

# The Tax Consequences of Land Conservation in Reading

## I. Summary

The main purpose of this report is to research and document the tax implications of permanently conserving land in Reading. This work has been undertaken because Vermont towns rely on the property tax to fund local schools, police, highway work, recreation programs and general government. Responsible town officials, attempting to offer their citizens a balanced program of services without exorbitant taxes, can make better decisions if they have a clearer understanding of the way land use decisions will affect their ability to pay for local government.

Permanent land conservation, whether acquisition of all the rights in land or of the development rights, generally results in value being removed from the Grand List. The tax consequences will depend on:

- the value of the parcel
- whether the parcel is owned by state government, the town, or a non-profit organization, and
- whether the parcel is protected through fee simple acquisition or through acquisition of development rights.

Because the **school tax** represents over three-quarters of the tax bill in Reading, the school tax will be explained first. In the late 1990's, Act 60 (and later, Act 68) changed the way towns pay for education, and also changed the relationship between the Grand List and school taxes. Now, the school effective tax rate depends on the per-pupil spending and not on the tax base. Shrinking the tax base by taking land off the tax rolls for land conservation won't change the school tax rate. Similarly, growing the tax base won't change the school tax rate, as long as the district continues to spend the same amount per pupil.

The municipal tax is affected by changes in the Grand List. There is often an increase in the **municipal tax** rate resulting from a conservation acquisition, except when the land is acquired by the Vermont Agency of Natural Resources. In Reading, when land is acquired by the Agency of Natural Resources, the town usually will receive *more* in payment from the state than it would receive if the land remained in private ownership.

Because, in the long term, permanent conservation of land precludes development of that land, the study also looks briefly at the long-term tax consequences of development. The main conclusion of this report and a recent related study conducted jointly by the Vermont League of Cities and Towns and the Vermont Natural Resources Council (from which this report borrows heavily) is that taxes tend to be higher in towns that have the most developed property, and there seems to be no easy way to develop that will keep taxes low over the long term.

Although this study focuses on the property tax effects of land use decisions, we do not want to give undue importance to the tax bill as a factor in deciding how a town should

grow. Perhaps the best long-term strategy is to maintain a balance between population growth, commercial development, and land conservation.

When planning for a town's future, property taxes are just one of many concerns. Most communities strive to create a prosperous and healthy environment in which to raise the next generation—not solely to maintain low tax rates. The challenge when evaluating planning options is to strike a balance between what improves the community, what is responsible, and what taxpayers can afford.

## **II. School Taxes**

The basic premise of education finance in Vermont is that all school districts should be able to raise an equal amount per pupil with equal effort. For “homestead property” (a primary residence and all contiguous land) the equalized school tax rate depends on the spending per pupil, after non-tax revenues have been accounted for, not on the local Grand List. For nonresidential property—which is defined as all property that is not homestead-- the equalized school tax rate is the same in every school district.

Because the school tax rate does not depend on the local Grand List, having lots of conserved land or lots of commercial property in a town makes little difference in the equalized school tax rate. Similarly, increasing (or decreasing) the local Grand List does not increase or decrease school tax rates, unless it also results in an increase in the amount spent per pupil. This is likely to happen if a school expansion is needed.

When the tax rates are set, the town collects the school tax for the state Education Fund. The state Education Fund then pays each school district the amount voted per pupil, plus other “categorical aid” such as aid for special education and transportation. The Education Fund is the mechanism that allows all towns the ability to have the same tax rate for a given spending level, regardless of property wealth.

## A. How Local School Tax Bills Are Determined Under Act 68

### 1. Non Homestead Property

Under Act 68, all non-homestead property in the state has a uniform equalized school tax rate set by the Legislature. The non-homestead rate is *not affected* by any of the following:

- the size of the local Grand List
- reductions in the Grand List due to land conservation
- additions to the Grand List due to development
- the local school budget.

For FY 05, this rate was set at 1.54 per \$100 of equalized property value.<sup>1</sup> The state adjusts this rate by the district's common level of appraisal (the ratio of listed value to fair market value in the town as determined by the state) and the town sends out the tax bills.

