

# Potential Structural Options for an Education Income Tax

Education Income Tax Study Committee

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# Outline of talk

- Potential structures for an education income tax (EIT)
- Considerations of structures through the context of principles of a high-quality tax system



# Potential structures for an EIT



# *Option A*

Replace homestead property tax with income education tax rates tied to a statewide yield

## Basic structural changes:

- Replace the homestead property tax (and income sensitivity) with an EIT that is tied to local spending decisions
- Retain the nonhomestead property tax in its current structure
- All other aspects of the Education Fund would remain the same

*(This is essentially the same structure presented in [S.212](#); this was the structure recommended by the Tax Structure Commission)*



# *Option B*

Add EIT to the Education Fund as another revenue stream, keep property taxes, remove income credit

## Basic structural changes:

- Add an EIT with brackets that is not tied to local spending decisions to the Education Fund
  - This would be an additional revenue stream, and would be forecasted like other revenues (e.g. sales & use tax revenues, meals and rooms tax revenues, etc.)
- Retain some form of property taxes
  - Homestead property taxes could remain tied to local spending decisions (or not)
  - Revenues from the EIT could be used to buy down only the homestead property tax, or could be used to buy down all property taxes
- Remove the income credit from homestead property taxes

*(This is a similar structure as presented in [H.911 \(2018\) as it passed the house](#))*



# *Option C*

## Replace homestead property tax with EIT not tied to statewide yield

### Basic structural changes:

- Replace the homestead property tax (and income sensitivity) with a progressive EIT that is not tied to local spending decisions
  - This would be an additional revenue stream, and would be forecasted like other revenues (e.g. sales & use tax revenues, meals and rooms tax revenues, etc.)
- Retain the nonhomestead property tax as a flexible lever
  - This rate would be adjusted depending on the amount that would need to be raised after all other revenue sources
- Increase the amount kept in the stabilization reserve to adjust for volatile revenue performance



# Option D

## Adjust current education funding system's thresholds

### Potential structural changes:

- The housesite caps could be adjusted
  - *Recall the current housesite value caps are \$400,000 and \$225,000*
    - *Income sensitivity does not apply to the part of the housesite value in excess of these caps*
- The income cap could be adjusted
  - *Recall the current household income threshold is \$90,000*
    - *Households with incomes below \$90,000 have income sensitivity on the first \$400,000 of housesite value*
    - *Households with incomes above \$90,000 have income sensitivity on the first \$225,000 of housesite value*
- The circuit breaker could be adjusted
  - *Recall the circuit breaker applies to households with incomes under \$47,000*
    - *Households with incomes below \$47,000 receive additional income sensitivity to adjust the percentage of income they pay on property taxes*

(Bills adjusting thresholds included [S.52 \(2019\)](#) and [S.175 \(2016\)](#))



# Review

- Option A - Replace homestead property tax with income education tax rates tied to a statewide yield
- Option B - Add EIT to the Education Fund as another revenue stream, keep property taxes, remove income credit
- Option C - Replace homestead property tax with EIT not tied to a statewide yield
- Option D - Adjust current education funding system's thresholds for the housesite caps, the income caps and/or the circuit breaker





# Considerations

The following considerations are high level, and not meant to serve as an exhaustive list



# General considerations

- This is a highly complex and nuanced policy discussion
  - Because of this complexity and nuance, goal setting and prioritization is critical
- At a high level, different EIT structural options differ depending on prioritization of principles
  - Level of difference across structures depends on the principle
  - The analysis of certain principles is not possible at this stage
- The Education Fund is different – how would shortfalls and surpluses be addressed?
  - Currently, most education expenditures are not under the Legislature's jurisdiction, only the revenues
  - Under the current system, the flexible lever is both homestead and nonhomestead tax revenues



# Sustainability and reliability - Volatility

*Options are ranked by likelihood to increase volatility*

Option	Option description	To what extent would this option increase volatility in EF revenues?
C	Replace homestead property tax with EIT not tied to local spending decisions	<ul style="list-style-type: none"> <li>• <b>Likely increase volatility</b> because income tax base is more volatile than property tax base</li> <li>• Likely more volatile than other options because there would only be one flexible lever, unless a reserve is created</li> </ul>
A	Replace homestead property tax with income education tax tied to local spending decisions	<ul style="list-style-type: none"> <li>• <b>Likely increase volatility</b> because income tax base is more volatile than property tax base</li> <li>• Likely less volatile than Option C because income tax would be subject to a statewide yield and could serve as a flexible lever</li> </ul>
B	Add EIT to the Education Fund as another revenue stream, keep property taxes, remove income credit	<ul style="list-style-type: none"> <li>• <b>Likely increase volatility</b> because income tax base is more volatile than property tax base</li> <li>• Likely less volatile than Option C and A because:               <ul style="list-style-type: none"> <li>• Both homestead and nonhomestead property taxes would remain as flexible levers, and</li> <li>• The EIT would be an additional funding stream</li> </ul> </li> </ul>
D	Adjust current education funding system's thresholds	<ul style="list-style-type: none"> <li>• <b>Unclear increase in volatility</b> due to lacking structural details</li> </ul>

