

Act 127 Study: Income-Based Education Tax

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Since Act 60 twenty-five years ago, the Legislature has been fine-tuning ability to pay based on Household Income

- ▶ 2000: Allows business loss only if netted against a capital gain on the same business in the same year
- ▶ 2004: Excludes income earned by a dependent up to \$6,500
- ▶ 2007: Includes gifts received in excess of \$6,500
- ▶ 2010: Double counts interest and dividends over \$10,000. Disallows subtractions from AGI
- ▶ 2012: Limits double counting of interest and dividends to people under 65
- ▶ *See JFO's Revenue History in Fiscal Facts for a comprehensive history of changes*

Resulting in a much different income metric

3

	Household Income	AGI (filer)
Non-taxable social security (\$1.2B)	✓	
Non-taxable interest (\$0.1B)	✓	
Non-taxable Capital Gains (\$0.4B)	✓	
Double count interest and dividends over \$10,000 (if under 65)	✓	
Roth IRA earnings	✓	
Cash gifts over \$6,500	✓	
Subtraction for social security and Medicare taxes withheld (\$1.1B)	✓	
Deductions for business losses (\$0.3B)		✓
Deductions for educators, self-employed, IRAs, student loans, etc.		✓

While also shifting more towards property

- ▶ **1998: Unlimited adjustments for eligible households**
- ▶ 2007: Maximum adjustment lowered to \$10,000
- ▶ 2008: Maximum adjustment lowered to \$8,000
- ▶ 2010: Maximum house-site value eligible for adjustment lowered to \$500K
- ▶ 2018: Maximum house-site value eligible for adjustment lowered to \$400K and maximum education adjustment capped at \$5,600

Addressing Misconceptions about the current system:

All lower income households pay based on income.

False. People only get a credit (i.e. “pay on income”) if it benefits them to pay based on their income rather than their property value.

A shift towards income helps all lower income households.

False. For low- and moderate-income households that currently pay based on property, it would force them onto a higher track.

In the current system, you either pay based on income or property.

False. The current system has limits on how much property value is income sensitized, and beyond those limits people pay based on property.

WHO WOULD PAY MORE?

THE EDUCATION INCOME TAX **INCREASES** TAXES ON HOMEOWNERS WHOSE PROPERTY VALUE IS LOW RELATIVE TO THEIR INCOME. THIS INCLUDES A BROAD SWATH OF WORKING FAMILIES LIVING IN MODEST HOMES.

- FOR EXAMPLE, A MOTHER AND DAUGHTER WHO LIVE TOGETHER IN A \$50,000 MOBILE HOME AND EACH MAKE \$20 AN HOUR PAY ABOUT \$750 NOW IN EDUCATION TAXES BUT WOULD PAY ABOUT \$2,000 UNDER THE PROPOSAL.

WHO WOULD PAY LESS?

THE EDUCATION INCOME TAX **DECREASES** TAXES ON HOMEOWNERS WHOSE PROPERTY VALUE IS HIGH RELATIVE TO THEIR INCOME.

- FOR EXAMPLE, A PERSON RECEIVING ANNUAL DISBURSEMENTS OF \$40,000 IN TAX-EXEMPT INTEREST AND LIVING IN A MILLION-DOLLAR HOME PAYS ABOUT \$11,000 NOW AND WOULD PAY \$0 UNDER THE PROPOSAL.

How to Read the Upcoming Impact Tables

Average Change to FY20 Education Tax: Current Law vs. Education Income Tax (Dollars)

Household Income	Equalized Housesite Value			
	0 to 100K	100K to 225K	225K to 400K	Over 400K
0 to 47K count	\$ (30) 11,530			
47K to 90K count				
90K to 140K count				
140K to 250K count				
250K to 1M count				
Over 1M count				

The average education tax change for that group would have been a \$30 decrease

In FY20, there were 11,530 homesteads whose household income was between \$0 and \$47,000 with housesite value between \$0 and \$100,000

