

VERMONT DEPARTMENT OF TAXES

ACT 73 SECONDARY RESIDENCES REPORT OF 2021

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SUBMITTED TO

House Committee on Ways and Means
Senate Committee on Finance

SUBMITTED BY

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History

This report was prepared according to Section 22 of Act 73 (relating to miscellaneous tax changes). The Act took effect on July 1, 2021. It was signed by Governor Phil Scott on June 8, 2021.

Section 22 requires the Department of Taxes to submit a report “proposing options to collect and report data annually on the number and grand list value of secondary residences located within this State.”

Requested information

This report is required to contain recommendations relating to the following topics:

1. A definition for “secondary residences” to determine the new grand list classification of properties that would be subject to data collection and reporting.
2. A structure and an implementation plan for collecting and reporting data on secondary residences as part of the grand list, including the State entity or State and municipal entities that would conduct the data collection and reporting.
3. Initial and on-going education and guidance for municipalities and listers.

Background

The Department of Taxes maintains a record of all municipal grand lists. 32 V.S.A. § 3410. The law requires that municipal grand lists be prepared by local listers and assessors and provided to the Department of Taxes by the clerks of each town and city. *Id.* In practice, listers and assessors provide part of the information directly to the Department while clerks and treasurers provide part of the information. The Department assists municipal listers and assessors with property valuation training and technical assistance but does not control how municipal employees conduct the work. 32 V.S.A. § 3401. When all municipal grand lists are compiled, they are referred to collectively as the “grand list book,” “the grand list,” or the “VT grand list.”

The grand list is the basis for the collection of all property taxes in the State, which is more than \$1 billion annually. *Lister and Assessor Handbook, Division of Property Valuation and Review (Rev. July 2021) at 26*, available at: <https://tax.vermont.gov/sites/tax/files/documents/GB-1143.pdf>. Grand list information is used for many other purposes, such as determining the average value of a home in a municipality and determining the amount of money each municipality will receive to conduct mass reappraisals. *Id.* The grand list must contain a listing of every owner, every real estate parcel, and all taxable personal property. 32 V.S.A. §§ 5404-5405. The entry for each parcel includes more than 20 items of required information, while most parcels have dozens more data fields that include other notes and details. All exempt property is included in the grand list with a value and stated method of valuation. *Id.* Towns and cities receive \$8.50 and \$1 per-parcel payments on all real estate parcels that have been assessed. 32 V.S.A. § 4041a. The payments support state and local grand list maintenance and municipal reappraisals.

After the grand list is finalized each year, the Property Valuation and Review Division of the Department of Taxes is required to report on the tax rates in every municipality, the value of all exempt property, and the appraisal practices and methods used throughout Vermont. 32 V.S.A. § 3412.

Vermont’s statewide education property tax is unique. There are policy and legal reasons for Vermont’s

differences, which are well established and beyond the scope of this report. For the purposes of this report, it is sufficient to note that our statewide taxation system adds a significant layer of complexity. It requires uniform statewide data collection while also making data collection more difficult. It becomes more difficult partly because it requires the coordination of many more entities than a system that is based solely on a local jurisdiction. Essentially all other states handle property taxes entirely locally, which makes statewide tracking unnecessary.

In addition, Vermont has a Homestead Declaration process to ensure all primary residences are subject to the homestead-specific education property tax rate, and that property tax adjustments can be provided based on income for Vermont homestead parcels. For this purpose, property is categorized as either nonhomestead or homestead. A homestead is the principal dwelling and parcel of land surrounding the dwelling, owned and occupied by the resident as the person's domicile. See, Vermont Department of Taxes Online Tax Glossary, available at: <https://tax.vermont.gov/tax-learning-center/glossary#domicile> (defining "domicile" for Vermont tax purposes).

All property is considered nonhomestead (formerly called "nonresidential"), unless it is declared as a homestead. The education property tax rate levied on nonhomestead property differs from the rate levied on homestead property. It is the responsibility of the property owner to claim the property as a homestead if they are a Vermont resident and they own and occupy a homestead as their domicile as of April 1 of the relevant tax year.

