Policy Brief: Fair Taxes

Tax policies enacted in 2019 bring Maine to major tax fairness milestone

by Sarah Austin, Policy Analyst | September 4, 2019

A core premise of tax fairness is that those who benefit the most from our economy should contribute proportionately to investments that ensure future generations can also thrive. But for years in Maine, this basic element of equitable tax policy has been turned on its head.

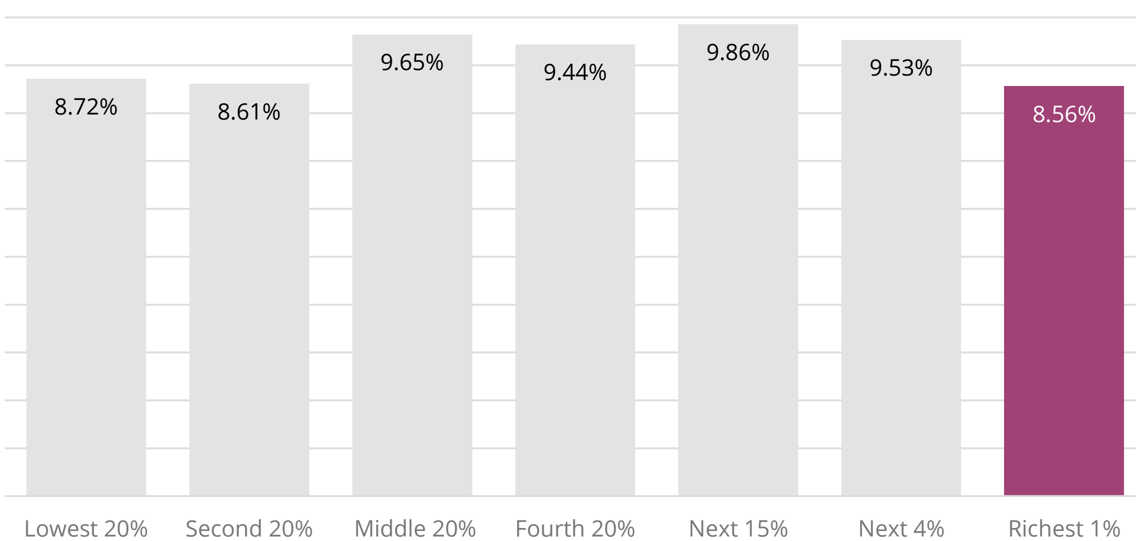
A calculation known as the "average effective tax rate" reveals how much of every dollar earned is paid to state and local taxes and is a key measure of tax fairness.

Going back at least as far as 1996[1], the poorest Mainers paid a higher average effective tax rate than the top 1 percent. In 2019, the wealthiest households in Maine paid less in taxes, by this measure, than any other income group.[2]

That changed as a result of this year's legislative session, when several tax policies were enacted that propelled Maine to a major milestone on the path toward tax fairness.

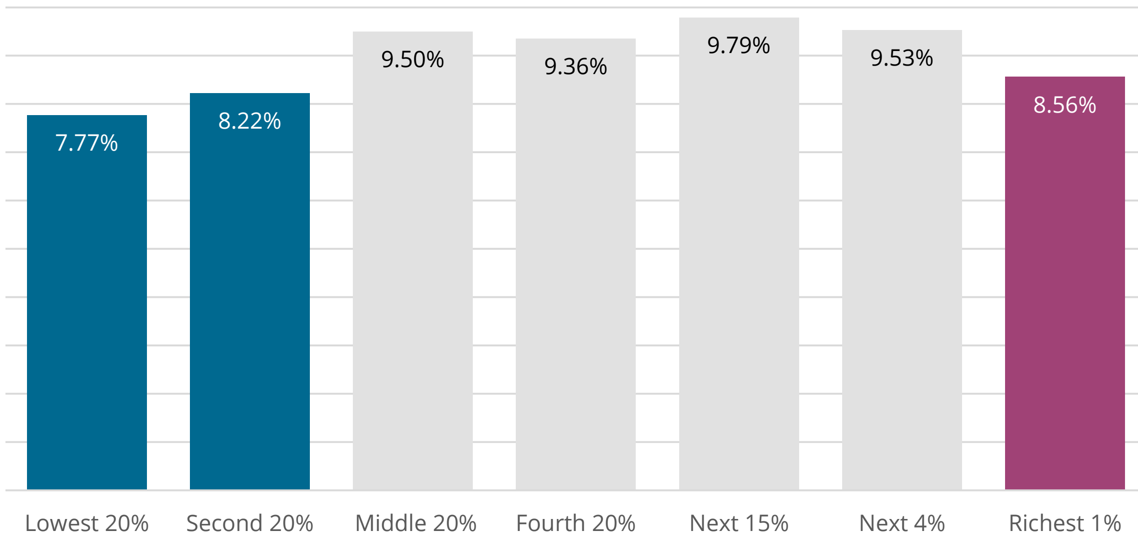
Starting in 2020, the Mainers who earn the least will no longer pay more than those who earn the most. That year, the bottom 40 percent of households will pay a lower average effective tax rate than the top 1 percent. This is the first time in decades that Maine has achieved this basic benchmark for tax fairness.

