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H.P. 1110 House of Representatives, March 21, 2007

An Act To Enact the 2007 Tax Reform and Tax Relief Act

Reference to the Committee on Taxation suggested and ordered printed.

Millicent M. MacFarland
MILLICENT M. MacFARLAND
Clerk

Presented by Representative WOODBURY of Yarmouth.
Cosponsored by Senator PERRY of Penobscot and
Senator: MILLS of Somerset.

Be it enacted by the People of the State of Maine as follows:

CONCEPT DRAFT
SUMMARY

This bill is a concept draft pursuant to Joint Rule 208.

This bill proposes to enact the 2007 Tax Reform and Tax Relief Act to bring together 3 major categories of tax reform and tax relief into a comprehensive package that would be sent to referendum for voter ratification. The major components are:

1. Ten-Year Tax Burden Reduction Plan. The first part of the bill draws on aspects of the so-called "Taxpayer Bill of Rights," and the so-called "LD 1," and establishes a statewide tax burden reduction factor, applied uniformly to all levels of government. The tax burden reduction limitations would restrict government spending to a rate of growth below the growth rate of personal income in Maine, thereby lowering Maine's tax burden over a 10-year period.

2. Financial Incentives for Administrative Efficiency and Tax Burden Reduction. The 2nd part of the bill creates financial incentives for administering schools and municipalities through service-delivery areas of a sufficient size to obtain cost efficiencies. It puts into law a very strong incentive-based approach to consolidated service delivery, rather than imposing a statewide mandate on municipal decision-making. The remaining 5% of the State's General Purpose Aid, or "GPA," school funding obligation that is scheduled to be added to the GPA funding formula by FY2009 would be distributed to school districts, based on a set of "efficiency points" awarded to districts that achieve school consolidation and tax burden reduction targets. A similar set-aside would be created with new state funding to municipalities, awarded through an "efficiency point" system, and allocated among municipalities that achieve service-sharing efficiencies and tax burden reduction targets at the municipal level.

3. Income Tax Reduction to 4% of Income. Through a rebalancing of income and sales taxes, the elimination of many exemptions and deductions from both the income and sales tax systems and an increase in various sales and excise tax rates, the 3rd part of the bill would reduce the income tax rates to a flat 4% of income. An earned income tax credit for low-income and middle-income workers would assure that a major income group would not pay more in taxes than they pay under current law.

4. Homestead Property Taxes Capped at 5% of Income. The 4th part of the bill proposes to integrate the Maine Residents Property Tax Program, also known as the Circuitbreaker Program, and the Maine resident homestead property tax exemption program into an expanded and redefined Homestead Tax Credit Program. The amount of the tax credit would be determined based on a formula that equates to an income-based tax cap of 5% of income. As a simplification of the current Circuitbreaker Program, the new benefit formula would be based on "adjusted gross income," rather than the more complicated definition of income currently applied for Circuitbreaker Program benefits and would be distributed to municipalities as a pre-payment toward the tax assessment on

homestead property so that the net tax bill imposed on homeowners is reduced accordingly.

PART A
TAX BURDEN REDUCTION PLAN

The 10-year tax burden reduction plan would consist of the following 4 proposals.

Proposal A-1. Impose a tax burden reduction factor on all levels of government

The bill would establish spending limits for government at all levels, drawing on aspects of the Taxpayer Bill of Rights, also known as "TABOR," and Public Law 2005, chapter 2, the so-called "LD 1." The basic formula would limit the growth in government spending to the rate of total income growth in Maine, reduced by a uniform tax burden reduction factor applied across-the-board to all levels of government.

1. Rate of total income growth. The first part of the formula is the baseline rate at which total incomes are growing in Maine. It encompasses population growth, cost-of-living growth or inflation and standard-of-living growth or productivity into one unified measure of the total Maine economy. The rate of total income growth is already monitored regularly and easy to apply to any spending formula.

2. Tax burden reduction factor. The 2nd part of the formula, the tax burden reduction factor, defines how much government spending should be allowed to grow relative to the economy as a whole. A tax burden reduction factor of 50%, for example, would require government spending to grow at no more than half the rate of growth of the overall economy. The tax burden reduction factor selected for Maine will determine the speed with which the burden is lowered over time.

