

## 2. Summary of Recommendations

The Commission makes the following recommendations:

1. **Restructure the homestead education tax**
2. **Broaden the sales tax base**
3. **Modernize income tax features**
4. **Undertake analysis in order to eliminate tax burden/benefit cliffs**
5. **Improve administration of property tax**
6. **Create a comprehensive telecommunications tax**
7. **Utilize tax policy to address climate change**
8. **Collaborate with other states to build a fairer, more sustainable tax system**

### Recommendation 1: Restructure the homestead education tax

#### Key components:

- A. Eliminate the Property Tax Credit
- B. Eliminate the homestead education property tax, and implement income-based education tax for all residents (owners and renters) with rate tied to locally voted budgets.
- C. Levy the non-homestead education property tax on all property except the residence and 2-acre site.
- D. Create renter credit to offset the non-homestead property tax effectively paid through their rent.

The commissioners agree that the complexity is overwhelming the effectiveness of the current homestead education tax.

We recommend eliminating the Property Tax Credit and levying a direct tax instead. The current system, with a homestead property tax in one year and an income-based credit coming in the following year, blurs the connection between the budget vote and the tax bill. It also leads people to see the credit as a subsidy rather than a means to calculate each household's fair share. It creates administrative issues for local officials who need to apply the credit to the tax bills, and then answer questions from homeowners. There are also confidentiality concerns, as the credit amount is an indication of household income. In addition, it means that a tax increase in one fiscal year is only partially covered in that year; some of the cost must be made up in the following fiscal year.

The current system allows homeowners to choose the lesser of the education property tax on their housesite or a tax on their income. This double system creates more than double the trouble, as it forces the match between the two systems, administered by different levels of government, with different calendars, with different confidentiality

requirements. We recommend moving to a single system and, to maintain equity, we recommend a direct residential tax on income.

Before endorsing income, we examined:

- Whether house value is a good proxy for wealth, and we found that it is not; house value is a high proportion of net worth for low income households and a low proportion of net worth for high income households.
- Whether house value is a good indication of income, and we found that it is not; a house value of average value is owned by households of all incomes.
- Whether a housesite exemption could offset the regressivity of the property tax without necessitating an income-based adjustment, and we found we could not.

Given the divergence between the value of a house and both income and wealth, and given the impracticality of determining, measuring or taxing net worth, the commission believes that income is the best way to measure taxpayer equity and the most progressive way to tax residents for education at this time.

While the historical and administrative reasons for the distinction between renters and homeowners are clear, the commission could not find a principle-based justification for treating the two groups of residents differently. The commission believes the locally voted education tax should be based on the income of all residents. Renters would receive a credit to offset the education property tax paid through their rent. We recommend initiating a process of data collection and analysis to enable the implementation of this change.

The commission believes that the equity of the locally voted education tax is crucially important. Unlike many other taxes, it both collects and distributes. After the allocation of categorical grants, we rely on the locally voted tax to raise the amount needed to provide the education of the students in each district. If this tax is inequitable, it is likely that education will be distributed inequitably. For this reason, we believe the relationship between income, poverty, and education spending is vitally important to track. At this time, it appears that a combination of district consolidation, heavier weighting for poverty, and moving to an income-based tax for residents will improve the equity of the education tax.

## **Recommendation 2: Broaden the sales tax base**

### **Key components:**

- A. Expand the sales tax base to all consumer-level purchases of goods and services except health care and casual consumer-to-consumer transactions.
- B. In health care, extend the provider tax to those provider categories that are not currently included.
- C. Use the gain from broadening the base to protect low-income Vermonters and reduce the sales tax rate to 3.6%.
- D. Continue to eliminate the sales tax on business inputs.

All other things being equal, a broader tax base is more fair, more sustainable/stable, and simpler than a narrow tax base. If you combine a broader tax base with a lower rate, the new system becomes even more sustainable.

Vermont has one of the narrowest sales tax bases in the nation. There are a variety of historical reasons for the exclusion of various industries and economic categories from the sales tax. We examine each of those reasons, find that there are only three categories whose exclusions from the sales tax still make sense: health care, whose complexity requires separate treatment; casual sales for which the administrative burden of sales tax collection outweighs the potential revenue; and business inputs.

