M A I N E

L E G I S L A T I V E   R E S E A R C H

C O M M I T T E E

STUDY OF THE FEASIBILITY OF
AN INCOME TAX IN THE STATE OF MAINE

FIRST REPORT

to

ONE HUNDRED AND SECOND LEGISLATURE

JANUARY, 1965

STATE OF MAINE

SUMMARY REPORT

to

ONE HUNDRED AND SECOND LEGISLATURE

<u>LEGISLATIVE RESEARCH COMMITTEE</u>

From the Senate:

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1 Deceased February 2, 1964.
2 Appointed March 26, 1964 to succeed Senator Cole.

January, 1965

LETTER OF TRANSMITTAL

December 29, 1964

To the Members of the 102nd Legislature:

The Legislative Research Committee is pleased to submit this study on the feasibility of a State income tax as ordered by the 101st Legislature.

This report which was contractually studied for the Committee, under authority of the Legislature, contains the findings and recommendations of the Legislative Research Committee as developed by Dr. Alfred G. Buehler of the Warton School of Finance, University of Pennsylvania.

The Committee sincerely hopes that the information herein contained will prove of benefit to the members of the Legislature and the people of the State of Maine.

Respectfully submitted,

Dwight A. Brown, Chairman

ORDERED, the House concurring, that the Legislative Research Committee study the feasibility of an income tax in the State of Maine, its rates, exemptions and impact on the people of Maine and report its findings to the 102nd Legislature, and be it further

ORDERED, that the Legislative Research Committee is authorized to employ professional and technical assistance in its study thereof.

I N T R O D U C T I O N

Since the close of World War II our state and local government has been seeking means of raising necessary revenue for the support of programs on all levels. It has been to these ends that Maine state government has revised its tax base to include new sources from the application of the sales tax while at the same time allowing local government the basic revenue from the property tax. These changes have been made necessary by increasing costs of education, health and welfare, mental health, and associated programs, along with increases in administrative costs of government generally. As an example, in 1957 census data indicate nationally that states collected revenues of $28.8 billion which represented $169.14 per capita and was equivalent to 8.34% of state income. In 1963, states collected $44.2 billion which represented $234.77 per capita, or 9.61% of state income. In relation to income, Maine's percentage of the tax collection was 9.25% in 1951 and in 1963 it was 10.36% of income.

We should note that it has been difficult for Maine's economy to follow the growth pattern of other states which are situated in a more advantageous geographical location. This, then, results in Maine having high freight rates, a slowly rising economy, and a slowly rising population. Therefore, for this reason it is more important to Maine than many other states to have a favorable business climate.

The advisability of an income tax in Maine for the support of general services is frequently advocated by various groups and as a result nearly every legislature has been faced with an income tax proposal. The 101st Legislature was no exception and although the income tax proposal did not receive substantial support from legislators or groups, it did seem advisable to give the income tax proposal further study. Therefore, the aforementioned Order to "study the feasibility of an income tax for Maine" was referred to the Legislative Research Committee and prompts the following report.

The Limited Sources of Tax Revenue

It is popularly thought that a new tax always taps a new source of revenue but such is not the case. Since state and local governments, like the federal government must draw their revenues from the property, income and spending of the people it follows that every tax will fall on one or more of these sources, no matter how it is devised. Legal limitations may influence the choice of taxes to reach these sources as due. Economic, psychological, and political factors are also of importance.

The federal government may not constitutionally tax property directly. It has, however, taxed transfers of property with the gift and estate taxes. The personal income tax is the major federal revenue source, producing nearly $48 billion in 1963 of the total federal taxes of over $100 billion. Another type of income tax, that on payrolls, is imposed to finance old-age insurance. There is also a federal unemployment compensation tax. Therefore, the federal revenue structure is thus dominated by personal and corporate income taxes, to which is added substantial sums in the form of pay roll taxes constituting approximately 85% of the total federal tax revenue structure. The balance of the federal revenue is obtained principally from federal excise taxes, gift and estate taxes, and custom duties which accounts for the remaining 15%.

Looking now toward local government revenues, we find they have traditionally relied heavily on property taxes for revenue. While municipalities do rely upon the property tax, we find the state relies upon selected and general sales taxes, income taxes, licenses, and various minor imposts as sources of revenue. State and local tax revenues in the United States in 1963 were $44.2 billion, as reported by the Bureau of the Census. This total does not include $3.0 billion of state employment taxes and $272 million of state liquor store profits which are, in effect, taxes. All together, these revenues amounted to $47.5 billion, as indicated in the attached table. (p. 4A)

Considering the country as a whole, local tax collections have recently surpassed state taxes. In approximately twenty states, well over half of the tax revenues are derived from local levies. In Maine, local taxes in 1962 represented 52.3% of the total tax revenue; in New Hampshire 62.5%; in Massachusetts, 60.8%; in Connecticut, 43.4%; in Vermont 49.6%; and Rhode Island 48.4%. While it would appear that local property taxes are a heavy burden in Maine, it should be noted, however, that it is less than it is in at least two of our sister New England states. Total state tax collections for the nation in 1964 are reported at $24.2 billion, excluding employment taxes and state liquor store profits. However, the biggest single revenue producer for the states was the general sales tax, with revenues of $6.1 billion. This does not include sales tax revenues of local governments probably exceeding $500 billion. Personal income tax revenues increased to nearly $3.4 billion and corporation income taxes to $1.7 billion. Local taxes on personal and corporation income probably yielded in excess of $270 million.

As one studies the patterns of taxation in the different states, he notes considerable diversity. Therefore, it might be important for us to discuss the import of property, income and consumption taxes which vary from state to state. Some states, including Maine, Ohio, Illinois, Michigan and Texas, collect state sales taxes but not an income tax at either the personal or corporate level; while other states, such as Massachusetts, Minnesota, Delaware, and Alaska, tax personal and corporation income but do not impose a sales tax. New Jersey leans very heavily on property and corporate income taxes, but lacks a general personal income or sales tax. While in contrast, Nebraska and New Hampshire have not yet adopted either. Some states, such as Maryland, Kentucky, Wisconsin, and California, have personal and corporation income taxes, as well as a sales tax.

Regardless of the pattern of state and local taxation, tax revenues must be derived from the state and local economies. While excise, sales taxes, licenses, and other taxes may tend to restrict spending or saving, a tax imposed on income will reduce the funds available for such saving or spending.

