# VERMONT DEPARTMENT OF TAXES

## REPORT FROM ACT 183 OF 2024: PROPERTY TAX CREDIT ASSET DECLARATION

**Submitted to**
**House Committee on Ways and Means**
**Senate Committee on Finance**

**Submitted by**
**Office of the Commissioner**
**Vermont Department of Taxes**

**Prepared by**
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**December 15, 2024**

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VERMONT
DEPARTMENT OF TAXES

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Act 183, Sec. 21. PROPERTY TAX CREDIT; ASSET DECLARATION; REPORT

On or before December 15, 2024, the Commissioner shall recommend administrative and policy improvements for property tax credit claims, including the use of an asset declaration. The report shall be submitted to the House Committee on Ways and Means and the Senate Committee on Finance.

# Executive Summary

The Department of Taxes does not recommend including an asset declaration as part of the property tax credit claim. There are three primary reasons for this recommendation which are explained in detail in Part 1 of this report:

1. An asset declaration would impose an additional administrative hurdle for the roughly 125,000 homesteads who apply for income-based property tax relief each year
2. There is no established process for taxpayers to value their assets and there is no established process for the Department of Taxes to confirm asset values
3. If the asset declaration was used to deny the claims of some filers over a certain threshold, it would function as another arbitrary "cliff" in the benefit structure of the program

Importantly, the conclusions and recommendations in this report are supported by observations and recommendations from the Lincoln Institute of Land Policy, which is an independent, nonpartisan organization that researches how property is taxed in jurisdictions across the United States. The Lincoln Institute has assembled the most authoritative database on the different configurations of property tax relief programs in use around the country and provides guidance on the most effective ways to provide targeted property tax relief. The Lincoln Institute does not recommend the use of an asset test in property tax relief and its reasoning is cited several places in this report.

In Part 2 of the report, the Department of Taxes recommends reconfiguring the existing credit program as a homestead exemption tiered based on household income. This change would make the program more progressive with respect to property wealth, would address the "lag" in the system, and would make Vermont's current system of local control more sustainable by strengthening the connection between budget vote and tax bill. Additional justifications and related policy considerations are discussed in detail in that part of that report.

# Part 1 – Asset Declaration

## 1. An asset declaration would impose an additional administrative hurdle for the roughly 125,000 homesteads who apply for income-based property tax relief each year

Of Vermont's roughly 170,000 "homesteads" (households who own their own home and occupy it as their principal residence), around 125,000 apply for income-based property tax relief each year. The income metric that is used to determine program eligibility and credit amounts is "household income" as it is defined in 32 V.S.A. § 6061. Because the current benefit program operates from the assumption that income is the best metric for a household's ability to pay, the law attempts to capture all possible income sources available to every member of the household.

For most taxpayers, "Household income" is more complicated to report than the measurement of income that is used for Vermont personal income tax purposes (Vermont taxable income) and substantially more complicated than the measurement of income used for other benefit programs such as the Renter Credit and Medicaid (Modified Adjusted Gross Income or "MAGI"). Reflective of the complicated statutory definition, the tax form which the Department of Taxes uses to collect that information (the HI-144[1]) is notoriously challenging for taxpayers to fill out, challenging for tax preparation software companies to implement, and challenging for the Department of Taxes to audit.

A declaration of household assets would likely resemble the household income form in many ways, but instead of asking for things like wages, business income, and social security income, it would ask for retirement account balances, securities, and real estate value for each member of the household (see Part 5 of the federal Estate Tax Form 706[2] for a potential template). If the declaration was more of an *attestation* that total assets do not exceed a certain amount, credit applicants would still need guidance on how to value and take inventory of their total household assets.

One example of an asset attestation currently in use in Vermont is the Child Care Financial Assistance Program (CCFAP) application form. Notably, the Department of Children and Families recently amended its definition of assets[3] to only include liquid assets. According to DCF, the reason for this change was because some filers with significant business assets (but who were otherwise eligible for assistance based on the income) were exceeding the one-

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[1] https://tax.vermont.gov/sites/tax/files/documents/HS-122-2023.pdf#page=3
[2] https://www.irs.gov/pub/irs-pdf/f706.pdf#page=3
[3] https://outside.vermont.gov/dept/DCF/Shared%20Documents/CDD/CCFAP/CCFAP-ELIGIBILITY-ASSET-LIMIT.pdf

million-dollar asset limit. The issue of which types of assets to include or exclude would likely be an ongoing issue for a property tax credit asset declaration as well.

Adding another layer of complexity to the application for the property tax credit would also conflict with recent efforts by the Legislature and the Department of Taxes to make the program more accessible and the application less burdensome. For example, in recent years the Department of Taxes has simplified the income reporting for filers who are married filing jointly and converted website descriptions and form instructions to plain language wherever possible. In 2024, the Legislature reduced or eliminated late filing penalties (Act 144 of 2024) and instructed the Department of Taxes to supply towns with notices on how property owners can apply for credits and access resources in a variety of languages (Act 106 of 2024). Adding a declaration of assets would contradict those efforts and introduce a new barrier to Vermont homeowners trying to access the property tax relief they are entitled to.