Figure 1: Before 2019's tax changes, the wealthiest households paid less than any other group — including the poorest households



Note: Average effective state and local tax rate by income group
Source: Institute on Taxation and Economic Policy, October 2018

Figure 2: Starting in 2020, the Mainers who earn the least no longer will pay more than the top 1 percent



Note: Average effective state and local tax rate by income group
Source: Institute on Taxation and Economic Policy, July 2019

This landmark in the fight for fair taxes is the result of three tax policies enacted this year:

- an expansion of the Maine Earned Income Tax Credit, or EITC, which gives a tax break to working families who have to make ends meet on low incomes;
- larger refundable property tax credits for homeowners and renters with low incomes; and
- an increase to the Homestead Exemption, which decreases property taxes owed by Mainers for their primary residences.

Each of these policies provides greater benefits for Mainers with lower incomes than for those with larger paychecks. They built on the success of previous fairness-oriented policies, such as the creation of the Property Tax Fairness Credit in 2013[3] and the decisions to make Maine's EITC refundable and to create a Sales Tax Fairness Credit in 2015.[4] Together, these efforts have fundamentally shifted Maine's tax code for the better.

In the national context, Maine now joins a select group of states that have achieved this basic measure of tax fairness. In 2018, just five states and the District of Columbia had tax codes in which the bottom 20 percent paid a lower average effective tax rate than the top 1 percent.[5]

But progressivity is only one measure by which to assess the quality of a state's tax code. The other is adequacy – whether the tax code raises enough revenue to fund core economy-boosting investments such as schools and local services, infrastructure, and health care.

Regardless of the work ahead, this year's milestone in tax fairness is a strong foundation for future work to achieve a fair and adequate tax code.

Strengthening Maine's EITC boosts incomes for working families

No tax policy enacted in 2019 did more to improve fairness in the state's tax code than the expansion and modernization of the Maine EITC.

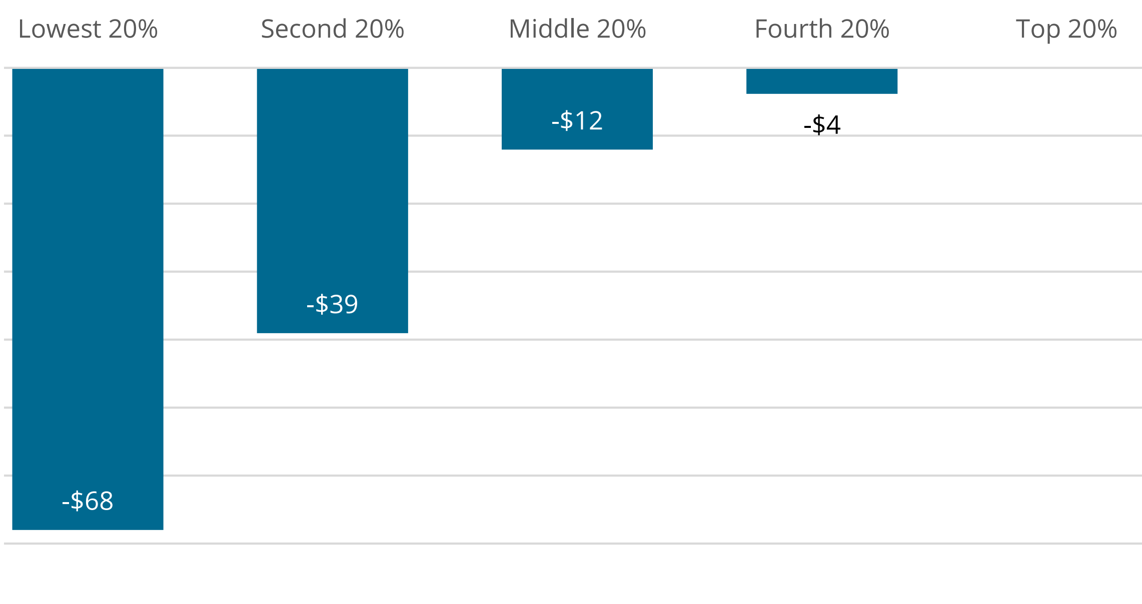
Unlike recently enacted tax cuts at the federal level, which delivered massive windfalls to the very wealthiest households and large corporations, the Maine EITC is a commonsense tax break for hardworking Mainers with low-to-moderate incomes. That money goes right back into our communities and our economy.

