Maine needs progressive revenue solutions to build a stronger, fairer future
by Sarah Austin, Tax and Budget Policy Analyst | January 26, 2021

The incoming Legislature has the opportunity to address longstanding problems in the state’s tax code that have made life harder for Maine families.

Maine has for years underfunded schools, local services, and other investments that support families, communities, and the economy. This lack of funding is the result of a tax code that prioritizes low taxes for high-income households and profitable businesses over the public goods and services that benefit all Mainers.

Those policy choices have exacerbated inequality in Maine, as wealthy households and corporations prospered while children learned in underfunded schools, workers commuted on crumbling roads, and struggling families saw cuts to crucial safety net programs that are supposed to help them get back on track.

Long-term revenue solutions are needed to meet current needs, reduce hardship and inequality, and build a fairer, stronger economy.

The state must change its tax laws to fairly raise the revenue necessary to ensure sufficient funding for education, health care, infrastructure, and other services that help families and communities thrive.

In the wake of a pandemic that wreaked havoc on Maine families and the economy, investment beyond the pre-COVID status quo is more important than ever.

This paper explores several revenue-raising options available to legislators. Maine’s revenues come from a variety of taxes and fees, most notably the income tax, sales tax, and corporate taxes. A solution to meet Maine’s needs could involve any or all of those revenue streams.

In crafting policy options, MECEP prioritized two goals:

• **Fairness, or progressivity.** The tax change should ask more of the households and businesses that have more to contribute.

• **Adequacy.** The tax changes, as a whole, should raise the funding Maine needs to fulfill its commitments, such as the statutory funding requirements for schools and communities, and to meet Mainers' needs.

Lawmakers should consider the goals of fairness and adequacy as they Maine must raise new revenue to meet current needs, reduce hardship and inequality, and build a fairer, stronger economy for all Mainers.
craft a plan to raise the revenue Maine needs.

It is important to note that these two priorities do not necessarily go hand-in-hand: A state tax code can be fair by ensuring wealthier households pay more than those with low-incomes without raising adequate funds to invest in shared priorities. Likewise, a tax code could conceivably raise all the funds necessary to meet the state’s needs but do so in a way that unfairly asks the poorest households and small businesses to pay a larger share of their income than those with more resources.

In recent years, policymakers have made improvements in the fairness of Maine’s tax code. But those improvements have come with tax cuts that undercut our state’s ability to invest in Maine’s future, including the repeal of a voter-approved tax on high incomes to fund education.

This year’s pandemic recession slowed economic activity, caused large job losses, and cut into small business profits, all of which further limited the tax code’s ability to fund the state services necessary for a strong, shared recovery.

Building a tax code that is fair and adequate is a necessary step to ensure opportunity and prosperity for all Mainers. The revenue-raising options contained in this report can form the basis for a more equitable tax code, and economy, for the future.

New revenue will help Mainers regain ground

Schools, municipalities, and families have fallen behind while wealthy households and corporations have benefited from tax breaks.

Asking those at the top to pay more will allow Maine to begin meeting unmet needs so families and communities can regain ground.

Over the past 10 school years, Maine has underfunded its public schools by $2.54 billion.

Over the same period, the state pushed a $707 million shortfall onto property taxpayers by failing to fully fund local services such as road maintenance, parks, and water treatment.

Even before the pandemic, roughly 19 percent of Maine adults could not afford their monthly bills and 17 percent could not afford a $400 emergency, like a car repair or hospital bill.

Maine personal income taxes are the largest state-level source of revenue. In fiscal year 2020, personal income taxes totaled $1.8 billion and accounted for 44.2 percent of general fund revenues. The personal income tax is assessed on all households. It is also assessed on the profit of many Maine businesses, most of which are pass-through entities. Pass-through business entities, such as sole proprietorships, partnerships, and S-Corporations, make up about 95 percent of all businesses nationally. These businesses do not pay corporate income taxes and instead pay only personal income taxes on their business’s profits.

As a result of income tax changes over the past decade, income tax revenue is down $430 million annually compared to what would have been raised under the 2010 tax code. Additionally, the repeal of the voter-approved tax increase on high incomes means Maine is missing another $150 million annually.

