How Will Merger Incentives Affect My Education Property Taxes?

Act 46 of 2015 continued and extended tax incentives from earlier acts for towns that merge school districts into specific types of districts. If the new district is agreed to before July 1, 2016, and becomes operational by July 1, 2017, each town in the new district will see a reduction in its homestead education property tax rate. The reduction will be 10 cents in the first fiscal year of operation, 8 cents in the second year, 6 cents in the third, 4 cents in the fourth, and 2 cents in the fifth. Towns in eligible merged districts that don't become operational until after July 1, 2017, (but before July 1, 2019) will still get the incentives, but instead of starting at 10 cents in the first year, the reduction will start at 8 cents and will only last four years.

In both the four- and five-year mergers, if the town's prior year rate is less than the incentive rate, the town's new tax rate can increase by no more than 5% annually until it reaches the incentive rate. [1] For towns in which the prior year rate was greater than the incentive rate and it is a five-year merger, the town's new rate drops to the incentive rate. If it's a four-year merger, the town's new rate can decrease by no more than 5% annually until it meets the incentive rate. This +/- 5% applies to both taxpayers who pay based on property value and those who pay based on income.

In every town in Vermont, some residents pay their education taxes based on the value of their property and some pay based on a percentage of their income. **Both types of taxpayers in a town belonging to a school district that merges will see a reduction in their property tax bills.** It's easy to calculate how much of a reduction the taxpayers who pay the property rate will see, but for the taxpayers who pay based on their income, it's a little more complex. The goal of this fact sheet is to outline how the merger incentives will work for both types of taxpayers.

Education tax rates in a town are impacted by several factors, and the rates in a town tend to change from year to year because of these factors. For the example town in this fact sheet, we'll assume that those factors all stay the same from year to year so that it's easier to demonstrate and explain the effect of the merger incentives.

Assumptions:

- The town spends $15,000 per pupil every year
- The statewide "Property Dollar Yield" is $9,701 every year (the FY17 amount)
- The statewide "Income Dollar Yield" is $10,870 every year (the FY17 amount)
- The CLA (Common Level of Appraisal) in the town is exactly 100% every year
- The first year of operation for the merged district is FY17
- The town belongs to a single school district rather than multiple school districts (if a town belongs to multiple school districts, the district tax rates are prorated for the town)

[1] Some rare limitations apply. See Act 73 of 2017.

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Tax Rates Before Incentives/Working with Yields

Besides offering the incentives for towns that merge, Act 46 also simplified the steps in the tax rate calculation process for residents of all towns. Starting in FY17, to get your town's tax rates, you just divide your town's per pupil spending by the appropriate "yield" amount (see "Assumptions" on page 1). Here's how it works in our example town:

- For property rate payers: $15,000 ÷ $9,701 = **$1.546** (tax rate per $100 of property value)
- For income rate payers: $15,000 ÷ $10,870 x 2% = **2.76%** (of household income)

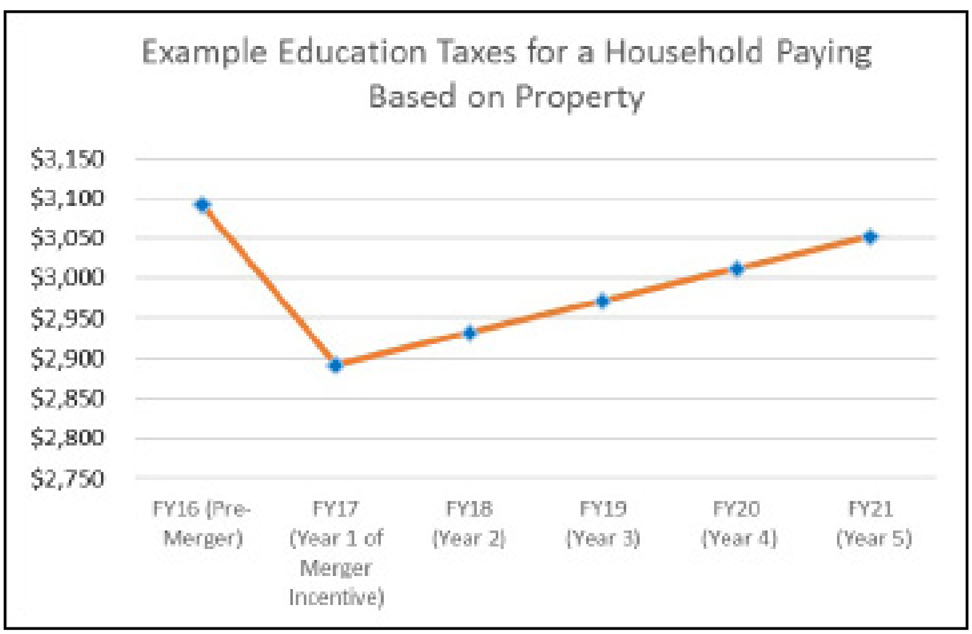
Because we assumed that the per-pupil spending isn't going to change and the yield numbers aren't going to change, these will be the tax rates in the town that are used for the two types of taxpayers (property or income) for all years in the example.

