VERMONT DEPARTMENT OF TAXES

ACT 127 INCOME-BASED EDUCATION TAX REPORT OF 2023

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SUBMITTED TO
House Committee on Ways and Means
House Committee on Education
Senate Committee on Finance
Senate Committee on Education

SUBMITTED BY
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Vermont Department of Taxes

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Table of Contents

Please note: At the time of drafting this report, there is a special Legislative Committee meeting to make its own recommendations regarding the implementation of an income-based education tax and submitting a final report on December 31, 2022. Given the concurrent timing of the two reports, this report may not reflect that committee's final recommendations regarding the design of an education income tax. As usual, the Tax Department will be available during the legislative session to offer specific feedback related to any potential tax legislation that is introduced.

I. Executive Summary

Act 127 of 2022, an act relating to improving student equity by adjusting the school funding formula, charged the Department of Taxes with producing this report regarding the implementation of an income-based education tax system. Senior staff at the Department met several times in relation to this charge as well as S.212, a bill introduced in 2022 that proposed an education income tax to replace the homestead education property tax. Staff flagged various considerations and concerns related to that proposal and to the concept of an education income tax, generally. The report that follows offers recommendations (where possible) using S.212 as a template for what the Legislature may be considering.

In general, the Department recommends a high degree of caution any time policymakers are considering a novel approach to taxation, which this would be. In all states, public education is paid for by local property taxes in conjunction with state aid. There are some examples of local income taxes, such as notable ones in Philadelphia and New York City, but there is no state that has a statewide income tax to pay for general expenses and a second statewide income tax to pay for education.

Besides the challenges relating to implementing a novel tax system, we recommend that the Legislature consider whether an education income tax proposal would be consistent with the six principles of the National Council on State Legislature's (NCSL) "Principles of a High-Quality Tax System." In our assessment, two key specific-to-Vermont questions emerge:

1. *Regarding the principle of Fairness:* Is it important that all Vermont tax types be progressive with respect to income, or is the progressivity of the overall tax structure what's important?
2. *Regarding the principle of Simplicity:* Would an education income tax make it easier for Vermonters to understand the impacts of their school budget vote?

Beyond the above, we also recommend that the Legislature investigate how an education income tax might intersect with the demographic and housing challenges the state is facing. Policymakers should take a concerted look at who would benefit from such a change, organized not only by combinations of income and property value, but also by household size, age, and race. The Department can assist in providing that data, if needed.

Following is a summary of specific recommendations related to the four issues outlined in the Department's study charge:

Renter Credit: Under an education income tax, renters would potentially be subject to two redundant education taxes: the education income tax and the non-homestead education tax they pay indirectly through their rent. To ensure fairness, renters would either need to be exempted from the education income tax or refunded the property tax portion of their rent. Exempting renters from the income tax would insulate them from the impacts of their budget votes and would be challenging to administer. Refunding the property tax portion of their rent is more feasible but would mean that renters would be paying two taxes throughout the taxable year through wage withholding or estimated payments and would potentially be getting a very large refund from the State after filing their credit claim. This fluctuating cashflow situation would be impractical for the State and unsustainable for some impacted households throughout the year. Despite the cashflow issue, the Department would recommend the second option, and would recommend the current law renter credit structure be leveraged rather than returning to the prior law renter rebate which posed administrative challenges for the Department, excessive paperwork for landlords, and confidentiality problems for renters. The cost of refunding all renters the education property taxes indirectly through rent would be substantially more than the current law credit. See that section for estimates and reasoning.

Transitioning: The property tax base for the coming year is known with near 100% accuracy while the income tax base is more variable and subject to economic conditions. To accommodate that inherent variability, and the fact that income tax revenue flows are not well-contained and can span fiscal years, the Department recommends consulting with the Treasurer's office on an appropriate Education Fund reserve level that would ensure schools have necessary funds and the State maintains its bond rating. At the taxpayer level, a transition of this magnitude would need substantial lead time and communication so taxpayers can know what to expect and how to pay their liability. Taxpayers' escrow arrangements and automatic payments to towns would need to be amended. The Department recommends a substantial lag time between enacting an education income tax and initializing it so that an outreach campaign could be conducted.

