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'An Idea Whose Time Has Come'

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A Tax Policy for Maine

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November 17, 1975

The Honorable James B. Longley
Office of the Governor
State House
Augusta, Maine 04333

Dear Governor Longley:

The Tax Policy Committee has completed its deliberations and is pleased to submit for your consideration some important interim and fundamental tax policy directions for the State of Maine. The recommendations of the report represent a majority view of the Tax Policy Committee.

The Committee urges you to give careful study to all of the recommendations and welcomes the opportunity to give you the benefit of the differing perspectives which the Committee shared in arriving at its recommendations. We fully realize that the report must stand the test of your scrutiny, public review and ultimate action by the Legislature.

The Committee recognizes the great difficulties in securing favorable action on tax reform issues. We hope this report will stimulate the public support and leadership essential to the tax reform needed in Maine.

Sincerely yours,

John L. Salisbury

John L. Salisbury
Chairman

JLS:saw

AN IDEA WHOSE TIME HAS COME:
A TAX POLICY FOR THE STATE OF MAINE

Summary of Recommendations

Presented below is a summary of the Governor's Tax Policy Committee's recommendations. These reforms cover five basic areas:

A. *Fundamental Reforms.* These changes are the long-range goals of this report's Maine tax policy.

B. *Financing Fundamental Reforms.* The Committee does not recommend an increase in total State taxes but rather a shifting of burdens within the present tax structures.

C. *Interim Reforms.* These changes are necessary only if the fundamental reforms are not attainable in the near future. They are incremental reforms, "steps" that lead logically to the long-range fundamental goals.

D. *Financing Interim Reforms.* Again, the Committee does not recommend an increase in the total State taxes but rather a shifting of burdens within the present tax structures.

E. *Reforms in Administration.* These reforms will result in greater administrative efficiency and will aid in the elimination of unfair tax breaks.

Each of the committee's recommendations represents a majority but not necessarily unanimous opinion of the members. Where views differed substantially, members have filed minority opinions included in the appendix.

A. RECOMMENDATIONS FOR FUNDAMENTAL STRUCTURAL REFORMS

The Property Tax

The Municipal Property Tax Should be Reduced

The property tax is an increasingly heavy and unfair burden on the necessity of housing. Property taxes should generally be restructured to more clearly reflect the costs of the services provided to property. It is recommended that the cost of education and welfare be removed from the property taxes of Maine citizens and the burden of these expenses be shifted to other broad based taxes within the State tax mix. The remaining municipal property taxes (primarily service related) would continue to be collected by and available for communities. This reform represents, on the average, an approximate 50% reduction in taxes. *See* page 24.

Nonresidents Should Continue to Pay Their Equitable Share of Property Taxes

Consumption and property holdings are the prime measures of wealth that the State has for non-residents. It is primarily through the property tax and sales tax that the State is able to tax nonresidents for their fair share of State expenses. It is recommended that only residents be exempted from paying for education and welfare through the property tax. This exemption will be administered through an income tax credit. Of course residents would continue to pay the same share of education and welfare; but it will be primarily through the more equitable income tax. *See* page 26.

Upon Achieving a Primarily Service Related Municipal Property Tax,
Business Inventories Should be Taxed

When the municipal property tax burden is reduced to a level that in general reflects the specific services a municipality renders to all property within that municipality's limits, then it would be inconsistent to exempt business inventories from taxation. It is recommended that the exemption of business inventories be repealed. Improved information on inventory values should be provided to local assessors by the State to more accurately reflect inventory values. *See* page 28.

A Local, Optional, Income Tax Should be Made Available to Municipalities

As property taxes would no longer be supporting education, it is recommended that a local, optional, income tax be made available to municipalities that with to make an additional tax effort in order to improve educational quality. *See* page 29.

The Personal Income Tax

Increase the Income Tax's Share of the State Tax Mix

The income tax is the most equitable of our major tax revenue sources yet it is by far the least utilized. It is recommended that a large percentage of the cost of education and welfare be shifted from the property tax to the personal income tax. *See* page 29.

Income Tax Equity Should be Improved

Various Federal IRS provisions, not present in the Maine personal income tax, increase the equity of the tax as to determining each citizen's ability to pay. It is recommended that the following Federal provisions be incorporated in the State personal income tax:

a. Head of Household Schedule ($100,000 shift in burden);

b. Standard (includes low income allowance) deductions ($4.7 million shift);

c. Retirement Income Credit ($208,500 shift in burden). *See* page 30.

The Sales Tax

The Sales Tax Base Should be Expanded

The current Maine Sales Tax, because it exempts food and heating fuel, has lost most of its regressiveness. Still, in order to be a truly progressive tax,[1] the sales tax base should be expanded to include most tangible goods and services. *See* page 31.

Sales Tax Should Become a Levy on Luxury Consumption

With a sales tax base that includes most consumption items - goods and services - it becomes possible to convert the sales tax into a tax on luxury consumption. Along with the expanded base, an income tax credit should be instituted which will return to each Maine citizen an amount which in whole or in part, is reflective of a minimum consumption level, thus, any monies in excess of the credit paid out in sales taxes by a citizen will to a greater degree reflect "luxury" consumption. *See* page 32.

[1] As used in this report, a tax is *progressive* if its rate increases as ability to pay increases; a tax is *proportional* if its rate stays the same at all levels of ability to pay; a tax is *regressive* if the effect of its rate decreases as ability to pay increases.

B. FINANCING FUNDAMENTAL REFORMS

The Personal Income Tax

The personal income tax should be increased to assume approximately 61% of the $98.3 million shifted burden. The present vertical progressivity of the tax should be maintained or slightly improved in the upper income brackets. Such an increase would place the income tax's share of State revenues at a reasonable 20-21%. *See* page 34.

Corporate Income Tax

The dramatic reduction in property taxes will result in a significant drop in business tax levels. The corporate income tax should assume approximately 5% of the shifted burden. *See* page 35.

The Sales Tax

The sales tax base should be expanded to include most tangible goods and services with a credit instituted, thereby converting the sales tax into a tax reflecting to a greater degree luxury consumption. This expanded sales tax should assume approximately 14% of the shifted burden. *See* page 36.

Current State Property Related Services

It is recommended that the State transfer to the municipalities the cost of some property related services currently provided by the State. *See* page 38.

Taxation of Inventories

With the conversion of the municipal property tax to a tax more closely reflective of the services provided property, business inventories should again be taxed. This reform will eliminate the $11.5 million still to be raised under 30 M.R.S.A., § 5056 to reimburse municipalities for revenues lost when business inventories were phased out from property taxes in 1973. (*See* page 38.) This cost avoidance will represent approximately 15% of the shifted burden.

Real Estate Transfer Tax

Because the fundamental reform plan will lower property taxes, on the average, by 50%, it is reasonable to increase the current real estate transfer tax formula. Property owners gain from such relief. *See* page 38.

Domestic Insurance Premium Tax

The tax on domestic insurance companies should be raised to 2% of premiums and fund approximately .5% of the shifted burden. *See* page 39.

C. RECOMMENDATIONS FOR INTERIM STRUCTURAL REFORMS

If fundamental reform is not at this time possible, the following "steps" or interim reforms should be accomplished.

The Property Tax

Institute a General Property Tax "Circuit Breaker"

Until the fundamental reform of removing the cost of education and welfare from the property tax burden is attainable, the committee recommends the interim step of adoption of a general property tax circuit breaker with a $10 million expenditure limit. *See* page 40.

Reimburse Loss of Inventory Taxes Through Revenue Sharing Formula

In 1977 when business inventories are completely exempt from the property tax, reimbursement for lost tax revenues will continue indefinitely in an inconsistent and unjust manner. It is recommended that the reimbursement method be repealed and an equivalent amount be distributed through the State revenue sharing formula to all communities in Maine. *See* page 42.

Personal Income Tax

Income Tax Equity Should be Improved

Until the fundamental reform plan - the shift from property taxes to other broad based taxes - is attainable, the Federal IRS provisions listed above should still be enacted as soon as possible. *See* page 45:

a. Head of Household schedule;

b. Standard (includes low income allowance) deductions;

c. Retirement income credit.

Sales Tax

The Sales Tax Rate Should be Lowered

Until the fundamental reform to sales taxes described above is attainable, the sales tax base should still be expanded to include services and the rate reduced to a level that will generate equivalent revenues. *See* page 45.

D. FINANCING INTERIM REFORMS

Preferred Plan

A majority of the committee recommends that the total amount be funded from an increase in the income tax. *See* page 46. If this proposal is not acceptable, the following options are suggested.

First Alternative

It is a possibility that the income tax could fund a portion of the reform with the remainder (approximately $14 million) being taken from an expansion of the sales tax base with a corresponding reduction of the sales tax rate to 4-1/2%. *See* page 46.

Second Alternative

It is also a possibility that interim reforms could be funded by $15 million income tax increase and imposition of a service levy on inventories. This would eliminate the need for $11.5 million more in inventory reimbursements to the municipalities. *See* page 47.

At the same time, it would be recommended that the current $3.5 million inventory property tax reimbursement method be shifted to the present State-local revenue sharing fund. This would minimize the slight increase in property taxes.

E. REFORMS IN ADMINISTRATION

Property Tax

Tree Growth, Open Space and Farm Land Provisions

As a Fundamental Change, Farm Land, Open Space, and "Tree Growth" Classifications Should be Repealed

Because the committee advocated the substantial reduction of property tax, and thus reducing pressure on farm land, open space and "tree growth" owners to pay high taxes, and because effective land use planning should be done through local zoning regulations and not taxation, our recommendation is that the farm land, open space, and "tree growth" classifications based upon current use valuation be eliminated in the future. *See* page 48.

Until Current Use Classifications of Farm Land, Open Space, and "Tree Growth" Are Repealed, an Investigation and Adjustment in the "Tree Growth" Formula Appear to be Necessary

Due to time constraints, the committee was only able to conclude that the tree growth formula did not adequately reflect the property's value. It is recommended that the Executive or Legislative branch carry out further research into the tree growth formula, specifically as it relates to land values, stumpage and growth rate factors. *See* page 49.

Until They are Repealed, Eliminate Unfair Tax Breaks From Farm Land, Open Space and "Tree Growth" Classifications

a. Because the seller of any of the above properties realizes a tax break during his ownership of land under current use classification, it is recommended that the seller, not the buyer, pay the recapture fee at the time of sale of the property–that fee being equal to the taxes which would have been assessed if the land had been assessed at its fair market value on the date of classification withdrawal or sale less the amount of taxes actually paid plus interest, for the previous ten years (fifteen years for open space).

b. In the case of tree growth land, the above provision would go into effect when the Property Tax Division has a necessary record of fair market valuations.

c. Recapture should be instituted at either the time of ownership change or change in use. Sale of property does not end a classification; only change in use would alter that.

d. To avoide mass transferrals rather than sales of property, a recapture tax should be levied on transfer of property rights.

e. In order to eliminate the so called "gentleman farmer" from undeserved preferential treatment, the committee recommends that farm land classification be defined on the basis of minimum production of \$100 gross income for one year on a tract containing at least ten contiguous acres. The present provision that requires farm production for 3 of 5 calendar years would be eliminated. *See* page 50.

Institutional Property Tax Exemptions

It Should be Locally Optional Whether Exempt Properties Pay in Lieu Service Charges

Because of inequities involved in the exemption from taxation of institutional properties, it is recommended that the legislative body in each municipality be given the option of levying an in lieu assessment that would reflect the cost of services, excluding welfare and education, rendered by the community to various classifications of property tax exempt non-profit institutions. *See* page 52.

The classification of property upon which communities would vote to permit in lieu service charges would be:

a. Church property (excluding houses of worship);

b. Hospital properties;

c. Private colleges, universities, elementary and secondary schools;

d. All other non-profit tax exempt organizations.

State Should Pay Municipalities For Services Provided to State Owned Property

State owned property makes up a great percentage of tax exempt property in many municipalities, thus denying them of substantial revenues. It is recommended that there be consistency in State in lieu assessments for service costs as recommended for other exempt institutions. An appropriation level should be determined in order to reimburse municipalities for service provided to State owned tax exempt property. *See* page 56.

Inheritance and Estate Taxes

"Death" Taxes Should Be Based on the Federal System

a. It is recommended that the current inheritance and estate taxes be repealed and replaced by a single estate tax based upon a percentage of the Federal taxable estate. The rates of such a tax would be graduated upward to insure no loss in revenue.

b. The name of the "Inheritance Tax Division" should be changed to "Estate Tax Division."

c. An estate tax rate should be adopted similar to the schedule attached in Appendix F. *See* page 57.

Income Tax

Nonresident Capital Gains Should be More Efficiently Collected

In order to facilitate better collection (and thus avoid evasion) of the tax on income made on the sale of real estate by nonresidents, the committee recommends that the Bureau of Taxation collect that tax at the point of sale. Sufficient resources should be provided the Bureau to accomplish this task. *See* page 58.

Not Presently Advisable to Have Federal Collection of State Income Taxes

Because Federal collection of State income taxes would cause a lack of flexibility and stability on the part of the State in determining its tax base, it is recommended that the so-called "piggyback" method of tax collection not be adopted as a more administratively efficient manner of collecting State income tax. *See* page 58.

Tax Shelters

No Tax Shelter Adjustments At This Time

The committee recommends that no current action be taken with respect to revision of Maine income taxation affecting so-called tax sheltered investments. *See* page 60.

Unorganized Territory

The Unorganized Territory Should Pay the Uniform Tax For Education, And Be Taxed at a Rate That Pays For the Other Services It Receives

A fairly detailed review of tax expenditures for services to the unorganized territory and the uniform property tax for educational purposes shows that property owners of this part of the State are not paying their fair share of taxes. The unorganized territory pays $6,262,145 in property taxes, yet receives $2,037,430 more than that for services and education from the State. The committee recommends that the Legislature adjust the State tax rate and tree growth formula so that the taxes in the unorganized territory properly reflect services provided it and reflect revenues comparable to what the uniform education tax would yield. *See* page 61.

The Report of the Governor's Tax Policy Committee

AN IDEA WHOSE TIME HAS COME: A TAX POLICY FOR THE STATE OF MAINE

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I

INTRODUCTION

"He (Holmes) did not have a curmudgeon's feelings about his own taxes. A secretary who exclaimed, 'Don't you hate to pay taxes! ' was rebuked with the hot response, 'No, young feller. I like to pay taxes. With them I buy civilization.'"

Frankfurter, Mr. Justice Holmes and the Supreme Court (1939)

Civilization. It is never an inexpensive goal. And in Maine, with its low income levels, chronic unemployment, countless acres of land yet too little industry,(1) it is a goal that cannot be realized without an unusually heavy burden of taxation. In 1973, Maine citizens ranked seventh in the country as to the percent of personal income which is paid for state and local taxes.(2)

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1. The 1973 Maine per capita income was $4,082. Maine consistently has had one of the lowest per capita incomes in the country and the lowest of the New England states. From 1970 through 1974, the State average rate of unemployment was 6.6%, a significant increase over the United States' average of 5.3%. See State Planning Office, Profile of Poverty - Maine (1975).

2. Total State and Local Taxes as a Percent of Personal Income (1963, 1968, 1973)

	Taxes as Percent of Personal Income			Percent Change		National Rank	
	1963	1968	1973	1963-1968	1968-1973	1968	1973
U.S. Average	9.6	10.8	12.9	12.5	19.4	-	-
New England States							
Connecticut	8.5	9.1	13.6	7.1	49.5	46	11
Maine	10.2	10.5	14.2	2.9	35.2	27	7
New Hampshire	9.0	9.1	11.0	1.1	20.9	47	42
Rhode Island	9.7	10.1	12.2	4.1	20.8	31	27
Vermont	11.5	12.5	16.8	8.7	34.4	6	2
Massachusetts	9.6	11.2	14.8	16.7	32.1	20	6

Source: U.S. Department of Commerce, Bureau of Census, Governmental Finances in 1972-1973, Series GF73, No. 5, Table 24, P. 50, and historical data.

This report is not concerned with the issue of whether current State tax revenues are, in the aggregate, too large or too meager. It does not recommend that total taxes be increased. Rather, it urges reforms - both structural and administrative - to the revenue system as it now exists, with the hope of insuring that whatever revenues must be raised, they are levied both equitably and efficiently.

Maine, as other States and cities, has operated for too long without a long-range, publicly debated tax policy. This report seeks to start that debate.

II

CAUTION IN STATE - LOCAL EXPENDITURES

The assignment of this committee concerns only sources of revenue, not how these revenues are expended. However, an important word of caution is in order if all the benefits of tax reform suggested in this report are to be retained for more than a few short years.

From 1963 to 1973 total state and local expenditures increased more than threefold. During the same period the Gross State Product (GSP), a measure of total income generated in Maine, only a little more than doubled. Simultaneously, that part of total Gross State Product going to the State-local public sector has increased from slightly less than 11 percent of GSP to in excess of 16 percent. See Table 11-1, page 4.

A continued imbalance in the growth of the Gross State Product and State-local expenditures would result in a deterioration of our tax base as a source of sufficient revenues. Such an event could lead to a fiscal crisis with both our State and municipal governments being even further hampered in providing services.

The percentage of Maine personal income that is paid in State-local taxes was the seventh highest in the nation.(3) Although the benefits of the services provided by such an expansion are not to be underestimated, it is important to note that five years ago Maine's rank was only 27th.

Great prudence, then, should be exercised in further increasing the public sector's percentage of the Gross State Product. Rather, the primary focus should be on effectively allocating the limited tax resources Maine has and assuring the efficient expenditure of those tax dollars.

