Restructuring Education in Vermont: Fundamentals and Funding

Supplementary report on H.541 as passed by the Vermont House*

Prepared for the Vermont Business Roundtable
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1. How the Plan Would Work

Q1. What is the intent of H.541?

A. H.541, the property tax reform bill passed by the Vermont House, is designed to fundamentally change the way education is paid for in Vermont. First, all teachers’ salaries and benefits (with some exclusions) will be paid for out of the state General Fund. Second, there will be no local property tax on a house (and a maximum of two acres of land) to pay for local schools. Instead, each town will levy a local income tax to pay the local share of education costs.

Q2. How does the part of the bill that has the state pay for teachers’ salaries work?

A. The state of Vermont will pay for all teachers’ costs so that each school district can attain a ratio of 14.4 students per teacher. If a school district has 144 students, the state will pay for 10 teachers.

Q3. What if the school wants to hire more than 10 teachers?

A. In that case the local district has to pay for the extra teachers just like it would pay for any other expense. The state will pay for the 10 most expensive teachers in this case and the local district will pay for the least expensive teachers.

Q4. How much will this cost the state?

A. The bill’s supporters estimate the cost at $334.6 million.

*The Senate Education Committee has recommended the following changes to H.541 as passed by the House: (1) Deleting the statewide teachers’ contract; (2) Including a component on education quality. The bill is currently being considered by other Senate committees and action has not yet been taken on this bill by the full Senate.
Q5. Where will the state get this money?

A. Most of the money comes from existing state support of education, including state aid to education, teachers’ retirement contributions, special education, property tax rebate funds, and other existing appropriations. There are new taxes that will be levied so that the state ends up paying for 50% of the cost of education. These new taxes include the following:

- a one percentage point increase in the sales tax, raising it to 5%;
- a two percentage point increase in the meals and rooms tax, raising it to 9%;
- a two percentage point increase in the corporate profits tax;
- a one percentage point increase in the telephone property tax;
- a $4 per day tax on auto rentals and auto leases, up to a maximum of $120 per lease;
- extending the sales tax to liquor;
- eliminating the sales tax exemption for non-farmers on agricultural products such as fertilizer, seed, and other agricultural products sold to non-farmers;
- a portion of the revenues that will be obtained from a statewide property tax.

Q6. How much money will each of these new taxes raise?

A. See section 2 below for a detailed discussion of these taxes.

Q7. What is the statewide property tax?

A. The statewide non-residential property tax is one of the two major revenue sources that would be used to replace the local residential property tax currently used to fund local education expenses. Under the plan, there would be a 1.2% tax on all non-residential property (equivalently, the tax would be $1.20 per $100 of fair market value). This includes commercial and industrial property, land in homesteads in excess of two acres, vacation and other second homes, and other non-residential property. The tax would be levied at a uniform rate across all towns and cities in Vermont and would generate about $210 million. As noted earlier, there would be no local school property tax levied in any town in Vermont. The only property tax would be for municipal purposes. And the plan also eliminates the local property tax on business inventory, machinery, and equipment.

Q8. Are those the only new taxes?

A. No, there is another major new tax. Each town would levy a local income tax to support education. This would have raised about $91 million in 1994.

Q9. How would the local income tax work?
A. Each town would vote on its school budget just like it does now. Currently, when you vote on your school budget, you are implicitly voting for a tax rate that will generate the revenues needed to fund that budget after other revenue sources, such as state aid to education, are considered. Under H.541, the school budget you vote on would not include teachers’ salaries (those would be paid for by the state, as noted above). The other costs of running the schools would lead to a local income tax rate that would result from the budget passed by the town.

It is worth noting that one of the aims of the plan is to insure that people in similar economic circumstances pay similar taxes. One criticism of Vermont’s property tax is that two families, each earning identical incomes and living in identical houses, could now pay significantly different local property taxes, depending on where they live. Under H.541 this local property tax differential would be replaced by a possible local income tax differential, again depending on differences in the local income tax in each town. Two towns could easily have different local income tax rates depending on the amount of money each town wanted to spend on education.

Q10. So except for teachers’ salaries, would the local income tax that I vote on pay for all my local school costs?

A. No. There is a complicated mechanism for distributing those income tax revenues and the revenues that are received from the statewide non-residential property tax.

Q11. Can you explain how the local income tax and statewide property tax revenues are distributed?

A. Those revenues (about $270 million) do not go into the General Fund. There is a new entity set up called the School Board Trust Fund Board. The Board receives all the local income tax revenues and 87% of the statewide property tax revenues (the other 13% go into the General Fund and are used to finance the state takeover of teachers’ salaries, as noted above). The Board then distributes those funds based on something called the guaranteed yield. The guaranteed yield basically guarantees that in every town in the state, for every percent of increase in the local income tax (as a percent of the federal tax liability), the town will get a certain amount of money per student. The way it works in the first year is that for every one percent local income tax, each town will get $264 per pupil. In no town in the state does the one percent actually result in $264 per pupil; the statewide property tax makes up the difference. For example, if a town voted a 10% local income tax, it is guaranteed to get $2,640 ($264 x 10 point local income tax rate) per student.

Q12. What’s the point of this mechanism?

A. It’s designed so that lower income towns have the same ability to raise a fixed amount of money per student as richer towns.
Q13. What if a town wants to spend more?

A. There is no limit on how much a town can spend on non salary expenditures. But remember that after a town has reached a limit of 14.4 students per teacher, the state does not pick up the bill for teachers’ salaries. That has to come out of the funds received from the School Board Trust Fund and means the town has to vote a higher local income tax. And if a town spends more than 150% of the average (non-salary) cost to educate each student, the Board only returns $158 per student for each percent of local income tax levied.

Q14. Won’t this local income tax be different in each town and be an added burden for employers when they do their employees’ withholding?

