STATE OF MAINE

JOINT SELECT COMMITTEE ON STATE TAX POLICY

1. Introduction

Of all the tools of government, taxes can be the bluntest, the most unwieldly. Often their burdens fall unfairly, without recognition of our differing situations. The sales tax cannot distinguish between the person who lives frugally and the person simply too poor to buy many goods. The property tax cannot distinguish between the family house that has been held for generations and the lot purchased for quick development. The personal income tax reflects cash flow and family size but can tell little of a person's wealth in stocks or bonds. Alone, the income, sales or property tax can be an unfair levy; but taken together in a balanced tax structure they can greatly improve the chances that each of us will be taxed according to our "ability to pay."

The recommendations of this report . . .

continued, page 1-1

A PROGRESS REPORT ON MAINE'S STATE AND LOCAL TAX STRUCTURE

DECEMBER 1976

STATE OF MAINE

JOINT SELECT COMMITTEE ON STATE TAX POLICY

Office of Legislative Assistants
Room 427 – State House
Augusta, Maine 04333

November 19, 1976

Legislative Council
108th Legislature
State House
Augusta, Maine 04333

Members of the Council:

In accordance with H.P. 2247, an Order establishing the Joint Select Committee on State Tax Policy, we enclose the final report of the committee.

Sincerely,

Samuel W. Collins, Jr.

Senator Samuel W. Collins, Jr.
Chairman

Mary Najarian

Representative Mary Najarian
Vice Chairman

STATE OF MAINE

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REPORT SUMMARY

1. INTRODUCTION

Alone, the income, sales or property tax can be an unfair levy; but taken together in a balanced tax structure they can greatly improve the chances that each of us will be taxed according to our "ability to pay". The recommendations of this report do not seek to raise the total tax burden of the state. Rather they shift the burdens within the state-local tax structure. See pages 1-1 to 1-2.

2. A PROGRESS REPORT ON THE CURRENT TAX STRUCTURE

Because Maine is a land rich, income poor state, the current mix of broad based state taxes - sales, income, property - is acceptable at this time. *See* pages 2-1 to 2-3. However, because the general tax structure remains regressive,changes are still needed. *See* pages 2-4 to 2-5.

The Uniform Property Tax (UPT) should not be repealed for the following reasons:

A. The UPT is a state, broad-based tax that, when combined with the income and sales taxes, more accurately reflects each person's "ability to pay".

B. The UPT only *raises* funds for education, it does not determine how much money each town *receives* from the state.

C. The UPT is a state tax but one that is collected by each town, with the revenues belonging to the state's general fund. Its mill rate is determined by the state's valuation of all property in the state. The yearly state valuation process encourages accurate local assessing practices.

D. The UPT is a more equitable way of taxing. It is not an education tool and has little relation to "local control".

See pages 2-5 to 2-15.

3. REFORMS TO STATE-LOCAL PROPERTY TAXES

1. The property tax on inventories is hard to administer and harmful to the business climate. Its repeal should be continued and reimbursement made through the state revenue sharing formula. See pages 5-1 to 5-2.

2. A general property tax circuit breaker would ease any unfair burdens caused by the Uniform Property Tax (UPT) and local property tax. It would generally enhance the "ability to pay" accuracy of property taxes. If the Legislature fails to enact a general circuit breaker, then the elderly tax relief formula must be revised. *See* pages 3-3 to 3-6.

3. The accuracy of the state valuation is essential to the fairness of the UPT and the local property tax. Their accuracy is threatened by assessor error - either state or local. The committee supports improvements to the state valuation procedures and recommends state assessors assist the local assessor where necessary. *See* pages 3-6 to 3-7.

4. The UPT is a broad-base state tax. If increased revenues from the UPT are possible due to an increase in the value of Maine property, then some additional revenues should be returned in such a way that they benefit the most in need. See page 3-8.

4. REFORMS TO THE PERSONAL INCOME TAX

1. While the personal income tax is the most accurate of our broad based taxes in terms of taxing according to "ability to pay", the rate schedule can impose on some an unfair burden. Last session's personal income tax increase in some cases resulted in such burdens. Thus:

   A. a Head of Household schedule should be adopted;

   B. a state retirement credit should be adopted;

   C. an income averaging formula should be adopted.

   See pages 4-1 to 4-3.

2. A personal income tax should be progressive but not confiscatory, and have a sufficient number of brackets and gradations in the percentage rate to correctly identify each person's "ability to pay". The current income tax schedule should be investigated in order to achieve these qualities. See

pages 4-3 to 4-4.

5. REFORMS TO THE SALES TAX

The sales tax can lose much of its regressivity by exempting necessities. The sales tax should not be imposed on residential water, gas or electricity. See pages 5-1 to 5-2.

2. The progressivity of the sales tax can also be improved by the selective taxation of services. See page 5-2.

3. Ideally, the sales tax should be a levy only on personal consumption. This would allow more accurate taxation of luxury consumption and improve Maine's business climate. The sales tax exemption for new manufacturing machinery and equipment should be expanded to fishing and, eventually, agriculture.

See page 5-3.

6. FINANCING THE OMNIBUS TAX REFORM BILL

The recommendations of this report do not seek to increase the total tax burden of the state. Rather, they shift burdens within the state-local tax structure. The financing recommendations stand on their own as worthwhile changes to our tax laws:

A. Increase the real property transfer tax.
See page 6-1.

B. The sales tax base should be expanded to include amusements.
See page 6-2.

D. Include life insurance proceeds of over $50,000 in the taxable estate.
See page 6-2.

E. Apply the 5% tax to cigarettes. *See* page 6-3.

F. Collect a percent of the federal minimum tax on "loophole" or "tax shelter" income.
See page 6-3.

G. Utilize federal revenue sharing funds.
See page 6-3.

H. Impose a minimum tax on all corporations.
See page 6-3.

I. Part of the new revenues due to be realized from the Uniform Property Tax (UPT) should be returned through a property tax circuit breaker and reimbursement to the towns for loss of inventory tax revenues.
See page 6-4.

7. AREAS DESERVING FUTURE STUDY

1. The Tree Growth Tax and Farm and Open Space Tax should be evaluated as to whether the burdens they impose are equitable in relation to the burdens of other property taxes. Such tax breaks are justified only if that land is seriously threatened by changes harmful to the public's interest.
See page 7-1.

2. The current state-revenue sharing formula might be improved so as to make it more accurate in its determination of need. See page 7-2.

3. Fundamental reform of the state sales tax should be pursued.
See page 7-2.

4. The administrative difficulty of taxing the unorganized territory at the same property tax rate as the organized areas should be resolved. See page 7-3.

I. INTRODUCTION

Of all the tools of government, taxes can be the bluntest, the most unwieldly. Often their burdens fall unfairly, without recognition of our differing situations. The sales tax cannot distinguish between the person who lives frugally and the person simply too poor to buy many goods. The property tax cannot distinguish between the family house that has been held for generations and the lot purchased for quick development. The personal income tax reflects cash flow and family size but can tell little of a person's wealth in stocks or bonds. Alone, the income, sales or property tax can be an unfair levy; but taken together in a balanced tax structure they can greatly improve the chances that each of us will be taxed according to our "ability to pay".

The recommendations of this report recognize this interrelationship of our broad based taxes and seek to adjust the impact of these taxes so they might better reflect not only individual differences but also Maine's changing economic and social conditions. No member of the committee considers this report to be the last word on tax policy; rather we view it as another step in what should be a continuing process of examination.

Our recommendations represent at all times the opinion of at least the majority of the committee.

It is important to state at the outset that this report assumes that the State's revenue requirements for the fiscal year June 30, 1978 will be approximately the same as for the fiscal year 1977, except that it will be necessary to replace the revenues lost by next year's repeal of the property tax on inventories.

Finally, our recommendations do not seek to raise the total tax burden on Maine citizens but rather attempt to shift the burden from those most in need of relief to those better able to pay.

2. A PROGRESS REPORT ON THE CURRENT STATE TAX STRUCTURE

§1. Introduction

BECAUSE MAINE IS A LAND RICH, INCOME POOR STATE, THE CURRENT MIX OF BROAD BASED STATE TAXES - SALES, INCOME, PROPERTY - IS ACCEPTABLE AT THIS TIME.

When judged against the standards articulated by the 1975 Report of the Governor's Tax Policy Committee [1/] - taxation based on each person's ability to pay, efficiency of administration, and maintenance of a competitive business climate - Maine has made considerable progress in recent years. We have a progressive personal income tax, a broad-based sales tax that, because it exempts food, does not seem too regressive, [2/] and a broad-based state property tax (The Uniform Property Tax). Our current state - local tax structure (1975-76) is:

1/ The Report of the Governor's Tax Policy Committee 5-19(1975)[hereinafter referred to as Tax Policy].

2/ Tax Policy at 18.

