

**TESTIMONY OF
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DEPARTMENT OF ADMINISTRATIVE AND FINANCIAL SERVICES**

Before the Joint Standing Committee on Taxation
Hearing Date: *May 4, 2023*

*LD 1544 – “An Act to Improve Economic Security for Maine Children by
Establishing the Maine Dependent Tax Credit”*

Senator Grohoski, Representative Perry, and members of the Taxation Committee – good afternoon, 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 Neither For Nor Against LD 1544, *“An Act to Improve Economic Security for Maine Children by Establishing the Maine Dependent Tax Credit.”*

This bill effectively replaces the existing non-refundable \$300 Maine dependent exemption tax credit with a broader and refundable \$350 Maine dependent tax credit. For tax years beginning on or after January 1, 2023, the bill proposes to sunset the nonrefundable dependent exemption tax credit and to establish the refundable Maine dependent tax credit (“Credit”). The Credit is equal to \$350 for each individual for whom the taxpayer has provided more than 50% of the individual’s financial support during the tax year and who was either born during the tax year or lived with the taxpayer for more than half of the tax year. The Credit is subject to a phase-out equal to \$7.50 for each \$1,000, or fraction thereof, that the taxpayer’s Maine adjusted gross income exceeds \$200,000 (\$400,000 for married taxpayers filing jointly). The credit is indexed for inflation annually beginning in 2024 and is prorated for nonresidents and part-year residents based on Maine-source income. Further, the Credit may not be considered income,

an asset, or a resource for purposes of any state or municipal benefits or assistance programs.

The bill specifies the way the credit must appear on tax forms and directs the State Tax Assessor and the Commissioner of Health and Human Services (DHHS) to coordinate efforts and make “the application” for the Credit – that is, the tax return and relevant forms and worksheets – available through the DHHS publicly accessible state benefits web portal for food supplement, health care, cash assistance or childcare benefits. The State Tax Assessor is also required to add certain information to the tax expenditure report submitted to the Legislature by February 15th of each odd-numbered year.

The Administration opposes this bill taken as a whole, but not all its elements. For example, enhancing the current dependent tax exemption credit and indexing for inflation could be one component of a workable income tax relief and assistance proposal/package. That said, the bill adds significant complexity by requiring taxpayers and MRS to make “dependent” determinations independent of federal determinations. These determinations are already widely considered to be a complicated, fact-specific area under the Code. MRS currently relies on the validation process used by the Internal Revenue Service (IRS) for purposes of determining dependents. The IRS currently has resources available to validate the social security number and individual identification number for claimed dependents at the time the return is processed, whereas MRS does not currently have access to these same resources. For simplification and consistency with federal treatment, MRS recommends that the definition of “dependent” in Section 5 of the bill should remain linked to the federal determination under the Code.

Further, the additional information necessary to meet the requirements for the expenditure report, including the age of the dependent and geographic location

of the taxpayer, would ultimately add complexity to the individual income tax return. Next, the creation of additional refundable tax credits adds complexity and limits fiscal flexibility when there are times of revenue shortfalls. Finally, the effectiveness of the existing refundable personal income tax credits in providing targeted income tax relief – such as the sales tax fairness and the property tax fairness credits – should be considered before creating another refundable tax credit.

Note that the DAFS/MRS income tax “Conformity Bill”, LD 7, in Section 5 of the Committee Amendment “A” proposes, for tax years beginning on or after January 1, 2026, to adjust the base for the dependent exemption tax credit to the number of federal personal exemptions that the taxpayer is eligible to claim for the same taxable year under Internal Revenue Code, Section 151. Any action on this bill should include review of the status of LD 7.

There are additional possible technical concerns:

- The bill overlaps the personal exemption amount allowed for a taxpayer’s spouse under 36 M.R.S. § 5126-A.
- For consistency, the term “fraction” (page 2 of the bill, line 13) should be replaced with “ratio.”
- As drafted, the Credit will first be adjusted for inflation during 2024 for taxable years beginning in 2025.

The estimated revenue impact of implementing *refundability* of the current \$300 dependent exemption tax credit would reduce the General Fund revenues by approximately \$25 million a year. Increasing the credit to \$350 and making it refundable obviously would result in a larger reduction in tax liability.

The extent of required computer programming changes and additional staff required to process and audit affected returns is unclear; estimated administrative costs are under review. Significant administrative costs would apply if MRS must audit tax forms to independently substantiate the eligibility of dependents for Maine income tax purposes.

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.