Most likely to increase volatility




Least likely to increase volatility



# Sustainability and reliability – Balance

*Options are ranked by likelihood to increase income share in state revenues*

	Option	Option description	What extent would this option increase income share of state revenues?
<p>Most likely to increase share of income taxes</p>  <p>Least likely to increase share of income taxes</p>	C	Replace homestead property tax with EIT not tied to a statewide yield	<ul style="list-style-type: none"> <li>• <b>Increased share of income taxes, decreased share of property taxes</b> <ul style="list-style-type: none"> <li>• ~40% of property tax revenues would be replaced with income tax revenues</li> <li>• Income taxes would aim to not raise more than homestead property taxes would have raised</li> </ul> </li> </ul>
	A	Replace homestead property tax with income education tax tied to a statewide yield	<ul style="list-style-type: none"> <li>• <b>Increased share of income taxes, decreased share of property taxes</b> <ul style="list-style-type: none"> <li>• ~40% of property tax revenues would be replaced with income tax revenues</li> <li>• Income taxes would aim to not raise more than homestead property taxes would have raised</li> </ul> </li> </ul>
	B	Add EIT to the Education Fund as another revenue stream, keep property taxes, remove income credit	<ul style="list-style-type: none"> <li>• <b>Increased share of income taxes, decreased share of property taxes</b> <ul style="list-style-type: none"> <li>• Scale of change in balance would depend upon the amount raised for the income tax</li> </ul> </li> </ul>
	D	Adjust current education funding system's thresholds	<ul style="list-style-type: none"> <li>• <b>Unclear change in balance</b> due to lacking structural details</li> </ul>



# Fairness

*Evaluation of fairness ultimately depends on policy goals and design*

Option	Option description	Considerations of both vertical and horizontal equity
A	Replace homestead property tax with EIT tied to a statewide yield	<ul style="list-style-type: none"><li>• Tax rates would still vary by town<ul style="list-style-type: none"><li>➤ Two households with the same income in different towns would likely have different tax rates and bills (based on local per pupil spending)</li></ul></li><li>• Tax rates may be adjusted to account for progressivity*</li></ul>
B	Add EIT to the Education Fund as another revenue stream, keep property taxes, remove income credit	<ul style="list-style-type: none"><li>• Property tax rates would still vary by town</li><li>• EIT tax rates would not vary by town</li><li>• Brackets of EIT could be made as progressive as desired</li></ul>
C	Replace homestead property tax with EIT not tied to a statewide yield	<ul style="list-style-type: none"><li>• Tax rates would not vary by town spending decisions</li><li>• Brackets of EIT could be made as progressive as desired</li></ul>
D	Adjust current education funding system's thresholds	<ul style="list-style-type: none"><li>• More difficult to target progressivity with respect to income</li></ul>

\*Note: This would introduce significant additional complexities



# Simplicity

*Adjustments to simplicity will largely depend on policy design*

Option	Option description	Added simplicities	Added complexities
A	Replace homestead property tax with income education tax rates tied to a statewide yield	<ul style="list-style-type: none"><li>• Removal of PTC</li></ul>	<ul style="list-style-type: none"><li>• Significant logistical and administrative challenges for both taxpayers and administration</li><li>• If EIT is designed to be progressive, significant additional complexities</li></ul>
B	Add EIT to the Education Fund as another revenue stream, keep property taxes, remove income credit	<ul style="list-style-type: none"><li>• Removal of PTC</li></ul>	<ul style="list-style-type: none"><li>• Another forecasted revenue source in the Education fund with associated uncertainties, but not incongruent with other state funds</li></ul>
C	Replace homestead property tax with EIT not tied to local spending decisions	<ul style="list-style-type: none"><li>• Removal of PTC</li><li>• Tax rates would not vary by town</li></ul>	<ul style="list-style-type: none"><li>• Another forecasted revenue source in the Education fund with associated uncertainties, but not incongruent with other state funds</li></ul>
D	Adjust current education funding system's thresholds	<ul style="list-style-type: none"><li>• Adds to an existing system</li></ul>	<ul style="list-style-type: none"><li>• Likely to layer additional complexity into system</li></ul>



# Accountability

*As long as tax rates depend on local decisions, not all taxpayers will know their tax rates when voting on budget*

Option	Option description	Would homestead taxpayers know their tax rates when voting on local budget?
A	Replace homestead property tax with income education tax tied to a statewide yield	No
B	Add EIT to the Education Fund as another revenue stream, keep property taxes, remove income credit	Income tax – yes ( <i>assuming EIT is not used as a flexible lever</i> ) Property tax – no
C	Replace homestead property tax with EIT not tied to a statewide yield	Yes ( <i>assuming EIT is not used as a flexible lever</i> )
D	Adjust current education funding system's thresholds for the housesite caps, the income caps and/or the circuit breaker	No



# Tax Neutrality - Education Cost Containment

*While cost containment is not a “principle of a high-quality tax system”, it is a frequent consideration in Vermont’s education financing*

Option	Option description	Considerations
A	Replace homestead property tax with income education tax tied to local spending decisions	<ul style="list-style-type: none"><li>• Similar to current status as education spending decisions would impact tax rates, but taxpayers would not know tax rates when voting on budget</li></ul>
B	Add EIT to the Education Fund as another revenue stream, keep property taxes, remove income credit	<ul style="list-style-type: none"><li>• Likely very limited cost control as property tax rates would be less than they are in the current system</li><li>• Potential increase in sensitivity of property tax may incentivize some cost containment</li></ul>
C	Replace homestead property tax with EIT not tied to local spending decisions	<ul style="list-style-type: none"><li>• Limited to no tax incentives to put downward pressure on local spending (“Tragedy of the Commons”)</li></ul>
D	Adjust current education funding system’s thresholds for the housesite caps, the income caps and/or the circuit breaker	<ul style="list-style-type: none"><li>• May not have desired level of cost control if certain income groups are shielded from spending decisions because of circuit breakers/exemptions</li></ul>





# Final considerations

- High level of analysis can only inform at a high level
- Ultimately, alignment with principles will (or will not) be realized based on prioritization of principles, and detailed policy decisions



# Questions?

