

April 19, 2010

TAX REFORM DELIVERS BENEFITS TO MAINE HOUSEHOLDS

by Dan Coyne

In June 2009, Maine lawmakers passed historic tax reform that exports a greater share of taxes to nonresidents and results in a modestly more progressive tax system. This reform is “perceived widely as the most significant tax reform in Maine of the past 40 years.”¹ Unfortunately, Maine people have yet to realize its benefits. Opponents, led in part by legislators who failed to block the original bill, have put the measure on hold by forcing a “people’s veto” scheduled for a vote on June 8, 2010. The outcome of this vote will determine whether tax reform finally becomes law, lowering overall taxes for Maine families. If the “people’s veto” succeeds, Maine’s tax code—widely criticized as outdated and unstable—will remain substantially unchanged.

Principal Areas of Reform

Almost one year ago, the Maine Legislature passed and Governor John Baldacci signed into law LD 1495, An Act to Implement Tax Relief and Tax Reform. Most of the law’s provisions were originally scheduled to take effect on January 1, 2010. If the people’s veto is defeated, the same provisions of tax reform will become effective January 1, 2011.

LD 1495 changes Maine’s tax system primarily in three areas: the income tax, the sales tax, and the Maine Residents Property Tax and Rent Refund Program. In its entirety, the tax reform law is virtually revenue neutral and benefits Maine people at all income levels.



Mainers are one step away from modestly more progressive tax relief under a restructured tax system that maintains critical public investments by shifting the tax burden to nonresidents.

Income Tax: More Mainers See Relief

Maine currently has four marginal tax rates: 2%, 4.5%, 7%, and 8.5%. Tax reform replaces these rates with a single rate of 6.5% and a 0.35% surcharge on all taxable income earned above \$250,000. The law also repeals standard and itemized deductions while authorizing new tax credits.

The primary new tax credit is a refundable household credit available to Maine residents. The credit has a base amount of \$700 for single taxpayers, \$1,050 for head of household taxpayers, \$1,200 for married taxpayers filing jointly, and \$600 for married taxpayers filing separately. Each exemption claimed on a taxpayer's federal income tax return increases the base credit by \$250; however, the credit is phased out for higher income taxpayers.

The other income tax credits created by tax reform are a 5% charitable contributions credit on contributions in excess of \$250,000, and a \$60 credit for taxpayers aged 65 years or older, phasing out at higher incomes.

Of particular significance, the law also makes the Maine earned income tax credit refundable. Coupled with the household credit, married taxpayers filing jointly can receive a refund up to \$150, and all other taxpayers can receive up to \$125.²

The combined effects of the new rates and credits will lower income taxes for 95.6% of Maine households, including refunds for approximately 263,000 Maine households currently paying no income taxes.

Sales Tax: A More Balanced System

Currently, Maine has a 5% sales tax levied on a variety of goods and, to a lesser extent, services. In order to raise the money to reduce income taxes for most households, tax reform

does not change the general 5% rate but rather applies the sales tax to more services. When sales taxes were first imposed, services did not represent as substantial a portion of the economy as goods. To account for the increased role of services in the broader economy, many services previously exempt from the sales tax will now be taxable, such as installation, repair, and maintenance services; transportation and courier services; personal property services; and amusement, entertainment, and recreation services.

While the general sales tax rate is not increased, the rates for prepared food and lodging (except camping areas) are increased from 7% to 8.5%. The short-term car rental sales tax is increased from 10% to 12.5%. At the same time, tourism promotion and marketing funding is increased.