That cell is green because households in that "bucket" are likely to see their taxes go down with an education income tax

Average Change to FY20* Education Tax (Dollars) 9

Average Change to FY20 Education Tax: Current Law vs. Education Income Tax (Dollars)

Household Income	Equalized Housesite Value			
	0 to 100K	100K to 225K	225K to 400K	Over 400K
0 to 47K	\$ (30)	\$ (240)	\$ (570)	\$ Ex 2 (5,250)
count	11,530	27,210	8,050	1,070
47K to 90K	\$ Ex 1 500	\$ (90)	\$ (240)	\$ (2,330)
count	5,520	33,410	17,310	2,000
90K to 140K	\$ 1,580	\$ 390	\$ (880)	\$ (4,320)
count	1,190	16,290	17,990	3,190
140K to 250K	\$ 3,180	\$ 1,710	\$ 20	\$ (3,110)
count	200	3,850	9,570	4,200
250K to 1M	\$ 7,670	\$ 6,280	\$ 4,510	\$ 1,650
count	40	600	2,480	3,510
Over 1M	*	\$ 40,340	\$ 57,570	\$ 66,270
count	*	20	90	340

*FY20 is modeled to be consistent with prior modeling done by JFO on S.212

Total Change to FY20 Education Tax (Millions)

Total Change to FY20 Education Tax: Current Law vs. Education Income Tax (Millions)

Household Income	Equalized Housesite Value			
	0 to 100K	100K to 225K	225K to 400K	Over 400K
0 to 47K count	\$ (0.3) 11,530	\$ (6.5) 27,210	\$ (4.6) 8,050	\$ (5.6) 1,070
47K to 90K count	\$ 2.8 5,520	\$ (2.8) 33,410	\$ (4.2) 17,310	\$ (4.7) 2,000
90K to 140K count	\$ 1.9 1,190	\$ 6.4 16,290	\$ (15.9) 17,990	\$ (13.8) 3,190
140K to 250K count	\$ 0.6 200	\$ 6.6 3,850	\$ 0.2 9,570	\$ (13.1) 4,200
250K to 1M count	\$ 0.3 40	\$ 3.7 600	\$ 11.2 2,480	\$ 5.8 3,510
Over 1M count	\$ 0.1 *	\$ 0.6 20	\$ 5.4 90	\$ 22.6 340

How is the Median Household Affected?

The median household income in 2019 was around \$73,000



In a \$50,000 house, they would pay about \$1,100 more



In a \$200,000* house, they would pay about the same



In a \$500,000 house, they would pay about \$1,400 less

** The median property value was about \$200,000 for 2019*

IMPACTS TO RENTERS

12

- RENTERS WOULD BE EXPOSED TO TWO EDUCATION TAXES: THE NEW EDUCATION INCOME TAX AND THE NON-HOMESTEAD PROPERTY TAX THEY PAY INDIRECTLY THROUGH THEIR RENT. WE ESTIMATE RENTERS WILL PAY ABOUT \$70M IN EDUCATION INCOME TAX.
- CHANGING THE RENTER CREDIT PROGRAM TO FULLY REIMBURSE ALL RENTERS FOR THE PROPERTY TAX PAID THROUGH RENT WOULD COST ABOUT \$110M* PER YEAR COMPARED TO ABOUT \$10M CURRENTLY
- THE LEGISLATURE JUST TRANSITIONED THE RENTER REBATE TO THE CURRENT CREDIT FORMAT IN 2020, MAKING IT MORE LIKE A TYPICAL HOUSING SUBSIDY AND EASIER TO BOTH ACCESS (FOR RENTERS) AND ADMINISTER (FOR THE TAX DEPARTMENT)

* Assuming 75,000 rental units at \$100,000 average value each and a \$1.50 NHS tax rate,
or \$12,000 average rent paid with 12.5% attributable to NHS property taxes

IMPACTS TO RURAL VERMONTERS

IN S.212, HOMESTEADS WITH MORE THAN TWO ACRES WOULD PAY THE NON-HOMESTEAD PROPERTY TAX ON ANY ACREAGE OUTSIDE OF THE “HOUSE-SITE”. CURRENTLY THEY PAY THE HOMESTEAD RATE ON THOSE ACRES. THE NON-HOMESTEAD RATE IS A STATEWIDE RATE THAT DOES NOT REFLECT LOCALLY-VOTED EDUCATION SPENDING AND IS OFTEN HIGHER THAN THE HOMESTEAD RATE IN RURAL COMMUNITIES.