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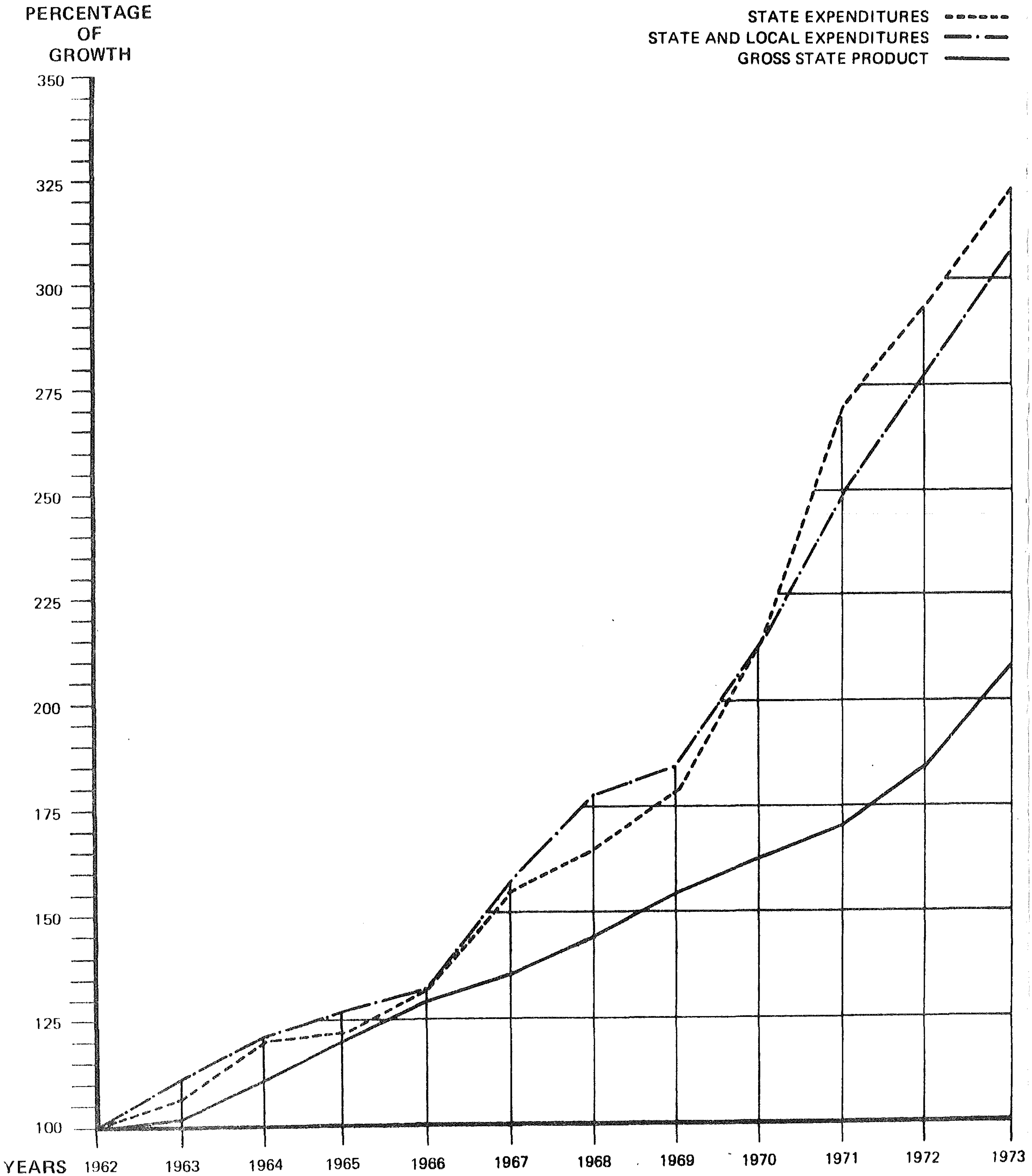
3. Id.

TABLE II-1

GROWTH OF EXPENDITURES FOR THE STATE OF MAINE AND THE STATE AND LOCAL GOVERNMENTS COMBINED COMPARED TO GROSS STATE PRODUCT [4]



SOURCE: UNITED STATES DEPARTMENT OF COMMERCE, CENSUS OF GOVERNMENTS.

4. Federal Reserve Bank of Boston (1975).

III

STANDARDS FOR AN EQUITABLE AND EFFICIENT TAX STRUCTURE

The objectives of a sound tax structure are two: to raise revenues equitably and to provide adequate funds to subsidize necessary services. Tax policy should not be viewed primarily as an instrument of social reform, nor should any tax mix result in severe economic dislocations for any person or community. Therefore, the State of Maine's tax structure should reflect the following characteristics. (For a general analysis of Maine's present tax system, see Appendix A.)

Equity

An equitable tax structure is, most fundamentally, one that reflects each citizen's "ability to pay".(5) This is measured by the degree of vertical and horizontal equity present in the tax structure.

1. Horizontal equity refers to equal treatment of equals; persons in the same relevant financial circumstances should be taxed the same amount.
2. Vertical equity refers to a tax rate that increases as a person's or family's ability to pay increases.

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5. "Ability to pay taxes is the capacity of paying without undue hardship on the part of the person paying or an unacceptable degree of interference with objectives that are considered socially important by other members of the community. If A has more income than B, it seems reasonable that A has a greater ability to pay taxes in the sense that the payment of a given amount will hurt A less and will be less likely to force a cut in socially desirable consumption." Goode, The Individual Income Tax, 18(1964).

Ideally, an equitable tax structure would result in persons paying only what they can afford; unfortunately the general effect of state and local taxes has been regressive[6] when compared to federal taxes.

Competitive Business Climate

The State tax structure must be designed so as to maintain a favorable posture toward the business climate of competing states. While it is generally accepted that tax differences among different locations are not such a dominant factor in industrial development that they should be given primary consideration in the formulation of tax policy, a tax structure should not impede such development and it should, if possible, provide some incentive for economic progress.[7] "Business climate" is perhaps a too narrow concept, for surely any business location is also determined by the quality of life that greets its workers, and it is State tax revenues that, at least in part, provide such quality. A 1973 survey by the Federal Reserve Bank of Boston showed that Maine's total "tax climate index" matched Massachusetts' index as the highest in New England. This was due mainly to Maine's high property taxes and does not speak well for a competitive business climate in Maine:

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6. As used in this report, a tax is regressive if the effect of its rate decreases as ability to pay increases; a tax is proportional if its rate stays the same at all levels of ability to pay; a tax is progressive if its rate increases as ability to pay increases.

7. Advisory Committee on Business Taxation, Report to Governor Kenneth M. Curtis, 2, 35 (1972).

A COMPARISON OF THE LEVELS OF BUSINESS TAXES - 1973(8)

Collections as a Percent of Income Originating in the Business Sector

	Corporation Net Income Taxes	Property Taxes	Other Business Taxes	Unemployment Compensation	Total "Tax Climate Index"
U.S. Average	.9	1.9	.8	.8	4.4
New England States					
Massachusetts	1.3	2.9	.5	1.3	6.0
Connecticut	1.2	2.1	1.1	1.0	5.5
Maine	.5	3.2	1.0	1.3	6.0
New Hampshire	.9	2.4	.6	.6	4.5
Rhode Island	1.1	2.0	1.1	1.3	5.5
Vermont	.7	3.4	.9	.9	5.9

Administrative Efficiency

Not only should the administrative costs of collection bear a reasonable relation to the amount of revenues gained from any tax, but also the taxpayer should not be heavily burdened by a too confusing or complex method of payment.

Stability and Flexibility

Maine's tax structure must strike a balance between a reliable revenue

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8. Only the business portion of the property tax is included. The apportioning of property was based upon the data in Census of Governments, U.S. Bureau of the Census, 1967. Massachusetts' taxes have recently been considerably increased.

Other business taxes include sales and gross receipts tax revenue on insurance and public utilities as well as certain license tax revenues.

Sources: Survey of Current Business, No. 8, 1974. State Tax Collections in 1973 Department of Commerce, Table 3, p. 7; Table 4, p. 8; and Table 5, p. 9. Governmental Finances in 1972-1973, Bureau of the Census, Table 17, pp. 31-33.

yield and the ability to respond to changing economic conditions.

These two principles are of profound significance for State governments. Maine, like many other states, finds itself periodically in a financial crisis due to its inelastic tax structure. A specific tax is income elastic if the natural growth in revenues from that tax is proportionately greater or equal to growth in income. With a revenue elasticity of 1.0 the state-local public sector of the economy would maintain the same growth rate as the total economy. With elasticity of 1.2, growth in the state-local sector would match the automatic growth in National government tax receipts and thereby create a fiscal equilibrium within our federal system.(9) Without some approximation of elasticity, a State is periodically faced with a fiscal crisis: the economy grows, demand for state services increases, yet revenues do not keep pace. Thus tax rates must be adjusted upward. Even after the enactment of the highly elastic personal income tax, Maine's total tax structure remains inelastic. Of the fifty states, Maine ranked 12th from the bottom with an elasticity of .92.(10) Why? Primarily due to its extreme reliance on the very inelastic property tax. Thus, the Legislature must often respond to the revenue needs of the moment without fully anticipating the long range fiscal needs of the State.

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9. An elasticity ranking of 1.0 would mean a proportionate response of the State tax structure to a 1% change in personal income. See Advisory Commission on Intergovernmental Relations (ACIR), Federal-State-Local Finances: Significant Features of Fiscal Federalism, 3(1974). (hereinafter cited as Features of Fiscal Federalism).

10. Id. at 52.

Balanced Tax Structure

Finally, the above standards - equity, competitiveness, efficiency, fiscal stability and flexibility - seem achievable only in a planned, relatively balanced tax structure. To place too great an emphasis on any single State-local tax is to inevitably cause an extraordinary tax burden on some citizens. Maine's tax structure is not balanced; its current mix of taxes is disproportionately weighted toward the property tax:

PRESENT TAX STRUCTURE (1974-75)

	Millions	Percent of Mix
Property	$208.2	39.7%
Sales	137.8	26.3
Personal Income	43.8	8.4
Corporate Income	20.9	4.0
Other (11)	113.2	21.6
	$523.9	100.0%

However, to simply impose a strictly balanced structure on Maine's unique conditions would be to ignore the facts that Maine is a state of low incomes, yet great landed wealth; a State which depends on the trade of vacationers and expends great revenues to insure that the State is worthwhile to visit. Thus, this report will recommend steps by which a balanced tax structure can be achieved while still reflecting the needs and resources characteristic to Maine.

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11. "Other" taxes include all undedicated revenues (alcohol, cigarettes, aeronautical, and miscellaneous business) and the dedicated motor fuel tax.

IV

AREAS OF NEEDED REFORM IN THE MAINE TAX STRUCTURE

Does tax reform mean an increase in the total taxes raised by the State? Not at all. Rather, achievement of the standards listed in Section III can be realized in the Maine tax structure through the following general actions:

1. Designing a more balanced tax structure, one which is suitable to the characteristics of Maine and which places a greater emphasis on the personal income tax and less on the property tax.
2. Refashioning our broad based taxes - income, sales and property - so that each one taxes according to a citizen's ability to pay.
3. Implementing reforms in tax administration that assure more accurate and efficient collection of taxes.

Design of a More Balanced Tax Structure

In Maine the tax structure needs better balance: the property tax accounts for nearly 40% of all State-local revenues, while the income tax accounts for only 8.4%. The property tax levies a burden on a necessity: shelter. (*See* Appendix B, *Who Pays the Local Property Tax?*) Moreover, the *Census of Governments* data documents that as more and more public and business property is exempted from the property tax, it increasingly becomes a tax on housing. In 1969 in Portland, the property tax was estimated at 30.2% of the total cost of shelter.[12] Overall, this tax burden represents on the average 3.8% of a Maine citizen's income. This burden is the

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12. Federal Reserve Bank of Boston, *Options for Fiscal Structure Reform in Massachusetts*, 45(1975) (hereinafter cited as *Options for Fiscal Structure Reform*).

16th heaviest in the country.(13) These are reasons enough to explain why the property tax is popularly felt in this country to be the "least fair" tax of all, federal or state.(14)

What happens when an unbalanced tax structure such as Maine's places this burden on the necessity of housing? The following general results are, by and large, agreed upon by fiscal experts:

1. "Such high property taxes inevitably discourage investment in homes and home improvement and encourage spending on less heavily taxed items as automobiles, boats, travel, and entertainment. More importantly, in some low-income communities high property taxes discourage investments in new apartment houses, office buildings and manufacturing plants."(15)

2. A heavy property tax will magnify assessment mistakes, a deficiency common to communities.(16) High value properties are often under-assessed relative to low-cost residences. Where such variations occur the tax is made regressive.(17)

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13. Id. at 15. See also ACIR, Financing Schools and Property Tax Relief - A State Responsibility, 35-42 (1973).

14. ACIR, Changing Public Attitudes on Governments and Taxes, 9(1975)

15. Id. at 46. See also New Jersey Tax Policy Committee, the Property Tax (1972):" . . Dr. Dick Netzer found that the property tax as now constituted is a deterrent to new housing and the maintenance of existing homes and that it places a particular burden on low-income renters." at 20. (hereinafter cited as New Jersey Tax Policy Committee).

16. The Governor and the 107th Legislature recognized this deficiency by enacting into law L.D. 1917, a comprehensive reform of assessing practices. The Statement of Fact defined this need: "The purpose of this Act is to establish minimal assessing standards for Maine communities that will insure by 1979 equitable assessing practices . . . ."

17. ACIR, Property Tax Circuit Breaker: Current Status and Policy Issues, 14(1975).

3. A too heavy property tax means public services will be distributed with great inequity. The poor of Van Buren or Portland, or any of Maine's urban centers, will pay higher property taxes yet receive less services per dollar. Why? "The tax may be regressive among jurisdictions as well as among individuals. If one jurisdiction consists predominately of low-income families in low-cost housing, while a second jurisdiction is characterized by higher-income families living in higher-valued residences, property tax rates must be higher in the "poor" area in order to provide the same level of services as in the "rich" jurisdiction, other things being equal. The higher rates imposed on the low-income families contribute to the overall regressivity of the property tax."(18)

4. "Excessive property taxes have had an adverse effect upon environmental quality. This stems largely from the unending search of municipalities for tax ratables which is reflected in 'fiscal zoning'. Such zoning contributes to misuse of land resources, misdirected planning, and unnecessary pollution."(19)

5. High property taxes drive more affluent residents to suburbs with lower tax rates, leaving behind the poor and elderly in deteriorating neighborhoods.(20)

6. A high property tax is socially divisive because it encourages "snob" zoning: "Communities which are primarily inhabited by high-income people benefit by having lower tax rates because their inhabitants live in expensive homes which create a substantial tax base. Thus the tax structure provides a built-in incentive for communities to exclude medium and low income people by zoning."(21)

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18. Id.at 14. See also Connecticut Conference of Mayors and Municipalities, Property Taxpayers On the Ropes (1975): "Connecticut's property-poorest cities and towns levy an average tax rate which is more than twice the rate levied in the State's property richest. Yet, on average, the State's property poorest cities and towns can raise less than one quarter of the per capita tax yield raised in the property-rich municipalities. The property poorest town is able to raise less than one eighth of the per capita tax yield raised in the town with the richest property tax base." at 34.

19. New Jersey Tax Policy Committee 19.

20. See Massachusetts Public Finance Project, The Rich Get Richer and the Poor Pay Taxes, 27(1974).

21. Options for Fiscal Structure Reform 12.

These socially damaging effects of a too burdensome property tax clearly recommend that the property tax be made a smaller part of the State tax structure. To what tax should the burden mainly be shifted? The answer is equally clear: the personal income tax. Maine is 16th in the nation in terms of property tax burden yet we are 38th in terms of income tax burden.(22) The personal income tax can absorb most of this shifted burden.

Equitably the income tax is superior to our current property tax as a means of measuring the average person's ability to pay (the income tax reflects family size, the property tax does not) and, at only 8.4% of our current tax mix, it is an extremely underutilized tax source. Specifically, the Advisory Commission on Intergovernmental Relations (ACIR) in Washington suggests that the individual income tax assume a 20-25% share of a State's tax structure for the following reasons:

1. The personal income tax is a highly equitable tax, reflecting both horizontal equity and vertical equity.

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22. INDIVIDUAL INCOME TAX: 1973

	As a Percent of Personal Income		As a Percent of Federal Tax Liability	
	Percent	National Rank	Percent	National Rank
U.S. Average	1.5	-	13.5	-
New England States				
Massachusetts	2.8	6	25.4	9
Connecticut	.3	41	3.1	28
Maine	.8	37	9.1	38
New Hampshire	.2	42	1.9	42
Rhode Island	1.4	22	16.2	18
Vermont	2.6	8	27.6	5

Source: State Tax Collections in 1973, Table 3, p. 7, Table 6, p. 10, Preliminary Statistics of Income 1972, Individual Income Tax Returns, Table 6, p. 25. Prepared by the Federal Reserve Bank of Boston (1975).

2. The personal income tax responds well to economic growth, thereby producing revenue system elasticity. Revenues will grow as the economy grows and new services will not mean an automatic tax increase.[23]

Because Maine is a tourist state and revenue expenditures to accomodate our visitors are significant, the role of the sales tax, which taxes the consumption of both residents and visitors,[24] in the Maine tax structure should be larger than the 20-25% that is also recommended by ACIR. Currently, it is 26.3% of the tax mix and in Section V of this report the committee will recommend a slight increase in this percentage.

While the shift of burden from the property tax to the personal income tax, with slightly increased reliance on the sales tax, would produce the more balanced tax structure Maine needs, this reform is futile if the broad-based taxes that make up that structure do not reflect a person's ability to pay.

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23. Features of Fiscal Federalism 1-4.
The property tax lacks this ability to keep pace with economic growth. This is one of the roots of towns' and cities' failure to provide necessary services without increasing the property tax to an unfair level. John Menario, Portland city manager, described the failings of the property tax for the Commission on Maine's Future and made the following points:

1. Portland has been operating on the same resource base -- property -- since 1820 and it is no longer sufficient;
2. Property tax initially meant a city would be wealthier if it built tightly and as a result many cities were spoiled forever;
3. Industry and buildings, in the long run, only bring higher taxes; in 1973 Portland had its greatest development year with $15 million in new buildings. Today those buildings only produce $460,000 in added property tax revenue, not nearly enough to meet rising costs.

Menario's solution: increase State revenue sharing by returning to communities a percentage of the State income tax. See Sleeper, "City Officials Eye Tax Reform", Portland Press Herald, 1, col. 1 (July 19, 1975).

24. In Maine, 13.8% of our total taxes is generated by tourists; 10.3% is generated by out of State tourists. See Northeast Markets, Tourism in Maine: Analysis and Recommendation, 69(1975).

Refashioning Our Broad Based Taxes So That Persons Are Taxed According to Ability to Pay

The Property Tax

Is the property tax regressive in its incidence? This question in recent years has been heatedly debated. One camp of economists, the traditionalists, theorized that the burden of property taxes on structures (i.e. houses) was borne in proportion to consumption of such commodities and therefore was regressive because consumption of housing looms much larger in a poor person's budget. The other camp, the revisionists, offered a new and more persuasive argument that while the above analysis may be true for a given locality, when the property tax is viewed nationwide it is generally borne by the holders of all capital. Since capital on the average is more concentrated among high-income families than even income, the property tax is progressive.(25)

Thus, while the theorists arguing for a progressive property tax seem correct in their nationwide analysis, the practical burden in different localities might mean an extraordinary property tax for low-income homeowners and renters. Henry Aaron, the most persuasive of the new theorists, admits that despite its over-all theoretical progressivity, some poor do in fact pay more:

> ". . . even with respect to that portion of the tax levied on housing, it (economic analysis) now suggests that the property tax is probably progressive on the average, although some low income families may be exposed to heavy burdens."(26)

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25. Aaron, Henry J., Who Pays the Property Tax?, 19-20 (1975) (hereinafter cited as Who Pays the Property Tax?).

26. Id. at 2 .

Mr. Aaron further states that any progressive estimates should further be tempered by realizing the regressive effect of the Federal income tax on homeowners and renters:

> ". . . property taxes paid by a homeowner are deductible even though gross inputed income on his investment is not counted as part of his income. Such deductibility makes a proportional or even a progressive tax regressive to homeowners since the national Treasury pays a fraction of the property tax of all taxpayers who itemize their deductions."(27)

Therefore in considering whether or not our current property tax in Maine, as it is administered in each locality, with different assessment standards and different degrees of property wealth, is a superior method of measuring ability to pay, it is important to look beyond the theoretical argument of the revisionists and look at Maine's individual householders:

> "It is possible to grant virtually all the points of the revisionists and still maintain that the residential component of the property tax is very regressive indeed, provided one recognizes the pattern of tax rate differentials in metropolitan areas, the associated geographic distribution of renters and owners at various income levels and the way in which assessments are actually done." (28)

Therefore, this report will recommend in Section V that fundamental municipal property tax reform be afforded through a reduction in rates. Resident property tax payers will pay approximately for the services provided them. At reduced rates the lightened property tax burden will more directly correspond to each person's ability to pay. Regressive or progressive, this relief is needed:

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27. Id. at 47.