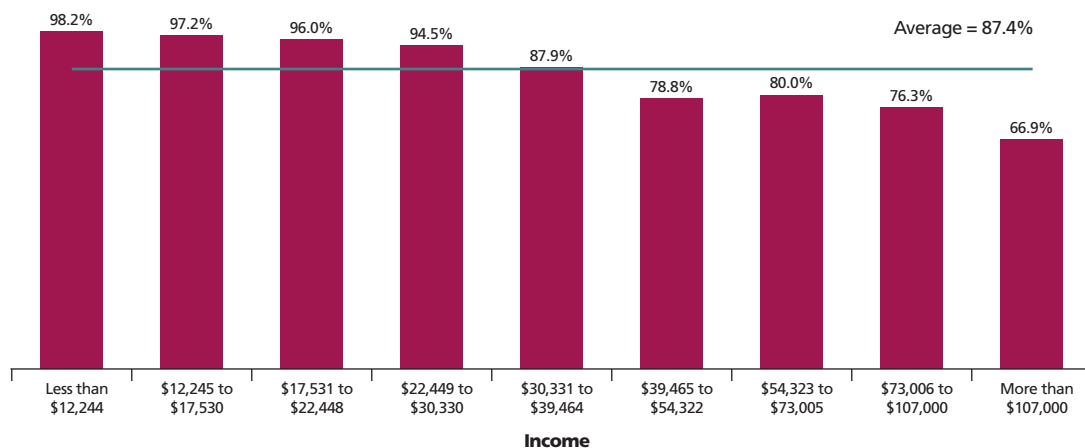
Circuit Breaker Program: Better Access to Relief

The Maine Residents Property Tax and Rent Refund Program, better known as the "circuit breaker

program," is a progressive tax relief program that provides partial refunds to eligible taxpayers for either property taxes assessed or for rents paid during a calendar year. Under current law, approximately 96,000 taxpayers will receive a refund under the program in 2010-11. Eighty-two and a half percent are families with incomes of \$40,000 and less.

The tax reform law streamlines the circuit breaker application process. It also modifies the income and benefit calculations and includes the application for a refund with the individual income tax form beginning in the 2010 tax year. For those who do not file an income tax return and do not apply for a refund electronically, Maine Revenue Services will mail an application.

Tax Reform Benefits a Majority of Maine Families of All Income Groups
Percent of Families whose Taxes will Decrease



Source: MECEP Analysis of data from Maine Revenue Services.

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Critical Impacts of Tax Reform

Three important aspects of any tax system are progressivity; the maintenance of adequate revenue to support critical public services such as education, health care, and transportation over the long-term; and the exportation of taxes to nonresidents who take advantage of services available in Maine. Tax reform, as embodied in LD 1495, fulfills these objectives.

Improves Progressivity for Maine Families

A distributional analysis of the tax reform law reveals that it is modestly more progressive than the tax system currently in place. Overall, when the changes to the income and sales taxes are considered together, 87.4% of Maine families will receive a tax reduction averaging \$149.90 in 2011.³ For those families receiving cuts, average tax reductions range from \$45.20 for families earning \$12,244 or less to \$1,031.50 for those earning \$107,000 or more. Generally, lower income households see the greatest percent tax change while higher income households see the lowest percent tax change.

With a broadened sales tax base, many will pay an increase in total sales tax. However, when considering the impact of the sales tax changes along with the income tax changes, most Mainers receive a net benefit from tax reform.⁴

Making the Maine earned income tax credit refundable is important because it puts money directly in the pockets of people who most need it. And they

will likely use it to purchase necessities and important services here in Maine, helping small businesses and our local economy.

In addition, the circuit breaker program provides relief to families with higher property taxes as a share of household income. Unfortunately, fewer than half of those eligible for a refund currently apply for and receive it. The alignment of applications with income tax filing season is expected to encourage more people to apply for and receive a refund. This is especially important because such families could face higher property taxes as municipalities raise tax rates to make up for revenue shortfalls.

Maintains Public Services and Preserves Jobs

The tax reform package is virtually revenue neutral; there are no cuts to critical public infrastructure programs

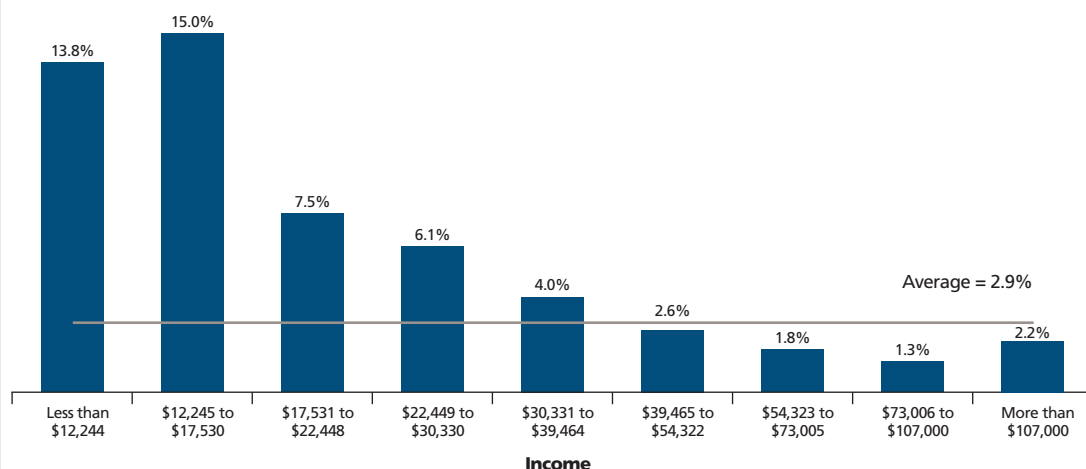
essential public services such as health care, education, and transportation suffer, but there is a direct negative impact on jobs, both private and public. MECEP estimated, for example, that \$285 million in cuts to health care and education as proposed by the December 2009 state budget supplemental would have caused as many as 10,000 jobs to be lost.⁵

