Report on the Implementation of Senate Bill No. 175 of 2016

1. Statutory Charge

Act No. 132 of 2016 directs the Joint Fiscal Office, with the assistance of the Office of Legislative Council and the Department of Taxes, to prepare a report on the implementation of Senate Bill No. 175 as introduced. Relevant sections of Act 132 and Senate Bill No. 175 are included at the end of this report.

2. Overview

Senate Bill No. 175 (the proposal) would redistribute the education homestead tax burden by requiring most taxpayers to pay the tax on household income[1] rather the property value.[2] Compared to current law, the proposal would increase homestead taxes paid by most taxpayers with income over $90,000 and decrease homestead taxes paid by most taxpayers with income under $90,000.[3]

Rather than taxing income directly, the proposal would extend the current-law property tax adjustment to all taxpayers. For most taxpayers with income under $90,000, a property tax adjustment would be *subtracted* from the tax on homestead value in the following year; for most taxpayers with income over $90,000, a property tax adjustment would be *added* to the tax on homestead value in the following year.

Key findings:

- In FY2017, the median homestead tax under a revenue-neutral version of the proposal would have decreased by about 16% on taxpayers with income under $90,000 and would have increased by about 53% on taxpayers with income over $300,000.

- As drafted, it is unclear how taxpayers with income between $90,000 and $137,500 would have been treated under the proposal. Two alternatives that would have increased or decreased the homestead tax for these taxpayers are evaluated.

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[1] Throughout this report, income refers to household income. For this purpose, household income is generally federal adjusted gross income received in a calendar year by all persons of a household while members of that household. However, there are numerous modifications to this starting point. See http://tax.vermont.gov/property-owners/household-income/sources.

[2] If enacted, Senate Bill No. 175 would have applied to property tax adjustment claims filed for FY2018 and after. Claims filed in FY2018 would have appeared as an adjustment on property tax bills in FY2019. This analysis is based on school finance data for FY2017, the most recent data available.

[3] The homeowner rebate, which is available to taxpayers with income under $47,000 and effectively limits combined education and municipal property taxes to a fixed percentage of income between 2% and 5%, is not included in this analysis.

- Capping the amount of income subject to tax at $1 million would have reduced the total homestead tax by $16.4 million in FY2017. Even with this cap, the mean homestead tax for taxpayers in this income class would have increased by more than 127%.

- Processing an additional 57,000 property tax adjustment claims annually would increase the administrative burden on the Department of Taxes. In addition, municipal officials might have to reissue more property tax bills due to increased numbers of late filers.

- Directly taxing income would be simpler; however, the proposal offers the possibility of moving the education tax closer to an income tax without significantly disrupting existing state and local law and practice.

- Income taxes are generally more volatile than taxes based on property value; however, the overall impact of the proposal on the stability of Education Fund revenue sources would not necessarily be significant.

- Although the current-law homestead tax becomes regressive in the highest income classes, the incidence of the state's revenue system as a whole is more important than the incidence of any single one of its components.

- Additional legislation may be necessary to prevent taxpayers from converting homesteads to nonresidential property to avoid income-based taxes by transferring ownership to a trust or business entity and then renting the reclassified property.

- The Legislature addressed the issue of taxpayer confidentiality with the passage of Act 143 of 2012; however, high-income taxpayers may be sensitive about revealing their income to local officials for the first time.

A memorandum from the Department of Taxes summarizing administrative considerations raised by the proposal can be found on pages 12-15 of this report.

3. Application of the Property Tax Adjustment

This section describes how the property tax adjustment is determined and applied to homestead tax bills under current law and how the property tax adjustment and its application would be modified under the proposal.

a. Current Law

Under current law, the homestead tax is initially assessed on the value of the homestead. However, taxpayers with income under $90,000 may generally pay the tax on their "housesite" based on income rather than property value if the tax on income is lower. The housesite is a taxpayer's home and up to two acres of contiguous land; additional property is subject to the homestead tax on value regardless of a taxpayer's income.

There are some exceptions to the general rule that eligible taxpayers may pay the tax on income rather than housesite value: (1) housesite value in excess of $500,000 is taxed on its value regardless of a taxpayer's income; (2) taxpayers with income under $47,000 may take the homestead exemption and pay the property tax after deducting $15,000 from housesite value in lieu of the tax on income; and (3) a taxpayer's property tax adjustment (the difference in the tax bill based on income versus property value) may not exceed $8,000 annually.

In addition, in order to eliminate a benefit cliff, taxpayers with income over $90,000 may pay the tax on income *plus* the tax on housesite value in excess of $250,000. This provides a partial property tax adjustment that diminishes as income increases to taxpayers with income up to $137,500. For this purpose, the upper limit on income varies from year to year depending on the relationship between the tax rate on housesite value, the tax rate on income, and the housesite value limit.

Since the homestead tax is initially assessed on homestead value for all taxpayers, the property tax adjustment is used to ensure that eligible taxpayers ultimately pay the lower of the tax on income or the tax on value. The property tax adjustment is generally the difference between the tax on income and the tax on homestead value. This amount is *subtracted* from the tax on homestead value that appears on property tax bills the following year to determine the actual amount to be paid.[4]

b. Proposal

Under the proposal, the homestead tax on taxpayers with income under $90,000 would be determined in the same way it is determined under current law.[5] However, taxpayers with income over $90,000 would be required to pay the *higher* of the tax on housesite value or the tax on income. Since housesite value as a multiple of income generally decreases as income increases, the tax based on income usually would be higher – sometimes substantially higher – than the tax on housesite value for most taxpayers with high income.

Taxpayers with income between $90,000 and $137,500 would pay more under the proposal since these taxpayers would pay the higher of the tax on income or the tax on housesite value. Under current law, these taxpayers receive a partial property tax adjustment that is based partly on housesite value and partly on income. Since the intent of the bill may have been to

[4] Act 185 of 2006 provides that, beginning in FY2007, homestead property tax bills are reduced by the property tax adjustment. Previously, taxpayers received a "prebate" check to be used to help pay their property tax bill. See the "Property Tax Adjustment Study" prepared by the Department of Taxes in 2016 for a discussion of the reasons for the change.