Accurate Modeling: Adjusted Gross Income (AGI) and Household Income (HHI) are substantially different measures of income and therefore ability to pay. The most significant difference is that AGI is a federally defined metric determined on a tax filer basis while household income is a Vermont defined metric determined on a household basis. Over the past twenty-five years, the Vermont Legislature has regularly adjusted the statutory definition of household income to better capture ability to pay, ending up at an income definition that differs substantially from AGI. The Tax Department recommends that the Legislature weigh the balance of simplicity versus fairness in this case.

Administering: Administration for an education income tax would need to happen at the State level since towns are not equipped to administer an income tax. This transition will have a fiscal impact to towns because towns are currently allowed to retain 0.225% of all homestead property taxes collected, they benefit from the interest earned on property taxes held in their accounts, and they collect penalties and interest paid on delinquent taxes. The Department recommends that the Legislature consult with the Vermont League of Cities and Towns and the Vermont Municipal Clerks' and Treasurers' Association to understand the full fiscal ramifications to towns. At the state level, the Department recommends the Legislature consider whether low-income people (those who are not required to file personal income tax) will be subject to the tax, and, if so, the mechanism by which they will pay it. Policy decisions will need to be made regarding whether and how education income tax revenue should be separated from personal income tax revenue and how to handle the calculation of tax liability for situations when a taxpayer's residency or housing status changes over the course of the year.

II. Enabling Legislation

The Department of Taxes provides this report as required by Act 127 of 2022, Sec. 18, which States:

On or before January 1, 2023, the Department of Taxes, in consultation with the Agency of Education and the Joint Fiscal Office, shall submit a written report to the House Committees on Education and on Ways and Means and the Senate Committees on Education and on Finance that makes recommendations regarding the implementation of an income-based education tax system to replace the homestead property tax system, including:

(1) restructuring the renter credit under 32 V.S.A. Chapter 154 or creating a new credit or other mechanisms to ensure that Vermonters who rent a primary residence participate fairly in the education income tax system;

(2) transitioning from the current homestead property tax system to the new income-based education tax system;

(3) accurate modelling, given the differences between household income for homestead property tax purposes and adjusted gross income for income tax purposes; and

(4) administering a new proposed education income tax system.

III. Report Recommendations

Restructuring the Renter Credit

Vermont's roughly 75,000 renting households currently pay education property taxes indirectly through their rent. Landlords are assessed the non-homestead education property tax on the property and pass that cost on to renters along with the other costs of owning the property. In Vermont, the non-homestead education property tax rate is a statewide rate adjusted by the town CLA and not reflective of local education spending decisions. Under an education income tax (EIT) that applies to renters as well as homeowners, renters would be exposed to two education taxes: the EIT and the property taxes they pay indirectly through their rent. This arrangement would be unfair to renters, so they would either need to be exempted from the EIT or refunded the education property tax portion of their rent.

The primary means by which people pay income taxes is withholding (around 80%), and to a lesser extent, estimated payments (around 20%). Vermont's withholding tables are designed so that most people will end up getting a modest income tax refund if they accurately complete the Vermont withholding form (W-4VT) they file with their employer. The withholding tables accommodate household size and filing status, because those things crosswalk to number of exemptions claimed and standard deduction, which are the most significant inputs to the Vermont taxable income calculation which impact nearly every taxpayer. The withholding tables (mostly) do not accommodate special tax situations, anticipation of credits, income-earned outside of normal wages, investment earnings, etc. Most people file this form once with their employer when they are first hired and only update it if they are aware of how a life change such as getting married or having a child might impact their taxes.

If renters were exempt from the EIT to avoid redundant taxation, they would benefit from a mechanism that allows them to avoid having that tax withheld from their paychecks (or excluded from their required estimated payments). For many renters, the EIT withholding amount would end up being about the same amount as their existing Vermont income tax withholding because their existing Vermont income tax is calculated based on their taxable income after their anticipated standard deduction and personal exemptions while their EIT withholding would be based on their wages alone (since it is based on AGI). For example, a single person who earns $1,500 on a biweekly basis ($39,000 per year) has about $40 withheld each paycheck for regular Vermont personal income tax and would have roughly the same amount withheld for the EIT, assuming an effective rate of about 2.5%. It would benefit that renter to not have their take home pay reduced by that amount for a tax they will not owe.