A. The local income tax will be different in each town, depending on the preferences and priorities of town voters. But employers will withhold at the same amount statewide. They won’t have to be responsible for adjusting each employee’s withholding to match up to their town’s local income tax rate. There would be a uniform withholding rate statewide that would not vary by town. However, as a result of this, at the end of the tax year some employees would find that they did not have enough local income taxes withheld (if they lived in a town with a higher than average local income tax rate) and some would have too much withheld (if they lived in a town with a lower than average income tax rate).

Q15. Can we determine what the local income tax will be in each town?

A. We can determine what the local income tax will be if there was no change in each town. That is, a local tax income tax rate can be calculated assuming each town’s spending under H.541 is identical to what it is now. Those local tax rates have been widely circulated.

Q16. Are these estimates accurate?

A. They are probably accurate, but they are based on an unchanging pattern of expenditure. The whole point of H.541 is to enable low income (and presumably low spending) towns to be able to spend more. And high spending towns might elect to spend less because of their high local income taxes.

Q17. But don’t all the analyses assume that there will be no change in spending if H.541 takes effect.

A. That’s right.
Q18. Are there any other parts of the bill that will lead to higher spending or more taxes?

A. Yes, the state’s takeover of all teacher salaries also includes a stipulation that all teachers in the state receive the same salaries if they have the same level of seniority and same credentials. Other spending issues are discussed in the answers to Q41.

Q19. How will those statewide teachers’ salaries be determined?

A. The state will negotiate salaries with the Vermont Education Association (VEA), the labor union which represents teachers.

Q20. Will the state be better able to effectively negotiate with the VEA than local school boards?

A. That’s the premise of some of the bill’s sponsors, and is probably one reason the VEA is so opposed to that provision of the bill.

Q21. If the state does negotiate more effectively, won’t that save money for taxpayers?

A. If that is the only effect, yes. But that portion of the bill would bring all teachers’ salaries up to the highest paid teachers in the state, and that is estimated to add about $50 million to the cost.

Q22. How is that additional $50 million to be raised?

A. There is no provision for it in the bill.

Q23. So let me understand this. The local school bill would be paid by two different government agencies. The state’s General Fund would pay for all of the teachers’ salaries and benefits as long as a school district did not employ more teachers than the 14.4 to one ratio of students to teachers entitles them. The funds would come from new broad based taxes, part of the statewide property tax revenues, and money the state is currently spending on aid to education.

The School Board Trust Fund would give each school district $264 per student for each one percent local income tax that was levied. Its revenue sources are the $1.20 statewide property tax and all of the local income tax revenues raised.

A. That is correct.
Q24. So a town’s local income tax revenues don’t really stay in the town?

A. That is also correct. The revenues go to a central depository controlled by the Trust Fund Board. They don’t immediately go to the town clerk or local government treasury. Eventually all those revenues do come back to the towns as part of the guaranteed yield that each town receives.

Q25. The School Board Trust Fund Board seems to be a key to this bill. Who are the people on the Board?

A. The Board consists of four people appointed by the Vermont School Boards Association.

Q26. Exactly what are the Board’s duties?

A. The Board has two main duties. The first is to set the guaranteed yield. The second is to set the statewide property tax rate. The two are linked together in a rather complicated manner. But essentially, the statewide property tax must raise slightly more than twice the amount that the local income tax raises. When the School Board Trust Fund sets the guaranteed yield, they must set a non-residential property tax rate that will generate sufficient revenues to fund the guaranteed yield.

Q27. What if there is not enough tax money raised to fund the total amount guaranteed to all towns?

A. The statewide property tax will generate an amount of money that is relatively easy to forecast. The local income tax, on the other hand, will not be easy to forecast and there will likely be either too much or too little money raised. If there is too little money, there will not be enough to distribute as promised. It is not clear what will then happen. The Board will have the power to borrow money, but only on the basis of anticipated revenues. If the revenues are not forthcoming, it is hard to see how they can borrow the money. And the Board does not carry the full faith and credit of the state to back up its notes.

Q28. Is there any oversight on the Board’s tax setting authority?

A. The Board must set the guaranteed yield and the statewide non-residential property tax rate by January 5 each year. The legislature has until January 30 to act on the Board’s recommendation. If the legislature does not act on them, the guaranteed yield and the statewide property tax rate take effect with no direct legislative action.
Q29. How does the bill affect renters?

A. The owner of an apartment building or a house that is rented to tenants pays the non-residential property tax rate. The owner must distribute a form to tenants itemizing the amount of property taxes attributable to their portion of the rent. Therefore if a building pays $3000 in property taxes and there are two identical apartments in it, the landlord must provide each tenant with a document stating each has paid $1500 in property taxes. The tenants then use this form and get reimbursed for the full amount. The money comes out of the State Trust Fund Board and is paid through its revenue sources.

Q30. How does the bill affect special education?

A. Under the statewide teachers' contract, the state will fund one special education teacher for each 113 students in the school district. The bill also makes a provision for extraordinary special education costs, which are defined as costs for one child that exceeds six times the average net cost per child. Districts are reimbursed 80% of these costs. According to the bill "the state board shall define 'expenditures for special education' without consideration of available resources."

2. Revenue Analysis

Q31. Exactly how much money would the new taxes raise and how accurate are the revenue projections asserted by the proponents of H.541 and what are the new taxes?

A. There are a number of new taxes and new revenue sources that are being proposed to fund H.541. What follows is an itemization and discussion of each of them.

*Property Taxes*

The plan is to reduce property taxes paid for education by renters and homeowners (with a property size of two acres or less) to zero. The savings projections here are quite accurate. Vermont homeowners will save about $190 million. The plan also eliminates the tax on business machinery and equipment. Towns will not levy any property tax to fund education, so businesses will not have to pay school property taxes either.