[5] Under the proposal, the $8,000 cap on the property tax adjustment would be repealed. However, only 29 of the 376 taxpayers would have exceeded the cap on the homestead tax alone. Most taxpayers exceed the cap only after taking into account the homeowner rebate. Eliminating the cap on taxpayers receiving the homeowner rebate would cost $22.5 million – of this amount, $7.1 million would be paid for from the Education Fund.

hold these taxpayers harmless, a variation that would move the breakpoint from $90,000 to $137,500 is discussed below in Section c.

Under the proposal, the calculation of the property tax adjustment and its application to the property tax bills of taxpayers would not change. However, to ensure that taxpayers with income over $90,000 pay the higher of the tax on income or the tax on homestead value, the property tax adjustment would be *added* to rather than *subtracted* from the tax on homestead value that appears on the taxpayer's property tax bill in the following year to determine the actual amount to be paid.[6]

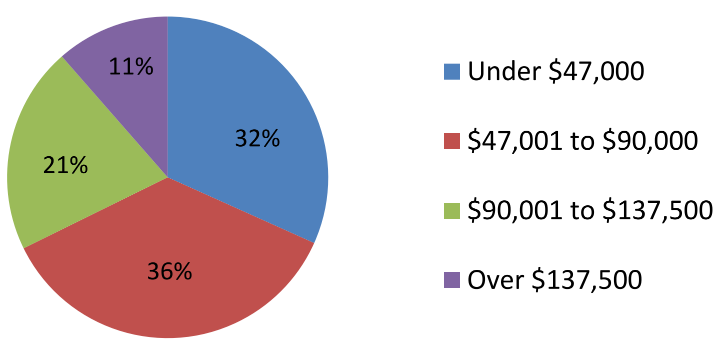
4. Analysis of Senate Bill No. 175

This analysis of the homestead tax burden is based on final FY2016 school finance data and estimated property tax adjustment claims for FY2017. Since only taxpayers claiming a property tax adjustment need to report their household income to the Department of Taxes, household income is not available for most taxpayers with income over $137,500. For the purpose of this analysis, adjusted gross income (AGI) has been used in lieu of household income when income is not available.

AGI is not a perfect proxy for household income. First, AGI is reported to the Department of Taxes by personal income tax filer rather than by household. Although most couples file joint tax returns, a household may include more than one filer. In addition, household income is defined broadly to include more sources of income than AGI, including nontaxable sources. However, AGI is the only available proxy and the difference between AGI and household income is generally not large, particularly for taxpayers in the higher income classes.

a. Homesteads by Income Class

The following pie chart shows the percentage of homesteads in each of four relevant income groups. The total number of homesteads statewide in FY2017 is estimated to be 170,830.



[6] See page 16 of this report for an illustration of the application of the proposed property tax adjustment to the homestead tax bills of two hypothetical taxpayers in FY2018.

b. Proposal as Introduced

The proposal as introduced would have raised about $78 million more than was raised on the homestead tax under current law. Under current law, this additional revenue would have been returned to taxpayers by raising the property and income yields and thereby lowering homestead tax rates for all taxpayers compared to the proposal.[7] The proposal is analyzed below both before and after this additional homestead tax revenue is accounted for so that the differences between the proposal and current law are more apparent.

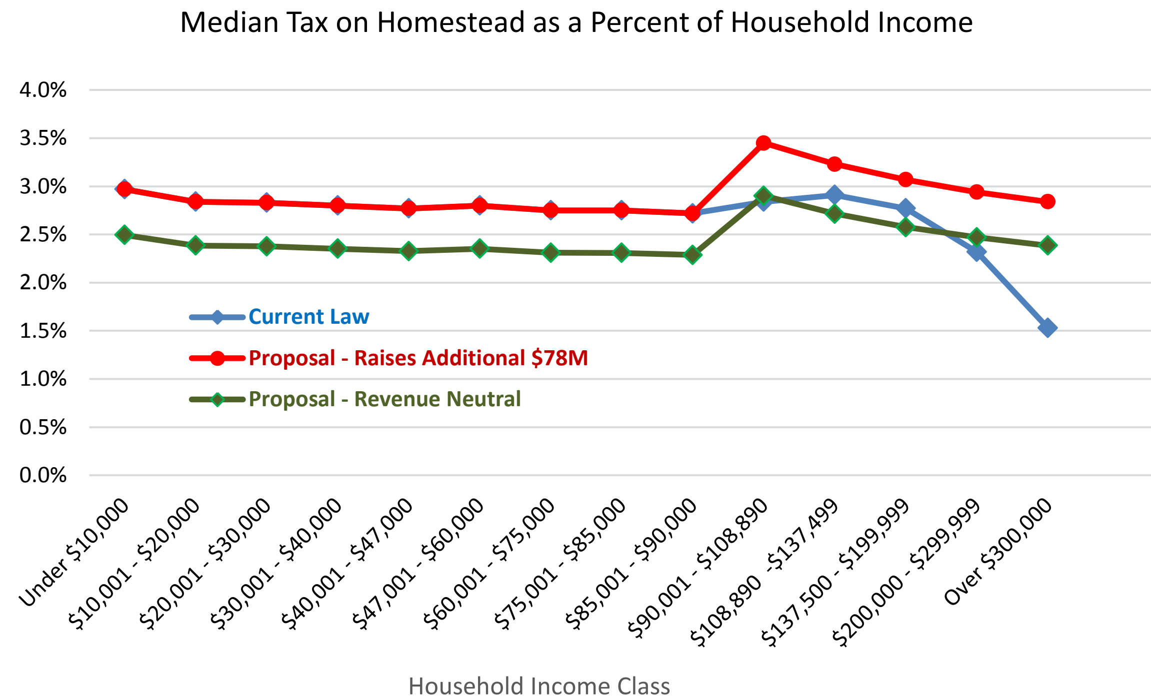
The following line graph compares the median tax on homesteads as a percent of income by income class under the proposal and current law. Initially, there would have been no change from current law for taxpayers with income under $90,000; however, after adjusting tax rates to be revenue neutral, the median homestead tax as a percentage of income for taxpayers in these income classes would have been about 16% lower than under current law.

Initially, for taxpayers with income between $90,001 and $137,500, the proposal would have resulted in a significant increase in the median homestead tax as a percent of income due to the loss of the partial property tax adjustment. Even after adjusting tax rates to be revenue neutral, the median homestead tax as a percent of income for taxpayers in the $90,001 to $108,890 income class would have been about 2% higher than under current law. This happens because the partial property tax adjustment declines as income increases from $90,000 to $137,500.

