1,643 Million



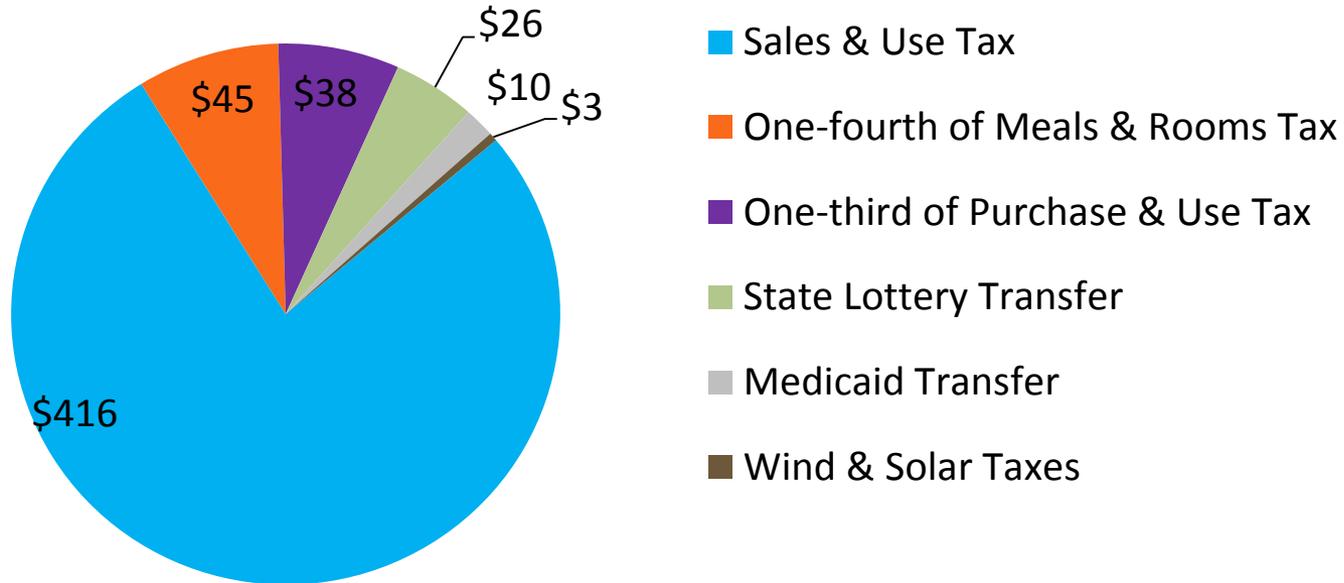
*\* In any fiscal year, nonrecurring revenues may also be available. See the definitions of reversion and prior-year surplus in Slide 9. In FY2019, available sources included a \$10.9 million reversion and a \$21.2 million surplus from FY2018.*

*\*\* The net homestead property tax is the gross homestead property tax less the property tax adjustment (see slide 9).*

# NON-PROPERTY TAX SOURCES\*

One-third of total recurring sources are non-property tax sources.

