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TESTIMONY IN OPPOSITION TO INCOME AND ESTATE TAX CUTS IN THE GOVERNOR'S BIENNIAL BUDGET PROPOSAL
(An Act Making Unified Appropriations and Allocations for the Expenditures of State Government, General Fund and Other Funds, and Changing Certain Provisions of the Law Necessary to the Proper Operations of State Government for the Fiscal Years Ending June 30, 2016 and June 30, 2017)

February 17, 2015

Good afternoon Senator Hamper, Representative Rotundo, Senator McCormick, Representative Goode, and members of the Joint Standing Committees on Appropriations and Financial Affairs and Taxation. I am Joel Johnson, an economist at the Maine Center for Economic Policy (MECEP). MECEP advances public policies that help Maine people prosper in a strong, fair, and sustainable economy.

I am here today to testify in opposition to the Governor's plan to cut personal income taxes and corporate income taxes, and to eliminate the estate tax. The Governor's plan is based on the risky assumption that cutting taxes for wealthy individuals and corporations will result in more economic growth and job creation. It would drive state revenue as a share of the state economy to historically low levels, setting Maine up for fiscal crises down the road, especially during times of recession or slow economic growth. This reduction in revenue will force cuts to education, health care, and local communities, which in turn will undermine the foundation of a strong, sustainable Maine economy.

The combined fiscal impact of these tax cuts in FY 2019 is about $677 million per year, according to Maine Revenue Services. That's a tax cut equal to 19% of General Fund revenue forecast for that year. The sales tax increases in the Governor's budget don't cover the cost of that tax cut, and as a result, the state must cut spending by $266 million in FY 2019. That spending cut will grow into subsequent fiscal years as the corporate income tax cut fully phases in.

Approximately $167 million of the governor's proposed spending cuts will come in the form of the elimination of revenue sharing to towns and cities. Faced with a loss of revenue sharing and struggling to meet obligations to fund K-12 education, state and local governments will have to raise taxes and/or cut spending. That means higher taxes and/or fewer services like snowplowing, public safety, road maintenance, libraries, and parks. The governor's proposal saves an additional $12 million by eliminating the homestead exemption for most Mainers.

The governor's proposal fails to specify the remaining $90 million in state spending cuts it encompasses. In fact, the Governor's budget only specifies a two-year spending plan while proposing tax cuts that span multiple budget periods. The income and estate tax cuts proposed in the Governor's budget, combined with revamped arbitrary limits on state appropriation growth, will prevent the state from reaching the statutorily-mandated goal of funding 55% of the cost of K-12 education in the state any time in the near future. Yet the Governor's budget proposal includes a target of 55% for Fiscal Year 2017 and beyond. That is not a credible, achievable objective given the income and estate tax cuts included in a different section of the same budget proposal.

Personal Income Tax Cuts

Personal Income tax cuts don't create job growth or economic growth, and they don't have a major impact on interstate migration. Real-world results in states that have cut income taxes in recent years and careful academic studies that have examined the impact of state income taxes on economic growth both show little factual evidence to support the assertion that cutting personal income taxes is a good strategy for economic growth. There are common-sense explanations for these real-world results and academic conclusions. First of all, states must balance their budgets. So they must offset income tax cuts with spending cuts and/or increases in other taxes. Those tax increases and/or spending cuts slow the economy and tend to offset whatever economic benefits income tax cuts create. Second, state taxes pay for services that businesses, individuals, and families need: K-12 schools, higher education, job training, workforce development, public recreation, road maintenance, public safety, etc. And third, other factors have much greater impacts on state economic growth. These include proximity to markets, the industry mix, the quality of the workforce, natural resource endowments, and broader economic trends.[1]

It's also far from clear that state personal income taxes drive interstate migration. The Appropriations and Financial Affairs Committee last week engaged in a lengthy discussion with Department of Administrative and Financial Services officials on the issue of residency and wealthy retirees relocating to Florida, but there was no mention of extensive, valuable migration data published by the IRS and available through an interactive tool at the Tax Foundation's website[2]. There is a lot to be learned from this data, but one obvious fact that does not lend itself to the tax flight theory is that the flow of taxpayers from New Hampshire to Florida since 1993 has been even larger than the flow of Maine taxpayers to Florida. New Hampshire has a very small personal income tax and no estate tax, but that clearly hasn't stopped New Hampshire residents from relocating to Florida. It's not clear why we would expect Maine to be any different. In fact, over the same time period, more taxpayers moved from New Hampshire to Maine than from Maine to New Hampshire.