Maine's EITC is based on [the successful federal Earned Income Tax Credit]. Eligible households receive the federal EITC when they file federal income taxes and claim the state EITC, which is calculated as a percentage of the federal credit, on their state returns. For years, Maine's EITC had been worth 5 percent of the federal credit, making ours one of the smallest EITCs in the country. It was long overdue for a boost. This year, lawmakers increased the state EITC from 5 percent to 12 percent of the federal credit for families with children, bringing the maximum state credit from $328 a year up to $787.[6]

The new law also increased the state match for childless working adults from 5 percent of the federal credit to 25 percent. This change counters the disproportionately small federal credit these working Mainers receive compared to workers with children. For working, low-income adults without kids, that means a new maximum credit of $132, compared with the $26 maximum for which they were previously eligible.[7]

Lastly, Maine's EITC will now be available to independent childless workers between 18 and 24 years old, even if they don't have children. The EITC is meant to help low-income workers make ends meet, but these young workers had been left out for years. This modernization will make 16,000 Mainers newly eligible for the EITC.

Figure 3: EITC changes concentrate benefits on working Mainers with the lowest incomes



Note: Average tax change by income quintile.
Source: Institute on Taxation and Economic Policy, June 2019.

The expansion and modernization of Maine's EITC amounts to a $16 million tax cut targeted specifically at those hardworking Mainers who need it most. More than 100,000 Maine households will benefit. Because the credit was made refundable in 2015, this expansion means additional income through larger tax refunds for eligible households, which helps counter growing income inequality and the increased cost of living.

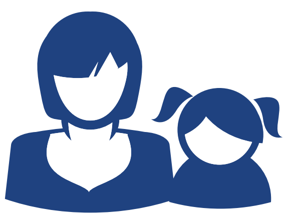
More property tax relief for low-income renters and homeowners

Because the property tax is assessed regardless of ability to pay, Mainers with lower incomes pay a greater percentage of their income to property taxes than Mainers who earn more. According to the Institute on Taxation and Economic Policy, the bottom 20 percent of Mainers by income — those with less than $19,700 in annual income — pay 4.2 percent of their total income to property taxes. That's the highest of any group. The top 1 percent, by comparison, earn more than $434,500 in annual income but pay the lowest effective property tax rate, at about 2.3 percent of their income.[8]

Maine's Property Tax Fairness Credit, or PTFC, boosts income tax returns by providing a refundable tax credit to low- and moderate-income Mainers for whom property taxes or rent make up a disproportionately large share of their annual spending.

This year's budget bill expanded the PTFC to benefit more Maine families and to provide larger refunds to many of those who are eligible. The new rules allow filers whose property taxes amount to more than 5 percent of income to receive a credit. The prior threshold was 6 percent.[9]

Figure 3: How will Maine families benefit from 2109 changes to the Property Tax Fairness Credit?



Single parent with one dependent child
Earns $25,000 annually; pays monthly rent of $900

Previous Property Tax Fairness Credit: $120
New Property Tax Fairness Credit: $370

Senior couple, no dependents
Earns $35,000 annually; pays $2,500 in property tax

Previous Property Tax Fairness Credit: $400
New Property Tax Fairness Credit: $750

Source: MECEP analysis.

Changing the income threshold means families with income up to $65,000 are now eligible for the program. The prior income cut off was $54,167.

This year's changes will increase the PTFC for roughly 36,000 households, with an average additional benefit of $159 per household. The expansion amounts to a $5 million annual tax cut for eligible households.

Increased Homestead Exemption helps improve tax fairness

While property taxes are disproportionately paid by people with low incomes, all Mainers have seen property tax bills increase as a result of tax policies that have shifted costs to municipal governments.[10]

The Homestead Exemption is a tax program that shields a portion of a resident's primary home value from property taxes. In 2019, lawmakers expanded Maine's homestead exemption from $20,000 to $25,000.

In aggregate, the program shifts the balance of property taxes slightly away from primary residences and toward business properties, rental properties, and second homes.

At $27.4 million per year, the increased Homestead Exemption is the largest tax cut enacted by the Legislature this year. But unlike the EITC and PTFC, the Homestead Exemption does not provide targeted relief to Mainers with low incomes. Any Maine resident, regardless of income, can receive the Homestead Exemption for their primary residence.

