High-level feedback to Tax Structure Commission from Joint Fiscal Office on Education Chapter -received by 12/10/2020

Clearly communicating the problem(s), the solution(s), and the rationale for them

- Overall, the recommendations of the commission tend to be buried. Does the commission recommend a system based upon income with a single rate?
- There does not appear to be strength or conviction in the recommendation as there was with the sales tax chapter. It is a recommendation that taxes be based upon income but it is not laid out very strongly and is constantly weighed against other tax structures. Examples of this include:
    - The summary section (which should not be in the back of the report) says that the commission thinks simplicity can be achieved by taxing either property or income, but not both. Then it goes on to say that it thinks income is best. If it thinks that a pure income-based tax would be the best of the three broad options, a pure property-based tax would be second best, and the current hybrid model is the worst, why not say so straight away?
    - Section III is an overview of five various approaches that could be taken, complete with commission thoughts and pros and cons. This section is confusing because if the commission has decided upon a certain one of these, why is it overviewing all the other approaches in such detail? Giving Option 1 or Option 4 as much space in the report as the actual recommendation (which appears to be Option 3) muddles the overall recommendation of the report. The final recommendation of the commission is paramount. Section III should be called “Alternative Approaches Considered but Ultimately Not Recommended” and then lay out precisely why they were rejected as compared to the final recommendation.
- How were the five approaches chosen? The commission heard many hours of testimony on education funding, including significant policy options that do not seem to be represented here. It also heard testimony on the desirability of the current system and the belief that the current system represents the best compromise among the various goals of the tax system; those testimonies are not represented here. Of course, the commission is not compelled to reference every proposal it heard in testimony, but it would be helpful to have insight into the commission’s process for determining which approaches would make the cut and which would not.
- Several problems with the current system are referenced throughout the chapter, with complexity, equity, volatility, and cost control getting top billing as pain points and components such as the CLA being identified as culprits causing the pain. But the chapter seems to lack a comprehensive analysis of the major options for dealing with each of the culprits and the pros and cons of each. In other words, if policymakers determined that the commission’s preferred solution was untenable, would they still be left with a road map for addressing the pain points individually? Would the information in the report still be useful and actionable?

Clearly stating which policy and administrative details are being proposed and which are unresolved

- The report carries with it pretty drastic changes to the education taxation system but seems to gloss over the major overhaul this would represent and the details that would need to be ironed out by someone.
- Many details about using income taxes would need to be fleshed out: How would the tax base be established for this rate? Would it simply use AGI from a Vermonter's IN-111 PIT form? The report states that a homestead declaration and household income would still be required. Why? What about nonresidents? Would they pay the existing nonresident tax based on property value? Would it be better to use the consensus forecast for PIT for the upcoming fiscal year as the tax base?
- For individuals with very high incomes, their income fluctuates a lot from year to year. If the previous tax year's base was used for setting the rate, then an individual with a large capital gain in one year and then more normal income in another year would see a significant jump in their education income tax in that one year. This isn't a huge hurdle, but remember that with the personal income tax, the delay between the income and tax paid is, in most cases, a year or less. If the tax base for the education income tax were backward looking, then someone with a large capital gain would need to set aside money for at least a year so they could pay that tax bill.
- How would the property tax credit for renters work? Would an assessor appraise the value of the rental unit? How is the size of the credit determined? Is it simply dividing the property tax paid by the landlord by the number of units?
- Timing issues are also considerable and warrant more discussion.

Referencing lessons learned and best practices from other states

- Vermont's hybrid model for deriving the one-quarter of Education Fund dollars that come from homestead property tax may be unique, but the challenges inherent with education funding are not. Virtually all states struggle with cost control, equity, complexity, and volatility. How does Vermont stack up to other states in these regards? What lessons can Vermont learn from other states?
- Where do student equity and performance come into play? While these topics may be beyond this commission's scope, at least in terms of detailed solutions, ultimately they are the reason Vermont constructed this whole system. Plus, taxpayers like to know that their dollars are being spent efficiently and effectively. With Vermont's education spending levels near the top of the nation's, are there measures that could be taken to help taxpayers feel assured they are getting the most bang for their buck?

Discussing equity and progressivity in a comprehensive, nuanced manner

- Progressivity and ability to pay can be measured relative to a number of benchmarks, from income to wealth to property values. The chapter acknowledges that while there are correlations between income levels and property values, there is also significant heterogeneity. And yet the chapter seems to revert back to simply relating progressivity to income and equating income with ability to pay.
- Organizations such as the Lincoln Land Institute have noted the correlation between property value and wealth. Other states seem to acknowledge this as well, by virtue of

having both residential property taxes and income taxes contribute to the support of education.