28. Netzer, Dick, "Is There Too Much Reliance on the Property Tax?", in Property Tax Reform, 21(1973). See also Financing Schools and Property Tax Relief - A State Responsibility, supra note 13 "If the property tax burden falls on renters and consumers, it is regressive throughout the entire income range. If it bears entirely on capital, it is regressive up to the $10,000 - $15,000 income class and becomes progressive in the upper-income ranges." at 31.

"In a real sense the regressivity issue is something of a red herring . . . there would be a need for property tax relief even if the tax were proportional - or even progressive - if the absolute level of the tax worked a hardship on some persons. A reasonable analogy is the need for exemptions to shield subsistence-level income under an income tax that features sharply progressive rates."(29)

The Personal Income Tax

Our State-local tax structure attempts, in the aggregate, to fairly tax each citizen's ability to pay. The measures of this ability are a person's wealth, consumption and income and no single tax can meet these measures alone. Property taxes, for example, do not completely reflect a person's accumulated wealth (e.g. stocks and bonds). Our present consumption taxes do not distinguish between the different buyers of necessities, one who pays with a $100 bill and the poorer person who can pay only in change or food stamps. But of all the broad based taxes, the personal income tax is the most responsive to each citizen's taxpaying capacity.(30)

The personal income tax is the only member of our tax mix that can accurately distinguish between the size of taxpaying families (through

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29. Property Tax Circuit Breakers: Current Status and Policy Issues, supra note 17 at 16.

30. Goode, Richard, The Individual Income Tax (1964):

"Income is an incomplete measure of the quantity of resources at the disposal of a person since it does not take account of wealth which also represents command over resources . . . .

Nevertheless, wealth has a claim for consideration only as a supplementary index of ability to pay. It does not rival income as the primary index. The principal reason is that wealth, as usually defined, does not include the expectation of future income from personal effort . . . it takes no account of economic resources of persons who depend on earnings from personal services." at 21.

personal exemptions) and the different income levels of families (through the graduated rate). However, while the broad mechanism of the personal income tax is a generally equitable source, its accuracy is further enhanced by special rate tables (e.g. joint and single returns) and personal deductions designed to make it a more efficient revenue source. Currently Maine has lagged behind in the adoption of such means of increased accuracy and in Section IX the committee will recommend reform.

The Sales Tax

Of our current taxes, the sales tax is in theory most regressive. However, Maine, by exempting food sold in the grocery store and fuel oil, has removed, on the average, most of the regressiveness from its sales tax.(31)

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31. Features of Fiscal Federalism 12. See also Vars, "Equity Trade-Offs in Sales Taxation", National Tax Journal 657-58 (1975). Vars offers the following sales tax equity analysis:

INDICES OF VERTICAL AND HORIZONTAL EQUITY UNDER ALTERNATIVE RETAIL SALES TAXES

	Indices of	
Type of Retail Sales Tax	Vertical Equity[e]	Horizontal Equity[f]
Broad Based Tax		
Including Food	-0.15	2.54
Exempting Food	-0.04	1.94
Uniform Tax Credit on		
Per Capita Basis[a]	0.02	1.75
Per Family Basis[b]	0.21	1.18
Vanishing Tax Credit Variable on		
Income Per Capita[c]	0.82	0.89
Family Income & Size[d]	1.02	0.61

For reasons expressed above, the committee recommended expanding the sales tax share of the State tax mix. This can be accomplished while also improving the equity of the sales tax in general. How? By gradually transforming the sales tax into a tax more reflective of luxury consumption.

A major deficiency in retail sales tax is its nearly exclusive application to tangible commodities.(32) Through exemptions of specific goods and the near complete avoidance of taxation of services the sales tax base had eroded and become a levy that weighs much heavier on the poor than any other citizen class. This regressivity can be alleviated by expanding the sales tax base and instituting a credit(33) for minimal purchases. The tax then is converted to a levy on luxury consumption.

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31 Continued

$2.60 per capita.

[b] $8.60 per family.

[c] For families with income less than $1,000, the credit equals $10.80 per capita. For every additional $1,000 in family income the credit per capita is reduced by $1.80 vanishing at incomes greater than $6,000.

[d] The credit is the recently enacted New Mexico adoption adjusted to equal the cost of an over-the-counter food exemption.

[e] Vertical equity, in this analysis, is defined as the difference between the mean effective tax rate on families in the 5 highest and 5 lowest income classes under each tax, divided by the mean effective tax rate on all families.

[f] Horizontal equity requires equal treatment of equals (e.g. families equal incomes and equal sizes.

If conditions in Maine match this analysis, then Maine's current sales tax is somewhat horizontally progressive and slightly vertically regressive.

32. Morgan, David, Retail Sales Tax, An Appraisal of New Issues (1964), See also Features of Fiscal Federalism 3; Tax Foundation, State and Local Sales Taxes 21, 63 (1970); ACIR, Fiscal Balance in the American Federal System, 132 (1967); Shannon, John, "Tax Relief For the Poor", Proceedings of the National Tax Association, 1967, 557-596 (1968).

33. "Tax Relief For the Poor", supra note 32: "Recent tax credit innovations on the State sales tax have almost squared the revenue circle - that of maximizing consumer tax yields while minimizing the burden which these levies impose on low income families. Until recently, only the costly exemption approach was used to minimize regressivity of the general sales tax." at 581. See Walters, Elsie, Tax Review, 71 (1970).

The tax credit would be administered through the State personal income tax. Each citizen would be allowed to subtract from the amount of the income taxes owed a sum reflective of sales taxes paid on a minimum standard of living. Poor people who owed no income taxes would receive their credit directly from the State. The credit would be flat-rate--each citizen receiving the same amount. For example, if it were determined that $25 per month of goods and services (not including food, medicine, or medical services) represented a minimum standard of living, then, at a 5% sales tax rate, a person's credit for 12 months would be $15. Thus all other sales taxes paid -- those over $15-- could be considered a tax on "luxury consumption."

Even if the tax credit decided upon only partially reflected non-luxurious consumption, the equity of the sales tax would still be significantly enhanced because wealthier people will naturally purchase every month considerably more than a minimal amount of goods and services.

Thus, for the following reasons the committee will recommend in Section VI to expand the sales tax base to include most services:

1. Expenditures on services tend to rise as incomes rise, thus the higher incomes bear the greater weight; therefore taxation of services tends to make sales tax less regressive. Also expenditures for services rise more rapidly with income than they do for commodities, the yield of the taxes therefore adjusts more exactly in terms of rising levels of economic activity. The inclusion of services in the sales tax base will increase the responsiveness (income elasticity) of the tax to changing economic activity, particularly where the long run trend for growth is gross state income. Taxing services would postively affect progressivity of the tax.

2. Under the philosophy that sales taxes should cover as broad a base of consumer expenditures as possible, with exemption only when specifically justified, the tax should apply to services as well as commodities, since both categories satisfy personal wants. A haircut, concert, or plane ride satisfy personal desires in the same manner as does an automobile, new suit, or piano. If tangibles are taxed and services are excluded from the base, then the sales tax discriminated against individuals whose tastes run to goods as opposed to ones who prefer services. There is no economic feature of most services that warrants their exclusion from taxation. To tax goods but not services distorts the allocation of consumer dollars in favor of services.

3. A number of services (e.g. repairs) are rendered in conjunction with the sale of taxable commodities. Compliance and administration are far simpler if the entire charge is taxable than if a separation between service and commodity is necessary. Compliance costs would be reduced for businesses presently providing both goods and services. Problems in separating tangibles from services would be eliminated. Taxing services facilitates administration and lowers the costs of sales tax.

4. Increased revenues might eventually allow a <u>reduction</u> in sales tax (services share of the economy has increased dramatically). As we become more urbanized, we can expect the services sector to grow. From 1960-1968, spending for services rose by 69%, a rate higher than for commodities (60%). Yet services are not taxed.[34]

Further, the committee will recommend that with this base expansion, a flat rate[35] credit be instituted that will represent, in whole or in part, taxes on that portion of consumption that is not luxurious. Because this expansion of the sales tax base will produce, at a conservative estimate, approximately

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34. <u>State and Local Sales Taxes, supra</u> note 32 at 23.

35. An example of a <u>flat</u> rate credit is Massachusetts' $4 for each taxpayer, $4 for spouse and $8 for each qualified dependent. <u>See</u> Chap. 62 (Sec. 6b added by ch. 14, Acts 1966). Vermont has a variable rate credit, based on income and exemptions. <u>See</u> H.B. 125, Laws 1969; Chap. 152, Sec. 5829. New Mexico has a general low income tax credit that takes into account all state and local taxes paid by residents and is designed so that families below the U.S. poverty level have a total tax burden <u>after credit</u> equal to that of a family at the poverty level.

$29 million in new revenues, (36) the cost of the tax credit is easily assumed.

Appendix C details the equities involved in taxing specific services. For example, the burdens imposed by taxing services such as medical care would not seem acceptable.

The above reform of the sales tax into a levy on luxury consumption - an expanded tax base with a flat credit - produces greater revenues in a far more equitable manner.

Finally, implicit in recommending that the sales tax base be expanded to include most tangible goods and services is recognition of the fact that sales tax exemptions have proliferated in recent years and are rarely reviewed by the Legislature to insure they are still needed. Once exemptions are introduced, interest groups feel free to press for even more, thus leading to a severely eroded sales tax base. A sales tax credit, rather than ever-expanding exemptions, is a more fiscally sound approach to tax relief.

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36. This estimate is based on statistics from the Maine Bureau of Taxation, the Maine State Planning Office and the ESCO 1972 report, State of Maine Government Finances Relief and Reform (1973-1975). The total does not include revenues from a sales tax base including grocery store food and fuel oil or other present sales tax exemptions.

Implementing Reforms in Administration For Greater Efficiency and Elimination of Unfair Tax Breaks

The committee will also recommend, in Section VII, reforms that can be made statutorily or through a change in regulations. These reforms, unlike those above, will not cause a significant shift between Maine citizens in tax burdens but will increase the equity of specific tax measures. Tax legislation is often unpredictable in its market effect. How the consumer or investor will respond to a new tax levy is at best an uncertain science and such "reforms" in administration are periodically necessary.

V

TAX POLICY FOR FUNDAMENTAL REFORM

"To tax and to please, no more than to love and be wise, is not given to man."

- Edmund Burke

No tax exists that pleases. Though these reforms will not increase total tax revenues, burdens will indeed be shifted, both within the tax structure as a whole - from the property tax to the personal income tax and, slightly, the sales tax - and also within individual taxes. The goal: to more properly reflect ability to pay.

How specifically will this more equitable and efficient tax structure be accomplished? The committee is well aware that the fundamental structural reforms this report calls for are dependent on the political process. They are aware that the arguments presented in this report might not immediately be accepted in full. Voters might agree that, yes, change is necessary, but must we go this far at once?

Therefore, two separate structural reform plans are presented. The first will detail the fundamental reform goals the committee feels are essential, the second will offer interim reforms, steps that lead logically to the fundamental changes necessary.

Recommendations For Fundamental Structural Reforms

The Property Tax

1. The Municipal Property Tax Should be Reduced.

The property tax is an increasingly heavy and unfair burden on the necessity of housing. Property taxes should generally

> be restructured to more clearly reflect the costs of the services provided to property. It is recommended that the cost of education and welfare be removed from the property taxes of Maine citizens and the burden of these expenses be shifted to other broad based taxes within the State tax mix. The remaining municipal property taxes (primarily service related) would continue to be collected at the local level for local use. This reform represents, on the average, an approximate 50% reduction in property taxes.

It is fundamental to any discussion of tax reform to realize that the State is as constitutionally responsible for taxes assesed by municipalities as it is for those it assesses itself. The State has both the authority and obligation to remove inequities in local taxation as well as State taxation. As argued above in Section IV, pages 10 to 13, the current municipal property tax burden is too heavy on many people and a poor reflection of each citizen's ability to pay. It should be reduced to a level generally reflective of the services provided to the property in each municipality. This is accomplished by removing the cost of education and welfare from the property tax revenues, thereby producing, on the average, an approximate 50% reduction in property taxes. These expenses, education and welfare, have little relation to local property wealth, and both programs are more equitably funded when their costs are assumed by other broad based taxes.

The remaining municipal property tax - reflecting generally the cost of property related services - would be free to handle only essential municipal needs. However, with such property tax relief will also come the temptation at the local level to raise taxes for non-urgent services. (37) The committee would therefore furthur recommend that for the first fiscal year following property tax relief there be imposed stringent rules on local budget and tax levies so that citizens would at least once be aware of their reduction in taxes. Without such awareness, "local control" seems a empty slogan.

What are the mechanics of this property tax reduction? In order to insure that non-resident property owners pay their fair share of State expenses, the property tax relief will be given residents in the form of an income tax credit.

2. Non-residents should continue to pay their equitable share of property taxes.

Consumption and property holdings are the prime measures of wealth that the State has for non-residents. It is primarily through the property tax and sales tax that the State is able to tax non-residents for their fair share of State expenses. It is recommended that only residents be exempted from paying for education and welfare through the property tax. This exemption will be administered through an income tax credit. Of course residents would continue to pay the same share of education and welfare; but it will be primarily through the more equitable income tax.

37. Financing Schools and Property Tax Relief - A State Responsibility, *supra* note 13: ".... before the relief program is enacted, a State must clarify its objectives to guarantee property tax relief by putting shackles on local government fiscal powers; or to allow local governments to take advantage of the opportunity and use up part or all of their new-found property tax capacity." at 86.

Specifically, the State through the municipalities would assess a property tax on all owners of presently tangible property located in the State. This levy would cover approximately the entire education and welfare costs now borne by all property owners. The tax would be payable to the State and due on the income tax return due date, or April 15 if no income tax return is due. Those exempt would "pay" the tax by the mere attaching of a copy of the tax bill to their tax return. Those partially exempt would pay the non-exempt portion at that time. Renters (lessees) who were State residents would receive an income tax credit or refund to the extent they are exempt. Lessors would be required to notify resident lessees of their proportionate share of the State education-welfare property tax assessed on their leased property.

The resident property owners who would be exempt from that part of the property tax to provide for education and welfare are:

1. Owners of residential property and all other non-business property of a citizen living in Maine (as defined in Maine income tax law).
2. Inventories and stock in trade.
3. Other business property (except leased rental property) to the extent of the ratio of Maine payrolls and Maine property to total payroll and total property. A business whose only business activity outside the State is sales would be totally exempt.
4. Statutorily exempt property (hospitals, schools, etc.)

For non-resident individuals or businesses, current property taxes will not decrease or increase because of these recommended reforms. (38)

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38. The only exception would be non-resident property subject to the "tree growth" valuation provisions. See 36 MRSA § 578, subsection 1.

3. Upon achieving a primarily service related municipal property tax, business inventories should be taxed.

When the municipal property tax burden is reduced to a level that, in general, reflects the specific services a municipality renders to all property within that municipality's limits, then it would be inconsistent to exempt business inventories from taxation. It is recommended that the exemption of business inventories be repealed. Improved information on inventory values should be provided local assessors by the State to more accurately reflect inventory values.

In general, properties that receive a large percentage of a municipality's services - police protection, fire protection, etc. - are business inventories. The present law(39) by 1977 will totally exempt four categories of business inventories: industrial inventories, stock in trade, agricultural produce and forest products and livestock, including fowl. With municipal property taxes reduced to reflect more closely the cost of services rendered, it becomes practical and important to reinstitute inventory taxation. Any property that receives services should be taxed.

Recognizing that in the past it has been difficult to administer this tax, the committee recommends that the Maine corporate and personal income tax forms reflect the average annual inventory data required for the Federal tax, and that the State provide this data to local assessors. This reform, coupled with the lower tax burden, would prevent most serious inequities.

Other possible administrative reforms would be:

a. It is suggested that the sales tax division assess inventory values in communities and then the communities could bill and collect the service charge from these inventories.

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39. See 30 MRSA § 5056.

b. If the inventory tax were to be reinstated, uniform and predictable valuation standards such as an audit appraisal method should be considered.

4. A local, optional, income tax should be made available to the municipalities.

As property taxes would no longer be supporting education, it is recommended that a local, optional, income tax be provided municipalities who wish to make an additional tax effort in order to improve educational quality.

Some communities desire to raise locally additional tax monies for the enhancement of the educational quality of their schools. The committee believes this tax effort should be restricted to the most equitable revenue source - the personal income tax.

The community would set a tax rate, limited to a percentage of its Maine income tax liability. The maximum dollar amount collected would be limited to a percentage of the State educational grant to that community.

ACIR, which cautiously recommends local tax levies, believes the following safeguards are necessary:[40]

1. A uniform local tax base which conforms to that of the State;

2. State administration and collection of the tax.

The Personal Income Tax

1. Increase the income tax's share of the State tax mix.

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40. ACIR, Local Revenue Diversification: Income, Sales Taxes and User Charges, 2-3 (1974).

The income tax is the most equitable of our major tax revenue sources, yet it is by far the least utilized. It is recommended that a large percentage of the cost of education and welfare be shifted from the property tax to the personal income tax.

As described above in Section IV, page 17, the personal income tax is the most equitable, both horizontally and vertically, yet it represents only 8.4% of our current state tax mix. Rather, it should assume a greater percentage of its present share of the tax mix.

This should be accomplished, in general, by maintaining the same degree of relative progressivity and perhaps by adding more income rate levels above the $15,000 or $20,000 adjusted gross income level.

It must be noted that an income tax increase should not be so high as to lessen iniative, reduce incentive, or force people to relocate.

Finally, as discussed in Section IV, page 13, an increased income tax would not only make our tax structure more equitable, but it would improve its income elasticity, thereby making the State revenue system more responsive to changing economic conditions.

2. Income tax equity should be improved.

Various Federal IRS provisions, not present in the Maine personal income tax, increase the equity of the tax as to determining each citizen's ability to pay. It is recommended that the following Federal provisions be incorporated in the State personal income tax:

A. Head of Household Schedule ($100,000 shift in burden);

B. Standard deductions (includes low income allowance) ($4.7 million shift);

C. Retirement Income Credit ($208,500 shift in burden).

Specifically, these Federal provisions are:

1. The Head of Household rates are about half way between the joint and single rates. A head of household is an unmarried person who is nonetheless maintaining a residence for a close dependent (e.g. a father or mother). This recommendation will necessitate an approximately $100,000 shift in tax burdens within the current tax structure.

2. The Standard Deduction is a flat amount which can be taken in lieu of itemized deductions of the individual taxpayer. There are two kinds: the percentage standard deduction and the low income allowance. The shift in burdens: approximately $4.7 million.

3. The Retirement Income Credit is designed to give those who have retirement income, but do not receive tax-exempt social security or similar types of tax-exempt benefit payments, a tax exemption approximately the same as that received by social security beneficiaries. The shift in burdens: approximately $208,500.

How will these shifted burdens be absorbed? Primarily through an increased personal income tax rate but also slightly by an expanded sales tax base.

The Sales Tax

1. The sales tax base should be expanded.

> The current Maine Sales Tax, because it exempts food and heating fuel, has lost most of its regressiveness. Still, in order to be a truly progressive tax, the sales tax base should be expanded to include most tangible goods and services.

By expanding the base, the sales tax will increase its share of the State tax mix. This will insure that visitors pay their fair share of the State's expenses and will produce a balanced tax mix that more accurately reflects Maine's economic character. Moreover, by expanding the base to include personal and business services, the tax is made more equitable:

consumption of services increases with income. See Section IV, pages 19 to 22.