However, the benefits of the Homestead Exemption still make our overall tax code a little more progressive. The $25,000 exemption for a home worth $100,000 represents a 25 percent reduction in property taxes, while the same exemption for a home worth $1 million amounts to a 2.5 percent reduction.

The increased Homestead Exemption will benefit roughly 306,000 Maine households. The benefit value varies depending on local property tax rates, but on average it amounts to a property tax savings of roughly $375 annually, up from $300 before the expansion.[11]

Looking forward: Raising adequate revenue through fair taxes

For years, tax policies at the state and federal level have too often tilted the scales in favor of the very wealthiest households and corporations.

These include Maine's income tax cuts in 2011 and 2015, which fueled a $864 million revenue hole in the state's 2020-2021 budget.[12] They also include the 2018 federal Trump Tax Cuts, a $1.5 trillion restructuring of the federal tax code that provided huge giveaways to corporations and the wealthiest households in the country, paid for in part by future tax increases on the bottom 80 percent of households.[13]

The tax policies enacted this year by the Maine Legislature moved the state toward a fairer tax system. However, there is still more work to be done. While the wealthiest 1 percent of Mainers will no longer pay less than those who earn the least, they will still contribute less to our state's needs than those in the middle of the income distribution.

Reversing decades of tax giveaways at the top would secure the revenue we need to strengthen our economy and increase opportunity for Maine families and small businesses.

In addition to greater strides toward progressivity in the state tax code, policymakers must also work to increase revenue overall, to address longtime funding shortfalls in education and local services.

This year's budget made strides toward meeting statutory funding minimums, but still fell short. This year, our state's public schools were underfunded by $98 million and local services such as road maintenance, public safety, clean water, and parks, were underfunded by $68 million.

These shortfalls are a direct result of policy decisions that favored tax cuts for the wealthy over investments in Maine's people, communities, and economy.

To meet these minimum standards for public services, Maine will need to raise additional revenue without undermining its victories in tax fairness for families with low incomes. Reversing decades of tax giveaways at the top would secure the revenue necessary to invest in those things that strengthen the foundation of our economy and increase opportunity for Maine's families and small businesses.

Endnotes

1 Ettlinger, Michael P., et. al. "Who Pays? A Distributional Analysis of the Tax Systems in All 50 States." Citizens for Tax Justice and Institute on Taxation and Economic Policy. June 1996. https://itep.org/wp-content/uploads/whopays1stedition.pdf
2 Wiehe, Meg, et. al. "Who Pays? A Distributional Analysis of the Tax Systems in All 50 States. Sixth Edition" Institute on Taxation and Economic Policy. October 2018. https://itep.org/wp-content/uploads/whopays-ITEP-2018.pdf
3 The Maine Legislature created the PTFC as a compromise in the 2013 budget, which eliminated a property tax relief program known as the "Circuit Breaker." At the time it was enacted, the PTFC's benefit provided a smaller benefit than the Circuit Breaker to low-income households with high property taxes. However, its creation ensured that future Legislatures had an existing targeted property tax relief program to build upon. Including this year, the PTFC has now been expanded three times.
4 The sales tax is the most regressive tax in Maine. The Sales Tax Fairness Credit offsets regressivity by offering a refundable tax credit for Maine households with income up to $51,750.
5 Wiehe et. al. "Who Pays?"
6 MECEP analysis of data from the Institute on Taxation and Economic Policy.
7 Ibid.
8 Wiehe et. al. "Who Pays?"
9 For the purpose of the Property Tax Fairness Credit, renters' property tax is calculated as 15 percent of their total annual rent.
10 Martin, Garrett, and Joel Johnson. "The Consequences of Maine's Income Tax Cuts: Recent Tax Cuts Increase Costs for Municipalities, the Poor, and the Middle Class." Maine Center for Economic Policy. October 2012. https://www.mecep.org/wp-content/uploads/2012/10/MECEP_Maines_Income_Tax_Cut_Report_10-16-2012.pdf
11 MECEP analysis of data from the Institute on Taxation and Economic Policy.
12 Austin, Sarah. "Fiscal Policy Foundations I: Re-Balancing Maine's Tax Code." Maine Center for Economic Policy. August 2018. https://www.mecep.org/wp-content/uploads/2018/09/Fiscal-Policy-Foundations-I_Re-balancing-Maines-Tax-Code.pdf
13 Austin, Sarah. "Maine Families Pay More Under Final GOP Tax Bill." Maine Center for Economic Policy. December 19, 2017. http://blog.mecep.org/2017/12/maine-families-pay-more-under-final-gop-tax-bill/