Maine Center for Economic Policy

POLICY BRIEF

Legislature splits the difference in final tax compromise

The Maine Legislature has enacted a tax package negotiated in response to the federal tax overhaul signed into law by President Donald Trump in December.

The Maine law, enacted with bipartisan support, represents a compromise between legislative Republicans, who backed Gov. Paul LePage's plan to replicate Trump's tax cuts for the wealthy and profitable businesses, and Democrats, who proposed policies to benefit low- and middle-income families.

The compromise, enacted August 30, contains elements of the Trump tax plan, but it rejects the worst policies embraced by Congress or proposed by Gov. LePage. At the same time, it expands a vital property tax relief program for Maine homeowners and renters. The final legislation costs $26.8 million this budget cycle[1] — less than either the governor's or the Democrats' initial offerings — thereby preserving more public resources for investments in Maine's people and communities.

FEDERAL OVERHAUL PROMPTS COMPETING VISIONS FOR FUTURE OF MAINE'S TAX CODE

The federal Tax Cuts and Jobs Act, or TCJA, was enacted into law and signed by President Trump in December 2017. The Act made dramatic changes to the federal tax code, tilting it in favor of wealthier households and profitable businesses while ultimately raising taxes on low- and moderate-income households across the country. As a result, the bottom 80 percent of Maine households — those with taxable incomes under $147,000 — will see a tax increase in 2027, when short-term individual tax cuts expire, while higher-income households and profitable businesses will continue to see tax breaks in perpetuity because of permanent changes to tax laws affecting corporations. Those corporate tax cuts benefit high-

[1] This policy brief describes key components of LD 1655 as finally enacted by the Maine Legislature, but is not exhaustive. Revenue and expenditure figures contained herein will not sum.

income households because stock ownership is concentrated among the wealthiest. [2]

Passage of the federal tax law triggered a debate in Maine about whether to update our own tax code to mirror the federal changes.

Gov. Paul LePage offered a plan to double down on some provisions of the federal tax law while rejecting others. The LePage Tax Bill would have cost $89.5 million during the current two-year budget cycle, and $124.9 million[3] over the next biennium. Much like the federal law, the governor's proposal created new benefits for wealthier households and successful businesses, while offering little to low- and moderate-income Mainers. For example, under LePage's plan, the bottom one-fifth of Maine households would have received just a one-dollar tax cut, on average.

Democrats in the Legislature crafted their own proposal, which included expanded tax credits for low- and middle-income working families and increased property tax relief for homeowners and renters. The Democrats' plan also carried a smaller price tag than the governor's proposal — $51.5 million versus $89.5 million. Despite the lower cost, it would have done more good for more Mainers by focusing its benefits on those left behind by the federal tax overhaul.

Neither Gov. LePage nor legislative Democrats were able to assemble the votes to pass their versions of "tax conformity" by the time the Legislature adjourned in May. The tax policy package approved by the Legislature on August 30 is the result of negotiations that took place in the interim after adjournment of the regular session in May.

MAINE FAMILIES SCORE WINS WITH PROPERTY TAX RELIEF, PERSONAL EXEMPTION SOLUTION

The Legislature's tax compromise includes several provisions that make Maine's tax code fairer for low- and middle-income families. Most notably, the law includes a

[2] "Maine Families Pay More under Final GOP Tax Bill"; Sarah Austin, Maine Center for Economic Policy; December 19, 2017.
[3] These figures have been updated since the previous MECEP policy brief, "Comparing Maine's Democratic and Republican Tax Bills," to reflect revised figures from Maine Revenue Services.

substantial expansion of the Property Tax Fairness Credit, or PTFC, an income-based tax credit available to Maine homeowners and renters.