2. Sales tax should become a levy on luxury consumption.

> With a sales tax base that includes most consumption items - goods and services - it becomes possible to convert the sales tax into a tax on luxury consumption. Along with the expanded base, an income tax credit should be instituted which will return to each Maine citizen an amount which in whole or in part, is reflective of a minimum consumption level. Thus, any monies in excess of the credit paid out in sales taxes by a citizen will to a greater degree reflect "luxury" consumption.

The sales tax credit would be a flat rate credit - an equal amount for each Maine citizen. Each person would subtract the specified amount of the credit from his or her owned State income taxes. This would be reflected in decreased deductions from a worker's paycheck witholdings. If a person were out of work or too poor to pay income taxes, he or she would fill out a simple application for the amount of the credit. The sales tax would thus become at least somewhat reflective of "luxury" consumption.

Finally, a credit system would allow the State to more carefully scrutinize current exemptions to the sales tax base. Exemptions are a less accurate and more expensive form of tax relief.

VI

FINANCING FUNDAMENTAL REFORMS

The Committee's fundamental tax plan will require a shift of burdens from the municipal property tax to other more equitable taxes. The total burden that must be shifted is approximately $98.3-million. This figure does not represent an increase in the State's total taxes, but rather an equitable redistribution of the tax burdens within the current revenue sources.

Summary of Fundamental Reform Funding Recommendations

1. The personal income tax should be increased to assume approximately 61% of the shifted burden.

2. The corporate income tax should assume approximately 5% of the shifted burden.

3. The sales tax, with an expanded base and credit, should assume approximately 14% of the shifted burden.

4. Current State property related services should be transferred to the municipalities.

5. The cost-avoidance of inventory tax reimbursements should fund approximately 15% of the shifted burden.

6. An increase in the real estate transfer tax should fund a portion of the shifted burden.

7. The tax on domestic insurance companies' premiums should fund approximately .5% of the shifted burden.

1. The Personal Income Tax

The personal income tax should be increased to assume approximately 61% of the $98.3-million shifted burden. The present vertical progressivity of the tax should be maintained or slightly improved in the upper income brackets. Such an increase would place the income tax's share of State revenues at a reasonable 20-21%.

As we have noted, the income tax has the ability to handle a greater burden of revenue production in the future.

By relying more greatly on the personal income tax, the fairness of State-local taxation would be improved by permitting a greater share of tax burden to be adjusted to family size - "a criterion typically disregarded by the property tax and violated by the sales tax."(41)

Reliance on the State personal income tax for a much greater percentage of all tax revenue would "both tone up the equity features of the system and insure an overall State-local system elasticity of between 1 and 1.2 ....."(42) Thus matching the automatic growth rate of the economy.

In comparison with other states' income tax rates, Maine's rates are relatively low. The State ranked 39th (in 1973) nationwide in paid personal income tax as a percent of total personal income (.75% of personal income; national average is 1.41%).(43) In their report to Governor Curtis in 1972,

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41. Features of Fiscal Federalism 2.

42. Id at 1-2.

43. Carol S. Meyers, A Comparison of State and Local Tax Effort in the District of Columbia and the Fifty States, 7 (1975).

ESCO Research, Inc. reported that in that year, more than 99.7% of Maine residents paid less than one-half of the national median rates in their income brackets.(44)

A plan maintaining the same relative progressivity could be developed to raise any amount of revenues needed. In addition, more levels could equitably be built into higher income brackets in order to produce additional revenues.

2. Corporate Income Tax

> The dramatic reduction in property taxes will result in a significant drop in business tax levels. The corporate income tax should assume approximately 5% of the shifted burden.

To help finance the fundamental reforms, it is suggested that the corporate income tax be increased in one of the two following manners:

1. 6% for corporate incomes under $25,000 and 8% for those incomes above that level.
2. 6% for incomes under $25,000, 7% for those between $25,000 and $50,000 and 8% for incomes above $50,000.

It is estimated that the former schedule would yield approximately $5-million over present revenues, which now yield only 4.0% of State-local revenues. Because property tax is a business as well as residential tax, corporations will receive a substantial benefit when property taxes are reduced. The corporate income tax could be one of the methods used to absorb the loss of property tax revenues.

44. ESCO Research, Inc., State of Maine Government Finances Relief and Reform 1973-1975, 60 (1972). (hereinafter cited as ESCO report).

Currently, Maine and New Hampshire have the lowest maximum corporate income tax rates in New England (7%).[45] According to the ESCO report, the business community much prefers corporate income taxes in lieu of other unfair business taxes becuase that tax better reflects corporate profits and is better administered.[46]

A 1971 report by the Tax Institute of America stated, "so long as the corporate income tax in a state is reasonably comparable to those of other states and to the personal income tax, there is no reason to believe that the tax has significantly affected locational decisions."[47] That same report also noted that poorly administered and excessive property tax policies discouraged industrial expansion and location more than did the corporate income tax rates. A report to Governor Curtis by the Advisory Committee on Business Taxation comments in the same area by pointing out "that taxes as a factor, though important, are not the major consideration in stimulating or retarding economic growth."[48]

3. The Sales Tax

> The sales tax base should be expanded to include most tangible goods and services with a credit instituted, thereby converting the sales tax into a tax to a greater degree reflecting luxury consumption. This expanded sales tax should assume approximately 14% of the shifted burden.[49]

45. A Comparison of State and Local Tax Effort in the District of Columbia and the Fifty States, 8 (1975).

46. ESCO Report, 58-59.

47. Id. 58-59.

48. Advisory Committee on Business Taxation, Report to Governor Kenneth M. Curtis, 38 (September 12, 1972).

49. Passed 10-1 by vote of the Committee.

"Excluding services from the tax base makes the sales tax even more regressive, since purchases of services become increasingly more important as one moves up the income scale."(50) ACIR also points out that Maine was one of the five states in 1971 that met the productivity and anti-regressivity tests of the sales tax; however, expansion to services combined with a credit would be even more progressive and productive in the future and might be more politically acceptable. Because the expanded base would provide $29-million or more in revenue (at 5%), it could, even with a credit, bring to the state substantial revenues.

Tax Foundation estimates that exemption of services costs 14% of potential tax revenues. They ask, "Why tax the purchase of a washing machine while exempting a commercial laundry?"(51) If tangibles are taxed and services excluded from the base, then the sales tax discriminates against individuals whose tastes run to goods as opposed to those who prefer services. There seems to be no inherent economic feature of most services that warrants their exclusion from taxation. Taxation of services is also an appropriate method of gaining additional revenues from transients and seasonal residents: visitors who enjoy our state yet otherwise do not contribute their full share to the cost of State expenditures.

To offset much of the effect that taxation of services may have on lower income groups, an income tax credit for general sales taxes paid, such as employed in several states, should be adopted. This credit would be based upon a minimum consumption level of items that are taxed at the point of sale. This would further the Committee's concept of the sales tax as a levy

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50. Features of Fiscal Federalism, 3.

51. State and Local Sales Taxes, supra note 32 at 23 .

on luxury consumption.

4. Current State Property Related Services

It is recommended that the State transfer to the municipalities the cost of some property related services currently provided by the State.

5. Taxation of Inventories

With the conversion of the municipal property tax to a tax more closely reflective of the services provided property, business inventories should again be taxed. This reform will eliminate the $11.5-million that still must be raised under 30 MRSA 5056 to reimburse municipalities for revenues lost when business inventories were phased out from property taxes in 1973. (See Section V, Pages 28 & 29) . This cost avoidance will represent approximately 15% of the shifted burden.

6. Real Estate Transfer Tax

Because the fundamental reform plan will lower property taxes, on the average, by 50%, it is reasonable to increase the current real estate transfer tax formula. Property owners gain from such relief.

In considering the pitfalls for general property tax relief, Henry Aaron, in Who Pays The Property Tax, agrees with the ACIR observation that:
tion that:

> ....a sudden change in property taxes will affect how investors view the market and could result in some dramatic economic effects.
>
> Because the property tax is deeply entrenched in the capital structure, the economic consequences of a drastic reduction, say 50% of all classes of property, should be taken into account when property tax relief is proposed. Owners of land, whether occupied or vacant, would reap large gains. Owners of houses and other buildings would experience somewhat smaller gains.[52]

52. Who Pays the Property Tax?, 64-65.

7. Domestic Insurance Premium Tax

The tax on domestic insurance companies should be raised to 2% of premiums and fund approximately 0.5% of the shifted burden.

It is very interesting to compare the approximate tax structure that results from these fundamental reforms with the tax mix suggested as a general guide by ACIR:

Taxed	Present Mix	ACIR (53)	Fundamental Reforms
Property	39.7%	20-30%	21.5% (app.)
Sales	26.3%	20-25%	29.5% (app.)
Personal Income	8.4%	20-25%	20.4% (app.)
Corporate Income	4.0%	5%	5.5% (app.)
All Other	21.6%	20%	23.1% (app.)

The result is a generally balanced tax structure, reflective of Maine's identity as a valued vacation area.

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53. Features of Fiscal Federalism 1 - 2.

VII

TAX POLICY FOR INTERIM REFORM

If, politically, the arguments for the above fundamental reforms are too new and unfamiliar to be accepted by the public, the committee feels the following interim steps, each of which leads toward the fundamental reforms listed above, be instituted.

The Property Tax

1. Institute a general property tax "circuit breaker".

Until the fundamental reform of removing the cost of education and welfare from the property tax burden is attainable, the committee recommends the interim step of adoption of a general property tax circuit breaker with a $10 million expenditure limit.

The ACIR in 1975 strongly recommended the adoption of a property tax circuit breaker:

> "The property tax can quickly create a disproportionate claim on a family's financial resources once retirement, the death or physical disability of the bread-winner, or unemployment reduce sharply the flow of income. Local governments as a rule have neither the legal authority nor the fiscal capacity to alleviate the potential property tax over-burden situations, but States have both. Twenty-two States now have an efficient tax relief mechanism designed to avoid the special hardships frequently experienced by low-income property owners, pioneered by Wisconsin in 1964. Low-income elderly homeowners, and frequently renters, in these States can claim a State-financed tax credit, rebate, or reduction in tax for that portion of their property tax liability deemed by the legislature to be excessive in relation to their household income. Because the program becomes effective when the property tax is high in relationship to income and thus prevents property tax overloads without cutting off the flow of revenue from those able to pay, this concept is known as the circuit-breaker."(54)

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54. Property Tax Circuit Breaker: Current Status and Policy Issues, supra note 17 at 27.

> "To the extent that landlords can shift the property tax to tenants, low-income households in rented quarters also feel the pinch of extraordinary property tax burdens in relation to current income. Most of the circuit-breaker States have recognized this by establishing a percentage of gross rent constituting property taxes accrued. This percentage serves as the property tax equivalent which renters may use in computing their credit or rebate."

> "As a means of preventing fiscal overburdens, the circuit-breaker has unique advantages. Because this tax relief program is financed from State funds, it neither erodes the local tax base or interferes in any way with the local assessment or rate-setting processes. It can be designed to maximize the amount of aid extended to low-income home-owners and renters while minimizing loss of revenue. It operates to reduce intergovernmental fiscal disparities between high and low-income communities as well as reducing disparities between high and low-income persons; because the poor tend to be clustered together, the major portion of the relief will rebound to the benefit of both low-income households and low-income communities."

The committee endorses generally the provisions of LD 1671, AN ACT to Provide State Relief to Householders for Extraordinary Property Tax Burdens (107th Legislature), with the provision that a $10 million limit be placed on expenditures for the non-elderly portion of its formula. This circuit breaker's specific formula is as follows: (55)

> For any taxable year, a claimant shall be entitled to a refund equal to 60% of the amount by which the property taxes, or rent constituting property taxes, upon the individual's homestead for the taxable year exceeds a percentage of the individual's income for the taxable year determined according to the following schedule:

If Household Income (Rounded to the Nearest Income) is:	Then the Taxpayer is Entitled to 60% Credit for the Property Tax Paid in Excess of this Percent of that Income
$ 3,999	4.0%
4,000 - 7,999	4.5%
8,000 -11,999	5.0%
12,000 -15,999	5.5%
16,000 -and up	6.0%

55. Under LD 1671, Maine's current elderly property tax relief program would be unchanged. See 36 M.R.S.A., Part 9, Chapter 901.

> Limitation. No refund or grant under this chapter shall exceed $500. In no event shall the refund exceed the amount of the property tax. See Appendix E for comparison of the impact on typical taxpayers relief and the relief realized from conversion to a municipal property tax (the Fundamental Reform Plan - cost of welfare and education eliminated from property tax burden.)

2. Reimburse loss of inventory taxes through revenue sharing formula.

In 1977 when business inventories are completely exempt from the property tax, reimbursement for lost tax revenues will continue indefinitely in an inconsistent and unjust manner. It is recommended that the reimbursement method be repealed and an equivalent amount be distributed through the State revenue sharing formula to all communities in Maine.

By 1977 the amount of annual reimbursement made to municipalities that have lost tax revenues from the exemption of business inventories - industrial inventories, stock in trade, agriculture, produce and forest products and livestock - will equal $15 million annually. By statute, this reimbursement will continue forever. $11½ million of the total expense has not yet been budgeted for. Although many states have provided for a phasing out of the inventory tax and reimbursements over a period of years, Maine law, for some unknown reason, provided no definite time limit for reimbursement to the communities (who may be able to replace these lost revenues through inflation or new valuations, although they argue otherwise). In 1965, Connecticut began a phase out of taxes on inventories over a ten year period ending this year. Valuations were reduced ten percent each year until total exemption was reached in 1975. Rhode Island exempted inventories in 1966, but imposed a ten percent surtax on corporation income tax payments so some revenue could be recovered.(56)

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56. P.F Liniger, "Exemptions of Inventories from Ad Valorem Taxation," in Proceedings of the National Tax Association, 1966, 500, 1967.

According to the State Property Tax Division, there were several reasons for the elimination of the inventory tax:

1. Adjoining states do not have such a tax thus the fear that business and industry would relocate elsewhere.

2. During the past few years, more and more states have dropped the tax.

3. Warehousing and construction in Maine were suffering, thus jobs were being lost.

4. The tax was the most difficult to administer and enforce; the inventory (personal property) hardest to value; and the tax was the most onerous of all taxes.

There is substantial evidence that too heavy taxation of inventories is contrary to the principal theories of taxation: "It frequently is a more significant tax on enterprises with least ability to pay taxes, and given the widely varing physical characteristics of inventories, there is not necessarily any relationship between taxes paid and amount of services received."(57)

Other reasons for not taxing business inventories are:

1. It is difficult to administer and enforce.

2. It is not difficult for a business, under the present system, to deceive the State in its inventory estimate.

3. Competition arises between towns who attempt to attract business by offering low assessments as a deal with that business. This makes administration difficult and abuses at the local level more frequent.

4. It treats different businesses unequally and unfairly. A car dealer's inventory is easily accountable because it's on his front lot; however, an antique business has items that an assessor can never find, much less value. Also, many businesses such as hardware stores keep many items in stock for years and pay a tax on them each year, not just once. It is actually a tax placed on material that is not producing an income to the owner.

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57. Id. at 500.

However, as was stated above in our recommendation of a fundamental reduction in the property tax burden, these disadvantages are manageable if the currently too heavy property tax burden were reduced to more closely reflect services provided them and if the State provides local assessors with the inventory assessments which are found on the Federal Income Tax form. See Section V, pages 28 to 29. But if such fundamental reform is not immediately acceptable, then interim reform must be brought to the method of indefinite reimbursement selected by the Legislature.

To show the absurdity of indefinite reimbursements, here is one blunt example: Winslow will receive reimbursements forever for the inventory of Scott Paper which will close its doors there when its new Skowhegan plant opens. Skowhegan will receive nothing although the industry will be located in its town. That is to be expected because it lost no inventory tax. However, Winslow will collect over $123,000 each year for an industry that is not even in town.

Moreover, many inventory rich municipalities are doubly blessed by these reimbursements, to the detriment of all other Maine municipalities. Because of the lower valuations due to inventory exemption, the state tax rate for education is $\frac{1}{2}$ mill higher so as to compensate for loss of tax revenue. The small and coastal communities, which have little industry, must therefore pay more in state funding of education while not receiving a reimbursement. Appendix D, Tables 1 and 2 are good indicators of what is occuring in state valuation for education compared with reimbursements.

From our charts, we can see that the larger industrial communities are gaining substantially from the inventory exemption bill while rich coastal and non-industrial towns are paying more for education than they should.

Thus, the committee recommends that reimbursements for lost revenues cease and instead the State should distribute an equivalent amount through the State revenue sharing formula[58] to all municipalities in Maine. For selected municipalities' shares, see Appendix D.

Such a distribution of monies would provide greatly needed revenue sharing funds and would insure that towns unfortunate enough to lack significant inventories would not be forced to pay an inflated share of such state costs as education and welfare.

Again, if the fundamental property tax reforms recommended above were enacted, such measures would not be needed.

Personal Income Tax

1. Income tax equity should be improved.

Until the fundamental reform plan - the shift from property taxes to other broad based taxes - is attainable, the federal IRS provisions listed above should still be enacted as soon as possible. See Section V , page 30:

A. Head of Household Schedule;
B. Standard (includes low income allowance) deductions;
C. Retirement income credit.

Sales Tax

1. The sales tax rate should be lowered.

Until the fundamental reform to sales taxes described above is attainable, the sales tax base should be expanded to include services and the rate reduced to a level that will generate equivalent revenues.

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58. 30 M.R.S.A. § 5055 . The State revenue sharing formula equals the product of municipal population and tax commitment divided by State valuation.

VIII

FINANCING INTERIM REFORMS

If the fundamental reform plan is not attainable in the immediate future, then the committee, in Section VII, proposed an interim reform plan, one that leads toward the fundamental changes felt necessary. The interim reform plan would mean a $26.5-million shift in tax burdens.(59) The Committee offers three optional funding plans.

Preferred Plan

A majority of the committee recommends that the total amount be funded from an increase in the income tax.

It seems clear that an income tax increase is necessary to fund some part of any reform. "The personal income tax should stand out as the single most important revenue instrument in the State tax system....."(60) Because the income tax currently provides only 8.4% of total State-local revenues and because it most closely approximates what society considers as an equitable manner of distributing costs, the income tax seems to be the levy most able to be expanded and most consistent with the Committee's goal of a tax system based upon ability to pay.

First Alternative

It is also a possibility that the reforms be funded by an approximately $12-million income tax increase and that the sales tax base be expanded to include almost all goods and services. This increase would allow a reduction in the sales tax rate to 4½% while also raising the necessary $14-million. (61)

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59. $26.5-million equals $5-million for income tax reforms; $10-million for the property tax circuit breaker; and $11.5-million inventory reimbursements through the State-local revenue sharing formula.

60. Features of Fiscal Federalism 1.

61. Expansion of the base at 4½% would provide about $27-million; reduction of the rate would mean a loss of about $13.75-million

As a Second Alternative

Interim reforms could be funded by $15-million income tax increase and imposition of a service levy on inventories. This would eliminate the need for $11.5-million more in inventory reimbursements to the municipalities.

At the same time, it would be recommended that the current $3.5-million inventory property tax reimbursement method be shifted to the present State-local revenue sharing fund. This would minimize the slight increase in property taxes.