In particular, we believe there are more efficient ways to protect low-income Vermonters from the burden of a sales tax on necessities, and more effective way to promote public goods than exemptions from the sales tax. We also believe that there is nothing inherent in services that makes them less amenable to a sales tax than goods, and the historic exclusion of most services from the sales tax will become more destabilizing over time as services become a larger and larger portion of the consumer economy.

As part of its proposal, the commission recommends extending the sales tax to those grocery-type items currently exempt from the Meals tax, including items like whole pies, cakes, loaves of bread, etc., to be consistent with the extension of the sales tax to groceries.

We conclude that health care is not amenable to a sales tax, but that we can create a functional approximation of a sales tax on health care, without limiting Vermonters' access to health care, by extending the provider tax to the remaining health care provider categories that are not currently subject to the provider tax.

Finally, we recommend putting almost all of the gain from broadening the sales tax/provider tax base into lowering the sales tax rate to around 3.6%.

### **Recommendation 3: Modernize income tax features**

#### **Key components:**

- A. Expand the personal income tax base.
- B. Study the effect on Vermont Pass-through Entities (PTEs) of an entity level tax.
- C. Examine opportunities to improve Vermont's estate tax.
- D. Explore options to improve the corporate income tax.

We recommend expanding the personal income tax base by a) continuing to promote Vermont as a remote worker destination and ensuring that rural areas have the infrastructure such as high speed broadband internet to support remote workers, and b)

continuing to review tax expenditures to ensure these expenditures are accomplishing the purpose for which they were intended.

We recommend studying the effect on Vermont Pass-through Entities (PEs) of an entity level tax to replace the present system of non-resident withholding and composite return filing. Consider mandatory composite filing for all PE with non-resident members. Continue to allow the individual non-residents to file a Vermont return and take a credit for their share of the taxes paid.

We recommend examining opportunities to improve Vermont's estate tax by: a) continuing to monitor what our neighboring states and the federal government are doing relative to exemptions, b) studying the possible elimination of the present estate tax structure and replacing it with a "capital gain" type of tax on death.

We recommend exploring several aspects of corporate income tax, including: a) the effect of adopting Finnegan with respect to Unitary Tax apportionment, b) the effect of adopting a Single Sales factor approach to apportionment for multistate corporations, c) tax expenditures related to the corporate tax to ensure they are still serving their intended purpose.

#### **Recommendation 4: Undertake analysis in order to eliminate tax burden/benefit cliffs**

##### **Key components:**

- A. Undertake an ongoing study of income, taxes, and the transfers or benefits that help families meet their basic needs.
- B. Find ways to lessen the steepness of the tax and benefit cliffs.

Although we think of taxes as payments to government, the redistribution of those payments, through benefits and credits, is crucial in determining the equity of the whole structure. A comprehensive and ongoing study of income, taxes, and the transfers or benefits that help families meet their basic needs would help future legislatures look at changes over time, recommend adjustments, and measure progress.

As has been demonstrated in the Basic Needs reports, different family types have different needs. Looking at the combined effect of taxes and public benefits for different family types at different income levels would reveal where the family may go backwards—earning more in wages but losing a greater amount in benefits (aka the benefit cliff). This is devastating if it is unexpected; if it is anticipated, it is a disincentive to work. We need to make it a reality for people to work more hours, take on more responsibility in their job, earn more money, and see some improvement in their ability to make ends meet.

There is a crucial link between our other recommendation to broaden taxes –particularly the sales tax—and this recommendation to analyze the current distribution of taxes and

benefits, and to remedy the unintended problems. A significant portion of the new revenue resulting from the broadened sales tax would be deployed to strengthen and rationalize the distribution system to support lower-income Vermonters, and to make sure that no one is harmed by the tax changes.

## **Recommendation 5: Improve administration of property tax**

### **Key components:**

- A. Move expenditures for mental health services and for employee health insurance from the Education Fund to the General Fund.
- B. Establish an ongoing Education Tax Advisory Committee.
- C. Develop a program at Property Valuation and Review to appraise large and/or complicated property and to defend the appraisals.
- D. Study alternatives to the common level of appraisal.

In order to align local budgets with the costs local officials can actually control, we recommend the State move expenditures for mental health services and for employee health insurance from the Education Fund to the General Fund, along with proportionate revenue sources.

We also call for an ongoing Education Tax Advisory Committee to monitor the system, to report regularly, and to make annual recommendations to the Legislature. Annual recommendations would include the tax rate(s) and yield(s) and the amount of the stabilization reserve. Other recommendations, such as adjusting student weights or other changes to the system could be brought to the Legislature's attention as needed.