Creating a mechanism for renters to avoid having the EIT withheld would mean a change to our withholding form where people would indicate their housing status so their employer could turn EIT withholding on or off. This would be a unique and novel element of the Vermont withholding structure and it is not clear how well it would be managed by employees and employers. As mentioned above, withholding forms are usually only completed once at the time of hire but a person's housing status could change through the year as they transition from renting to buying their own home or living with a family member who is a homeowner, which would make them subject to the EIT. Complicated scenarios emerge, which, coupled with the novel withholding structure, raises concerns with this approach. Additionally, since the EIT rate or rates would reflect the local budget decisions, exempting renters from the EIT would insulate them from their budget decisions, which runs counter to the goal of having them participate equitably in the education finance system.

The second option of refunding renters the non-homestead education property taxes they pay indirectly through their rent is more plausible but is not without its own complications. This format would be like the prior law Renter Rebate program, which refunded lower-income renters the inferred property taxes paid through rent that exceeded certain statutory percentages of income, based on the assumption that municipal and education property taxes combined constitute 21% of rent. The prior law renter rebate mostly mirrored the "super circuit breaker" portion of income-sensitized property taxes for homeowners with income up to $47,000. Importantly, under an EIT it would not be fair to have income limits as part of a new renter credit since all renters would be exposed to the two education taxes.

A new credit program under the EIT could then potentially be simplified from the prior law rebate program by removing the income parameters and simply refunding all renters the non-homestead education property taxes they paid indirectly through their rent. This would result in a potentially large credit amount following the end of each tax year for all renters. This may present cashflow issues for renters who might prefer to have the money available for ongoing monthly expenses rather than receiving a large check after tax filing season. This might also present cashflow problems for the State because the scale of total rebating under this new program would be more than half as large as total refunding for personal income taxes. Assuming this is paid from the State's Education Fund, this outflow of cash at the end of the fiscal year, along with potential refunding of EIT for non-renters, would need to be planned for to ensure school districts have the funds needed for operation.

The Tax Department was unable to trace the origin of the prior law assumption that property taxes constitute 21% of rent paid, but an updated and data-driven figure would be an important input to the revised credit program described above. To inform this estimate, the Tax Department gathered sample Multiple Listing Service (MLS) data from Brattleboro of a dozen multi-units that were sold during 2022. Among those properties, property taxes as a share of gross income (the total rent received for the building) ranged from a low of 9% to a high of 20%, with an average of 15%. Municipal tax rates in Brattleboro in FY22 were $1.308 compared to $1.6314 for non-homestead education taxes, resulting in an education share of property taxes of 55%. If 15% of rent is attributable to property taxes, and 55% of property taxes is education, then 8.2% of rent is attributable to education property taxes in Brattleboro, on average (based on this sample). Brattleboro has comparatively high municipal taxes, so 10% might be a more accurate figure to use. More data would need to be gathered to generate a "tax share of rent" figure that is justifiable in the context of a statewide credit program.

Under the prior law Renter Rebate program, renters received an individualized certificate from their landlord that told them the net rent paid for their unit after accounting for things like included utilities, subsidies, and any services. A factor of 21% was applied to this rent amount to estimate the amount of property taxes paid through rent. The individualized landlord certificate presented challenges for renters who may have been hesitant to ask their landlord to fill out that form for them. Also, a single rebate was issued to only one member of the household based on the aggregate income of all the members of that household, forcing them to share sensitive income details (and social security numbers) with each other, and forcing them to eventually split the rebate that only the one applicant received (often blended with their personal income tax refund). The Renter Credit reform enacted in Act 160 of 2020 addressed those problems and tied the credit amount to benchmark HUD median rents by county (and family size) instead of the actual rent amounts provided by the landlord. This change allowed landlords to start submitting a simplified certificate (one per property) directly to the Department rather than an individualized certificate for each renting household. The Tax Department would recommend this revised format be leveraged to avoid the administrative issues that made the prior system so challenging to both access and administer. Additionally, programmatic changes of this nature are complicated for the Department to implement and involve significant staff time and resources, so leveraging the current law structure as much as possible would reduce pressure on the Department.