Part of this loss in revenue will be replaced by a new statewide property tax of $1.20 on non-residential property. Business property will now be taxed at a uniform statewide rate, as will all non-residential property. This brings in a great deal of new revenue from towns which have historically had low tax rates. Most of these are the ski towns and most are located in southern Vermont. The revenues to be raised from this new tax can be forecasted quite accurately.
Local Income Tax

Another part of the loss in revenue will be made up by a new local income tax, which will raise about $90 million. The local income tax will vary town by town, but the statewide average is 10.4% of a person’s (or family’s) federal tax liability. For 1993, Vermonters paid 28% of their federal tax liability to the state for the state income tax (upper income residents paid a higher percent). In 1994, the state tax rate for all Vermonters will be 25% of the federal tax liability if there are no changes enacted by this year’s legislature. Therefore, the average income tax rate statewide would be 35.4% of the federal tax liability (25% current state rate plus 10.4% average local tax rate).

This local income tax rate varies by town. The town with the lowest rate is Reading, with a 3% rate. Winhall would have the highest local income tax rate at 31.4%

These tax rates, and the statewide average rate, assume that each town would spend the same amount per student under the new plan as it does currently. If the new law encourages people in towns to spend more or less, these tax rates would change.

Revenue estimates for income taxes are notoriously hard to make. One problem is that we only know the actual income in each town two years after the fact. For example, in November 1993, the state published data on income levels in each town for calendar year 1992. Using the income tax to fund local schools involves making some major assumptions about economic growth in Vermont, as well as in each town, and can lead to significant revenue shortfalls, as has been true for the state in the past few years. In good times, revenues may come in over estimate. But the accuracy of state or local income tax forecasting is a problem.

Sales Tax

The sales tax is scheduled to be reduced to 4% on July 1, 1995. The proposal keeps the rate at 5%. The one cent increase in the state sales tax rate will bring in about $33 million. Sales tax revenues are not as volatile as income tax revenues, but there is a margin of error in sales tax estimates.

Meals and Rooms Tax

The meals and rooms tax, which is a tax on hotel rooms and meals eaten at restaurants, will be raised to 9%. It is currently 7% and is scheduled to be reduced to 6% on July 1, 1994. The tax increase is projected to raise $21 million. Meals and rooms taxes are sensitive to economic conditions in a manner similar to the sales tax. Both of these taxes are easier to forecast than the income tax, but forecasting them during the past several years has been problematic for state revenue forecasters.
Corporate Profits Tax

The corporate profits tax will be raised by two percentage points, with the total percent dependent on the total corporate profits. Corporate profits are among the most volatile of all revenue sources and the most difficult to estimate. The estimated $9.0 million should not be treated as a firm number.

Telephone Property Tax

An increase in the property tax of telephone companies (basically NYNEX) is projected to raise $3.9 million. The tax rate is increased from 2.37% to 3.37% of net book value of personal property. Because the state already has a telephone property tax and telephone property does not change dramatically, this estimate is very accurate.

Auto Rental Tax

This is a completely new tax which will be levied at a rate of $4 per day on auto and truck rentals. It will also apply to auto and truck leases, up to a maximum of 30 days. It does not include rentals for loaners of cars if the car is being serviced or repaired by that company. Anyone who leases a vehicle in Vermont will pay a tax of $120 on the lease. The average lease in Vermont is about four years, which raises the cost of leasing a car by $30 per year. The legislature’s revenue estimate for this tax is $8 million. This is probably too high. My estimate for taxes raised by this tax is $2.3 million. Because this is a brand new tax there is little data upon which to make an accurate estimate of revenues. The legislature’s revenue estimate is based on a totally different methodology and data base than is my estimate.

Non-Farmer Agricultural Exemption Lifted

This tax essentially eliminates an exemption from the state sales tax that applied to agricultural products. These products include agricultural feed, seed, plants, fertilizer, baler twine, lime, semen, breeding fees, baby chicks and turkey poults, ag chemicals, vet supplies, and bedding. These will only be exempt from the sales tax if they are sold to a farmer (defined as anyone who earns at least one-half of annual gross income from farming).

The legislature estimates that $6 million will be raised by eliminating this exemption. There is little way of determining the accuracy of this figure for the same reasons as noted above for the auto rental tax. There are almost no data upon which to base a revenue estimate and these numbers must be seen as little more than an educated guess.
Apply Sales Tax to Liquor

This proposal is designed to raise $2.5 million by extending the state sales tax to hard liquor. The forecast is probably fairly accurate, but it should be noted that this will encourage border county residents to purchase liquor in New Hampshire, which will decrease Vermont’s tax revenue from this source. It is also important to note that Vermont already taxes hard liquor under a different tax.

3. Fiscal Impact on Families

Q32. How would the average family be affected by the plan?

A. The answer depends on whether a family owns or rents a house, what its income is, what its current property tax situation is, and what the local income tax rate would be in the town. It also depends on what happens to total spending on education if the plan is implemented. Every time the state of Vermont has radically changed education funding in the past, it has been accompanied by a significant increase in state education spending.

Q33. How about a statistically average Vermont homeowner?

A. An average Vermont family earns about $40,000 per year and lives in a house worth about $100,000. Their current local property tax for schools is about $1,120. The bill’s proponents claim that after subtracting the property tax and adding in all the new taxes, the average family will save $539. My analysis shows a savings of $460. The difference between the two estimates is due to different assumptions and methodologies used to estimate how much the new taxes would cost an average taxpayer.

But both numbers miss a very important point. Income and property taxes are both deductible expenses on the federal (and hence Vermont) income tax. Therefore, a proper accounting of the impact of deductibility needs to be done and would be appropriate for any family or taxpayer that itemizes their deductions. Most homeowners would itemize because they have mortgage interest and property tax deductions.

When the appropriate accounting is done, the net tax savings for an average income Vermont family shrinks to $389 using the methodology of the bill’s proponents and to $335 using my methodology. The tables that follow this narrative detail the results presented here.