Some Tax Principles

Ideally, Maine and other states could raise needed tax revenues from the growth of the economy as revenues increase with the growth of expenditures. However, nothing is ideal. In earlier days incidental excises and licenses, and occasionally some form of income taxation, added to property taxes, sufficed to support the modest government outlays. As public school systems developed and other public programs were undertaken for the services of a growing population, property taxation became inadequate and various supplementary taxes were devised by the states. Even so, property taxation, after disintegration during the depressed 1930's has shown remarkable growth. Taxes related to sales, income, and other activity in expanding economies have furnished additional "growth revenues". Thus, more revenues were raised from existing taxes with the growth of the economy and new taxes were enacted. However, in time, revenues were again inadequate and tax rates were increased in the relentless hunt for still more revenue to finance rising expenditures.

The overall system of taxation, federal, state, and local, must not only be productive of adequate revenue, it must also distribute the costs of government over the community with reasonable equity. No single tax will provide all the needed revenues, and no one tax will balance the costs of government equitably over the population. Local governments cannot impose taxes without regard for state requirements, and the states cannot tax without considering federal taxes. The central government is affected by the tax behavior of the state and local governments, since its tax payers are also subject to state and local taxes. The principles of taxation can therefore be applied with reasonable success only with respect to all of the taxes levied by the state, local, and federal governments.

Every tax violates the canons of taxation in one manner or another. It may yield large revenue but be very inequitable, while on the other hand it may be equitable but complex and of little revenue importance. Again it may seem to be just, but actually be a drag on the economy. Continuing criticism of American property, spending, and income taxation demonstrates the impossibility of meeting all of the requirements of perfect taxation, even when all of the taxes are appraised in relation to each other and the total tax system. It is clear, however, that state, local, and federal taxation must be accepted by the population as reasonably fair if it is to be highly productive, even though the standards of fairness are crude and rather indefinite.

Ability To Pay

It is often said in Maine and other states that taxes should be imposed according to ability to pay. In the minds of many persons ability to pay is associated with the personal net income tax incorporating a graduated, or progressive, rate structure. Over the centuries and even in recent times, however, ability to pay has also been related to various property, excise, sales, and other taxes. During the nineteenth and early twentieth centuries many sacrifice theories of taxation were advanced. These called for equal, minimum, least aggregate, or other measures of sacrifice in the interpretation of ability to pay as a subjective principle of taxation. In some way, never definitely determined, the pain, discomfort, or sacrifices caused by taxation were to be weighed, and tax justice was to be meted out in a manner to accomplish the desired sharing of sacrifice. As the law of diminishing marginal utility was formulated by economists, it was brought to the support of the sacrifice theories and progressive taxation was demanded.

Pain, sacrifice, discomfort, and disutility of taxes have proved to be beyond measurement in any definite, standard, comparable manner. They are subjective and vary for a person from time to time and among people at the same time. We know that taxes cause sacrifices, but we can measure the sacrifices only in money or in some other objective standard. Unfortunately, a dollar is not always equally valuable in the opinion of a person and its desirability varies among different persons at a given time, so the dollar is also unsatisfactory as a measure of sacrifice. Then, too, although the law of marginal utility may be applicable with respect to units of apples, gasoline, or another object, it has been argued by some economists that it is not applicable to dollars of income. Others say that even if our incomes do experience a diminishing marginal utility as they increase, it is impossible to measure this utility because we are again driven back into subjective valuations. As a consequence, it is not known what scale of graduated tax rates might be required to tax according to ability to pay.

The objective measures of ability to pay, whether they be property, spending, or income, may be assumed to indicate a capacity to pay taxes without showing precisely that capacity. Efforts to arrive at a standard of ability to pay lead to exemptions, deductions, credits, and other tax differentials to allow for the personal status and responsibilities of each tax payer, according to the judgments exercised. After a basis of taxation is arrived at in a series of value judgments, the choice of appropriate tax rates involves still another series of value judgments and what should be the final outcome is bound to remain a matter of opinion. It is also debatable how far ideas of ability to pay should be and may be carried into income, property, and spending taxes.

services accordingly. As generally interpreted, taxation according to benefits is thought to lead to flat rate taxation of property, spending, and income, and not to graduated rates.

Fairness A Vague Concept

Determining what is fair in taxation appears to be as difficult as deciding what is good or beautiful. Everyone may have a somewhat different idea of what is fair and therefore some compromise must be worked out. The difficulties and complexities encountered in the quest for fairness in distributing the costs of government by taxation are illustrated in the discussion of Professor Roy Blough in his book, The Federal Taxing Process, published by Prentice Hall in 1950. Professor Blough's analysis grew out of his experience as a tax scholar, Director of Tax Research in the U.S. Treasury for Presidents Roosevelt and Truman, and a member of President Truman's Economic Council. He declares:

"One of the points that this chapter has endeavored to make clear is that while everyone believes in tax fairness there are many different ideas about what is fair... No one is in the position to prove that his conception of fairness is the right one, since justice is in the area of man's aspirations rather than in the area of scientific measurement... Concepts of fairness are relative rather than absolute in that the principle alternatives must be kept in mind... The view taken in this book is that there are various legitimate objectives of tax policy, that they are sometimes in competition with each other, and that accordingly they must be weighed and balanced against each other in the process of reaching a decision... Maintaining a careful distinction among the various considerations affecting tax policy--for example, economic prosperity and fairness--is thus a helpful method for use in thinking clearly about them and their proper relation to tax policy." (Pages 407-408)

Taxation and Economic Growth

Historically, justice in taxation has been related to a consideration of what is fair to each tax payer. It has dealt with the troublesome question - how much of the cost of government should be apportioned to him? This involves formulating measures of the relative economic status of each tax payer, of the cost of each government service, and judgments as to his fair share of the total cost. Since each taxing government is only one of a number of governments taxing the individual directly or indirectly, the taxes imposed by other governments must also be included. Decisions as to what is just have been reached after a series of value judgments involving the tax payers, the beneficiaries of public services, administrative and legislative officials of the taxing governments, and various interest groups. Final decisions are a compromise of the many points of view expressed and the pressures exerted by the interested parties.

For a long time it has been recognized that it is not enough to think only of the sacrifices and monetary burdens placed on each individual by taxation. Increasingly, emphasis has been placed on the relationships of taxation to community objectives, to the common desire to promote economic growth, employment, and a more abundant income for consumers. As government expenditures have increased, the role of governments in the health and activity of the national, state and local economies has become more and more influential. With American taxes now at a level of $150 billion annually and each year taking more and more money out of the purses of the tax payers, it is evident to every thinking person that taxation affects every activity of the individual and the community, indirectly if not directly.

