126th MAINE LEGISLATURE

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Legislative Document **No. 1496**

H.P. 1073 House of Representatives, May 2, 2013

An Act To Modernize and Simplify the Tax Code

Reference to the Committee on Taxation suggested and ordered printed.

Millicent M. MacFarland

MILLICENT M. MacFARLAND
Clerk

Presented by Representative KNIGHT of Livermore Falls.
Cosponsored by Senator WOODBURY of Cumberland and
Representatives: DION of Portland, GIDEON of Freeport, HARVELL of Farmington, KESCHL of Belgrade, LIBBY of Lewiston, VOLK of Scarborough, Senators: CAIN of Penobscot, GOODALL of Sagadahoc, KATZ of Kennebec.

Be it enacted by the People of the State of Maine as follows:

CONCEPT DRAFT

SUMMARY

This bill is a concept draft pursuant to Joint Rule 208.

Overview

This bill would overhaul Maine's tax code. It is designed to raise a larger share of tax revenues from nonresidents, while relieving the tax burden on year-round residents. The bill reduces Maine state income taxes, corporate income taxes and homestead property taxes; moderates the regressivity of sales and property taxes on lower-income households; stabilizes tax revenues; and creates a more attractive tax environment for individuals and businesses that locate in Maine.

Because nonresidents share many of the benefits of Maine's communities, roads, hospitals, environment and quality of life while they are here, while avoiding many of the taxes paid by residents only, the reforms also reflect a fairer apportionment of government costs.

The bill accomplishes its objectives by increasing revenues from sales and excise taxes, which are paid by both residents and nonresidents in proportion to the time they spend here, and by collecting less from income taxes and homestead property taxes, which are paid almost entirely by residents.

The bill creates 2 refundable tax credits. A sales tax fairness credit is designed to offset the regressive burden of sales taxes on lower-income families. A property tax fairness credit, combined with the increased homestead exemption, is designed to offset the regressive burden of property taxes.

Property tax reform

This bill more carefully targets property tax relief to owners of homestead property and to municipalities with higher property tax mill rates and higher overall tax burdens. The plan also provides proportionately more relief to households with lower incomes and lower property wealth, moderating the regressive impact of the property tax.

1. Homestead property tax exemption. The bill increases the homestead property tax exemption to $50,000 except that the exemption may not exceed 50% of the value of the homestead. Municipalities would be reimbursed by the State for half of the cost of the homestead exemption. Payment from the State to municipalities for homestead tax relief would be over $120,000,000 annually. A large majority of resident homeowners will see property tax reductions of over $500; many will see property tax reductions of $1,000 or more.

2. State-municipal revenue sharing. The bill replaces the current state-municipal revenue sharing formula by providing for the transfer of 1.5% of sales and income tax

revenue to be distributed only to municipalities with higher mill rates, using the new so-called Revenue Sharing II formula enacted in the 125th Legislature. Payment from the State to municipalities for municipal revenue sharing would be over $40,000,000 annually.

3. Property tax fairness credit. The bill replaces the Circuitbreaker Program with a new property tax fairness credit that is administered as an integral component of Maine income tax returns. The new program is greatly simplified as compared to the Circuitbreaker Program. The property tax fairness credit refunds to taxpayers half of the amount by which property taxes exceed 6% of income, up to a maximum refund of $1,000 per household. Only the first $250,000 of property value qualifies for the property tax fairness credit. Renters also qualify for credit, using 15% of their rent as the portion of rent that is eligible for the credit. Tax abatements provided by municipalities for hardship must be subtracted when calculating the property tax fairness credit.

4. Property tax exemption for certain property. The bill amends the property tax exemption for certain private nonprofit institutions and organizations. The full 100% exemption would be retained for the first $250,000 of just value. The exemption would be reduced from 100% of the full just value of the property to 75% for the portion of just value exceeding $250,000. The full 100% exemption would be retained for places of worship, and the tax treatment of parsonages would be unchanged from current law.

5. Telecommunications excise tax. The bill returns the taxation of telecommunications personal property to municipalities rather than being collected by the State. Revenues from the telecommunications excise tax remain with municipalities to assist with local budgets.