1975-76 STATE - LOCAL TAX STRUCTURE *

Tax	Revenue	Approximate Percentage of Total Tax Revenue
Property:		
State Property (includes Uniform Property Tax - $120 million)	$ 132,139,539.15	19 %
Municipal Property	100,935,944.00 **	14 %
Municipal Auto Excise Tax	22,507,798.00 **	3 %
Municipal Inventory and Livestock	12,595,344.00 **	2 %
Spruce Budworm Tax	2,837,259.00	.2%
Total Property Taxes	$ 271,015,884.15	39
State Sales	151,335,808.52	22
Personal Income	52,266,430.03	7.3%
Unemployment Compensation Tax	35,537,656.00	5 %
Corporate Income	32,642,106.92	5
Highway Fund	52,283,138.51	7.3%
Alcoholic Beverage Operations	22,933,750.01	3
Motor Vehicle Lic. & Reg.	22,128,483.95	3
Cigarette	23,935,432.43	3.4%
Others ***	37,369,389.26	5
Total	$ 701,448,079.78	100 %

* All figures from State Bureau of Taxation - Property Tax Division and State Controller's Fiscal 1975-76 computer data.

** 1975 figures used as 1976 data unavailable.

*** Other taxes include:

Inheritance	$ 7,361,635.75
Milk Taxes	509,528.98
Corporation Regulatory Taxes	516,532.19
Public Utility Taxes	10,282,860.86
Insurance Co. Taxes	8,369,557.92
Bank Taxes	211,470.16
Game License Taxes	91,893.01
Harness Racing Pari-Mutuel	1,300,890.84
Service Oriented Licenses	2,053,916.07
Fishing & Game Licenses	4,649,401.75
Misc. License Fees	2,021,701.73
TOTAL	$ 37,369,389.26

When you consider that by 1977 we will be raising about $18 million more than in 1975 from the personal income tax[3/] the general mix of Maine taxes seems somewhat balanced. We are a state tax rich in land yet currently too poor in income[4/] to relax our general reliance on the property tax. As our economy expands and personal incomes significantly increase, then the state tax mix would provide a greater role to the personal income tax.

3/ See Chapter 661, Public Laws of 1975. If this estimated increase in the personal income tax is added to the tax mix, then the relationship of our three broad-based taxes is changed accordingly:

Total property taxes	38%
Personal income tax	10%
Sales tax	21%

4/ This point of view was articulated in John Robinson's and John O'Sullivan's minority report to the Governor's Tax Policy Report:

> 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.

HOWEVER, BECAUSE THE GENERAL TAX STRUCTURE IS STILL REGRESSIVE, CHANGE IS NEEDED.

§2. Improvements

Still, there is much improvement needed. The Lile study 5/ makes this clear:

MAINE FAMILY TAX BURDENS, BY TYPE OF TAX

Family of four (Adjusted gross income)	Individual Income State	General Sales State	Residential Property 6/	Motor Vehicles	Cigar-ette Tax	Percentage Total Tax Burden
A. $ 5,000	$ 0	$ 89	$ 392	$ 133	$ 60	13.5%
B. 7,500	14	118	525	133	60	11.3%
C. 10,000	39	144	574	133	60	9.5%
D. 17,500	228	211	980	199	60	9.5%
E. 25,000	674	250	1225	199	60	9.6%
F. 50,000	2788	363	2100	199	60	11.0% 7/

Our recommendations will help spread the burden of Maine taxes more fairly. Some of our suggestions will call for tax increases but these monies will not be spent on increased government expenditures but rather will be used to lower other taxes or soften their burden on those least able to pay.

5/ Stephen E. Lile, Family Tax Burdens Compared Among States and Among Cities Located Within Kentucky and Neighboring States, Kentucky Department of Revenue (1975). The chart presented in this report was updated by the committee staff in an attempt to reflect the increase in personal income tax rates established by Chapter 661, Public Laws of 1975.

6/ Property tax estimates are based on these income/house value parings: $5,000/14,000; $7,500/$18,750; $10,000/$20,500; $17,500/$35,000; $25,000/$43,750; $50,000/$75,000.

7/ This finding, that the poorest people in Maine pay the highest percentage of their income in taxes, is enforced by the State Planning Office's conclusion that over the years 1967-1973 the Maine household in the top quarter income brackets gained $600 more in constant purchasing power than did the bottom 25%. See State Planning Office, Profile of Poverty - Maine: A Data Source 5 (1975).

This means that Maine's total tax burden will not be increased but rather that burdens will be shifted. This does not mean, however, that burdens will shift only from the less fortunate to those more able to pay. We will be looking again in Chapter 3, Section 1 at last session's personal income tax increase in order to make sure that its rates were not unfairly burdensome on certain middle income brackets. But, before we describe what <u>ought</u> to be done, it is very important to tell what we feel <u>ought not</u> to be done. And that is: The Uniform Property Tax (UPT) should not be repealed.

THE UNIFORM PROPERTY TAX IS A STATE, BROAD-BASED TAX THAT, WHEN COMBINED WITH THE INCOME AND SALES TAXES, MORE ACCURATELY REFLECTS EACH PERSON'S "ABILITY TO PAY".

THE UPT <u>RAISES</u> FUNDS FOR EDUCATION, IT DOES NOT DETERMINE HOW MUCH MONEY EACH TOWN RECEIVES FROM THE STATE.

<u>§3. What is the role of the Uniform Property Tax (UPT) in financing education?</u>

In 1973, in L.D. 1994, the state dramatically changed the education finance laws. It created a new system to distribute to each locality 100% of their basic education needs, and a new system to raise from a state property tax approximately 50% of the money they would be distributing. Today, the system of distribution is called the School Finance Act of 1976; and the Uniform Property Tax (UPT) is the method the Act uses to raise no more than half of its costs.

This is an important distinction: one part of the School Finance Act distributes the money, one part of it, the UPT, raises it. In no way does the UPT influence how much each locality receives. But before examining how the UPT mill rate is set, we should understand the significance of the School Finance Act's distribution system.

The School Finance Act 8/ provides from the state the basic minimum expenditure for education that each locality must make. This level is set by the Legislature and the Governor after they receive information from the localities as to the amount actually spent in the previous year. This, not the UPT, is the most profound change brought about by the School Finance Act. Why? Because before 1973, when the state was providing only approximately one-third of the basic cost of education, th many property poor towns had to struggle to raise th other two-thirds from the local property tax. And some could not.

8/ For a more detailed explanation of the school funding process, see Appendix A. "Capsule Description of the 'School Finance Act of 1976'".

The result was that the education resources a child could expect depended a great deal on where he or she lived. A wealthy town could have a generous school budget, a poor town could not. In many other states, courts had demanded that similar conditions be ceased: "the quality of a child's education [should not be] a function of the wealth of his parents or neighbors."9/

The role the UPT has played in this distribution system is to raise no more than 50% of the School Finance Act's basic education allowance. The UPT is a broad-based state tax. This year, at 13 mills, it raised 45.4% of the state's basic education grant. Even though the UPT's mill rate is set according to what the state calculates will be approximately one half of the cost of education, the UPT's revenues are not dedicated. They are general fund dollars and

9/ Serrano v. Priest 487 P. 2d 1241 (1971). This California decision was based on the finding that such unequal conditions violated the 14th Amendment's equal protection clause. Subsequently, the U.S. Supreme Court said education was not a federally protected fundamental right. However, the court did say that some state's school finance laws were inequitable and should be addressed by each state legislature. Since then many states have been challenged in court under the theory that the state's constitution specifically raised education to a fundamental right. Maine's constitutional language - "A general diffusion of the advantages of education being essential to the preservation of the rights and liberties of the people..." - certainly seems to encourage such an interpretation.

are mixed with our other broad-based taxes - the sales and income taxes - and used to pay to each town 100% of their basic education cost. From a tax policy point of view this is very important; because it means basic education in Maine is being paid by a combination of broad-based taxes. Thus, each person's contribution to education is determined in part by his income, by how much he consumes, and how much property he possesses. This is a much better indication of "ability to pay" than in the days before the first school finance act in 1973, when approximately two-thirds of each town's education costs were raised by the local property tax.

§4. How is the Uniform Property Tax (UPT) administered?

In 1976 the UPT raised approximately $120 million.

THE UPT IS A STATE TAX BUT ONE THAT IS COLLECTED BY EACH TOWN, WITH THE REVENUES BELONGING TO THE STATE'S GENERAL FUND. ITS MILL RATE IS DETERMINED BY THE STATE'S VALUATION OF ALL PROPERTY IN THE STATE. THE YEARLY STATE VALUATION PROCESS ENCOURAGES ACCURATE LOCAL ASSESSING PRACTICES.

This is how, generally speaking, the state determines how much it will be:

A. First, state assessors compute the total market value (just value) of the property in each Maine community. They cannot just take the local assessor's figures because few Maine towns maintain their assessments at fair market value.[10/] Thus, the state assessors must raise each town's total property value to approximate what it would be if it were sold on the open market. In doing so they try to adjust for any possible errors the local assessors might have made.[11/]

10/ If one local assessor values his town's property at 40% of its market value and the other town assessor uses a 80% ratio, then the former town's mill rate will be double the latter town's rate.

11/ When a local assessor values property at only a small percentage of its true market value, it is much easier to make a mistake.

The state then adds together the full market values of all the properties in all the towns, and arrives at a yearly state valuation. A very important benefit of this state valuation process is that it encourages localities to keep their property valuations as accurate as possible. Without accurate assessing at both the local and state level, true property tax equity is impossible (see chapter 3, §3)

B. Then the state computes the total cost of a basic education for each of the different types of students in Maine (e.g. grade school students, special education students, etc.). This figure is set by the Governor and the Legislature after they receive information on the amounts actually spent the previous year. The state then calculates what Uniform Property Tax (UPT) mill rate, when multiplied by the state valuation, would raise approximately 50% of the revenues needed. Last year the UPT raised 45.4% of the basic education allocation.