For taxpayers in the two highest income classes, the proposal would have brought the median tax on homesteads as a percent of income more in line with other taxpayers. Even after adjusting tax rates to be revenue neutral, the median homestead tax as a percent of income would have been significantly higher for most taxpayers with income over $200,000. For taxpayers with income over $300,000, the median homestead tax as a percent of income would have been almost 56% higher than under current law.

Two detailed tables comparing the mean homestead tax, median homestead tax, and median homestead tax as a percent of income by income class are included on pages 17 and 18 of this report. This information is presented graphically here:

[7] The homestead property tax rate equals a district's per-pupil education spending divided by the property yield. The tax rate on income equals 2% multiplied by a district's per-pupil education spending divided by the income yield. The property yield and the income yield are set annually subject to two additional conditions: (1) the Education Fund's statutory reserve is maintained at 5% of prior-year net appropriations; and (2) the percent change in the median homestead property tax, the median tax on income, and the nonresidential property tax are equal.



c. Variations

Several variations to the proposal as introduced are analyzed below.[8] These variations include: (i) repealing exceptions to the general rule that taxpayers with income under $90,000 may pay the homestead tax on income; (ii) capping the amount of income subject to the homestead tax; (iii) moving the income breakpoint from $90,000 to $137,500; and (iv) eliminating the tax on the value of property in excess of the housesite for taxpayers paying on income.

i. Repeal the Current-Law Exceptions to the General Rule

Repealing the current-law exceptions to the general rule that taxpayers with income under $90,000 may pay the lower of the tax on housesite value or income would simplify the homestead tax but would also require some of these taxpayers to pay more or less than under current law:

- About 1,000 taxpayers pay the homestead tax on the value of their housesite in excess of $500,000 in addition to the tax on income. Under this variation, these taxpayers would have paid a lower housesite tax than under current law.

- About 6,800 taxpayers with household income under $47,000 paid the homestead tax on the value of their housesite after deducting $15,000 from its fair market value in lieu of the tax on income. Under this variation, these taxpayers would have paid a higher homestead tax than under current law.

[8] Variations ii to iv are also analyzed without the current-law exceptions to the general rule that taxpayers with income under $90,000 may pay their tax on income.

Compared to the proposal as introduced, this variation would have reduced the total homestead tax by about $1 million.

ii. Cap the Amount of Income Subject to Tax at $1 Million

Since the homestead tax for taxpayers with very high income would increase significantly under the proposal, the statutory charge calls for an analysis of the impact of capping the amount of income subject to tax.

The following table presents the mean homestead tax for 350 taxpayers[9] with income over $1 million if the amount of income subject to tax had been limited to $1 million. Even with a $1 million cap, the mean homestead tax for this income class would have increased by $17,101 or more than 132% of the mean tax under current law.

Mean Homestead Tax

Income Class	Current Law	Proposal as Introduced	With $1M Income Cap
Over $1,000,000	$12,966	$75,712	$30,713

Compared to the proposal as introduced, this variation would have reduced the total homestead tax by about $16.4 million.

iii. Move the Income Breakpoint from $90,000 to $137,500

Under the proposal as introduced, it is unclear how the homestead tax would be determined for taxpayers with income between $90,000 and $137,500. For the purpose of the analysis presented above, it was assumed that these taxpayers would pay the higher of the tax on income or value. Although this would simplify the determination of the homestead tax, it would result in a significant tax increase for taxpayers in this income class over current law.

There are two variations that would have lowered the homestead tax on taxpayers in these income classes compared to the proposal as introduced:

- Maintain current law so that taxpayers in these income classes would continue to be eligible to lower their homestead tax on value with a partial property tax adjustment. Under this variation, these taxpayers would have paid the same amount as under current law.

- Move the income breakpoint from $90,000 to $137,000 so that taxpayers in these income classes would pay the lower, rather than the higher, of the tax on income or homestead value. Under this variation, these taxpayers would have paid less than under current law.

[9] The number of taxpayers with household income over $1 million can vary from year to year because of tax events such as the realization of capital gains.

The following table presents the mean homestead tax determined under each variation for taxpayers with income between $90,000 and $137,500. Under current law, about 35,600 taxpayers are eligible for a partial property tax adjustment.

Mean Homestead Tax

Income Class	Current Law	Proposal as Introduced	With $137,500 Breakpoint
$90,001 - $108,890	$3,121	$3,867	$2,675
$108,891 - $137,500	$3,984	$4,570	$3,250

Compared to the proposal as introduced, either of these variations would have reduced the statewide homestead tax: (1) Maintaining current law would have reduced the total homestead tax by about $23.6 million and (2) Moving the income breakpoint to $137,500 would have reduced the total homestead tax by about $45.8 million.

iv. Eliminating the Tax on the Value of Property in Excess of the Housesite

Applying the tax on income to the entire homestead, regardless of size, would simplify the determination of the homestead tax, but would also introduce some inequities to the benefit of taxpayers with homesteads that exceed two acres or include additional improvements. The value of additional acreage is generally much lower than the value of the two-acre housesite, especially in rural parts of the State and taxpayers with homesteads larger than 25 acres may be eligible to enroll their land in the use value appraisal program.[10]

The following table presents the average and total homestead tax on the value of additional acreage by income class under current law. Under current law, about 68,000 taxpayers paid their housesite tax plus the homestead tax on the value of additional property.

Homestead Tax on Additional Acreage

Income Class	Average	Total (millions)
Under $47,000	$144	$7.8
$47,001 - $90,000	$142	$8.7
$90,001 - $137,500	$182	$6.5
Over $137,500	$305	$5.5

Compared to the proposal as introduced, this variation would have reduced the total homestead tax by almost $29 million.

[10] Land enrolled in the use value appraisal program is classified as forest or agricultural land and subject to a flat tax per acre regardless of its fair market value. More than 727,000 acres of homestead property valued at $892 million is currently enrolled in the program.

5. Issues

a. Administration

Under the proposal, all resident homeowners would be required to report their income on Schedule HI-144 and file a property tax adjustment claim on Form HS-122 with the Department of Taxes annually.[11] Currently, only taxpayers claiming a property tax adjustment need to file these documents. The Department of Taxes currently processes about 160,000 household income schedules annually. If all taxpayers were required to file, the Department of Taxes would have to process forms for roughly 40,000 additional taxpayers annually at an estimated cost of $270,000 to $750,000.