<b>Step for Calculating Non Residential Rate</b>	<b>Reading FY 05</b>
Adjust the state nonresidential rate by the town's Common Level of Appraisal	$\$1.54 / .7693 = \$2.0018$

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<sup>1</sup> The statutes call for a rate of \$1.59. This can be adjusted by the Legislature. In FY 06 it will be \$1.51.

## 2. Homestead Property

Under Act 68, the equalized homestead school tax rate is based on the district's spending per pupil. This rate is not affected by the size of the Grand List or by reductions in the Grand List due to land conservation; it is affected by changes in per-pupil spending.

After subtracting expenses paid for by federal aid, by state categorical aid, or non-tax revenues<sup>2</sup>, the school board would divide the remaining spending by the number of equalized pupils to come up with the district's proposed per-pupil spending.<sup>3</sup>

The district's per-pupil spending is then looked at as a percent of the state's base grant amount, to calculate the district's "spending adjustment." For FY 05, the state's base grant amount is \$6,800.<sup>4</sup> In a district spending 120% of the base grant amount, (or \$8,160 in FY 05) the "spending adjustment" would be 120%. The homestead equalized school tax rate is calculated as the state's homestead base education rate, (which was set at 1.05 for FY 05<sup>5</sup>), multiplied by the district's "spending adjustment." In a district spending 120% of the base grant amount, the equalized homestead rate would be 1.05 X 120% or 1.26.

The steps to calculating homestead tax rate are:

<b>Step for Calculating Homestead Rate</b>	<b>Reading FY 05</b>
Calculate spending per pupil by dividing education spending (less special revenue) by equalized pupils.	$\$1,260,422 / 119.98 = \$10,505.$
Calculate "spending adjustment" by dividing spending per pupil by state base grant.	$\$10,505 / \$6,800 = 154.49\%$
Calculate equalized homestead rate by multiplying state base homestead rate by district's spending adjustment	$\$1.05 \times 154.49\% = \$1.62$
Adjust by the town's common level of appraisal (ratio of listed value of property to fair market value as determined by the state)	$\$1.62 / .7693 = 2.1085$

<sup>2</sup> These non-tax revenues are known as "Tier One" revenues. In some towns, capital expenditures are also subtracted. Contact the Department of Education for information on capital expenditures in your town.

<sup>3</sup> The student count to be used is weighted by the Department of Education for poverty, non-English speaking students, and secondary students. The Department then published the "equalized student count."

<sup>4</sup> The base grant amount is adjusted for inflation. In FY 06 it will be \$6975.

<sup>5</sup> The statutes call for an equalized homestead rate of \$1.10. This can be adjusted by the Legislature. In FY 06 it will be \$1.02.

## Special Provisions for School Taxes on Housesites of Residents

There are special provisions that apply to the housesite (primary residence plus up to two acres) of residents with household incomes less than \$75,000.<sup>6</sup>

Resident households with incomes less than \$75,000 can pay based on their income instead of their property value. The income payment is calculated as 1.9% of the household income multiplied by the district's "spending adjustment."<sup>7</sup>

**Example:** Household with \$40,000 Income and \$100,000 housesite in a district with a "spending adjustment" of 120% (spending \$8160 per pupil).

Paying on property value, the school tax would be \$100,000 @ 1.05 X 120%, or \$1260

Paying on income, the school tax would be \$40,000 @ 1.9% X 120%, or \$912.

Resident households with incomes less than \$75,000 may also receive a credit for taxes paid on extra acreage surrounding their houses.<sup>8</sup>

Resident households with incomes less than \$47,000 may choose to pay homestead taxes on the equalized value of their homestead less \$15,000. In some cases, this calculation would result in greater savings than the income method.

The income provisions protect lower-income residents in towns where the homestead values may be appreciating rapidly. A resident with a \$40,000 income and a \$300,000 house in one town would pay the same tax as a resident with a \$40,000 income and a \$100,000 house in another town that had the same per-pupil spending.

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<sup>6</sup>The statutes call for the base income percentage to be 2%. When the legislature lowers the state's homestead rate, as it did in FY 05, this percentage is lowered as well. In FY 06 it will be 1.85%.

