Albin
Randall
& Bennett

CERTIFIED PUBLIC ACCOUNTANTS
BUSINESS ADVISORS

January 22, 2024

Senator Grohoski, Representative Perry, and Members of the Joint Standing Committee on Taxation, my name is John Hadwen, and I live in Falmouth, Maine. I am writing to provide detailed testimony in support of Maine LD 1891, a legislative initiative that introduces a pass-through entity tax and a child care tax credit. As a Certified Public Accountant (CPA) and Principal of Albin Randall & Bennett, I have examined the provisions of LD 1891 and am eager to highlight the significant benefits that these measures can bring to Maine's economic landscape.

The pass-through entity tax proposed in LD 1891 represents a judicious approach to taxation that aligns with contemporary trends observed in many states across the nation.

For many years, the federal government granted a deduction for state income taxes paid by individuals and businesses. Congress, in 2017 with the enactment of the Tax Cuts and Jobs Act (TCJA), capped the deduction of state taxes to $10,000 per year ("SALT Cap"). This limitation significantly impacted individual owners of pass-through entities – S corporations, partnerships, and LLCs. This cap did not apply to taxes paid by businesses such as C corporations.

However, in 2020, the IRS – in Notice 2020-75, announced the IRS would not apply the $10,000 SALT Cap to pass-through entities if the state income tax was imposed directly on the entity. If Maine allows an election to move its point of taxation from the individual owners of a passthrough entity to the entity itself, the federal government will not impose the $10,000 cap on deductions claimed by the entity.

The pass-through entity tax ensures equitable taxation by taxing business income at the individual owner level. This approach avoids the issue of double taxation that can burden businesses operating as C corporations, contributing to a fair and balanced tax system.

Many small and medium-sized enterprises (SMEs) choose the pass-through structure for its flexibility. LD 1891's pass-through entity tax recognizes the unique needs of these businesses, providing a tax framework that supports their growth and development.

A majority of states across the U.S. have implemented some form of pass-through entity tax or have made adjustments to existing structures to accommodate these business entities. This reflects a recognition of the vital role that pass-through entities play in the economic landscape and the importance of tailoring tax policies to their specific characteristics.

Maine is one of six remaining states with an individual income tax that has not implemented a pass-through entity tax.

The potential repeal of TCJA after the 2025 tax year has prompted discussions on whether the Pass-Through Entity Tax is worth implementing for 2 years.

The potential repeal of TCJA raises concerns about the resurgence of the Alternative Minimum Tax (AMT) for individual taxpayers. AMT is a separate tax system that requires some taxpayers to calculate their tax liability twice. First, under ordinary income tax rules, then under the AMT, and pay whichever amount is highest. Under the AMT rules the taxpayer does not receive a deduction for taxes paid. Pass-through entities can serve as a protective mechanism against the impact of AMT, as their income is not subject to this tax at the entity level.

Under a pass-through entity tax structure, individual owners report their share of the business income on their personal tax returns. This income is then subject to regular income tax rates, avoiding the complexities and potential higher tax liability associated with the AMT. As discussions around tax reform evolve, the pass-through entity tax becomes a strategic option to shield taxpayers from the uncertainties surrounding the AMT.

An advantage of a pass-through entity tax, especially in the context of a potential TCJA repeal, is the potential for self-employment tax savings. Self-employment tax is a tax consisting of Social Security and Medicare taxes primarily for individuals who work for themselves. The self-employment tax rate is generally 15.3%. That rate is the sum of 12.4% for Social Security and 2.9% for Medicare.

Generally, the individual owners of pass-through entities taxed as partnerships are subject to self-employment taxes on any net profits reported on their personal tax returns. This tax would allow these owners to deduct their state income taxes in computing their net profits, resulting in significant savings on self-employment taxes.

Another compelling feature of a pass-through entity tax is the collection of tax at the entity level. Traditionally, pass-through entities are "tax-transparent," meaning income is not taxed at the entity level. However, some proposals suggest introducing a mechanism for taxing a portion of income at the entity level, providing a source of revenue for the government.

This approach not only ensures a fair contribution from businesses but also simplifies the tax landscape. By collecting tax at the entity level, compliance and enforcement become more straightforward, reducing the administrative burden on individual taxpayers and tax authorities alike.

Lastly, what happens if TCJA is extended and/or the SALY CAP remains at $10,000? While we don't know what the future holds this could be a possibility in which case, we would regret not implementing a pass-through entity tax now.

LD 1891 also addresses a critical aspect of family life by introducing a child care tax credit. As a CPA with a deep understanding of family financial dynamics as well as having 6- and 8-year-old daughters, I appreciate the positive impact that this credit can have on Maine families.

The landscape of the modern workplace is evolving, and as businesses adapt to the changing needs of their workforce, the demand for family-friendly policies is on the rise. A business-supported child care tax credit emerges as a strategic and mutually beneficial solution, offering advantages not only to employees but also to businesses seeking to enhance productivity, employee retention, and overall company culture.

One of the primary benefits of a business-supported child care tax credit is the positive impact on employee productivity and engagement. By providing financial support for child care expenses, businesses empower working parents to focus on their professional responsibilities without the distraction of worrying about the well-being and care of their children.

When employees feel supported in managing their family responsibilities, they are more likely to be engaged and committed to their work. This, in turn, contributes to increased productivity, efficiency, and overall job satisfaction within the workplace.

A business-supported child care tax credit becomes a powerful tool for employee retention and recruitment. In today's competitive job market, businesses that prioritize the well-being of their employees, especially working parents, gain a distinct advantage. Offering a child care tax credit demonstrates a commitment to creating a family-friendly work environment, making the company more attractive to both current and prospective employees.

Employees are more likely to stay with a company that understands and supports their needs, reducing turnover costs for businesses. Additionally, the availability of a child care tax credit can be a compelling factor for job seekers evaluating potential employers.

Businesses that implement a child care tax credit not only support individual employees but also contribute to fostering a positive company culture. Such initiatives communicate a commitment to the well-being of employees and their families, creating a workplace where individuals feel valued and supported.

A positive company culture has cascading effects, leading to improved morale, teamwork, and collaboration among employees. It also enhances the company's reputation, making it an employer of choice in the eyes of both employees and external stakeholders.

Contrary to the perception that offering child care support is a financial burden on businesses, a well-structured child care tax credit can actually provide a financial incentive for companies. By encouraging workforce participation and reducing employee turnover, businesses can realize cost savings associated with recruitment, training, and onboarding.

Moreover, the positive impact on employee productivity and job satisfaction can lead to increased revenue generation and business growth. The potential for tax credits can be seen as an investment in a more efficient and content workforce, yielding long-term benefits for the business.

In conclusion, LD 1891 is a great piece of legislation that acknowledges the nuanced needs of both businesses and families in Maine. The pass-through entity tax aligns with national trends and supports a fair and efficient tax system for businesses, while the child care tax credit recognizes the challenges faced by working parents and provides practical financial relief. I urge the committee to wholeheartedly support LD 1891 for the long-term benefit it offers to Maine's economic prosperity.

Thank you for your time and consideration.

Sincerely,

John E. Hadwen, CPA

John E. Hadwen, CPA