Therefore, the principal emerges that taxation should be consistent with community goals of economic and social improvement. It should retard economic growth and prosperity as little as possible. As Presidents Kennedy and Johnson have recently urged, taxation should not be a drag on the economy. It should not seriously weaken economic incentives to productive activity, it should not be a heavy drain on investment, and it should not deprive consumers of essential purchasing power. Since an increased output of goods and services is required to satisfy increased consumer demands, and since increased investment and production are needed to provide more jobs and larger payrolls, tax restraints on economic growth should be minimized.

Every tax, considered apart from the benefits which may accrue to the taxpayer from beneficial government services, is a burden. It takes money from the taxpayers and in some way changes the pattern of their economic activity as it removes funds which might be spent or invested. But every tax does more. It also affects the economy of the community, its growth and development, the employment it offers, and the flow of income out to its population. It is desirable, therefore, that state and local, as well as national, taxes should be as conducive as possible to the objective of a vigorous, healthy, expanding economy and a steadily rising level of community living.

Property Taxation In Maine

The wealth of the community constitutes a very important source of taxation, and property taxes have evolved over the centuries as a means of taxing the owners of this wealth. Therefore, with these considerations in mind, let us now examine some of the major sources of tax revenue in Maine and also give some thought to the tax systems of the other states.

Complaints have been heard for many years that property taxes are excessive and are imposing unbearable burdens. In spite of resistance by the taxpayers, however, property taxes have shown surprising growth possibilities. They have increased revenues tremendously, rising from $12.9 billion in 1957 to over $20 billion in 1963 according to the Bureau of the Census. State and local nonproperty tax revenues have increased at about the same rate, growing from $16 billion in 1957 to $24.2 billion in 1963.

Maine has long relied heavily on real property taxation. It furnished revenues of $74.7 million in 1957, of which $73.3 million were local taxes and by 1963, Maine's real property taxes were $108.3 million and local governments raised $106.0 million of this amount. By this time, nonproperty taxes in Maine had increased to $96.0 million as compared with $70.4 million in 1957. Property tax revenues in Maine thus increased at a faster rate from 1957 to 1963 than nonproperty taxes. However, the increase in the Maine sales tax rate to 4% brought substantially greater revenues from a nonproperty source in 1964.

A number of indicators seem to point to comparatively high property taxes in Maine. It is one of a small number of states raising over one-half of the total state and local tax revenues from property. This group includes Massachusetts, New Hampshire, Connecticut, New Jersey, Ohio, Minnesota, Nebraska, and a few other states.

Property tax revenues per capita in Maine exceed the national average. They were $109.39 in 1963, as compared with a national average of $106.51. Maine per capita property tax revenues exceeded those in Vermont but were lower than the per capita revenues of Connecticut, Massachusetts, New Hampshire, Rhode Island, or the four remaining New England states. Vermont had the lowest per capita figure in New England of $102.93. (p. 14A)

Property Tax Reforms Are Needed

Studies of property taxation in Maine have repeatedly cited serious inequalities in assessment and the need for reforms in tax administration. Some properties are undoubtedly taxed more heavily than others of a similar nature. Different classes of property are also assessed at different ratios of market value. Wealthier localities have more taxable property than the less wealthy and can support schools and other public functions with lighter taxation.

What the reasonable revenue limitations of property taxation in Maine may be is not certain. Additional revenues could be raised by increasing assessments of properties plainly undertaxed in comparison with a common standard of community performance. A uniform state tax on property could be employed to enlarge the contributions of the richer localities to a common pool of funds for state aid to education. Other taxes going into state funds for subsidies to local governments on some equalizing basis have

TABLE 2

Levels of State and Local Taxes in New England - 1963*

	TAXES PER CAPITA			TAXES AS PERCENT OF STATE INCOME		
	Total	Property	Other	Total	Property	Other
Maine	$206.78	$109.39	$97.39	10.36%	5.49%	4.87%
Connecticut	263.95	138.96	124.29	8.50	4.48	4.02
Massachusetts	269.70	158.10	111.61	9.61	5.63	3.98
New Hampshire	202.20	130.48	71.72	9.02	5.82	3.20
Rhode Island	230.71	110.15	120.56	10.00	4.63	5.37
Vermont	231.66	102.93	128.73	11.50	5.11	6.39
U.S.AVERAGE	234.77	106.51	128.26	9.61%	4.36%	5.25%

*Unemployment compensation taxes and liquor store profits excluded.

Source: U.S. Bureau of the Census and State of Maine a similar effect of channeling funds from the areas with relatively greater tax resources into those with fewer resources in relation to needs.

Further study of property taxation in Maine is clearly desirable to determine more adequately what its problems are and how best to overcome them. Such study is also desirable to determine the appropriate role of property taxation as a revenue, keeping in mind the objective of the maximum economic growth and community prosperity. Property taxation is too important to be given up, but it can be materially improved and its impediments to economic growth can be minimized.

The Sales Tax

The Maine sales tax, levied on the sales of tangible personal property at retail, is a member of the family of general sales taxes. These are commonly imposed by the states at the retail level but several states extend their taxes to manufacturing and wholesaling. These taxes are distinguished from excises or taxes on selected commodities and services sometimes called "selective sales taxes". The alcohol, cigarette, and gasoline taxes now tax articles of mass consumption and may tax about as many people as are taxed by the general sales tax.

The Maine sales tax became effective on July 1, 1951, at the rate of 2%, after many other states had proved the productivity of retail sales taxes. The rate remained at 2% until 1957, when it was advanced to 3%, and in 1963 the rate was advanced to 4%. Other states have followed a similar pattern in rate revision. Tax rates which were originally 1% or 2% have frequently been boosted to 3% or more. Michigan and Washington, like Maine, now have sales tax rates of 4%. If numerous local sales taxes are added to the state tax rate, then California, Illinois, and Mississippi are now exposed to a 4% sales tax. The Pennsylvania tax rate has gone up to 5%, a level enforced in several Canadian provinces. The Rhode Island sales tax rate is 3%, that of Connecticut 3.5%. The New York City tax rate is 4%.

Sales tax revenues in Maine for the fiscal years ending June 30, 1952 and 1963, respectively, were \$11.2 million and \$40.8 million. In 1952 sales tax revenues were approximately one-fifth of the total state government taxes, excluding unemployment compensation taxes. By 1964, over one-third of the total came from the sales tax in Maine, as in 13 other states. Revenues have increased with the growth in trade and with increases in tax rates.

Next to property taxes, as previously noted, general sales taxes provide more state and local tax revenue than any other tax, considering the country as a whole. Their total yield in 1963 was \$6.6 billion. Taxes on sales of alcohol, cigarettes, gasoline, and other selected items together furnished nearly \$7.8 billion. Personal income taxes supplied \$3.3 billion and corporate income taxes \$1.5 billion. At the state level, the general sales tax has become the most productive of all revenues, considering the nation as a whole, raising \$6.1 billion in 1964.