<sup>7</sup> Residents with incomes exceeding \$75,000 may substitute the income-based payment for the school taxes due on the first \$160,000 housesite value. In addition, they would pay the school property tax on any housesite value in excess of \$160,000.

<sup>8</sup> The credit is \$10 per acre for the acres between 2 and 5 as of December 2003. The intent of the legislation is for the credit to eventually apply to the acres between 2 and 25.

## **B. How Conservation Acquisitions Affect School Taxes**

The most important difference that results from Acts 60 and 68 is that school tax rates are not based on the Grand List.

The equalized school rate applied to *non-homestead* property is uniform throughout the state. The *homestead* rate varies from town to town based on spending per pupil—not on the local Grand List. A town with high property values would have the same equalized homestead school tax rate as a town with low property values if the spending per pupil were the same. A town with lots of land owned by the Agency of Natural Resources would have the same equalized homestead school tax rate as a town with no public land if the spending per pupil were the same.

Conservation land owned by the federal, state, or town government does not pay property taxes and is not part of the Grand List. Development rights held by a certified conservation organization are also exempt from the property tax. While this change in the Grand List affects municipal taxes, it does not affect school taxes.

Although land conservation would not affect the school tax rate, it is possible that tax bills could rise on property adjacent to the conserved parcel, simply because land conservation may make surrounding property more desirable and valuable.

## **C. How Development Affects School Taxes**

The equalized school rate applied to *non-homestead* property is uniform throughout the state. It does not depend on new development that might be added to the local Grand List.

Even though a new development would pay school taxes, the taxes paid by the development would not change the equalized homestead school tax bills of residents in the school district—unless it affected the spending per pupil. These are ways that a new development might affect the spending per pupil:

- If the development necessitates an increase in per-pupil spending—most notably because a school addition is required—the spending per pupil and the homestead rate could increase.
- If additional students reduce the per-pupil spending by more efficiently utilizing excess capacity, the tax rate would decrease.

In addition, new development can affect property values. This, in turn, would affect the tax bills of those properties even though the tax rate does not change. If the development raises the value of neighboring properties—by making a neighborhood more desirable, for example—tax *bills* on some properties would rise because they are more valuable. On the other hand, if the development lowers property values—because of decreased desirability of property near an industrial facility, for example—the tax *bills* of some properties would change even though the tax *rates* stayed the same.

Acts 60 and 68 essentially spread across the whole state the cost of new students, the tax base additions from new development, and the tax base losses due to business failures, fires, or depreciation. For this reason, there would be less fluctuation in school tax rates resulting from changes in the local Grand List or from new students than there has been prior to the passage of these acts.

- *If there is no change in per-pupil spending*, there will be no change in school tax rates of property owners in the school district.  
There will be no change in per-pupil spending either if there are no new students or if it is assumed that the school district will maintain the same “level of service” by spending the same amount per pupil on the new students that it is spending on existing students.
- *If the per-pupil spending increases*, the equalized *homestead* school tax rate will increase. If, for example, the school district must build an addition in order to accommodate the new students, the additional capital cost would be added to the education spending, thereby increasing the spending per pupil and the homestead school tax rate. The non-homestead rate would not be affected.

### **III. Municipal Taxes**

The municipal tax rate is calculated by dividing the amount to be raised by the value of the Grand List.

If the budget is held constant and the Grand List is reduced, the tax rate will increase.

If a land use change increases the demand for services (and therefore the amount to be raised) as well as the Grand List, the change in the tax rate will depend on whether the cost/tax base ratio is smaller or larger than the town average.

#### **A. How Conservation Acquisitions Affect Municipal Taxes**

If land is acquired by the town, the municipal (not school) taxes that would ordinarily be paid on the land must be made up by other taxpayers.

If land is acquired by the Agency of Natural Resources, the town receives a payment in lieu of taxes. This payment is one percent of the fair market value of the parcel, as determined by the state division of Property Valuation and Review. Because Reading’s municipal tax rate is currently about 0.3% of fair market value, the state pays more than twice as much per \$100 of value as a private owner would.