The tax reform law helps prevent such unintended consequences. The State Planning Office last year estimated that tax reform “would support about 750 jobs, \$20 million in earnings, and contribute \$42 million to Maine’s Gross Domestic Product.” Maine households will have more disposable income to spend because reform transfers substantial revenues to be paid by nonresidents.

While the best economic research suggests that lowering the top income tax rate will not have a significant

Lower Income Families Receive Greater Benefits Relative to Income

Percent Tax Reduction for Maine Families by Income



Source: MECEP Analysis of data from Maine Revenue Services.

as a result of tax reform. This is significant because for every \$1 of services cut from the budget, \$1 less is spent in the local and state economies. In such circumstances, not only do

effect on business development or progressivity, there is the widespread perception among many, especially those in the business community, that lowering the top rate will improve

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investors' perceptions of Maine.

Finally, tax reform lends stability to the long-term fiscal picture. Currently, state revenues are highly volatile, increasing faster than incomes in periods of growth and falling more rapidly than incomes in periods of recession, resulting in chronic revenue shortfalls for policymakers attempting to maintain programs.

Exports the Tax Burden

Tax reform will reduce taxes for many Maine families by exporting more of the burden to nonresidents. Broadening the sales tax base to include activities like entertainment and athletic events and raising the lodging tax shifts more of the tax burden to people who are not full-time Maine residents. Exporting the sales and income taxes to nonresidents will help put upwards of \$40 million back into the wallets and pocketbooks of Mainers. To help offset the sales tax increase on certain industries, tax reform increases funding for tourism promotion and marketing to attract more tourists.

Conclusion

Mainers are one step away from modestly more progressive tax relief under a restructured tax system that maintains critical public investments by shifting the tax burden to non-residents. With a successful "No" vote this June, 87.4% of Mainers will receive an average net tax savings of \$149.90 in 2011. This is direct help for families struggling to survive in this troubling economic climate, and it is money that will stay in the local and state economies and buoy Maine small businesses.

The tax reform law, while not perfect, will open the door to more far reaching reforms that will make Maine's tax system fairer, assure greater state revenue stability, and encourage greater economic growth that benefits more Maine people.

About the Author

Dan Coyne is the Fiscal Policy Analyst at the Maine Center for Economic Policy.

Endnotes

- 1 New England Public Policy Center, Federal Reserve Bank of Boston.
- 2 Unless noted otherwise, details of tax reform provisions can be found on the Maine Revenue Services website: <http://www.state.me.us/taxreform>.
- 3 Maine Revenue Services has an excellent calculator that helps predict the amount of relief a taxpayer might receive under tax reform: <http://www.state.me.us/revenue/incomeestate/1040/taxreformindividual.htm>.
- 4 For a detailed distributional breakdown, see <http://www.mecpep.org/view.asp?news=757>.
- 5 <http://www.mecpep.org/view.asp?news=629>.

SAVE THE DATE!

Tuesday, April 27, 5 – 7pm
Shepard Lee Lecture Series

Tax Reform: How Maine Compares with Other States

By Robert Tannenwald, Senior Fellow with the Center on Budget and Policy Priorities' State Fiscal Project.

Reception at 5. Panel discussion to follow the lecture.

Lee Community Room, Wishcamper Center, 34 Bedford St., Portland. Register today online: www.mecpep.org.



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Tel: 207-622-7381
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