Under an EIT, a revised renter credit could be structured as 10% of the HUD fair market rent (40th percentile) based on family size and county, irrespective of income. Because the program would be designed for the entire population of renters and not just those who are low-income, it may be more appropriate to use a median rent (which HUD does not publish) rather than the 40th percentile. The cost of the new credit format would be high and may exceed the education income tax generated from renters (based on a rough analysis of Census data on renter household income). The Census estimates there are roughly 75,000 renting households in Vermont. If the average fair market rent for those households is $1,500 per month (for refence, the FY23 two-bedroom FMR for Chittenden County is $1,615), the aggregate credit-eligible rent would be $1,350M, with a total 10% credit cost of $135M. These rough estimates are provided for a sense of the possible program cost and how that might impact EIT rate setting. For reference, the cost of the current law renter credit is around $9M and is paid out of the General Fund.

Transitioning to the New System

The current Vermont property tax year is on a well-contained fiscal year basis while the income tax year is on a calendar year basis and much less contained. Education property taxes are paid by property owners to their towns between one and four times per fiscal year and the towns are responsible for paying the Education Fund three times per year, whether the entire expected property tax has been collected or not. This ensures that school districts get the funds they need on the timeframe they expect it. The existing income tax operates on a calendar year basis but the revenue spans fiscal years, with withholding and estimated payments coming into the State over the calendar year and then reconciliation (e.g., refunds or payments) concentrated heavily the following March-June. Payments or refunds associated with a particular taxable year can sometimes happen years later if there is an issue with the return. Under an EIT, the protracted and poorly contained nature of income tax revenue flows might impact the expected revenue inflow to the Education Fund, and therefore the availability of funds to schools. For that reason, the Department recommends the Legislature consult with the Treasurer's office to determine an appropriate reserve level that would ensure schools are fully funded and the State's bond rating is maintained.

Related to the prior issue, the residential property tax base for the upcoming fiscal year is known with near 100% certainty while the income tax base is not. Net homestead taxes only account for about 25% of total

Education Fund sources, but a transition to an EIT would jeopardize a portion of that were a recession to occur. This is the case now with the non-property sources of revenue to the Education Fund, such as the sales tax. This additional exposure to economic fluctuations may also impact the needed reserve level, and, again, the Treasurer's office should be consulted in that regard.

As part of the transition, the State would need to plan to notify taxpayers that a new income tax is beginning so that they can commence the appropriate withholding or estimated payments to comply with the tax. The fact that the property tax year is on a fiscal year basis while the income tax year is on a calendar year basis significantly complicates this transition. If EIC estimated payments and withholding began on January 1st, along with regular personal income tax withholding and estimates, that would overlap with the second half of the previous property tax year.

It is unclear to the Department how property tax credits would be handled in the transition, since they are "lagged," meaning calculated based on the property taxes paid in the fiscal year prior to the one where they are applied. In real estate transactions, the buyer usually compensates the seller for their property tax credit at the time of transfer because it is based on taxes the seller paid but will be applied to the buyer's bill (32 V.S.A. § 6063). Applying that logic, the State would have to send checks for prior year property tax credits in the first year of the EIT which would add a roughly $170M cost to the Education Fud for one year only. The Legislature could theoretically end this practice as part of the transition to an EIT, but the real estate community would need advanced notification and there could be other legal implications.