Therefore, one can conclude that an average family would save about $500 in taxes if the bill is implemented but only about $350 after the impact of tax deductibility is considered.
Q34. Are these numbers likely to change?

A. Yes, these are only estimates and assume no changes in the actual amount spent in each district. There will likely be higher expenditures in the low-spending districts and there might be offsetting declines in expenditures in the high-spending districts.

Also, none of the tax estimates include the cost of the statewide teachers' contract, which would cost about $50 million if implemented in 1994. This would cost the average family about $180, which would bring the net tax savings to an average family, after accounting for tax deductibility, to about $200.

4. Broader Economic Impacts: Economic Competitiveness

Q35. How would H.541 affect Vermont's competitive position and the long run health of the state's economy?

A. There are a number of ways to answer this question. One way is to compare Vermont's taxes with those of other states. The two standard ways of comparing taxes is to look at taxes per capita and taxes as a percentage of income. Another way is to examine marginal tax rate faced by upper income taxpayers to examine the potential impact on entrepreneurs and business people making investment location decisions.

Q36. How would H.541 affect per capita taxes in Vermont?

A. The most current information we have on tax comparisons across states is for fiscal year 1991. As Table 1 shows, in that year, Vermont's state and local governments collected taxes of $2,121 per person (column 1). That was 2% higher than the national average (column 2). If it was in place in 1991, H.541 would not have changed our overall tax picture very much.

The type of taxes we levy is very different from the national average. Vermont's property tax bill per capita in 1991 was $925 per person, 39% above the national average. H.541 would reduce that to about 5% below the national average. The bill would also increase our general sales tax, but it would still be quite a bit below the national average. It would have a major impact on the personal income tax, raising it from 3% above the national average to 37% above the national average. The catch-all category of "other taxes" would also rise from the current level of 18% above the national average to 47% above the national average.

Q37. What about taxes as a percent of income?

A. The changes there are very similar to those discussed above and are shown in Table 2. There would be a big decline in property taxes as a percent of income, and a large increase in income taxes, which would rise to 45% above the national average.
### Table 1

#### Tax Per Capita

<table>
<thead>
<tr>
<th></th>
<th>(1) Actual FY91 VT Per Capita Taxes</th>
<th>(2) Actual FY91 Per Capita Taxes: VT as Percent of US Average</th>
<th>(3) VT FY91 Per Capita Taxes if H.541 Was in Effect</th>
<th>(4) FY91 Per Capita Taxes if H.541 Was in Effect: VT as Percent of US Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>$2,121</td>
<td>102.0%</td>
<td>$2,126</td>
<td>102.2%</td>
</tr>
<tr>
<td>Property</td>
<td>$925</td>
<td>138.8%</td>
<td>$634</td>
<td>95.2%</td>
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<tr>
<td>General Sales</td>
<td>$222</td>
<td>44.5%</td>
<td>$275</td>
<td>55.3%</td>
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<tr>
<td>Corporate Income</td>
<td>$48</td>
<td>59.8%</td>
<td>$63</td>
<td>77.9%</td>
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<tr>
<td>Personal Income</td>
<td>$454</td>
<td>103.0%</td>
<td>$602</td>
<td>136.5%</td>
</tr>
<tr>
<td>Motor Fuel</td>
<td>$92</td>
<td>108.9%</td>
<td>$92</td>
<td>108.9%</td>
</tr>
<tr>
<td>Motor Vehicle License</td>
<td>$62</td>
<td>155.2%</td>
<td>$62</td>
<td>155.2%</td>
</tr>
<tr>
<td>Other Taxes</td>
<td>$318</td>
<td>117.6%</td>
<td>$398</td>
<td>147.3%</td>
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<tr>
<td>Corporate and Personal Income</td>
<td>$502</td>
<td>96.3%</td>
<td>$665</td>
<td>127.4%</td>
</tr>
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</table>

### Table 2

#### Tax as Percent of Income

<table>
<thead>
<tr>
<th></th>
<th>(1) Actual FY91 VT Taxes as Pct of Income</th>
<th>(2) Actual FY91 Taxes as Pct of Income: VT as Pct of US Average</th>
<th>(3) VT FY91 Tax as Pct of Income if H.541 Was in Effect</th>
<th>(4) FY91 Taxes as Pct of Income if H.541 Was in Effect: VT as Percent of US Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>12.2%</td>
<td>108.1%</td>
<td>12.2%</td>
<td>108.4%</td>
</tr>
<tr>
<td>Property</td>
<td>5.3%</td>
<td>147.2%</td>
<td>3.6%</td>
<td>100.9%</td>
</tr>
<tr>
<td>General Sales</td>
<td>1.3%</td>
<td>47.2%</td>
<td>1.6%</td>
<td>58.6%</td>
</tr>
<tr>
<td>Corporate Income</td>
<td>0.3%</td>
<td>63.4%</td>
<td>0.4%</td>
<td>82.6%</td>
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<tr>
<td>Personal Income</td>
<td>2.6%</td>
<td>109.2%</td>
<td>3.5%</td>
<td>144.7%</td>
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<tr>
<td>Motor Fuel</td>
<td>0.5%</td>
<td>115.5%</td>
<td>0.5%</td>
<td>115.5%</td>
</tr>
<tr>
<td>Motor Vehicle License</td>
<td>0.4%</td>
<td>164.5%</td>
<td>0.4%</td>
<td>164.5%</td>
</tr>
<tr>
<td>Other Taxes</td>
<td>1.8%</td>
<td>124.7%</td>
<td>2.3%</td>
<td>156.1%</td>
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<tr>
<td>Corporate and Personal Income</td>
<td>2.9%</td>
<td>102.1%</td>
<td>3.8%</td>
<td>135.1%</td>
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</table>

Note: These analyses assume no major increase in total spending. Only a $3.1 million increase called for in H.541 is included.
Q38. What would happen to Vermont’s marginal income tax rate?