There would be no direct impact on administration of the homestead tax at the municipal level unless the additional taxpayers required to file the Schedule HI-144 and Form HS-122 would significantly increase the number of taxpayers filing late. To the extent that taxpayers with income over $137,500 file their federal income tax forms late, administration of the homestead tax under the proposal could become more burdensome for local officials who would be required to reissue more tax bills.

b. Complexity

The current system of using the property tax adjustment to ensure that most taxpayers ultimately pay the homestead tax on income rather than housesite value is unnecessarily complex. Changes in housesite value, income, and homestead tax rates from one year to the next make it difficult for taxpayers to understand how their tax bill is determined and, in some cases, can create hardships for taxpayers with significant changes in their personal circumstances.

In many ways, directly taxing income would be much simpler. However, past attempts by the Legislature to move toward an education income tax dating back at least to the 1990s have run into significant technical and political difficulties. This proposal offers the possibility of moving closer to a homestead tax on income for all taxpayers without significantly disrupting current state and local law and practice. However, rather than reducing the complexity of the current system, the proposal would add an additional layer.

c. Volatility

Income taxes are generally less stable than taxes based on property value because taxes on income are more vulnerable to economic downturns, especially when they rely heavily on high-

[11] Schedule HI-144 is available here: http://tax.vermont.gov/sites/tax/files/documents/2016-HS-122-2015-HI-144.pdf and Form HS-122 is available here: http://tax.vermont.gov/sites/tax/files/documents/2015-HS-122-web.pdf.

income earners.[12] Although it is likely that the homestead tax on residents with income over $90,000 would become more volatile than under current law, the overall impact on Education Fund revenue sources would not necessarily be significant. Only $426.1 million or about 27% of total Education Fund revenue sources were attributable to the homestead tax in FY2017 and more than two-thirds of taxpayers already pay the homestead tax primarily on income.

d. High Marginal Personal Income Tax Rate

The current-law homestead tax becomes regressive in the highest income classes; however, the incidence of the state's revenue system as a whole is more important than the incidence of any single one of its components.[13] Vermont currently has very high marginal personal income tax rates. A significant increase in income-based taxes on taxpayers in the highest income classes who already bear a high personal income tax burden could lead some residents to consider establishing their domicile in other jurisdictions so that their Vermont property would be taxed at the uniform nonresidential property tax rate.

e. Homestead and Nonresidential Classification

Under current law, it might be possible for a taxpayer to have a homestead reclassified as a nonresidential property by transferring ownership of the homestead to a trust, a corporation, or some other entity and then renting the property. At present, this is not a significant issue because the tax rate on homesteads is generally lower than the uniform tax rate on nonresidential property or the difference between the two tax rates in districts where the homestead tax rate is higher is not large. Under the proposal, reclassification could become a problem because the difference between the homestead tax based on income and the nonresidential property tax could be very large for high-income taxpayers. It may be possible to address this issue through additional legislation related to the definition of homestead.

f. Taxpayer Confidentiality

Prior to FY2007, eligible taxpayers received their property tax adjustment directly in the form of a check. When the property tax adjustment was added to the homestead tax bill beginning in FY2007, taxpayers and local officials raised concerns about publicly disclosing a taxpayer's income. The Legislature addressed this issue with the passage of Act 143 of 2012. Under Act 143, the property tax adjustment provided by a municipality to a taxpayer shall be considered confidential return information subject to disclosure only in limited circumstances. In addition, taxpayers may opt to have the Department of Taxes apply their state personal income tax refund to the property tax adjustment to obscure their income. However, high-income taxpayers may be sensitive to revealing information related to their income to local officials for the first time.

[12] However, as became apparent during the recession beginning in late 2007, dramatic fluctuations in the growth of property values can occur. Since the implementation of Act 68 in FY2005, annual growth rates in the education grand list ranged from -2.0% to 13.3%.

[13] For a discussion of this issue see "Principles of a High-Quality State Revenue System," National Conference of State Legislatures, Fourth Edition, June 2001, updated June 2007.

g. Tax Liability Offsets

As drafted, the proposal would remove the ability of the Department of Taxes to offset property tax adjustments for outstanding tax liabilities. The property tax adjustment offset is particularly effective in collecting small debts that are often difficult or impossible to collect through other means. However, the proposal could be amended so that the Department of Taxes could continue to use this method to collect outstanding taxes owed by taxpayers eligible to receive a reduction in their property tax bill without affecting other parts of the proposal.

h. Transition Issues

Since property tax adjustments determined in any one year are not applied to homestead tax bills until the following year, full implementation of the proposal would take place over two tax years. In the second year of implementation, homestead taxes would increase significantly for high-income taxpayers. High-income taxpayers who sold their homesteads before taxes were assessed in the second year following implementation of the proposal would be able to avoid their full tax. Otherwise, no transition issues have been identified.

i. Other Issues

No other issues have been identified by the Joint Fiscal Office.

MEMORANDUM

TO: Joint Fiscal Office
FROM: Candace Morgan, Director of Policy, Outreach, and Legislative Affairs
Vermont Department of Taxes
DATE: December 6, 2016
SUBJECT: Administrative Considerations on S.175

The Tax Department was asked to comment on changes to tax administration resulting from the proposed S.175. The proposal under consideration would require homestead education taxpayers to pay based on household income rather than property value. Rather than taxing income directly, the proposal would extend the current-law property tax adjustment (PTA) to all homestead taxpayers. The current PTA system is complex to administer today; using this structure as a foundation for an income-based education tax creates and/or exacerbates some administrative challenges. Some high-level considerations are outlined below:

Department capacity

Under this proposal, all resident households would now receive an income-based “adjustment” to their Education Tax liability. This represents an increase of almost 50% in all PTA related work of the Tax Department, including: processing and verifying homestead declaration forms, processing and verifying household income forms, and responding to taxpayer issues related to property tax adjustments. Furthermore, the increase in adjustments is for those taxpayers with higher income, which generally have more complicated income types to verify on the household income form. Outreach and education to the newly affected filers would be another area of PTA-related work, which already draws significant department resources.

The Department of Taxes currently processes about 160,000 household income schedules annually. The household income form has about 30 income components, many of which are complicated or impossible to audit. Due to their complexity, about 34% of these schedules are subject to manual review by Department staff during the initial processing. Additionally, about 1,200 returns are examined every year by our audit staff. These are selected by using federal data to identify situations where household income is claimed to be less than what a taxpayer is reporting on their federal taxes.

