

# Vermont Legislative Council

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## MEMORANDUM

To: Senate Committee on Finance

From: Abby Shepard, Legislative Council

Date: April 28, 2020

Subject: Constitutional limits to property tax relief

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You inquired into the constitutionality of providing relief from the statewide education property tax for homestead property owners only, or alternatively, for homestead property owners and only certain types of nonhomestead property owners. Classification of property for taxation purposes must have a rational basis to be valid under the Vermont Constitution. This means that classification must bear a reasonable relationship to the purpose of the tax and be equally and fairly applied among like classes of taxpayers. If certain classes of nonhomestead property owners were singled out for relief, the distinction for eligibility could not be based on Vermont residency to be valid under the U.S. Constitution, because a State cannot discriminate unfairly in favor of its citizens or against the citizens of another state through its tax laws. Vermont law currently provides property tax relief to homestead owners only, in the form of the property tax credit. This distinction is not based on residency.

### Current Law

The Vermont education property tax distinguishes between two types of property use: homestead and nonhomestead.

- A **homestead** is “the principal dwelling and parcel of land surrounding the dwelling, owned and occupied by a resident individual as the individual's domicile or owned and fully leased on April 1, provided the property is not leased for more than 182 days out of the calendar year [...]”<sup>1</sup>
- **Nonhomestead** property is everything else, with specific carve-outs for certain exempt property.<sup>2</sup> Nonhomestead properties are namely real property used for business and other nonexempt purposes, and secondary residences, regardless of the owner’s state of residence (Vermont or elsewhere).
- Vermont statute also **exempts** certain properties from the statewide education property tax.<sup>3</sup>

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<sup>1</sup> 32 V.S.A. § 5401(7); Vt. Reg. § 1.5401(7).

<sup>2</sup> 32 V.S.A. § 5401(10).

<sup>3</sup> 32 V.S.A. ch. 125.

Different statewide education tax rates apply depending on whether the property is classified as homestead and nonhomestead. Nonhomestead properties are subject to a flat rate, while the rate at which homestead properties are taxed is further bifurcated based on property value or both property value and the owner's household income.<sup>4</sup> The property tax credit is the mechanism used to adjust a homestead owner's property tax liability according to the prior year's household income<sup>5</sup>. This existing form of property tax relief is not available to nonhomestead property owners.

### **Constitutional Considerations**

The courts have recognized that state legislatures have broad latitude in creating classifications and distinctions in their tax statutes.<sup>6</sup> However, these powers are not unlimited. The U.S. Constitution places limits on state legislatures in regulating citizens from other states. The Privileges and Immunities Clause forbids a State from discriminating unfairly in favor of its citizens or against the citizens of another state through its tax laws.<sup>7</sup> With respect to property classification, this means that Vermont may not single out non-Vermont citizens for discriminatory taxation. The current nonhomestead classification does not violate the Privileges and Immunities Clause of the U.S. Constitution because it does not only apply to non-Vermont residents. Both Vermont resident and non-Vermont resident individuals and businesses may own properties that are classified as nonhomestead.

The Vermont Constitution provides both protections and limits with respect to taxation. The Common Benefits Clause provides that government is for the common benefit of the people and "not for the particular emolument or advantage of any single person, family, or set of persons, who are a part only of that community."<sup>8</sup> As applied to education, the Supreme Court of Vermont in *Brigham* clarified that the State is responsible for providing public education to its citizens by ensuring substantial equality of educational opportunity throughout Vermont.<sup>9</sup> The Vermont Constitution is silent on how this right has to be financed. The Proportional Contribution Clause is intended to ensure that no property owner pays more than their fair share of the tax burden, and requires the same analysis as the equal protection clause of the U.S. Constitution.<sup>10</sup> The Supreme Court of Vermont stated that "the goal of the Proportional Contribution Clause is protection of the individual from unfair government action, while the aim of the Common Benefit Clause is to protect the state from favoritism to individuals and to remind citizens of the sense of compact that lies at the heart of constitutional government."<sup>11</sup>

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<sup>4</sup> 32 V.S.A. §§ 5402(a), 6066, 6066a.

<sup>5</sup> 32 V.S.A. Ch. 154.

<sup>6</sup> *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 526, 79 S.Ct. 437, 3 L.Ed.2d 480 (1959); *Schievella v. Vt. Dep't of Taxes*, 171 Vt. 591, 593, 765 A.2d 479, 481–82 (2000).

<sup>7</sup> U.S. Const., Art. IV, Sec. 2.

<sup>8</sup> Vt. Const., Ch. I, Art 7.

<sup>9</sup> *Brigham v. State*, 166 Vt. 246 (1997).

<sup>10</sup> *Allen v. Town of West Windsor*, 2004 VT 51, ¶ 9, 177 Vt. 1, 852 A.2d 627; *Burlington Electric Dep't v. Vt. Dep't of Taxes*, 154 Vt. 332, 337, 576 A.2d 450, 453 (1990).

<sup>11</sup> *In re Prop. of One Church Street City of Burlington*, 152 Vt. 260, 264–65, 565 A.2d 1349, 1351 (1989).

The Vermont Constitution does not prohibit taxes that distinguish among classes of taxpayers.<sup>12</sup> The courts have consistently upheld the power of the state to divide different kinds of property into classes and assign them different tax burdens so long as the divisions and classifications are neither arbitrary nor capricious.<sup>13</sup> Some discrimination in taxing is inevitable and, unless it is based on a suspect class such as state of residence, any distinction only requires a rational basis.<sup>14</sup> To withstand constitutional scrutiny under the Proportional Contribution Clause,<sup>15</sup> any legislative classification of taxpayers must meet two basic conditions to have a rational basis:

1. the classification must bear a reasonable relation to the purpose of the tax; and
2. the classification must be fairly and equitably applied among like classes of taxpayers.<sup>16</sup>

With respect to property tax relief, the current classification of homestead versus nonhomestead property meets these constitutional requirements. Any further division of the nonhomestead classification would need to be reasonably related to the purpose of the tax (funding substantially equal educational opportunity throughout Vermont) and be fairly and equitably applied among like classes (other nonhomestead property owners). Providing relief based on a distinction between Vermont and non-Vermont residents would likely be subject to constitutional challenge as invalid under the Privileges and Immunities Clause of the U.S. Constitution.

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<sup>12</sup> *State v. Harrington*, 68 Vt. 622, 629, 35 A. 515, 517 (1896).

<sup>13</sup> *USGen New England, Inc. v. Town of Rockingham*, 2003 VT 102, ¶ 42.

<sup>14</sup> *In re One Church Street*, 152 Vt. 260, 265; *Burlington Electric Dep't v. Vermont Dep't of Taxes*, 154 Vt. 332, 338, 576 A.2d 450, 453 (1990).

<sup>15</sup> Vt. Const., Ch. I, Art. 9.

<sup>16</sup> *In re One Church Street*, 152 Vt. 260, 266.