Maine’s income tax is the state’s primary progressive tax, meaning that it is based on ability to pay. It achieves this by taxing higher amounts of income at higher rates. Maine’s income tax code also contains several refundable tax credits, which reduce a household’s income tax bill and can result in a refund. For example, a household with a $600 state tax liability that is eligible for $700 in state refundable income tax credits would not pay any income taxes and would be owed a $100 refund from the state. Refundable tax credits help low-income families afford basic living expenses and help make up for other aspects of the tax code, such as the sales tax and property tax, that ask more of low-income households than high-income ones.

Because of its revenue-raising potential and inherent fairness, the income tax should be the first place to look for opportunities to raise revenue. Increasing taxes on high incomes is the best way to meet unmet needs, fund state investments in education and health care, and ensure every family and community can thrive.

**Here are several ways to increase income tax revenues:**

- Lawmakers can adjust the state’s income tax brackets and rates. Maine has three tax brackets with tax rates of 5.8 percent, 6.75 percent, and 7.15 percent. Adding new brackets with higher tax rates for higher amounts of income would raise new revenues.

- Lawmakers can increase taxes on certain types of income, such as capital gains — a form of income primarily for the wealthy that is derived from selling investments such as stocks or property at a profit. Instead of taxing capital gains as regular income, Maine could assess an additional tax that would affect only a small percentage of households. These targeted taxes would allow these sources of income to be taxed at a higher rate than income earned through salary or wages.

- Lastly, lawmakers can increase income tax revenues by limiting deductions or credits that help to lower tax liability. While this is an option on the table, Maine has made significant progress in recent years to limit deductions for households with high incomes. As a result, this report does not include proposals to limit income tax deductions or credits.

**Raising Revenue with Changes to Personal Income Tax Rates**

Tax rates apply to taxable income, which is typically significantly less than a household’s total, or gross, income. Taxable income is gross income after deductions and exemptions are applied. Most households headed by single filers claim a standard deduction and personal exemption on their state income tax that lowers their taxable income by $16,400 and married households are able to claim $32,800 in deductions and personal exemptions.

For example, a single Mainer would have to earn more than $16,400 to owe any income tax. And while Maine’s top income tax rate of 7.15 percent is applied at taxable income above $51,700 for a single filer, that same Mainer would have to earn $68,100 in gross earnings before they owed income tax at the top rate. Then, the top rate would apply only to income above the threshold, with income below that level taxed at the lower rates.

By creating new rates and brackets, Maine can raise significant revenue through the income tax.

Maine can raise $200 million,
$400 million, or $600 million annually, with new top tax rates of 10.25 percent, 12.4 percent, and 15.35 percent, respectively. These proposals would affect only 4 to 12 percent of Maine households, representing the highest-income earners in the state.

Raising Revenue with Changes to Capital Gains and Dividends Taxes

Maine also can change the way it taxes dividends and capital gains which are sometimes referred to as “unearned income.” Dividends are the annual or quarterly payouts from stocks or other investments. Capital gains are the income generated from selling assets such as investment properties, valuable collections, and stocks.

Most families’ primary asset is their home. Families build wealth by building home equity, particularly as they pay down their mortgage and their homes increase in value over time. The capital gains tax would hold most families harmless, even if their homes had grown in value. Federal and state tax law exempts up to $250,000 of capital gains from the sale of a primary residence for single filers, and up to $500,000 for joint filers, such as married couples.

MECEP has assessed two options (next page), both of which would add an additional surcharge to dividends and capital gains that exceed the taxable income threshold. Each would affect only 0.7 percent of Maine households.
Sales Taxes

Sales taxes are the second-largest source of revenue at the state level. Sales taxes accounted for 38 percent of general fund revenues in fiscal year 2019. Sales taxes are collected at the time of sale and vary depending on the type of good or service being purchased. Some sales in Maine, such as legal services, advertising, and most groceries, are exempt from the sales tax, while general purchases of goods are taxed at 5.5 percent and prepared food and beverages are taxed at 8 percent.