As a means toward the Committee's fundamental goal of the municipal property tax more closely reflecting services rendered, the assessment of inventories for in lieu service assessments is a key factor. In this particular package, inventories would be charged for services while all other property would be assessed the regular amount. The $3.5-million currently budgeted for reimbursement to the municipalities for revenues lost when business inventories were exempted from taxation in 1973 should be distributed through the State-municipal revenue sharing formula, thereby minimizing the increase in property taxes.

Finally, Appendix E details the different reductions in tax butdens under both the Fundamental Reform plan and the Interim Reform plan.

IX

REFORMS IN ADMINISTRATION

FOR GREATER EFFICIENCY AND ELIMINATION OF UNFAIR TAX BREAKS

To find a value good and true,
Here are three things for you to do:
Consider your replacement cost,
Determine value that is lost,
Analyze your sales to see
What market value really should be
Now if these suggestions are not clear,
Copy the figures you used last year.[62]

Anonymous

In addition to the above structural reforms designed to produce in general a more balanced tax system and, specifically, broad based taxes based on a person's ability to pay, the committee also recommends the following reforms to be accomplished through statutory change or revision of agency regulations.

Property Tax

Tree Growth,[63] Open Space and Farm Land[64] Provisions

1. Farm Land, Open Space and Tree Growth" classifications should be repealed.

Because the committee advocates the substantial reduction of property tax, thus reducing pressure on farm land, open space, and "tree growth" owners to pay high taxes, and because effective land use planning should be done through local zoning regulations and not taxation, our recommendation is that the farm land, open space, and "tree growth" classifications based upon current use valuation be eliminated in the future.

62. Who Pays the Property Tax? 56.

63. 36 M.R.S.A. § 574.

64. 36 M.R.S.A. § 585.

In our fundamental reform package, we have recommended the elimination of welfare and education support from the municipal property tax, thus, on the average, municipal property taxes will be reduced by fifty percent.

Resident farmland, tree growth land, and open space owners will then be able to afford to pay in lieu assessments for services rendered, therefore there would be little need for preferential treatment in land valuation.

According to Henry J. Aaron, special farmland treatment is inequitable because such treatment reduces taxes for owners of rapidly appreciating assets and therefore rapidly growing wealth. There is no indication that this land is an illiquid asset, that farmers as a class are unwilling to farm land owned by themselves or others, or that they are unable to negotiate bank loans.[65] Thus, these people can pay their fair share of a reduced property tax while the land remains at a use that is consistent with state and local desires.

In accordance with the committee's belief that state-local tax policy should not be a means toward social policy, it is felt that public control of land use can be better handled by zoning laws rather than by statutory tax laws, that place the classification option in the hands of the individual, which is not the best method of land use planning. If communities wish to maintain land for a particular use, then zoning regulations would effect that policy.

2. Until current use classifications of farm land, open space and tree growth land are repealed, an investigation and adjustment in the tree growth formula appears necessary.

Due to time constraints the committee was only able to conclude that the tree growth formula did not adequately reflect the property's value. It is recommended that the Executive or Legislative branch carry out further research into the tree growth formula, specifically as it relates to land values, stumpage and growth rate factors.

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65. Who Pays the Property Tax? (86)

research into the tree growth formula, specifically as it relates to land values, stumpage and growth rate factors.

3. Eliminate unfair tax breaks from "Tree Growth", Open Space and Farm Land provisions, until classifications are repealed.

A. Because the seller of any of the above properties realizes a tax break during his ownership of land under current use classification,(66) it is recommended that the seller, not the buyer, pay the recapture fee at the time of sale of the property -- that fee being equal to the taxes which would have been assessed if the land had been assessed at its fair market value on the date of classification withdrawal or sale less the amount of taxes actually paid plus interest, for the previous ten years (fifteen years for open space).

B. In the case of tree growth land, the above provision would go into effect when the Property Tax Division has a necessary record on fair market valuation. (67) (67)

C. Recapture should be instituted at either the time of ownership change or change in use. Sale of property does not end a classification; only change in use would alter that.

D. To avoid mass transferrals rather than sales of property, a recapture tax should be levied on transfer of property rights.

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66. *Id.* at 56.

67. Currently, records of fair market valuation of tree growth property go back only two years.

E. In order to eliminate the so called "gentleman farmer" from undeserved preferential treatment, the committee recommends that farmland classification be defined on the basis of minimum production of $100 gross income for one year on a tract containing at least ten contiguous acres. The present provision that requires farm production for 3 of 5 calendar years would be eliminated.

The device of assessing these lands at current value was originally intended to shield farmers, etc., from the rise in taxes on rapidly appreciating land prices and to encourage the continued use of the land in either of the three classifications (tree growth, open space, or farmland). Because the owners of farmland and open space could not afford such fair market taxation out of their income, it was felt that many would be forced to sell land to developers and speculators, who would alter the use of the land. Elderly farmers would be forced off of their land at an age when they could not easily pursue another profession. In the case of tree growth valuation, the feeling was that classifying and assessing forestland in this manner would promote better management of the unorganized territory's forested areas. The special classifications are also looked upon as a method "to limit the social and human costs of unplanned growth",(68) to conserve these areas for the purposes of farmland, open space, and forestland, and to avoid a resulting change in use or poor management technique. Recapture penalties attempt to discourage the classification change.

However, it is now thought by tax experts that special classification of land provides an additional tax break and boon to the owners of a valuable and appreciating asset, at the expense of other taxpayers:

> While a tax break on such land may be desirable to protect those who wish to continue farming from experiencing unfavorable cash flow, the deferred taxes should be recovered when the farmland is sold.(69)

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68. Who Pays the Property Tax 85.

69. Id. at 95.

Therefore, the seller should be liable for payment, for ten years of preferred tax break in the case of tree growth land and farmland, and fifteen years for open space.

At the present time, the tree growth recapture penalty is the greater of a) an amount equal to the taxes which would have been assessed if the land had been assessed at its fair market value on the date of withdrawal of classification less the amount of taxes actually paid, for the previous 5 years, or b) an amount equal to the percentage of difference between the 100% valuation of the land as classified on the assessment date preceding withdrawal, and the fair market value of property on the date of withdrawal. The committee's recommendation, which applies to sale as well as withdrawal, would eliminate part b and change five years to ten years, thus making the recapture provision on farmland, forestland, and open space virtually the same.

Institutional Property Tax Exemptions

1. It should be locally optional whether exempt properties pay in lieu service charges.

Because of inequities involved in the exemption from taxation of institutional properties, it is recommended that the legislative body in each municipality be given the option of levying in lieu assessments that would reflect the cost of services, excluding welfare and education, rendered by the community to various classifications of property tax exempt non-profit institutions.

The classification of property upon which communities could vote to permit in lieu service payments would be:

A. Church property (excluding house of worship)
B. Hospital properties
C. Private colleges, universities, elementary and secondary schools
D. All other non-profit tax exempt organizations.

By allowing local governments the option of charging in lieu service charges for currently tax exempt properties, the committee is, in effect, recognizing that only municipalities have the capacity to determine whether these properties should pay service assessments. Their decision would be based upon the influence that these properties have upon tax base, quality of life, and short or long term capitol gains and losses. Possibly, for example, Brunswick may decide that because Bowdoin College provides so much of a benefit to the community, and serves such a public purpose, in lieu service charges would not be needed, or vice versa.[70]

Local decision makers would be accountable to the voters for their exemption policies. Local citizens could no longer claim to be paying the tax burden for other exempt properties because their representative council members or selectmen would be deciding who should pay service assessments, or the citizens themselves would, through referendum, be making the decisions.

But, the committee is also recognizing that those properties place a heavy burden on these communities for provision of such essential service as polic and fire protection, street lighting, sewage disposal and treatment, snow removal and so forth -- a burden that is subsidized by the owners of taxable property in these municipalities.[71] In most areas of the state, tax exempt property is expanding quickly and eroding municipal resources. According to the study, Institutional Property Tax Exemptions in Maine, there is $1.89 billion of tax exempt property in the State, accounting for 20% of taxable property plus exempt real property.[72] According to Fortune

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70. For complete examination of the tax exemption problem, see D. Wihry and S. Burnham, Institutional Property Tax Exemptions in Maine, June 1975.

71. Property Taxpayers on the Ropes, supra note 18 at 37..

72. Institutional Property Tax Exemptions in Maine, supra note 70 at 36 .

magazine, in 1972, one third of real property in the U.S. is exempt. (73)

Just a few examples of the effect of tax exemptions on Maine communities show that Bangor contains $209.9 million of tax exempt property which amounts to more property value than is presumably taxed in the city ($202.5 million). Thirty two percent of total property in Farmington is exempt. In Limestone, 72% of the town's total property is exempt from taxation. (74) As it was noted in Section IV, property tax exemptions mean the property tax is increasingly becoming a tax on housing.

Besides the revenue loss due to exemptions, which is "highly uneven among taxing jurisdictions, being concentrated in large central cities and smaller places that are sites for state capitals, universities, Federal installations, large medical centers, and the like",(75) there are several other key factors involved in the committee's decision to recommend service assessments:

1) "Property tax is an erratic and inefficient form of subsidy."(76) Subsidies should be open, direct, and periodically reviewed, suggestions that exemptions violate. (77)

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73. Alfred Balk, "The Extent and Economic Effect of Property Tax Exemptions," in Proceedings of the 65th Annual Conference on Taxation, National Tax Association, 264 (1972).

74. Institutional Property Tax Exemptions in Maine, supra note 70 at 235-76.

75. Options for Fiscal Structure Reform 45.

76. Dick Netzer, "Property Tax Exemptions and Their Effects: A Dissenting View," in Proceedings of the 65th Annual Conference, National Tax Association, 268 (1972).

77. Id. at 269.

2) Haphazard exemption patterns " . . . for all their good intentions along with selfish interests that untie them, tend to cause over building by exempt institutions such as churches -- and where exempt, fraternal/civic welfare groups. It fosters careless acquisition of government land; malapportional hidden subsidies to only some poor, aging, veterans, and industrial entrepreneurs; inhibition of necessary park and recreation land acquisition for fear of further contracting the shrinking tax base; and added burdens to already troubled central cities on whose welfare the nation -- and those cities suburbs -- depend."(78)

3) The impact of property tax exemptions tends to be unequal and in many instances a community must bear the exemptions for an institution that serves a must wider area.(79) This case is especially true for large communities such as Bangor and Portland whose institutions provide innumerable services for outlying areas who do not share in the tax burden.

4) The use of exemptions leads to overstimulation of those activities relative to the level that would be generated(80) with a service fee concept. As tax exempt institutions acquire or inherit more and more property which becomes tax exempt, the municipality loses some of its taxable base, thus the need to raise taxes for others.

5) Exemptions cause short term capitol losses to property owners whose property lies in areas with exempt property.(81)

6) The units of government that suffer the revenue losses do not make the decisions about tax exemptions; these are imposed by state legislatures who do not have to live with the consequences of their decisions.(82) Legislatures gain political benefits by aiding those in need of relief and thereby injure local governments with their benevolence.(83) By imposing

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78. "The Extent and Economic Effect of Property Tax Exemptions," _supra_ note 73 at 266.

79. _See_ _New Jersey Tax Policy Committee_ 30-40.

80. _Id._ at 30.

81. _Institutional Property Tax Exemptions in Maine_, _supra_ note 7 at 125.

82. "Property Tax Exemptions and Their Effects: A Dissenting View", _supra_ note 76 at 268.

83. _Who Pays the Property Tax?_ 84.

> exemptions, legislatures are giving blind subsidies "which cannot be reviewed and fixed by those who pay it, as sound finance demands."(84)

It is a fact that exempt institution properties are receiving valuable services at no cost. In the interest of furthering the committee's goals that all property (in the future) shall pay for the services provided to it, and that everyone begin to pay a fair share, the committee has recommended that the local option be given to these communities to get back a portion of lost revenues and thus have the opportunity to lower property taxes or maintain the level of services to all.

2. <u>State should pay municipalities for services provided to State-owned property.</u>

3. State owned property(85) makes up a great percentage of tax exempt property in many municipalities, thus denying them of substantial revenues. <u>It is recommended that there be consistency in State in lieu assessments for service costs as recommended for other exempt institutions. An appropriation level should be determined in order to reimburse municipalities for services provided to state owned tax exempt property.</u>

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84. <u>New Jersey Tax Policy Committee</u> 30.
This New Jersey study identifies a number of criteria which should be applied when evaluating any property tax exemptions. These could be used by local governments when determining which property should pay a service fee.
1) The property tax loss should be clearly identified and considered a cost of government.
2) Exemptions should have clearly defined objectives and benefit to the community.
3) No exemption should be granted if it benefits one group at the expense of another equally disadvantaged group.
4) No exemption should be granted if it costs more to administer than the cost of an alternative public program.

85. It would serve little purpose for a municipality to tax municipal-owned property. Of course, federal property cannot be taxed by a lesser jurisdiction.

Inheritance and Estate Taxes

1. "Death" taxes should be based on the federal system.

It is recommended that the current inheritance and estate taxes be repealed and replaced by a single estate tax based upon a percentage of the Federal taxable estate. The rates of such a tax would be graduated upward to insure no loss in revenue.

2. The name of the "Inheritance Tax Division" should be changed to "Estate Tax Division".

3. An estate tax rate should be adopted similar to the schedule attached in Appendix F.

The committee has found that a single estate tax, based on a percentage of the Federal taxable estate, would be a more efficient alternative for the collection of so-called "death taxes". This single estate tax would replace the current State inheritance tax and current State estate tax. If such a "piggyback" estate tax were adopted, less than 40% of the returns now processed would have to be handled, thus reducing administrative costs. A tax of this kind is "self assessing" (payment is submitted with the return). See Appendix F for suggested new tax rates under this reform plan.

This tax would be imposed upon the entire estate, which then would be liable for its payment. The relationship of the beneficiaries to the deceased is not considered (except in the case of a surviving spouse, who under Federal law is entitled to receive tax free one half of the adjusted gross estate). This means that the computation of the tax is greatly simplified. Similarly, since the tax is levied along Federal estate guidelines, it can be calculated as soon as the net taxable estate is determined. Further, this tax reflects each estate's "ability to pay" because smaller estates are exempted.

Income Tax

1. Non resident capitol gains should be more efficiently collected.

In order to facilitate better collection (and thus avoid evasion) of the tax on income made on the sale of real estate by non residents, the committee recommends that the Bureau of Taxation collect that tax at the point of sale. Sufficient resources should be provided the Bureau to accomplish this task.

2. Not presently advisable to have Federal collection of State income taxes.

Because federal collection of state income taxes would cause a lack of flexibility and stability on the part of the State in determining its tax base, it is recommended that so-called "piggyback" method of tax collection not be adopted as a possibly more administratively efficient manner of collecting state income tax.

"Piggybacking" is an alternative mechanism of tax collection, using Federal tax liability as the base and eliminating the need for duel tax forms at the Federal and state levels. According to the Internal Revenue Code, at least two states, having residents who in the aggregate file 5% or more of the federal individual income tax returns, must notify the Secretary of the Treasury of an election to enter into an agreement for federal collection. At this time, no state has entered into this agreement. Thus, the "piggyback" system is inoperative. Even if Maine opted for this plan, it could not enter the agreement because of lack of a second state or 5% of the total tax returns.

While in effect, the state law must incorporate all future changes in federal income tax laws and must also adopt either a percentage of taxpayer federal income tax liability or federal taxable income, each with several adjustments.

By tying the state income tax to both federal taxable income and federal tax rates, the state would also adopt the inconsistencies of the Federal tax base; thus changes in the Federal law would be automatically and immediately reflected in the state's revenues.(86) The state, by "piggybacking", ties itself to the social policy whims of Congress which uses tax policy as a social policy in order to increase employment and personal expenditures during recession and readjust prices during inflation. What this conformity causes is a constant need of State legislatures to adjust their tax rates so as not to lose substantial revenues when Congress cuts taxes (as it did in the 1975 Tax Reduction Act).

The experience of Oregon in this regard should be noted. That state adopted the Federal income tax base in June, 1969, in order to simplify regulations for the taxpayers. Several months later, the Federal income tax law was modified, resulting in unanticipated revenue losses of $30 million. Although Oregon offset the loss with a rise in other taxes, a proposed 1971 tax cut would have reduced the state's revenue by another $14 million. In anticipation of this loss,(87) Oregon's legislature dropped the adoption of Federal law changes.

It is because the federal government has different uses for the income tax (to stimulate or retard economic growth) than does the State, that piggybacking would dramatically affect the state income tax system.

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86. Options for Fiscal Structure Reform 162.

87. Id. at 162.

Tax Shelters

1. No tax shelter adjustments at this time.

The committee recommends that no current action be taken with respect to revision of Maine income taxation affecting so-called tax sheltered investments.

It is the understanding of the Committee that Congress is reviewing the Federal Tax Provisions regarding tax shelters. Hopefully, their study will identify the extent to which tax inequities arise from such investments and will result in Congressional action to reduce or eliminate these problems.

Inasmuch as the Maine income tax is based primarily on income reported for Federal income tax purposes, Federal adjustments, when completed, will directly affect Maine taxpayers. The committee urges that once corrective legislation is adopted by Congresss, the Maine Legislature should review those changes to insure that their application to Maine taxpayers is equitable and does not diminish economic or capital expansion incentives within our State.

The Committee cautions that some tax sheltered investments, as such, are not necessarily inconsistent with the economic good of the State. It is often erroneously believed, that tax shelters are onerous; however, when properly used, they are a prime method by which capital investment is made within Maine. Thus, it is our feeling that, although taxation as it relates to tax sheltered investments should be modified to eliminate certain inherent inequities, a full analysis should be made first to insure that corrective taxation at the Federal level does not depress legitimate incentives for business and economic expansion with Maine. For these reasons, the Committee believes that it should not at this time deal with tax shelters, but instead should wait until Congress makes its determination on the future of such shelters.

Unorganized Territory

1. <u>The unorganized territory should pay the uniform tax for education and be taxed at a rate that pays for other services it receives.</u>

A fairly detailed review of tax expenditures for services and the uniform property tax for educational purposes shows that property owners of this part of the State are not paying their fair share of the taxes. The unorganized territory pays $6,262,145 in property taxes, yet receives $2,037,430 more than that for services from the State See table IX - 1, page 62.

The committee recommends that the Legislature adjust the State tax rate and tree growth formula so that the taxes on the unorganized territory property reflects services provided it and also reflect revenues comparable to what the uniform education tax would yield.

UNORGANIZED TERRITORY SHARE OF EDUCATION [1] COSTS AND
AN ANALYSIS OF OTHER COSTS OF STATE SERVICES [2] TO THE UNORGANIZED TERRITORY

Estimated Property Taxes Receivable		$6,262,145.00
Estimated State Expenses		
Education (13.25 mills x state valuation)	$4,246,249	
State Planning Office	2,000	
Bureau of Property Taxation Administration	200,000	
Soil and Water Conservation Commission	10,000	
Pesticide Control	1,000	
Forest Fire Control	1,712,000	
Forest Management	84,000	
Bureau of Geology	56,000	
LURC	318,000	
Conservation - Central Administration	35,000	
Bureau of Public Lands	33,000	
Bureau of Water Quality	15,000	
University of Maine Forestry Research	21,000	
Reimbursement to Counties for Services to Unorganized Territories	1,039,514	
Department of Health & Welfare - General Assistance	60,000	
Entomology	381,000	8,213,763.00
Excess of Estimated Expenses over Property Taxes Receivable		(1,951,618)
Spruce Budworm Control		
Estimated Excise Taxes Receivable	2,264,188	
Less - Estimated Expenses	2,350,000	(85,812)
Total Amount, Estimated Expenses in Excess of Estimated Taxes Receivable		(2,037,430)

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1 The unorganized territory's share of education costs is estimated at 13.25 mills times state valuation of that area. This is the same rate of the uniform property tax paid in municipalities by all other property for educational purposes. The unorganized territory would be considered a "pay in" community if it were incorporated as a municipality. Actual costs of education for unorganized students is $1,858,128, according to the State Department of Education.