6. Business equipment tax reimbursement. The bill provides for full funding of property tax reimbursements to businesses under the BETR program up to the 12-year period of service originally covered under the program. Continuing reimbursements after the first 12 years of service are eliminated.

7. Government efficiency grants. The bill provides $1,000,000 in funding annually from the General Fund to the Fund for the Efficient Delivery of Local and Regional Services to be used for grants to municipalities to increase collaboration in service delivery and to identify other cost efficiencies in governance.

Income tax and estate tax reform

This bill reduces income taxes for most Maine taxpayers. The simplified lower-rate system provides incentives for persons to locate their homes and businesses in Maine thereby increasing jobs and laying the foundation for a more prosperous economic future.

1. Individual income tax reform. The bill imposes a maximum 4% total income tax rate, eliminates nearly all deductions from income and computes a household's income tax assessment based on federal adjusted gross income. Progressivity in tax rates is achieved using 2 new refundable tax credits administered in conjunction with the income tax filing, a sales tax fairness credit and a property tax fairness credit. These credits create a more integrated tax system that promotes progressivity in the combined burden of all state and local taxes, including income, sales and property taxes.

The base sales tax fairness credit is set at $1,000 for single filers or $2,000 for joint filers, plus $500 per dependent and $500 per member of the household over 65 years of age. The credit amount is phased out as income rises. This credit is refundable up to $500 for single filers or $1,000 for joint filers, plus $100 per dependent and $100 per member of the household over 65 years of age, up to a maximum household refund of $1,500. The property tax fairness credit, already described, is fully refundable up to $1,000.

The sales tax fairness credit is automatically integrated into the tax or refund computation and is dependent on income and filing status only. The property tax fairness credit is also computed as part of the taxpayer's annual tax return, but varies based on the property taxes actually paid. The net distributional impact of the income tax, after accounting for the sales tax fairness credit, is as follows. Those households that are also eligible for the property tax fairness credit would have a smaller tax or a larger refund.

A. Single filers. As structured, and without accounting for the property tax fairness credit, single filers with income below $8,800 would pay no income taxes and would receive the full refundable sales tax fairness credit of $500. Single filers with income between $8,800 and $17,600 would owe no taxes and would receive a refundable credit of less than $500, with the amount phasing out over this income range. Single filers with income between $17,600 and $60,000 would also be eligible for the sales tax fairness credit as an offset to their income taxes but would owe a net tax. Their total effective tax rate would increase progressively with income. Single filers with income above $60,000 would pay the full 4% income tax rate on all of their adjusted gross income.

B. Joint filers with no dependents. Joint filers with no dependents and income below $17,600 would pay no income taxes and would receive the full refundable sales tax fairness credit of $1,000. Joint filers with income between $17,600 and $35,300 would owe no taxes and would receive a refundable credit of less than $1,000, with the amount phasing out over this income range. Joint filers with income between $35,300 and $120,000 would also be eligible for the sales tax fairness credit as an offset to their income taxes but would owe a net tax. Their total effective tax rate would increase progressively with income. Joint filers with income above $120,000 would pay the full 4% income tax rate on all of their adjusted gross income.

C. Four-person families. Four-person families with income below $27,700 would pay no income taxes and would receive the full refundable sales tax fairness credit of $1,200. Four-person families with income between $27,700 and $46,100 would owe no taxes and would receive a refundable credit of less than $1,200, with the amount phasing out over this income range. Four-person families with income between $46,100 and $120,000 would also be eligible for the sales tax fairness credit as an offset to their income taxes but would owe a net tax. Their total effective tax rate would increase progressively with income. Four-person families with income above $120,000 would pay the full 4% income tax rate on all of their adjusted gross income.

The bill repeals nearly all income tax deductions, including deductions for home mortgage interest, real estate taxes paid, medical and dental expenses, charitable contributions, theft and casualty losses, other itemized deductions, affordable housing, social security benefits taxable at the federal level, contributions to capital construction funds, premiums paid for long-term care insurance, pension income and contributions to qualified tuition plans under Section 529 of the United States Internal Revenue Code of 1986, so-called 529 plans.