General sales taxes rose to wide popular acceptance during and after the depression of the 1930's in the effort to supplement the property tax as a major revenue and to moderate increases in that tax. The need for more money for public education and other purposes and resistance to adding to the federal income tax rates slowed down the early state movement to income taxes and also held down state income tax rate increases. Labor unions and retail merchants generally opposed sales taxes in many states, while farmers and business groups often favored them. Opposition to general sales taxes has greatly weakened in many states and what originated as an emergency revenue has become an important mainstay of many state tax systems. Numerous local governments in a number of states have also adopted similar taxes.

The burdens of the Maine sales tax, like those in several other states, are moderated by the exemption of food for off-premise consumption, domestic fuel, automobile trade-ins, and certain other articles. Census data provide some measures of the comparative sales tax "bite" of the state sales taxes over the country. Among the 36 states with general sales taxes in 1963, 26 collected per capita revenues higher than those of Maine, which amounted to $30.69 per capita while those of Connecticut were $38.21 and those of Washington, a state with neither a personal nor a corporate income tax but with a sales tax rate of 4%, attained the per capita maximum of $98.93. Again California raised $46.24 per capita from a state tax of 3%, Illinois $53.53 per capita from a state tax of 4%, and Michigan $61.59 per capita from a state tax of 4%. The Pennsylvania tax, at a rate of 4% and exempting food for off-premise consumption and clothing, returned $34.82 per capita.

Maine is, of course, a state with a relatively low per capita income. In comparing sales tax collections with state income in 1963, using Census data and not including local sales taxes in various states, one finds that 22 states collected sales taxes representing a higher ratio of income than the Maine tax. The Maine ratio of 1.57% exceeded ratios of 1.27% in Connecticut and 1.41% in Rhode Island. Ratios frequently ran higher in other states. The ratio for California state sales taxes was 1.65%, that of Illinois 1.89%, and that of Michigan 2.59%. The Pennsylvania ratio was 1.48%.

The data available for 1964 appear to indicate that Maine revenues per capita from the 4% sales tax are lower than in a number of other states. (Income data for 1964 are not yet at hand.) It seems evident, also, that a number of states are obtaining sales tax revenues equivalent to a higher percentage of state income than Maine.

Maine sales tax revenues were 30.6% of total state government tax revenues in 1963, excluding unemployment compensation taxes, according to the Bureau of the Census. Fourteen states collected relatively more sales tax revenue. In both Hawaii and Illinois the ratio exceeded 50%. The Washington ratio was 42.1%. Connecticut has a ratio of 30.3%, nearly equal to that of Maine, and Rhode Island a ratio of 27.4%.

Sales Tax Burden

Critics of general sales taxes have frequently denounced their regressive burdens. An example would be a low income family which spends relatively more of its income than a high income family. In such a case the ratio of spending to income tends to decrease up the income scale. It is, therefore, noted that a sales tax takes a bigger percentage of the smaller income than of the larger. A sales tax without exemptions is particularly regressive in its burdens.

Many studies of sales tax burdens have emphasized the importance of the food exemption in reducing regressivity. Additional exemptions in Maine are sales of domestic fuel, automobile trade-ins, repair services to tangible personal property, and other services which are taxed in some of the states. Laundry and dry cleaning service and the services of barber and beauty shops might, for example, be taxed. Such data as are available suggest that the exemption of services is likely to benefit the lower incomes relatively less than the higher incomes.

Part of the Maine sales tax burden is borne by tourists and other nonresidents. A study of tourist activities in Maine in 1959 led to the conclusion that $1,686,000 may have been paid in sales and use tax revenues in 1959, when the tax rate was 3%. This was 6.88% of sales tax revenues. (A Study of the Vacation Industry in Maine, Arnold H. Raphaelson, Tadeusz A. Siedlik and John D. Coupe, Chapter III, University of Maine, 1961.) Although Maine exports to other states may not be directly subject to the sales tax, this tax is a business cost to some extent and, like other business costs, tends to be included in prices. Thus an unknown amount of sales and property taxes are shared by other than residents.

Taxes on sales of selected commodities, such as alcohol, cigarettes, and gasoline, are also paid to an appreciable extent by nonresidents purchasing in Maine. These taxes, it should be observed, also cast regressive burdens over the population. The man in the lower income bracket buying alcohol, cigarettes, or gasoline is taxed at the same rate as the man in the higher income bracket purchasing the same articles. The ratio of taxes paid to income will be higher, as a rule, on the lower incomes than those above them. These taxes have no exemptions and are more regressive in burden than a food-exempt sales tax. They are popularly accepted with little real resistance, however, and one hears few complaints about their regressivity.

The use of tax collections to finance such services as public education, highways, health, hospitals, and other essential services has removed much of the curse on general and selected sales taxes. With sales tax revenues increasing from $27.3 million in 1960 to $30.1 million in 1963, state aid for education in Maine increased from $14.2 million to nearly $18.6 million. As sales revenue increases, more money is made available for education.

The general retail sales tax has become an indispensable revenue in Maine, as it has in many other states. It is a major growth revenue here as elsewhere in the country. While it may be mildly regressive, the public services it finances appear to benefit the lower income groups more than the upper income groups, and are also distributed regressively. The tax has been found to be consistent with growth objectives in many states and does not give evidence of retarding industrial and other economic activity in Maine, nor does it appear to restrict employment or trade.

The Personal Income Tax

A revenue often proposed in Maine but never adopted is the general personal net income tax. This is to be distinguished from the taxes in New Hampshire and Tennessee which are laid only on the income from intangibles in lieu of property taxes. Also to be placed in a separate category is the gross income tax of Indiana and the local income taxes in a number of states which apply to gross income in the form of wages, salaries, and other personal earnings from sources other than property.

A general personal net income tax is now found in 34 states. The other 16 states, including Maine, have preferred to raise their revenues from other sources. Among this group are New Hampshire, Connecticut, Rhode Island, New Jersey, Pennsylvania, Ohio, Michigan, Illinois, Nebraska, Florida, Washington, Texas. Eleven states get along without either a personal or corporate net income tax, including Maine, New Hampshire, Florida, Illinois, Michigan, Nebraska, Nevada, Ohio, Texas, Washington, and Wyoming. Indiana could be cited as the 12th state in the group since its tax is not levied on net income, although it does tax gross income or adjusted gross income, the latter pertaining to corporations.