The state estimates that the value of the land owned by the Agency of Natural Resources in the town of Reading is slightly over \$2 million. The state’s payment in lieu of taxes (PILOT) of one percent of that value totals \$18,000 in FY 05. If the ANR property were

privately owned and paying municipal property taxes, the tax rate in Reading would actually be higher than it is now as shown below.<sup>9</sup>

If ANR land were privately owned: Hypothetical Tax Calculations for Reading		
	Current	If ANR land were on the tax rolls
Budget	330,423	330,423
Less PILOT	18,019	0
Budget to be raised from taxes	312,404	330,423
Current Grand List	772,681	772,681
Plus state land if taxable	0	15489.89
Total Grand List	772,681	788,171
Municipal Rate	0.404	0.419

If the development rights are acquired by a non-profit conservation organization or by the state or town, the listers are directed to tax the fee owner only on the remaining rights. In general, the assessed value drops and the fee owner pays less in municipal taxes. This difference in municipal taxes is shifted to other taxpayers in town.

It is possible that nearby land will increase in value as a result of a conservation project. Advertisements for real estate often mention that a parcel is adjacent to protected land. As a result, the taxes on adjacent parcels may increase.

## B. How Development Affects Municipal Taxes

Development can either increase or decrease the municipal tax rate. While development usually increases the Grand List, it also usually requires municipal services. Depending on whether the new tax revenues outweigh the new costs, the municipal tax rate may go up or down as a result.

What follows are some examinations of the relationship between municipal (not school) tax bills and land use patterns in all Vermont towns.

### 1. Population

The most likely type of development a community will experience is housing. While new housing increases the tax base, it also requires municipal services—thereby increasing the municipal budget. The chart below shows the relationship between population in a town and the municipal tax bill on the average-value house.

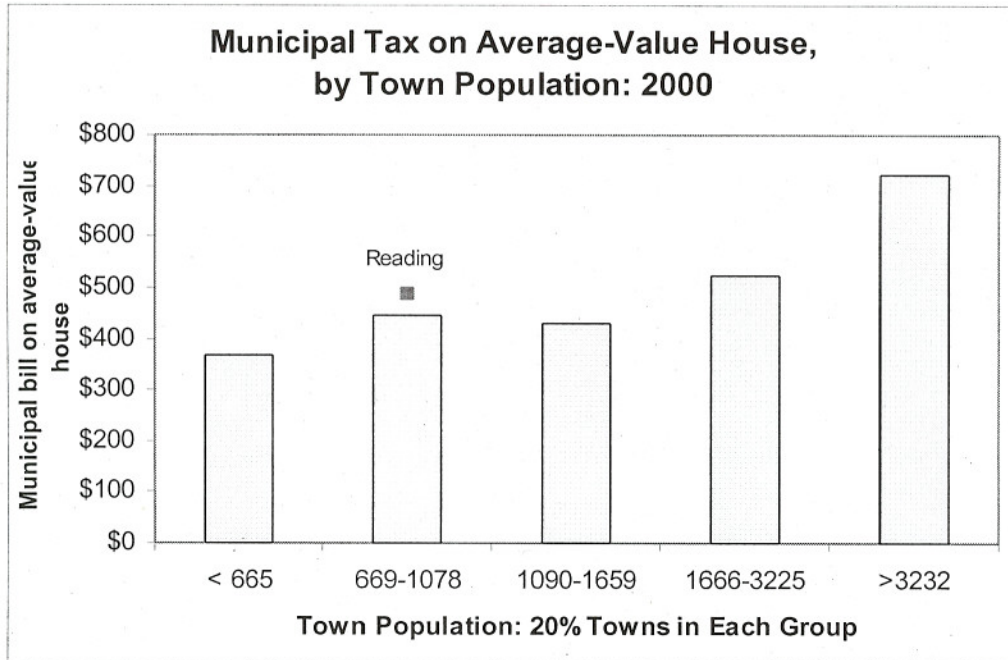
To examine the relationship between population and municipal taxes, all Vermont towns were ranked according to the number of year-round residents and divided into five

<sup>9</sup> This assumes the listed value would be the fair market value, as determined by Property Valuation and Review, adjusted by the common level of appraisal.



groups. The municipal (not school) tax bill was calculated for the average-value house in each town and averaged for each group.