The bill repeals most income tax credits prospectively, allowing the continued carry-forward of tax credits for projects and initiatives already awarded or accrued but eliminating new or future credit awards. Prospectively eliminated credits include the jobs and investment tax credit, the credit for contributions to family development account reserve funds, the credit for employer-assisted day care, the credit for employer-provided long-term care benefits, the credit for educational opportunity, the retirement and disability credit, the forest management planning income credits, the high-technology investment tax credit, the credit for dependent health benefits paid, the quality child care investment credit, the earned income credit, the Pine Tree Development Zone tax credit, the biofuel commercial production and commercial use credit, the tax benefits for media production companies, the dental care access credit, the new markets capital investment credit, the credit for wellness programs, the credit for Maine fishery infrastructure investment and the Maine Public Employees Retirement System innovation finance credit.

2. Corporate income taxes. The bill reduces corporate income tax rates to 3.5% on income up to $50,000 and to 7.5% on income above $50,000.

3. Estate tax. The bill repeals the estate tax.

Sales and excise tax reform

The bill raises about $700,000,000 in additional sales and excise tax revenues annually, paid by both residents and nonresidents in rough proportion to the time they spend in Maine. These revenues are redirected to provide tax relief that goes almost entirely to residents. The net result of this restructuring is an increased revenue contribution from nonresidents and a reduced revenue contribution from residents. The additional burden of sales taxes on lower-income and middle-income taxpayers is offset by the sales tax fairness credit that is administered in conjunction with the income tax.

1. Expanded sales tax base. The sales tax would be applied to nearly all consumer purchases with the exception of health care and education, raising about $400,000,000 in additional sales tax revenues annually. While the specific definitions for the expanded sales tax base will need to be constructed with advisory expertise from Maine Revenue Services, many consumer purchases in the following sales categories would become taxable: amusement, entertainment and recreational services; groceries; coal, oil, gas and wood for cooking and heating; residential electricity; publications; coin-operated vending machines; residential water; personal care services; personal property services; real property services; elective cosmetic services; funeral services; barber shop, beauty parlor and health club services; cleaning, storage and repair of clothing and shoes; business and legal services purchased by consumers; other professional services purchased by consumers; informational services purchased by consumers; certain transportation and storage services; installation, repair, maintenance and other labor service fees; basic cable and satellite television services; telecommunications services; and meals served in cafeterias and dining halls. The sales tax treatment of leasing and rentals would be revised to be more consistent with the treatment of such transactions in most other states.

2. Sales and excise tax rate increases. The bill increases certain sales and excise tax rates, raising about $300,000,000 in additional revenues annually. The general sales tax rate increases from 5% to 6%. The service provider tax rate increases from 5% to 6%. The cigarette tax increases from $2 to $3.50. The taxes on other tobacco products are raised to a level that is equalized with cigarettes. The tax rate on prepared foods increases from 7% to 8%, and the definition of "prepared foods" is expanded. The total excise tax rate on malt liquor and hard cider products increases from 35¢ to 70¢ per gallon. The total excise tax rate on wine increases from 60¢ to $1.20 per gallon. The tax rate on automobile rentals increases from 10% to 15%.

The tax rate on lodging increases from 7% to 8%, plus an additional 2% to be allocated to the Tourism Marketing Promotion Fund. This 2% set aside would replace the allocation to the Tourism Marketing Promotion Fund from the tax on lodging and prepared meals and increase the resources available for tourism promotion from $10,000,000 to $16,000,000.

The real estate transfer tax on residential property increases from 0.44% to a progressive rate structure. Residential real estate with a value of less than $250,000 would be taxed at 0.6%. Residential real estate with a value between $250,000 and $500,000 would be taxed at 0.8%. Residential real estate with a value between $500,000 and $1,000,000 would be taxed at a rate of 1%. Residential real estate with a value above $1,000,000 would be taxed at a rate of 1.5%. All other property would be taxed at 1%.

3. Sales tax collector fee. A sales tax collector fee is created to compensate businesses that collect sales taxes on behalf of the State. This fee is set at 0.5% of sales taxes collected and would be retained by vendors for their effort in collecting sales taxes. Every business that collects sales taxes will be compensated.