At the taxpayer level, most taxpayers now pay their property taxes through escrow. Escrow is an arrangement where a property owner pays their mortgage-lender a monthly amount for not only the mortgage, but also other property-related expenses such as insurance and property taxes. Escrow helps taxpayers by spreading housing expenses out into twelve equal payments over the course of the year and helps banks by ensuring that the home (on which the bank holds a lien) is insured and out of delinquency. Under an EIT, a homeowner would no longer owe their town for education property taxes, so this part of the escrow arrangements would need to be amended. Also, some Vermont towns have automatic payment options set up, and these arrangements would also need to be amended in the transition. The Vermont Bankers' Association and the Municipal Clerks' and Treasurers' Association could potentially provide more details about the implications of the EIT transition to escrow arrangements and automatic payments.

Accurate Modeling Given the Differences Between Household Income and Adjusted Gross Income

Household Income and Adjusted Gross Income are significantly different measures of income. Adjusted Gross Income (AGI) is a figure that comes from a taxpayer's federal level tax return and includes all the items of income that the federal government has decided should be included in the taxable base as well as all the deductions that the federal government has decided should be allowed against that base. Importantly, federal tax rates are not applied to AGI; they are applied to Federal Taxable Income (FTI), which is AGI less the taxpayer's standard deduction or itemized deductions and any deduction for qualified business income. Household Income (HHI), as defined in Vermont law, is unique to Vermont and is designed to reflect "ability to pay" for the purposes of income-sensitized property taxes.

Prior to Act 11 of 2018, Vermont's statute and income tax form started with FTI and added or subtracted certain things to get to Vermont Taxable Income. Since Act 11, both the law and the forms start with AGI and add or subtract certain things to get to Vermont Taxable Income as defined under 32 V.S.A. § 5811. Vermont did not switch to AGI as its tax base in 2018 and the Act 11 changes were mostly a reorganization of provisions – ending up at a nearly identical tax base for most taxpayers. The personal income tax rates in Vermont apply to Vermont Taxable Income, just as they did prior to Act 11. The changes under that Act were designed to simplify Vermont's tax calculation and insulate the State from any potential changes made by the federal government to FTI in the future. Federal level changes affecting FTI are more common than changes affecting AGI, although changes to AGI do occasionally happen, such as the recent examples of the exclusion of alimony paid in the Tax Cuts and Jobs Act of 2017 and the one-year deduction of up to $300 for charitable contributions enacted in the CARES Act of 2020.

There are a wide range of technical differences between AGI and HHI that can cause variances between the AGI and HHI of some households, but the more fundamental difference is that AGI is determined on a filer basis while HHI is determined on a household basis. For the purposes of the current law income-based property tax credit, the statutory definition of household is "for any individual and for any taxable year, the individual and such other persons as resided with the individual at any time during the taxable year" (32 V.S.A. § 6061). This means that the incomes of spouses filing separately, unmarried partners living together, adult children earning income while living in the home, and people living in the house for only part of the year are all added together when calculating household income. The income of a spouse of a claimant who is not a member of the household but who is not legally separated from the credit claimant is also included in household income (4)(A)(ii). Meaning that if two people are married and own a home together, but one works outside of Vermont for most of the year, the entirety of that person's income is included in the household's income. This is different than personal income taxes, where the income of that spouse would be apportioned based on where it is earned, and they would only have to pay taxes on their Vermont-sourced income. These discrepancies create winners and losers versus current law. Consider, for example, a married couple who maintain a Vermont residence, but one spouse works out of State while the other spouse lives in Vermont and does not earn income. They would pay substantially less with an EIT than under current law homestead property tax.

Household income is more inclusive of the various types of income that a household may realize since it is designed to holistically capture a household's ability to pay. A transition to AGI would potentially benefit taxpayers who have the types of income that are not part of AGI because their taxable income for the EIT is likely to be lower than their household income used to determine eligibility for an income-based property tax credit. For example, a retired married couple both receiving $22,000 of nontaxable social security would pay education taxes under current law based on $44,000 of household income but they would pay on an income of zero dollars under an EIT because their social security is likely to be entirely nontaxable. Similarly, someone whose income is mostly Roth IRA distributions or municipal bond interest, which are also nontaxable, would also stand to benefit from an EIT.

There are 14 different types of income that are included in HHI but not AGI, and they are shown in Table 1 below. The counts of tax filers and amounts of income reflect the totals for the entire Vermont resident taxpayer population for 2019, when available. In cases where data is not available from Vermont tax records, national figures are extrapolated to Vermont based on population share.