Generally, the sales tax is regressive. The poorest one-fifth of families pay a share of their income in Maine sales taxes that is nearly nine times larger than the top 1 percent. Prior Legislatures have already supported this offset by creating and expanding Maine’s Sales Tax Fairness Credit. The revenue-raising options below include expanded Sales Tax Fairness Credits on par with the increase in the sales tax. This is an essential step for ensuring a more equitable revenue stream if lawmakers pursue sales tax increases. However, the credit is limited in its ability to reach some of households with the lowest incomes.

To meet the fairness benchmark of sound revenue policy, any effort to raise revenues through the sales tax must be matched with a refundable income tax credit to offset the effects of the increase on the poorest households.

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<table>
<thead>
<tr>
<th>Dividend and capital gains surcharge</th>
<th>For single filer taxable income over</th>
<th>For married taxable income over</th>
</tr>
</thead>
<tbody>
<tr>
<td>2%</td>
<td>$250,000</td>
<td>$500,000</td>
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<table>
<thead>
<tr>
<th>Dividend and capital gains surcharge</th>
<th>For single filer taxable income over</th>
<th>For married taxable income over</th>
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<tbody>
<tr>
<td>4%</td>
<td>$250,000</td>
<td>$500,000</td>
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Note: “HH” in these and subsequent tables means “households.” For non-married filers with children, the income brackets are 1.5 times the single filer brackets.

Source: Institute on Taxation and Economic Policy, October 2020

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Chart: Maine sales tax asks most of poorest households

Note: Average sales taxes paid as percent of income by income group, using 2015 income levels.

Source: Institute on Taxation and Economic Policy.
incomes that are not required to file taxes. While there is a 95 to 99 percent take up rate for the sales tax fairness credit among eligible households that file income taxes, the take up rate drops into the 70s when eligible non-filing households are included.6

Lawmakers have proposed a seasonal sales tax increase in the past. If such proposals are introduced again, lawmakers should make the same considerations for fairness as they would for a year-round increase. Policymakers have in the past looked to narrow tax bases such as cigarette and liquor for new revenue. Increased taxes on these products could raise tens of millions of dollars of revenue annually but would be regressive. These revenue streams also are not sustainable: Revenue decreases over time as increased prices discourage purchases of the taxed products. For that reason, these revenues are best suited to fund public health efforts that reduce tobacco and alcohol addiction and associated diseases, not long-term investments such as education, roads, and bridges.7

### Sales Tax Options

#### Changes to Hold Harmless the Bottom 40% of HH

<table>
<thead>
<tr>
<th>Tax rate</th>
<th>Additional revenue raised</th>
<th>Sales Tax Fairness Credit amount</th>
<th>Credit phaseout range (see note)</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.50%</td>
<td>$0 (Current Law)</td>
<td>$125 - $225</td>
<td>$20,000 - $40,000</td>
</tr>
<tr>
<td>6.50%</td>
<td>$200 million</td>
<td>$350 - $450</td>
<td>$25,000 - $45,000</td>
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<tr>
<td>7.70%</td>
<td>$400 million</td>
<td>$625 - $725</td>
<td>$25,000 - $45,000</td>
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<tr>
<td>8.90%</td>
<td>$600 million</td>
<td>$900 - $1,000</td>
<td>$25,000 - $45,000</td>
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#### Sales Tax Options

#### Changes to Hold Harmless the Bottom 60% of HH

<table>
<thead>
<tr>
<th>Tax rate</th>
<th>Additional revenue raised</th>
<th>Sales Tax Fairness Credit amount</th>
<th>Credit phaseout range (see note)</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.50%</td>
<td>$0 (Current Law)</td>
<td>$125 - $225</td>
<td>$20,000 - $40,000</td>
</tr>
<tr>
<td>7.10%</td>
<td>$200 million</td>
<td>$575 - $675</td>
<td>$50,000 - $70,000</td>
</tr>
<tr>
<td>9.10%</td>
<td>$400 million</td>
<td>$1,1225 - $1,325</td>
<td>$50,000 - $70,000</td>
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<tr>
<td>11.20%</td>
<td>$600 million</td>
<td>$1,875 - $1,975</td>
<td>$50,000 - $70,000</td>
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</table>

Note: The STFC begins to phase out at different income levels depending on family size. Under current law, the credit begins to phase out at $20,000 for an individual without children, and $40,000 for a four-person household.

