

INCOME-BASED EDUCATION TAX STUDY COMMITTEE
DRAFT DECISION POINTS
12/1/2022

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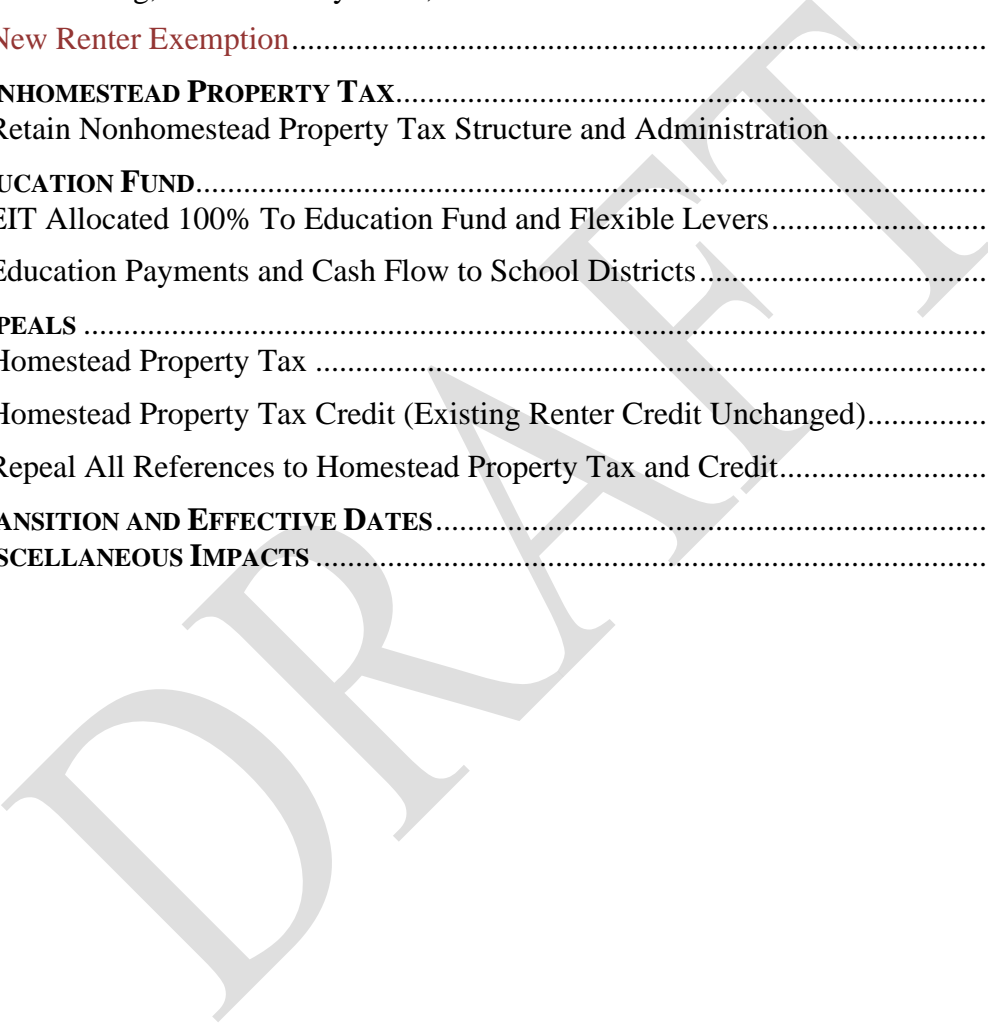
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PURPOSE OF DOCUMENT

This document is a compilation of the potential technical and administrative structure and outstanding decision points for enacting an income-based education tax as considered by the Study Committee.