The modern net income tax movement started in 1911 in Wisconsin with a strong state tax commission. Efforts to reform property taxation has been more or less fruitless. Turning property taxation over to the local governments in many states left problems of unequal assessment and poor administration unsolved. Resort to classified property taxes in Minnesota and a few other states seemed, for a time, to offer a promising new road to reform. Success here was only partial, at best. When Wisconsin showed that an income tax could be productive the states began to enter this field, probably encouraged also by the enactment of the federal personal net income tax in 1913. By 1937 there were 32 state income taxes. Then the movement halted. Depression brought declining incomes. West Virginia had demonstrated in 1921 that a general sales tax could also furnish substantial revenues. Now the states began to turn to general sales taxes as depression or post-depression revenues. With the Second World War and the Korean War, federal income tax rates scared and discouraged state entry into this field. Increases in the old-age insurance tax rates may also have been a deterrent. Since 1937 only Alaska and West Virginia have adopted personal net income taxes.

State income tax revenues were approximately $3.0 billion in 1963 and increased to nearly $3.4 billion in 1964. This compares with general sales tax revenues of $5.5 billion in 1963 and over $6.1 billion in 1964 raised by state governments. These collections do not include local income and sales taxes. Local income tax revenues apparently were about $270 million in 1963 and local sales tax revenues over $500 million.

The rates of the state income taxes have tended to rise somewhat over the years. Presently only 10 states start their rates at 1%, while most start at 2% or 3%. Graduated rate scales are usually enforced and commonly rise above 5%. Eight states have top rates of 10% or higher. The Vermont tax rates range from 2% to 7.5%, the highest rate applying to income over $5,000. Rates in New York rise from 2% to 10% on income above $15,000, while Massachusetts has classified income taxes with rates arranged according to the nature of the income, rather than the amount.

Exemptions to the state income taxes, like those for the federal income tax, were initially generous, as a rule. Revenue pressures have commonly caused a lowering of the exemptions to the federal figure of $600 for single persons and $1,200 for married couples. A number of states still have higher exemptions than the federal. Vermont, however, grants a single person an exemption of only $500 and a married couple only $1,000. Many of the states still allow a deduction for the federal income tax in computing income subject to state taxation. Vermont and New York do not allow this deduction. Massachusetts permits a limited deduction.

Increased revenue demands caused the states to resort to income, sales, and other taxes as property tax revenues proved to be inadequate to maintain both local and state government spending. The graduation of personal income tax rates was favored by many as an acceptance of ability to pay as a tax principle. Higher rates on the higher incomes has had political appeal in many states. Rate graduation also increases revenues because tax rates go up as incomes increase with prosperity. As incomes climb, revenues rise faster than income on account of the step-up in rates.

Economists have endeavored to distinguish "real income" from money income by translating current dollars into dollars of constant purchasing power. A man may have twice the income in dollars today that he had in 1939 but the purchasing power of the larger income may be no greater or may even be smaller. The cost of living index is nearly 30% higher today than the 1950 index. This indicates that an income of $5,176 is needed to purchase consumer goods and services equivalent to those available in 1950 for $4,000, assuming the entire income is spent.

Income taxes do not allow for rising prices and changes in purchasing power. The tax base increases even if income dollars buy less, and with progressive tax rates, the tax toll increases still more. Much of the gain in federal and state income tax revenue is to be attributed to the growth in money incomes which reflect rising levels of prices. The increase in the real income of the taxpayer may be partly, largely, or entirely an illusion, depending on his success in securing enough income dollars to offset the decline in the purchasing power of each dollar.

The valuation base for property taxes and the volume of sales subject to sales taxation also reflect rising prices. Assessed values of property may, however, lag behind rising market values. The value of taxable sales responds to changing market prices but the sales tax is imposed at a flat, rather than a graduated, rate, and tax revenues are not boosted by rate progression. Property, sales, and income tax rates, of course, may be raised and have been from time to time.

It was observed earlier that the net income tax has often been hailed as the most perfect application of ability to pay. It has also been noted that property, sales, and other taxes have frequently been justified as taxes related to ability to pay.

Troublesome problems remain. How shall net income be defined for taxation? What exemptions and deductions shall be allowed? Should the tax-exempt bond be abolished? Should capital gains be taxed as ordinary income? Should all differentials in the tax base be abandoned and a gross income tax be adopted? After many years of debate over the determination of net income, the federal income tax base is still characterized by many differentials. More discriminations in favor of this or that group or activity are proposed every year. Action by Congress on the Revenue Act of 1964 has added more differentials and critics contend that net income is not defined on equitable and rational grounds but on a basis of political expediency. In any event, clear, consistent concept of ability to pay has certainly not emerged. Indeed the numerous tax differentials might be interpreted as evidence of a recognition of the ability not to pay.

At what scale of rates should a net income tax be imposed to recognize ability to pay? The answer must be indefinite because relative abilities to pay are unknown. In practice, income tax exemptions, deductions, and rates are the products of compromises over ideas of fairness, revenue needs, political pressures, and economic considerations. Legal and administrative limitations are also considered. Some kind of a net income tax and some scale of rates are "roughed out" in the battle over the budget and taxes. There is agreement, however, that a place for the graduated net income tax must be maintained in the American system of state, local, and federal taxes. Does the federal income tax provide sufficient emphasis on graduation? Some observations here may help to place the problem in perspective for Maine.

The Importance of the Federal Income Tax in Maine

The biggest tax paid by Maine residents is the federal income tax. This personal tax on 1961 income amounted to $157 million for Maine. Federal collections from the entire country were $41.3 billion in 1961 and $45.6 billion in 1962. They are now estimated by the Treasury at $47 billion for the fiscal year 1965 after allowing for the 1964 rate reductions. Federal income tax collections in Maine should, therefore, show an increase over 1961 and 1962. Further the tax rates and revenues from the old-age insurance taxes have also been increasing.

Federal tax revenues in 1963, including unemployment compensation and old-age insurance taxes, totaled over $101 billion for the entire country. Applying a formula used by the Tax Foundation to allocate federal tax revenues by origin among the states, it may be estimated that federal taxes of $444 million were taken from Maine residents in 1963. State and local taxes, including unemployment compensation taxes and state liquor store profits, were nearly $223 million. Of the total taxes of $667 million taken from Maine, equal to over one-third of state income, the federal taxes were a little over two-thirds of the total.

In 1963 the graduated federal personal income tax provided $47.6 billion in revenue, or nearly one-third of the nation's total taxes. Federal estate and gift taxes, imposed at graduated rates, raised another $2.2 billion. The progression in American tax burden comes primarily from these taxes.

