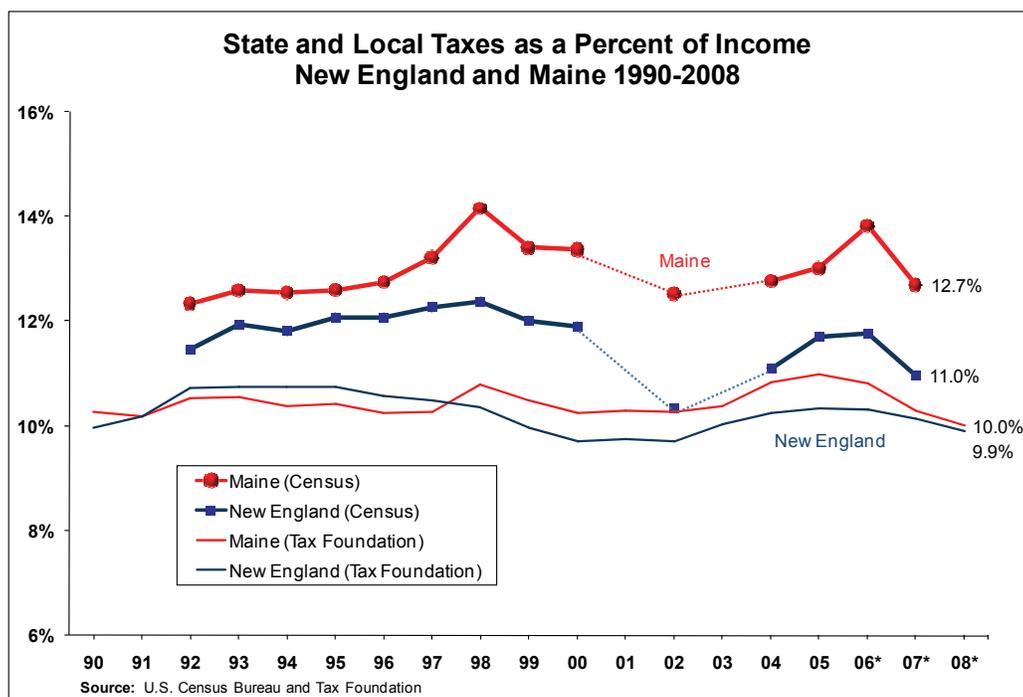


Tax and Fiscal Policy

“And among citizens generally, tax reform is viewed widely as a building block of long-term economic growth, and a more stable and sustainable approach to financing state and local government. The current tax system has been described as antiquated, imbalanced, burdensome, unfair, uncompetitive, archaic, and volatile.”

Richard Woodbury, New England Public Policy Center,
The Struggle for Tax Reform in Maine, 2003-2009

Taxes are a means of collecting the revenue needed to pay for public services desired by Maine people. Because the money comes primarily from Maine people and Maine businesses, taxes are a cost and consideration for our residents and businesses alike. We want working roads, good schools and emergency services; but, we also expect quality for a reasonable price. As a result, tax and fiscal policy requires a balancing of public need and public means. Additionally, Maine would like to remain competitive with other states for new residents and businesses. Our tax and fiscal policies must not make us outliers, acting as disincentives for investing in Maine. As the graph below illustrates, in 2007, Maine’s tax burden fell from 14% to 12.7%, but remained above the New England average.



Facts and Findings

Maine's State and Local Tax Burden decreased in recent years but remains high relative to the region and the nation.

According to the Maine Economic Growth Council, Measures of Growth in Focus, 2010:

- State and local taxes were 12.7% (U.S. Census) of income in 2007, down from 14% in 2006
- State and local taxes were projected to decrease to 10% (Tax Foundation) of income by 2008
- Maine ranked 6th highest for tax burden in the U.S. in 2007 and had a higher burden than every New England state except Vermont which ranked 5th

Maine's State and Local Taxes Per Capita (without regard to income levels) also fell in 2007 in both national rank and in absolute dollars per capita.

According to the Maine Economic Growth Council, Measures of Growth in Focus, 2010:

- Per capita state and local taxes fell from \$4,393 in 2006 to \$4,280 in 2007 – this corresponds to a decrease in national rank from 11th to 14th
- In 2007, tax collections per capita were lower than all other New England states except New Hampshire

Maine's Tax Mix puts a heavy burden on property and income taxes, which influence business and individual investment decisions.