- Tax systems built on both residential property taxes and income taxes seem better able to ensure contributions from high-income, low-wealth residents, low-income, high-wealth residents, and everyone in between than a system that doubles down on income and gives residential property a pass (or allows residential property taxes to contribute only to the much smaller non-educational, municipal tax).
- The piece talks a lot about vertical equity and the importance of a tax system that is progressive relative to income. A single rate based upon income would not represent progressivity. Would there be a progressive rate structure based upon income?

Addressing the role of balance and diversification in achieving revenue stability

- The chapter discusses the relative volatility of the property and income tax bases, but it glosses over the fact that the growth cycle of the two bases typically don't coincide.
  - Tom Kavet has pointed out that, with the exception of the Great Recession which was largely precipitated by the housing crisis/subprime mortgage crisis, real estate market cycles tend to be regional and completely different from business cycles.
  - For this reason, tax diversification plays a crucial role in achieving a stable revenue system and limiting pain during down years.
  - What would be the stability impact of removing residential property from the State's tax base portfolio and being the only state to not have taxes on residential property contribute to k-12 education?
- Studies from the Tax Policy Center and Federal Reserve Bank have shown that state tax revenue has become more sensitive to business cycle fluctuations as revenue streams become more dependent on income taxes in general and capital gains in particular.
  - The Rockefeller Institute has also pointed to the volatility of capital gains-related revenue, noting an extreme example of Massachusetts seeing capital gains-related revenue jump to $2.1B in 2008 then fall to $0.5B in 2009.
  - The California Legislature studied the factors that make personal income tax revenue so volatile.

Explaining the role of cost control

- The tax system is not the best way to ensure cost control in the education system, but the section seems too glossed over. The Administration spent three sessions hammering on school spending, Act 46 was passed to lower spending. All candidates for major state offices agreed with the statement "property taxes are too high." Property tax rates are quite high in Vermont and the reason is not because of the convoluted tax system.
- While Vermonters complain about the complexity of the system, they also complain as much if not more about the actual rates and dollars being too high. No taxation system is going to make individuals not complain about a tax if they feel the tax itself is too high. The report should at least touch upon the fact that, for those who believe property taxes are too high, the changing of the tax system is not likely to make those complaints go away. Rather, it will simply shift the burden to different people.
  - For instance, two years ago the legislature put the meals and rooms tax and sales tax in the education fund to diversify the sources of money in the Education Fund.

At the time, this was thought to be a good way to simplify the financing system and reduce volatility for taxpayers.
    - However, in 2021, there is great concern about the increase in property tax rates and the burden they will place on households in light of COVID-19 and significant increases in school spending.
    - The tax and financing system cannot solve this problem. Only more money or reduced spending can.

Considering the winners and losers of proposals

- Will this chapter, or another part of the report, discuss the combined state tax incidence by income?
- Given the diversity of household situations both at a point in time and over a lifetime, it would be helpful to widen the lens. Why should other taxpayers subsidize the low-income retiree with lots of wealth in housing and financial assets?
- What would be the top marginal aggregate income tax rate? Would it be over 10%? At what point does that rate scare off high-income entrepreneurs? What is the cost of doing so?
- The BRTC's minority report enumerated several downsides of the income tax vis a vis the property tax and consumption taxes. Should this chapter address those concerns?

Checking for consistency with rest of report

- Other sections of the report emphasize the value of conformity with other states and the risks inherent with being the only state to follow a particular approach. Should this chapter discuss how Vermont's education finance system is an outlier among the 50 states, how its income sensitivity program is more generous in terms of eligibility caps and benefit levels than virtually any other state, and that a move to a pure education income tax for all residents would presumably make Vermont the only state to not derive any education funding from a residential property tax? If there is a reason that conformity is crucial in other areas but less important in this one, that would be good to address directly.

Explaining jargon and acronyms

- Report will be accessible to a broader audience if terms like yield, CLA, EEGL, ARRA etc. are defined and explained.

Acknowledging the impacts of Covid-19 and recessions

- The Covid-19 recession may change many of our perceptions about the stability of the pieces of the tax base. We used to think of non-residential real estate as relatively stable but residential real estate as subject to housing booms and busts. Again, the Covid-19 recession has had the opposite effect in many markets. Such basic questions may be the starting point for the next Tax Structure Commission, but the questions need to be raised here.
- The chapter could benefit from a discussion of what the recommended changes would mean for countercyclical tax rates.