C. If the UPT were strictly a state tax, the UPT mill rate (last year it was 13 mills) would be levied directly on each property owner in the state. But because the lo assessors collect our property taxes, the state simply tells each town how much its residents owe the general fund. (Last year it would have been 13 mills x the town's state valuation). Then each town, using its own values and its locally voted mill rate assesses the tax. Thus, the UPT is collected along with town's local property tax. Some localities, relatively rich in real estate value, collect more than is needed for their own schools and they have been called "pay-in" towns. But this is a misleading term because the UPT really is paid by individual property owners through the municipal collection process. Each town pays at the same rate. Indeed, under the UPT, all property holders are like those of us who pay an income tax or sales tax. Each tax is a state tax.

D. Finally, if a town feels its basic education grant from the state is not sufficient it may tax itself an additional amount through the <u>local</u> property tax. Probably the reason some people continue to think of the UPT as a local tax is that almost all of the revenues raised by it are never actually sent into the state's general fund but rather kept at the local level as part of the locality's basic education grant from the state. The reason for this is simply administrative convenience. Why actually forward the dollars to the state's general fund when they would just be sent back again?

THE UPT ONLY RAISES EDUCATION FUNDS. OTHER PARTS OF THE SCHOOL FINANCE ACT DISTRIBUTE THE FUNDS AND REQUIRE THE MINIMAL EXPENDITURES.

§5. The UPT - a summary of its effects.

We can now see the profound change the UPT has made possible in education funding:

A. Each locality's basic cost of education is now coming from the state's general fund.

B. Because practically all education is now being funded by general fund monies - a mixture primarily of income taxes, sales taxes, and Uniform Property Taxes - the cost of education now better reflects each citizen's income, consumption and property holdings. And that is a greatly improved indication of "ability to pay".

Thus, the UPT's role is only the first of two steps in financing education in Maine: the UPT only raises money; it does not in any way affect how the education dollars are allocated to the localities.[12/]

12/ The report of the 1976 Governor's Task Force on Tax Policy seems to be unclear as to the nature and role of the UPT. If the UPT were repealed, yet the School Finance Act left otherwise unchanged, each community would still receive the same basic education grant from the state. The money would simply have to be raised elsewhere.

Now, this does not mean the UPT is a flawless system for raising education funds. The state valuation, upon which the UPT mill rate is based, must be accurate and in Chapter 3, section 3 we make a strong recommendation in that area. Further, the Uniform Property Tax, which makes up about 19% of the general fund, often causes an unduly heavy burden on low income homeowners and renters, and in Chapter 3, section 2, we also address that problem. But before dealing with those problems, we must confront clearly a charge that threatens the equity achieved by the UPT even more than the above problems. That charge is: the UPT lessens local control of education and fiscal responsibility.

THE UPT IS A MORE EQUITABLE WAY OF TAXING. IT IS NOT AN EDUCATION TOOL AND HAS LITTLE RELATION TO "LOCAL CONTROL".

<u>§6. The Uniform Property Tax does not lessen local control of education.</u>

It can be seen clearly now that the UPT alone has no real effect on local control of education. The UPT is only a funding mechanism. It does not distribute education dollars. It does not set the spending level below which no locality can drop its education efforts. These latter functions are other aspects of the School Finance Act.

So, as to whether most towns could now lower their taxes by voting to spend less on education, the repeal of the UPT alone would not accomplish this.[13/] The UPT is separate from the School Finance Act's minimum education expenditure requirement and is not involved in issues of local control.[14/]

13/ If the UPT alone were repealed, yet the rest of the School Finance Act kept in place, what would be the result? This would mean the property tax was no longer a state levy, and that each property holder in the state would no longer be paying at generally the same rate. Persons living in property rich towns would have a lighter property tax burden; persons in poorer towns might be more sorely taxed. The fairness of the Maine tax structure might be lessened. This would depend on ho the Legislature decided to replace the lost UPT revenues. If it returned entirely to the local property tax for approximately 50% of the costs of basic education, the tax structure would become more inequitable. If it made up the UPT revenues with a combination of local property taxes and, for example, personal income taxes, the equity of the Maine tax structure might even be improved. The personal income tax is our most accurate broad-based tax. But this assumes that the local property tax is accurately assessed and we have already emphasized the important role the state valuation process and the levying of the UPT play in improving local assessment practices (see Chapter 2, section 4, ¶A).

14/ The organization Save Our State is currently seeking signatures for an initiated bill that would only repeal the UPT but leave the rest of the School Finance Act functioning.

§7. Conclusion: do not repeal the Uniform Property Tax

Thus, in recommending that the UPT not be repealed, the committee is not arguing for any particular theory of how the state should distribute education dollars. Our concern is tax equity not education equity. The UPT helps assure that each of us is taxed more equally for the costs of education and that our total state tax bill is more reflective of our "ability to pay". This the committee endorses and hopes will continue.

Finally, even if the state increased its non-UPT share of education funding from 54.6% to a percentage that would mean there would no longer be any localities that raised from the UPT more than its own school needs (no more "pay-in towns"), still the UPT should not be repealed. Not only is it an equitable way to raise state revenues but its administration - the yearly state valuation process and levying of the tax - offers great encouragement to localities to keep their local assessments accurate. And without accurate assessments, there can be little property tax equity, either at the state level or the local level (<u>see</u> chapter 3, §3).

3. REFORMS TO STATE-LOCAL PROPERTY TAXES

THE PROPERTY TAX ON INVENTORIES WAS HARD TO ADMINISTER AND HARMFUL TO THE BUSINESS CLIMATE. IT'S REPEAL SHOULD BE CONTINUED AND REIMBURSEMENT MADE THROUGH THE STATE REVENUE SHARING FORMULA.

§1. The repeal of the property tax on inventories should continue but the reimbursement schedule should be changed.

1. Findings. In 1977, when the property tax on inventories - industrial inventories, stock in trade, agriculture produce, forest products and livestock - will be completely repealed, the state will still be obligated, under the terms of the repeal, to reimburse Maine towns for their lost revenues. Reimbursements are justified, but the law states that the payments will be made to towns on the basis of their 1973 state valuation. The inequity of this situation is clear when you look at the effect repealing the inventory tax had on small, inventory poor towns when it was combined with the Uniform Property Tax (UPT). Exempting inventories so lowered the state valuation that in 1975 it became necessary to increase the UPT mill rate by 1/2 mill.[1/] Thus small, inventory poor towns paid a higher UPT mill rate yet received little reimbursement for the lost local property tax on inventories.

2. Recommendation. The committee considers it of the highest priority that repeal of the property tax on inventories be continued. This tax is hard to administer accurately and harmful to the business climate.

1/ For a description of this effect on small, inventory poor towns, see Tax Policy at Appendix D. Also increased were county taxes and local property taxes for additional education resources.

Further, the current reimbursement system should be replaced by distributing the money owed, approximately \$14 million in 1977 and every year thereafter, through the current state revenue sharing formula.2/

2/ The current level of state revenue sharing funding is 4% of the sales tax and income tax (personal, corporate) revenues. The state revenue sharing formula is:

$$\frac{\text{Population of the town}}{\text{State Population}} \times \left[\frac{\text{Total municipal property tax commitment}}{\text{Total property tax in state}} \div \frac{\text{Municipal state valuation}}{\text{total municipal valuation for the state}} \right]$$

A GENERAL PROPERTY TAX CIRCUIT BREAKER WOULD EASE ANY UNFAIR BURDENS CAUSED BY THE UPT AND LOCAL PROPERTY TAX. IT WOULD GREATLY ENHANCE THE "ABILITY TO PAY" ACCURACY OF PROPERTY TAXES. IF THE LEGISLATURE FAILS TO ENACT A GENERAL CIRCUIT BREAKER, THEN THE ELDERLY TAX RELIEF FORMULA MUST BE REVISED.

<u>§2. Why a general property tax circuit breaker is needed.</u>

1. <u>Findings</u>. A property tax circuit breaker would resolve one of the most frequently heard criticisms of the property tax in general and the Uniform Property Tax (UPT) in particular: that it forces property rich but income poor persons to raise more money than they can afford.[3/] A general property tax circuit breaker would limit hardships caused by property taxes by providing

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3/ In testimony before the committee, Dr. Timothy Smeeding of Bowdoin College offered statistics to show that the UPT might very well be putting a too heavy tax burden on persons living on valuable land (e.g., inherited coastal land) yet who had small incomes. Dr. Smeeding advocated a general property tax circuit breaker as one means of relief.

relief to those citizens whose property tax burden constituted a high percentage of their income. The program would impose an "ability to pay" factor into a person's net property tax. In commenting on the desirability of property tax circuit breakers, the Advisory Committee on Intergovernmental Relations (ACIR) states:[4/]

"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 nor 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 homeowners and renters while minimizing loss of revenue. It operates to reduce inter-governmental fiscal 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."

4/ ACIR, Property Tax Circuit Breaker: Current Status and Policy Issues 27 (1975).

