TESTIMONY OF
MICHAEL J. ALLEN, ASSOCIATE COMMISSIONER FOR TAX POLICY
DEPARTMENT OF ADMINISTRATIVE AND FINANCIAL SERVICES

Before the Joint Standing Committee on Taxation
Hearing Date: *April 9, 2024*

LD 1363 – "*An Act to Exempt Resident Minors' Income from Income Tax*"

Senator Grohoski, Representative Cloutier, and members of the Taxation Committee – good morning, my name is Michael Allen, Associate Commissioner for Tax Policy in the Department of Administrative and Financial Services. I am testifying at the request of the Administration Against LD 1363, "*An Act to Exempt Resident Minors' Income from Income Tax.*"

This bill proposes to exempt the taxable income of individuals that are under 18 years of age from Maine income tax. The bill also provides an income subtraction modification to reduce Maine taxable income by the amount of income earned by individuals under 18 years of age that are claimed as dependents on the taxpayer's income tax return, to the extent the income is included in the taxpayer's federal adjusted gross income.

Currently, all individuals with Maine taxable income are subject to the Maine income tax, regardless of age. Generally, for tax years beginning in 2024, a taxpayer who can be claimed on another taxpayer's income tax return has Maine taxable income if they have earned income greater than $14,600 or unearned income greater than $1,300.

For federal tax purposes, the "kiddie tax" is imposed on minors whose unearned income exceeds a certain threshold, which is $2,600 in 2024. The kiddie tax applies the taxpayer's marginal tax rate to the unearned income of the taxpayer’s dependent(s). The kiddie tax was enacted to close a loophole that allowed taxpayers to reduce their overall tax by shifting unearned income to their dependent(s).

It is not clear what the tax policy justification is for this proposal. This bill adds complexity to tax returns and may encourage tax avoidance by shifting income to dependents under the age of 18. Additionally, the absence of a cap on the amount of the income exclusion may result in increased fraudulent activities as some taxpayers may attempt to shift taxable income to minor dependents to avoid Maine's individual income tax.

The Administration also notes the following technical concerns:

- The bill should clarify whether an individual’s income for the tax year becomes taxable if they reach 18 years of age by the close of the tax year.
- Sections 1 and 2 of the bill should be amended to include an application date. Consistent with Section 3, it is recommended that Sections 1 and 2 of the bill apply to tax years beginning on or after January 1, 2026.
- Section 3 and the Summary of the bill limit the subtraction modification to the income “earned” by the taxpayer’s dependent(s) who are under 18 years of age. However, only “unearned” income of a taxpayer’s dependent(s) may be included on the taxpayer’s federal and State income tax returns.
- The bill should be amended to clarify the tax treatment of Maine source and non-Maine source taxable income for part-year residents and nonresidents who are under 18 years of age.

- It is unclear whether the bill affects the taxable income of an estate or trust subject to the fiduciary income tax.
- Taxpayers are not currently required to report their age or birthdate on their Maine individual income tax return.
- Depending on the application date of the bill, the changes may result in a significant number of amended individual income tax returns filed for prior years.

The preliminary estimated fiscal impact is a revenue loss of $800,000 per year, with the possibility of additional loss from tax avoidance.

The preliminary estimated administrative costs are under consideration. However, computer programming and related system testing costs are required to add one income subtraction modification line to the individual income tax return.

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.