## 2. There is no established process for taxpayers to value their assets and there is no established process for the Department of Taxes to confirm asset values

While income is relatively straightforward to track over the course of the year (for most types of income) and standardized methods of reporting income already exist, such as W-2s and 1099s, the same is not true for asset values. By nature, income tends to accrue over the course of a calendar year, but asset values are constantly changing. Any attempt at valuing assets would require a "point in time" snapshot of the asset values, but the "point in time" approach may lead some high-wealth taxpayers to use avoidance strategies such as shifting liquid assets to avoid being penalized.

The current convention for valuing property in Vermont is to use an "as of" date of April 1, but since property is an illiquid asset, it is harder to manipulate the value. For the estate tax, which is a tax on total assets that is only paid once upon death and only paid by around one hundred Vermonters each year, the "as of" date is simply the date of death (with some limited exceptions). Since valuing assets is so complicated, estate tax returns are always prepared by trained accountants. But unlike the estate tax, an asset declaration as part of the property tax credit claim would have to be completed by around 125,000 Vermont taxpayers and it would need to be done not just once, but annually. Commercial tax preparation software platforms are generally not configured to handle asset values so this would likely require a Vermont-specific add-on that those vendors would need to implement, or it would require taxpayers to use a paid accountant (or try to do it themselves).

Assuming taxpayers could somehow gather this data and report it, a parallel burden would exist for the Department of Taxes to verify the amounts reported. The Department of Taxes receives a large amount of income data each year from employers, banks, and the IRS, but does not receive any asset values beyond Vermont property values (i.e., the grand list). If reported amounts are going to be verified, the Department of Taxes would need to set up a novel reporting system to try to at least gather the values of commonly held assets like retirement account balances. It is unclear how the values of other assets such as securities, property owned in other states or countries, collectibles, etc. would be verified.

### 3. If the asset declaration was used to deny the claims of some filers over a certain threshold, it would function as another arbitrary "cliff" in the benefit structure of the program

In the current program there are two thresholds or "cliffs" where a household's benefit can change substantially: at $47,000 of income and at $90,000 of income. The point at which a household is no longer eligible for an income-based credit, which is $115,000 for 2024, is not a cliff because credit amounts gradually phase out between $90,000 of income and that amount. At $47,000 of income, the credit calculation transitions from being based on a 2% income tax rate that is set in statute, to being based on income tax rates that vary by town based on the school district's per pupil spending. This transition point in the system can cause an abrupt change to the credit amount of up to about $800. A bigger change happens at $90,000 of income, where the credit changes from covering up to $400,000 of property value (technically *equalized housesite value)* to only covering $225,000 of property value. Crossing this threshold can result in a change of up to $3,500 in the credit amount. From a policy perspective, cliffs are problematic because there is no significant difference between a household with income of $89,999 and $90,000 and the impact to the credit amount can influence taxpayer behavior.

The various thresholds and limits in the current credit program exist because of the competing policy priorities of taxing households based on ability to pay (income) while also attempting to tax households with higher levels of property wealth. That tension has existed in Vermont since even before Act 60 and is reflected in the frequent revisions to the property tax adjustment program. This history is well documented by the Joint Fiscal Office in the "History of Property Tax Relief and the Property Tax Adjustment 1970 – Current" section of its Fiscal Facts booklet[4]. The notion that someone living without a mortgage in a home worth half a million dollars should be asked to contribute towards the state's obligations is not only intuitive, it is supported by data. According to the Census[5], for all but the top 1% of households in the United States, home equity constitutes 31.4% of wealth (second only to retirement accounts as 32.1%), greatly outstripping other asset types such as stocks and mutual funds (10.9%) and other real estate such as second homes (3.1%).

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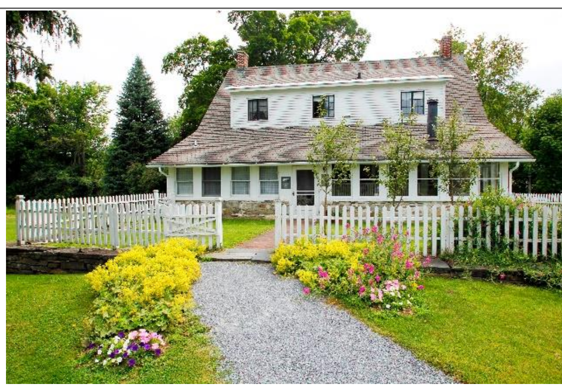
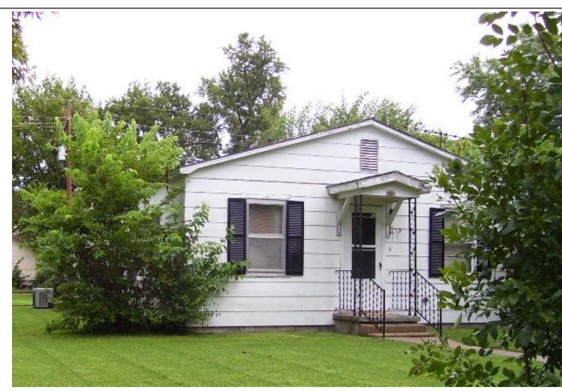
[4] https://ljfo.vermont.gov/assets/Publications/2024-Fiscal-Facts-Booklet/0e9a90d441/2024-Fiscal-Facts-Booklet-Entire-Booklet.pdf#page=80