2. Recommendation. The state should enact a property tax "circuit breaker" system that insures that if any Maine resident's property tax or rent bill exceeds a set percent of income and thus constitutes an unfair cash flow burden, then the "circuit is broken" and the state will provide tax relief. We recommend that the program be available only to Maine residents and apply only to taxes paid on their principal residence. On October 14, 1976 ACIR communicated with the committee, affirming its advocacy of circuit breaker property tax relief, and suggesting that the committee might be able to work with Dr. Robert Kleine, ACIR's Senior Resident in Public Finance, an expert in circuit breaker design, in structuring a property tax relief formula suited to Maine conditions.

Therefore, the committee will prepare for submission to the 108th Legislature, as part of its omnibus tax reform bill, a general property tax circuit breaker formula. It is expected that this relief program will not cost more than $10 million per fiscal year.

At the same time the committee, with the assistance of ACIR, is designing a general property tax circuit breaker, it will also investigate the need and feasibility of making the following reforms to the current Elderly Householders Tax and Rent Relief

Act:

A. increase the income limitation to $5,000 for an applicant who's single and $6,000 for applicants applying as a couple;

B. lower the percentage of household income that claims are limited to from 21% to 18%;

C. have tax rent refunds based on the current year's tax bill.

If the Legislature fails to enact a general property tax circuit breaker, then reform to the elderly tax relief formula is needed.

THE ACCURACY OF THE STATE VALUATION IS ESSENTIAL TO THE FAIRNESS OF THE UPT AND THE LOCAL PROPERTY TAX. THEIR ACCURACY IS THREATENED BY ASSESSOR ERROR - EITHER STATE OR LOCAL. THE COMMITTEE SUPPORTS IMPROVEMENTS TO THE STATE VALUATION PROCEDURES AND RECOMMENDS STATE ASSESSORS ASSIST THE LOCAL ASSESSOR WHERE NECESSARY.

§3. Accuracy of the state valuation should be improved and the state should initiate the valuation by state assessors of large manufacturing properties:

1. Findings. As was stated above in chapter 2, §4, the real gains in equity achieved by the Uniform Property Tax (UPT) are seriously undermined if the state valuation - the state's equalization to full market value of all local property valuations - is inaccurate. Such inaccuracy could be the result of errors by the state assessors or errors by the local assessors. Currently the Joint Select Committee on State Property Tax Valuation is conducting an exhaustive examination of the methods used by the state to arrive at the state valuation.

2. Recommendation. During the 107th Legislature, the statutes setting assessing standards at the local level were revised so as to enhance local autonomy.[5/] In order to further such freedom and to free the local assessor from a task that is increasingly within the expertise of only a few highly trained assessors, the committee recommends that the state assume the responsibility for assessing the value of large industrial properties. Therefore, it is recommended that the state value all industrial properties with a just value of $5 million or more and all electrical, water and gas public utility properties. The tax would still be levied and collected at the local level through the utilization of the 100% valuation adjusted to the local assessment ratio and then applying the local property tax rate. The state would be reimbursed for its costs of assessments.

5/ Chapter 545, Public Laws of 1975.

THE UPT IS A BROAD BASED STATE TAX. IF INCREASED REVENUES FROM THE UPT ARE POSSIBLE DUE TO AN INCREASE IN THE VALUE OF MAINE PROPERTY, THEN SOME OF THESE ADDITIONAL REVENUES SHOULD BE RETURNED IN SUCH A WAY THAT THEY BENEFIT THE MOST IN NEED.

§4. Why increased revenues from the Uniform Property Tax (UPT) should be used to provide property tax relief to those most in need.

1. Findings. Although chapter 6 of this report describes how the committee's omnibus tax reform bill is to be funded, the committee's decision to use some of the revenues scheduled to be automatically generated by the 1976 School Finance Act needs to be treated as a major tax revision.

The state valuation (now a yearly event) for fiscal year 1976-77 increased the value of all Maine property by more than $2 billion. Since the 1976 School Finance Act specifies that next year, and every year thereafter, the mill rate will be 12.5, the UPT will thus produce next year $ 28 million more than was needed last year to fund education.[6]

6/ The establishment of a permanent 12.5 mill rate may be in conflict with another section of the act (§3747, sub-§8), which specifies that the UPT cannot be used to raise more than 50% of the cost of education in any year.

2. Recommendations. The committee recommends that the $28 million dollars due to be realized at the 1977-78 UPT mill rate be used in the following manner:

A. Approximately $10 million be used to finance a property tax circuit breaker (see chapter 3, section 2);

B. No more than $8 million be used to fund part of the $14 million due to be reimbursed to the towns because of the repeal of the property tax on inventories (see chapter 3, section 1); and

C. The UPT mill rate be lowered at least 3/4 a mill (approximately $6.5 million in revenues) and however much more can be afforded while continuing to raise 45.4% of the cost of basic education in Maine.

4. REFORMS TO THE PERSONAL INCOME TAX

THE 107TH LEGISLATURE'S INCREASE IN THE PERSONAL INCOME TAX FAILED TO ADEQUATELY PROVIDE FOR THE SINGLE PERSON WHO IS THE HEAD OF A HOUSEHOLD, THE RETIRED PERSON, OR THE PERSON WITH A RAPIDLY FLUCTUATING INCOME.

§1. The basic rates of Maine's personal income tax need to be adjusted in view of their impact on certain segments of the population.

1. Findings. While the personal income tax is the most accurate of our broad based taxes in terms of taxing according to "ability to pay", 1/ the rate schedule can impose on some an unfair burden. Last session's personal income tax increase in some cases resulted in such burdens. For example, in the following comparative analysis of last session's income tax increase, consider the 1977 increases imposed on the middle income single taxpayer:

1/ Tax Policy at 17.

Adjusted Gross Income	Single 1 Exemption 1975 1/	Single 1 Exemption 1977 2/	Married 2 Exemptions 1975 1/	Married 2 Exemptions 1977 3/	Married 4 Exemptions 1975 1/	Married 4 Exemptions 1977 3/
$ 5,000	$ 50	$ 26	$ 25	$ 9	$ 5	$ -0-
7,500	103	92	55	34	28	14
10,000	170	218	100	78	60	39
15,000	350	528	220	224	160	144
17,500	450	728	295	322	235	228
20,000	550	944	370	472	310	352
25,000	750	1,394	540	816	460	674
30,000	980	1,860	740	1,216	660	1,056
40,000	1,480	2,860	1,140	2,068	1,060	1,888
50,000	1,980	3,860	1,540	2,968	1,460	2,788
75,000	3,460	6,360	2,760	5,420	2,660	5,220
100,000	4,960	8,860	4,010	7,920	3,910	7,720

1/ 1975 Standard deduction was 10% of adjusted gross income, to a maximum of $1,000.

2/ 1976 and 1977 Standard deduction computed at 16% of adjusted gross income, with a maximum of $2,400 and a minimum of $1,700.

3/ 1976 and 1977 Standard deduction computed at 16% of adjusted gross income, with a maximum of $2,800 and a minimum of $2,100.

2. Recommendations. The committee feels the personal income tax schedule should be adjusted in the following ways.

A. Adoption of a Head of Household schedule. This rate would be approximately half-way between the single person's rates and the married-joint rates. "Heads of Households" are single persons, unmarried, who maintain a household for a close relative. This reform should cost approximately $135,000.

B. Adoption of a state retirement credit, which would parallel the existing advantage of recipients of social security payments. This should make Maine more appealing as a retirement location for the elderly of other states. This reform should cost approximately $417,000.

C. Institute an income averaging formula for persons with an unexpectedly high income for one year. This reform should cost approximately $435,000.

A PERSONAL INCOME TAX SHOULD BE PROGRESSIVE BUT NOT CONFISCATORY, AND HAVE A SUFFICIENT NUMBER OF BRACKETS AND GRADATIONS IN THE PERCENTAGE RATE TO CORRECTLY IDENTIFY EACH PERSON'S ABILITY TO PAY.

§2. The personal income tax schedule adopted last session left much work undone.

1. Findings. Last session's personal income tax increase unfairly burdened some segments of our population while unnecessarily lightening the load on others. Further, its income brackets could have been narrower and the percentage rate increases made in smaller increments. Corrections of

these problems would provide a better indication of "ability to pay".

2. Recommendation. The committee intends, with the aid of a new computer program nearing completion by the Bureau of Taxation, to investigate new rate schedules for inclusion in our 108th Legislature omnibus tax reform bill. The committee's general goals during this investigation will be to investigate who exactly is paying the new tax and, if necessary, to:

A. narrow the income brackets and even them out to obtain a more uniform progressivity; and

B. increase the relative progressivity of the percentage rates by making the increments smaller (e.g., .5%, 1%, 1.5%).

These goals should be accomplished without increasing the total revenues currently raised by the personal income tax and by not going above the current maximum rate of 10%.

5. REFORMS TO THE SALES TAX

THE SALES TAX CAN LOSE MUCH OF ITS REGRESSIVITY BY EXEMPTING NECESSITIES.

§1. The sales tax, if possible, should not be imposed on essentials.

1. Finding. Potentially, the sales tax is a regressive levy. The poor pay a greater percentage of their income in sales taxes than do the wealthy. However, by exempting necessities from the sales tax much, if not all, of the regressive burden of the sales tax seems to be removed.[1/]

1/ Tax Policy at 18.

2. Recommendation. The sales tax should not be imposed on sales of residential water, gas or electricity. This exemption would cost approximately $3.3 million.

