Governor LePage's
Tax Reform and Relief Plan

"Governor LePage's proposal is both comprehensive and well thought out, reducing tax burdens and holding out the potential to trigger a substantial improvement to the state's business climate."

– Tax Foundation

Governor LePage's Tax Reform & Relief Plan

Governor LePage's second term tax reform and relief plan proposes to align Maine's tax system with the 21st century economy by making it more competitive, simpler, stable and fair. Achieving these objectives will contribute to long-term growth by incentivizing businesses to locate and expand in Maine, individuals to work and raise their families here, and retirees to make Maine their state of residence. This plan accomplishes those goals, <u>while providing over $300 million of direct tax relief for Maine resident families.</u>

Competitiveness

- Reduce top marginal individual income tax rate from 7.95% to 5.75%
- Cut taxes on all pensions and eliminate tax on military pensions
- Reduce top corporate income tax rate from 8.93% to 6.75%
- Repeal Maine's estate tax to preserve Maine's family businesses
- Modernize Maine's sales tax rates and base, while continuing competitive rates nationally
  - 6.5% general rate for sales & use and on prepared foods (including alcoholic beverages)
  - 6% service provider tax
  - 8% tax on lodging and short-term auto rentals

Simplification

- Repeal cumbersome and obsolete income tax credits and loopholes
- Eliminate corporate alternative minimum tax (AMT)
- Create new credit for medical expenses and eliminate itemized deductions
- Transfer telecommunications excise tax to municipalities
- Repeals BETR program by transferring property to BETE program

Stability

- Replace unstable municipal revenue sharing program with authority for municipalities to tax large non-profit entities
- Strengthening the position of the Budget Stabilization Fund
- Modernize sales tax base to include services, with exemptions for sales to businesses

Fairness

- Create sales tax fairness credit to provide relief from modernized sales tax base to low and middle income Maine resident households
- Expand current Property Tax Fairness Credit to provide direct property tax relief to low and middle income Maine resident households
- Expand Homestead Exemption for elderly residents

Modernizing Maine's Tax Code

Maine's state and local tax system has been essentially unchanged since the introduction of the income tax in 1969. The economic transition over the last 40 years, which was in its early stages at that time, has made the current tax system out of date and uncompetitive with other states.

A modernization of the sales and income tax bases, a lowering of income tax rates, and elimination of the estate tax will align Maine's state tax system with the 21st century economy, make the state more competitive, contribute to long-term economic growth, protect lower and middle income households from shouldering more of the tax burden, and provide a simpler, more stable revenue base to meet the state's spending commitments. <u>All of this can be accomplished while providing over $300 million of direct tax relief for Maine resident families.</u>

The following is a summary of the bold reforms necessary to simplify and stabilize Maine's tax code, to bring fairness for all taxpayers at both the local and state levels, and to provide our hardworking Maine families and businesses – small and large - the opportunity to compete and thrive in today's economy. ***Independent analysis conducted by the Tax Foundation noted that these reforms, if fully implemented, would improve Maine's ranking in the Tax Foundation State Business Tax Climate Index from 33rd to 23rd.***[1]