[5] https://www2.census.gov/library/publications/2024/demo/p70br-202.pdf#page=7

Because residential real estate value is generally a household's biggest or second biggest asset, it would make logical sense to include it in any potential asset declaration. And it would also make sense that, given scarce resources, policymakers might want to use an asset threshold such as $1,000,000 as a cutoff for credit eligibility. If so, that would create a third "cliff" in the credit system, and it would potentially be the biggest cliff of all because a household's credit could be zeroed if they have just $1 more of assets. Notably, in a scenario where a household's only asset was its home and it was worth $999,999, the household would potentially be entitled to the maximum credit under the current system which is $5,600. But if their home was worth just one dollar more, the household would be disqualified under a one-million-dollar asset limit, causing their credit to fall to zero.

Using an asset test to potentially disqualify some high asset households calls into question the overall policy design of the current program. Under current law, at a given level of income the level of property tax assistance provided by the state increases as home value increases. There is a limit to the education tax credit of $5,600 or the taxes on $400,000 of property value (whichever is less), but people in higher-value homes still get the biggest credits in the current program and their credit amounts are not phased out as their property value increases.  But if income is the best measure of ability to pay, why would an arbitrary level of assets such as one million dollars suddenly trigger wealth to be the best measure of ability to pay? Table 1 below illustrates how in the current system the credit increases as the home value increases.

**Table 1. FY25 Current Law Net Education Property Tax for Two Example Households**

| <br>**Household 1** | <br>**Household 2** |
|---|---|
| Value: $400,000 | Value: $100,000 |
| Household Income: $50,000 | Household Income: $50,000 |
| Current Law Education Tax:<br>$6,065 (taxes based on property value)<br>- $4,580 (income-based credit)<br>= $1,485 net education taxes | Current Law Education Tax:<br>$1,516 (taxes based on property value)<br>-$31 (income-based credit)<br>= $1,485 net education taxes |

*Assumptions: $15,000 FY25 district per pupil spending resulting in 1.51612 homestead rate and 2.97% income rate, 100% CLA, ignore lag in the credit.*

In its report on Property Tax Circuit Breakers[6], the Lincoln Institute recommends the following as an alternative to an asset test (pg 13).

> Perhaps the best way to incorporate net worth into considerations of property tax relief eligibility is to focus on home value. Homes are easier to value than other assets and must be revalued periodically for property tax purposes. With the growing market for reverse mortgages over the last decade, it is becoming more reasonable to expect households with very high-value homes to borrow against those homes to pay their taxes.

Consistent with that perspective, tax relief programs in many other states phase out or otherwise limit the relief granted to people in higher value homes.

- In Nebraska, the homestead exemption phases out for homesteads that are valued at 200% of the county average[7].
- In Hawaii, Maui County has a circuit breaker that phases out for property value between $1M and $1.3M[8].
- Massachusetts allows communities to vote to exempt up to 35% of the average (median) assessed value of a residential property in the community[9], which helps people in lower value homes much more than people in higher ones. In fact, a very large number of states allow homesteads to exempt a flat amount or flat percentage from their taxable property value.

All these formats give much more benefit to households who are “house poor” than Vermont’s.

## Conclusion

In the Lincoln Institute’s Report on Property Tax Relief for Homeowners[10], the authors note,

> A small number of programs also set limits on household net worth. This makes sense in theory, to avoid using scarce resources to lower the tax burden on owners with significant wealth but limited cash income. However, net worth tests greatly increase administrative complexity, particularly if nonliquid assets are included, and may

[6] Lincoln Institute of Land Policy: Property Tax Circuit Breakers
[7] https://revenue.nebraska.gov/sites/revenue.nebraska.gov/files/doc/pad/info/96-299.pdf#page=4
[8] https://mauicounty.legistar.com/View.ashx?M=F&ID=13033430&GUID=37241F8B-5140-4B46-A672-B2B2C2D1E6C1
[9] https://www.mass.gov/doc/living-with-the-residential-exemption/download
[10] Lincoln Institute of land Policy: Property Tax Relief for Homeowners

discourage participation because of more burdensome application requirements and privacy concerns.