2 The above list does not include estimation for services such as state police, environmental protection, and possibly others which would normally be costs borne by the local property tax.

X

CONCLUSION

> "Regrettably, I am afraid that this State is going to be able to give you little assistance....It is true, however, that there were statistics to prove that the state sales tax provided 22 percent of the state's overall revenue. But no one ever really knew or cared why. Or what tax structure might be fairer or more efficient".
>
> Response to a survey of other States' tax structure studies. (88)

One can hardly read a newspaper today without being reminded that if only the revenue needs of the moment are considered, the future will arrive with confusion, inequalities and dangerous inefficiencies.

It is the conviction of this committee that perhaps even more valuable than the implementation of every recommendation in this report would be the emergence of a public, continuing examination of this State's present and future tax structure. What taxes are most efficient? Most equitable? What is their role in relation to the entire tax structure? Such questions are rarely heard from government or from Maine citizens. Many of this report's recommendations are debatable. Let them be.

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88. The committee wrote to all 50 states in search of recent studies of state tax structure.

Appendix A

The following description of the State-local tax structure was prepared by the League of Women Voters of Maine, Tax Task Force.

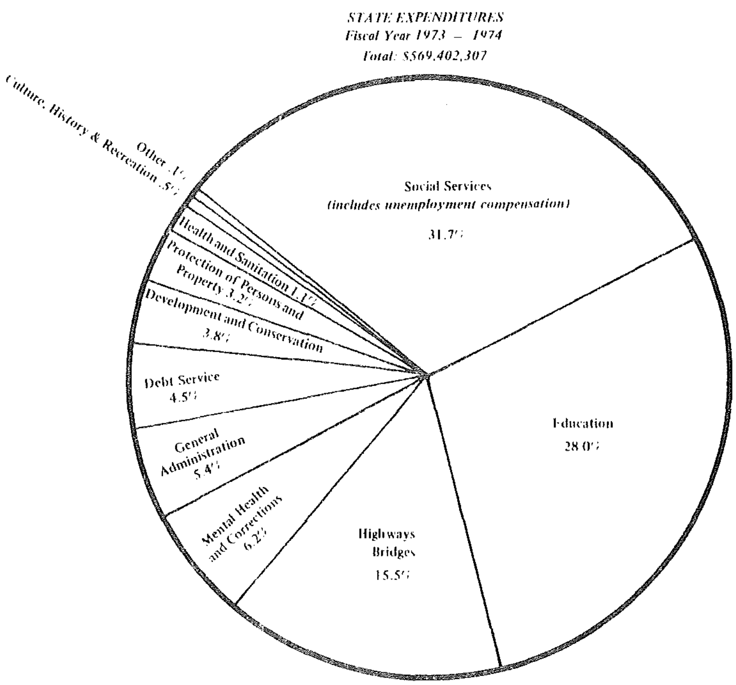
FACTS & ISSUES

LEAGUE OF WOMEN VOTERS OF MAINE
Tax Task Force

MAINE TAX UPDATE
January 1975

Every Maine Legislature must decide on a budget. It can change revenue needs by changing state programs, or it can change revenues by changing taxes. It usually does some of both.

A new budget, however, begins with the current state financial structure.



THE FUNDS – HOW IT IS HANDLED

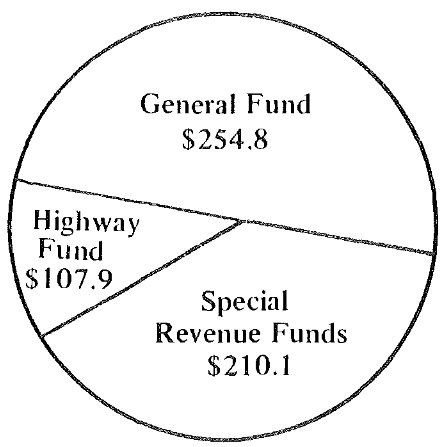
There are three types of operating funds through which the State handles its financial transactions – the General Fund, the Highway Fund and other Special Revenue Funds.

The General Fund supplies money for most of the major functions of State government and contributes to the other funds and various public service enterprises operated by the State. The revenues for the General Fund are derived from general State revenue sources such as the sales and use taxes, the income tax and the liquor and cigarette taxes.

The Highway Fund is used for operation of the Bureau of Highways and its related divisions in the Department of Transportation. Its revenues are generated mainly by the gasoline and use fuel taxes, motor vehicle and driver's license fees, and federal grants and municipal matching funds. Major construction is financed through bond issues.

The other **Special Revenue Funds** are financed by taxes and fees paid by special groups, e.g., the milk tax paid by farmers and dairies and the fees for hunting and fishing licenses, and by other segregated or dedicated revenue sources. Among these other sources are the unemployment compensation tax, federal and state-municipal revenue sharing, and federal grants (the largest contributor to Special Fund operations). The Special Revenue Funds are expended for specific purposes and are used for the development and conservation of natural resources, promotion of Maine products, social services, education, and protection of the public.

MAJOR OPERATING FUND
Revenues - Fiscal 1973 - 1974
(in millions of dollars)
Total: $572,811,426

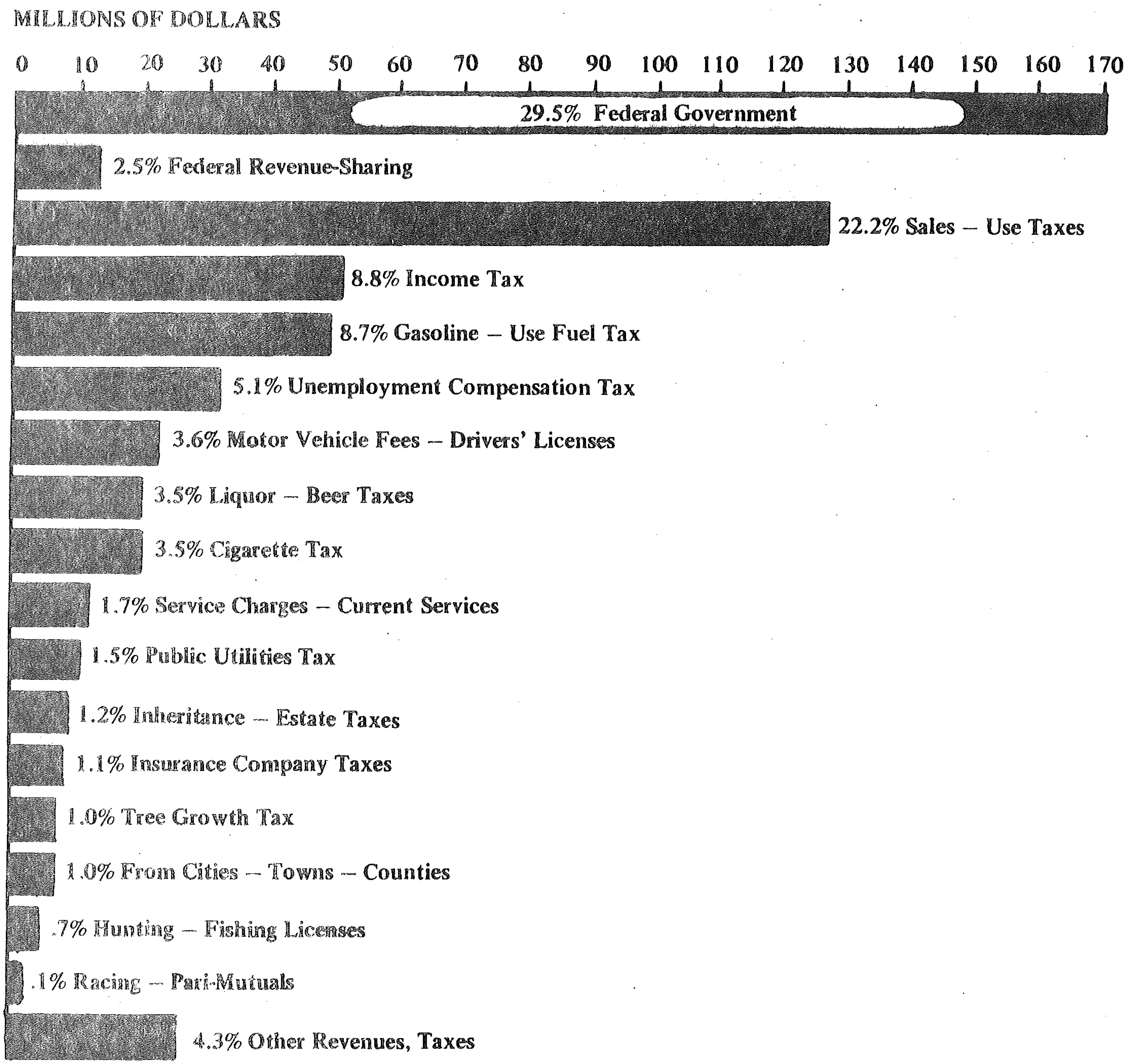


FEDERAL REVENUE SHARING

The enactment in 1972 of the Federal Revenue-Sharing Program began a five-year experiment in a new concept of federal aid to the states and municipalities. In the past, federal aid programs have kept the decision-making power in the hands of the federal government and have included such requirements as local matching of federal funds, development of local plans which conform to federal standards and formulas, and federal audit of these plans.

The revenue-sharing program represents a break with this tradition. Although there are certain guidelines to be followed under the program, control over planning, appropriating, spending, accounting and auditing lies with the states and municipalities. There are some restrictions on the use of the money – it cannot be used to match federal funds in grant programs or for school operating expenses. Plans for the use of revenue-sharing money must be reported to the federal government and made available to the public through local newspapers.

MAINE SOURCES OF REVENUE
Fiscal Year 1973 – 1974



Note: The Maine State Lottery began in June, 1974. No revenues were received in the above fiscal year.

The amount of revenue-sharing money received under the program by each state and municipality is based on formulas that include such factors as population, income and tax effort. These factors are reviewed annually. First year monies amounted to $5.3 billion nationally and will increase during the five years of the act to $6.5 billion in 1976.

As of June 30, 1974, Maine had received in quarterly payments a total of $86,690,299. Of this amount, $28,896,766 has gone to the State, $3,790,702 to the counties, and $54,002,831 to the municipalities.

STATE REVENUE SHARING

The State also has a revenue-sharing program enacted by the 105th Legislature. Under this program, the State returns to the municipalities, monthly, 4% of the sales and use taxes and personal and corporate income taxes that have been collected. In fiscal 1973-74, $9,071,949.22 was distributed to municipalities. The amount varies with state tax collections. In return, the State keeps the telephone tax revenue formerly distributed to the municipalities. This State revenue-sharing money is an additional source of revenue which reduces the property tax burden.

LOCAL TAXES

Revenue for municipalities in Maine comes from federal government, state government, taxes on real and personal property, motor vehicle excise taxes and all or portions of other taxes and fees collected by local government. Property is the chief tax base for local government, as there are no local sales or income taxes in Maine. In 1973 total local property tax collections were $215.5 million. Excise taxes brought in another $17 million. These two local property tax sources yielded double the revenue from the major state tax – the sales and use tax.

The State Constitution declares that all real and personal property shall be assessed equally at just value, except that farm, forest, open space and wildlife sanctuary lands may be assessed at the value in their current use under specific conditions.

The Legislature decides which kinds of property shall be taxable. Actual valuation of property and collection of taxes, however, are done by local assessors and treasurers. Because of the unevenness of local assessment, the State Bureau of Property Taxation uses checks of property sales to equalize assessment among towns for the purposes of state aid such as for highways, revenue sharing and schools.

Although the Maine Constitution requires that a general valuation of property shall be done every ten years, in many communities this is not done.

COUNTY TAXES

In Maine, county government is responsible for sheriff departments and jails, prosecutors and courts, certain highways and bridges, maintaining property records, and some other safety and welfare programs. Their budgets are drawn up by elected County Commissioners and must be approved by the State Legislature. Tax revenue needs for county government are apportioned to the towns which must levy enough taxes to pay their share.

SOME TAX TRENDS

In recent years, total tax collections have soared. Higher tax rates have led to increasing resistance, especially to the property tax. The trend has become decreased reliance on the property tax and increased reliance on the income tax. Both federal and state revenue sharing have provided some property tax relief.

Meanwhile, interest has continued in "property tax reform" – a term with many meanings. The Advisory Commission on Intergovernmental Relations lists Maine as a leader in property tax reform, but notes that the Bureau of Property Taxation is underfinanced to meet the proposed schedule of reforms.[1]

For some, property tax reform means improved assessment administration. In 1974, Maine established a Bureau of Property Taxation. Among its assignments is the formation of assessment districts over the whole state, each with a qualified professional assessor, by July, 1977. Reform of assessment administration could also include use of computers to help keep assessment up-to-date.

Property tax reform can mean tying tax liability to ability to pay. The Maine State Legislature has provided for graduated property tax rebates from state funds for elderly homeowners and renters of low income. A few other states have extended this approach to all low-income homeowners.

Property tax reform for some means simply paying less property tax. Maine's school financing law (LD 1994) reduces the portion of public school education paid for by property tax dollars from about 66% to 50% (current level) statewide, but it is subject to appropriation by each Legislature. This property tax portion is raised by a flat statewide mill rate (currently 14 mills) for education, a decrease for most municipalities, but an increase for some.

Property tax exemptions – granted by the State Legislature, usually without compensation to municipalities – are being restudied to see if they really serve the public purpose. In some communities, more than half of real estate is tax exempt.

TAXES AND THE ECONOMY

In recent years, governments have relied on growth in the economy to bring in most of the tax dollars to pay for rising costs of government from inflation and expanded programs. Individual income tax collections in Maine have almost doubled between 1969 and 1974 because of increased incomes. Rising incomes also led to increased sales tax revenues. Municipalities have looked to new building to expand the tax base.

Recession, however, will reduce tax income. It is not known how much revenue Maine will not collect because of recession, but deficits may be a problem.

[1] ACIR *The Property Tax in a Changing Environment*, M-83, Washington, D.C. March, 1974, pp 23 & 110.

Appendix B

The following chart explains the different sources of local property tax revenues.

TABLE 102 – WHO PAYS THE LOCAL PROPERTY TAX?
Estimated Local Property Tax Collections
By Source, 1972[1]

Source	Amount (millions)			Percentage distribution		
Nonbusiness						
Nonfarm residential realty[2]	$19,023			47.3		
Farm realty[3]	817			2.0		
Vacant lots	320			0.8		
Total nonbusiness realty		$20,160			50.1	
Nonfarm personalty[4]	657			1.6		
Farm personalty	113			0.3		
Total nonbusiness personalty		770			1.9	
Total nonbusiness			$20,930			52.1
Business						
Farm realty[5]	1,860			4.6		
Vacant lots	480			1.2		
Other realty[6]	9,170			22.8		
Total business realty		$11,510			28.6	
Farm personalty[7]	454			1.1		
Other personalty[8]	4,287			10.7		
Total business personalty		4,741			11.8	
Public utilities		3,019			7.5	
Total business			19,270			47.9
Total			$40,200[9]			100.0

1 ACIR staff estimates based on estimated 1972 collections distributed on basis of 1967 Census data, latest available statistics.
2 Includes both single-family dwelling units and apartments. An estimated $14 billion or 36 percent of all local property taxes was derived from single-family homes; about $5 billion or 12 percent of property tax revenue came from multi-family units.
3 Estimated collections from the taxation of the "residential" element of the farm.
4 The collections produced through the taxation of furniture and other household effects.
5 Estimated collections from the taxation of land and improvements actually used in the production of agricultural products—this is exclusive of the land and buildings used in a residential capacity by the farmer.
6 Commercial and industrial real estate other than public utilities.
7 The estimated collections from the taxation of livestock, tractors, etc.
8 Estimated collections from the taxation of merchants' and manufacturers' inventory, tools and machinery, etc.
9 This is the estimated grand total for *local* property tax receipts. In addition, there is an estimated $1.3 billion in State property taxes. The data needed for a similar distribution of State receipts is not available. However, it is estimated that approximately $450 million of the State receipts are derived from general property taxes and could probably be distributed among the various sources of revenue in the same proportion as local receipts. The remaining $850 million in State receipts consists mainly of State special property taxes on business personal property, but includes a substantial amount from special property taxes on motor vehicles, most of which is collected by the State of California.

Source: ACIR compilation. (1)

1. Features of Fiscal Federalism 173.

Appendix C

While there is general agreement among tax authorities that the sales tax base should be expanded to include services, exactly what services should be included in an expanded base is debatable. The following chart, adopted from a similar chart prepared for a 1976 Virginia tax policy report, is a useful compilation of various services and related policy issues.

Adapted from Table A.4 – pp 522-523 <u>Fiscal Prospectives and Alternatives: 1976,</u> A Staff Report to the Revenue Resources and Economic Commission – Richmond, Va.
By Barry E. Lipman and Richard D. Brown

POSSIBLE TAXABLE SERVICE	IS THE SERVICE ALREADY SUBJECT TO OTHER TAXES?	EASE OF ADMINISTRATION	TAXPAYER EQUITY	POTENTIAL NET REVENUE IMPACT
AMUSEMENTS – movie theaters; performances; bowling, pool, skating, swimming, riding, and other recreation fees; Turkish baths; massage and reducing salons; health clubs; golf and country clubs; other recreation clubs; itinerant amusement shows.	Localities may charge license fees for amusements.	This would require collections from many new dealers, including one night performances and itinerant amusement shows. A question would arise about taxing amusements to raise money for charities, and "charitable" would have to be defined. Relating to clubs where fees are paid in the form of membership dues, it might logically follow that all dues to all clubs are taxable.	This category would have to include most types of amusements to avoid discrimination against the ones taxed.	Very good. Should be taxed.
BUSINESS SERVICES – advertising; promotion and direct mail; armored cars; janitorial services; mailing services; telephone answering services; testing laboratories, wrapping, packing, and packaging of merchandise; weighing; sign painting; equipment rental; collection agencies; bookkeeping services; secretarial services; employment agencies.	Only subject to license fees and possibly corporation taxes.	Most of these are fairly easy to define and would add new dealers to the tax rolls. However, advertising is difficult to define, there is a question about taxing interstate commerce, and it would be costly to administer the tax on out-of-state advertisers. Services rendered to business firms are not suitable for sales tax because they are essentially producers' goods and not personal wants.	Taxing these services would frequently discriminate against small nonvertically integrated firms (e.g., any business without its own maintenance crew).	Good. (not including advertising maintenance.)
CONSTRUCTION SERVICES – all construction services relating to buildings and structures erected for the improvement of realty; real estate construction contracts; carpentry; masonry; plastering; painting; papering, and interior decorating; excavating and grading; pipe fitting and plumbing; house and building moving; well drilling.	Same as above.	The purchase of real property, including structures, is a capital investment and not a consumer expenditure. Repairs and remodeling may be classified as repairs to tangible property and therefore are taxable. It would be difficult to enforce complete compliance among so many small concerns. Many new dealers would be added to the tax rolls.	Taxing construction could be a penalty to potential investors and might be detrimental to the hard pressed construction market. Taxing only a primary contractor would discriminate against general contractors and would be easily avoidable. Taxing all minor work done by carpenters, plasterers, etc. would be equitable if all categories were included.	Very good. (except for major construction).
EDUCATIONAL SERVICES – private schools; dancing schools, music lessons; flying lessons; vocational schools, modeling schools, art schools.	Private schools are not usually subject to taxes, but some dancing schools are in some states.	Careful definition would be necessary to encompass all types of educational services. Since many lessons are taught by private individuals, evasion would be easy.	This is a very questionable category since it taxes people for learning a vocation.	Good. (not including private schools).
FINANCIAL SERVICES – bank service charges; finance charges; all types of insurance premiums; investment counseling.	None.	The dealers in question would be easily locatable. Finance charges would have to be differentiated from interest. Finance charges apply to bank credit cards and retail store credit cards as well as financial institutions. It would be necessary to define the types of insurance premiums taxed. Would out of state firms retaliate by moving out or would other states tax Maine insurance firms?	Taxing this category penalizes people with small accounts, people dealing with certain banks, credit users, and people dealing with investment counselors rather than bankers or stock brokers. Taxing insurance is often a form of saving as well as a purchase of the service.	Good. (question of insurance premiums or finance charges has to be dealt with).