If all taxpayers were required to file, the Department of Taxes would have to process forms for roughly 40,000 additional taxpayers. We would estimate that to absorb the additional work by having all resident taxpayers receive an income-based “adjustment,” the Department would need an additional 3 FTEs. The Department would also need to consider additional outreach costs and IT programming, depending on the nature of the changes. This would result in anywhere between $270,000 (3 FTEs only) to $750,000 (with programming costs and additional outreach factored in).

Introducing PTAs for higher-income filers

There are particular challenges to verifying household income forms from the new population of higher-income taxpayers that would be required to file under S.175. Higher-income filers more often report income types that are most difficult, often impossible, to verify from other income data sources, such as the federal return. For example, business losses and capital gains are difficult to check because the rules on the household income form are much different than for AGI.

Any Department verification of the household income form is based on federal tax forms. The Department must wait until the IRS finishes transmitting return data for that tax year, which usually happens more than a year after a filer received their PTAs. Adjustments to PTAs based on federal data verification (which require the town to rebill the taxpayer) happen to some extent today, but would happen more often under S.175 when the Department is tasked with checking complicated income components from higher-income filers that require federal data to verify. A large share of higher-income people file their federal taxes on extension (October 15), further delaying the receipt of federal data and Department adjustments.

Any consideration of S.175 should also include a review of the current household income schedule and identify possible ways to simplify the calculation. There are more than thirteen different types of income that must be reported on the form and seven allowable deductions from that income.[14] Many of the lines on the form are used by less than 5% of filers and small amounts of money are reported.

Of the thirteen types of income on the HI-144, about two-thirds of all filers enter an amount on the line for wages, salaries, and tips. The other types of income are reported at much lesser rates.

Table 1: HI-144 Income Types - Usage and Impact[15]

HI-144 Line	Income Type	Households Reporting	Median Amount ($)	Estimated PTA Impact ($)	Estimated RR Impact ($)
a	Cash public assistance and relief	2%	3,542	89	177
b	Social security, SSI, disability, railroad retirement, veteran's benefits, taxable and nontaxable	45%	17,735	443	887
c	Unemployment compensation/ worker's compensation	6%	3,165	79	158

[14] Taxpayers claiming a property tax adjustment must complete both the HS-122 (Declaration of Homestead) and the HI-144 (Household Income Schedule). The HI-144 is also used to calculate household income for renter rebate claims, filed on the PR-141.

[15] The median amounts in tables 1 and 2 are based on the household income schedules of taxpayers who reported an amount on the corresponding line. The estimated impacts represent the decrease to the property tax adjustment or renter rebate credits if the income type was no longer on the household income form (for someone who claimed the median amount).

d	Wages, salaries, tips, etc.	67%	40,255	1,006	2,013
e	Interest and dividends	52%	251	6	13
f	Interest on U.S., state, and municipal obligations, taxable and nontaxable	6%	650	16	33
g	Alimony, support money, child support, cash gifts	4%	5,400	135	270
h	Business Income	18%	8,455	211	423
i	Capital gains, taxable and nontaxable	17%	2,603	65	130
j	Taxable pensions, annuities, IRA and other retirement fund distributions	35%	11,335	283	567
k	Rental and royalty income	7%	3,521	88	176
l	Farm/partnerships/S corporations/LLC/Estate or Trust income	5%	7,842	196	392
m	Other income	24%	635	16	32

Of the seven different types of adjustments to household income, the adjustment for Social Security and Medicare tax withheld is used by about 71% of filers. The other adjustments that are allowed are used much less frequently.

Table 2: HI-144 Adjustment Types - Usage and Impact

HI-144 Line	Adjustment Type	Households Reporting	Median Amount ($)	Estimated PTA Impact ($)	Estimated RR Impact ($)
o	Social Security and Medicare tax withheld on wages	70.7%	3,307	83	165
p	Child support paid	1.3%	4,337	108	217
q1	Business Expenses for Reservists	0.1%	829	21	41
q2	Alimony Paid	0.4%	7,800	195	390
q3	Tuition and Fees	0.9%	1,743	44	87
q4	Self-employed health insurance deduction	5.3%	2,922	73	146
q5	Health Savings account deduction	1.7%	2,000	50	100

State revenue impact

As contemplated for this report, Sec. 3 of S.175 of 2016 removes the ability of the Department to offset PTAs for outstanding tax liabilities. [16] This is a powerful collection tool because PTA offset is effective in collecting debts from taxpayers that are often difficult/impossible to collect

[16] Sec. 3. 32 V.S.A. § 6064 is amended to read:

§ 6064. ~~CLAIM APPLIED AGAINST OUTSTANDING LIABILITIES~~

~~The amount of any property tax adjustment amount resulting under this chapter may be applied by the Commissioner, beginning July 1 of the calendar year in which the claim is filed, against any State tax liability outstanding against the claimant.~~ [Repealed.]

though other means. The state collects approximately $1.9M annually, across all tax types, from this collection method. The Department does not take a position on the use of PTA offset for the collection of delinquent taxes, but points out that this change would lead to an immediate revenue loss to the state.

Tax avoidance

S.175 requires homestead taxpayers to pay the proposed tax based on household income. Under current law, it is relatively easy for someone with means to legally avoid declaring a homestead in Vermont, claiming their Vermont home as nonresidential instead. To avoid declaring a homestead, a taxpayer merely needs to lease their property as of April 1, or spend more than half the year away from Vermont. Additionally, a taxpayer could transfer ownership of their homestead to a trust, corporation, or some other entity and then renting the property. Under current law, the money saved on property taxes by switching from a homestead taxpayer to a nonresidential taxpayer is relatively small (even for someone with a million-dollar home). The savings under the proposed legislation, however, could be significant (e.g. a household that makes $5M a year could owe an extra $125,000). With so much money on the line, it is a reasonable assumption that higher-income people with means would legally reclassify as nonresidents, thereby eroding the savings projected for the lower income households.

There are a number of loopholes to avoid paying the homestead tax rate under current law. Addressing the reclassification challenge through statutory changes to the definition of homestead is complicated, and would introduce an additional level of complexity with unintended consequences. It would be preferable to fix this tax avoidance issue by coming up with a new system for identifying who would pay education tax based on income.