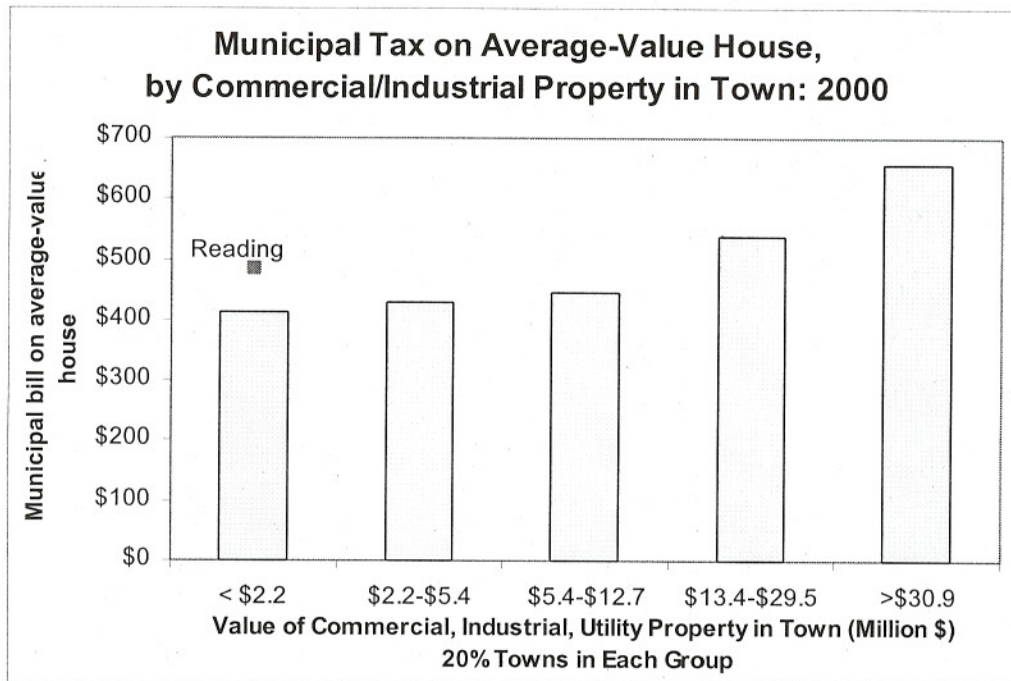
This is consistent with the findings of the Cost of Government Services studies which document that residential property has the highest ratio of cost to value; that is, residential property costs the municipality more per \$100 of taxable value than most other types of property.<sup>10</sup>



## 2. Commercial and Industrial Property

Although commercial and industrial development is often sought to lower taxes, in general, towns with more commercial and industrial property have higher, rather than lower taxes. In the chart below, all Vermont towns were ranked according to the fair market value of taxable commercial and industrial property and divided into five groups. The municipal (not school) tax bill was calculated for the average-value house in each town and averaged for each group.

<sup>10</sup> See the Cost of Government Services reports prepared by the American Farmland Trust, Herrick Mill, No. 1 Short Street, Northampton, MA 01060. See also: Robert W. Burchell. 1992. *Fiscal Impact Analysis and the Fiscal Impact Hierarchy: A Glimpse at the Argument*. Prepared for the Lincoln Institute of Land Policy, Cambridge, MA.



As shown in the graph, the municipal tax bills tend to be higher in the towns that have the most commercial and industrial property value and lower in the towns that have the least.<sup>11</sup>

It should be pointed out that the increase in tax bills is not necessarily a direct result of the commercial or industrial development. Municipalities that have commercial and industrial development generally have jobs and residences. As documented by many studies of the cost of government services, most residences demand more in services than they contribute in taxes. It is probably the combination of commercial and residential developments that result in higher taxes—not the commercial development alone. However, it is unlikely for a town to successfully retain commercial or industrial development without residential development.