The federal income tax was weighed in the balance by President Kennedy and his advisers and found wanting. In his tax message to Congress of January 24, 1963, President Kennedy declared:

"Originally designed to hold back war and postwar inflation, our present income tax rate structure now holds back consumer demand, initiative, and investment. After the war and during the Korean conflict, the outburst of civilian demand and inflation justified the retention of this level and structure of rates. But it has become increasingly clear - particularly in the last five years -- that the largest single barrier to full employment of our manpower and resources and to a higher rate of economic growth is the unrealistically heavy drag of Federal income taxes on private purchasing power, initiative, and incentive."

The President recommended accordingly a downward revision in the rates of both the personal and corporate income taxes and a list of structural reforms. In the Revenue Act of 1964, Congress enacted, with the approval of the President, reductions in tax rates from the top to the bottom. Recently President Johnson and Secretary Dillion of the Treasury have advocated reductions in certain excises and subsequent reductions in income taxes to remove tax drags on the economy.

The new emphasis on national economic growth indicates a reversal in tax policy, and particularly income tax policy. If the federal policy is valid, it would appear that the chief tax obstacle to faster economic growth is the personal income tax. This, then, should be a time for income tax moderation, rather than a time for new taxes on income, if Presidents Kennedy and Johnson are correct in their judgment and if one assumes that Congress acted wisely in bringing down income tax rates.

A State Income Tax

Some may say that the time is now propitious for a state income tax because of the federal income tax reductions. One may point to the revenues raised from the personal income tax by other states in the fiscal year 1964. Vermont raised $14.5 million, Massachusetts $202.5 million, and New York the most of any state, over $1.1 billion. One-third of all state level income tax revenues were raised in New York, however it should be noted that none of the foregoing states imposes a sales tax.

It has been previously stated that Maine is a state with a comparatively low per capita income. Census data on income distribution for 1959 show that 73.5% of the population had incomes under $6,000. This compares with 73.1% in Vermont and 62.9% as a national average. In Maine, 6.0% of the population had an income of $10,000 or over, in Vermont 6.8%. The national average was 12.0%. In Massachusetts 13.3% of the population had incomes of $10,000 over, in New York 15.7%.

U.S. Treasury statistics of income for 1961 tell a similar story. The taxpayers in Maine with adjusted gross incomes under $5,000 reported 37.6% of the adjusted gross income and paid 22.5% of the federal income tax. For the nation, taxpayers in this group reported only 25.3% of the adjusted gross income and paid only 14.4% of the total tax. Those with adjusted gross incomes from $5,000 to $10,000 had 43.7% of the Maine income and paid 43.3% of the tax. This group, for the nation, had 43.9% of the income and paid 37.9% of the tax while the same group in Maine with adjusted gross incomes over $10,000 reported 18.7% of the total gross income and paid 34.2% of the tax. For the country as a whole, this group had 30.8% of the adjusted gross income and paid 47.9% of the tax. This data clearly indicates incomes in Maine average below those of the nation for tax purposes.

Therefore, if Maine should endeavor to raise substantial income tax revenues, it would, like Vermont, have to depend on the lower incomes for a great part of the revenue. U.S. Treasury data for 1961 indicate that 70.1% of the adjusted gross income in Maine and 55.1% of the income tax fell on those with adjusted gross incomes below $8,000. Persons with adjusted gross incomes under $7,000 had 61.1% of the adjusted gross income and paid 45.0% of the income tax.

Tax Revenues From Nonresidents

As a low income state with a tourist industry and other economic contacts with nonresidents, Maine should draw such tax revenue as it reasonably can from nonresidents who benefit from its state and local government services. Their spending, owning property, and otherwise placing funds in economic activity in Maine reflect an ability to pay taxes. Although a personal income tax would fall on some nonresident income, particularly where such income could be taxed by withholding taxes at the source of wage and salary payments. Nevertheless, Maine could apparently draw only a very minor part of income tax revenues from nonresidents. Vermont obtained nearly 4.3% of its income tax on 1961 income from nonresidents, New York 4.8% on 1963 income, and Massachusetts only 1.8% on 1963 income. Maine is less fortunately situated than any of these states with respect to employment and other income producing activity of nonresidents. Vermont has a considerable New Hampshire population moving across the border for employment and can depend more on nonresidents for income tax revenue than Maine apparently could.

Available data strongly suggest the conclusions that the retail sales tax is a better source of revenue from nonresidents than a personal income tax would be. Tourists and other nonresidents purchasing in the state pay the tax on taxable items, even if they secure no income from the state. Further, the personal income tax is not a business cost which is shifted by price to buyers of goods and services. The sales tax, however, is a business cost to a certain extent, and along with other business costs is shifted to consumers, nonresidents as well as resident. In addition the sales tax on goods exported from the state acts indirectly to some extent as a business cost and is thus shifted to consumers outside the state, even though such exports can not be taxed directly on sales at the retail level.

Progression And Regression in State Income Tax Burdens

An income tax may be imposed at graduated rates, unlike a sales tax, and some persons consider this an advantage in taxing according to assumed ability to pay. An interesting recent statistical analysis by an economist at the University of Connecticut indicates that the progression pattern achieved in state income taxes at graduated rates is surprisingly different, in effect, from what is commonly supposed. After allowing for the deductibility of state income taxes in determining income subject to federal taxation, the tax burden was then compared with income remaining after paying the federal tax and computed as a percentage of it to arrive at a "net burden". The ratio of the state income tax to the residual income of a married couple with an adjusted gross income of $5,000 was found to be 2.40% in Vermont in 1960. The ratio was 4.15% at $10,000 of adjusted gross income, a maximum of 4.73% at $25,000, 4.15% at $50,000, 3.67% at $100,000, and 2.60% at $1,000,000. The ratio in each state progressed upward to a peak, frequently at $25,000, and then declined. A regressive burden then resulted. The result is that the net burden generally was found to be greater on an income of $10,000 than on an income of $1,000,000. (Emanual Melichar, State Individual Income Taxes, University of Connecticut 1963).

This study concludes that state income taxes, after allowing for federal tax deductibility, are progressive on the lower and middle income brackets and regressive in burden on the upper brackets. Another factor is relevant here. Tax-exempt bonds are more likely to be the refuge of the wealthy than of the poor. Interest on such bonds is not included in adjusted gross income and is not taxable. If such interest were considered in computing net burdens of state income taxes, they would be still more regressive because the ratios of taxes to residual income would be reduced to a greater extent in the upper brackets than in the middle and lower.

Sharing The Federal Income Tax

A new development in the income tax situation is the consideration being given in Washington to sharing federal income tax revenues with the states. Both the Republican and Democratic platforms of 1964 spoke of state fiscal needs and promised more aid to the states. The Republican platform of July 15 pledged, "Credit against federal taxes for specified state and local taxes paid, and a transfer to the states of excise and other federal tax sources, to reinforce the fiscal strength of state and local governments so that they may better meet rising school costs and other pressing urban and suburban problems."