Secondary home tracking in other jurisdictions

As a testament to the difficulty in defining a secondary residence, the Department was not able to identify any other states or jurisdictions that define and report on secondary residences as proposed in this request from the Legislature. While there is no state or local tracking, some other jurisdictions attempt to identify secondary residences through the income tax for the purposes of determining eligibility for certain income tax provisions. California is proposing to disallow the interest mortgage deduction for secondary residences. A.B. 1905, 2019-2020 Leg. Sess., (Cal. 2020). This would be done through the income tax and uses federal definitions to have taxpayers claim whether a residence is a primary residence.

New York is considering a proposal to allow local jurisdictions to increase taxes for certain secondary residences through the property tax system. The proposal is written so that local jurisdictions choose whether to offer an exemption for primary residences (in lieu of taxing secondary residences directly). A municipality that chooses to offer the exemption is responsible for determining whether a taxpayer qualifies. It would be optional and there is no state-wide tracking because this would be a policy handled entirely by local jurisdictions with little state involvement. S.B. S44B, 2019-2020 Leg. Sess., (N.Y. 2020).

The IRS uses a definition of "second home" when determining whether a taxpayer qualifies for a mortgage interest deduction when filing an income tax return. A taxpayer's "main home" is the home where they "ordinarily live most of the time" and any other home is a second home. I.R.S. Publication 536 at 4 (Revised Dec. 7, 2021), available at: <https://www.irs.gov/pub/irs-pdf/p936.pdf>. To qualify for the deduction, the taxpayer must also use the second home "more than 14 days or more than 10% of the number of days during the year that the home is rented at a fair rental, whichever is longer." Id. This definition has limited usefulness for purposes of this report because it is used only for income tax purposes and is something declared directly by a taxpayer when filing income taxes in certain situations. Not all qualifying taxpayers claim the deduction and only some second-home owners qualify, so it only captures a fraction of second-home owners.

A definition for "secondary residences" to determine the new grand list classification of properties that would be subject to data collection and reporting

There are several possible ways to define “secondary residences” for purposes of a grand list classification. There may also be ways to identify secondary residences without relying solely on the grand list. Every option has challenges and policy implications, requiring further legislative decision making.

A definition of “secondary residence” would have at least two basic parts.

The first would identify the type-class or physical characteristics of a qualifying property, such as those classified within a “residential” category on the grand list and which specific property types within that classification qualify. Identifying a property type classification is likely to be the easier part to implement using the grand list.

The other necessary part of a definition is related to how the property is used. There must be a use-based component to the definition, such as the amount of time the property is used as residence by the owner, whether uses by others (such as long-term renters) disqualify the property as a secondary residence, and other factors. There are several potential use-based factors that could be included, depending on the desired policy outcomes. For example, some residential properties are used as rental properties that provide housing to people other than the owner, while others serve short-term renters in all or part of the property.

Property type definition component

A grand list definition for “secondary residence” needs to first identify the types of properties that qualify. Generally, it would be properties that are classified in the grand list as residential, but some commercial and industrial properties are used as residences too. Some farms are listed as a residential category on the grand list (but not all).

Likewise, some seasonal dwellings are used as a residence year-round. A definition should be clear about whether the following types of properties could qualify as secondary residences: condominiums, timeshares, camps, mobile homes, residences divided into multiple units, residences held by a trust, and farm employee housing. The Legislature would have to address a number of policy decisions regarding whether each class of property would be included.

See the table below for the various fields and their descriptions. The Division of Property Valuation and

Review and the Vermont Assessors and Listers Association seek to reduce the number of property categories to help streamline the valuation process. With difficulty, assessing officials could possibly track whether a property is categorized in a particular way and whether it falls into a particular category based on physical characteristics or ownership.

Figure 1 shows the various categories used in the grand list book to track types of residential properties and their descriptions.

