

To: Joint Fiscal Committee
From: Mark Perrault, JFO
Peter Griffin, LC
Date: September 20, 2011
Subject: Flood-related property tax abatements

We have been asked to look at the issues raised with education tax abatements for taxpayers who suffered flood-related property damage during Tropical Storm Irene. It is likely that some of these taxpayers will be asking local boards to abate their education taxes for FY2012. Under current law, although local boards have the authority to abate education taxes, towns remain obligated to the state for the full amount due. Other property taxpayers in town must make up the difference.

We do not yet know the total value of taxable property that has been lost to the flood, but some hard-hit towns may have difficulty absorbing the cost of abating their municipal tax let alone the education tax. The question is likely to arise that towns will be asking the state to forgive all or a portion of the education tax due on flood-damaged property.

Once the statutory criteria are met, local boards are largely free to use their own discretion as to whether abating the education tax is warranted. In addition, it appears a town could choose to abate education taxes without abating municipal taxes. Decision-making by local boards raises several issues that policy-makers should consider before committing to cover the cost of flood-related education tax abatements:

- Local boards would be granted power to abate state education tax without any consequences for other town taxpayers. This also moves decision making about the imposition of a state tax to local officials.
- Since the cost of the state tax abatements would be borne statewide if the education tax abatement was fully covered by the state, local boards might be too generous in granting abatements. Under current law, boards could abate the education tax and not the municipal property tax which increases this concern. In addition, local decision-making would inevitably result in different outcomes for similarly-situated taxpayers living in different towns. To the extent that some sort of legislation was developed, establishing uniform guidelines could minimize some of these issues.
- Unless a source of non-property tax revenue is indentified, the cost of abating the education tax on flood-damaged property would ultimately result in higher base education tax rates for other taxpayers.
- There are equity issues in several respects:
 - No such practice was in place for the spring floods or other more limited disasters.

- There is no similar abatement process for taxpayers paying on the basis of income when their income falls.
- There is likelihood that such events will be more frequent given global warming. A legislature initiative would be setting a precedent for future disasters.

If the legislature does choose to move forward with some full or partial abatement, the cost estimates are as follows: The cost of flood-related abatement of education taxes may range between \$2 and \$4 million. There are several factors mitigating the cost:

- For most Vermonters, the abatement would be only the difference between the income-sensitized tax and the education tax on the diminished value of their housesite.
- Most of the flood-related property damage is likely to be residential.
- The education tax does not apply to the value of machinery & equipment or inventory.

Property damage due to Irene will result in the ongoing loss of some education tax revenues, but otherwise, this is a one-year issue. Next April 1st, the grand list will be revised to account for losses towns will be liable to the state only for the education tax actually assessed.

State Funding of Education Property Tax Abatements

Draft 1.0

**Prepared by Rep. Oliver Olsen
September 25, 2011**

Introduction

Tropical Storm Irene caused substantial destruction to hundreds of Vermont homes, businesses, and other structures. As a consequence, many Vermont municipalities will be confronted with requests for property tax abatements.

Under current law, the lost revenue associated with an abated property tax payment is absorbed by the property taxpayers within that municipality, which increases the municipal property tax rate (all other things being equal). However, the impact is magnified by the abated education tax, which is not absorbed into the statewide education grand lists, but is instead absorbed into the municipal budget – an expense that is shifted onto the municipal tax rate.

The Joint Fiscal Office and Legislative Council have drafted a memo (dated September 20, 2011) that explores this issue in some detail, and raises a number of policy questions that the Legislature will need to consider if statutory changes are contemplated.

The purpose of this paper is to build on the JFO/LC memo, by offering additional perspective and some ideas that could be incorporated into a potential solution.

Equity in Relation to the State's Education Finance System

Vermont's education finance system is designed to equalize access to funding for primary and secondary education. In theory, if two towns have the same per pupil costs to educate their children, the tax rate in each town should be identical, even if one town has substantially greater property wealth (i.e. a larger tax base). For the purpose of education taxation, there is one statewide grand list. And although local municipalities are required to collect the tax, it is, by definition, a state tax.