The reality is that state taxes have a much smaller impact on interstate migration than the arguments about tax flight might suggest.[3]

Given these basic facts about state economic performance, deep income tax cuts are a risky strategy that Maine should not pursue.

Estate Tax Elimination

The estate tax is a tax on wealth flowing from deceased persons to their designated heirs. Only the wealthiest Mainers—those with a net worth of more than $2 million – pay the state's estate tax. Of the more than 13,000 Mainers[4] who die each year in Maine, only 150 (about 1.3 percent) leave behind enough wealth to trigger the estate tax. The heirs of this small number of estates end up paying no more than 7.2% of the value of the estate.[5]

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[1] Center on Budget and Policy Priorities, 2013 (http://www.cbpp.org/cms/?fa=view&id=3936)
[2] http://interactive.taxfoundation.org/migration/
[3] Center on Budget and Policy Priorities, 2014 (http://www.cbpp.org/cms/?fa=view&id=4141)
[4] Census Bureau State Population Estimates (http://www.census.gov/popest/data/state/totals/2014/index.html)
[5] Maine's statutory marginal estate tax rates are 8% on value from $2,000,000to $5,000,000, 10% on value from $5,000,000 to $8,000,000 and 12% on value above $8,000,000. After accounting for the $2 million exclusion amount and the federal deduction for state estate taxes paid, the effective rate maxes out at 5.9%.

The estate tax helps make the state's tax system fairer. Without an estate tax, Maine's wealthiest families would pay zero state taxes on much of the money they inherit. Increases in the value of assets like stocks and real estate that are held until death would go untaxed.[6]

A popular yet misleading claim made by estate tax critics is that it hurts small businesses and forces their heirs to sell the family business to pay the estate tax bill. The reality is that very few small businesses are subject to the estate tax because very few are worth enough to trigger the tax. Small businesses and family farms are valued for estate tax purposes according to special valuation considerations and after taking account of both assets and liabilities. Closely-held businesses also often qualify for valuation discounts due to lack of marketability and lack of control. A 2005 report[7] by the Congressional Budget Office (CBO) looked closely at this issue. They used federal estate tax returns to estimate that only 135 small businesses and 123 farms nationwide would owe any federal estate tax if the federal estate rules were similar to Maine's current rules ($2 million exemption). Extrapolating those estimates to Maine suggests that no more than a handful of small businesses owe any Maine estate tax in any given year, and virtually zero face liquidity constraints to pay the tax.

Low-income Mainers already pay a larger share of their income than wealthy Mainers, and eliminating the estate tax would only make that worse. Governor LePage and the 125th Legislature cut Maine's estate tax in half back in 2011, providing a windfall for about 600 estate worth more than $1 million. Meanwhile, they cut property tax relief for low- and middle-income Mainers, failed to make critical investments in our public schools, and took away health coverage for tens of thousands of low-income Mainers.

In summary, we urge the legislature to reject the governor's proposed tax cuts for three basic reasons. First, the proposal does not pay for the cuts. This is fiscally irresponsible and sets Maine up for future fiscal crises, which will lead to deep cuts to education, health care, job training, and other foundational components of a strong, sustainable economy. Second, the governor's proposal forces false choices and places a higher priority on income and estate tax cuts for Maine's wealthiest individuals and large corporations at the expense of property tax relief for middle-class Mainers. And third, the evidence from academic research and experience in states which have followed this strategy does not support the notion that these tax cuts will help Maine's economy.

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[6] Capital gains are subject to the income tax only when they are realized (when the asset is sold before death).
[7] http://www.cbo.gov/sites/default/files/07-06-estatetax.pdf