Figure 1. Residential Categories on the Grand List

| Residential Categories on the Grand List | Description |
|---|--|
| Residential 1 | Dwelling with fewer than 6 acres. |
| Residential 2 | Dwelling with 6 or more acres. |
| Mobile Home Landed | Landed mobile home. |
| Mobile Home Unlanded | Unlanded mobile home. |
| Seasonal 1 | Seasonal dwelling with fewer than 6 acres. |
| Seasonal 2 | Seasonal dwelling with 6 or more acres. |
| Commercial Apartments | Multiple unit dwellings with six or more units. |
| Farms | Can be subjective. |
| Other | There is variation across municipalities concerning how this field is used. Some use it for condos, lakefront property, boat slips, airplane hangars, timeshares, or other properties where the market expresses a value different than other grand list categories. |

The property-type aspect of a definition should be as clear and objective as possible. Adding to the complexity, existing grand list categories may be used inconsistently across the state. Many different assessing officials across 254 jurisdictions work to compile the grand list each year. There are differing practices across municipalities (see “other” in the table above) and widely varying degrees of training and experience between assessing officials. A definition requiring a subjective opinion about a property would exacerbate inconsistencies in the grand list book. Of note, both PVR and Vermont Assessors and Listers Association (VALA) seek to reduce the number of property categories to help streamline the valuation process.

Use-based definition component

The use-based component of a definition becomes difficult to implement if Vermont wants to rely solely on the grand list to identify secondary residences.

Some challenges could be overcome by additional work from local assessing officials, but much of the needed information is not available during the standard assessment process.

Assessing officials currently lack access to how a property is used throughout the year. Specifically, an

assessing official will not know how much time the owner spends there, which is a necessary part of identifying whether a residence is primary or secondary. Similarly, assessing officials will not always be able to determine whether part of a commercial or industrial property is used as a residence. Some of the issues surrounding assessing officials and use-based classification are discussed in the implementation section below.

As a group, listers and assessing officials have experienced an expansion of their duties and responsibilities over the past decade. Much of the work is done by part-time elected officials and current workloads are already challenging to manage. At this time, the introduction of significantly more responsibilities could lead to inconsistencies and errors throughout the entire grand list as the workload grows. Accordingly, the discussion of tracking secondary residences aims to minimize additional work for municipal officials.

A structure and an implementation plan for collecting and reporting data on secondary residences as part of the grand list, including the State entity or State and municipal entities that would conduct the data collection and reporting

One strategy for getting both property type and used-based criteria necessary to identify a secondary residence would be to rely on assessing officials for the property type categorization of a property in combination with information on the owner's use of the property from another source. Two possibilities for determining the owners use of the property are to (1) identify how owners use a property from the existing homestead declaration process, or (2) require a self-attestation for owners of secondary residences by way of a form or survey from the town or Department.

1. Derive property usage information from the homestead declaration process.

Vermont already tracks residences that are used as primary residences outside of the grand list. The definition of "homestead" is the best pre-existing definition, and it directly relates to whether properties are used as primary or secondary residences. If Vermont uses this approach, it could define a "secondary residence" as any dwelling that meets the type-class criteria for a secondary residence and is not a homestead. The applicable statute defines a homestead as 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 or, for purposes of the renter credit under subsection 6066(b) of this title, is rented and occupied by a resident individual as the individual's domicile." 32 V.S.A. § 5401(7)(A). The statutory definition has additional clarifying parts. 32 V.S.A. § 5401(7)(B)-(H).

If a secondary residence is defined as a dwelling meeting a certain property type criteria that is not a homestead, Vermont may want to further augment the definition depending on whether it is desirable for secondary residences used as rental units to be counted. All commercial apartments could qualify as "secondary residences" unless the definition accounts for that. One way to refine this definition while still relying on data submitted to the state is to exclude properties in which the landlord is required to provide a landlord certificate. All owners of rental properties used for long-term rentals are required to provide a landlord certificate. 32 V.S.A. § 6069(a)-(b). However, owners who only use a property for short-term rentals are not required to file a landlord certificate with the Department and would still qualify as secondary residences under this strategy.