POSSIBLE TAXABLE SERVICE	IS THE SERVICE ALREADY SUBJECT TO OTHER TAXES?	EASE OF ADMINISTRATION	TAXPAYER EQUITY	POTENTIAL NET REVENUE IMPACT
PERSONAL SERVICES – barbers and beauty salons; dry cleaning, pressing, dyeing and laundry; coin operated laundry and dry cleaning; shoe repair and shoe shine; alterations; sewing and stitching; fur storage, repair, dyers, and dressers, etc.	Possibly license fees.	Since most of these services are provided by retail stores which already collect the tax on some items, it would be fairly easy to extend coverage to these items. It might be beneficial to set some sort of lower limit to exempt shoe shine boys and other extremely small operators. There is no reason not to tax these.	Satisfactory although most states do not – perhaps because viewed as necessities.	Good.
PROFESSIONAL SERVICES – accountants, architects, attorneys, artists, chemists, doctors, dentists, nurses, allied health personnel, veterinarians, engineers, geologists, surveyors, morticians, pharmacists, chiropractors, fortune tellers, pawn brokers, taxidermists, interior decorators.	Some of these may have license fees.	Difficult to collect from so many independent practitioners.	There are questions about taxing health and legal services. Who pays the tax on court assigned legal services?	Very good.
PUBLIC UTILITIES – electric power, gas, water, telephone and telegraph.	Already taxed in some form or other including sales tax on use.	These services are simple to define and to collect.	Hurts low income taxpayer most. But credit would offset that. Luxury consumption theory applies well here.	Very good.
REPAIR SERVICES – auto repair; battery, tire, and allied; oilers and lubricators; washing, waxing, and polishing; wrecker service; vulcanizing and retreading; boat repair; machine repair; motorcycle, scooter, and bike repair; motor repair; tin and sheet metal repair; roof, shingle, and glass repair; electrical repair; household appliance, television and radio repair; jewelry and watch repair; furniture, rug, upholstery repair and cleaning; office and business machine repair; swimming pool cleaning; wood preparation; welding; finishers; polishers; exterminators.	License fees - none other.	Repair services are fairly easy to define. Many retail dealers offer repair services so that extending coverage to these would not be difficult. It might lower dealer compliance costs.	Satisfactory.	Very good.
INTRASTATE TRANSPORT SERVICE – buses; taxis; trucks; trains; airplanes.	License fees at local level.	Intrastate transportation is difficult for both Bureau of Taxation and dealer to collect taxes on since it requires the separation of intrastate from interstate transportation.	Penalizes nonvertically integrated firms and individuals not using private transportation which many states are now subsidizing.	Very good.
MISCELLANEOUS – boarding of animals; grooming of animals; stud fees; engraving; photography, and retouching; printing and binding; refuse services; parking lots; warehouses and lockers.	License fees.	Easy to define and administer.	Satisfactory. Should be taxed to broaden base and bring about sales tax equity.	Low for all categories.

Appendix D

The following tables chart, by municipality, the estimated differences between the current statutory plan for reimbursement of lost business inventory taxes and the proposed replacement of such reimbursements by distributing an equal amount of money through the municipal revenue sharing formula.

Table 1

Municipalities Paying Less Uniform School Tax Due to Deletion of Inventories From State Valuation (Over $10,000)

Municipality	Amount of Reduction in Uniform School Tax Due to Deletion of Inventory From State Valuation	Current Business Inventory Reimbursement	1977 Business Inventories Reimbursement Estimate	1977 Using Revenue Sharing Formula
Portland	404,965	897,323	2,134,029	1,191,526
Bangor	281,837	393,800	1,058,817	759,872
So. Portland	295,058	112,806	815,942	430,194
Lewiston	225,438	151,700	747,228	712,559
Jay	109,570	000	230,678	46,133
Augusta	104,225	112,361	421,169	371,073
Presque Isle	101,181	93,683	330,129	237,899
Waterville	98,761	129,577	414,394	330,909
Wilton	93,719	000	123,060	55,321
Auburn	91,198	88,236	385,398	434,246
Biddeford	78,304	000	228,236	352,398
Westbrook	74,842	135,902	406,187	237,991
Brunswick	70,221	51,768	271,436	273,812
Houlton	57,403	59,633	193,466	166,744
Old Town	54,998	000	116,677	137,459
Madawaska	51,306	000	151,360	88,775
Freeport	49,799	14,615	138,974	66,701
Brewer	46,830	60,231	199,994	178,124
Caribou	42,290	69,589	196,319	193,624
Dexter	40,002	13,559	99,370	59,441
Belfast	37,128	3,631	104,498	93,938
Farmington	35,335	24,760	118,216	88,699
Sanford	34,966	66,217	215,983	[illegible]

(continued)

Municipality	Amount of Reduction Uniform School Tax Due to Deletion of Inventory From State Valuation	Current Business Inventory Reimbursement	1977 Business Inventories Reimbursement Estimate	1977 Using Revenue Sharing Formula
Rockland	34,297	56,053	178,617	119,316
Bath	33,589	51,102	181,755	183,342
Bucksport	31,071	56,359	152,130	48,617
Skowhegan	25,557	36,962	122,184	136,800
Saco	24,079	35,430	159,542	192,161
Ellsworth	24,042	30,872	122,294	63,888
Winthrop	23,844	19,448	98,848	60,995
Pittsfield	23,837	2,166	65,860	76,250
No. Berwick	23,007	000	6,537	37,189
Thomaston	22,787	000	58,380	35,072
Calais	21,394	4,928	66,757	71,093
Winslow	20,256	23,546	123,265	96,008
Norway	19,210	000	48,553	51,914
Dover-Foxcroft	17,746	000	56,060	62,971
Madison	17,499	10,277	62,476	67,673
Hampden	16,387	000	52,900	68,852
Paris	15,279	3,270	53,132	44,907
Rumford	15,126	44,476	159,753	149,800
Searsport	14,704	12,414	55,965	26,231
Fairfield	14,419	7,410	60,923	80,894
Peru	13,167	26,455	55,954	24,349
Corinna	12,956	000	20,879	25,000
Oakland	10,926	000	33,690	41,566
Oxford	10,775	000	30,585	20,596
Fort Kent	10,314	22,952	58,117	76,598

Table 2

Municipalities Paying More Uniform School Tax Due to Deletion of Inventories From State Valuation (Over $10,000)

Municipality	Amount of Increases in Uniform School Tax Due to Deletion of Inventory From State Valuation	Current Business Inventory Reimbursement	1977 Business Inventories Reimbursement Estimate	1977 Using Revenue Sharing Formula
Wiscasset	131,056	000	8,739	12,882
York	52,539	000	2,857	49,353
Wells	44,808	1,398	15,372	44,874
Cape Elizabeth	39,755	2,075	6,502	127,427
Yarmouth	31,160	6,862	28,509	64,813
Mount Desert	26,743	000	2,614	19,835
Harpswell	25,991	000	512	19,260
Old Orchard Beach	23,025	8,043	21,689	103,725
Standish	22,970	000	5,712	32,397
Kennebunkport	18,720	824	8,124	24,030
Windham	17,555	000	35,764	79,370
Cumberland	17,543	1,435	15,605	53,371
Kittery	16,856	6,249	29,950	168,327
Gorham	15,898	9,257	31,777	107,625
Boothbay	15,734	000	5,648	11,289
Scarborough	15,626	000	76,993	115,894
Millinocket	15,187	000	78,709	101,553
Naples	14,475	460	2,379	7,656
Waldoboro	14,423	000	25,559	39,624
Bristol	13,931	000	3,492	13,841
E. Millinocket	13,805	000	18,089	34,597
Boothbay Harbor	13,764	2,430	25,989	15,906

(continued)

Municipalities	Amount of Increases in Uniform School Tax Due to Deletion of Inventory From State Valuation	Current Business Inventory Reimbursement	1977 Business Inventories Reimbursement Estimate	1977 Using Revenue Sharing Formula
Bar Harbor	13,087	19,501	40,250	56,163
Raymond	13,214	000	8,419	8,232
Rockport	12,859	000	3,197	23,806
Falmouth	12,273	11,392	63,807	85,272
St. George	11,804	988	2,782	14,402
Eliot	11,519	000	5,521	32,265
Buxton	10,697	2,848	12,235	36,039
Shapleigh	10,277	15	1,246	5,053
Gray	10,087	000	12,751	36,885

Appendix E

The following charts are analysis of

1) the burden of current property taxes;

2) circuit breaker property tax relief (the Interim Reform plan);

3) the tax relief realized by converting the current property tax to a levy that generally reflects only the cost of services provided property (Fundamental Reform plan).

This impact is measured by 4 different income brackets ($3,999, $7,999, $11,999, and $15,999), in six different municipalities (Portland, Bangor, Rockport, Castine, Millinocket, Fort Fairfield) and for the average property tax rate in the State.

Column 1

The analysis is based on the net income after allowable exemptions, if any, and the following tabulation shows gross allowable income for various size families in each of the four income levels studied allowing $1,000 exemption for each household member.

Gross Income

Family Size

1 Gross Income	2 Gross Income	3 Gross Income	4 Gross Income	5 Gross Income	Net Income
4999	5999	6999	7999	8999	3999
8999	9999	10999	11999	12999	7999
12999	13999	14999	15999	16999	11999
16999	17999	18999	19999	20999	15999

Column 2

Valuation of homestead (dwelling and one acre) in thousands. Shows over and underhoused individuals.

Column 3

Original tax owed to municipality.

Column 4

Net tax after circuit breaker reduction (from original tax).

Column 5

Each municipality spends a different percentage of its revenues on local needs, excluding education and welfare. This column reflects the tax that homeowners would pay under the special assessment concept in each community. (e.g. Portland uses 51.5% of revenues for local needs - the last column shows the taxes that would be paid under that percentage).

ANALYSIS OF CURRENT TAX, CIRCUIT BREAKER RELIEF (Interim Reform)
SERVICE ASSESSMENTS RELIEF (Fundamental Reform)

MUNICIPALITY: Portland

Income	Property Value In Thousands	Current Property Tax Owed	Interim Reform: Net Tax After Circuit Breaker Relief	Fundamental Reform: Net Tax After Reducing Tax to Reflect Services Provided Property
$3999	$ 10	$ 280	$ 208	$ 144
	15	420	264	216
	20	560	320	288
	25	700	376	361
	30	840	432	433
	35	980	488	505
	40	1120	620	577
	50	1400	900	721
7999	10	280	280	144
	15	420	384	216
	20	560	440	288
	25	700	496	361
	30	840	552	433
	35	980	608	505
	40	1120	664	577
	50	1400	900	721
11999	10	280	280	144
	15	420	420	216
	20	560	560	288
	25	700	640	361
	30	840	696	433
	35	980	752	505
	40	1120	808	577
	50	1400	920	721
15999	10	280	280	144
	15	420	420	216
	20	560	560	288
	25	700	700	361
	30	840	840	433
	35	980	920	505
	40	1120	976	577
	50	1400	1088	721

ANALYSIS OF CURRENT TAX, CIRCUIT BREAKER RELIEF (Interim Reform)
SERVICE ASSESSMENTS RELIEF (Fundamental Reform)

MUNICIPALITY: Bangor

Income	Property Value In Thousands	Current Property Tax Owed	Interim Reform: Net Tax After Circuit Breaker Relief	Fundamental Reform: Net Tax After Reducing Tax to Reflect Services Provided Property
$3999	$10	$ 360	$ 240	$194
	15	540	312	292
	20	720	384	389
	25	900	456	486
	30	1080	580	583
	35	1260	760	680
	40	1440	940	778
	50	1800	1300	972
7999	10	360	360	194
	15	540	432	292
	20	720	504	389
	25	900	576	486
	30	1080	648	583
	35	1260	760	680
	40	1440	940	778
	50	1800	1300	972
11999	10	360	360	194
	15	540	540	292
	20	720	648	389
	25	900	720	486
	30	1080	792	583
	35	1260	864	680
	40	1440	940	778
	50	1800	1300	972
15999	10	360	360	194
	15	540	540	292
	20	720	720	389
	25	900	888	486
	30	1080	960	583
	35	1260	1032	680
	40	1440	1104	778
	50	1800	1300	972

ANALYSIS OF CURRENT TAX, CIRCUIT BREAKER RELIEF (Interim Reform)
SERVICE ASSESSMENTS RELIEF (Fundamental Reform)

MUNICIPALITY: Castine

Income	Property Value In Thousands	Current Property Tax Owed	Interim Reform: Net Tax After Circuit Breaker Relief	Fundamental Reform: Net Tax After Reducing Tax to Reflect Services Provided Property
$3999	10	$125	$125	$ 33
	15	188	171	49
	20	250	196	65
	25	313	221	81
	30	375	246	98
	35	438	271	114
	40	500	296	130
	50	625	346	163
7999	10	125	125	33
	15	188	188	49
	20	250	250	65
	25	313	313	81
	30	375	366	98
	35	438	391	114
	40	500	416	130
	50	625	466	163
11999	10	125	125	33
	15	188	188	49
	20	250	250	65
	25	313	313	81
	30	375	375	98
	35	438	438	114
	40	500	500	130
	50	625	610	163
15999	10	125	125	33
	15	188	188	49
	20	250	250	65
	25	313	313	81
	30	375	375	98
	35	438	438	114
	40	500	500	130
	50	625	625	163

ANALYSIS OF CURRENT TAX, CIRCUIT BREAKER RELIEF (Interim Reform)
SERVICE ASSESSMENTS RELIEF (Fundamental Reform)

MUNICIPALITY: Fort Fairfield

Income	Property Value In Thousands	Current Property Tax Owed	Interim Reform: Net Tax After Circuit Breaker Relief	Fundamental Reform: Net Tax After Reducing Tax to Reflect Services Provided Property
$3999	10	$ 353	$ 237	$199
	15	530	308	298
	20	706	378	397
	25	883	449	497
	30	1059	559	596
	35	1236	736	696
	40	1412	912	795
	50	1765	1265	994
7999	10	353	353	199
	15	530	428	298
	20	706	498	397
	25	883	569	497
	30	1059	640	596
	35	1236	736	696
	40	1412	912	795
	50	1765	1265	994
11999	10	353	353	199
	15	530	530	298
	20	706	642	397
	25	883	713	497
	30	1059	784	596
	35	1236	854	696
	40	1412	925	795
	50	1765	1265	994
15999	10	353	353	199
	15	530	530	298
	20	706	706	397
	25	883	881	497
	30	1059	952	596
	35	1236	1022	696
	40	1412	1093	795
	50	1765	1265	994

ANALYSIS OF CURRENT TAX, CIRCUIT BREAKER RELIEF (Interim Reform)
SERVICE ASSESSMENTS RELIEF (Fundamental Reform)

MUNICIPALITY: Millinocket

Income	Property Value In Thousands	Current Property Tax Owed	Interim Reform Net Tax After Circuit Breaker Relief	Fundamental Reform Net Tax After Reducing Tax to Reflect Services Provided Property
$3999	$10	$ 215	$182	$ 86
	15	323	225	129
	20	430	268	172
	25	538	311	215
	30	645	354	258
	35	753	398	301
	40	860	440	344
	50	1075	575	430
7999	10	215	215	86
	15	323	323	129
	20	430	388	172
	25	538	431	215
	30	645	474	258
	35	753	517	301
	40	860	560	344
	50	1075	646	430
11999	10	215	215	86
	15	323	323	129
	20	430	430	172
	25	538	538	215
	30	645	618	258
	35	753	661	301
	40	860	704	344
	50	1075	790	430
15999	10	215	215	86
	15	323	323	129
	20	430	430	172
	25	538	538	215
	30	645	645	258
	35	753	753	301
	40	860	860	344
	50	1075	958	430

ANALYSIS OF CURRENT TAX, CIRCUIT BREAKER RELIEF (Interim Reform)
SERVICE ASSESSMENTS RELIEF (Fundamental Reform)

MUNICIPALITY: Rockport

Income	Property Value In Thousands	Current Property Tax Owed	Interim Reform Net Tax After Circuit Breaker Relief	Fundamental Reform Net Tax After Reducing Tax to Reflect Services Provided Property
$3999	$10	$160	$160	$ 66
	15	240	192	98
	20	320	224	131
	25	400	256	164
	30	480	288	197
	35	560	320	230
	40	640	352	262
	50	800	416	328
7999	10	160	160	66
	15	240	240	98
	20	320	320	131
	25	400	376	164
	30	480	408	197
	35	560	440	230
	40	640	472	262
	50	800	536	328
11999	10	160	160	66
	15	240	240	98
	20	320	320	131
	25	400	400	164
	30	480	480	197
	35	560	560	230
	40	640	616	262
	50	800	680	328
15999	10	160	160	66
	15	240	240	98
	20	320	320	131
	25	400	400	164
	30	480	480	197
	35	560	560	230
	40	640	640	262
	50	800	800	328

ANALYSIS OF CURRENT TAX, CIRCUIT BREAKER RELIEF (Interim Reform)
SERVICE ASSESSMENTS RELIEF (Fundamental Reform)

MUNICIPALITY: State Average Rate

Income	Property Value In Thousands	Current Property Tax Owed	Interim Reform: Net Tax After Circuit Breaker Relief	Fundamental Reform: Net Tax After Reducing Tax to Reflect Services Provided Property
$3999	$10	$277	$207	$139
	15	416	262	208
	20	554	318	277
	25	693	373	347
	30	831	428	416
	35	970	484	485
	40	1108	608	554
	50	1385	885	693
7999	10	277	277	139
	15	416	382	208
	20	554	438	277
	25	693	493	347
	30	831	548	416
	35	970	604	485
	40	1108	659	554
	50	1385	885	693
11999	10	277	277	139
	15	416	416	208
	20	554	554	277
	25	693	637	347
	30	831	692	416
	35	970	748	485
	40	1108	803	554
	50	1385	914	693
15999	10	277	277	139
	15	416	416	208
	20	554	554	277
	25	693	693	347
	30	831	831	416
	35	970	916	485
	40	1108	971	554
	50	1385	1082	693

Appendix F

The following chart lists the new tax rates for the proposed Estate Tax (combining the current Estate Tax and the current Inheritance Tax).