We recommend the creation of a program at Property Valuation and Review to appraise large and/or complicated property and to defend the appraisals. We also recommend analyzing other ways in which local administration could be strengthened and supported by the State. The current per-parcel payment should be reviewed and a payment schedule that is based on both the size of the town and the certification of the local officials should be considered. We believe that the State can make investments in the administration of the property tax that will be offset by increased tax revenue.

Finally, we call for a study of alternatives to the common level of appraisal (CLA). The State must ensure Vermonters in different towns pay a comparable education tax on properties of equal value and therefore must be able to determine what constitutes equal value. However, the CLA can contribute to wild swings in valuation estimates and tax liability. Several alternatives have been proposed and should be studied to evaluate fairness, simplicity, and administrative burden.

## **Recommendation 6: Create a comprehensive telecommunications tax**

**Key components:**

- A. Repeal the Telephone Personal Property Tax (TPP).
- B. Study changing FCC regulations.
- C. Craft a comprehensive telecommunications tax with an adequate revenue stream to sustainably support the Vermont Universal Service Fund, E911 and public access services.

We recommend repealing the TPP tax as it is declining every year and is based on somewhat outdated technology as a base for the tax, and replace the lost revenue with another source based on more contemporary and long-term sustainable technology, or simply increase other telecommunications taxes on the providers to make up for this lost revenue.

We recommend creating a comprehensive telecommunications tax, with careful attention to changing FCC regulations, that also supports the Vermont Universal Service Fund, E911 and public access services.

**Recommendation 7: Utilize tax policy to address climate change****Key components:**

- A. Implement tax credits and exemptions to reduce the upfront cost of some investments that will make the transition to a low-carbon economy possible.
- B. Take a fresh look at the role of taxes in mitigating climate change.
- C. Whether it is a carbon tax or a cap-and-trade agreement, care must be taken to return revenue to lower-income households.

Even though the commission strives to keep the tax base as broad as possible, we support the use of tax credits and exemptions to reduce the upfront cost of investments that will make the transition to a low-carbon economy possible.

We recognize that Vermont, being farther north and farther from the Atlantic than many northeastern cities, will see interest from people moving to avoid the consequences of climate change. At the same time, we recognize that intact forests are important tools in addressing climate change as they store carbon, prevent erosion and flooding, and protect biodiversity. Are we able to guide new development toward villages and away from forests? The Vermont Climate Action Commission report puts it this way: “Demographic change, greenhouse gas emissions, severe weather, and financial challenges prompt a fresh look at Vermont’s smart growth strategies and land use governance as means to address climate change.” We agree. And we recommend that the fresh look include role of taxes in the mix.

Although the tools chosen to speed the transition to clean energy may not technically be taxes, we recommend carefully returning revenue or benefits to overcome any potential regressivity.

## **Recommendation 8: Collaborate with other states to build a fairer, more sustainable tax system**

### **Key components:**

- A. Add an annual excise tax to the registration fees for electric cars.
- B. Partner with other states to coordinate and strengthen our tax structures.
- C. Work with other states to develop uniform asset-reporting requirements and collect information.

Every state in the nation is evaluating decreases in gasoline consumption as a threat to transportation funds. We recommend that Vermont add an annual excise tax to the registration fees for electric cars as their contribution to the Transportation Fund in lieu of paying gas taxes. This tax should persist until the technology is available to charge each vehicle for the miles, or even better, the pound-miles it travels on Vermont roads. We also recommend that VTrans and Department of Taxes track other approaches as they progress in other states to ensure that our system continues to evolve and adopt best practices.

The commission recommends collecting information on assets in Vermont, initiating reporting requirements if necessary, and working with other states to explore the issues and to design and evaluate possible uniform approaches. The effort of the Multistate Tax Commission to bring clarity and consistency to the sales tax through the coordination of member states is a recommended model.

The commission recommends collaborating and partnering with other states to coordinate and strengthen our tax structures. Some past successful efforts include streamlining the sales tax with the Multistate Tax Commission and joining the Regional Greenhouse Gas Initiative. This type of partnership has the advantage of reducing the “race to the bottom” in which states try to lure business by lowering taxes; it clarifies jurisdictional issues; it simplifies filings for businesses in several states; and it improves the state’s tax structure. Rather than moving to the middle, together we may be able to move the middle, and end up with a fairer system.