A challenge with the strategy of using Homestead Declarations and Landlord Certificates is compliance of non-filers. Currently, the Department receives between 40,000-50,000 Landlord Certificates, though the Census estimates as many as 100,000 or more rental units in the state. Currently, the Department only seeks unsubmitted Landlord Certificates in cases where a taxpayer is seeking a Renter Credit (formerly Renter Rebate) and is impeded by the lack of the Landlord Certificate. Additionally, there are a significantly more limited number of cases each year where taxpayers who should file a Homestead Declaration fail to do so, as there are usually incentives such as the Homestead tax rate or a Property Tax Credit, but compliance is still not perfect. The data gap in Landlord Certificates would be an impediment to data quality and doing additional compliance for non-filed Landlord Certificates in cases where a renter is not claiming a credit would require additional positions for the Department and would be costly for data tracking purposes.

The other drawback to this strategy is that it limits Vermont's ability to craft a use-based definition of secondary residences with more nuance than what is captured from homestead declarations and landlord certificates. The Legislature should review the homestead definition to determine whether it captures the types of information being sought and consider whether the information currently gathered is consistent and accurate enough for the desired purpose. For example, the homestead definition does not always capture special living situations, such as farm employee housing and multiple residences on a single agricultural parcel. This should be considered as a policy decision if the homestead approach is taken for tracking.

Ultimately, should the Legislature move to require reporting on secondary residences, the Department sees a definition based on homestead certificates and landlord certificates as a way to identify secondary residences while reducing reliance on the grand list and eliminating the creation of new work for assessing officials, albeit increasing administrative pressures on the Department.

2. Derive property usage information from a new attestation approach.

Secondary homeowners could respond to a survey or self-attestation form coming from the municipality or the Department. It would be similar to a homestead declaration but would relate to whether the property meets the definition of a "secondary residence." This approach could be modified to only require an attestation when homeowners seek an exemption.

The strength of this strategy is the flexibility it allows in crafting a specific use-based definition component for secondary residences. The significant challenge with this strategy is compliance. The property type could be cross-checked with the grand list to identify potential non-filers and for outreach, but this would not be sufficient to ensure compliance from all, or even most, who are required to file. Without an accompanying incentive or penalty structure and enforcement capabilities, this data collection system may prove to be insufficient.

Discussion

If there is a statutory requirement for secondary residences to be tracked through the grand list, our current system for property valuation requires that assessing officials and other municipal staff track the information

and transmit it the Department to be compiled into the grand list book. Accordingly, a structure for collecting and reporting data on secondary residences as part of the grand list would be based around the work of assessing officials. It would first require a uniform process for all assessing officials to collect and track the data. A similar approach was taken when assessing officials were asked to begin tracking the value of exempt properties.¹ 32 V.S.A. § 5404. Officials were required for the first time to value exempt properties or list the insurance replacement value for the properties. The alternative approach allowing insurance replacement values involved readily available information and allowed for flexibility, even though it is not as accurate for grand list purposes as traditional property valuation. The Department's experience with that change in the workloads of assessing officials provides some insight into what to expect if they were required to collect and report on secondary residences.

It would be challenging to create a uniform process for tracking secondary residences and would require more than what was required to list a value for exempt properties. For exempt properties, it took years and many additional trainings to widely adopt a new practice. Further, the grand list information was still not completely accurate several years after the mandate was enacted. When listing exempt properties, assessing officials had the information needed to do the task, but they lacked incentive because the information was not necessary to conduct their work. It was seen by some as additional work for nothing. Listers are already asked to do substantial work for low compensation. The Department expects that assessing officials will not want to add the tracking of secondary residences to their workloads. Especially because it will require substantial work—tracking secondary residences would apply to exponentially more properties and require the collection of information on how properties are used. Homeowners change how they use their properties often, which would require ongoing additional work.