LEGEND

■ Writing in black is a *draft* Study Committee decision

■ Writing in red is an outstanding decision point

EDUCATION INCOME TAX

New Education Income Tax

- Education Income Tax (EIT) would be structured with progressive income tax rates and brackets on:
 - The adjusted gross income (AGI) of
 - All individuals (residents, part-year residents, and nonresidents)
 - Constitutional limits only allow Vermont to tax nonresidents' *Vermont-source* income. Personal income tax achieves this in 32 V.S.A. §§ 5822(e) [adjustment for non-Vermont-source income applied to tax liability] and 5823 [Vermont-source income].
- What are the rates and brackets?
 - To be determined
 - For example rates and brackets, see Option 2, p. 12 of JFO presentation on Nov. 10, 2022.
 - Note that the example rates and brackets are preliminary and subject to further changes. The example rates do not include any expenditures or other adjustments.
- EIT rates would be adjusted by district based on locally voted education spending per equalized pupil
 - Rates would be increased or decreased by the same percentage that locally voted education spending exceeded or fell below statewide average education spending
 - statewide average education spending based on prior year
 - education spending would use same definition as under current law
 - Currently, the General Assembly sets the property and income yield based on local education spending decisions. Then, on or before June 30th, the

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Commissioner of Taxes calculates the spending-adjusted homestead tax rate for each town based on its local spending decisions and the yields passed by the General Assembly. 32 V.S.A. § 5402(b)(1).

- Would this structure and timing be retained?
- Would rates be adjusted statewide as a lever to accommodate revenues being higher or lower than forecast? If so, when would that happen?
- Retain Dec. 1st letter process. 32 V.S.A. § 5402b.
 - Subsec. (a): amend to remove recommendations for yields and replace with a calculation of the EIT rate.
 - In subdivs. (1)–(4), assumptions used in calculation would need to be changed:
 - EIT rate would be X%
 - Statutory reserves would be maintained at X%
 - Would the percentage changes to the average nonhomestead and EIT rate or tax liability be required to be equal for purposes of the calculation?
 - Subsec. (b): default EIT rate is only relevant if rate will be adjusted to compensate for any other revenue streams under- or overperformance. Otherwise, the default rate will be what is set in statute.
 - Subsec. (c): amend Ed Fund Outlook language to include EIT rate.
- Would a cap be set on the amount of AGI that is subject to the EIT?
 - Although broached in meetings, there has been no recommendation made by the IBETSC regarding a cap on the amount of AGI subject to the EIT.
 - Note that adding a cap would require other changes such as an increase in the EIT rates to generate the same amount of revenue.

Administrative Considerations

- Would the general administrative and assessment laws governing the personal income tax apply to the EIT?
 - Would there be a safe harbor for underpayment penalties and would it follow current personal income tax law?
 - Current law underpayment penalty safe harbor for estimated payments to avoid is penalties or interest is if tax liability is less than \$500 or taxpayer had no tax liability in the preceding taxable year. 32 V.S.A. § 5855(b).
 - Overpayments/refunds
 - Would the EIT follow the current personal income tax law that authorizes the Commissioner to offset the taxpayer's liability for any tax type administered by the Dept. and for any tax period by using any payment from a taxpayer or refund owed to the taxpayer? 32 V.S.A. § 3112.
- How would taxpayers who do not file income tax returns be treated?

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- Would the EIT follow the same requirements in those imposed by personal income tax law? Current requires filing by:
 - residents, part-year residents, and nonresidents who earned Vermont income
 - who are required to file a federal income tax return, and
 - who either:
 - earned or received more than \$100 in Vermont income, or
 - who earned or received gross income of more than \$1,000 as a nonresident. 32 V.S.A. §§ 5861 [filing requirements] and 5823(b)(1)–(6) [sources of income for nonresidents].
- Would a homestead declaration be required to be exempt the nonhomestead tax? Or would the personal income tax form be used?
- Would there be a separate renter declaration or would the only documentation come from checking a box on the VTW-4 to be exempt from withholding (then reconciliation would occur in April)?
- Prior to Act 60, a taxpayer was required to disclose on the taxpayer's personal income tax form the amount of real property taxes assessed by a municipality on the taxpayer's housesite (domicile dwelling and up to two acres of land surrounding the dwelling). 1995 Act 47, Sec. 20 adding subsec. (f) to 32 V.S.A. § 5861. This requirement was repealed in 1999, during the Act 60 transition. 1999 Act 49, Sec. 56. At that time, Vermont switched to a homestead declaration and property tax adjustment, so the housesite municipal tax was declared on a different form. Additionally, the housesite value is provided on property tax bills by the town to the taxpayer. All of this is now addressed in 32 V.S.A. chs. 135 and 154, under the housesite and homestead definitions and property tax bill information requirements.