Homestead Property Rate with Incentives

For the taxpayers in the town who pay based on property, the merger incentives are easy to calculate: 10 cents off in the first year, 8 cents off in the second, and so on. Here's how it will work for those taxpayers:

Homestead Property Rates					
	FY17	**FY18**	**FY19**	**FY20**	**FY21**
Before Incentive	$ 1.546	$ 1.546	$ 1.546	$ 1.546	$ 1.546
Incentive	$ 0.10	$ 0.08	$ 0.06	$ 0.04	$ 0.02
Final	$ 1.446	$ 1.466	$ 1.486	$ 1.506	$ 1.526

Suppose a taxpayer owns a $200,000 property in this town. In the first year of the merger they will save $0.10 x $2,000 = $200. In other words, if the town hadn't merged, the taxpayer would have paid $3,092 ($1.546 x $2,000), but because of the merger incentive, they will only pay $2,892 ($1.446 x $2,000) for their FY17 (2016-2017) education property taxes, saving $200. In the second year they will save $160, the third year—$120, the fourth year—$80, and the fifth year—$40. Here's a graphical illustration of how the incentives will impact this example taxpayer:



Household Income Rate with Incentives

Act 46 and earlier acts spelled out how the incentives would work for those paying based on property, but for those paying based on income, the language was not as explicit, saying only, "The household income percentage shall be calculated accordingly." The Agency of Education developed a method for calculating the income incentive that translates the 10 cents, 8 cents, 6 cents, etc., property tax rate reductions into proportional reductions in the household income percentage—the number that determines how much those paying based on income will pay. Here's the formula the Agency of Education and the Department of Taxes will be using:

Incentive Household Income Percentage = Incentive Property Rate x (Property Yield ÷ Income Yield) x 2%

Here's the formula applied to our example town for FY17:

Incentive Household Income Percentage = $1.446 x ($9,701 ÷ $10,870) x 2% = **2.58%**

Using the formula, here's how the incentives will play out for those paying based on income in our example town over the entire incentive period:

Homestead Income Rates					
	FY17	**FY18**	**FY19**	**FY20**	**FY21**
Before Incentive	2.76%	2.76%	2.76%	2.76%	2.76%
Incentive	0.18%	0.14%	0.11%	0.07%	0.04%
Final	2.58%	2.62%	2.65%	2.69%	2.72%

Suppose a household earns $75,000 per year in this town. In the first year of the merger, the household will save 0.18% x $75,000 = $135. In other words, if the town hadn't merged, the taxpayer would have paid $2,070 in taxes, but because of the merger incentive, they will only pay $1,935 for their FY17 (2016-2017) education property taxes, saving $135.

Important Note

It should be noted that the taxpayer paying based on property and the taxpayer paying based on income will both experience a savings of about 6.5% in the first year of the merger. The resident paying based on property is getting $200 off a $3,092 bill (6.5%) and the resident paying based on income is getting $135 off a $2,070 bill (6.5%).