Proposed Application of the Property Tax Adjustment

The following table illustrates the application of the property tax adjustment to the tax bills of two hypothetical homeowners in FY2018. The property tax adjustments are determined in FY2017 based on the difference between the tax on homestead value and the tax on income and applied to the taxpayers' property tax bills in FY2018.

Taxpayer with Income under $90,000	**FY2017**		**FY2018**	
	Homestead Value	Household Income	Homestead Value	Household Income[17]
Average homestead tax rates	$1.53	2.7%	$1.53	2.7%
Housesite value or income	$150,000	$75,000	$150,000	$75,000
Homestead tax (*lower* amount)	$2,291	$2,025	$2,291	$2,025
Less property tax adjustment			**($266)**	
Tax due			$2,025	
Tax based on income		$2,025		
Tax based on homestead value		$2,291		
Property tax adjustment		**($266)**		

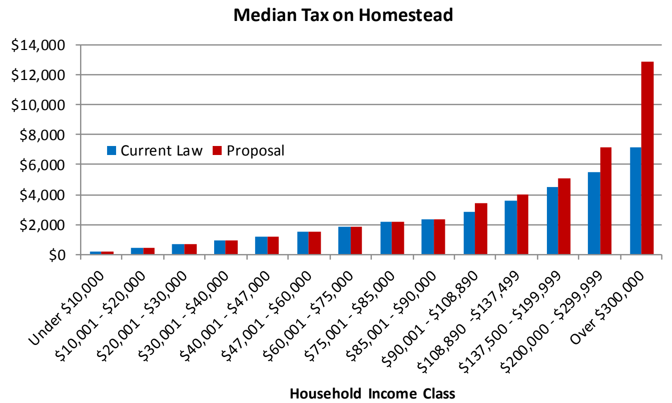
Taxpayer with Income over $90,000				
Average homestead tax rates	$1.53	2.7%	$1.53	2.7%
Housesite value or income	$300,000	$180,000	$300,000	$180,000
Homestead tax (*higher* amount)	$4,590	$4,860	$4,590	$4,860
Less property tax adjustment			**$270**	
Tax due			$4,860	
Tax based on income		$4,860		
Tax based on homestead value		$4,590		
Property tax adjustment		**$270**		

[17] To keep the illustration from getting too complicated, housesite value, income, and homestead tax rates are held constant over the two-year period.

Senate Bill No. 175 as introduced

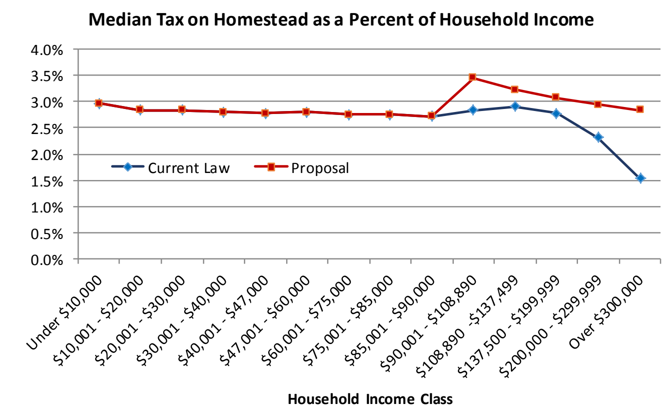
Tax on housesite only

Household Income Class	Current Law Average Tax	Current Law Median Tax	Median Percent of Income	Proposal Tax Ave	Proposal Tax Median	Tax/Income Median
Under $10,000	203	186	2.70%	202	186	2.70%
$10,001 - $20,000	409	410	2.69%	408	410	2.69%
$20,001 - $30,000	657	671	2.68%	657	671	2.68%
$30,001 - $40,000	911	937	2.68%	911	937	2.68%
$40,001 - $47,000	1,130	1,165	2.67%	1,130	1,165	2.67%
$47,001 - $60,000	1,422	1,438	2.68%	1,422	1,438	2.68%
$60,001 - $75,000	1,777	1,800	2.67%	1,777	1,800	2.67%
$75,001 - $85,000	2,094	2,134	2.67%	2,094	2,134	2.67%
$85,001 - $90,000	2,295	2,336	2.66%	2,295	2,336	2.66%
$90,001 - $108,890	2,964	2,718	2.75%	3,710	3,295	3.31%
$108,890 -$137,499	3,778	3,409	2.81%	4,364	3,891	3.11%
$137,500 - $199,999	4,749	4,294	2.65%	5,412	4,905	2.97%
$200,000 - $299,999	5,807	5,237	2.21%	7,429	6,955	2.84%
Over $300,000	8,077	6,752	1.44%	19,890	12,389	2.83%



Tax on housesite plus excess acres at property tax rate

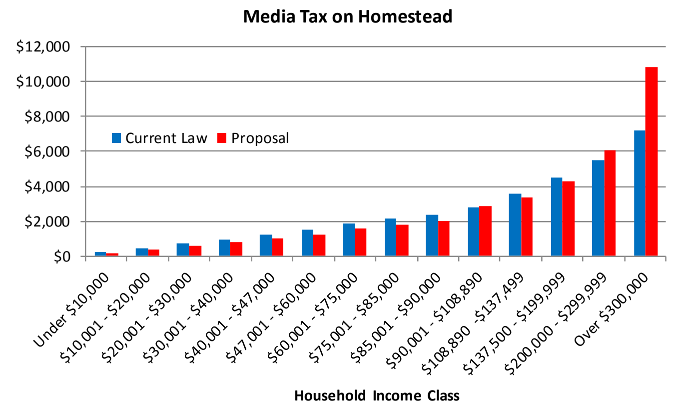
Household Income Class	Current Law Average Tax	Current Law Median Tax	Median Percent of Income	Pollina Tax Ave	Pollina Tax Median	Tax/Income Median
Under $10,000	400	231	2.97%	399	231	2.97%
$10,001 - $20,000	565	455	2.84%	564	455	2.84%
$20,001 - $30,000	805	717	2.83%	805	717	2.83%
$30,001 - $40,000	1,044	983	2.80%	1,044	983	2.80%
$40,001 - $47,000	1,261	1,206	2.77%	1,260	1,206	2.77%
$47,001 - $60,000	1,558	1,493	2.80%	1,558	1,493	2.80%
$60,001 - $75,000	1,914	1,861	2.75%	1,914	1,861	2.75%
$75,001 - $85,000	2,245	2,192	2.75%	2,245	2,192	2.75%
$85,001 - $90,000	2,455	2,396	2.72%	2,455	2,396	2.72%
$90,001 - $108,890	3,121	2,813	2.84%	3,867	3,417	3.45%
$108,890 -$137,499	3,984	3,557	2.91%	4,570	4,035	3.23%
$137,500 - $199,999	4,988	4,490	2.77%	5,651	5,078	3.07%
$200,000 - $299,999	6,123	5,498	2.32%	7,745	7,182	2.94%
Over $300,000	8,579	7,174	1.53%	20,392	12,914	2.84%