The 1964 budget of President Johnson, following the trend in recent years, called for increased grants-in-aid to the states. The Democratic platform of August 1964 promised more aid to state and local governments. It declared, "The Federal Government exists not to subordinate the states, but to support them". Proposals were being discussed during the Kennedy administration to share federal tax revenues substantially with the states. During the 1964 campaign President Johnson brought up the prospect of income tax sharing. After the election a study of the proposal was ordered, apparently with the thought that such tax sharing, through transfers of funds to the states, could begin in 1966. If $2.0 billion of income tax revenues were set aside for this purpose, as some have proposed, and if the aid were distributed on a population basis, the Maine share at the outset would be $20 million. Preliminary plans actually call for distributing some of the funds on a needs basis which would increase the share going to the lower income states.

Underlying the income tax sharing proposal is undoubtedly the thought that the federal government is in a superior position to tax income and can develop a scale of rate graduation more effectively than the states. The states, it is evident, can add little to graduation of taxes. Their income taxes, after progression to a point, tend to become regressive in burden in relation to the income remaining after federal taxation.

Industry And The Income Tax

American business opinion appears to be generally more favorable to the sales tax as a state revenue than the income tax. Reaction to the federal income tax rates is probably one reason for this attitude. Management would usually prefer to pay a sales tax to an income tax. The latter is commonly considered to be no serious deterrent to retail trade and to spread the costs of government more evenly. Further the tax climate for industrial growth, according to widely held business opinion, is less favorable where the state enforces a graduated income tax. It is often stated that European countries with faster economic growth rates than those which the United States has enjoyed have relied relatively more on sales and excise taxes and relatively less on income taxes for revenue. The taxation and economic growth relationship is difficult to establish because of the variable factors involved, but it is clear that there is at least a psychological disadvantage to industrial development in the reactions of many business executives and investors to a graduated income tax.

To be weighed on the other side are preferences among some for the income tax. Since all taxes have both advantages and disadvantages, the choice should be the alternative among the various revenue measures available to Maine which offers the fewest disadvantages.

Income Tax No Substitute For Sales Tax

So far as Maine is concerned, an income tax does not appear to be a practicable substitute for the productive sales tax now providing annual revenues exceeding $40 million. It takes years to develop a new tax to this stage. Experience also shows that the income tax is best suited to a high income economy where available investment money is plentiful and a satisfactory rate of economic growth is assured. However, the Maine economy is one of relatively low income with a slow rate of economic growth. Therefore it follows that if industry is to be encouraged, investment should also be encouraged. As the federal income tax experience has demonstrated to the satisfaction of Presidents Kennedy and Johnson and to Congress, economic growth at a faster rate apparently requires not more, but less, income taxation.

S U M M A R Y

1. Maine, along with the other states, has been experiencing rising costs of state and local government.
2. The tax revenues of a state must be drawn from its economy. To the flow of economic activity both residents and non-residents contribute.
3. The Maine economy has been growing at a slower rate than the economies of many other states.
4. Per capita personal income in Maine in 1963 was $2,007. This was lower than the per capita income of any other New England state and below the national average of $2,449.

Taxes in Maine And Other States

Maine state and local taxes, including state unemployment compensation taxes and state liquor store profits as taxes, in effect, increased to approximately $223 million in 1963. Federal taxes taken out of the Maine economy in 1963 are estimated at $444 million. Total taxes are estimated at $667 million, a sum equivalent to one-third of the state income.

For the nation as a whole, property taxation is still the biggest revenue producer in the state and local tax system. Its national yield in 1963 exceeded $20 billion. Property taxation in Maine provided over $108 million in 1963.

General sales taxes supplied state and local governments with $6.6 billion in revenue, ranking next to the property tax in 1963. Maine raised over $30 million from the retail sales tax in 1963 and over $40 million in the fiscal year ending June 30, 1964.

The pattern of taxation varies from state to state. Some states impose sales taxes but no income taxes. Some tax both personal and corporate income but have no sales tax. Some states utilize the corporate income tax and a sales tax, while other states tax both personal and corporate incomes and also collect a sales tax. One state, Nebraska, has no income taxes and no sales tax. A common feature in all states, however, is the locally important property tax.

The states reach nonresidents as well as residents through their property, income, sales, excise, license and other taxes. Nonresidents benefit from state and local government services and their economic activity reflects an ability to pay taxes.

The Principles Of The Tax System

Taxes are traditionally regarded as sources of revenue and the tax system must provide adequate productivity. Every state would prefer to raise the increasing revenues it needs from the growth in taxable activity in its economy rather than by raising tax rates or imposing new taxes. From time to time, however, tax increases have been found necessary.

Taxes should be distributed as fairly as possible over the population. Ability to pay is often regarded as a leading principle of tax justice. It lacks a precise common definition, however, and has been related to property and spending taxes as well as to income and other taxes. Many persons believe that ability to pay requires the taxation of income at graduated rates.

The determination of taxable income has been a controversial subject, however, and it is uncertain what scale of tax rates ability to pay might require. Debate also arises over the desirability of adding state income taxes to the federal tax, with its graduated rates.

Some persons would prefer to tax according to benefits received from government. Their preference is usually for flat rate, or proportional, taxes. The measurement of benefits encounters difficulties similar to those found in determining ability to pay.

Fairness in taxation is a vague concept. What is fair is a matter of opinion, and opinions vary widely.

In recent years greater emphasis has been placed upon the community objective of economic growth, high level employment, and rising personal incomes. Taxes are sought which are most consistent with growth objectives and retard growth as little as possible.

The principles of taxation can be applied with reasonable success only in the system of state, local, and federal taxes. Each tax has some advantages and some disadvantages. The best possible balance should be sought in the tax structure, considering the taxes imposed by the various governments.

Property Taxation In Maine

Property tax revenues over the country have displayed a surprising and continuing growth. In Maine they increased from $74.7 million in 1957 to $108.3 million in 1963.

Maine is one of a small number of states where property taxes supply over one-half of the state and local tax revenue.

Property taxes per capita in Maine exceed the national average. They were $109.39 in 1963 as compared with the national average of $106.51. In New England, however, only Vermont in 1963 had lower property taxes per capita than Maine.

A U.S. Bureau of the Census study placed Maine and Massachusetts at the top of the nation in the estimated average effective tax rate on real property. The rate allowed for variations among the states in ratios of assessed to sales values and computed estimated effective tax rates in relation to full values. The rate in Maine and Massachusetts was 2.4% of full value. The rates in the other New England states were 2.1% for Vermont, 1.9% for New Hampshire, and Rhode Island, and 1.6% for Connecticut.