A declaration of assets in Vermont would make an already complicated tax relief program even more so. And if the declaration of assets was used to cut off eligibility for households over some threshold, this calls into question the existing design of Vermont's income-sensitized property tax system, which inherently provides more benefit to people in more valuable homes. If policymakers want to focus the benefit on those who are less wealthy and have lower value property (lower assets), they should strongly consider the homestead exemption framework outlined in the second part of this report.

## Part 2 – Administrative and Policy Improvements

The Department of Taxes recommends that the current income-based property tax credit system be restructured as a homestead exemption tiered based on household income. This change would enable school districts to accurately present to all owners of homesteads a table showing how much they will pay in education property taxes in the coming year if the budget is approved. It would also make the property tax more progressive with respect to property wealth.

In the current funding system, the primary cost control mechanism is the decisions made by local voters, but it is almost impossible to link budget vote to net-of-credit tax bills for the two thirds of voters who get an income-based credit. With a homestead exemption, all homesteads in a town would pay the exact same homestead property tax rate based on the per pupil spending of their school district, but low- and moderate-income households would have a portion of their property value exempt from the tax.

The complexity of the current credit system and the various formats it has taken over the past thirty years have given rise to widespread misconceptions about how different households pay for public education. A myth frequently heard at school board meetings and elsewhere is that two thirds of voters in town “pay based on income” so they do not need to worry about the school budget or property tax rates. This widespread myth is especially harmful because it can lead voters to make uninformed budget decisions and experience unanticipated tax increases when their bill arrives.

Another widely held and harmful misconception is that all low and moderate-income households benefit from Vermont’s income sensitivity program — which is also false. A household only gets an income-based credit if what it would pay based on income is lower than what it would pay based on property. This means that the household’s property value must be high enough relative to its income to get a credit, and low-income households in low value properties such as mobile homes often get little or no property tax assistance from the state. In fact, there are thousands of Vermont households who technically *qualify* for a credit based on their income, but because their property is not worth enough, they do not get one.

Table 2 on the following page illustrates how the complexities of the current credit system impact how households at different combinations of income and property value pay for education. The large share of households in the “Pay on Income and Property” column, who pay based on both income and property, is a result of the two limits on how much property value is sensitized in the current system. Those limits are $400,000 of property value (technically equalized housesite value) for households with income under $90,000 and $225,000 of property value for households with income over $90,000. Because property values over those thresholds are not income-sensitized, impacted households are paying partially based on income and partially based on property.

Also notable is the population of 30,610 households that pay based on income and have household income up to $47,000 (and housesite value under $400,000). These households are the ones who are truly insulated from school budget decisions because the income rates are locked in statute and do not reflect local spending (ignoring the lag in the system). However, most households who receive an income-based credit are paying based on rates that reflect per pupil spending because their income is over $47,000. And within every income group there are households that are technically *eligible* for a credit based on their income, but they pay exclusively based on property.

This profound complexity is why school districts and elected officials cannot tell voters what their education taxes will be, why damaging myths exist about how Vermonters pay for education, and why voters sometimes end up making uninformed decisions about school budgets and wind up frustrated by the unexpected tax liabilities that often result.

**Table 2: FY24 Education Taxpayer Type by Household Income Group**

| Income Group | Count | Pay on Income | Pay on Income and Property | Pay on Property |
|---|---|---|---|---|
| $0 to $47,000 | 33,960 | 30,610 (90%)* | 1,400 (4%) | 1,950 (6%)** |
| $47,000 to $90,000 | 50,020 | 40,150 (80%) | 3,810 (8%) | 6,060 (12%) |
| $90,000 to $128,000 | 32,600 | 3,800 (12%) | 20,430 (63%) | 8,370 (26%) |
| Over $128,000 | 56,420 | N/A | N/A | 56,420 (100%) |
| **All Homesteads** | 173,00 | 74,560 (43%) | 25,640 (15%) | 72,800 (42%) |

**Income tax rates for households up to $47,000 are locked in statute and uniform across the state. The rates for households over $47,000 are variable and reflect school district per pupil spending.*
***Almost all of these 1,950 are receiving a credit based on the "housesite exclusion value" under 32V.S.A. § 6066 (a)(C)(ii) which is an exemption of $15,000 exemption from the housesite value*

A potential framework for a homestead exemption could be as indicated in Table 3 below. This framework was configured based on the three most recent property tax years to try to

- minimize winners and losers as much as possible versus the current law credit system,
- maintain revenue neutrality (i.e., it would cost the education fund roughly the same amount as the current system), and
- maintain the overall existing level of progressivity with respect to income as much as possible.

Implementation of a homestead exemption in a future year could incorporate different program parameters based on updated data or different policy goals. The income cutoffs in the table below were chosen because they match the income cutoffs in the current system, helping to minimize winners and losers versus current law.