Senate Bill No. 175 as introduced -- Revenue Neutral

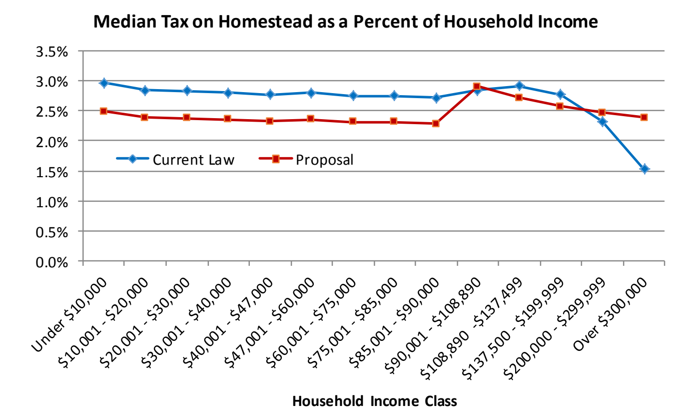
Tax on housesite only

Household Income Class	Current Law Average Tax	Current Law Median Tax	Median Percent of Income	Proposal Tax Ave	Proposal Tax Median	Tax/Income Median
Under $10,000	203	186	2.70%	169.78	156.41	2.27%
$10,001 - $20,000	409	410	2.69%	342.84	343.98	2.26%
$20,001 - $30,000	657	671	2.68%	551.73	563.59	2.25%
$30,001 - $40,000	911	937	2.68%	765.36	787.45	2.25%
$40,001 - $47,000	1,130	1,165	2.67%	948.88	978.19	2.24%
$47,001 - $60,000	1,422	1,438	2.68%	1194.77	1207.76	2.25%
$60,001 - $75,000	1,777	1,800	2.67%	1492.30	1512.13	2.24%
$75,001 - $85,000	2,094	2,134	2.67%	1759.20	1792.28	2.24%
$85,001 - $90,000	2,295	2,336	2.66%	1927.70	1961.97	2.23%
$90,001 - $108,890	2,964	2,718	2.75%	3116.33	2767.81	2.78%
$108,890 -$137,499	3,778	3,409	2.81%	3665.94	3268.65	2.61%
$137,500 - $199,999	4,749	4,294	2.65%	4546.30	4120.28	2.49%
$200,000 - $299,999	5,807	5,237	2.21%	6240.11	5842.20	2.39%
Over $300,000	8,077	6,752	1.44%	16707.79	10406.75	2.38%



Tax on housesite plus excess acres at property tax rate

Household Income Class	Current Law Average Tax	Current Law Median Tax	Median Percent of Income	Pollina Tax Ave	Pollina Tax Median	Tax/Income Median
Under $10,000	400	231	2.97%	335.12	194.32	2.49%
$10,001 - $20,000	565	455	2.84%	473.99	382.48	2.39%
$20,001 - $30,000	805	717	2.83%	676.48	602.06	2.38%
$30,001 - $40,000	1,044	983	2.80%	876.91	825.61	2.35%
$40,001 - $47,000	1,261	1,206	2.77%	1058.80	1012.78	2.33%
$47,001 - $60,000	1,558	1,493	2.80%	1308.53	1254.36	2.35%
$60,001 - $75,000	1,914	1,861	2.75%	1608.17	1563.19	2.31%
$75,001 - $85,000	2,245	2,192	2.75%	1885.53	1841.26	2.31%
$85,001 - $90,000	2,455	2,396	2.72%	2062.60	2012.96	2.29%
$90,001 - $108,890	3,121	2,813	2.84%	3248.19	2869.87	2.90%
$108,890 -$137,499	3,984	3,557	2.91%	3839.19	3389.08	2.72%
$137,500 - $199,999	4,988	4,490	2.77%	4747.15	4265.21	2.58%
$200,000 - $299,999	6,123	5,498	2.32%	6505.95	6032.90	2.47%
Over $300,000	8,579	7,174	1.53%	17129.17	10847.97	2.39%



Act No. 132 of 2016

Sec. 8. IMPLEMENTATION OF S.175 OF 2016
(a) On or before December 15, 2016, the Joint Fiscal Office, with the assistance of the Office of Legislative Council and the Department of Taxes, shall issue a report identifying any issues related to the implementation of S.175 of 2016, an act relating to creating an education tax that is adjusted by income for all taxpayers. The report shall be delivered to the Senate Committees on Finance and on Education and the House Committees on Ways and Means and on Education.

(b) The report shall address:

(1) the impact of the proposed changes on different groups of taxpayers, including taxpayers who pay an education property tax based on property value and those who pay based on income, given a transition point in Sec. 4 of this act of $47,000.00, $90,000.00, and $250,000.00;

(2) the impact of imposing a cap, of various amounts, on the total amount of taxes paid by a taxpayer under the proposal, but at least including an analysis of a cap of $25,000.00;

(3) the impact of the proposed changes on towns and the State, including administrative issues resulting from the proposed changes;

(4) any transition issues created by the proposed changes;

(5) the impact of the proposed changes on taxpayer confidentiality, if any; and

(6) any related issues identified by the Joint Fiscal Office.

Senate Bill No. 175

It is hereby enacted by the General Assembly of the State of Vermont:

Sec. 1. 32 V.S.A. § 6062(b) is amended to read:

(b) ~~Only one claimant per household per year shall be entitled to relief~~ One claimant per household shall file for an income adjustment under this chapter.