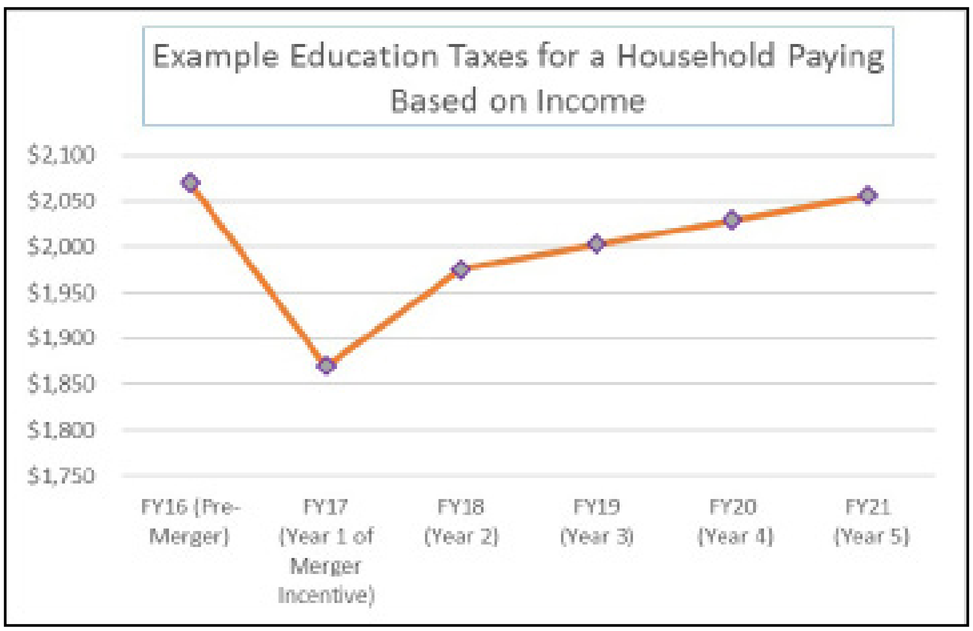
Factoring in the "Lag"

The households in Vermont that pay based on income (more than half of all households) receive a property tax adjustment from the State of Vermont that's applied as a credit to their property tax bill. However, the adjustment that a household sees applied to their FY17 (2016 – 2017) property tax bill is calculated based on FY16 property taxes and 2015 income. The reason for this is because these are the property tax and income data the Department of Taxes has during the time we calculate adjustments. This is why some people say the system has a "lag" or a "lookback" (i.e., the credit that a household generates in one year doesn't get applied until the next). The lag in the adjustment system makes the merger incentives a little more complicated for the residents of the town who pay based on income.

The incentive income rates shown in the table on page 3 are technically correct, but because of the "lag" in the adjustment system, the residents in the town who pay based on income will see a strange pattern in the reductions in their property tax bills. In the first year, they'll actually see the full 10 cent reduction in their bills because their adjustments from the previous year are being applied to an overall lower tax bill (i.e. the adjustment has not "caught up"). Here's what the net taxes will be for a household with a $200,000 house and $75,000 in household income (without the merger, this household would be paying $2,070 per year in education property taxes):

Net Taxes Due After Income Sensitivity Adjustment					
	FY17	FY18	FY19	FY20	FY21
Education Tax	$ 2,892	$ 2,932	$ 2,972	$ 3,012	$ 3,052
Adjustment (from previous year)	$ 1,022	$ 956	$ 969	$ 983	$ 996
Net Taxes Due	$ 1,870	$ 1,976	$ 2,003	$ 2,029	$ 2,056

As you can see in the graph below, the incentive structure is not as smooth for the taxpayers who pay based on income as it is for those who pay the property rate:



Conclusion

Households that pay education taxes based on the value of their property and those that pay based on their income will both realize tax rate reductions if their town chooses to merge districts. Unfortunately, there is no simple way to translate the 10 cents, 8 cents, 6 cents, etc., property rate incentives from Act 46 into proportional reductions for those paying based on income. The lag in property tax adjustment system further complicates the situation. Despite these particulars, the Agency of Education and the Department of Taxes will be working together to make sure that every taxpayer of a merging town receives the full benefit of the property tax incentives as they were laid out in Act 46. But for any given town involved in an eligible merger, taxpayers paying based on property and taxpayers paying based on income will both see the same proportional reduction in taxes paid as a result of the property and income incentives.