

**TESTIMONY OF
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Before the Joint Standing Committee on Taxation
Hearing Date: *January 31, 2023*

LD 7 – “*An Act to Update References to the United States Internal Revenue Code of 1986 Contained in the Maine Revised Statutes*”

Senator Grohoski, Representative Perry, and members of the Taxation Committee – good afternoon, my name is Daniel D’Alessandro, Associate Tax Policy Counsel in the Maine Revenue Services, Office of Tax Policy. I am testifying at the request of the Administration in Support of LD 7, “*An Act to Update References to the United States Internal Revenue Code of 1986 Contained in the Maine Revised Statutes.*”

LD 7, commonly known as the conformity bill, is submitted annually by the Department of Administrative and Financial Services to update the reference to the United States Internal Revenue Code in Title 36 of the Maine Revised Statutes. Maine’s conformity to the Internal Revenue Code primarily affects the State’s income tax laws, which are substantially based on the Code.

The Maine Legislature must annually review amendments to the Code made by Congress and enacted into law since the last conformity date to determine whether it wants to conform to some or all the federal changes that impact Maine’s tax laws. Maine’s conformity to the Code allows Maine income taxpayers to use their federal income tax return as a starting point for their Maine income tax return.

In addition to those amendments that must be reviewed annually, and where conformity requires an affirmative act of the Legislature, the Legislature has also enacted a limited number of provisions where the State automatically conforms to amendments without the need for additional legislation. This so called “rolling conformity” is the exception and limited by the Maine Constitution’s prohibition that the Legislature not “surrender the power of taxation.”

Last year’s conformity bill, P.L. 2021, c. 594, updated the Title 36 reference to the Internal Revenue Code of 1986 as amended through December 31, 2021. Since then, three pieces of significant federal tax legislation have been enacted: the Inflation Reduction Act, the CHIPS and Science Act of 2022, and the SECURE Act 2.0 (part of the Consolidated Appropriations Act of 2023).

While the Inflation Reduction Act and the CHIPS and Science Act made significant changes to federal alternative taxes and credits, they have a much more modest impact on Maine income taxes because the Maine income tax is not linked to those taxes or credits. Most provisions of the two bills have no, or only minor, impact on Maine income taxes.

One item from the Inflation Reduction Act worth noting at this time is the extension of the limitation on excess business losses of non-corporate taxpayers by two years through tax year 2028. This limitation was enacted in the 2017 Tax Cuts and Jobs Act, the TCJA, and Maine conformed to it at the time of its enactment – and has continued to apply it since then despite a suspension of the limitation at the federal level for tax years 2018-20. The Administration proposes to conform to the extension of the limitation now.

The third federal Act is a retirement bill called the SECURE Act 2.0 which will have modest impact on Maine income taxes. The SECURE Act 2.0 makes numerous changes to qualified retirement plans and annuities – including changes to when, in what amounts, and for what reasons, employers and taxpayers may make contributions or take distributions from these retirement plans. In addition, the bill makes changes to federal retirement tax credits. Most of these changes do not have a direct impact on Maine taxes.

Many of the SECURE Act 2.0 provisions change the rules under which retirement plans must operate – but not how these plans are taxed. These provisions do not create the kind of conformity items we normally discuss in the conformity context. They do not create new deductions or new types of income, or otherwise adjust common tax attributes; they are more akin to retirement industry regulations. However, they are within the Code, and they do have technical conformity linkages to Title 36. The Administration proposes to, and strongly recommends, conforming to all of these changes because MRS has not been, and should not be, tasked with regulating the retirement industry.

In addition, there are provisions of the SECURE Act 2.0 that more directly modify the taxation of contributions and distributions from retirement plans. Decoupling from these federal provisions – i.e., not conforming – would require burdensome new procedures for Maine taxpayers because retirement accounts would contain funds subject to differing taxation at the State and federal level. Taxpayers, and the State, would be forced to track these differences throughout the entire lifespan of the account. As such, the Administration is also proposing to conform to these changes.

One final element of the SECURE Act worth noting in terms of timing and possible modest fiscal impact is the modification of the tax deduction for charitable contributions of conservation easements to address transactions carrying a high potential for abusive tax avoidance.

MRS will provide further information on the provisions of these three bills that impact Maine income tax and their expected revenue impact for the work session.

I would now like to address two items that Maine is currently in Code conformity with, but which present important future impact consideration. In your materials for today you should have a copy of a Committee Amendment proposed by the Administration addressing expiring provisions of the 2017 federal tax reform act, “The Tax Cuts and Jobs Act” (TCJA), and their impact on the Maine standard deduction and dependent exemption tax credit provisions. The Revenue Forecasting Committee (RFC) noted that the expiration of these provisions will result in a revenue increase of over \$300 million dollars annually starting with tax year 2026. Remember, as explained at last week’s orientation, the revenue forecast provided by the RFC must be based on current law, and under both federal and state tax law these two items are scheduled to sunset at the end of tax year 2025.

The two federal TCJA provisions are the increase in the standard deduction and the replacement of the personal exemption with an increased child and other dependent tax credit that, until 2026, also applies to “non-qualifying child” dependents (for instance, dependents 17 and older).

Currently, Maine allows a standard deduction equal to the federal standard deduction which, under current law, will decrease substantially when the federal deduction decreases. Prior to the TCJA, Maine had its own standard deduction in the same ballpark as the current standard deduction. So, the tax year 2026 Maine standard deduction would be lower than even the pre-TCJA standard deduction.

Turning to the Maine dependent exemption tax credit, dependents allowed at the federal level for the child and other dependent tax credit are eligible for the \$300 dependent exemption tax credit in Maine. When the TCJA changes to the federal child tax credit expire “non-qualifying child” dependents will no longer qualify for Maine’s dependent exemption tax credit.

The proposed Committee Amendment addresses both of these issues by delinking the Maine standard deduction and dependent exemption credit from their federal equivalents thereby maintaining them at current levels separate from the TCJA sunset dates and preventing the \$300 million plus tax increase currently in Maine law for tax years 2026 and later. The Administration is presenting this amendment at this time so that legislative work on the FY24/25 biennial budget can be done with clear knowledge that forecasted FY26/27 General Fund revenues will be approximately \$11.1 billion and not \$11.6 billion as currently forecasted.

The Administration looks forward to working with the Committee on the bill; representatives from MRS will be here for the Work Session to provide additional information and respond in detail to the Committee’s questions. I would be happy to answer any questions you have for me now.