Sec. 2. 32 V.S.A. § 6063(a) is amended to read:

(a) The ~~right~~ requirement to file a claim under this chapter is personal to the claimant and shall not survive his or her death, but the right may be exercised on behalf of a claimant by his or her legal guardian or attorney-in-fact. When a claimant dies after having filed a timely claim, the property 1 tax adjustment amount shall be credited to the homestead property tax liability of the claimant's estate, as provided in section 6066a of this title.

Sec. 3. 32 V.S.A. § 6064 is amended to read:

§ 6064. ~~CLAIM APPLIED AGAINST OUTSTANDING LIABILITIES~~
~~The amount of any property tax adjustment amount resulting under this chapter may be applied by the Commissioner, beginning July 1 of the calendar year in which the claim is filed, against any State tax liability outstanding against the claimant.~~ [Repealed.]

Sec. 4. 32 V.S.A. § 6066 is amended to read:

§ 6066. COMPUTATION OF INCOME ADJUSTMENT

(a) ~~An eligible~~ The homestead education property tax of a claimant who owned the homestead on April 1 of the year in which the claim is filed shall be ~~entitled to an adjustment amount~~ determined as follows:

(1)(A) For a claimant with household income of $90,000.00 or more<u>, the education property tax shall be the greater of:</u>

(i) the statewide education tax rate, multiplied by the equalized value of the housesite in the taxable year; or

(ii) ~~minus (if less)~~ the sum of:

(I) the income percentage of household income for the taxable year; plus

II) the statewide education tax rate, multiplied by the equalized value of the housesite in the taxable year in excess of $250,000.00.

(B) For a claimant with household income of less than $90,000.00 but more than $47,000.00, the education property tax shall be the lesser of:

(i) the statewide education tax rate, multiplied by the equalized value of the housesite in the taxable year, minus (if less); or

(ii) the sum of:

(i)(I) the income percentage of household income for the taxable year; plus

(ii)(II) the statewide education tax rate, multiplied by the equalized value of the housesite in the taxable year in excess of $500,000.00.

(C) For a claimant whose household income does not exceed $47,000.00, the education property tax shall be the lesser of:

(i) the statewide education tax rate, multiplied by the equalized value of the housesite in the taxable year, minus the lesser of:

~~(i)~~(ii) the sum of the income percentage of household income for the taxable year plus the statewide education tax rate, multiplied by the equalized value of the housesite in the taxable year in excess of $500,000.00; or

~~(ii)~~(iii) the statewide education tax rate, multiplied by the equalized value of the housesite in the taxable year reduced by $15,000.00.

(2) “Income percentage” in this section means two percent, multiplied by the education income tax spending adjustment under subdivision 5401(13)(B) of this title for the property tax year which begins in the claim year for the municipality in which the homestead residence is located.

(3) A claimant whose household income does not exceed $47,000.00 shall also be entitled to an additional adjustment amount equal to the amount by which the property taxes for the municipal fiscal year which began in the taxable year upon the claimant’s housesite~~, reduced by the adjustment amount determined under subdivisions (1) and (2) of this subsection, exceeds~~ exceed a percentage of the claimant’s household income for the taxable year as follows:

If household income (rounded to then the taxpayer is entitled to the nearest dollar) is: credit for the reduced property tax in excess of this percent of that income:

$0 - 9,999.00	2.0
$10,000.00 - 24,999.00	4.5
$25,000.00 - 47,000.00	5.0

(4) In no event shall the credit provided for in subdivision (3) of this subsection exceed the amount of the reduced property tax.

(b) An eligible claimant who rented the homestead, whose household income does not exceed $47,000.00, and who submits a certificate of allocable rent shall be entitled to a credit against the claimant’s tax liability under chapter 151 of this title 1 equal to the amount by which the allocable rent upon the claimant’s housesite exceeds a percentage of the claimant’s household income for the taxable year as follows:

If household income (rounded to then the taxpayer is entitled to the nearest dollar) is: credit for allocable rent paid in excess of this percent of that income:

$0 - 9,999.00	2.0
$10,000.00 - 24,999.00	4.5
$25,000.00 - 47,000.00	5.0

In no event shall the credit exceed the amount of the allocable rent.

Sec. 5. 32 V.S.A. § 6067 is amended to read:

§ 6067. CREDIT LIMITATIONS
~~Only one individual per household per taxable year shall be entitled to a benefit under this chapter.~~ An individual who received a homestead exemption or adjustment with respect to property taxes assessed by another state for the taxable year shall not be entitled to receive an adjustment under this chapter. No taxpayer shall receive an adjustment under subsection 6066(b) of this title in excess of $3,000.00. ~~No taxpayer shall receive total adjustments under this chapter in excess of $8,000.00 related to any one property tax year.~~

Sec. 6. 32 V.S.A. § 6068 is amended to read:

§ 6068. APPLICATION AND TIME FOR FILING

(a) A tax adjustment claim or request for allocation of an income tax refund to homestead property tax payment shall be filed with the Commissioner on or before the due date for filing the Vermont income tax return, without extension, and shall describe the school district in which the homestead property is located and shall particularly describe the homestead property for which the adjustment or allocation is sought, including the school parcel
account number prescribed in subsection 5404(b) of this title. A renter rebate claim shall be filed with the Commissioner on or before the due date for filing the Vermont income tax return, without extension.

(b) ~~Late-filing penalties.~~ If the claimant fails to file a timely claim~~, the amount of the property tax adjustment under this chapter shall be reduced by $15.00, but not below $0.00, which shall be paid to the municipality for the cost of issuing an adjusted homestead property tax bill. No benefit shall be allowed in the calendar year unless the claim is filed with the Commissioner on~~
~~or before October 15~~ but files a claim on or before October 15, the Department of Taxes shall charge the claimant a late filing fee of $15.00. If the claimant fails to file a claim on or before October 15, then notwithstanding any other provision of law, the Department of Taxes shall calculate the adjustment amount under subdivision 6066(a)(1)(A) of this title as four times the statewide education tax 1 rate, multiplied by the equalized value of the housesite in the taxable year, and the Department of Taxes shall calculate the adjustment amount under subdivision 6066(a)(1)(B) of this title as two times the statewide education tax rate, multiplied by the equalized value of the housesite in the taxable year.

~~(c) No request for allocation of an income tax refund or for a renter rebate claim may be made after October 15.~~ [Repealed.]

Sec. 8. EFFECTIVE DATE
This act shall take effect on January 1, 2017 and apply to income adjustment claims filed for fiscal year 2018 and after.