Source: Institute on Taxation and Economic Policy, October 2020
The corporate tax is the third-largest source of general fund revenue, although it is much smaller than income or sales taxes. In fiscal year 2019, it raised $216 million and represented 5 percent of general fund revenues. The tax is assessed on the profits of businesses that are organized as C-corporations which represent a small share of businesses in Maine. Nationally, C-corporations make up only 5 percent of businesses.

Maine's corporate income tax applies to all corporations with significant sales in the state, regardless of where those corporations are headquartered. Corporations based outside the state, such as online retailers, big box stores, and supermarket chains, make up a large portion of the Maine corporate tax base. These businesses pay Maine corporate income tax based on the amount of their sales in the state.

Maine cut its corporate tax in 2018, costing the state $5 million per year in revenue from corporate filers, an added benefit to the already large tax breaks these corporations received from federal tax cuts enacted in 2017. The benefits of these tax breaks accrue to the wealthiest households. An assessment of state corporate tax changes between 1980 and 2010 showed no relationship between corporate tax rates and median wage growth, but a comparison of income growth for the top 1 percent over the same time showed corporate tax cuts coincided with an increase in income gains for the wealthiest households.

Raising corporate income taxes can be a valuable part of a plan to raise the revenue Maine needs. Maine’s top corporate tax rate applies only to profits above $3.5 million. The proposals included here increase the top corporate income tax rates to match the individual top income rates proposed in this report. Additionally, a proposal with a 2 percent increase to the existing corporate top rate is included. The
proposals would raise between $30 and $145 million annually.

**By raising the top rate, Maine can generate much-needed revenue without affecting the smallest Maine businesses and start-ups.**

**Closing Business Tax Loopholes**

Maine’s tax code contains several specialized tax benefits for businesses that cost tens of millions of dollars annually. Some of these programs are structured to benefit only a single business in the state. Costly tax expenditures provide questionable, if any, value to Maine people, but are a primary mechanism through which the tax code can be tilted in favor of a select few businesses. Lawmakers should consider closing these loopholes as a way to recapture revenue.

Some examples of wasteful tax expenditures include:

- The Business Equipment Tax Reimbursement (BETR) and Business Equipment Tax Exemption (BETE) programs lower the property taxes businesses pay on their equipment by exempting equipment from the property tax or reimbursing businesses for property taxes paid on their equipment. Together the programs cost roughly $70 million per year. An independent, nonpartisan review of the program confirmed its financial benefit to businesses but found little evidence that the program met the Legislature’s goal of incentivizing investment. The distribution of benefits in fiscal year 2018 show most of the benefits going to larger businesses, with 75 percent of the BETR benefits received by 8 percent of beneficiaries. Reviewers of the program assume a similar distribution for the BETE program.

- The Employment Tax Increment Financing Program allows employers to take a percentage of their employees’ withholdings rather than paying the full amount to state taxes. In exchange, the business is supposed to provide high-quality jobs, but there is little accountability or transparency. Maine’s program costs roughly $12 million a year and the bulk of the benefits go to a small number of recipients; 58 percent of the benefits paid between 2012 and 2018 went to fewer than 5 percent of participating businesses.

- The Shipbuilding Facilities Credit was created in 1997 and extended in 2018 to provide a tax credit for large capital investments for employers in the shipbuilding trade. Only one business, General Dynamics’ Bath Iron Works, meets the 5,000-worker threshold necessary to receive the credit. BIW receives roughly $2.8 million annually through the credit. Despite having given away $60 million in tax breaks since its creation, the program has not been evaluated for efficacy in retaining high quality jobs. It also does not appear to be creating jobs for Mainers; Reported employment levels at Bath Iron Work, the only employer receiving the credit, are lower than its initial 1997 employment count.