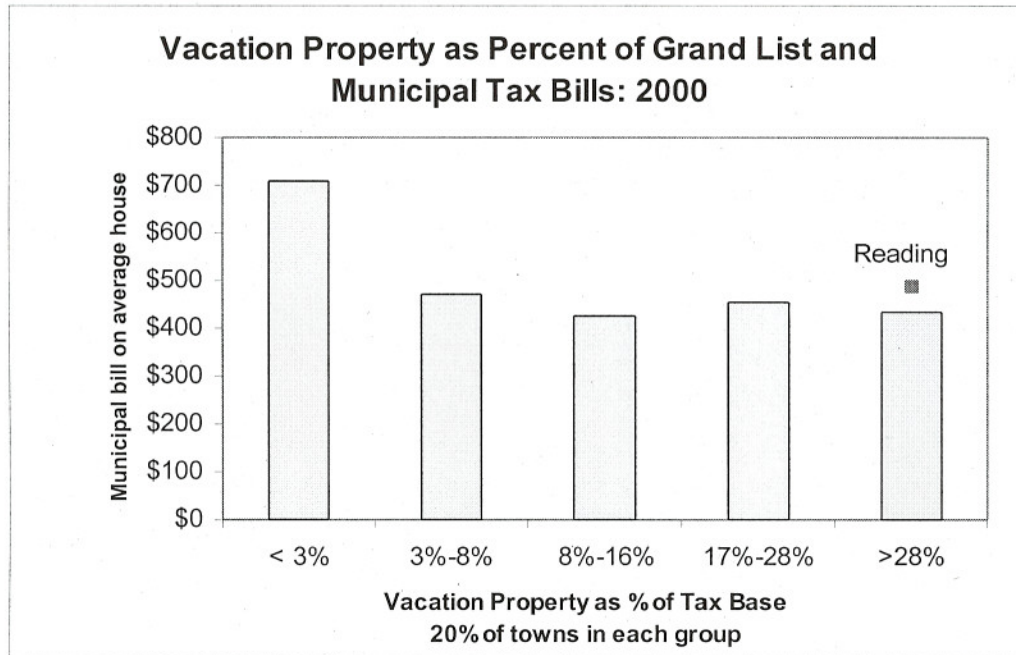
### 3. Vacation Homes

Prior to Act 60, vacation homes were Vermont's main "tax-positive" type of development. They paid both school and municipal taxes, and they didn't put kids in school. Since Act 60, the state as a whole rather than the host town benefits from the school taxes on second homes. Looking at municipal taxes alone, there is not a clear pattern between either the *number* of vacation homes or the total *value* of vacation property and tax bills. However, towns in which vacation property makes up a larger

<sup>11</sup> Pearson correlation coefficient showing the association between the fair market value of taxable commercial, industrial and utility property and the municipal tax bill on the average-value house in town = 0.400 P=0.0. Sources of data: Property Valuation and Review.

proportion of the Grand List tend to have lower municipal tax bills, as shown in the chart below.

In the chart, all Vermont towns were ranked according to the percentage of their Grand List made up of vacation home property and divided into five groups. The municipal tax bill on the average-value house in each town was calculated, and averaged for the group.



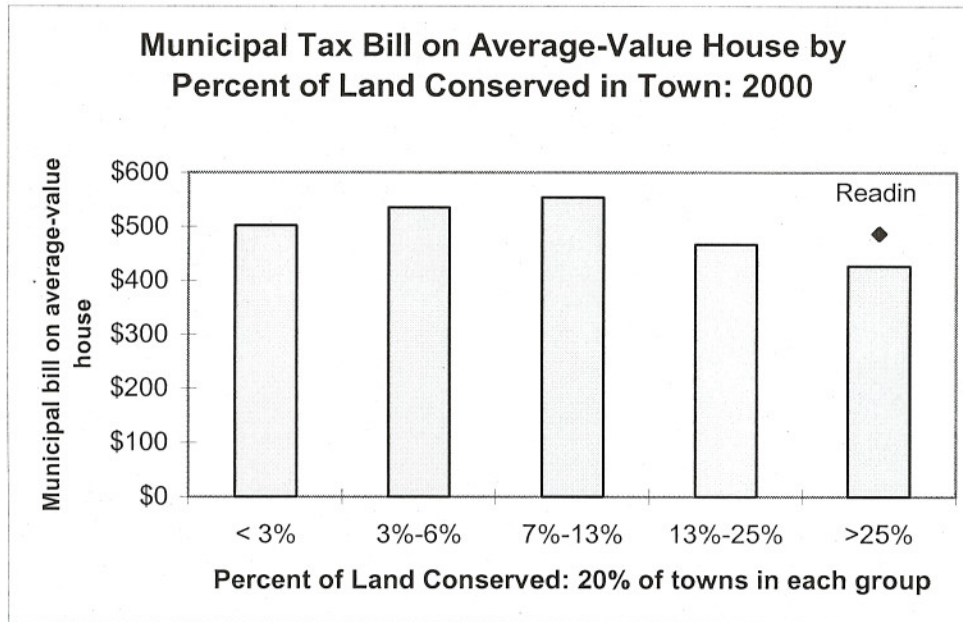
While it is generally true that a seasonal home requires less in municipal services than a year-round home does, the towns that have the *most* vacation home property to tax do not necessarily have lower municipal tax bills. Vacation property is associated with lower tax bills when it represents a higher percentage of the total Grand List.<sup>12</sup> This tends to be the case in the smaller, more rural resort towns.