\$538 Million

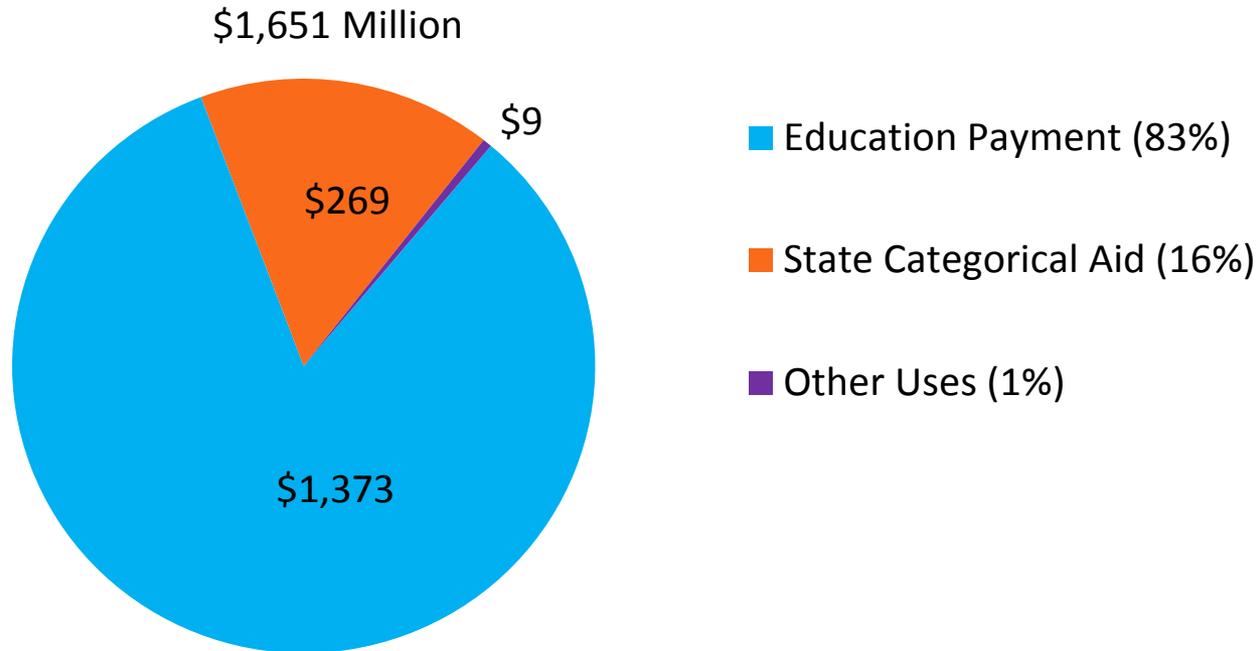


*\* Current-law projections for these sources are based on the revenue updates adopted by the Emergency Board in January and July.*

*\*\* Beginning in FY2019, the statutory general fund transfer to the education fund was replaced with dedicated revenue from the sales & use tax and the meals & rooms tax.*

# EDUCATION FUND USES\*

Nearly all uses are direct payments to school districts in the form of state categorical aid or the education payment.

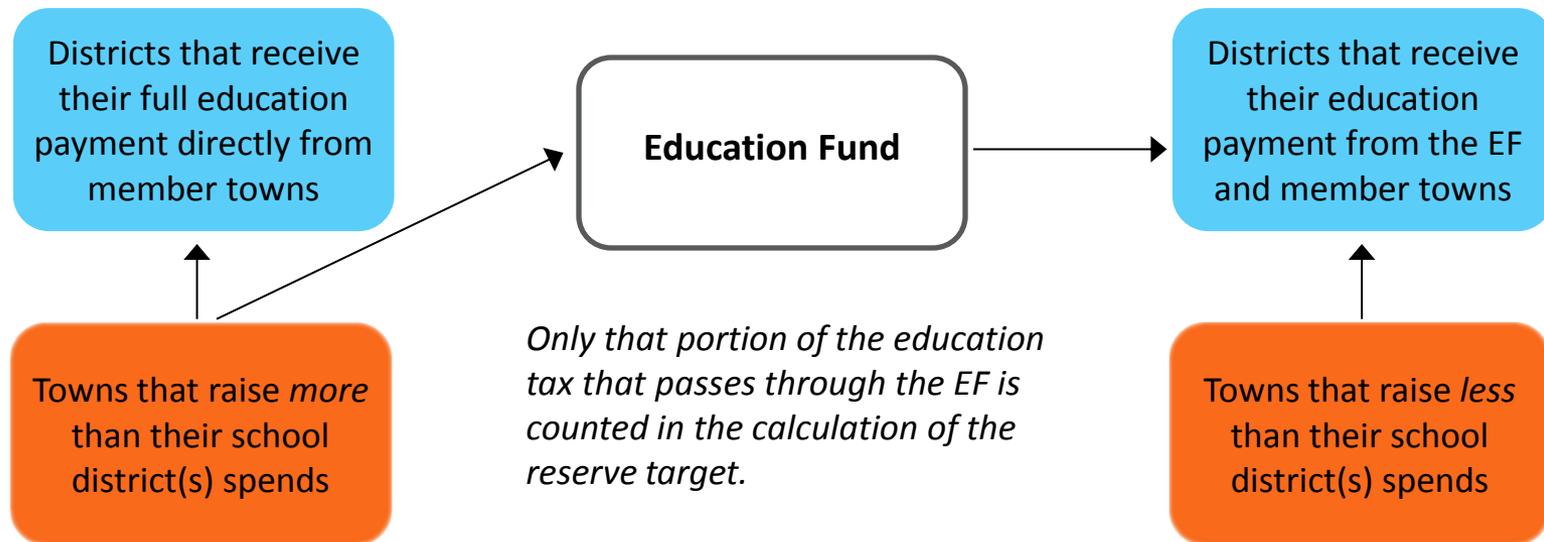


*\* Beginning in FY2019, four uses were transferred from the education fund to the general fund: adult education & literacy, community high school, renter rebate, and reappraisal & listing payment.*