The proposal would set the tax burden reduction factor at 50% in fiscal years 2008-09 and 2009-10, 60% in fiscal years 2010-11 and 2011-12, 70% in fiscal years 2012-13 and 2013-14, 80% in fiscal years 2014-15 and 2015-16, and 90% in fiscal years 2016-17 and 2017-18. Thus the bill would put in place a 10-year tax burden reduction plan designed to significantly reduce the burden over a 10-year time horizon. After the 10 years, the tax burden reduction factor would be maintained at 100%, rather than eliminated, to ensure that government grows no faster than total income, and thus Maine's tax burden stays at the lower level that has been achieved.

Proposal A-2. Establish a local distribution factor to account for differential growth among municipalities and counties

The global spending limits established in proposal A-1 would be applied uniformly to all levels of government. However, because of differential growth rates among municipalities and counties, the local limit may be adjusted up or down, depending on whether the local district is growing faster or slower than the statewide average. Areas growing faster than the statewide average would be permitted an upward adjustment in their spending limit. Areas growing more slowly than the statewide average would have their limit adjusted downward. Important to the overall system, however, is that the aggregate spending growth limit across all municipalities and counties is identical to the statewide limit.

To achieve both local variation and a uniform limit statewide, a municipal or county adjustment factor would be calculated by dividing the growth limitation factor, as defined in the Maine Revised Statutes, Title 5, section 1534, subsection 2, for municipal property by the statewide average property growth rate. This can be illustrated for both a high-growth and low-growth municipality using the following example: assume a statewide average property growth rate of 4%, a high-growth municipality with a growth rate of 6% and a low-growth municipality with a growth rate of 2%. The adjustment factors would be 1.5 for the high-growth municipality and 0.5 for the low-growth municipality. The spending growth limit for the high-growth municipality would be 1.5 times the statewide limit; the spending growth limit for the low-growth municipality would be 0.5 times the statewide limit; but the average across all municipalities would be the uniform statewide limit.

To apply the local adjustment system on a statewide basis, and to avoid the administrative complexity of the calculation for individual municipalities and counties, the Maine State Planning Office would be responsible for determining the growth rate limit for each municipal and county unit based on their reported property growth measures in the prior year.

Proposal A-3. Integrate spending growth limits with EPS for schools

Essential Programs and Services, or "EPS," as defined in the Maine Revised Statutes, Title 20-A, chapter 606-B, delimits the spending that is required to provide a minimum adequate level of education in school districts throughout the State. Historically, most communities have chosen a level of spending somewhat above this baseline "adequacy" standard. The growth limit proposed in this bill would allow school districts to continue to incorporate limited budget increases over time, but with the same uniformly-applied tax burden reduction factor from proposal A-1 that is applied to all other units of government.

The growth rate of a school district's EPS-defined costs would be used as the baseline growth rate allowance for each individual school district. However, in school districts spending more than EPS currently, the baseline rate would be reduced by the same tax burden reduction factor that applies statewide. This formula would restrict the growth in school spending, just like other units of government, but not require any radical readjustment in educational programs to the EPS adequacy standard.

For example, if a school district's EPS costs were determined to be $20,000,000 in 2006 and $21,000,000 in 2007, a 5% increase, and the State's tax burden reduction factor is 50%, then the school district would be allowed to increase its budget by 2.5%, even if the district is spending above the EPS level already. The formula would induce high-spending school districts to move toward EPS and tax burden reduction but without disruptive changes in programmatic priorities.

The tax-burden reduction factor would be applicable only to districts spending more than 2% above the EPS baseline. For school districts spending less than 2% above EPS, the spending limit would be set at a level 2% above the EPS baseline.

Proposal A-4. Strengthen the override procedures in current law

The bill would strengthen the override process in current law by requiring either a 2/3 vote of the governing body or a citizen referendum vote to exceed the spending limit in a municipality, county or school district.

PART B
ADMINISTRATIVE EFFICIENCY IN GOVERNMENT

This bill would establish incentives for administrative efficiency in government through the following 2 proposals.

Encourage Cost Efficiency in Administration and Contribution to Tax Burden Reduction by School Districts

This proposal would establish a multi-tiered school funding formula, designed to provide additional school funding assistance to school districts that are sufficiently consolidated to gain cost-efficiencies in administration and to school districts that are contributing to statewide tax burden reduction.

Specifically, the proposal would change the EPS funding formula to create a gradation of mill rate expectations that depend explicitly on district consolidation and budget decisions made by individual school districts in the previous year. The idea is to retain local control of school operations, but create much stronger incentives for administrative cost efficiencies.