A. The state marginal income tax rate, the amount of extra state income taxes paid on additional income, is currently one of the highest in the nation for upper income taxpayers. H.541 would bring Vermont’s marginal income tax rate even higher. It is nearly impossible to compare combined marginal state and local income tax rates because local income tax rates vary so much in those states that have different rates in different areas within the state. New York State, for example, has a top marginal tax rate of 7.88%. When New York City’s 4.46% rate is added to that, the combined rate for New York City residents is 12.34%, the highest in the nation. If H.541 was enacted, the top Vermont marginal tax rate for an upper income taxpayer living in a town with the average income tax rate would be 14.0%, higher than in New York City.

As of January 1994, Vermont’s state highest marginal income tax rate was 9.9%. This rate affects taxpayers with a taxable income of $250,000. It was the fourth highest marginal tax rate in the nation. The other high states are as follows:

<table>
<thead>
<tr>
<th>State</th>
<th>Highest Rate</th>
<th>Taxable Income Level At Which Rate Starts</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>11.00%</td>
<td>$414,000</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>10.89%</td>
<td>$250,000</td>
</tr>
<tr>
<td>Hawaii</td>
<td>10.00%</td>
<td>$40,000</td>
</tr>
<tr>
<td>Vermont</td>
<td>9.90%</td>
<td>$250,000</td>
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<td>Oregon</td>
<td>9.00%</td>
<td>$10,000</td>
</tr>
<tr>
<td>Minnesota</td>
<td>8.50%</td>
<td>$83,000</td>
</tr>
<tr>
<td>New Mexico</td>
<td>8.50%</td>
<td>$64,000</td>
</tr>
</tbody>
</table>

Q39. Another dimension of economic competitiveness is the quality of government services such as education. How is H.541 designed to improve the quality of public education in Vermont?

A. The simple answer to that question is that by allowing lower income towns to spend more per student, educational performance will improve. But there is conflicting evidence in the educational literature as to whether higher spending has any impact on educational performance.

In the one hundred and five page document, there are four sentences dealing with improving the quality of education. In their entirety, the statements dealing with education quality state that is the intent of this act to:

Through a collaborative, public and inclusive process:

(A) Set a vision for very high skills for all students.
(B) Provide leadership in the development of a systematic professional development program for educators.  
(C) Foster education-human services partnerships.  
(D) Provide regulatory flexibility when appropriate to aid in improving student performance.

Q40. Another component of competitiveness is to help control costs of government services. Does H.541 have any cost control components?

A. There is one component that the bill’s sponsors believe may serve to control costs; the statewide teachers’ contract. If the state is a more effective negotiating body than individual school districts, then in the future the state may be better able to control teacher salary cost and benefit increases than are local school districts negotiating in isolation. Others suggest that there will be less local pressure and therefore this part of the bill may not be an effective cost control measure.

This may also be true for other types of reforms, such as changing the entire method by which teachers are paid. The state, for example, may be able to more easily move to a system of pay for performance or merit raises for teachers than are individual districts.

Both of these points are controversial and are meant to be suggestive rather than definitive.

Q41. Are there other parts of H.541 that will affect the cost of public education in Vermont?

A. Yes, but they will all serve to increase costs of education.

First, the statewide teachers’ contract calls for all teachers in the state to receive the same salary for a given number of years of seniority and credit hours earned. The cost to the state’s general fund would be about $50 million in additional expenditures to bring every teacher’s salary up to the level of the highest paid teachers in the state.

Second, as noted earlier, the specific design of H.541 is to enable low spending towns to spend more than they currently spend. This would necessitate higher local income taxes and a higher non-residential property tax statewide.

Third, the guaranteed yield formula penalizes those towns that choose to spend more than 150% of the statewide average cost per student. This is one cost control strategy. But as the average spending increases (see above paragraph), the 150% threshold will also increase. This means that the penalty will be reduced and the revenues needed to fund the contribution to higher spending districts will likewise increase.

Fourth, expenditures needed for special education may also increase, as was noted earlier. It is not clear whether these costs would be similar under current law to what they would be under H.541.
Therefore, it is very likely that within a few years of its adoption, H.541 would lead to per students costs statewide that are higher than they would have been without H.541. Any cost savings that may result from the statewide teachers’ contract will be based on a higher level of spending than that which would prevail in the absence of H.541.

5. Summary

Q42. What is the broad intent of H.541?

A. The bill is intended to eliminate all the residential property taxes Vermonters currently pay to finance their schools and to replace them with other taxes. It is also designed to have the state assume all responsibility for negotiating and paying teacher salary costs.

Q43. What are the new taxes that will be needed to pay for this plan?

A. The major new taxes are a statewide property tax on non-residential property and a local income tax. Many other new taxes will be raised and the existing taxes increased. These include the sales tax, meals and rooms tax, corporate income tax, telephone property tax, a new tax on automobile rental and leasing, and applying the sales tax to hard liquor.

Q44. How will education finance differ if H.541 is adopted?

A. Currently, the state spends about $230 million on education aid to local districts. This includes general state aid, the state’s assumption of all teachers’ retirement contribution costs, special education, the property tax rebate program, and others. Local governments finance the rest of education costs, about $400 million, through the local property tax.

Under H.541 the state would pick up the entire cost of teachers’ salaries and benefits. This would cost approximately $360 million and would be paid for out of the state general fund. The balance of local education costs would be supported by the guaranteed yield formula, which would be financed through local income taxes and a statewide non-residential property tax. The statewide non-residential property tax would raise approximately $180 million. Local governments would levy a local income tax which would raise about $90 million.