According to Richard Woodbury, The Struggle for Tax Reform in Maine, 2003-2009:

- Maine's top income tax rate of 8.5% is the 7th highest top marginal income tax rate in the nation – the national median top marginal income tax rate is 6%
- The top rate in Maine is paid by people of incomes as low as \$20,150
- Property taxes accounted for 38% of total state and local tax revenues in FY2006, the 6th highest in the nation
- Property taxes as a percent of income were 5.3% in FY2006, making Maine's property tax burden the 3rd highest in the U.S.
- Maine has the largest percentage of second homes in the nation (15.6% - 5 times the U.S. rate) and can export some of the burden out of state

Maine’s estate tax can be a disincentive for retirees and higher income households establishing primary residence in Maine.

According to Richard Woodbury, *The Struggle for Tax Reform in Maine, 2003-2009*:

- Maine’s income level of exemption for estate taxes (\$1 million since 2006) is below the federal level (\$3.5 million in 2009) which results in Maine imposing a tax on households that are not subject to the federal tax

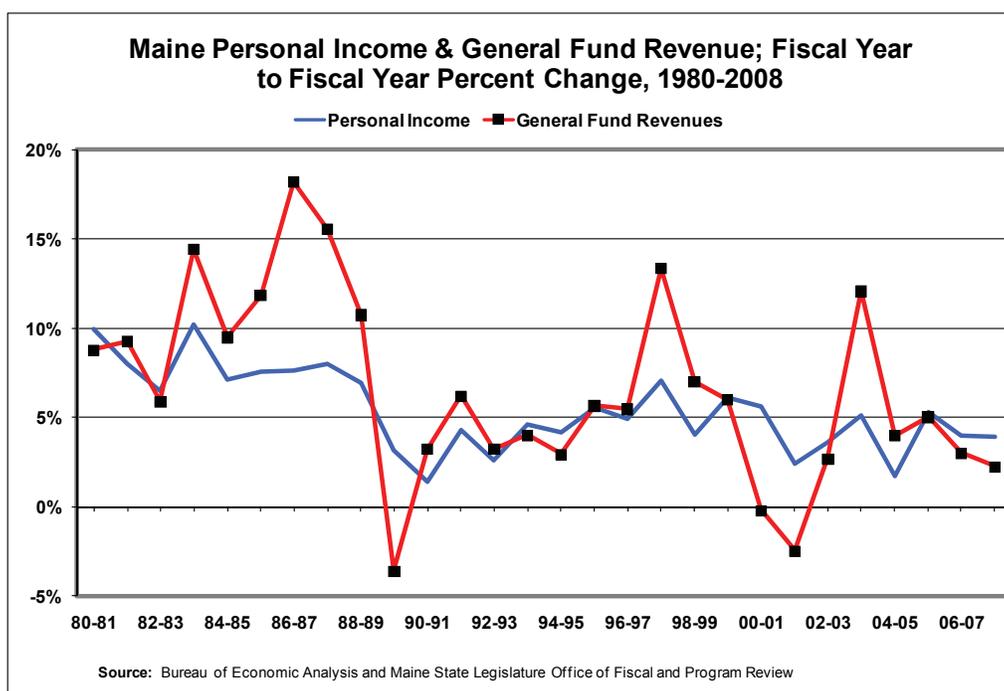
Maine’s tax structure is volatile and revenues decline when government supports are needed most.

According to Michael Allen, Director, Research/Econometrics Division, Maine Revenue Services:

- Maine’s top 2% of tax filers (10,000 filers) paid a third of Maine income taxes prior to the recession and by 2008 that decreased to 26% - a large drop in revenue
- Income tax revenue in 2009 accounted for almost half of the General Fund
- Income tax revenue fluctuates greatly with the economy

As the chart below shows:

- Modest upticks in income are followed by significantly large jumps in General Fund revenue
- Modest declines in income are followed by significantly large reductions in General Fund revenue



According to the Maine Office of Fiscal and Program Review:

- In a typical year about 40% of sales tax revenue comes from the sales of autos, auto parts and building construction materials
- Sales of these items fluctuate greatly with rises and falls in the economy
- Sales tax revenue in 2009 accounted for a third of the General Fund

Survey Says

MDF worked in partnership with several Maine trade and professional associations to distribute a survey to their members to understand their experiences with investment and policy issues in the state. 1,039 business leaders responded to the survey. The following is a summary of responses concerning tax and fiscal policy.