Another challenge relates to how information on the use of residences would be collected. As mentioned in the response regarding a definition for secondary residences, assessing officials currently lack access to how a property is used throughout the year. A system would have to be created to collect this information for every applicable type of property. It could possibly be achieved through a survey provided by Town Clerks or Treasurers, or a form submitted to the Department. To be effective, a survey would likely require incentives for compliance or penalties for noncompliance. Even with those, there would be a portion of property owners who do not respond. Many taxpayers, for instance, do not submit the new certification required for agricultural properties enrolled in Current Use even though failure to submit it could result in drastically higher property taxes.

If a survey approach is used, municipalities would need increased compensation for the substantial work required. This work would be annual and would require on-going funding. If the Department was tasked with this direct data collection on a new form, it would likewise need additional capacity and resources to manage data collection, verification, and reporting back to municipal grand lists without jeopardizing other priorities like the homestead cycle and property tax credit distribution. The number of resources needed would be contingent on the details and scope of work the Department would be taking on.

¹ Previously, many exempt properties had no grand list value because many assessing officials thought it was irrelevant because the properties would not be taxed. This practice meant that the true cost of property tax exemptions to education funding was unknown.

Figure 2 provides some possible approaches for structuring and implementing data tracking for secondary residences. The information is intended as a succinct at-a-glance comparison of the most significant factors involved. Some of these approaches can be used in conjunction.

Figure 2. Possible Approaches for Tracking Data

| Possible Approach | Advantages | Disadvantages |
|---|---|--|
| Updating and Using the Homestead Declaration and Landlord Certificate Processes | Existing process; large overlap with data sought. | May require amendment of existing statutory definitions; would need stronger enforcement of non-filers for Landlord Certificates; could result in incomplete information without use of other data sources; added administrative burden for the State. |
| Create a New Attestation or Filing Administered by the State or Towns | A more flexible definition of a second residence could be used with a new filing process. | Towns or the Department would need additional resources to administer a new filing; non-filers are likely to be a challenge unless the Legislature implements an incentive or penalty which could add to the administrative burden; |
| Create a New Secondary Residence Definition for the Grand List | Allows for the most flexibility in defining a secondary residence. | Significant challenges in workload and access to information to properly categorize definitions of a secondary residence at the town level. |

Initial and on-going education and guidance for municipalities and listers.

The Department is statutorily required to assist municipal listers and assessors with property valuation training and technical assistance. 32 V.S.A. § 3401. The Division of Property Valuation and Review achieves this by working with the Vermont Association of Listers and Assessors (VALA) and the Vermont League of Cities and Towns (VLCT) to provide training in the following areas: Lister Training, Advanced Lister Training, Data Collection, Advanced Data Collection, Land Schedule Training, Solar and Cell Training, IAAO 100 Real Estate Property Appraisal Workshops, Statutes & Rules in Property Assessment, Current Use Training, myVTax Training, Equalization Study Training, Reappraisal Process Training, and Tips & Tricks for Office Organization.

The Department employs seven District Advisors to provide direct support and training for all municipalities that need it. The District Advisors conduct most of the trainings provided by the Department.

VALA and VLCT provide additional trainings in which the Department frequently participates.

The Department publishes the Lister and Assessor Handbook, which is the primary resource for municipal property valuation in Vermont. It is available at: tax.vermont.gov/sites/tax/files/documents/GB-1143.pdf.

Conclusion

All of the approaches outlined in this report present their own difficulties, but the approach that we believe will cause the fewest challenges related to workloads for the State or towns is to utilize the existing submissions of Homestead Declarations and Landlord Certificates. However, this approach is not without faults or challenges. As noted, the Department currently does not receive 100% of Landlord Certificates and does not have resources to conduct compliance to receive all Landlord Certificates that don't impact tax administration. Additionally, this approach creates a more rigid definition of secondary residences that would be more challenging for the Legislature to amend without disruption to the existing Homestead Declaration and Landlord Certificate processes. Lastly, there are likely to be unusual or unique situations that are not captured through the existing processes, which lead to additional data imperfections. We thank you for the opportunity to submit this report, and look forward to further discussions on this topic.