Property tax relief

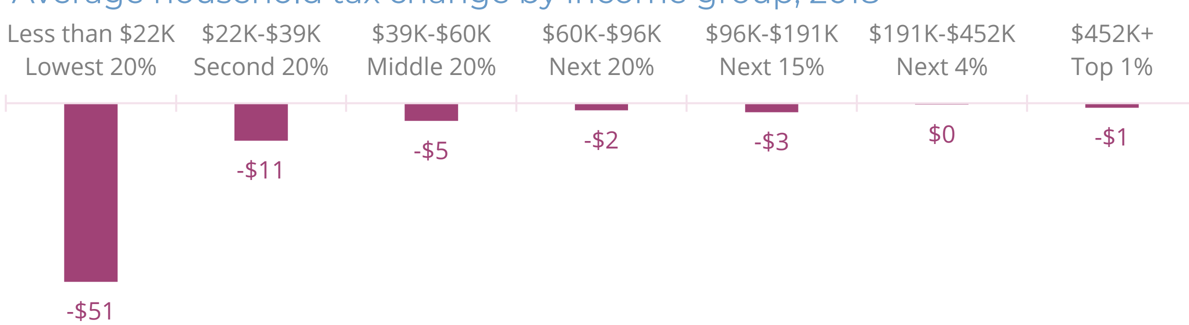
Property tax rates have increased across the state, thanks in no small part to previous income tax cuts that made it harder for the state to meet its fiscal obligations to communities, most visibly in funding for local services and K-12 education. For example, payments to municipalities for local services such as public safety and road maintenance have been reduced by $602 million between 2011 and 2019, and Maine has underfunded its share of school funding by $1.3 billion in the same period.

As municipalities struggle to make up the difference from state funding cuts, property taxpayers have felt the crunch.

The compromise tax law appropriates an additional $11 million each year for property tax relief through the PTFC, increasing total funding available for the program by 73 percent. The new funding will allow Mainers under 65 years old to claim a credit worth up to $750, up from the current level of $600. Seniors will be eligible for an additional $300, bringing the maximum available credit to $1,200. This expansion targets those Maine households hardest hit by rising property taxes. Most of the benefit from this expansion — 69 percent — will go to the bottom one-fifth of Maine households.

Expanded Property Tax Fairness Credit reduces taxes most for bottom one-fifth of Maine households

Average household tax change by income group, 2018



Source: The Insitute on Taxation and Economic Policy, June 2018

Personal exemption

The compromise law also resolves a dilemma created by the elimination of the federally administered personal exemption in the TCJA.

The personal exemption was a deduction used by nearly all families to lower their taxable income by $4,150 per household member. The deduction was administered by the federal government and applied to federal tax liability. Maine offered the same deduction to decrease families' Maine income tax. Elimination of the personal exemption at the federal level created doubt about Maine's ability to continue offering the deduction at the state level.

Straightforward "conformity" to the TCJA would have eliminated Maine's personal exemption, increasing income taxes on nearly every Maine household. Instead, the compromise approved by Maine's Legislature rejected conformity and chose to replace the personal exemption with a two-pronged approach for adult income tax filers and their dependents.

The bill creates a state-administered personal exemption for tax filers and a $300 nonrefundable child and dependent credit for their dependents. By replacing deductions for children with a nonrefundable credit, the compromise will result in a slightly larger benefit for middle-income families than the previous law.

Other individual income tax changes

The expanded PTFC and the personal exemption solution contained in the compromise tax law make Maine's individual tax code fairer and help to alleviate the pressure previous tax cuts, targeted at business and the wealthiest, have placed on property taxpayers.

But not all the individual income tax provisions in the law increase the progressivity of Maine's tax code. The final bill weakens Maine's limit on itemized and standard deductions for high-income households by allowing higher income households to claim larger deductions. The bill changes Maine law to begin limiting deductions at $80,000 of income for single filers and $160,000 for married filers. The previous limits began at $70,000 and $140,000 respectively. This change concentrates benefits on higher-income households.

LOOPHOLES CLOSED, BUT MORE THAN REPLACED BY EXPANDED, INEFFECTIVE BUSINESS TAX BREAKS

On the business side of the tax code, lawmakers found compromise in rejecting the governor's proposed repeal of the top corporate tax rate, as well as his $19 million giveaway to corporations that make out-of-state investments.