Table 1: Items of Income Included in Vermont Household Income but Not Federal AGI

Counts and Amounts Based on 2019 Resident Income Tax Data

Item	Count	Amount
Cash, public assistance, and relief*	1,500	$11M
Nontaxable social security, railroad retirement, and veterans' benefits	82,800	$1,024M
Workers' Compensation*	Up to 4,800	Up to $29M
Nontaxable interest on U.S., State, and municipal bonds	16,300	$115M
Alimony (for divorces on or after 1/1/19)**	No data	$2M, increasing
Support money other than gifts	No data	No data
Child support and gifts over $6,500	600	$3M
Nontaxable capital gains***	11,100	$400M
Nontaxable federal pensions and annuities	No data	No data
Nontaxable investment earnings from a Roth IRA	400	$3M
Loss of time insurance	No data	No data
Cost of living allowances paid to federal employees	No data	No data
Allowances received by dependents of servicemen and women	No data	No data
Double counting of interest and dividends for filers under 65	2,000	$31M

*based on filers of the household income form only. No data available for all income tax filers
**based on Joint Committee on Taxation TCJA estimate, scaled to Vermont
***based on property transfer data for 2020

There is only one item of income that is included in AGI but not in household income, and that is cancelled debt as shown in Table 2.

Table 2: Items of Income Included in Federal AGI but Not Vermont Household Income

Counts and Amounts Based on 2019 Resident Income Tax Data

Item	**Count**	**Amount**
Cancelled debt*	1,000	$11M

*based on IRS Statistics on Income table 1.3 and scaled to Vermont

AGI allows a wide range of deductions that are not allowed in HHI, the largest and most notable of which are the deductions for business losses, rental and royalty losses, and farm losses. Household income only allows business losses in two cases: 1) a loss may be netted against a capital gain reported in the same tax year from the sale of a business property; and 2) when married spouses each are sole proprietors of separate businesses, the loss from one business can be netted against the gain from the other as long as they occur in the same tax year. Besides those two special exceptions, losses are disallowed in the HHI calculation. The various deductions allowed in AGI but not in HHI are in Table 3.

Table 3: Deductions Allowed in Federal AGI but Not Vermont Household Income

Counts and Amounts Based on 2019 Resident Income Tax Data

Item	Count	Amount
Business losses	12,600	$115M
Rental and royalty losses	12,200	$122M
Farm losses	2,700	$52M
Educator expenses	8,400	$2M
Moving expenses	100	<$1M
Self-employed SEP, SIMPLE, and qualified plans	2,800	$54M
Penalty on early withdrawal of savings	1,600	$1M
IRA deduction	9,300	$47M
Various other deductions*	500	$4M

*based on IRS Statistics on Income table 1.3 and scaled to Vermont

Household income has just two deductions that aren't allowed in AGI: child support paid and a deduction for the social security and Medicare (FICA) taxes, which are usually 7.65% of total wages. Almost all taxpayers pay FICA taxes, but self-employed people pay both the employee's share and the employer's share. For that reason, the AGI of a self-employed person would be 15.3% higher than their HHI before consideration of any of the other income items.

Table 4: Deductions Allowed in Vermont Household Income but Not Federal AGI

Counts and Amounts Based on 2019 Resident Income Tax Data

Item	Count	Amount
Social security and Medicare tax withheld on wages*	Up to 314,700	$1,251M
Child support paid**	1,500	$8M

*based on IRS Statistics on Income Historic Table 2 for Vermont
**based on filers of the household income form only. No data available for all income tax filers

The differences between AGI and HHI are the result of legislative decisions over the past 25 years regarding the best way to measure a household's ability to pay its collective education property tax liability. While complicated, the current statutory definition and resulting household income form reflect what policymakers have determined to be the fairest combination of income elements (and individuals) to include in the household. A shift to AGI would provide simplicity but would create winners and losers versus current law depending on the household's composition and income profile.