So, if we accept the fact that this is fundamentally a state tax, and we apply the associated principles of equity to the question of education tax abatements, logic would dictate that the state should shoulder the financial burden of education tax abatement. In essence, for the education finance system to truly be equitable, we should equalize the cost of education tax abatements across the statewide grand list, just as we equalize access to property wealth for tax collection purposes. Otherwise, we end up obfuscating an inequitable education tax burden by shifting it into the municipal budget.

What clouds the abatement issue is the fact that local municipalities are entrusted with the authority to abate property taxes, including the education tax. So even though the education tax is a state tax, the state has no control over these abatement decisions. The JFO/LC memo raises a valid concern that some municipalities could be overly generous with abatements, since they can choose to abate the education tax, but not the municipal tax, under current law. This risk would be mitigated if municipal and education taxes were linked for abatement purposes (i.e. the municipality would have to abate the municipal taxes proportionately to the education tax).

Proportionality of Impact

The proportionality of fiscal impact on municipalities is another consideration when developing a sustainable and equitable policy for state funding of education tax abatements.

Most towns can absorb a few of abatements annually with minimal impact to the municipal tax rate. However, in the aftermath of a major disaster, some municipalities will be faced with an elevated number of abatement requests. When coupled with the cost of repairing damaged municipal infrastructure, the added cost of state education tax abatements becomes disproportionately burdensome.

The use of a damage threshold could provide a sustainable approach to determining whether the state will absorb the cost of tax abatements. For example, if damage and tax abatements related to an officially declared disaster exceed certain a percentage of the municipal budget, the state would cover the cost of any education tax abatements granted by the municipality.

Equity of Abatement Process

One of the problems with the abatement process today is that there is no common standard that municipalities use – if the broad eligibility criteria are met, the board of abatement has wide discretion to grant a full or partial abatement. In the best of times, some municipalities may be more generous than other municipalities with their abatements, even when presented with similar circumstances.

The inequity of the abatement process becomes more problematic in a community that is financially distressed. There is a risk that a municipality (due to infrastructure repair costs, volume of abatements, etc.) could deny justifiable abatement requests out of financial concern for the municipality. As a result, some of the hardest hit property owners in devastated communities could be denied much needed tax relief that they otherwise would have received if their town were in a stronger financial position.

Greater equity in the abatement process would be afforded by having the state absorb the cost of education tax abatements in the worst affected disaster areas. Additionally, along with funding, the state could provide more specific (and uniform) criteria for abatement of the education tax.

Abatement as an Investment in Recovery

For property owners who are unable to use their property and face substantial reconstruction costs, a property tax bill is one more financial obstacle on the road to recovery. In these cases, for every tax dollar we abate, we free up one more dollar for reconstruction.

The greater the financial burden left on the property owner, the greater the risk that he or she will not rebuild – reducing the property value and long term tax revenues. Freeing up money now will help accelerate the rebuilding process, which will help ensure that these properties stay on the grand list at full value, and remain taxable in future years.

State Funding of Abatements as Leverage to Encourage Best Practices

State funding for tax abatements could be used as an incentive to encourage best practice disaster mitigation planning and implementation at the municipal level. For example, as a condition of receiving state funding towards tax abatement, a municipality could be required to:

- become a participant (in good standing) of the National Flood Insurance Program (NFIP), if it is not already;
- avail themselves of the FEMA Disaster Mitigation Grant program to purchase and remove structures within the floodway (the riskiest sub-section of any FEMA mapped flood hazard area) where an abatement is to be granted;
- implement an emergency management plan, if it does not already have one.

Potential Sources of Funding

- **Existing Property Transfer Tax** – reduce the allocation to the housing and conservation trust fund from 50% to 30% and make the remaining 20% available to fund abatement grants. This would leave enough money to continue funding affordable housing programs, but would require VHCB to *temporarily* scale back and/or defer land conservation programs that are not already *contractually obligated* in FY12.
- **Savings from Non-Essential GF Spending Reductions** – a reduction of non-essential spending in FY12 should yield millions of dollars that can be reallocated to a tax abatement program for disaster areas.