**Table 3: Homestead Exemption – Potential Framework**

| Household Income | Exemption | Maximum Exemption |
|---|---|---|
| Up to $47,000 | 60% with an additional 10% for seniors | $200,000 |
| $47,000 to $90,000 | 50% | $200,000 |
| $90,000 to $125,000 | 10% | $50,000 |
| Over $125,000 | Not eligible | Not eligible |

To further try to minimize tax variances versus current law and to avoid a complicated interaction with Vermont's Use Value Appraisal program (Current Use), the exemption should be taken from the value of the housesite, not the entire homestead. The exemption would be applied for with the income tax return (as happens currently) and the exemption level (70%, 60%, 50%, or 10%) would be communicated by the Department of Taxes to the taxpayer and taxpayer's town before the property tax year begins, similar to current practice, except currently the Department of Taxes communicates an exact credit amount.

Towns could easily program the maximum exemption amount into their billing software for each of the exemption percentages. The exemption would then be applied to the housesite value for the ensuing property tax year and shown on the tax bill. For example, if a household had income of $60,000 in the prior year and a housesite value of $300,000, they would qualify for an exemption of 50% of their $300,000 housesite which is $150,000, leaving a taxable amount of $150,000. If the town was reappraising and the new listed value of that house in the ensuing property tax year was increasing to $400,000, the exemption would automatically be increased to $200,000 without the Department of Taxes or the taxpayer having to submit any updated information.

The most important policy justification for re-configuring the current income sensitivity program as a homestead exemption is to strengthen the connection between budget votes and tax bills to improve tax transparency and make local control of school budgets more sustainable long-term. Vermont is unusual for the combination of the high degree of local control voters have over school budgets juxtaposed with a hyper-complicated property tax system for homesteads (of which income sensitivity is a primary component).

The main justifications for a homestead exemption are summarized in the first two list items below, followed by other supporting observations and potential policy justifications.

### All homesteads in a town would pay the same homestead property tax rate

As described and shown earlier in this part of the report, the complicated configuration of the current system makes it very hard to know what different households pay for education, which gives rise to widespread misconceptions and frustration about tax liabilities. Under a homestead exemption, all homesteads would pay the same homestead education property tax rate, but low- and moderate-income households would have part of their property value exempted from the tax. No homestead would be insulated from school budget decisions in this system, but the impacts on lower income households would be less than the impacts on higher income ones with the same property value.

### Easy to model tax impacts of a school budget

To show how various households in a town would be impacted by a school budget, a school district could construct a basic table such as Table 4 below. Currently, most school districts only show the impacts to the gross property taxes and if they do try to incorporate income-based credit they ignore the lag in the system, which creates inaccurate tax amounts. As is true currently, there would need to be different tables for each town in the district (because of different CLAs) and any homestead value beyond the housesite would have to be handled separately as would any non-homestead portion of the property.

**Table 4: Projected FYXX Property Tax Amounts for Homesteads in Exampleville in XUUSD**
(Assuming $1.50 tax rate)

| Income Group | $75k | $125k | $175k | $225k | $275k | $325k | $375k | $425k | $475k |
|---|---|---|---|---|---|---|---|---|---|
| Senior up to $47k | $338 | $563 | $788 | $1,013 | $1,238 | $1,875 | $2,625 | $3,375 | $4,125 |
| Non-senior up to $47k | $450 | $750 | $1,050 | $1,350 | $1,650 | $1,950 | $2,625 | $3,375 | $4,125 |
| $47,001 to $90,000 | $563 | $938 | $1,313 | $1,688 | $2,063 | $2,438 | $2,813 | $3,375 | $4,125 |
| $90,001 to $125,000 | $1,013 | $1,688 | $2,363 | $3,038 | $3,713 | $4,388 | $5,063 | $5,738 | $6,413 |
| Over $125,000 | $1,125 | $1,875 | $2,625 | $3,375 | $4,125 | $4,875 | $5,625 | $6,375 | $7,125 |

### Would address the property value lag and would be sensitive to rate changes in the coming property tax year

One of the main criticisms of the current system is that it is “lagged” a year, meaning the credit that Vermont households are seeing on their property tax bill this year FY25 is based on their FY24 property taxes and their income from calendar year 2023. This can cause issues when property value changes abruptly such as in a reappraisal, when property tax rates change abruptly such as a state policy change like Act 127, or when a major budgetary change happens in the school district leading tax rates to change.

In FY25, to compensate for the lag in the system and try to help income-sensitized households deal with big rate increases, the Legislature enacted a one-time increase to the credit of 13% (which was roughly consistent with the statewide average bill increase). This was an imperfect solution that was not reflective of local rate changes but was deemed necessary by policymakers to try to compensate for the lag. Under a homestead exemption this would not be necessary because the exemption would be applied to the coming year’s property tax bill so the benefit would automatically scale with changes in property values or changes in tax rates.

### Homestead exemptions are commonly used in other states and Vermont already has one for veterans and the Homestead Exclusion Value

According to the Lincoln Institute, nearly every state has some version of a Homestead Exemption and Vermont currently has two: A $10,000 exemption for veterans (which most towns have voted to increase to $40,000) and the $15,000 “Housesite Exclusion Value (HEV)” exemption that is an increasingly minor feature of the existing property tax credit program. Homestead exemptions are a progressive and easy-to-understand way to provide property tax relief and many people already think of Vermont's system as a homestead exemption (and call it that) even though it is an income-based credit.