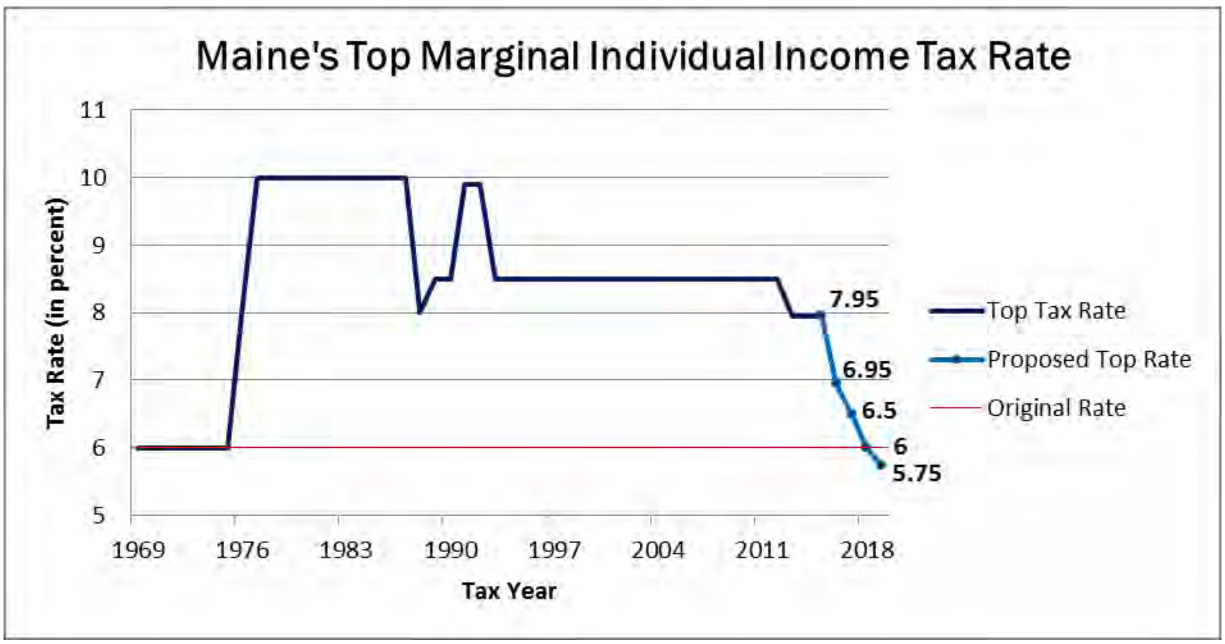
REDUCE INDIVIDUAL & CORPORATE INCOME TAX RATES

The income tax was enacted at a time when large corporations, often headquartered in Maine, with significant investments in plants and equipment were utilizing our natural resources and productive workforce to manufacture goods. Since that time these natural resource based industries have consolidated or moved their production to lower cost locations around the world. These large natural resource based manufacturers have been supplanted by high-tech manufacturing and service based businesses that tend to be smaller, capital intensive operations that depend on an educated workforce and can quickly

[1] The Tax Foundation is a non-profit, non-partisan tax research organization based in Washington, D.C (www.taxfoundation.org)

relocate to more business friendly environments. Most major corporations operating in Maine are now headquartered out of state, eliminating the ties key corporate decision makers previously had to our great state. These business leaders not only focus on the corporate income tax rate, but the individual income tax rate for which they and their highly paid managers will be subject.

Many businesses currently operating in Maine are pass-through entities that are taxed under the individual income tax. The work these entities perform can often be done anywhere. In a state highly dependent on small business and entrepreneurship, we have the 8th highest state and federal combined top marginal tax rate on pass-through income in the country. Not only does this relatively high tax rate dissuade pass-through companies from locating here, but it also dampens the incentive for existing business to expand through capital investment and additional employees.



Individuals and families are more mobile today than ever before. Telecommuting and our increased access to distant locales provide an opportunity for families to enjoy the Maine lifestyle and work in professions that are more diverse than the underlying Maine economy. However, the high tax burden these families face in Maine can be a deterrent to moving here. Currently, individuals and dual income couples are subject to a 7.95 percent top marginal income tax rate that begins at a relatively low level of taxable income. For example, under current law, Maine's top income tax bracket for a single filer begins at only $21,201 of taxable income per year. In a state that is in need of highly skilled workers, the current income tax system provides no incentive for these people to reside in Maine or for families to raise their children here.