Withholding, Estimated Payments, and Annual Reconciliation

- Vermont personal income tax withholding is generally required for wage income, pensions, annuities, and other payments if the payments are subject to federal tax withholding and the payments are made to:
 - a Vermont resident, or
 - a nonresident of Vermont for services performed in Vermont.
- Vermont withholding is calculated in the same way as federal withholding by using Vermont withholding tables or wage bracket charts. The taxpayer (such as an employee) provides either a federal or both a federal and a Vermont W-4 form to the person withholding from their payment (such as an employer). The taxpayer tells the person withholding how much to withhold by noting their income tax filing status (single or joint filer), number of withholding allowances (which includes number of dependents), and any extra withholding from each payment (for taxes due on another source of income not subject to withholding).
- Potential options for withholding

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- Taxpayer chooses to withhold from their wages a tranche (e.g., 0%, 75%, 100%, 125%, or 150%) of the prior year statewide average (mean) rate. Then the tax liability would be reconciled in April.
 - Which rate would be used: towns' average rate? School districts' average rate? Overall, statewide rate based on population?
 - Would the prior year's rate be adjusted:
 - Potential Option 1: based on the effective tax rate
 - OR
 - Potential Option 2: by the forecasted annual change in education spending per equalized pupil (which could be added to the Dec. 1st letter).
- Mandatory for homeowners but not for renters.
 - If exempt from tax, renters must self-certify to have zero EIT withheld from wages.
- Two different EIT tax rates will likely apply during the taxable year Jan.-Dec. used for income tax purposes to determine AGI:
 - (1) Jan.-June period with the rate from the second half of the fiscal/school year, and
 - (2) July-Dec. period with the new EIT rate for the first half of the fiscal/school year.
 - Options to address the 2 tax rates during one taxable year:
 - Potential Option 1: apply effective tax rate against entire year's AGI and reconcile in April. Withholding would be based on prior year's statewide average.
 - Potential Option 2: create a 6-month lag after the school district's budget has been voted, to apply the new tax rate to the entire taxable year beginning in January of the following year.
 - This option would require another funding source to make education payments to school districts from July-Dec. A potential source could be the stabilization reserve.
- Estimated payments would be required of non-wage earners, such as self-employed and members of passthrough entities, and the required payments would follow personal income tax law.
 - Estimated payments must currently be the lesser of either 90% of the current year's tax liability or 100% of the preceding year's tax liability. 32 V.S.A. § 5851(2).
- New withholding requirements for employers
 - Timing of standing up a new system (especially given pupil weighting transition 2025-2030).

New Renter Exemption

- Existing Renter Credit remains intact
- Will renters be exempt? If so, all renters or only some?

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- If all, could be structured as a full exemption from EIT.
- If only some renters are exempt, what are the eligibility requirements?
 - Would it be based on income? Location? Amount of rent? Some of the existing Renter Credit conditions?
- If renters are exempt to some degree, how would the expenditure be funded? Education Fund? General Fund? Special fund?
 - If from the Education Fund, and no other new revenue streams, EIT brackets would need to be adjusted and/or nonhomestead property tax rate would need to be increased.