### Makes it impossible to pay zero or negative for education

In the current system, there are situations where a household may pay nothing for education or even have a negative liability after the credit, which results in them getting money back from their town. This generally happens because the credit is based on prior year taxes and a property's taxable value may go down or the rates may go down the following year. While normally rare, the 13% increase in property tax credits in FY25 coupled with widespread rate changes from Act 127 resulted in more cases of negative tax liabilities than normal. With a homestead exemption this would be mathematically impossible because the exemption would be based on current year property values and property tax rates. There could still be rare cases where a household receiving an income-based homestead exemption on top of the $40,000 veteran's exemption could have a negative housesite value. To address this the Department of Taxes recommends that the taxable housesite value not be allowed to go below zero in any year.

### More beneficial to people with lower property values (usually smaller homes) and places where property values are lower than the current system

The current system calculates the credit as the difference between taxes based on property and taxes based on income (with various limitations described earlier). This means that people with higher property values get more benefit at a given level of income. Higher property value is usually the result of a larger home, or a home in a town where property values are higher. In the current system, a household in a smaller home or living in a town where property values are lower is likely to get less benefit from the state. Compared to current law, a homestead exemption would shift the benefit towards people in lower value property which would relieve some education tax pressure in property-poor towns. It would also incentivize the ownership of smaller homes and downsizing compared to the current benefit structure which incentivizes holding on to larger and more valuable homes as the value of the asset appreciates.

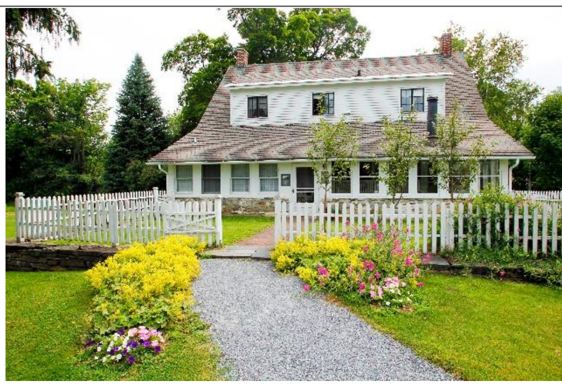
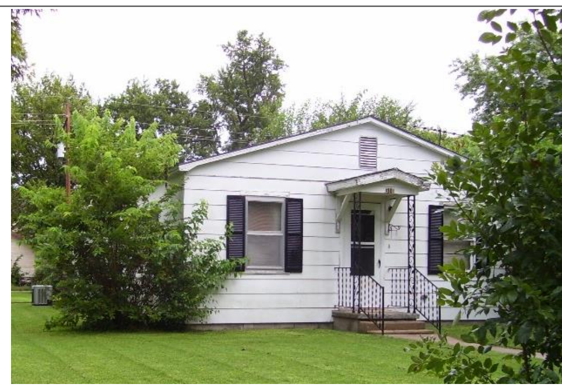
### Income limits could be indexed for inflation and the uppermost limit would be a policy choice rather than a function of the homestead property yield and income yield. Parameters could easily be adjusted for the coming year

Under a homestead exemption, the income limits could easily be changed without any implications for how people pay for education because all homesteads would be paying the education property tax. For that reason, the income thresholds should be indexed for inflation and rounded to the nearest thousand dollars to make tax calculations easier. The income level at which a household is no longer eligible would be set in statute as opposed to the current system where it is a function of the two yields and outside of the control of policymakers. The maximum exemption amounts and the additional exemption for seniors would also be straightforward to adjust and all adjustments (except for the maximum income eligibility level) would be straightforward to adjust for the property tax year starting in July after the Legislature adjourns. There would also no longer be a need for an income yield.

## Tax Impacts of a Homestead Exemption and Other Policy Consideration

Considering recent education tax increases around Vermont, it is an especially challenging time to change the structure of state provided property tax relief. Absent any other education funding changes, a homestead exemption would see some homeowners getting less benefit than they do under current law and some getting more. Additionally, thousands of homeowners in lower value properties would newly become eligible for assistance when they previously were not because their homes were not worth enough. In aggregate, a homestead exemption would shift the benefit from homeowners with higher value homes to those with lower value homes. The example in Table 5 below, recycled from Table 1 in this report, illustrates this effect:

**Table 5: FY25 Current Law Tax and Homestead Exemption Tax for Two Example Households**

|  **Household 1** |  **Household 2** |
|---|---|
| Value: $400,000 | Value: $100,000 |
| Household Income: $50,000 | Household Income: $50,000 |
| Current Law Education Tax: $1,485 | Current Law Education Tax: $1,485 |
| Homestead Exemption Tax: 3,032 | Homestead Exemption Tax: $758 |
| **Increase of $1,547 (+104%)** | **Decrease of $727 (-49%)** |