THE SALES TAX CAN BE MADE MORE EQUITABLE BY EXPANDING ITS BASE TO INCLUDE SOME SERVICES.

§2. The progressivity of the sales tax can also be improved by the selective taxation of services.

1. Findings. If only tangible goods are taxed by the sales tax and not services, then the sales tax discriminates against individuals able to afford some goods but not many services. Expenditures on services tend to increase as income rises, and persons with higher incomes would bear the greater burden if selected services joined goods in the sales tax base. Thus, taxing some services should positively affect the progressivity of the tax. Further, as far as administrative problems are concerned, taxing services would make administration of the sales tax easier.

2. Recommendation. We should expand the sales tax base to include amusements (e.g., films, golf courses, amusement parks, etc.). This would raise approximately $1.6 million in new revenues. In addition, the committee recommends in chapter 7 a thorough investigation of the sales tax. Such ideas as an expansion of its base or the institution of a general sales tax credit offer real possibilities for reform to our entire state-local tax structure.

IDEALLY, THE SALES TAX SHOULD BE A LEVY ONLY ON PERSONAL CONSUMPTION. THIS WOULD ALLOW MORE ACCURATE TAXATION OF LUXURY CONSUMPTION AND IMPROVE MAINE'S BUSINESS CLIMATE.

§3. <u>The sales tax exemption for new machinery and equipment should not be limited to manufacturers</u>.

1. <u>Findings</u>. In general the sales tax should become a levy on personal consumption. This would enable the sales tax to become a true tax on personal consumption practices and lay the foundation for reforming the sales tax so that it is levied according to a person's consumption of luxury, non-essential items. Further, removal of the sales tax from capital investment items would improve the state's business climate and aid small businesses. The committee does not at this time recommend all business equipment be exempted but rather restricts itself to areas of the Maine economy needing stimulation.

2. <u>Recommendation</u>. The current sales tax exemption for new machinery and equipment used in manufacturing should be extended in two stages:

A. first, it should apply to all depreciable machinery and equipment used in the fishing industries; and

B. when the budget permits, it should also apply to all depreciable machinery and equipment used in agriculture.

This credit should be limited to those whose primary source of income requires such goods. For fishing goods this would cost about $750,000; for agriculture goods the cost would be approximately $3.3 million.

6. FINANCING
THE OMNIBUS TAX REFORM BILL

§1. Introduction

The recommendations of this report do not increase the total tax burden of the state. Rather, they shift the burdens within the state-local tax structure. Some persons will pay more; some will pay less. Yet one of the goals of this report will be more accurate taxation according to each person's "ability to pay".

Further, these financing recommendations should not be viewed just as likely sources for increased revenues. They stand on their own as worthwhile revisions to our tax laws.

The tax reform recommendations of this report would produce a tax shift costing approximately $ 28.8 million. The financing recommendations raise approximately the same amount.

§2. Financing recommendations.

1. Recommendation: Increase the real property transfer tax.

   A. Description. The rates should be increased from .55 per $500 to $1.00 per $500. As property valuations have increased, the capital gains on sales can easily bear this increase.

   B. Gain. Approximately $.6 million to the state (and $.1 million to the counties).

2. Recommendation: The sales tax base should be expanded to include amusements.

A. Description. Taxation of amusements such as films, amusement parks, etc. would increase the progressivity of the sales tax.

B. Gain. Approximately $1.6 million.

3. Recommendation: increase the corporate income tax rate in the higher income brackets.

A. Description. The current corporate income tax rates are:

5% of income under $25,000 ;

7% of income over $25,000.

This should be made more progressive by increasing the rate on income over $100,000 to 8%.

B. Gain. Approximately $2.1 million.

4. Recommendation: include life insurance proceeds of over $50,000 in the taxable estate.

A. Description. Currently life insurance proceeds are exempt from the taxable estate of a deceased person. Yet, clearly such proceeds indicate ability to pay of that person's estate. It is no argument to say that the premiums have already been taxed, because all wealth that ends up in the deceased person's estate has been taxed at one time or another (e.g., by property, sales or income taxes).

B. Gain. Negligible.

5. <u>Recommendation: apply the 5% tax to cigarettes</u>.

A. <u>Description</u>. The cigarette is currently exempt from the sales tax yet surely it is a luxury consumption item and should be taxed.

B. <u>Gain.</u> Approximately $3.7 million.

6. <u>Recommendation: collect a percent of the federal minimum tax on "loophole" or "tax shelter" income</u>.

A. <u>Description</u>. The federal government now requires a taxpayer to pay a minimal tax on income currently exempted from taxation (e.g., tax shelter income). Maine should also receive from its residents a percentage of such income.

B. <u>Gain</u>. Approximately $.1 to .2 million.

7. <u>Recommendation: Utilize the increase in federal revenue sharing funds to pay for tax relief programs</u>.

A. <u>Description</u>. The Legislature is due to receive from the federal government an approximately $3.2 million increase in undedicated Title II funds.

B. <u>Gain</u>. Approximately $3.2 million.

8. <u>Recommendation: impose a minimum income tax on all state corporations</u>.

A. <u>Description</u>. Each corporation would be required to make a minimum yearly corporate tax payment of $20.00. Currently, approximately 50% of the state's corporations pay no tax at all.

B. Gain. Approximately $.12 million.

9. Recommendation: part of the new revenues due to be realized from the Uniform Property Tax (UPT) should be returned through a property tax circuit breaker and reimbursement to the towns for loss of inventory tax revenues.

A. Description. The new, increased state valuation reflects a growth in wealth of Maine property owners of over $2 billion. The UPT mill rate should be lowered from 12.5 to approximately 11.65 mills[1/] and the remaining revenues collected and passed back to the people through tax relief programs (see chapter 3, sections 1,2.)

B. Gain. This plan would gain approximately $17.7 million.

1/ This represents a reduction of nearly 1 mill in the UPT mill rate. This analysis assumes the same level of education expenditures as last year.

7. AREAS DESERVING FUTURE STUDY

§1. Introduction.

The formulation of a state tax policy is a continuing effort. The recommendations of this report would be incomplete if they were not accompanied by a listing of areas the committee feels deserve continuing attention.

THE LESSER TAX BURDEN GRANTED FOREST LANDS AND FARMS AND OPEN SPACES IS JUSTIFIED ONLY IF THAT LAND IS SERIOUSLY THREATENED BY CHANGES HARMFUL TO THE PUBLIC'S INTEREST.

§2. The Tree Growth Tax and Farm and Open Space Tax should be evaluated as to whether the burdens they impose are equitable in relation to the burdens of other property taxes.

A recent analysis by John Joseph, senior economist in the Maine Department of Conservation, suggests that the lower level of taxation enjoyed under the Tree Growth tax might not be justified if the land owners are not under substantial pressure to convert forest land to other uses.[1/] The committee thus recommends that the following areas of the Tree Growth tax be investigated and legislation proposed if necessary:

A. the discount factor;

B. stumpage prices;

1/ Joseph, "The Tree Growth Tax: Implications For Forest Policy and Tax Equity" (Preliminary Draft) 9 (November 1976).

C. Capitalization rate.

The Farm and Open Space tax should also be subjected to the same kind of analysis.

THE STATE REVENUE SHARING FORMULA MIGHT BE MORE ACCURATE IN ITS DETERMINATION OF RELATIVE NEED.

<u>§2. The current state-revenue sharing formula might be improved</u>.

Investigations should continue into whether or not a per-capita income factor should be added to the current state revenue sharing formula. Currently, the formula reflects only a town's population and property tax effort. The addition of an income factor could significantly increase the accuracy by which the state determines the towns most in need of revenue sharing funds. Per-capita income figures for Maine are available on both the state and federal levels.

<u>§3. Fundamental reform of the state sales tax should be pursued</u>.

THE SALES TAX SHOULD PLAY A CENTRAL ROLE IN THE FUTURE REFORM OF THE STATE-LOCAL TAX STRUCTURE.

A complete study of the sales tax should determine whether or not major reform is advisable. The following areas should be specifically investigated:

A. Whether or not the sales tax should be broadened to include selected services;

B. Whether such a broadening would make possible a reduced rate;

C. Whether the equity of state-local tax structure could be enhanced by establishing a comprehensive sales tax credit, to be returned to citizens through the personal income tax system. This credit might represent the sales tax cost of necessities, thereby converting the sales tax to a tax on luxury consumption.

§4. Explore solutions to the administrative difficulty of taxing the unorganized territory at the same property tax rate as the organized areas.

In addition to the UPT, there is another state property tax - the Local and State Government Tax. This tax is currently at 10 3/4 mills and is a device which allows the state to tax the unorganized territory at a rate sufficient to provide for their municipal services. However, the state constitution requires uniform property taxation so that these mills must also be assessed against municipalities in the organized territory. Currently, many organized towns are not raising this amount and thus creating a potential problem of illegal assessments.

One solution might be an amendment to the state constitution:

> Section 8 Taxation; intangible property. All taxes upon real and personal estate, assessed by authority of this State, shall be apportioned and assessed equally, according to the just value thereof, except that the Legislature, in levying a State Tax may fix a different rate of taxation upon properties outside of incorporated cities, towns and plantations than the rate within such municipalities. 1/

1/ Memorandum from Norman P. Ledew, Director, Property Tax Division (July 1975).