CURRENT LAW



EDUCATION INCOME TAX

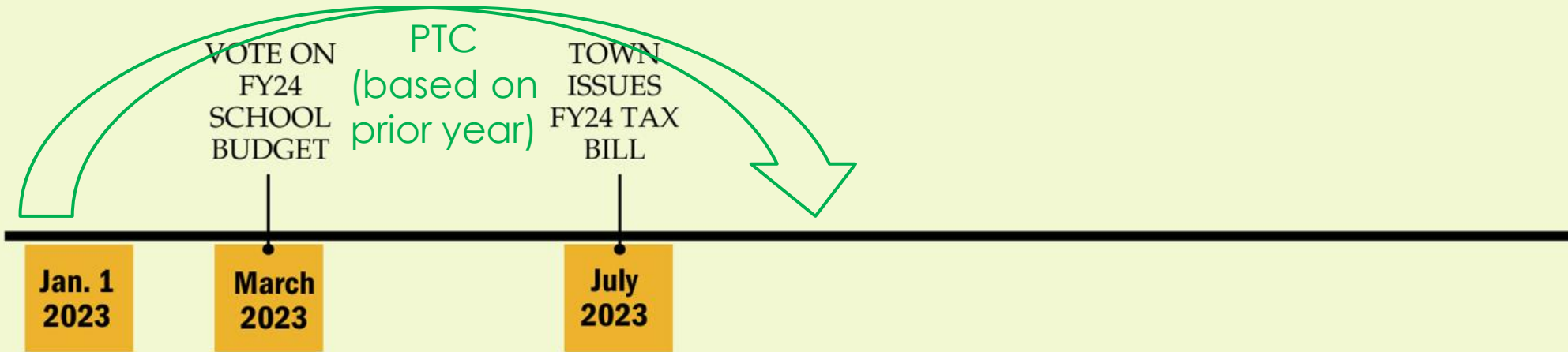


- ❑ MANY STATES PROVIDE PROPERTY TAX CREDITS TO LOW-INCOME HOUSEHOLDS, BUT AT \$8,000, VERMONT'S IS BY FAR THE MOST GENEROUS (THE NEXT HIGHEST IS MARYLAND AT \$3,000). AMONG OTHER THINGS, POLICYMAKERS APPRECIATE HOW THIS POLICY HELPS SENIORS AGE IN PLACE... AND THE POLICY IS WORKING!
- ❑ SINCE 1990, VERMONT'S AVERAGE HOUSEHOLD SIZE IN OWNER-OCCUPIED HOUSING HAS SHRUNK FASTER THAN ANY OTHER STATE'S (-12.5%) ACCORDING TO CENSUS DATA. AND, AS OF 2020, VERMONT HAS THE SMALLEST AVERAGE HOUSEHOLD SIZE IN THE COUNTRY (2.39).
- ❑ THE EDUCATION INCOME TAX WOULD GO FURTHER IN THIS DIRECTION BECAUSE THERE IS NO LIMIT TO THE AMOUNT OF PROPERTY VALUE DEDUCTIBLE, NONTAXABLE INCOME SUCH AS SOCIAL SECURITY IS NOT INCLUDED IN AGI, AND THE "CIRCUIT BREAKER" RATES IN S.212 ARE LOWER THAN CURRENT LAW