The homestead exemption framework outlined in this report fits most households reasonably well when compared to current law but would represent a noticeable decrease in benefit for households whose property value is very high relative to their income, such as the example on the left in the previous table. This is especially true for those households under $47,000 of income, which is the pre-Act 60 “circuit breaker” component of the existing system. Those households receive an income-based credit that is calculated from lower income tax rates which are locked in statute and not reflective of local per pupil spending. The income education tax rates for those households are as follows (from 32 V.S.A. § 6066 (a)(4)):

**Table 6: Income Tax Rates for Households up to $47,000 of Income**

| Household Income Bracket | Percentage of Income |
|---|---|
| $0 - $9,999 | 0.5% |
| $10,000 - $24,999 | 1.5% |
| $25,000 - $47,000 | 2.0% |

The example household in the table above with $50,000 in income and living in a $400,000 home would have received a bigger credit (and therefore paid less in net taxes) if their income was under $47,000 because the credit would have been based on the rates in Table 5.  For example, if their income was $40,000 instead of $50,000, they would have received a credit of $5,265 and paid $800 in net taxes. If their income was less than $25,000 they would have received the maximum education credit of $5,600 and paid $465 in net taxes. Under the homestead exemption framework in this report, they would have received a 50% exemption and paid property taxes based on $150,000, which would be $3,032. In the homestead exemption framework outlined in Table 3 there is an additional 10% exemption for seniors, but this does not totally mitigate the tax variance versus current law for households up to $47,000 in income with high property values.

In its report on “Property Tax Relief for Homeowners[11],” the Lincoln Institute recommends two policy options for policymakers to address this scenario (pg. 13).

> As an asset tax not necessarily related to current income, the property tax can create liquidity problems for taxpayers whose home value is not matched by their cash flow. This can be a long-term situation, as in the case of senior citizens on fixed incomes or homeowners with low incomes in gentrifying areas with rapidly increasing housing values. Other taxpayers may face a short-term cash flow problem when dealing with temporary situations such as job loss or emergency expenditures. Property tax deferrals can assist taxpayers who have sufficient home equity to serve as collateral, and circuit breakers can help with both short- and long-term liquidity challenges.

[11] Lincoln Institute of land Policy: Property Tax Relief for Homeowners

Either a circuit breaker or a deferral program would both come with some additional complexity and cost to the state. A modified circuit breaker could be designed that would be applied for at the time of income tax filing (like the Renter Credit) and issued as a check or incorporated into the income tax refund. This would potentially re-introduce the issue of some voters being insulated from school budget decisions, but since the credit would not be applied to the property tax bill, all homesteads in a town would still be paying the same homestead property tax rate during the course of the property tax year.

The second option would be for Vermont to establish a property tax deferral program, which is an option where certain qualified owners of residential property are allowed to choose to defer a portion of their local property taxes until the time when their property transfers. According to the Lincoln Institute, deferrals are offered in thirty other states and the District of Columbia. Two states that Vermont often looks to for tax policy ideas, Maine[12] (because of its similar demographics) and Minnesota[13] (because of its progressive tax structure) offer deferral programs. To ensure that back property taxes are paid, deferral programs necessarily require a tax lien be placed on the home and for deferred taxes to accrue interest. These two aspects of deferral programs are often perceived in a negative light and can discourage some eligible homeowners from participating. The use of property liens already exists in Vermont's current use program.

## Other Related Considerations

**The municipal portion of the circuit breaker for households with income up to $47,000 may need to be re-formatted. The low income (and low-income senior) exemption could be applied**

Under current law, homeowners with income up to $47,000 are eligible for an additional credit to their municipal property taxes if their municipal taxes in the prior year exceeded the percentages of income in 32 V.S.A. § 6066 (a)(3). The roughly $18M cost of this credit is paid from the General Fund directly to towns to negate what the Department of Taxes tells them to apply to the bills of the recipients. The credit amounts follow the same pattern as the education credits, where more valuable homes receive more of the benefit.

The equity of that arrangement is questionable for the reasons outlined in part one of the report, but also because in some towns municipal rates are high and pay for a broad range of services while in other towns rates are low and may pay for a very limited set of services. The municipal credit makes it so that a household in the town with a lot of services will get them for the same tax cost as a household in a town with limited service if their incomes are the same.

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[12] https://www.maine.gov/revenue/taxes/tax-relief-credits-programs/property-tax-relief-programs/deferral-program
[13] https://www.revenue.state.mn.us/property-tax-deferral-senior-citizens

One option for re-formatting this credit would be to make it follow the same homestead exemption as is outlined in this report for education taxes. Towns could elect to pick up the exemption and pay for a portion of it themselves through their local agreement rate as they do now for the Veterans exemption (with a possible state match). Another option would be to wrap it into a re-designed circuit breaker that is part of the income tax, but taxpayers might wonder why their income tax refund was so big and their municipal property taxes went up so much. It could conceivably be left as it is, but it might be confusing to have an income-based property value exemption for education and an income-based credit applied to the bill for municipal taxes.