An individual and corporate income tax structure that encourages highly skilled workers, families and corporations to locate here begins with lowering the top marginal tax rate. In the case of the individual income tax, a top statutory marginal tax rate of 5.75 percent will make Maine competitive with the rest of the nation. Similarly a top statutory marginal tax rate for corporate income tax filers of 6.75 percent (currently 8.93 percent) will be very competitive relative to other Northeastern states and competitive with other regions of the country.[2] ***According to analysis conducted by the Tax Foundation, the proposed modifications to the corporate income tax would cause Maine to leapfrog from 45th to 17th in the corporate tax ratings.***

ELIMINATE THE ESTATE TAX

Federal passage of the 2001 Economic Growth and Tax Relief Reconciliation Act significantly changed the structure of estate taxes. Prior to the law change, every state used the federal death credit as their estate tax, and there was no tax competition among the states. Regardless of a person's state of residence at death, the estate tax was the same. However, the 2001 changes to the federal law forced states to create their own estate tax or repeal the tax altogether. Over time, the majority of states have chosen to repeal the estate tax. Only 19 states currently have some form of estate or inheritance tax, most in the Northeast and Midwest.

The estate tax in Maine punishes family businesses, particularly the multi-generational job creators in many of our rural areas, such as farming and forestry. After the death of a family member, a family can be forced to either sell the business outright or to unload capital equipment to pay the looming estate tax liability. Often this results in a residual impact of loss of good paying, private sector jobs at those family businesses. In addition, combining an estate tax with a high individual income tax has forced more wealthy Maine residents to change their state of domicile in retirement. Maine not only loses significant income tax revenue from these former residents but other benefits that these individuals provide in

[2] Budgetary requirements necessitate that initial reductions in income tax rates leave the top marginal tax rates in excess of six percent. A scheduled phase-down of rates are included in the tax reform legislation.

retirement, such as donations to Maine charities and, most importantly, continued civic engagement in Maine's religious, educational and business institutions.

The Maine estate tax will be repealed to preserve Maine multi-generational family businesses, encourage current Maine residents to maintain their residency in retirement, and provide an additional incentive to non-resident retirees to move to Maine.

CUT TAXES ON PENSIONS AND ELIMINATE TAX ON MILITARY PENSIONS

Similar to the estate tax, many Mainers change their residence to other states after retirement due to the high taxes on pension benefits relative to other states. To make it more affordable for Mainer's to stay here in retirement, pension income, up to $35,000, will be exempt from state income tax. [3]

Most importantly, our veterans earned their pensions and our respect through a career of public service and sacrifice. Military pension benefits will be completely exempt from state income tax beginning in 2016. With this reform, Maine will join the 22 other states which honor their veterans by not taxing their pensions.

MODERNIZE THE SALES TAX

One area where Maine has a competitive advantage is the sales tax rate. The current 5 percent service provider tax rate, 5.5 percent sales and use tax rate, and the 8 percent tax rate on meals and lodging are very competitive compared to the combined state and local rates in other states. An increase to 6 percent in the service provider tax, 6.5 percent in the general sales and use rate, a reduction in the prepared meals rate to 6.5 percent, and

Current Sales Tax Rates		Governor's Proposed Sales Tax Rates	
Service Provider	5.0%	Service Provider	6.0%
Sales and Use	5.5%	Sales, Use and Meals	6.5%
Meals and Lodging	8.0%	Lodging and Auto Rental	8.0%
Auto Rentals	10.0%		

maintaining the current 8 percent rate on lodging will keep Maine in a very competitive posture nationally.

[3] Budgetary requirements necessitate that the pension income exemption is incrementally implemented. A scheduled phase-in of the exemption is included in the tax reform legislation.

The sales tax was developed during the mid-1950s when the economy was primarily based on the sale of goods and is becoming difficult to administer and comply with as the economy has increasingly become based on the sale of services. Services represent over 60 percent of current household budgets and tend to be less volatile than purchases of durable goods. A 2007 study by the Federation of Tax Administrators showed that Maine has the 11th narrowest sales tax base in terms of the taxation of services. Automobiles and building supply materials represent 30 percent or more of taxable sales in most years, leaving sales tax revenues vulnerable to changes in the economy that impact consumer purchases of big-ticket items like cars and home furnishings. The latest recession is a good example of how volatile our narrow sales tax base is to economic conditions. Starting with the second quarter of 2008, taxable sales decreased on a year-over-year basis for six straight quarters, often times by over 8 percent. In three of those quarters, automobile sales fell by over 15 percent.