The various measures of property taxation cited here are crude and refer only to assumed average conditions. They do not show variations in taxes on particular properties and there is always the question whether an adequate sample has been taken of assessments. Taken at their face value, the data appear to show that property taxes in Maine tend to be higher than in many other states.

Property Tax Study and Reforms Needed

Studies of tax administration in Maine have repeatedly cited the serious inequalities in assessments and the need for reforms in tax administration to improve the bulwark of local revenues. Further study is clearly needed to determine more adequately what the problems of property taxation are today and how best to overcome them. Such study is also needed to appraise the appropriate role of property taxation as a revenue in Maine.

The Sales Tax

Maine is one of 37 states imposing a general sales tax. Her tax, like that of most of the other states, is confined to sales of personal property at the retail level.

The Maine tax rate was advanced to 4% in 1963 and the state taxes in Michigan and Washington are levied at this same rate. In California and Illinois the combination of a state sales tax and local sales taxes blanketing the state result in a tax rate of 4%. The tax rate in Pennsylvania and several Canadian provinces has been raised to 5%.

Sales tax revenues of $40.8 million in Maine in 1964 were approximately one-third of state government taxes. A number of other states also raise one-third or more of their tax revenues from a general sales tax.

Importance Of Food Exemption

The chief criticism of sales taxes is that their burdens are said to be regressive, taking higher percentages out of low incomes than out of the middle and upper incomes. The exemption of food for off-premise consumption substantially moderates the regressivity of the Maine tax. Exemption for domestic fuel, motor vehicle trade-ins, agricultural items, and certain other exempt articles tend further to moderate any regressivity of miscellaneous sales taxes.

The alcohol, cigarette, and gasoline taxes also have regressive burdens. There is little popular opposition to them, however, and one seldom hears complaints that they have regressive effects.

A number of states are securing more sales tax revenue per capita than Maine. A number also obtain revenues which are equal to a higher percentage of state income.

Part of the Maine sales tax is paid by tourists and other nonresidents. To some extent the sales tax is paid by business firms as a cost and enters into the prices of goods exported from the state.

The sales tax has become an indispensable revenue in Maine, as it has in many other states. At the same time it has been found to be consistent with the economic growth objective in Maine and other states and does not appear to retard industry and employment.

The Personal Income Tax

A revenue often proposed in Maine but never adopted is the general personal net income tax. Such a tax is now found in thirty-four states. The remaining sixteen states, including Connecticut, Maine, and New Hampshire, raise their revenue from other sources.

The income tax movement started in Wisconsin in 1911 in the search for revenues to supplement the property tax. With the decline of incomes during the depression of the 1930's, a number of states turned to the general sales tax. By 1937, thirty-two states had adopted the personal income tax. Then the movement halted. Since that time only two more states have entered the field. Discouraging factors have been the advancing rates of the federal income tax and the old-age insurance payroll taxes. The productivity of general sales taxes and excises also contributed to the resistance to the income tax.

In 1963, state and local income taxes supplied $3.3 billion in revenue. Revenues have increased with rising personal incomes, a lowering of exemptions, and advancing tax rates. The Vermont tax rates range from 2% to 7.5%, the maximum applying to income over $5,000. Vermont exemptions are $500 for a single person and $1,000 for a married couple. Revenues from the Vermont tax were $14.5 million in 1964. It should be noted, however, that Vermont receives comparatively little income from a restricted sales tax - applied only to sale of rooms, rentals, meals and motor vehicle sales.

Importance Of The Federal Income Tax

The biggest tax paid by Maine residents is the federal personal net income tax which raised $157 million from 1961 income. Federal payroll taxes to finance old-age insurance were added to the income tax.

Presidents Kennedy and Johnson criticized the federal income tax as a drag on the economy, holding that it seriously curbed consumer demand, initiative, and investment. Congress responded to this criticism and reduced the tax rates at all levels in 1964. Since that time President Johnson has spoken of the desirability of further reductions to spur economic growth and employment.

The Low Incomes in Maine

In appraising the question of a state income tax, Maine should not only consider the burdens of the federal income and payroll taxes but should also consider the income tax base of the state. Maine is the state with the lowest per capita income of any of the New England states and with a lower per capita income than the national average.

Maine also has more of its income distributed among the lower income groups than does any other New England state and, in fact, is below the national average. The share of state income received by persons with incomes over $10,000 is smaller than in any other New England state and is also smaller than the national average. Therefore, a greater part of an income tax would have to be paid by the lower incomes to produce substantial revenues than would be paid in the remaining New England states, as well as in most other states.

Revenues From Nonresidents

Maine is in a comparatively unfavorable position to draw income tax revenues from nonresidents. It is less favorably situated than Vermont, Massachusetts, New York, and other states with income taxes. Relatively less employment and business activity involving nonresidents apparently occurs in Maine than these other states. The retail sales tax offers greater opportunities to tax nonresidents than a personal income tax.

Progression and Regression

Much of the support for a personal income tax comes from the advocates of a graduated tax, hitting the upper incomes at higher rates than the lower. A recent study of state income tax burdens, after allowing for the deductibility of federal income taxes in determining state income tax liability, has found that the net burden, or effective tax rate, progresses up to a point and then declines. The maximum effective rate is frequently at \$25,000. Regression in effective rates then occurs and the rate may be lower for an income of \$1,000,000 than for an income of \$10,000 or \$25,000. At most, only a small amount of limited progression in income tax burdens results from the state taxes. Regressivity sets in after the peak of progression is attained.

Sharing The Federal Income Tax Revenues

In considering the income tax question in Maine, another pertinent factor has recently emerged. This is the proposal current in Washington and cited by President Johnson which would share federal income tax revenues with the states. The President has authorized a study of this proposal.

If, as some have proposed, at least \$2 billion in federal income tax revenue were shared with the states on a population basis, the Maine share would be approximately \$20 million. If, as some further propose, a part of the \$2 billion were shared more generously with the low income states, Maine would receive a larger sum each year.

The Income Tax Not A Substitute For The Sales Tax

The income tax does not appear to be a suitable substitute for the sales tax in Maine. It takes years to develop a tax as productive as the sales tax. As a comparatively low income state, Maine is not in a favorable economic stage of development to raise similar revenue from an income tax.

The sales tax is less likely to affect employment, investment, and industry than the income tax. It also places more of the state and local tax burden on nonresidents, a desirable feature in a state with a low income economy.

In view of the consideration in Washington of federal income tax sharing with the states and other pertinent factors, it would also seem inadvisable for Maine to adopt a personal income tax as an additional tax at this time.