The following pages give a detailed breakdown of pre- and post-tax impacts on different income families using the Woolf methodology and that of the supporters of H.541.
**Woolf Analysis**

### H.541 Impact on Median Income Vermont Family

<table>
<thead>
<tr>
<th></th>
<th>(1) Increase (Decrease) in Tax Liability</th>
<th>(2) Increase (Decrease) in Value of Federal Tax Deduction</th>
<th>(3) Increase (Decrease) in Value of State Tax Deduction</th>
<th>(4) Increase (Decrease) in Tax Liability</th>
<th>(5) After Tax Change in Tax Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Family Income Level</td>
<td>$40,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>House Value</td>
<td>$100,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>School Taxes Paid Currently</td>
<td>$1,120</td>
<td>$(1,120)</td>
<td>$(168)</td>
<td>$(42)</td>
<td>$(910)</td>
</tr>
<tr>
<td>Local Income Tax at 10.4% of Fed</td>
<td></td>
<td>$433</td>
<td>$65</td>
<td>$16</td>
<td>$352</td>
</tr>
<tr>
<td>Sales Tax Increase</td>
<td>$132</td>
<td>$65</td>
<td>$16</td>
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<tr>
<td>Meals Tax 3 points</td>
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<tr>
<td>Auto Rental</td>
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<td>$17</td>
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<td></td>
</tr>
<tr>
<td>Telephone Property</td>
<td>$13</td>
<td>$17</td>
<td>$17</td>
<td>$17</td>
<td></td>
</tr>
<tr>
<td>Corporate Profits</td>
<td>$17</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Alcohol</td>
<td>$4</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**NET CHANGE IN TAXES**

<table>
<thead>
<tr>
<th></th>
<th>(1) Increase (Decrease) in Tax Liability</th>
<th>(2) Increase (Decrease) in Value of Federal Tax Deduction</th>
<th>(3) Increase (Decrease) in Value of State Tax Deduction</th>
<th>(4) Increase (Decrease) in Tax Liability</th>
<th>(5) After Tax Change in Tax Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>($464)</td>
<td>($103)</td>
<td>($26)</td>
<td>($335)</td>
<td></td>
</tr>
</tbody>
</table>

Comment:

Column 1 shows the median income Vermont family earns $40,000, lives in a $100,000 house, and pays $1,120 in property taxes for schools. Column 2 shows the estimated changes in taxes this family would face. Property taxes would decline by the full $1,120. This would be offset by increases in all the other taxes. The combined effect would be to lower the total tax bill by $464.

Column 3 takes into account the fact that income taxes and property taxes are deductible expenses for any family that itemizes on their federal income tax form. Any family that owns a home with a mortgage and has property taxes would itemize. The median income homeowner would pay $168 more in income taxes due to losing the deduction from property taxes. It would gain a $65 federal tax advantage from the deductability of local income taxes paid. The effect of these two factors would be a net increase of $103 in federal income taxes.

Column 4 takes into account the fact that any federal income tax changes also affect the Vermont state income tax liability owed. The net increase in state income taxes is $26.

Column 5 shows that after taking into account the net effect of these tax law changes and the impact on federal and state income taxes, the average homeowner's savings are $335.
The following set of analyses are based on the methodology used in the brochure "Property Tax Reform," published by the Vermonters for Property Tax Reform. The methodology and assumptions about tax payments is slightly different from the Woolf analysis titled "H.541 Impact on Median Income Vermont Family," but the results are similar.

Towns have been divided into four types, based on their local income tax rate. The average income tax rate statewide is 10.4%. This is called the average tax town. The low tax town has a local income tax rate of 8.0%. The high tax rate town has a local income tax rate of 12.0% and the very high tax town has a local income tax rate of 16% (the highest local income tax rate would be 31%).

For each town, there are nine combinations of income and housing value.

   Family 1 earns $40,000 and lives in a $100,000 house. This is the median family income and average valued house.

   Family 2 earns $25,000 and lives in an $80,000 house. This is a representative lower middle income family.

   Family 3 earns $25,000 and lives in a $150,000 house. This would be a representative retired couple with a relatively low income but a significant amount of housing wealth.

   Family 4 earns $80,000 and lives in a $150,000 house. This would be an upper income family situation.

   Family 5 earns $80,000 and lives in a $200,000 house. This would also be an upper income family living in a more expensive house.

   Families 6 and 7 earn $150,000 and live in houses worth $300,000 and $400,000. These would be represented by a upper income executive or professional.

   Families 8 and 9 earn $200,000 and live in houses worth $400,000 and $500,000. This represents rich Vermonters in the top of the income distribution in the state.

Lines 1 - 8 are reproduced exactly as they appear in the brochure noted above. Line 8, which is in boldface, shows the savings that would accrue to each family if H.541 was enacted. Any number in parenthesis means that taxes would increase for that family.

The two lines after line 8 are not shown in the brochure. These two lines take into account the deductibility of property and income taxes from the federal and state income tax liability. They show the after-tax impact of H.541. The final boldface line shows that the savings to most Vermonters are significantly smaller than they appear when the tax deductibility implications of H.541 are ignored.
### Low Tax Town