The baseline mill rate expectation for all school districts would be set annually at the rate that could be supported with state GPA funding that is equivalent to 50% of EPS costs. The additional 5% of the state's GPA funding, as required in the citizen referendum approved by the voters in June 2004, would be allocated into a supplementary school funding bonus system that would further reduce the mill rate expectation in eligible communities. The local mill rate expectation would be reduced by a fixed amount for each of the following efficiency points earned, up to a maximum of 5 efficiency points in each school district. Thus there would be in effect 5 tiers of mill rate expectation, depending on the administrative efficiencies and tax burden reduction targets achieved.

Efficiency points would be awarded as follows:

1. District size. Consolidated school districts would get efficiency points based on the size of the district, as follows:

A. At least 3,000 students, 3 efficiency points;

B. At least 2,000 but fewer than 3,000 students, 2 efficiency points; and

C. At least 1,000 but fewer than 2,000 students, 1 efficiency point; and

2. Adherence to Spending Limits. Districts could earn an additional 2 efficiency points by:

A. Spending at least the EPS baseline amount on education, but exceeding EPS by no more than 5%; or

B. Exceeding EPS by more than 5%, but adhering to the spending growth limits outlined in Proposal A-3, indicating a proportional contribution toward tax burden reduction.

The value of the efficiency points in terms of their implied reduction in mill rate expectation would be based on the cost of the mill rate reduction to State Government, calibrated to equate exactly to the incremental resources available from the last 5% of the State's 55% commitment.

Proposal B-2. Encourage Cost Efficiency in Administration and Contribution to Tax Burden Reduction by Municipalities

This proposal would parallel the incentive structure of school districts described in proposal B-1, but would be based on the population and geography served by consolidated municipal service delivery areas, or "MSDAs." As with schools, a new incentive-based revenue sharing program would be created, distributing significant funds to municipalities, based on a multi-tiered efficiency point system, as follows:

1. Municipal service area size. MSDAs would get efficiency points based on the size of the MSDA district, as follows:

A. MSDAs covering at least 60,000 people or 600 square miles would get 3 efficiency points;

B. MSDAs covering at least 40,000 people but fewer than 60,000 people or at least 400 square miles but fewer than 600 square miles would get 2 efficiency points;

C. MSDAs covering at least 20,000 people but fewer than 40,000 people or at least 200 square miles but fewer than 400 square miles would get 1 efficiency point.

2. Uniform property tax district. The efficiency points awarded on the basis of MSDA size would be doubled in any MSDA that is sufficiently consolidated to impose a single property tax rate across the entire district.

3. Adherence to spending limits. Two additional efficiency points would be awarded to MSDAs that adhere to the spending growth limits outlined in Proposal A-2.

PART C
INCOME, SALES AND ESTATE TAX REFORM

This bill proposes to reduce the income tax rate to a flat 4% of income and conform to the federal estate tax deduction while eliminating many exemptions and deductions from the income and sales tax systems and increasing sales and excise tax rates. This is done through the following 5 proposals.

Proposal C-1. Eliminate individual income tax exemptions, deductions and credits and impose a flat-rate 4% tax

The bill would eliminate almost all exemptions, deductions and credits from the Maine individual income tax law and impose a flat-rate 4% tax on adjusted gross income or "AGI." For anyone who files a federal income tax return, the AGI amount can be transcribed directly from the bottom of page one on the federal return and multiplied by 4% to determine Maine income tax liability. The only retained tax credit would be a redesigned earned income tax credit, which would provide additional tax relief to low-income and moderate-income households in Maine. The earned income tax credit would be calibrated so that households in all income categories pay no more in income taxes than they pay today.

Because income taxes are paid almost entirely by Maine residents, the primary goal of this reform is to rebalance the tax system away from taxes paid by residents only, i.e., the income tax, and toward taxes that are shared more evenly with those who enjoy Maine as nonresidents. Eliminating exemptions, deductions and credits is also important in establishing the largest possible income tax base, thereby allowing the tax rate to be lower and the application of the tax to be distributed more evenly across all payers.

Proposal C-2. Lower the corporate income tax to 4% for Maine businesses; eliminate business tax advantage programs and the alternative minimum tax; and conform to federal business depreciation schedules

Because of the interactions between income taxes, corporate taxes and the alternative minimum tax and the desire to make business in Maine more financially desirable generally, the reduction in the individual income tax rate to 4%, which applies to most small businesses in the State already, would be extended to the corporate income tax rate as well. At the same time, all tax exemptions, refunds, credits and economic development incentive programs would be eliminated prospectively, including tax increment financing, employment tax increment financing, business equipment tax reimbursements, Pine Tree Development Zone incentives and any other targeted tax advantages for certain business over others. The intent is to create a low-rate business-friendly environment for all businesses that is applied evenly and fairly to all. Businesses that have already qualified for these programs would continue to receive benefits. The tax advantages are eliminated only prospectively.