8. CONCLUSION

> In the early colonies, state and local expenses were met largely through voluntary contributions and through revenues from public lands and enterprise....thus in 1644 in New Haven, Connecticut, each resident "whose heart is willing" was asked to give a peck of wheat to support "poor scholars at Harvard College."
>
> Brandon, Tax Politics (1976)

Would that taxes could be voluntary. Or that each town could decide its own affairs without raising its eyes to its neighbors. But if the presence of broad based state taxes - income sales, the Uniform Property Tax - prevent such an ideal state, they also insure that in each town there is at least a basic level of services and benefits.

The recommendations of this report attempt to refine and improve the benefits that accrue from a well balanced state and local tax structure. Even if all the recommendations were enacted, the work is far from complete. A continuing debate is needed.

Finally, even though this report states that one of our broad based taxes - the Uniform Property Tax -- has little relation to the issues of local control of education or fiscal responsibility, the committee does not feel these to be minor issues. There is perhaps no more profound question for our federal system of government than:

> How can the state improve the lot of its citizen's lives without diminishing one of life's most important qualities: the opportunity to be responsible for one's own affairs?

And that is one question for which there is never an easy answer.

4/30/76

State of Maine
DEPARTMENT OF EDUCATIONAL & CULTURAL SERVICES
Augusta 04333

CAPSULE DESCRIPTION OF THE "SCHOOL FINANCE ACT OF 1976"

Each year, the Legislature determines a "basic education allocation" which serves as the basis for subsidy reimbursement to each administrative unit. The costs which make up the basic education allocation are:

-- In the year immediately prior to distribution of funds:
   - Elementary operating costs.
   - Secondary operating costs
   - 90% of the costs of special education programs operated by the unit.
   - 90% of the costs of vocational education.
   - 90% of the costs of operating school buses.
   - The costs of school bus purchases.

-- In the year of distribution of funds:
   - 90% of the costs of special education tuition.
   - 100% of the costs of capital outlay projects approved by the State Board of Education.
   - All debt service on approved school construction.

Each year the Legislature sets a uniform property tax that will produce no more than half of the total basic education costs, the other portion to be financed from state sales and income taxes. (In 1976-77 the uniform tax was set at 13 mills or 45.4% of the basic education allocation.)

Additionally, the Legislature appropriates funds for subsidy adjustments (1) for unusual enrollment increases within units and (2) to compensate for high costs associated with geographic isolation.

The Legislature also appropriates funds to guarantee each school unit a maximum return of $90 per pupil when an optional 2 mills are voted by local school units.

If the uniform property tax raised by a unit on its state assessed valuation of property is less than the unit's basic education allocation, the State pays the unit the difference.

If the uniform tax is greater than the unit's allocation, the unit sends the excess to the State.

The uniform tax is made available by municipalities to school officials on a monthly basis, and state aid is paid monthly, except for debt service which is paid the month prior to its due date.

State aid to each unit will range from zero dollars to approximately 90% of the basic operating costs, depending upon the state valuation of the unit.

Average state aid for 1976-77 is 54.6% of the basic education allocation.

MINORITY REPORTS

MINORITY REPORT BY MARSHALL COHEN

INTRODUCTION

In the Order by which the 107th Legislature established the Joint Select Commitee on State Tax Policy there was a clear mandate to the Committee to

> "study the past and present tax policy of this State and of other States and...[to] ...attempt to recommend a clear and comprehensive tax policy that is equitable to each of Maine's citizens, and which yields the maximum benefits from all of Maine's people."

It is my feeling that the Committee has, to a certain degree, failed to accomplish this purpose for which it was established. The Committee carefully reviewed the myriad tax statutes currently on the books in Maine. However, the Committee failed to approach its task from the perspective essential to fulfillment of its mandate to recommend a "clear and comprehensive tax policy."

The greatest defects of our state and local tax structures are their inherently regressive natures. Maine's taxes are not "equitable to each of Maine's citizens." In fact, the lower a citizen's income the higher will be his or her state and local tax burden. As a committee we only dealt tangentially with progressive tax reform.

Any tax structure must be viewed as a complex network of interrelated laws which have far reaching economic consequenses. A tax levied on one sector of the economy often has significant repercussions in other sectors. In not taking a broader view, the Committee, when it made its specific recommendations, failed to "see the forest for the trees." It tinkered with numerous individual taxes without giving adequate attention to the overall effect of its report and recommendations.

As a Committee we failed to continue on the path first broken by the 1975 Governor's Tax Committee, which recommended several fundamental and progressive reforms of Maine's tax structure. The common theme of our Committee's final discussions and recommendations was that we should propose only those reforms which were perceived as having a reasonable chance of enactment in the 108th Legislature. The Committee was not directed to recommend compromise tax reforms. Rather, we were requested to formulate a comprehensive tax policy. I do not feel we have accomplished the latter.

This minority report is divided into three parts. The first two parts contain specific criticisms of two majority proposals involving sales taxes and property taxes. The third part contains a proposal that I feel is the most efficient and effective means of achieving progressive tax reform in this State.

PART I

<u>Sales Tax Adjustments that Directly Affect Consumers</u>

The Committee has attempted to make the state sales tax more progressive by recommending that, (1) no sales tax should be imposed on sales of residential gas, water and electricity and (2) the sales tax should be extended to include amusements. Although these recommendations are a step in the right direction they do not directly confront the fundamental problem that the sales tax is a very regressive mechanism.

A blanket exclusion of certain utilities from the sales tax means that persons fully able to pay the tax will not be required to do so. Such a law would certainly help lower income families. However, the law would do little to change the disparity between the tax burdens of low and high income families. This first recommendation is not one which will lead to progressive tax reform.

At first glance, the recommendation that the sales tax base be expanded to include amusements appears to be sound. However, such a policy might prove to be a real hardship to the working class parent with a large family who wants to take that family bowling or to the movies once a week. All families, regardless of income, utilize theaters, amusement parks, bowling alleys, etc. on a fairly regular basis.

A more compelling argument can be made for extending the sales tax to those services which, unlike amusements, can be more clearly defined as luxury services, or services used by higher income families, such as fur storage, dry cleaning, beautician services, tax and investment consulting, commercial photo services, rug and window cleaning, etc. The taxation of selected income related services such as those described above would be a much more progressive measure than an across the board amusement sales tax.

The two Committee sales tax proposals discussed would cost the state approximately $1.7 million, and would only go a short way to alleviate the inequitable tax burden caused by sales taxes in general. There is, however, a method to lessen the regressive nature of the sales tax; a method more equitable to Maine citizens than the Committee recommendations. That would be to establish a sales tax credit or rebate mechanism. Such a mechanism could exist independently or in conjunction with an overall tax credit or rebate plan. Such a plan will be discussed later in Part III of this report.

PART II

Property Tax Circuit Breaker

Among several alternatives, a majority of the Committee chose to recommend to the 108th Legislature the adoption of a low income property tax circuit breaker. The circuit breaker concept was used in a bill introduced in the 107th Legislature. It was also discussed in dissenting reports prepared by the 1975 Governor's Tax Committee.

The purpose of a property tax circuit breaker is to alleviate the excessive burden imposed by property taxes upon lower income families. The circuit breaker, especially as proposed in the 107th Legislature, is not the best answer to the inequities of property taxes. Indeed, the circuit breaker bill described above, which was modeled after a bill designed by the Advisory Commission on Intergovernmental Relations, contains several provisions that could make property taxes more regressive for certain low income families.

As proposed in the last legislative session the circuit breaker contained a section which provided that,

> "no claim for relief under this chapter shall be allowed to any person who is a recipient of public funds for the payment of the tax or rent during the period for which the claim is filed."

The most logical reading of this provision leads one to conclude that citizens receiving SSI, AFDC or General Assistance, and using funds from those sources to pay rent or property taxes, are excluded from the benefits of the circuit breaker.* The overwhelming majority of citizens on SSI and AFDC use the funds received from those programs to pay rent or property taxes. A significant percentage of General Assistance applicants also receive assistance in the form of rent payments. The above described provision prevents the benefits of the circuit breaker from reaching the lowest level of low

*I realize that the statement of facts at the end of the circuit breaker bill indicates that SSI recipients should be able to benefit from the circuit breaker. However, the actual text of the bill leads one to the opposite conclusion.

income citizens who, I submit, are most in need of tax relief.

The circuit breaker bill further provides that in order to qualify for relief an individual can have no delinquent property taxes on his or her homestead. Such a provision further discriminates against the very low income person. If a citizen has experienced past difficulties in paying property taxes he or she most assuredly should not be excluded from obtaining present property tax relief. Indeed, our first concern should be for those persons whose homes are in jeopardy due to their inability to meet the ever increasing pressure of property taxes.

Another section of the circuit breaker bill requires that each renter wishing to obtain relief under the program furnish "reasonable proof of rent paid." Such a simple provision, innocuous on its face, can further operate to exclude from the benefits of the program the very people most in need. Circuit breaker bills are admirable in their recognition that renters pay property taxes, and should be entitled to relief from their indirect property tax burden. However, low income and poor families frequently find it difficult to keep a year's worth of rent receipts or they may not receive any rent receipts at all. Moreover, many such families do not use such middle class conveniences as checking accounts, which would enable them to comply with the requirements of proof of rent paid. The proof requirement could act as a significant deterrent to many renters otherwise eligible for benefits under the circuit breaker.