#### 4. Land Conservation

There is a long-term concern that land conservation locks up the land and therefore precludes the possibility that the town may see some development that would be more beneficial. However, as shown in the preceding graphs, development is more likely to be associated with high taxes than low.

<sup>12</sup> Pearson correlation coefficient showing the association between vacation property value as a percent of total fair market value of taxable property and the municipal tax bill on the average-value house = -0.267, P=0.0. The association between the number of vacation homes and the municipal tax bill is not statistically significant. Sources of data: Property Valuation and Review.

To examine the relationship between conserved land and municipal taxes, all Vermont towns were ranked according to the percent of land that was publicly or privately conserved, and divided into five groups. The municipal (not school) tax bill was calculated for the average-value house in each town and averaged for each group.



The graph makes it clear that the towns with a great deal of conserved land have not been driven to exorbitant taxes. This is mainly because these towns are more rural and have fewer people to serve.<sup>13</sup>

#### IV. Conclusions

This report explains how land conservation affects taxes in Reading, looking first at school taxes, which have changed significantly since the passage of Act 60. The school rate, which is about three-quarters of the total tax rate, depends on per-pupil spending rather than the Grand List. There is no change in the school tax rate on either homestead or nonresidential property when land is removed from the Grand List for conservation.

The municipal tax rate is still calculated as the municipal (not including school) budget to be raised from taxes divided by the Grand List. For this reason, some permanent land conservation may increase the municipal (not school) rate because it reduces the Grand List without reducing the budget.

<sup>13</sup> The Pearson correlation coefficient showing the association between the percent of land that has been conserved and the municipal tax bill on the average-value house = -0.24, P=0.0. Sources of data: Property Valuation and Review; Center for Rural Studies.

However, some conservation organizations provide a payment in lieu of taxes that effectively reduces the budget to be raised from taxes. This may offset the tax loss.

The Vermont Agency of Natural Resources currently makes a payment to the town equal to one percent of the fair market value of the property it owns. This is roughly three times the rate that privately owned land pays in Reading, where the municipal rate is estimated by the state to be 3/10 of one percent of the fair market value of the property.<sup>14</sup>

Land acquired by the Agency of Natural Resources would pay three times as much as it would if it were privately owned if the valuation is the same. Because the payment is based on a state appraisal, and because the newly acquired land may become part of a larger parcel, the valuation may change. However, in general, the land will pay more in ANR ownership than it would in private ownership.

If all the land currently owned by ANR were put back on Reading's Grand List, Reading's municipal tax rate would increase.

As illustrated in the graphs, municipal tax rates tend to be higher in the towns that are most developed and lower in the towns that are most rural. Reading's municipal taxes are slightly higher than the average of towns with similar characteristics.

While it is important to understand the tax consequences of land use decisions, tax calculations do not answer the question of whether or not a town should pursue conservation or development. The goal of town planning is a great community—not a low tax bill. The real challenge is to strike a balance between what improves the community, what taxpayers can afford, and what is fair.

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<sup>14</sup> The actual municipal tax rate \$0.404 X the common level of appraisal 0.769 = an effective tax rate of \$0.31. When applied to \$100 this yields \$0.31 or 3/10 of one percent of fair market value.