*\*\* State categorical aid includes special education aid, technical education aid, transportation aid, small school support, and flexible pathways.*

# STABILIZATION RESERVE

- The target stabilization reserve is 5% of net appropriations in the prior fiscal year.
- “Net appropriations” equals appropriations minus that portion of the education tax that is collected at the town level and sent directly to school districts.
- In FY2019, the target stabilization reserve in FY2019 is \$37 million.\*



\*  $Net\ appropriations \times 5\% = target\ stabilization\ reserve$   
 $\$1,635\ million - \$895\ million = \$740\ million \times 5\% = \$37\ million$

# WHAT IS EDUCATION SPENDING?

- Voters approve budgeted spending.
- Education spending is budgeted spending minus the following offsets:
  - Federal aid
  - State categorical aid
  - Tuition revenues from other school districts
  - Prior-year surplus or deficit, if any
  - Reserve funds, if any
  - Other offsets

# WHAT IS AN EQUALIZED PUPIL?

The calculation of equalized pupils is complicated:

- Average daily membership (ADM) is determined through a census in the fall.
- ADM is weighted to account for higher-cost pupils:
  - High school pupils
  - English-language learners
  - Low-income pupils
  - Pre-kindergarten pupils receive a fractional weight
- ADM is averaged over two-years.
- A 3.5% hold-harmless provision protects taxpayers from large swings in homestead tax rates due to steep declines in pupils.\*

*\* Act 46, the school merger bill, amended the 3.5% hold-harmless provision to eliminate the accumulation of so-called “phantom” students over time.*

# ADMINISTRATION OF THE PROPERTY TAX

- Administration of the statewide education property tax remains the responsibility of local government.
- Towns assess taxable property, issue tax bills, administer valuation appeals, collect delinquent taxes, and remit education property tax revenue to the State.
- Property tax bills include both the municipal property tax, the education property tax, and the property tax adjustment for eligible taxpayers.
- The education property tax rates are adjusted in each town to account for differences in local assessing practices. (See the next slide.)

# WHAT IS THE COMMON LEVEL OF APPRAISAL (CLA)?

- Since the education property tax is administered locally, it is necessary to adjust property values to account for differences in appraisal levels across towns.
- The CLA is a measure of how close each town's local appraisals are to the actual fair market value (FMV) in that town.
- The CLA is determined annually through the *Equalization Study* prepared by Property Valuation & Review.
- The following slide illustrates how the education property tax rates that appear on bills are calculated to account for differences in appraisal practices.

## TWO TOWNS – IDENTICAL EXCEPT FOR APPRAISAL PRACTICES

- The *equalized* homestead property tax rate is \$1.50 since per-pupil spending in both towns is \$15,330\*; but the towns appraise property at different percentages of FMV.
- Appraisals in Town A are 75% of FMV and appraisals in Town B are 100% of FMV.
- After adjusting the equalized tax rates by the CLA, the tax rates on bills are different, but the tax bills themselves are the same.

Town A		Town B	
Appraisal	\$350,000	Appraisal	\$262,500
FMV	\$350,000	FMV	\$350,000
CLA	$\$350,000/\$350,000 = 1.00$	CLA	$\$262,500/\$350,000 = 0.75$
Tax rate on bill: <b>\$1.50**</b> (\$1.50/1.00)		Tax rate on bill: <b>\$2.00**</b> (\$1.50/0.75 = \$2.00)	
Tax bill: <b>\$5,250</b> (\$1.50 x (\$350,000/100***))		Tax bill: <b>\$5,250</b> (\$2.00 x (\$262,500/100***))	

\*  $(\$15,330/\$10,220) \times \$1.00 = \$1.50$

\*\* *Applying the CLA to the tax rate instead of property value creates much of the confusion around the CLA; however, the tax bill is the same either way.*

\*\*\* *By convention, property values are expressed as 1% of appraised (listed) value for the purpose of calculating tax bills.*

## ADDITIONAL INFORMATION

Mark Perrault, Senior Fiscal Analyst

802-828-5972

[mperrault@leg.state.vt.us](mailto:mperrault@leg.state.vt.us)

Chloe Wexler, Legislative Fiscal Data Analyst

802-828-1488

[cwexler@leg.state.vt.us](mailto:cwexler@leg.state.vt.us)

Legislative Joint Fiscal Office – Education Finance

<https://ljfo.vermont.gov/subjects/education>

Agency of Education – Data & Reporting

<https://education.vermont.gov/data-and-reporting>

Department of Taxes – Property Owners

<https://tax.vermont.gov/property-owners>