I recognize that the problems of the circuit breaker I have ennumerated above could be rectified by amendments to the bill that was placed before the last Legislature. Such amendments would certainly not adversely affect the overall impact of such legislation. At the very least, if a circuit breaker mechanism is adopted by the legislature it should contain the amendments described above.

However, the major defect in the circuit breaker approach to property tax reform is that it only deals with one type of tax. It fails to deal with the many other taxes which make up the state and local tax structure. A circuit breaker mechanism would require a major allocation for administrative costs. If it was a program truly designed to address the problem of regressive taxes the large administrative cost could be justified. However, since the property tax circuit breaker only addresses one part of a complex problem, and since the programs outlined in Part III of this report deal with the entire tax structure, I feel the time and money necessary to implement a property tax circuit breaker would be better spent on one of the following two programs.

PART III

Two Alternative Proposals

There exist two principal alternatives to the circuit breaker program, which are more far reaching in their impact, and at the same time are more simply administered.

The first program would shift the entire burden of public welfare and education costs from the property tax to the income tax. Such a program would improve the progressiveness of the entire income tax structure, and include what has been termed a negative income tax as a method of tax relief to those at the lower end of the income scale. This is essentially a fundamental reform recommended last year by the Governor's Tax Policy Committee. It recognizes that the income tax is truly the most progressive of all taxes. Moveover, the administrative mechanism for such a program is already established, and has the flexibility to provide tax relief through a credit or rebate plan.

A second alternative, or perhaps an interim step toward the eventual shifting of the total tax burden to the income tax system, is to establish a comprehensive low income tax rebate plan similar to one currently operating in the state of New Mexico. This plan is designed to alleviate the burden of property, sales, and all other state and local taxes on low income families by giving back part of the total taxes paid by such families during a taxable year. The New Mexico program is so designed that, at the very least, families below the poverty level will pay no greater percentage of their income for taxes than families at or above the poverty level.

Data provided to the Committee shows that in 1975 a Maine family of four with an annual adjusted gross income of $5,000 bore a state and local tax burden of 13.6%. The same size family with an adjusted gross income of $7,500 incurred a burden of 11.5%. As income rose to $10,000 the tax burden decreased to 9.7%. This inequity of tax burdens is what any comprehensive tax reform policy must address.

The clear advantage of the two proposals contained in this section is that both are aimed at relieving the entire tax burden. They are comprehensive programs as opposed to the piecemeal approaches recommended in the majority report.

The New Mexico tax rebate model utilizes the existing state income tax structure, thereby greatly reducing administrative costs. The tax rebate program is an extremely flexible mechanism. The rebate formula may be designed to make the state and local tax system as progressive as the legislature desires. Furthermore, each year the amount of relief can be adjusted to reflect the financial needs of the state and its citizens.

A report prepared in 1975 by the United States Advisory Commission on Inter-governmental Relations stated that,

> "programs like New Mexico low income tax credit, if properly funded and administered, are potentially the most powerful tools yet tried for providing broad based relief to low and moderate income families...."

That same year a report sponsored by the United States Department of Housing and Urban Development said:

> "the mechanism [of a tax rebate program] is a flexible one and offers attractive administrative advantages....Because the comprehensive credit condenses many of the other tax credits currently used by the states to reduce regressivity (property tax, renters, food tax, and sales tax credits) into a single, efficient, easily administered credit formula, it has great promise for both New Mexico and other governments who select this approach."

In conclusion, I would simply state that it is my sincere hope that the Legislature, the Governor, and the public will recognize the need for comprehensive tax reform in Maine. 1977 is viewed by many in government as the year for tax reform in this state. It would be most unfortunate if the 108th Legislature adjourned with new tax measures that did not fully address the problem of the unfair tax burdens which now must be borne by lower income families in Maine.

MINORITY REPORT BY W. SCOTT FOX

The undersigned member of the committee submits this minority report in dissent of the introduction in the report of a circuit breaker which limits some property taxes and also to point out the failure of the report to deal with the underlying problem--the over reliance on real estate taxes as the primary revenue source for the state.

The circuit breaker purports to provide relief to overburdened low income tax payers from excessive real estate taxes, yet, the property tax is billed as one of three fair measures of taxation, the others being the income tax and sales tax. This contradiction arises because the real property taxes is not an equitable means of raising statewide revenues for statewide programs such as education and welfare. The circuit breaker is an attempt to deal with the surface symptoms of that problem without addressing the problem, itself. Indeed, the concept of the circuit breaker compounds the problem by reducing property taxes for some, while assessing those same taxes to other property owners. The nature of the circuit breaker concept together with the state uniform property tax assessment program, can have only one result--to continually raise greater and greater real estate taxes from a smaller and smaller base.

In this connection, it is important to understand that what is described in the committee report as a shifting of tax burden (as opposed to a tax increase) from circuit breaker recipients to non-circuit breaker recipients is, indeed, not true. The $10 million of relief granted to circuit breaker recipients would, in fact, be funded by new tax dollars resulting from an increase in property valuations. While the Uniform Property Tax rate is not expected to increase in 1977 and may, in fact, decrease slightly, property valuations have already been substantially increased, which will result in larger checks being written by tax payers. That indeed is a tax increase.

Finally, the circuit breaker concept does not stand the test of common sense. It is a relief program for low income people and, therefore, is essentially a welfare program. Yet, it does not distribute welfare impartially but rather only to those having disproportionately high wealth in relation to income.

W. Scott Fox, Jr.

MINORITY REPORT ON INCOME TAX REFORMS FROM PHILIP HUSSEY, JR.

The majority report does not fully address the problem of income tax levels both personal and corporate as it impacts industrial development in Maine.

A basic tenet of tax policy in Maine should be to encourage capital investment, thus creating more employment and high personal incomes. I do not feel that the majority report properly addresses this issue.

I am opposed to the increase in corporate income tax rate of 8% on income over $100,000. The present top rate of 7% places Maine in a non-competitive position. To increase it will further impede industrial development.

I am opposed to the language used in the majority report concerning Personal Income Tax on pages 4-3 and 4-4. There is not a strong commitment to revise the top rates (incomes of over $25,000) downward so that the present "disk effect" of tax effort as shown in the table shown on page 2-4 is corrected.

I therefore propose, to partially remove this inequity, that the interim rates known as "1976 Rates, Table B" of the Maine Individual Income Tax be made the permanent rate structure instead of the 1977 Table C Rates. The effect of this would be to reduce the maximum percentage rate from 10% to 8%.

In summary, these two changes would restore more equity to the income tax structure and assist in the desirable trend towards more capital investment in the State.

MINORITY REPORT ON A MUNICIPAL POINT OF VIEW FROM IRVINE W. MARSTERS, JR., BREWER CITY COUNCIL AND LOCAL GOVERNMENT REPRESENTATIVE

INTRODUCTION

I concur with most of the Committee's short-range recommendations for redistributing the tax impact among State of Maine taxpayers. However, there are two areas of major concern for Maine municipalities relating to: (a) the formula for reimbursement to municipalities for lost tax base (i.e., lost revenues) arising from the proposed repeal of the property tax on inventories; and, B) the proposed use of the major portion of the $28 million increased dollars to be realized from a 12.5 Uniform Property Tax mill rate to finance property tax relief.

MUNICIPAL REIMBURSEMENTS - REPEAL OF INVENTORY TAX

The Committee is correct in considering it of the highest priority that repeal of the property tax on inventories be continued. The tax is hard to administer accurately and equitably. It is an economic deterrent harmful to the Maine business climate. Further, the State is obligated, under the terms of the repeal, to reimburse Maine municipalities for their lost tax base (i.e., lost revenues). The law states that payments will be made to towns on the basis of their 1973 state valuation. The inequity of this approach is clear when you look at the effect repealing the Inventory Tax had on relatively small, inventory-poor municipalities, especially related to a shift of burden under the Uniform Property Tax, County Taxes, etc. Exempting inventories so lowered the state valuation (to the benefit of relatively inventory-rich communities) that small, inventory-poor communities paid higher Uniform Property Tax and county tax rates, yet received little, if any, reimbursement for the lost property tax on inventories.

The Committee correctly recommends that the current reimbursement approach (using 1973 state valuation) be replaced by distributing the revenue loss (approximately $14 million in 1977 and every year thereafter) through the current state revenue sharing formula. The Committee briefly discussed some criteria for determining the equity of the reimbursement formula but did not address it in the final report nor did it have adequate data to determine if the state's revenue sharing formula met the test of equity. Therefore, I suggest that if the reimbursement formula is to be acceptable it will take into consideration the net gains and losses from the past shift in State property tax burdens as a result of the repeal.

UNIFORM PROPERTY TAX MILL RATE

I strongly dissent from the Committee recommendation that the increased revenues (about $28 million on the new state valuation) due to be realized at the 12.5 Uniform Property Tax mill rate be used to provide property tax relief. While the Committee does recommend returning $11 million to all property taxpayers (state residents or not) by reducing the Uniform Property Tax to 11.75 mills, it does not go far enough in this regard. Instead of reducing the Uniform Property Tax mill rate further, the recommendation is to use approximately $10 million to fund a portion of the $14 million reimbursement to municipalities because of the repeal of the property tax on inventories.