Consumers' ability to purchase online or to use alternative means to purchase identical goods or services has also led to an erosion of the tax base. While administrative and statutory changes have been made to address these activities, the state continues to lose significant revenues every year. In addition, definitions and statutory language developed years ago no longer reflect the technological changes and innovations that have been introduced into the marketplace. For example, watching a movie can result in completely different levels of taxation depending on the method used to view the movie. A taxpayer visiting a movie theater or streaming a movie over the internet currently pays no sales tax; however, an individual purchasing or renting a DVD of the movie or ordering the movie through their cable or satellite provider pays sales tax.

Modernizing the sales tax base to include both goods and services and updating the rates to be competitive nationwide will export more of the tax burden to non-residents and provide stability to state revenues. A refundable sales tax credit administered through the individual income tax will offset the additional sales tax burden on lower- and middle-income households.

SIMPLIFY AND STREAMLINE THE TAX CODE

Maine income tax bases will be streamlined to eliminate income modifications that provide little benefit to taxpayers. The individual income tax base must be simplified by repealing itemized deductions. In addition, there are a number of business and personal credits that are no longer necessary because other changes in the tax laws have made them obsolete. These changes not only help offset the revenue loss from the rate reductions, but will also simplify the income tax laws.

OVERHAUL MUNICIPAL PROPERTY TAX RELIEF

Maine's state and local tax system is heavily reliant on the local property tax. The fact that the state has the highest percentage of second homes in the country and is land rich suggests this approach is not unreasonable. For many Maine households, however, this reliance on the property tax places a strain on their ability to pay and therefore to remain in their home. Elderly households on fixed incomes are particularly vulnerable to constantly rising property taxes.

There are various reasons why some homeowners are overly burdened by the property tax. First, low- to middle-income households located in "service center" communities face very high mill rates. Service center communities often have a significant portion of their property exempt from taxation because the property is owned by tax-exempt nonprofits. In addition, the population of service centers increases significantly during the work week requiring investments in infrastructure and emergency personnel. Second, households located along the coast, lakes or in the mountains have seen the value of their properties increase dramatically as wealthy, out-of-state, second homeowners have driven prices up. In many cases the mill rates in these towns are relatively low, but the ratio of housing values to resident incomes is extremely high. Finally, some households located in depressed areas have seen their property values plummet along with their income. As a result, mill rates have increased to maintain municipal services.

Because the reasons for burdensome property taxes vary across the state, property tax relief programs should focus on individual homeowners instead of municipalities. Rather than spreading relief across all property owners, focusing state resources directly to low- and middle-income households would target relief to those truly in need. Currently the programs that achieve this result best are the Homestead Exemption and the Property Tax Fairness Credit, and additional state resources will be directed to these and other municipal property tax relief programs.

Current state telecommunications excise tax revenue collection will be transferred to municipalities to assist them in broadening their property tax base. Municipal revenue sharing will be eliminated and municipalities will instead be given the authority to collect tax revenue from large non-profit entities. In the first case, a state level tax that generates approximately $9 million per year will be transferred to the local level with little or no burden on current taxpayers. The second initiative recognizes the growth of nonprofit organizations in our communities and requires large nonprofits to contribute to municipal coffers.

According to analysis conducted by the Tax Foundation, the proposed real and personal property tax reforms would improve Maine's property tax ranking from 40th to 35th.

SUMMARY

The state's tax system is antiquated and long overdue for major reform. A modernization of the tax system recognizing the challenges of the current economic environment is vital for the state's economy to prosper. A shift away from income tax reliance to an end user consumption tax is a key component of this modernization. While tax relief for Maine families will provide an important boost to the state's economy, bold tax reform will encourage businesses to locate and expand here, people to retire here and individuals to work and raise their families here. It will spark job creation and lead to a prosperous Maine for future generations.