NONHOMESTEAD PROPERTY TAX

Retain Nonhomestead Property Tax Structure and Administration

- Changes to nonhomestead property tax base
 - Nonhomestead tax would apply to the portion of a homestead property that exceeds the housesite and 2 acres.
 - Although discussed, no recommendation by IBETSC regarding creating new, separate categories of nonhomestead properties to be separated and taxed differently.
- Retain current administration of nonhomestead tax by municipalities (appraisals, billing, collection, defending initial grievances and appeals).
- How would the nonhomestead property tax be set?
 - Would it be used as a flexible lever to accommodate fluctuations in the Education Fund?
 - If so, would it be tied to any another tax rate?
 - Would its use as a flexible lever be statutorily required?
 - Currently the default rate is set in statute at a flat rate of \$1.59/\$100 of property value. 32 V.S.A. § 5402(a)(1). This rate is generally notwithstanding and a different rate is set by the General Assembly each year in session law.

EDUCATION FUND

EIT Allocated 100% To Education Fund and Flexible Levers

- In case of underperformance or unexpectedly strong performance of EIT revenues, how would the difference be accommodated?
 - Any other revenue streams?
 - Increase or decrease the EIT rates?

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- Change the amount set aside in the Stabilization Reserve or create another reserve?
 - If filling the Stabilization Reserve, how would this be funded, including after the Reserve is drawn down?

Education Payments and Cash Flow to School Districts

- Education payments can continue to follow the same timeline as under current law.
 - Netting between payments made from municipality to the school district and Ed Fund payments from State to school district three times per year. 16 V.S.A. §§ 426, 4011(c), and 4028(a).
 - Payments to the State by municipality required twice per year. 32 V.S.A. § 5402(c).
 - Retain 8% late payment penalty. 32 V.S.A. § 5409(1).

REPEALS

Homestead Property Tax

- Municipalities would still appraise and list homesteads on grand list, even though the housesite plus two acres on a homestead property would be exempt from nonhomestead property tax.
 - Note that current law already requires insurance replacement value of exempt properties to be listed. 32 V.S.A. § 4152(a)(6) and (c).
- Municipalities would still receive most existing payments from the State:
 - appraisals, maintaining grand list, and billing and collecting education property tax. 32 V.S.A. §§ 5405(f), 5410(k) and (h).
 - delinquent tax penalties. 32 V.S.A. § 5410(g).
 - 0.225% of tax collections allowance for timely payment. 32 V.S.A. § 5402(c).
- However, with the repeal of the property tax credit, municipalities would no longer receive payments for billing for late property tax credit claims. 32 V.S.A. §§ 5402(c).

Homestead Property Tax Credit (Existing Renter Credit Unchanged)

- Leave existing Renter Credit (in same subchapter as homestead property tax credit) untouched; continue General Fund funding
- How to deal with municipal “super circuit breaker” property tax credit for homeowners with household income at or below \$47,000?
 - Currently, this credit is part of statutory section that computes the homestead credit using the same income thresholds and household income

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definition. 32 V.S.A. § 6066(a)(4) and (a)(5). If the homestead property tax credit is repealed, none of the information currently collected by the State and used to determine eligibility for the “super circuit breaker” will be collected.

- Would it require filing by taxpayers and a declaration of the amount of municipal tax owed?
- Would the credit continue to be funded by the General Fund or would this become an Education Fund expense?
- Would the credit be structured like the existing Renter Credit, except for homeowners?
- Alternatively, would this become a refundable credit against the EIT for the lowest income earners?

Repeal All References to Homestead Property Tax and Credit

- Including homestead exemptions for veterans. 32 V.S.A. §§ 3800(g) and 3802(11).
- List in S.212, Sec. 27.

TRANSITION AND EFFECTIVE DATES

- When would homestead property tax be repealed and new EIT imposed?
 - Any lead time to implement new structure?
 - After pupil weighting changes take effect in 2025. At some point between 2025 and 2030.
- Include exemption from underpayment penalties and interest for a certain time period (1-5 years?) after effective date, so as to alleviate compliance burden.
 - This would apply to EIT-taxpayers, including renters, and employers updating their withholding processes.
- If increasing the Stabilization Reserve, to what extent, and how would it be funded:
 - initially during the transition, and
 - after the Reserve is drawn down especially in case of a downturn in the economy and revenues?

MISCELLANEOUS IMPACTS

- Tax Increment Financing (TIF) Districts?
- Escrow accounts for mortgages?