Whatever happens to the Uniform Property Tax, the basic policy previously adopted by the Legislature that no more than 50 percent of the costs of education should be borne by property taxation, should be maintained. Secondly, that the Uniform Property Tax not be used to raise revenue for other purposes such as the circuit breaker or to shift property tax burden from personal property taxpayers to real property taxpayers by funding the better portion of the municipal reimbursement from repeal of the Inventory Tax.

As a priority, the uniform state property tax mill rate should be reduced to a level no greater than the level of state education costs the past year, except to an extent necessary to cover essential increases in school costs. Further, there is an alternative to funding municipal reimbursements resulting from repeal of the Inventory Tax other than from the Uniform Property Tax increases. The municipal reimbursements ought to have the highest priority for funding from a combination of increases in corporate and personal income taxes and sales taxes.

Finally, I recommend the following as a tax policy posture for the future concerning state allocation of local education costs and the Uniform Property Tax. The Legislature should take full responsibility for setting the Uniform Property Tax mill rate each and every year at a level sufficient to cover no more than 50% of the costs of education. This would mean eliminating a standard or projected mill rate in the law and assuring that there be no element in the law that automatically raises revenue without specific legislative approval and/or for purposes other than meeting the costs of education. In effect, there should be no "passive increases" in the Uniform Property Tax.

The setting of an annual mill rate is even more important now since state property valuation in the future will take place each year and annual increases are certain to occur. Further, the Legislature should set the rate for the Uniform Property Tax early enough to allow municipalities to adopt their annual budgets without serious disruption.

CONCURRING REPORT FROM SENATOR PHILIP L. MERRILL

The majority report has my support as a short range program of tax reform. It recognizes the realities of the present political climate and, within those limits, makes great strides toward more equitable taxation.

The long range goal should be to provide a greater shift from property tax to the more progressive income taxes. This should be done in a way that will not diminish non-resident tax revenues - the circuit breaker once in place might provide the vehicle for further reductions in net property tax paid by Maine people. There is a great temptation to call for a greater shift this year; there are several reasons why this is not practical. First, we need more hard information about who pays the property tax, where they live, and what they earn. The facts gathered through administration of the circuit breaker and more complete income tax forms will provide some of that information. Beyond that , the State Planning Office should explore ways to gather that data, and supply it to State policy makers. Further, there was an increase in the income tax last year; without support from the Governor it would be near impossible to effect another increase this year.

Finally, taxes are the way we finance our state. A certain caution about rapid changes, even when we are sure of the direction we are going, is as appropriate to government as it is in the private sector.

As to the Uniform Property Tax, I do not share the majority commitment to this tax. I am entirely committed to the State guaranteeing a minimum expenditure for each child's education. I favor over 50% of those monies coming from non-property tax sources, and I favor a system that approximates tax power equalization.

The Uniform Property Tax is one way to guarantee the latter. It is not the only way and, considering the upheaval it has caused, it may not be the best. As we lessen our reliance on the property tax to fund education, we can abandon the Uniform Property Tax at a loss of less than the six million dollars we now receive in "pay-in" payments. I think we could take that step without any loss of tax equity and, possibly, with a great gain of support for our broader educational goals.

CONCURRING OPINION of Senator Collins:

I agree with much of the separate report of Senator Philip Merrill. My preferences in adjustment of the majority report would be to further reduce the mill rate of the Uniform Property Tax and to compensate for this by deferring the sales tax exemption described in 2B of Chapter 5, § 3 and the income tax benefits described under B and C of Chapter 4, § 1. Any further savings which the Governor and Legislature can achieve should further this reduction.

MINORITY REPORT FROM REPRESENTATIVE BONNIE POST AND PHILIP HUSSEY, JR.

The purpose of this report is to set forth the reasons why the minority of the committee favors the abolition of the Uniform Property Tax.

The School Finance Act (L.D. 1994) made fundamental policy decisions in two major subjects of Legislative concern. They are educational policy and tax policy. We recognize that the State has a constitutional obligation to see that each of its subdivisions in fact provides an adequate basic elementary and secondary school program. Furthermore, when communities are financially unable to do so, it is the obligation of the State to raise and appropriate sufficient money to give the necessary assistance. We support these provisions in the present law and feel that such provisions should be retained and be adequately funded from the State's regular general fund resources.

Our primary disagreement with the present law is with the tax policy features, specifically the State Uniform Property Tax. It should be noted that L.D. 1994 and its successors all have been the product of the Joint Standing Committee on Education. In our opinion the Legislature has made a fundamental and grievous error in tying these two major policy areas together in one law. It should separate the two and deal with each on its own merits.

When the Legislature passed the Sales Tax in 1951 it made the commitment to no longer collect a property tax from its municipalities and left to them the resource of real estate property tax revenues in the organized territories. The School Finance Act was the first step in backing down on that commitment and the recommendations of the majority of this committee would abandon it totally.

The School Finance Act provides for a State decision on a per student basic educational allowance and a State decision on what percentage of that allowance and other State educational subsidy should be raised by the Uniform Property Tax. When the State sets its mill rate, it is assessed against the municipality based on Just value or what the State feels the property in that municipality would be worth if it were sold. The municipality then raises enough money from its valuation to pay the bill. Thus, the Uniform Property Tax is a tax on municipalities <u>not</u> on individuals.

Using the basic education allowance, other costs and some estimates, as approved by the Legislature, the Department of Education computes how much each school unit is to receive. The first money a unit "receives" is the money raised by the State Uniform Property Tax on its own property. If that doesn't meet the State computed figure, the unit receives a subsidy from the State. If a unit raises more money from the Uniform Property Tax than the State figure, it pays in the excess to the State.

It's important to note that this State computation is not the amount the school unit itself needs, to provide a basic education for its own students, but rather is a computation including state-wide averages, estimates and past expenditures. Many times a community has to tax itself to meet the UPT, part of which it keeps and part of which it sends in to the State, and then tax itself to meet its own students' needs.

In fiscal year 1976-77 approximately 112 million of the State imposed Uniform Property Tax remained in the units where it was raised and the state actually distributed approximately 150 million additional in subsidy. Of this 150 million, 145.5 came from the general fund revenues and 4.5 million came from school units, which raised more from the State Uniform Property Tax than the state computed they should be receiving.

All of the money raised under the UPT is a true State tax in that municipalities have no control over the levy. However, it is only the 4.5 million which would have to be replaced if the UPT is repealed and the level of state wide subsidy to schools is to remain at the same figure as last year.

We feel that this repeal should take place for the following reasons:

1. The Uniform Property Tax removes local control of taxation.

The majority report contends that the UPT does not lessen local control of education while ignoring the question of local control of property taxation. Clearly, local communities no longer have any power over the largest percentage of their property taxes. In some communities, as much as 90% of a property tax levy is dictated by the State.

2. The UPT encourages fiscal non-responsibility.

It's poor practice for several levels of government to use the same tax since each can then point to "the other guy" as being responsible for the high level of taxation. In this case, citizens are frustrated as they go from place to place trying to control the taxes on their homes.

Fiscal non-responsibility is further encouraged in this particular situation by the fact that the complexities of the law cloud the relationship between state action and the ultimate level of an individual's property tax bill.

3. The complexities of the law discourage fiscal responsibility.

The examples could be many. For instance, citizens are told that 90% of regional vocational education is funded by the State. In fact up to 50% of the 90% which is the "State's" share comes from the UPT in the first place. Additionally, basing State obligations on prior years State costs plus local expenditures provide a built in escalation of State expenditures.

4. Moving the decision on the level and method of taxation from the local to the state level increases the possibility that extraneous factors will become involved in what is a political decision.

5. The fundamental political decision on the amount of money to be raised for education through property taxes should be made on the local level, since the governing bodies are more representative of the people who actually receive and pay for the service.

6. The State Valuations of the municipalities are at best the "expert opinion" of a very few civil servants employed by the Bureau of Property Taxation. The only way the State can insure the "uniformity" it seems to desire is to assume the valuation of all property in the State. Not only would State valuation of all real property represent the ultimate loss of local control of taxation, it would be immensely expensive.

7. The State Valuation identifies certain coastal, lakeside and other areas wealthy in land value. When taxes are collected and disbursed within a community this causes some problems but the UPT by taxing "wealthy" Matinicus to subsidize "poor" Cape Elizabeth is setting a social policy with which we do not agree.

When the State insists a community be taxed on just value or what its land would be worth if sold, it forces that community to increase its taxes accordingly. Property is a measure of ability to pay only when the property is sold and in many cases, that is what the UPT is forcing people to do.

8. The Uniform Property Tax is shrinking the tax base of some communities.

Individuals are taking advantage of such programs as conservation easements to escape the effects of the UPT. These types of programs have the added effect of shrinking the tax base of the municipalities. It should be noted those individuals who are most likely to place their property in these types of programs are wealthy with large land holdings.

9. By extending State control over a large percentage of the property tax revenue available to a community, the UPT has decreased the amount of revenues in many towns available for needed services.

In summary, we agree that our citizens should be able to control property taxation at the level of government closest to them. We believe that the U.P.T. has seriously eroded this preperogative and the amount collected through it should not be expanded to fund additional programs, as recommended elsewhere in this report. Such expansion would place the State in the position of utilizing the property tax as a major source of revenue and makes a bad situation even worse. Rather the tax should be repealed.