**Clamping Down on Tax Avoidance by Ending Offshore Tax Haven Abuse**

The state also can raise revenue by limiting corporations’ ability to use foreign tax havens to avoid paying Maine corporate income taxes. Multi-state and multinational corporations use complex international accounting schemes to move profits to a low-tax country even though the profits derive from sales made in a higher-tax environment. These corporations use tax havens to avoid paying roughly $52 million a year in Maine corporate income taxes.

Policymakers can close this loophole by reclaiming Maine-based profits booked to offshore tax havens with a policy called “worldwide combined reporting,” which would require corporations to report profits earned anywhere in the world, allowing Maine to tax a portion of those profits based on sales generated in Maine — thus neutralizing tax haven schemes.
The estate tax is owed on wealth that is passed on after death. After subtracting charitable contributions, Maine’s estate tax levies an 8 to 12 percent tax on wealth exceeding $5.8 million per person. Maine’s estate tax raises roughly $12 million per year. It affects only the very wealthiest Maine estates, representing less than 1 percent of total households, making it one of the state’s most progressive tax sources.

Maine has weakened its estate tax through several rounds of cuts that reduced revenue and fueled wealth disparities. Those cuts were achieved by increasing the amount of wealth that can be passed on tax free. Before the cuts, the estate tax was assessed on estates worth more than $1 million. Today, estates worth up to $5.8 million pay no estate tax at all. Maine can strengthen its estate tax and raise revenue by restoring a lower threshold. The options assessed here estimate the revenue-raising potential of such a change.

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<th>Taxable estate value</th>
<th>Additional revenue raised</th>
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<tr>
<td>0%</td>
<td>$0 - $5.8 million</td>
<td>$0 (Current Law)</td>
</tr>
<tr>
<td>8%</td>
<td>$5.8 million - $8.8 million</td>
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</tr>
<tr>
<td>10%</td>
<td>$8.8 million - $11.8 million</td>
<td></td>
</tr>
<tr>
<td>12%</td>
<td>$11.8 million and higher</td>
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**Estate Tax: Option 1**

**Lower Bracket Thresholds**

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<th>Rate</th>
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<th>Additional revenue raised</th>
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<td>8%</td>
<td>$2 million - $5 million</td>
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<tr>
<td>10%</td>
<td>$5 million - $8 million</td>
<td></td>
</tr>
<tr>
<td>12%</td>
<td>$8 million and higher</td>
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**Estate Tax: Option 2**

**Return to pre-LePage Estate Tax Law**

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<th>Rate</th>
<th>Taxable estate value</th>
<th>Additional revenue raised</th>
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</thead>
<tbody>
<tr>
<td>0%</td>
<td>$0 - $1 million</td>
<td>$32 million</td>
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<tr>
<td>8%</td>
<td>$1 million - $4 million</td>
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<tr>
<td>10%</td>
<td>$4 million - $7 million</td>
<td></td>
</tr>
<tr>
<td>12%</td>
<td>$7 million and higher</td>
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</table>

Conclusion

Policies to raise revenue are the only way to solve the persistent funding inadequacy baked into Maine’s tax code. This report offers a range of options designed to help Maine meet current and future funding needs.

Families and communities need crucial services such as schools, health care, and infrastructure to ensure health, safety, and an upward economic trajectory for everyone.

By raising needed revenue from those who can afford to pay more, Maine can ensure every family and community has the resources they need to thrive.

About MECEP

The Maine Center for Economic Policy is a nonprofit research and policy organization dedicated to economic justice and shared prosperity by improving the well-being of low- and moderate-income Mainers. Since its founding in 1994, MECEP has provided policymakers, advocates, media organizations, and the public with credible, rigorous research and analysis. MECEP is an independent, nonpartisan organization.

About the author

Sarah Austin is MECEP’s lead policy analyst on tax and budget. She holds a master’s degree in public affairs from the University of Wisconsin-Madison’s La Follette School of Public Affairs and a bachelor’s degree in environmental policy from Unity College. In addition to her role at MECEP, Sarah serves on the state’s Consensus Economic Forecasting Commission.
Endnotes