<table>
<thead>
<tr>
<th></th>
<th>Family 1</th>
<th>Family 2</th>
<th>Family 3</th>
<th>Family 4</th>
<th>Family 5</th>
<th>Family 6</th>
<th>Family 7</th>
<th>Family 8</th>
<th>Family 9</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INCOME</strong></td>
<td>$40,000</td>
<td>$25,000</td>
<td>$25,000</td>
<td>$80,000</td>
<td>$80,000</td>
<td>$150,000</td>
<td>$150,000</td>
<td>$200,000</td>
<td>$200,000</td>
</tr>
<tr>
<td><strong>HOUSE VALUE</strong></td>
<td>$100,000</td>
<td>$80,000</td>
<td>$150,000</td>
<td>$150,000</td>
<td>$200,000</td>
<td>$300,000</td>
<td>$400,000</td>
<td>$400,000</td>
<td>$500,000</td>
</tr>
<tr>
<td><strong>1. 1993 School Property Taxes</strong></td>
<td>$1,120</td>
<td>$966</td>
<td>$1,680</td>
<td>$1,680</td>
<td>$2,240</td>
<td>$3,360</td>
<td>$4,480</td>
<td>$4,480</td>
<td>$5,600</td>
</tr>
<tr>
<td><strong>2. Federal Income Tax</strong></td>
<td>$4,168</td>
<td>$2,225</td>
<td>$2,225</td>
<td>$12,160</td>
<td>$12,160</td>
<td>$27,600</td>
<td>$27,600</td>
<td>$47,400</td>
<td>$47,400</td>
</tr>
<tr>
<td><strong>3. Local Income Tax Rate</strong></td>
<td>8.0%</td>
<td>8.0%</td>
<td>8.0%</td>
<td>8.0%</td>
<td>8.0%</td>
<td>8.0%</td>
<td>8.0%</td>
<td>8.0%</td>
<td>8.0%</td>
</tr>
<tr>
<td><strong>4. Local Income Tax Liability (line 2 x line 3)</strong></td>
<td>$333</td>
<td>$178</td>
<td>$178</td>
<td>$973</td>
<td>$973</td>
<td>$2,208</td>
<td>$2,208</td>
<td>$3,792</td>
<td>$3,792</td>
</tr>
<tr>
<td><strong>5. Additional Other Taxes</strong></td>
<td>$250</td>
<td>$157</td>
<td>$157</td>
<td>$388</td>
<td>$388</td>
<td>$543</td>
<td>$543</td>
<td>$699</td>
<td>$699</td>
</tr>
<tr>
<td><strong>6. 1993 School Property Tax (line 1)</strong></td>
<td>$1,120</td>
<td>$966</td>
<td>$1,680</td>
<td>$1,680</td>
<td>$2,240</td>
<td>$3,360</td>
<td>$4,480</td>
<td>$4,480</td>
<td>$5,600</td>
</tr>
<tr>
<td><strong>7. Total New Taxes (line 4 + line 5)</strong></td>
<td>$583</td>
<td>$335</td>
<td>$335</td>
<td>$1,361</td>
<td>$1,361</td>
<td>$2,751</td>
<td>$2,751</td>
<td>$4,491</td>
<td>$4,491</td>
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<tr>
<td><strong>8. Estimated Tax Savings (Increase)</strong></td>
<td>$537</td>
<td>$561</td>
<td>$1,345</td>
<td>$319</td>
<td>$879</td>
<td>$609</td>
<td>$1,729</td>
<td>($11)</td>
<td>$1,109</td>
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<td><strong>Increase (Decrease) in Federal Inc Tax Deductions</strong></td>
<td>($118)</td>
<td>($108)</td>
<td>($225)</td>
<td>($198)</td>
<td>($355)</td>
<td>($357)</td>
<td>($704)</td>
<td>($248)</td>
<td>($651)</td>
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<tr>
<td><strong>Increase (Decrease) in State Inc Tax Deductions</strong></td>
<td>($29)</td>
<td>($27)</td>
<td>($56)</td>
<td>($50)</td>
<td>($89)</td>
<td>($89)</td>
<td>($176)</td>
<td>($62)</td>
<td>($163)</td>
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<tr>
<td><strong>Net Tax Savings (Increase)</strong></td>
<td>$389</td>
<td>$426</td>
<td>$1,063</td>
<td>$72</td>
<td>$436</td>
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<td>$849</td>
<td>($321)</td>
<td>$295</td>
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</tbody>
</table>