The compromise also cleans up several business tax loopholes, restoring $25 million in state revenue that would have been lost had the loopholes remained. That revenue, however, is more than expended on expanded business tax breaks elsewhere in the tax compromise, as noted below.

New tax benefits for profitable businesses were included in the final compromise, most notably the expansion of a program known as "section 179 expensing" and the Maine Capital Investment Credit — two "accelerated depreciation" programs that provide tax breaks to profitable businesses that purchase long-term assets such as computers, vehicles or large machinery.

Accelerated depreciation: section 179, Maine Capital Investment Credit

A normal depreciation schedule allows businesses to account for the way their long-term assets lose value, or depreciate, over time. Accelerated depreciation allows businesses to deduct a portion of their assets' current value faster than the asset loses value, resulting in immediate tax breaks for that business.

While accelerated depreciation may provide modest economic benefit when used temporarily during recessions, it has no discernable effect on investment decisions or job creation in times such as today, when the economy is doing relatively well.[4]

The bill permanently increases the section 179 expensing limit from $500,000 to $1 million, meaning some businesses will be allowed to write off up to $1 million in capital investments in the first year of purchase. The Maine Capital Investment Credit was scheduled to phase out by 2020. Instead, the bill extends the program until 2026 and more than doubles the credit available to businesses for investments made in Maine. Expanding these two tax breaks will cost Maine $35 million this budget cycle.

[4] "Ineffective 'Bonus Depreciation' Tax Break Should Remain Expired"; Chuck Marr and Brandon Debot, Center on Budget and Policy Priorities; November 13, 2014.

Corporate alternative minimum tax, income tax brackets

The compromise tax law unnecessarily cuts corporate taxes.

First, it follows the lead of the federal tax changes by eliminating Maine's corporate alternative minimum tax, or AMT, which previously mirrored the now-repealed federal corporate AMT. Alternate minimum taxes ensure profitable corporations still pay some tax even if they assemble enough credits, deductions and other accounting techniques to lower their tax liability to zero. With this policy repealed, Maine will no longer have this check on corporate tax loopholes.

Second, the law cuts corporate income taxes by adjusting the income levels necessary to enter the next tax bracket.

Old Law	
$0 to $25,000	3.5%
$25,000 to $75,000	7.93%
$75,000 to $250,000	8.33%
$250,000 and more	8.93%

New Law	
$0 to $350,000	3.5%
$350,000 to $1,050,000	7.93%
$1,050,000 to $3,500,000	8.33%
$3,500,000 and more	8.93%

While this revision to the corporate income tax structure makes our corporate tax code more progressive by taxing smaller corporations at a lower effective rate, the change nevertheless represents a $5 million annual reduction of state revenue that will affect Maine's ability to invest in its people and its future.

The repeal of Maine's corporate alternative minimum tax and the change to corporate income brackets will cost $8 million this budget cycle.

THOUGH A MIXED BAG, COMPROMISE PROVES MAINE IS IN CONTROL OF ITS OWN TAX DESTINY

The tax compromise enacted by the Legislature is an imperfect tax law. While it rejected the worst policies handed down by Congress and proposed by the governor, it continues an unfortunate habit of siphoning public revenue toward business tax breaks that do little to spur growth or job creation. At the same time, the inclusion of an expanded Property Tax Fairness Credit will make a real difference for the low- and moderate-income Mainers left behind by the TCJA.

But just as important as the individual provisions contained in the law, the compromise represents a win for Mainers who believe the state should chart its own course regarding tax policy.

Nearly every year, lawmakers consider legislation to update Maine's tax code to reflect changes made at the federal level. This year, the immense scope of changes to federal tax law contained in the TCJA prompted Maine's lawmakers to reconsider the idea that "tax conformity" is simply a routine, technical exercise.

By claiming Maine's control over its own tax code, lawmakers also remind future elected officials that no tax policy decision is a foregone conclusion; Maine always has a choice, and it's up to policymakers to make the right choice for the state's communities and families.