BUREAU OF TAXATION

October 8, 1975

Federal Taxable estate before Exemption of $60,000 equal to or more than	Federal Taxable Estate before exemption of $60,000 less than	Net Federal Tax on amount in Col. (1)	Net Rate of Federal tax on excess over amount in Col. (1)	Suggested Maine tax on amount in Col. (1)	Suggested Rate of Tax on excess over amount in Col. (1)	Credit for death taxes allowed on Fed. Ret. on an Estate equal to the amount in Col. (1).	Recommended Maine Tax in excess of Credit on an Estate equal to the amount in Col. (1)
0	60,000	0	0	0	0	0	0
60,000	65,000	0	.030	0	.015	0	0
65,000	70,000	150	.070	75	.025	0	75
70,000	80,000	500	.110	200	.04	0	200
80,000	90,000	1,600	.140	600	.05	0	600
90,000	100,000	3,000	.180	1,100	.065	0	1,100
100,000	110,000	4,800	.212	1,750	.08	0	1,750
110,000	120,000	6,920	.242	2,550	.09	80	2,470
120,000	150,000	9,340	.272	3,450	.10	160	3,290
150,000	160,000	17,500	.264	6,450	.10	400	6,050
160,000	200,000	20,140	.284	7,450	.105	560	6,890
200,000	300,000	31,500	.276	11,650	.105	1,200	10,450
300,000	310,000	59,100	.268	22,150	.105	3,600	18,550
310,000	500,000	61,780	.288	23,200	.115	3,920	19,280
500,000	560,000	116,500	.280	45,050	.115	10,000	35,050
560,000	700,000	133,300	.310	51,950	.125	16,000	35,950
700,000	810,000	176,700	.302	69,450	.125	18,000	51,450
810,000	900,000	209,920	.322	83,200	.13	23,280	59,920
900,000	1,060,000	238,900	.314	94,900	.13	27,600	67,300
1,060,000	1,100,000	289,140	.334	115,700	.14	36,560	79,140
1,100,000	1,310,000	302,500	.326	121,300	.14	38,800	82,500
1,310,000	1,560,000	370,960	.356	150,700	.15	52,240	98,460
1,560,000	1,600,000	459,960	.386	188,200	.16	68,240	119,960
1,600,000	2,060,000	475,400	.378	194,600	.16	70,800	123,800
2,060,000	2,100,000	649,280	.418	268,200	.175	103,920	164,280
2,100,000	2,560,000	666,000	.410	275,200	.175	106,800	168,400
2,560,000	2,600,000	854,600	.450	355,700	.19	143,600	212,100
2,600,000	3,060,000	872,600	.442	363,300	.19	146,800	216,500
3,060,000	3,100,000	1,075,920	.472	450,700	.19	187,280	263,420
3,100,000	3,560,000	1,094,800	.464	458,300	.19	190,800	267,500
3,560,000	3,600,000	1,308,240	.494	545,700	.19	234,960	310,740
3,600,000	4,060,000	1,328,000	.486	553,300	.19	238,800	314,500
4,060,000	4,100,000	1,551,560	.526	640,700	.19	286,640	354,060
4,100,000	5,060,000	1,572,600	.518	648,300	.19	290,800	357,500
5,060,000	5,100,000	2,069,880	.558	830,700	.19	398,320	432,380
5,100,000	6,060,000	2,092,200	.550	838,300	.19	402,800	435,550
6,060,000	6,100,000	2,620,200	.580	1,020,700	.19	518,000	502,700
6,100,000	7,060,000	2,643,400	.572	1,028,300	.19	522,800	505,500
7,060,000	7,100,000	3,192,520	.602	1,210,700	.19	645,680	565,020
7,100,000	8,060,000	3,216,600	.594	1,218,300	.19	650,800	567,500
8,060,000	8,100,000	3,786,840	.624	1,400,700	.19	781,360	619,340
8,100,000	9,100,000	3,811,800	.616	1,408,300	.19	786,800	621,500
9,100,000	10,060,000	4,427,800	.608	1,598,300	.19	930,800	667,500

Minority Reports

MINORITY REPORT

I. *Maine currently stands 45th of all the states in per capita income. In addition to a lower wage level Maine has a larger proportion of citizens over age 65 than most other states. At the same time we live in a "property intensive" state. We do not agree, therefore, that the "fundamental reform plan" shall be "the shift from property taxes to income taxes," or that the property tax is regressive. It is our opinion that the introduction of a "circuit breaker" with a family income limit, a home valuation limit and an overall State expenditure limit can provide relief for homeowners not able to pay their real estate taxes and at the same time make sure that the property tax is based on "ability to pay" as measured by the value of real property owned.*

II. *We are in favor of the long-range plan to assess "user fees" for services rendered to the owners of real property, whether the owners are otherwise taxable, or not, but we believe that the balance of assessment needs should be based upon "ability to pay" in a "progressive" manner using both the value of real property owned, and level of current income recieved as a measurement.*

III. *The amount of taxes taken from the economy of the State of Maine as measured by the percentage of Gross State Product going for State and Local taxes was 16% in accordance with the table furnished. This percentage, in our opinion, is exceedingly high, and for the year shown is approximately equal to that in Massachusetts. It is mandatory that we reduce this percentage, as a first priority, either by reducing expenditures or by increasing the amount of the "Gross State Product." We believe that the reforms recommended in the report should be accomplished only as fast as, and to the extent that, this priority can be achieved. If the economy of the State can be stimulated, revenues will be produced which can fund the recommended reforms.*

Respectfully submitted:
John Robinson
John O'Sullivan

CIRCUIT BREAKER

The undersigned members of the Committee submit this minority report in dissent of the local property tax "circuit breaker" as an interim goal for structural reform of the State's tax structure.

The circuit breaker is erroneously billed as a comprehensive property tax relief program that provides benefits to over-burdened taxpayers. The circuit breaker plan does not, in our opinion, solve the inequities inherent in current levels of local property taxation. While treating only surface symptoms, it purports to cure a major fault. In so doing, it may lull people into believing that no further remedy is required.

The following is a quote from the Brookings Institute publication of "Who Pays the Property Tax?" by Henry J. Aaron; "Tax relief in this form (circuit breaker) amounts, in fact, to an income maintenance system whose benefits are related to income and property tax payments. Circuit breakers offer a kind of housing allowance based on a peculiar formula and providing quite modest benefits;..." "Families whose incomes are temporarily depressed and whose housing expenditures are based on their normally higher incomes will qualify for more relief than will households whose incomes are normally low and who base their housing expenditures on those levels." Circuit breakers "...tend to subsidize (a) those within each income bracket who consume unusually large amounts of housing or who have unusually large ratios of property to current income, and (b) those with fluctuating incomes."

Mason Gaffney, in remarks to the President's Advisory Commission on Inter-governmental Relations September 14, 1972 said: "Those that become welfare cases should be treated by the welfare system on an impartial basis, without special favor to property owners. To use property tax relief as a substitute for welfare is to distribute welfare in proportion to wealth, surely an odd notion."

Aaron also states "It is questionable whether an <u>indirect</u> form of intra-state revenue sharing (circuit breaker) is necessary or desirable when all states have available such other means of aiding subdivisions as school aid and direct grants..." (emphasis added)

The circuit breaker does nothing to improve the business tax climate. The <u>fundamental</u> reforms, however, provide substantial relief to resident business.

Upon adoption of fundamental reform the circuit breaker would provide even more inequitable relief to those with large homes and adequate income.

The undersigned dissent from the adoption of the "circuit breaker" concept in the committee report because:

1. It is inconsistent with the position of the Committee supporting a general reduction of all municipal property taxes.

2. It erroneously suggests that the circuit breaker cures the excesses of local property taxes when, in fact, it does not.

3. It arbitrarily provides a welfare system to those who consume a large amount of housing.

JoAnne R. Babcock
Paul E. Fitzhenry
W. Scott Fox, Jr.
Jerome F. Goldberg
Peter Isaacson
Robert Kruger

MAINE INSURANCE PREMIUM TAX
MINORITY REPORT

One of the principles of a sound state-local tax policy structure enumerated by the Tax Policy Committee is "equity and fairness." The State of Maine's current insurance premium tax does not apply to certain nonprofit hospital or medical service organizations writing insurance. Such organizations are in competition with the private domestic and foreign insurance companies. Preferential tax treatment through exemption from the premium tax of such organizations does not meet the test of "equity and fairness." The Governor and the Legislature should be encouraged to introduce and secure passage of legislation providing for a premium tax on nonprofit hospital or medical service organizations at a rate equivalent to the premium tax on domestic companies. At a 1% rate this would yield an estimated $250,000, and at a 2% rate as proposed by the Tax Policy Committee, it would yield $500,000.

John L. Salisbury

A TRANSFER PAYMENT ALTERNATIVE

This brief report on "A Transfer Payment Alternative" is not being filed as a minority report, but is intended to outline a long-range approach worthy of more in-depth research than this member of the Governor's Tax Policy Committee has had the time to give during the Committee's deliberations.

The cornerstones of this proposal are: (1) the property tax on the resident property taxpayer should support only those services related to property; (2) the state categorical aid programs to schools and municipalities, except for capital construction or short-term incentive grants, should be eliminated; (3) in lieu of categorical aid programs to schools and municipalities, the state-local tax balance should be maintained through transfer payments returned directly from the state general fund revenues to the property taxpayer, and (4) the property tax should reflect to a greater extent than it does currently "ability to pay."

The transfer payment approach this proposal would incorporate is a property tax circuit breaker. Ultimately, the funding level of the circuit breaker would be the dollar sum of the most recently completed year's local expenditures for education and welfare. The alternative mechanics for instituting the circuit breaker are many. This author would suggest an approach that would provide a rebate to a resident property taxpayer after his property taxes exceeded a certain percentage of his income. I would suggest a lower percentage threshold for persons earning less than average income for a Maine family and a flat rate threshold for those who have incomes that exceed the average in Maine. The property tax circuit breaker would also apply to renters. In no case should the property owner receive a rebate in excess of 60% of his property tax bill.

The transfer payment approach would also incorporate a property tax rebate for business. Such a rebate would be based upon employee payroll and similarly should not exceed 60% of the property tax bill of the business. This concept would provide an incentive for industrial location and expanded business payrolls. This particular aspect of the transfer payment concept merits special research attention.

The administration costs of this proposal can, I believe, be minimized through a state-municipal cooperative approach. Again, this aspect of the proposal warrants a more detailed analysis than anyone has given it to date.

The advantages of the transfer payment alternative are severalfold: (1) the Governor and the Legislature would know annually what sum of money was necessary to fund the transfer payments program and could, through proper legislative drafting, prevent potential deficits; (2) the property tax would more appropriately reflect "ability to pay"; (3) the state categorical aid program which frequently determines local priorities and can contribute to increased expenditure of tax dollars will be eliminated, thereby assuring greater local control, and (5) an effective method of assuring a balanced state-local tax policy will be guaranteed.

The major disadvantage to the approach is the increased administrative complexities and corresponding potential lack of citizen understanding of the program.

John L. Salisbury

MINORITY REPORT

SENATOR PHILIP MERRILL

1. INTRODUCTION

My goals in seeking to reform Maine's tax system are threefold. First, we should make our tax structure more progressive; second, we should avoid narrowing the tax base, and, finally, we should do this without causing major dislocations in our economy.

Today Maine relies most heavily on its least progressive tax - the property tax. The sales tax is next, and the most progressive tax, the income tax, is relied on the least. As a result, the working man and woman pay a much higher share of taxes to the State than is fair or even productive.

I PROPERTY TAX

The short-range goals of the Committee are, for the most part, good steps toward correcting the great inequities created by the property tax. The circuit breaker and revenue sharing money to replace the property tax on inventories are needed and should be implemented. Beyond that, I believe the State should rely on the property tax less to finance education and go to a mix that raises no more than 45% from that source. If that was done we would be raising approximately 32% of our State-local tax dollar from property tax, and this is reasonably close to recommended goals of 20-30%. Because the proposed tax collects many dollars from the out-of-state taxpayer (estimates are as high as 25%), we are, therefore, justified in being reluctant to abandon this tax.

The Committee's long-range plan would have the State and local government of Maine raise only 21.5% of its money from property tax. My argument with this recommendation is with the premise on which it is devised. The philosophical underpinning of this recommendation is that property should be assessed only to pay for "property related services" (e.g. fire and police protection). It then becomes, in a theoretical sense, not a tax but a special assessment.

This course was recommended because the majority of the Committee is convinced that real property does not provide a reliable basis on which to tax people. The best analogy here is with the tax we levy on cars. In Maine we have a gasoline tax and that pays for the services rendered to cars, (e.g. roads, State police, etc.). We also pay an excise tax, not based on services but on the actual value of this car. This is a pure property tax.

The logic of the majority would say only the gasoline tax is appropriate. I believe the wealth represented by a valuable automobile is an appropriate item on which to base part of the taxation system. The person who owns a fine car or expensive home and earns $10,000 a year is more wealthy, and more able to pay taxes, than the person who owns no home and no car and earns the same income.

Consider two individuals who both have $100,000. The first buys a home for that amount. He keeps it for ten years and sells it for $140,000 and pays capital gains tax on $40,000. The second person buys a home for $20,000 and sells in ten years for $28,000 and pays capital gains on $8,000. This individual also invests $80,000 in stocks and sells them in 10 years for $112,000. In the meantime, the second individual collects $5,000 a year interest on his investment. He pays income tax on this and uses the remainder for travel and entertainment. Both individuals live in the homes they bought. The rental value of the first person's home is $5,000 per year. The rental value of the second is $1,440 per year. If there were no property taxes the first individual who took his wealth in a fine home would be getting the whole rental value tax free. The man who took his wealth in travel and entertainment pays a tax on that income. This is the problem of imputed income. It is completely separate from the question of how to pay for the services that the community and State provide the home.

It is my belief then that property is an element of wealth, and, as such, it should be taxed - if taxation is seeking to accurately reflect ability to pay. The problem with the property tax is not that it is unfair, but that we rely on it too heavily, and we do nothing to make sure it's effect on an individual taxpayer is not so harsh as to cause him to give up his home or go bankrupt. The revenue sharing, increased general funding of education, and the circuit breaker, go a long way toward solving these problems.

Present money collected by Property Tax	208.2	in millions
Loss of Property Tax from education change	13	
Increased revenue sharing	11.5	
Cost of circuit breaker	10	
New net total raised	173.7	

II SALES TAX

The long-range plan recommended by a majority of the Committee would have the State move from 26.3% reliance on sales tax to 29.5%. I think we ought to move down toward 20% instead of up to 30%. We should also strive to make this tax more progressive without losing out-of-state monies collected from this source.

My plan would exempt certain necessities from sales tax: water, gas for heating and cooking, and 500 kws. of electricity per month per household. It would also provide an income tax credit to equal the sales tax on $200-worth of clothing. To qualify for the latter, the taxpayer would have to live in Maine and file a Maine income tax return.

I would add a sales tax of 5% on amusements such as movies, etc. The net results of these changes would be no loss of out-of-state dollars. By exempting more necessities from the sales tax, the tax becomes a luxury tax and is, therefore, more progressive.

Money now raised with sales & use tax	137.8
Loss of sales tax revenue from water, gas, electricity exemption	2.5
Cost of clothing credit	10.
Money to be raised by tax on amusements	1.4
Net effect	126.7

III PAYING FOR TAX REFORM

I would compensate for the loss in tax revenues resulting from the reduction in property tax and sales tax by increases in the tree growth tax, the corporate income tax, and the individual income tax.

The <u>tree growth tax</u> raises the property tax money on about one half of Maine's land. It raises only about five million dollars a

year, and I believe an additional three million from this source would not be unfair to the paper companies. If done in concert with a new look at the whole formula, it would result in a more equitable tax to all concerned.

CORPORATE TAX

Because this plan would cut property tax on inventories and real property of Maine's business community as well as individuals, I believe it would be appropriate to increase by 1% the Maine Corporate Income tax. This would raise an additional five million a year.

INCOME TAX

The tax on individual income would have to be increased to collect 85 million instead of the 43.8 million now raised. While this is less of an increase than called for by the majority of the Committee, it is substantial. The increases should not be across the board and should be designed to make Maine's income tax more progressive. The plan submitted to the Committee by Bangor Representative, Philip Ingegneri, is included as an example of how this might be done.

CONCLUSION

For too long tax reform has been on the shelf; it is taken out and dusted off before elections and then forgotten.

Today the public is upset. We hear talk of a taxpayer rebellion. The issue is not only how much money government spends; but also whether it collects that money fairly, and from those most able to pay. This new public concern can result in action if it is coupled with the understanding that a more progressive and more visible tax must be raised to allow a more regressive tax to be lowered.

By reducing the taxes of those least able to pay, we strengthen the economy by increasing consumer spending power, and we strengthen our government by increasing public confidence.

	Present	Incremental	Long Range	Merrill
Property	208.2	186.7	112.6	173.7
Sales	137.8	137.8	154.5	126.7
P. Income	43.8	65.3	106.9	85 mil.
Corporate	20.9	20.9	28.8	25.9 mil.
Other	173.2	113.2	104.8	118.2

					ACIR
Property	39.7	35.6	21.5	32.8	20-30%
Sales	26.3	26.3	29.5	23.9	20-25%
Income	8.4	12.4	20.4	16.	25%
Corporate	4.0	3.9	5.5	4.8	5%
Other	21.6	21.6	23.1	23.3	20%

Present Personal Income Tax Rate

Single

If the taxable income is:	The tax is:
Not over $2,000	1% of the taxable income
$2,000 to $5,000	$20 plus 2% of excess over $2,000
$5,000 to $10,000	$80 plus 3% of excess over $5,000
$10,000 to $25,000	$230 plus 4% of excess over $10,000
$25,000 to $50,000	$830 plus 5% of excess over $25,000
$50,000 or more	$2,080 plus 6% of excess over $50,000

Joint

Not over $4,000	1% of the taxable income
$4,000 to $10,000	$40 plus 2% of excess over $4,000
$10,000 to $20,000	$160 plus 3% of excess over $10,000
$20,000 to $50,000	$460 plus 4% of excess over $20,000
$50,000 to $100,000	$1 660 plus 5% of excess over $50,000
$100,000 or more	$4,160 plus 6% of excess over $100,000

Rep. Ingegneri's Proposed Schedule

Single

If the taxable income is:	The tax is:
Not over $2,000	1% of taxable income
$2,000 to $4,000	$20 plus 3%
$4,000 to $6,000	$80 plus 4%
$6,000 to $8,000	$160 plus 5%
$8,000 to $10,000	$260 plus 6%
$10,000 to $15,000	$380 plus 7%
$15,000 to $20,000	$730 plus 8%
$20,000 to $25,000	$1,130 plus 10%
$25,000 to $30,000	$1,630 plus 11%
$30,000 up	$2,180 plus 12%

Joint

Not over $4,000	1% of taxable income
$4,000 to $8,000	$40 plus 3%
$8,000 to $12,000	$160 plus 4%
$12,000 to $16,000	$320 plus 5%
$16,000 to $20,000	$520 plus 6%
$20,000 to $30,000	$760 plus 7%
$30,000 to $40,000	$1,460 plus 8%
$40,000 to $50,000	$2,260 plus 10%
$50,000 to $60,000	$3,260 plus 11%
$60,000 up	$4,360 plus 12%