**“Cliffs” in the benefit structure**

The potential homestead exemption framework outlined in this report continues to have “cliffs” in the benefit structure, which can be problematic from a policy perspective. The reason those cliffs exist is because the framework was designed to minimize tax variances versus current law as much as possible, so the way the current credit system changes at $47,000 and $90,000 of income are reflected in the homestead exemption framework. Additionally, the exemption creates a third, smaller cliff, at $125,000 of income, where eligibility ends. To minimize cliffs, a different structure could be established, but this might increase tax impacts versus current law. If the Legislature decides to pursue this recommendation, it should consider those policy tradeoffs.

**Mobile home lot rent and allocated property tax**

Under current law (32 V.S.A. § 6066 (d) and (e)), homeowners who own their own mobile home but rent the lot they live on are allowed to have their mobile home lot rent included in their housesite taxes for consideration in the property tax credit claim. Similarly, homeowners who live on cooperatively owned land are allowed to have the pro-rata share of the property taxes they indirectly pay allocated to them and included on the claim. There are around 2,500 claimants who report either mobile home lot rent or allocated property taxes each year.

It should first be noted that owners of mobile homes are generally going to get more benefit from an exemption than they do under the current system, but one option for addressing this under a homestead exemption could be to have these two groups continue to report these values and then issue direct checks based on the exemption level. For example, if someone reported $600 in mobile home lot rent or allocated education tax and their exemption level was 50%, they would receive a check for $300.

**Handling the homestead exemption in real estate transactions**

Under current law (32 V.S.A. § 6063), the buyer of a Vermont property typically compensates the seller of a residence for any unused property tax credit at the time of transfer. This exists in Vermont real estate transactions because the property tax credit is lagged a year, so the credit appearing on the bill in one year can be thought of as being earned or generated based on taxes paid in the prior year and therefore the property of the seller. Having to compensate the seller for up to $8,000 of property tax credit can put additional strain on buyers already struggling to come up with a down payment and myriad other closing costs. Under a homestead exemption there would not be a lag so this transaction would not be necessary, but the exemption level applied to the bill *would* be based on the seller's prior year income.

The Department of Taxes recommends that the buyer not have to compensate the seller for the value of the exemption, but the buyer be given the option to re-apply for an exemption based on their own prior year income (if they will occupy the property as their homestead). The town would then re-issue the property tax bill with the exemption level that is appropriate for the buyer. Because homestead exemptions are very common in other states (and often based on the owner's income), exemplars for handling homestead exemptions in real estate transactions are readily available.

## Potential Phase Two

To avoid too much tax impact at one time, the department recommends the Legislature consider these policies in a potential phase two a few years after the homestead exemption has been implemented:

### Look at adjusting the income parameters based on household size or provide a subtraction for each household member

Normally, in housing assistance programs (and many state property tax relief programs), the size of the household is considered in the benefit. The assumption for that accommodation is that a household with one person and a household with four people have different amounts of *disposable* income after household expenses are taken into consideration even if their incomes are nominally the same. Because of that, income eligibility thresholds in these programs are often scaled based on household size. This would be an option under a homestead exemption, but because of the implications for education property tax transparency, a simpler option might be to allow households to make a set dollar amount subtraction for each person in the household when calculating total household income. This would be similar to what Vermont allows for personal income taxes through the subtractions for "personal exemptions", which is $5,100 per person in tax year 2024.

### Adjust the household income definition to be more like what's used for the Renter Credit (which is basically same as MAGI for Medicaid)

In an effort to be fair, the household income definition and resulting form are overly complicated and serve as a barrier to application for property tax relief. Many of the types of income the form asks for are reported by a very small subset of filers and only smaller amounts of money are generally reported. Under a homestead exemption tiered based on income, the precise amount of income the household earns would be less important than under the current system. Other states, such as Maine[14], use income metrics for their relief programs that are more similar to what Vermont uses for the Renter Credit and what is used for Medicaid eligibility (Modified Adjusted Gross Income or MAGI). The Legislature should consider looking simplifying the statutory definition to make the program more accessible.

## Conclusion

A homestead exemption such as the framework outlined in this report would make Vermont's property tax system for Vermont resident homeowners more progressive with respect to wealth and would make it possible to understand how school budget votes will impact taxes. For households in high-value homes who have low income, the tax increase under a homestead exemption could be offset with a circuit breaker credit or a deferral program. Various other aspects of existing policy would need to be addressed, but the system would be much simpler overall, fairer in many respects, and more consistent with how property tax relief is provided in the rest of the country.

[14] https://www.maine.gov/revenue/sites/maine.gov.revenue/files/inline-files/23_1040me_sched_pstfc_ff.pdf