Overall, respondents believe that reducing Personal Income Taxes and Property Taxes should be a high priority for the next Governor and Legislature:

- When asked to select the top 3 priorities, from a list of 19, for the next Governor and Legislature, personal income tax ranked 4th highest in overall rankings and property taxes ranked 6th in overall rankings
- For larger businesses and organizations (more than 50 employees), the corporate income tax was seen as a priority (5th)
- Sales taxes are seen as less of an issue ranking 12th overall, 9th for small businesses and 14th for larger businesses

Experts Recommend

The following is a summary of key recommendations from various reports, committees and efforts around tax and fiscal policy over the past few years.

Joint Select Committee on Future Maine Prosperity, Time for Change, 2008:

- Use the *Measures of Growth* indicators and benchmarks in assessing all legislation
- Use dynamic fiscal notes
- Create an economic development reinvestment fund
- Lower income tax and set spending cap mechanism at all levels
- Create a Blue Ribbon Commission to streamline/restructure government – to lower tax burden
- Alter taxes to encourage Maine residency
- Ensure \$500,000 invested annually in Fund for the Efficient Delivery of Local and Regional Services
- Long range plan should be part of each budget

Brookings Institution, Charting Maine's Future: An Action Plan for Promoting Sustainable Prosperity and Quality Places, 2006:

- Trim government by \$60-\$100 million to invest and to finance tax reform
- Increase Maine's Lodging Tax by 3% (from 7% to 10%) to fund Quality of Place Fund
- Fully fund the Efficient Delivery of Local and Regional Services, \$2 million annually, from Municipal Revenue Sharing

Speaker's Advisory Committee on Tax Reform, 2003:

- Reduce property taxes by increasing the circuit breaker program, and providing targeted municipal revenue sharing to highest property tax mil rates
- Lower income taxes by reducing the highest marginal rate to 8%, raising the personal exemption to the federal rate, increasing the Earned Income Tax Credit
- Expand the sales tax by raising the lodging tax from 7% to 10%, increasing the sales tax on prepared meals from 7% to 8%, and expanding the sales tax base to include recreational services, personal services and a number of other services

Investment Imperatives

Taxes remain an issue of concern for residents and businesses. Maine is faced with several challenges. The overall system should be adjusted (or reformed) in ways that control for volatility during economic cycles. Individual taxes should not be over-burdensome and act as deterrents to investment. And, fiscal policy should account for the needs of Maine people and be sustainable over time.

Recommendations

Reduce tax rates and adjust structures that are disincentives to investment or residency

- Income Taxes
 - Lower top marginal income tax rate (note: reducing from 8.5 to 6.5 would cost \$200-\$300 million in income tax revenue)
 - Adjust income brackets up so that top rate kicks in at a higher income (in 2010, the top rate was paid by single filers earning \$19,750 and joint filers earning \$39,550)
 - Index the income brackets so that they adjust with inflation over time
- Estate Taxes
 - Conform Maine's estate tax with federal estate tax by 2011 (note: conformity will cost Maine \$10-\$15 million a year in lost revenue)

Reform the tax system to protect against volatility in the larger economy

- Sales Taxes
 - Broaden the sales tax base to remove all existing exemptions except those on education, health care, manufacturing, and food

- With the inclusion of more goods and services, look at lowering the overall rate
- Income Tax
 - Lower top marginal rate, adjust brackets and index (see above)
- Utilize a true budget stabilization fund with strict spending limits in peak economic years and defined uses to help during economic downturns

Lower the property tax burden

- Fully fund the Fund for the Efficient Delivery of Educational Services by setting aside the 2% of Municipal Revenue Sharing annually as originally envisioned in the Maine Municipal Association initiative that was passed
- Fully fund the Fund for the Efficient Delivery of Municipal and Regional Services by setting aside the 2% of Municipal Revenue Sharing annually as originally envisioned in the Maine Municipal Association initiative that was passed