

To: The Tax Structure Commission
From: Rep. Cynthia Browning, Arlington
Re: Education Finance Reform
Date: 8/31/20

Thank you for the opportunity to communicate with you again.

I have reviewed some of the materials that the Commission has developed concerning the task of Education Finance Reform, although this review has not been as thorough as might be desired due to my competing endeavors. I do not envy you your assigned task of Education Finance Reform, especially since our current state of uncertainty must inevitably lead one to wonder when reforms might be undertaken. However, sometimes when a crisis highlights problems changes are possible.

Before I turn to the proposal that I might tentatively and conditionally make at this time, I will mention some of my biggest concerns with our current system.

*** I believe that the Education Fund should be used for paying for actual education expenses. It should not be used to pay for state policy decisions about who should get support for paying property taxes. Such costs were part of the General Fund before there was an Education Fund, and ideally that is where they should be now. I believe it is a violation of at least the spirit if not the letter of the Act 60 statute to cover the costs of Current Use and the Property Tax Adjustment programs within the Ed Fund. In addition, when property taxes rise, the costs of these support programs rise, creating a kind of vicious cycle of increases.

*** I believe that income is the best measure of the ability to pay, and our progressive income tax system has much to be said for it, although one weakness is the fact that some are able to shelter income from taxation. I also believe that income is the best basis on which to determine housing subsidies. Therefore a system that provides different size adjustments or credits for people with the same income but different house values or property tax liabilities may violate the principles of horizontal and vertical equity. This is true of the current Property Tax Adjustment system.

*** I believe that Homestead education property taxes should continue to be an important element of education financing for three reasons. One is that one factor in determining the value of a house is the education available in that area. A second is that it is harder to evade property taxes than to evade income taxes because of the public records. The third is that the only real cost control mechanism on education spending is the process of community votes on school budgets. However, this mechanism has been greatly weakened by the way that the current Property Tax Adjustment system insulates many homeowners from the full property tax implications of votes to approve higher levels of school spending, along with the complexity of the statewide/local tax rate determinations.

So given these views, I think that we should be aiming for an Education Finance System that 1) adds income tax revenue to the Ed Fund, reducing Homestead property tax rates but retaining a reduced role for that source of tax revenue, 2) somehow strengthens the cost control mechanism in that although overall Homestead property tax liabilities are lower, they vary with budget votes more directly, and 3) removes the cost in lost revenue for the Current Use program from the Education Fund and puts it in the General Fund, along with some of the revenue to cover those costs.

For me, all three of these changes would have to go together. I would not support an education income tax of any kind without reforms of the Property Tax Adjustment system and removal of Current Use. In my opinion the state has been neither transparent nor accountable in the management of the Education Fund with respect to

these programs, so I would need commitments to program reforms in order to contemplate replacing some of the Homestead property taxes with an education income tax surcharge, especially in terms of reducing the violations of horizontal and vertical equity within the PTA and the removal of the CU costs, and the restoration of the cost control mechanism through connecting school budget approvals and some degree of Homestead property tax liability.

I have tried to develop some suggestions for evolutionary changes in the existing system that would result in Vermonters paying for part of the costs of education with an income tax surcharge, reducing the reliance on Homestead property taxes, and alter the parameters of the existing Property Tax Adjustment program so that more Vermonters have changes in property tax liabilities due to changes in school budgets, albeit at lower levels.

This is just a tentative sketch, and I have not done any analysis of numbers and magnitudes. I have not explored incidence or particular cases of shifting burdens or “winners and losers”. I have developed the proposal working within the framework of the existing system as much as possible.

TENTATIVE PROPOSAL FOR CONSIDERATION.

(A.) Impose Education Surcharge on the Income Tax of some percentage or fraction of a percent of income, using the existing income tax system. This would be a set surcharge added to the existing rates, but paid at the same time as regular state income taxes. It could be a flat rate increase to all brackets. I would prefer a lower rate surcharge at lower income levels and higher at higher levels. The rates would not vary with school budget votes. This surcharge could be put in place in steps over time.