Federal Marginal Tax Rate: 15% 15% 15% 28% 28% 31% 31% 36% 36%

### Average Tax Town

<table>
<thead>
<tr>
<th></th>
<th>Family 1</th>
<th>Family 2</th>
<th>Family 3</th>
<th>Family 4</th>
<th>Family 5</th>
<th>Family 6</th>
<th>Family 7</th>
<th>Family 8</th>
<th>Family 9</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INCOME</strong></td>
<td>$40,000</td>
<td>$25,000</td>
<td>$25,000</td>
<td>$80,000</td>
<td>$80,000</td>
<td>$150,000</td>
<td>$150,000</td>
<td>$200,000</td>
<td>$200,000</td>
</tr>
<tr>
<td><strong>HOUSE VALUE</strong></td>
<td>$100,000</td>
<td>$80,000</td>
<td>$150,000</td>
<td>$150,000</td>
<td>$200,000</td>
<td>$300,000</td>
<td>$400,000</td>
<td>$400,000</td>
<td>$500,000</td>
</tr>
<tr>
<td><strong>1. 1993 School Property Taxes</strong></td>
<td>$1,120</td>
<td>$966</td>
<td>$1,680</td>
<td>$1,680</td>
<td>$2,240</td>
<td>$3,360</td>
<td>$4,480</td>
<td>$4,480</td>
<td>$5,600</td>
</tr>
<tr>
<td><strong>2. Federal Income Tax</strong></td>
<td>$4,168</td>
<td>$2,225</td>
<td>$2,225</td>
<td>$12,160</td>
<td>$12,160</td>
<td>$27,600</td>
<td>$27,600</td>
<td>$47,400</td>
<td>$47,400</td>
</tr>
<tr>
<td><strong>3. Local Income Tax Rate</strong></td>
<td>10.4%</td>
<td>10.4%</td>
<td>10.4%</td>
<td>10.4%</td>
<td>10.4%</td>
<td>10.4%</td>
<td>10.4%</td>
<td>10.4%</td>
<td>10.4%</td>
</tr>
<tr>
<td><strong>4. Local Income Tax Liability (line 2 x line 3)</strong></td>
<td>$433</td>
<td>$231</td>
<td>$231</td>
<td>$1,265</td>
<td>$1,265</td>
<td>$2,870</td>
<td>$2,870</td>
<td>$4,930</td>
<td>$4,930</td>
</tr>
<tr>
<td><strong>5. Additional Other Taxes</strong></td>
<td>$250</td>
<td>$157</td>
<td>$157</td>
<td>$388</td>
<td>$388</td>
<td>$543</td>
<td>$543</td>
<td>$699</td>
<td>$699</td>
</tr>
<tr>
<td><strong>6. 1993 School Property Tax (line 1)</strong></td>
<td>$1,120</td>
<td>$966</td>
<td>$1,680</td>
<td>$1,680</td>
<td>$2,240</td>
<td>$3,360</td>
<td>$4,480</td>
<td>$4,480</td>
<td>$5,600</td>
</tr>
<tr>
<td><strong>7. Total New Taxes (line 4 + line 5)</strong></td>
<td>$683</td>
<td>$388</td>
<td>$388</td>
<td>$1,653</td>
<td>$1,653</td>
<td>$3,413</td>
<td>$3,413</td>
<td>$5,629</td>
<td>$5,629</td>
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<tr>
<td><strong>8. Estimated Tax Savings (Increase)</strong></td>
<td>$437</td>
<td>$508</td>
<td>$1,292</td>
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<td>$587</td>
<td>($53)</td>
<td>$1,067</td>
<td>($1,149)</td>
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</tr>
<tr>
<td><strong>Increase (Decrease) in Federal Inc Tax Deductions</strong></td>
<td>($103)</td>
<td>($100)</td>
<td>($217)</td>
<td>($116)</td>
<td>($273)</td>
<td>($152)</td>
<td>($499)</td>
<td>$162</td>
<td>($241)</td>
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<tr>
<td><strong>Increase (Decrease) in State Inc Tax Deductions</strong></td>
<td>($26)</td>
<td>($25)</td>
<td>($54)</td>
<td>($29)</td>
<td>($68)</td>
<td>($38)</td>
<td>($125)</td>
<td>$40</td>
<td>($60)</td>
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<tr>
<td><strong>Net Tax Savings (Increase)</strong></td>
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<td>$383</td>
<td>$1,020</td>
<td>($118)</td>
<td>$246</td>
<td>($243)</td>
<td>$443</td>
<td>($946)</td>
<td>($330)</td>
</tr>
</tbody>
</table>

Federal Marginal Tax Rate: 15% 15% 15% 28% 28% 31% 31% 36% 36%
### High Tax Town

<table>
<thead>
<tr>
<th>Income Group</th>
<th>Family 1</th>
<th>Family 2</th>
<th>Family 3</th>
<th>Family 4</th>
<th>Family 5</th>
<th>Family 6</th>
<th>Family 7</th>
<th>Family 8</th>
<th>Family 9</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>$40,000</td>
<td>$25,000</td>
<td>$25,000</td>
<td>$80,000</td>
<td>$80,000</td>
<td>$150,000</td>
<td>$150,000</td>
<td>$200,000</td>
<td>$200,000</td>
</tr>
<tr>
<td>House Value</td>
<td>$100,000</td>
<td>$80,000</td>
<td>$150,000</td>
<td>$150,000</td>
<td>$200,000</td>
<td>$300,000</td>
<td>$400,000</td>
<td>$400,000</td>
<td>$500,000</td>
</tr>
</tbody>
</table>

1. **1993 School Property Taxes**: $1,120
   - House Value: $896
   - Local Income Tax Rate: 12.0%
   - Local Income Tax Liability (line 2 x line 3): $1,680
   - Additional Other Taxes: $500
   - Total New Taxes (line 4 + line 5): $250

2. **Federal Income Tax**: $4,168
   - $2,225
   - $2,126
   - $12,160
   - $12,160
   - $27,600
   - $27,600
   - $47,400
   - $47,400

3. **Estimated Tax Savings (Increase)**: $370
   - Increase (Decrease) in Federal Inc Tax Deductions: $(93)
   - Increase (Decrease) in State Inc Tax Deductions: $(23)
   - Net Tax Savings (Increase): $254

Federal Marginal Tax Rate: 15%

### Very High Tax Town

<table>
<thead>
<tr>
<th>Income Group</th>
<th>Family 1</th>
<th>Family 2</th>
<th>Family 3</th>
<th>Family 4</th>
<th>Family 5</th>
<th>Family 6</th>
<th>Family 7</th>
<th>Family 8</th>
<th>Family 9</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>$40,000</td>
<td>$25,000</td>
<td>$25,000</td>
<td>$80,000</td>
<td>$80,000</td>
<td>$150,000</td>
<td>$150,000</td>
<td>$200,000</td>
<td>$200,000</td>
</tr>
<tr>
<td>House Value</td>
<td>$100,000</td>
<td>$80,000</td>
<td>$150,000</td>
<td>$150,000</td>
<td>$200,000</td>
<td>$300,000</td>
<td>$400,000</td>
<td>$400,000</td>
<td>$500,000</td>
</tr>
</tbody>
</table>

1. **1993 School Property Taxes**: $1,120
   - House Value: $896
   - Local Income Tax Rate: 16.0%
   - Local Income Tax Liability (line 2 x line 3): $1,680
   - Additional Other Taxes: $500
   - Total New Taxes (line 4 + line 5): $250

2. **Federal Income Tax**: $4,168
   - $2,225
   - $2,126
   - $12,160
   - $12,160
   - $27,600
   - $27,600
   - $47,400
   - $47,400

3. **Estimated Tax Savings (Increase)**: $203
   - Increase (Decrease) in Federal Inc Tax Deductions: $(68)
   - Increase (Decrease) in State Inc Tax Deductions: $(17)
   - Net Tax Savings (Increase): $118

Federal Marginal Tax Rate: 15%