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Testimony Regarding LD 1088
An Act to Modernize the Tax Laws and Provide over \$75,000,000 to
Residents of the State in Tax Relief

By Christopher St. John, Executive Director, Maine Center for Economic Policy

Senator Perry, Representative Watson and members of the Joint Committee on Taxation. Thank you for this opportunity to participate in your very important discussion of tax reform. The bill before you represents the best opportunity for successful tax reform I have seen in over thirty years of observing and taking part in discussions of Maine's tax system.

We think it is important to start an analysis of any tax reform proposal to remind ourselves of the obvious purpose of our tax system: to raise the revenue to accomplish things together as a state that we cannot get done individually – providing the physical infrastructure and the education and health care and environmental protections we have collectively decided are essential to keep our communities and families thriving.

We may decide to change the WAY we collect revenue to improve fairness, to shift costs among taxpayers, to contribute to economic vitality in a variety of ways, but it is important not to lose sight of the overall goal of adequately paying for our collective investments.

In 1996 the Maine Policy Review published an article titled “Whose Tax Burden, Whose Tax Fairness, and Whose Tax Reform”, in which I argued that it would be a lot easier to make Maine's tax system worse than to make it better. Our system currently produces revenue at a rate that in general keeps pace with the Maine economy and is at least less regressive than the systems of most other states. The article began with the question, “Is 1998 the year for tax reform in Maine?” It appears now that 2009 might indeed be another unique opportunity for tax reform in Maine, and if it is, it becomes important to get it right.

In the last major state economic and fiscal crisis in 1991, a coalition that came to be known as Taxpayers for A Fair Budget advocated for increasing revenues as one part of the solution. At that time the general fund shortfalls were projected to reach one third of the projected expenditures. As you will remember those shortfalls were closed with great pain and difficulty and long hours by your legislative predecessors, using some terrible accounting gimmicks, some terrible program cuts, and tax increases – including a 10% surcharge on the income tax which lasted for two years and a penny increase in the sales tax which remained in place for eight years.

The revenue shortfall in FY 1991 may have been exacerbated by changes in 1989 in the income tax, which were projected to be “revenue neutral,” but which may have led to lower revenues than had been projected. Maine's capacity for revenue projection is vastly superior to what it was then, but we all need to keep our focus on those projections as we discuss potentially large changes in our tax structure.

In 1994 the Taxpayers for a Fair Budget Coalition was instrumental in the formation of the Maine Center for Economic Policy. Over the years we and our coalition

partners have reiterated before you numerous times the principles through which we evaluate any tax reform proposal. First, it is essential that a new tax system maintain adequate revenues to support the growth of essential government services at the rate that the general economy grows. Second, a new tax system should benefit as much as possible all Maine households. Third, it should target tax reductions to those who pay the greatest share of their household income in taxes. Fourth, it should export as much as possible our government costs to nonresidents who enjoy visiting our state. And finally a new tax system should maintain some balance between resident and business taxpayers.

As we view LD 1088, we are impressed that it appears to promise revenue neutrality – the ability to raise the same level of revenues as our current system, although from a different mix of sources. For many years many economists have written many analyses of the Maine tax system which have concluded that Maine government currently relies a little too heavily on income taxes and property taxes and less than other states on sales taxes.

We appreciate that because the bill adheres to our fourth principle – exporting more of Maine’s tax costs to nonresidents, it is able to deliver \$75 million in reductions in overall taxes to Maine taxpayers, and through an ingenious system of credits, seeks to deliver those benefits to all Maine households at all income levels. We look forward to studying with you Michael Allen’s wonderful distributional analysis of this proposal, but as we currently understand it, the new credits are designed to assure that the new system of revenue is no more regressive than the current system for most income groups. For us this is a fundamental requirement, which we hope you will keep in focus as you consider potential changes to the bill.

So to meet three out of five criteria makes the bill pretty good in our eyes, and our desire for improvements need not stand in the way of good things happening for Maine taxpayers. We would like to offer modest but important ways in which the bill could be strengthened. Maine’s current tax structure taxes most heavily the 20% of households with incomes below about \$11,000 annual income. They pay on average over 15% of their household income in taxes. From our view it is a shame to undertake major tax reform without targeting more of the benefits to this group that presently carry the heaviest load and are experiencing even greater needs in these difficult economic times..

We are particularly concerned about the very real danger that the bill could actually make things worse for low income households. We understand the bill to provide up to a \$75 refundable credit to low income households to compensate the degree to which they may face higher sales taxes due to other provisions in the bill. But just as currently about half of those estimated to be eligible for the property tax and rent refund program do not apply for those benefits, we fear that too many taxpayers who have no income tax liability will not file for the new credits.

We recommend four ways of addressing these potential defects of the bill. One would be simply to increase the amount of the new refundable credit, We think that would be desirable, but that would not completely address the challenge of getting the credit to those eligible if they don’t file. Two existing programs could be strengthened to provide more relief to many low income households. For some years the committee has considered allowing applications for the property tax and rent refund program to be filed as a schedule with income tax returns. We believe this would over time bring many more

low wage workers, who are filing for income tax refunds, into the Property Tax and Rent refund program. We also recommend another route to improve applications for Property Tax and Rent refunds for those who have very low incomes (and in general are less likely to have earnings and therefore income tax filing): by permitting applications through the Department of Health and Human Services Automated Client Eligibility System (ACES).

Finally the committee heard last week compelling testimony regarding the value of making our current state Earned Income Tax Credit refundable and increasing the proportion of the Federal credit which is allowed. These changes would also be excellent ways to make the overall tax reform package more beneficial for Maine's low income residents, and could stimulate more effective participation in the benefits already built into the bill.

We understand that each of these measures would cost some money which can only come in a revenue neutral proposal from decreasing some of the benefits to other Maine taxpayers. While the bill as presented distributes benefits in proportion to current tax liabilities across most income groups, the reduction of the top rate overwhelmingly benefits the very highest income taxpayers and business income that is "passed through" to the individual tax. We have heard the contention that this will make Maine more attractive for business location and investment and high wealth residents. But the economic literature does not support this hope.

We distributed to you earlier the survey by Robert Lynch of Economic Policy Institute that found little correlation between tax rates and business activity. We distribute today executive summaries from two studies – one in Ohio and one in New Jersey – that found that sharp changes in top income tax rates did not have significant effect on patterns of mobility into or away from those states. Many economists, including Nobel prize winner Joseph Stiglitz have suggested that in an economic downturn actually raising taxes on upper income households is preferable to state budget cuts that have the effect of increasing job losses.

Our concerns about the proposed top rate reduction have not led us to oppose this package at this time, because we recognize that the whole package does deliver important benefits to all Maine taxpayers. Because of the way the bill is structured we are willing to go along with a reduction in the top rate, which we would not support otherwise. To reiterate, we think it would be a great shame to miss the opportunity to deliver greater benefits for those carrying the heaviest load, by being too attached to a discredited economic theory that delivers the most to where it is least needed.. Since more money must come from somewhere to provide more benefits to those most in need, removing just a little of the huge benefit of this bill for the top income group would be the best way to accomplish that goal.