

February 15, 2018

The Honorable Janet Ancel, Chair  
House Ways and Means Committee  
Vermont State House  
115 State Street  
Montpelier, VT 05633

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Dear Representative Ancel,

I'm writing about the Ways and Means Committee's work this session on education funding. I understand the challenges the committee faces in making changes to the system, and it appears that there is a lot about the plan that has not yet been worked out. Nevertheless, I want to share some thoughts about the plan so far based on Public Assets Institute's analysis of the information the committee has posted on the Legislature's website.

**1. Income taxes:** The plan proposes to replace Vermonters' current option of paying school taxes on their primary residence based on household income with a statewide progressive income tax. The latest Tax Department data show that Vermonters paying school taxes based on income had household income of just under \$7 billion in 2017. At an average income-based tax rate of 2.55 percent based on JFO's recent Education Fund Outlook, they will pay about \$178 million in income-based taxes in fiscal 2018. The plan would raise \$172 million in new statewide education income taxes.

*Observations:* While this change would slightly reduce the amount of income-based taxes Vermonters pay to the Education Fund, unlike the existing income-based tax, the new education income tax is progressive. It would increase taxes on those at the top who currently pay the lowest percentage of their income in school taxes. However, while income-based school tax rates currently increase with per-pupil spending in each town, the new education income tax has fixed statewide rates. Because the rates are fixed and do not vary with per-pupil spending, we are concerned that the income tax as a percentage of total Education Fund revenue may decline over time as property taxes increase and would like to see the committee's longer-term revenue projections.

**2. Homestead property taxes:** Under the current system, when per-pupil spending goes up in a town, the homestead property and income rates both go up proportionally. Residents get to choose which tax they pay. Under the proposed plan, the most popular option, the homestead income-based tax option used by two-thirds of owner-occupied households, would be eliminated. This means that the homestead property tax rate would be adjusted to reflect changes in a town's voted spending above the base payment.

*Observations:* Under the proposed plan, when voters decide to spend more to educate their children, their only choice will be to increase property taxes, which

are regressive, rather than a tax based on their ability to pay. Acts 60 & 68 were designed to ensure that access to educational resources is not a function of school district wealth, whether property wealth or income wealth. By having the marginal school tax rates, that is, the tax rates affected by changes in a school district's voted per-pupil spending, be homestead property taxes, we are concerned that school districts, especially those with a significant number of low- and moderate-income homeowners, will be forced to vote down school budgets that income-wealthier districts will be able to afford, thus undermining equal access to educational opportunity.

**3. Tax consequences for school district spending decisions:** One of the current challenges for voters is the disconnect between changes in their education spending and changes in their school district's tax rates. The Common Level of Appraisal and the legislatively set yield often have a bigger impact on homestead tax rates than changes in a school district's education spending, leaving voters unsure what they are paying for and school districts frustrated that their efforts at cost control have little impact on their tax rates. They have local control over the budgets they pass, but not over the tax rates they face. The proposed plan includes a mechanism, like that in the original Act 60, that provides a basic amount per pupil to every district and then creates a sharing pool among all the towns that spend more than that amount. This structure means that towns in the pool face tax rates that will grow disproportionately faster than their spending increases. This provision of Act 60 was repealed a few years after passage because it was too confusing for voters.

*Observations:* With a commitment to local control, Vermont's school funding system relies on direct democracy decision-making by the voters of each town to set school budgets. For that process to work, the tax consequences of voters' spending decisions need to be crystal clear. The current system is too confusing for that process to work effectively, especially because of the Common Level of Appraisal (CLA) adjustment in each town and annual legislative actions that change the rules about how spending relates to taxes. The proposed plan provides a means for a January decision by the Emergency Board on the amount of per-pupil spending that the tax rate will yield, which will help provide clarity for school district voters. However, by leaving the property tax as the variable-rate tax that moves with spending per pupil, the plan doesn't address the confusion created by the CLA. The plan will create additional confusion by reverting to the repealed system, worsening the disconnect between tax-rate increases and spending per pupil increases.

**4. Streamlining:** The existing system is confusing to voters and complicated to operate. It needs to be streamlined. While the proposed plan's repeal of the option of paying school taxes based on income makes the system simpler by creating fewer options for taxpayers, it leaves the property tax in place as the single tax that moves with spending per pupil. The plan provides for a large sliding-scale homestead exemption adjustment to address taxpayers' ability to pay. It's not clear yet how this adjustment will be accomplished.

*Observations:* Large adjustments, like the proposed homestead exemption, are evidence of the failure of the tax system to address its goals efficiently. A more direct approach that bases school funding on taxpayers ability to pay without the need for an adjustment would be simpler and more efficient. On balance the proposed system increases complexity for taxpayers and would make it more difficult for them to understand the tax consequences of school spending decisions.

The plan commits the system to the property tax with all the confusion related to the CLA and problems for taxpayers of an increasing tax that is not based on their ability to pay. As noted above, it also adds the confusion of a disproportionate tax-to-spending relationship.

Under the proposed plan, the state will continue to collect about the same amount of income-based and property-based education taxes as it does now, but the distribution of who pays those taxes will change in some complicated ways. The committee, the Legislature, and the public should see a tax-incidence analysis that shows how various taxpayers will be affected before the plan moves forward. We would need to see that analysis in order to assess who does better and who does worse under the plan.

Vermont's education funding system is built on five principles: local control, fairness for students, fairness for taxpayers, simplicity and transparency for citizens, and taxes based on ability to pay. Any proposed changes to the system should advance these principles by striking a balance among them. Based on our analysis of the currently available information, we conclude that the proposal under consideration in the committee does not advance these principles better than the existing system. In fact, we believe it would set the system back.

We think there's a better approach to improving the education funding system that would advance these principles: eliminate the education property tax on primary residences and leave in place a 100 percent income-based system for residents. In addition to relieving Vermonters of the current problems with school property taxes on homes, such a system would be simpler and easy to understand, would be based on ability to pay, and it would ensure that everyone paid their fair share of educating Vermont's children while continuing to provide all kids equal access to resources.

Sincerely,



Paul A. Cillo  
President

CC: House Ways and Means Committee members, Sorsha Anderson  
Speaker Johnson, Katherine Levasseur  
Rep. David Sharpe