This bill would also eliminate the alternative minimum tax for both individual and corporate income taxpayers. Maine's tax laws for business depreciation would be amended to achieve conformity with federal depreciation allowances. These measures would benefit business and simplify tax filing and record keeping.

Proposal C-3. Conform to federal estate tax exemption

This bill would increase the exemption from the estate tax to the amount necessary to conform with the federal estate tax. The "decoupling" between Maine's exemption and the federal exemption has been cited as an important influence leading wealthier Maine retirees to make their place of residence, for tax purposes, outside Maine.

Proposal C-4. Increase the base and rate of the sales tax

This bill would impose a much broader sales tax on the products and services that are purchased in Maine, focusing particularly on consumer purchases. Because sales taxes are paid by both residents and nonresidents, in rough proportion to the time they spend in Maine, while income taxes are largely avoided by non-residents, even those who are here for as much as 6 months, less a day, this reform is designed to distribute Maine's tax burden in a more balanced way. Increased sales taxes are the single most effective method for sharing the tax burden in proportion to the time spent in Maine.

For these reasons, the bill would expand the sales tax base to include food, utilities and recreational activities and eliminate the exemptions for a number of other products and services and organizations that are not currently taxed. The broader base also provides greater stability in revenues, since it is less volatile, and ensures that the tax burden is shared more fully across all sectors of the Maine economy. The bill would also increase the rate of the general sales tax from 5% to 6%.

The proposed expansion of the sales tax base includes amusements, including sports and recreational activities; rental of recreational equipment and facilities; cable and satellite television and radio services; theaters and public entertainment; commercial amusements, commercial participant amusements, sightseeing, spectator sports and arcades; tickets for movies, plays, theaters, concerts, fairs and sporting events; fees for arcades, amusement rides, water slides, golf courses, bowling alleys, pool halls, skating rinks, ski lifts, rafting and boat trips and guide service; dance instruction and dance studio services; personal care services by barbers, beauticians, manicurists, tattoo artists, body piercers, massage therapists, reflexologists, tanning salons and exercise and fitness centers; grocery staples; coal, oil, gas, electricity and water for home use; separately charged labor service fees; sales of newspapers, books and magazines; sales to nonprofit organizations; funeral services; vending machine sales; dating services; flower and balloon delivery and other services to demonstrate personal appreciation; taxidermy services; flight and driving instruction; rentals for recreational purposes of boat moorings, boat slips and docks; cleaning, storage and repair of clothing and shoes; cleaning, repair, moving, rental, storage, maintenance and improvement of personal property, including motor vehicles, watercraft, boat moorings, snowmobiles, all-terrain vehicles, appliances, bicycles, jewelry, cameras, timepieces, firearms, musical instruments, electronic and electrical goods, furniture, rugs, upholstery and antiques; pet grooming and kennel services; home improvement services, including painting, papering and interior decorating; home lawn and landscaping services; swimming pool and spa installation, repair, cleaning and maintenance; locksmith, alarm and security services; waste management and remediation services; disinfection and pest extermination or control; Internet service fees; personal transportation services and courier services, including taxicab and limousine services; warehousing and storage services; information services, including purchases of services from newspaper and periodical publishers, book publishers, database, directory and other publishers, video and sound recording services and data processing services; and safe deposit box rentals.

Proposal C-5. Increase specialized sales and excise tax rates

The bill would increase the so-called "meals and lodging" tax rate from 7% to 10%, but redefine the meals subject to the higher tax rate to "table service" meals only. The bill would also raise taxes on cigarettes and other tobacco products; beer, wine and hard cider; and short-term auto rentals to levels that place Maine on the higher end of excise taxes among the 50 states.

PART D
PROPERTY TAX REFORM

The bill proposes the following 3 property tax reform proposals.

Proposal D-1. Establish a homestead tax credit program that reduces homestead property taxes to no more than 5% of income.

This proposal would integrate the Maine Residents Property Tax Refund Program, also known as the Circuitbreaker Program, and the Maine homestead property tax exemption program, established in the Maine Revised Statutes, Title 36, chapter 105, subchapter 4-B, into an expanded and redefined "Homestead Tax Credit Program." The new program would take effect for municipal budget years beginning on or after July 1, 2008.