(B.) Dedicate the revenue from the surcharge to be transferred to the Education Fund, using the extra revenue almost entirely to reduce the reliance on the Homestead Property Tax, so that the Homestead property tax rate declines. How much this tax rate declines would depend on the size of the surcharge and the amount of resulting dedicated revenue to be transferred.

(C.) Alter the parameters of the existing Property Tax Adjustment (PTA, aka Income Sensitivity) system to take into account these changes in ways that will reduce the scope and cost of the PTA, and also result in more voters having property tax liabilities more clearly and fully affected by school budget votes.

(D.) Remove the cost of Current Use from the Education Fund, along with most of the revenue to cover that cost, and operate that program in the General Fund.

DISCUSSION.

The Education Surcharge could be put in place gradually over time to avoid a sudden shift in the system that could create distortions.

As the income tax revenue is added to the Ed Fund, it should be used almost entirely to reduce the Homestead property tax rate, with a small amount going to reduce the Nonhomestead property tax rates as well. This is because renters would be paying the income tax, as well. The renter rebate program might need to be adjusted, depending on how things shake out. Most renters are in the lower income brackets, and if the surcharge is imposed progressively it would be a very low added rate there.

As Homestead property tax rates are reduced, the size of property taxes assessed will go down, therefore so will the size of the credits allocated by the Property Tax Adjustment program, and so will the cost of that

program. At the same time, we should reduce the generosity of PTA, so that as homestead property tax liabilities decrease the maximum income level for PTA eligibility goes down and the maximum dollar value of payment possible goes down. Other adjustments would be needed as well, for instance in the tax rate on household income, given that people are now actually paying based on income elsewhere. It is noteworthy that any homeowner with relatively high property tax liabilities due to either a high home value or high local property tax rates will see the biggest reduction in gross Homestead property tax liabilities (before any Property Tax Adjustments) with the addition of the income tax revenue to the Ed Fund, so they might need smaller subsidies overall.

The goal is to have a situation in which Vermonters pay for education on their income taxes, and if they own property they pay for education through property taxes as well. For many it might be an even switch, for many they would now pay more or less, depending on whether they have high income or high property values, and for those within the current PTA program, the goal would be to have more or less an even switch, but ending up with more variability in the remaining property tax component.

Because of the way that the scope of the PTA program would shrink more people are connected to the consequences of their school budget votes. But there would have to be a kind of reset process to reinstate the cost control mechanism at the new lower Homestead and Nonhomestead property tax rates. The reduction in these rates might lead voters to imagine the capacity to increase education or municipal spending and rates, forgetting that they are also paying for education on their income taxes. This would be another reason for imposing the surcharge gradually over time, so that a large drop in rates does not create the impression of taxing capacity, so to speak. Because the other parts of the system would not be fixed, the causes of different changes could be confusing.

Once the scope of the PTA program has shrunk like this, we can think about whether there is a better way to accomplish its goals – using MAGI instead of HHI, using a percentage or dollar value homesite value exemption, putting a housing tax credit on the income tax, etc. It is not clear to me that switching from the existing PTA program to a homesite exemption program is feasible without the accompaniment of the income tax surcharge revenue.

In order to prepare for a recession situation in which income tax revenues would decline, reserves should be accumulated. In addition, in such a situation voters might be less inclined to approve of higher budgets, which would constrain offsetting increases in property tax rates.

ALTERNATIVES.

I should note that I would be open to a version of an income tax surcharge that was just on Homestead property taxpayers if that were preferable. Presumably this charge would then be on a person's property tax bill. I would seriously consider this only if the other changes in the CU costs and the PTA program were also made.

I am not convinced that having an income tax rate that varies with budget votes is practicable, or worth the added complexity, but I could consider it as long as my other concerns were addressed as well.

I don't think I could support a version that has no Homestead property tax component, only a Homestead income tax, because of the connection between education spending and property value and because of the cost control mechanism. I will say again that the primary role of the Education Fund should be to finance education not to provide housing subsidies.