COMPLICATES CONNECTION BETWEEN VOTE AND TAX

BECAUSE VOTERS WOULD SEE NO IMPACT UNTIL FOLLOWING SPRING

CURRENT LAW



EDUCATION INCOME TAX

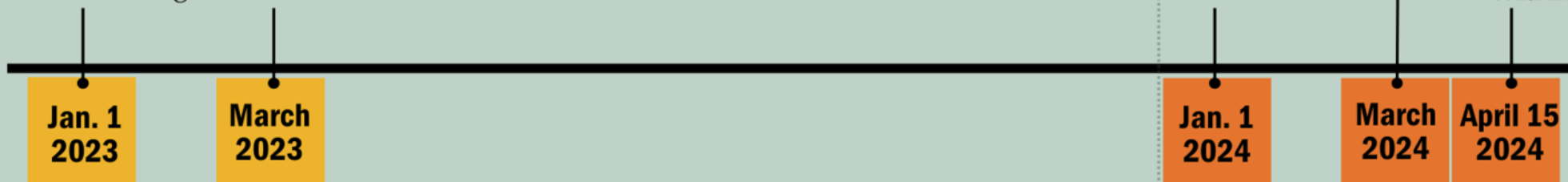
Taxpayer indicates residency status on W-4 and selects withholding level: low, medium, high

VOTE ON FY24 SCHOOL BUDGET

Adjust Withholding level for 2024?

VOTE ON FY25 SCHOOL BUDGET

- File 2023 income taxes
- Reconcile FY24 Ed. taxes owed based on prior year's vote and 2023 withholding



Administrative Complexity

1. Parallel tax systems: new ed. income tax would have all the same features as current state income tax system for about 1/3rd the revenue including withholding, estimated payments, annual reconciliation (payment or refund)
2. **Impractical for taxpayers to annually reconcile their regular income taxes separately from their education income taxes**
3. What happens if the person is not required to file a federal return (and so doesn't have an AGI)?
4. Major challenges related to reconciliation, generally
 - ▶ What happens when someone moves towns or out of state?
 - ▶ What happens when someone leaves a household?
 - ▶ What happens when a property is sold?
 - ▶ What happens when someone plans to sell their house and move out of state, but their house doesn't sell?

Volatility Issues

1. The residential property tax base for the coming year is known with near 100% certainty while the income tax base is not. The EF reserve might need to be increased
2. The non-homestead tax would have to absorb any economic shock in the education fund
3. **Taxing income more will result in less income, which will affect both the education income tax and the regular income tax**
4. High income people are the most able to manipulate their AGI and residency status. If their income is from a capital gain (such as the sale of a Vermont business) they could avoid the education income tax by not declaring residency
5. Different cash flow timing with an income tax could impact availability of funds to schools

Tax Policy Questions

18

- HOW SHOULD VERMONT TREAT PROPERTY WEALTH?

PROPERTY TRANSFER TAX (BUYING THE HOUSE) – TAXED ON PROPERTY VALUE

EDUCATION TAX (LIVING IN THE HOUSE) – ABILITY TO PAY(?)

ESTATE TAX (PASSING ON THE HOUSE) – TAXED ON PROPERTY VALUE

- IS THIS PROPOSAL CONSISTENT WITH THE PRINCIPLES OF A HIGH-QUALITY TAX SYSTEM*? WHICH ARE:

SUSTAINABILITY/RELIABILITY – NOT SUBJECT TO UNPREDICTABLE FLUCTUATIONS

FAIRNESS – HORIZONTAL EQUITY AND VERTICAL EQUITY

SIMPLICITY – EASY TO UNDERSTAND AND RAISES REVENUE EFFICIENTLY

ECONOMIC COMPETITIVENESS – RESPONSIVE TO INTERSTATE COMPETITION

TAX NEUTRALITY – SPREAD TAXES ACROSS A WIDE RANGE OF SOURCES

ACCOUNTABILITY – TAXES SHOULD BE EXPLICIT, NOT HIDDEN

- *PRINCIPLES OF A HIGH-QUALITY TAX SYSTEM (VERMONT.GOV)