Applications for the Homestead Tax Credit Program would be filed by full-year Maine residents in conjunction with their Maine income tax returns, beginning with the 2007 income tax filing year, for which returns are due by April 15, 2008. The application deadline will parallel the deadline for income tax returns, including any extensions.

For renters, the program will continue to provide retroactive reimbursement through a refundable income tax credit. For homeowners, however, direct reimbursements would be eliminated and replaced with individually calculated homestead tax credits applied directly toward the property taxes that an individual would otherwise owe to the municipality in the subsequent year.

The amount of the tax credit would be determined based on a formula that equates to an income-based tax cap of 5% of income. As a simplification of the current Circuitbreaker Program, the new benefit formula would be based on adjusted gross income or "AGI," rather than the more complicated definition of income currently applied for Circuitbreaker Program benefits. The credit would be calculated as half the amount by which property taxes exceed 4% of AGI, up to 6% of AGI and all of the amount by which property taxes exceed 6% of AGI.

The program for renters would have no minimum benefit, a maximum credit of $2000, and a maximum qualifying rent of $15,000 annually for single person households and $20,000 annually for multiple person households. The program for homeowners would have a minimum credit of $100 and no maximum credit.

The formula would be applied to AGI and property taxes, or rent, as the case may be, paid in the previous income tax year, which generally corresponds to the calendar year.

Full-year Maine residents could apply the credit to any currently-occupied homestead property specified in the application; thereby allowing for circumstances when a homeowner may have moved from one homestead to another. Once specified, however, the decision would be irrevocable. Municipalities will apply the credit to the homestead address specified in the application. Homeowners could also opt for a refundable income tax credit of half the amount of their homestead tax credit, if they no longer own a homestead residence.

By June 1, for tax returns filed by the April 15 deadline, and by December 1, for returns filed by the October 15 deadline, the Department of Administrative and Financial Services, Bureau of Revenue Services will transfer to the relevant municipal authority the full amount of the homestead tax credit. The municipal tax assessor will apply the credit to the amount otherwise due, balancing the obligation over any remaining payment deadlines, and billing homeowners only for the net amount owed on their property taxes.

The Homestead Tax Credit Program replaces the Maine Residents Property Tax Program, the Maine resident homestead property tax exemption program and the state-municipal revenue sharing program and redirects funds previously allocated to those programs to support the cost of the Homestead Tax Credit Program.

The 2006 Circuitbreaker Program, with a normal filing deadline of May 31, 2007, reimbursing taxes incurred in 2005, would proceed on its current schedule. The 2007 Circuitbreaker Program, reimbursing taxes incurred in 2006, would have the same eligibility and reimbursement criteria of the current Circuitbreaker Program, but with a filing deadline of December 31, 2007. The fully implemented new Homestead Tax Credit Program would become effective with the income tax returns filed for the April 15, 2008 deadline and based on AGI and taxes or rent paid in calendar year 2007.

Proposal D-2. Establish a local option real estate transfer tax and convert the homestead exemption to a local option program

This proposal allows municipalities, through a local referendum, to adopt a local option real estate transfer tax of up to 2% of the sale price. It would require that the funds raised through the local option tax be applied entirely to a local option homestead property tax exemption program or a local option circuitbreaker program. As discussed in proposal D-1, the bill would repeal the Maine resident homestead property tax exemption program, established in the Maine Revised Statutes, Title 36, chapter 105, subchapter 4-B, as it applies to the property tax imposed by municipalities.

Proposal D-3. Transfer responsibility for jails to the State and convert county finances to fee-for-service; funding

The bill would transfer responsibility for management and financing of county jails to State Government. Any additional services provided by counties on behalf of municipalities within the county would be contracted on a fee-for-service basis. Counties could no longer impose county assessments on local property taxes. The additional state funds needed to fund the jail system would be supported with a statewide property tax of no more than 3 mills with a concurrent $1,000,000 homestead exemption.

PART E
ENACTMENT BY REFERENDUM

Proposal E-1. Public Referendum

Given the controversial nature of tax reform in general and the heightened public emotion surrounding Maine's taxes in particular, this bill would be sent to referendum for public approval in a single question.

"Do you favor the adoption of a 10-year tax burden reduction plan, incentives for cost efficiency and tax burden reduction in government, a flat-rate income tax of 4%, a homestead tax credit program that limits property taxes to no more than 5% of income in most circumstances, the elimination of many exemptions and deductions from both the income and sales tax systems and an increase in sales and excise tax rates?"