Administering a New Proposed Education Income Tax System

Administration of the EIT would necessarily happen at the State level because Vermont's cities and towns are not equipped to administer an income tax. The Department of Taxes submitted a report[1] called for by Act 175 of 2020 that discussed a transition of the administration of all education property taxes (homestead and non-homestead) to the State level. Some of the town-level impacts detailed in that report apply in this case, because towns would no longer be collecting the homestead education property tax.

Currently, in exchange for collecting the State education property tax, towns are allowed to keep 0.225% of the revenue. If they no longer are collecting the homestead portion, that represents a direct loss of about $1.3M per year, statewide. Towns also rely on homestead tax revenue indirectly generated by holding funds in savings accounts for interest (known as "float"), and on penalties and interest paid on delinquent taxes – some of which they would lose without the homestead tax. Towns have at their disposal liens and tax sales as disincentives for non-payment of property taxes, but under and EIT, the State would be undertaking more collection activity and may not have as effective tools.

A State administered EIT (as proposed in draft legislation to date) would have all the same features as the current law Vermont Personal Income Tax for roughly one-third the revenue, including withholding, estimated payments, and an annual reconciliation (e.g., payment or refund). The parallel income tax streams, one directed to the State's General Fund and the other directed to the State's Education Fund, present challenges related to administration. For example, if there is an underpayment between the two income taxes, which fund gets payment priority? How would employers segregate withholding payments they make on behalf of employees? Would separate W-2 Statements be issued at the end of each year to employees and the Department?

From a taxpayer perspective, it may be problematic to have separate end-of-year reconciliations between the two income taxes. In other words, a taxpayer might wonder why, if they are getting a $500 refund on their Vermont personal income taxes and they owe $500 on their education income taxes, they cannot use one to offset the other. If they are allowed to use one to offset the other, there will be complicated transfers happening between the General Fund and the Education Fund during filing season each year (and beyond). This potential comingling would also make it more difficult for taxpayers to determine what their final education tax liability is.

Under current law, a taxpayer is required to file a Vermont personal income tax return if they are required to file federally and have at least $100 in Vermont Income (32 V.S.A. § 5861). Vermonters who have very low income and are not required to file federal income taxes are still responsible for Vermont education property taxes if they own property in the State. They are probably eligible for an income-based credit to their property taxes; in which case they can complete the household income form which constructs household income based on various items of income and can be completed even without a federal return to reference. Under an EIT assessed on AGI, people who are not required to file federally (and therefore in Vermont)

[1]W~Department of Taxes~Act 175 Vermont Education Property Tax Transition Study~2-2-2021.pdf

would need to reconstruct their AGI on a new Vermont household income form unless that population is specifically exempted from the education tax. Filling out the new household income form is something only that population would have to do, since people who have to file federally already have an AGI amount to input. Relatedly, if people with low income are still liable for the EIT (such as some people whose only income is social security), would they be required to make estimated EIT payments over the course of the year as is the requirement for personal income tax (32 V.S.A. § 5852)? The Legislature should weigh the administrative burden on the taxpayer in this case versus the potential revenue loss (and loss of "skin in the game") of exempting this filer entirely.

The Department anticipates potential administrative challenges at reconciliation, generally. For example, what happens when someone moves between towns (with different locally voted EIC rates) within the State or moves out of State? What happens when a property transfers and the residency status of the owners do not match? What happens when someone plans to sell their house and move out of State (so they don't file a declaration of residency), but their house does not sell? The Tax Department recommends the Legislature work through these questions to ensure that people are paying an amount of tax consistent with the policy goals of an EIT.

IV. Conclusion

It is challenging to make definitive recommendations regarding a theoretical tax structure that is without precedent in any other state. Where possible, the Department did make concrete recommendations in this report but there were clearly issues that staff were unable to resolve.

A change of this magnitude and complexity should be approached with great caution. This report mostly addresses the "how" of a potential education income tax, but it is worth thinking about the "why" of an education income tax and, in particular, why no other state is doing it or is considering it. The National Council on State Legislature's (NCSL) "Six Principles of a High-Quality Tax System" is a helpful framework for evaluating whether an education income tax is a good policy choice for Vermont.