

**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: *February 20, 2024*

LD 457 – “*An Act to Amend Maine’s Tax Laws*”

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 Against LD 457, “*An Act to Amend Maine’s Tax Laws.*”

This testimony is limited to the amendment as it affects the Maine individual income tax. For tax years beginning on or after January 1, 2025, the amendment proposes to phaseout the individual income tax pension income deduction in the same manner as the standard deduction phaseout, based on the income of the taxpayer.

The pension deduction amount has been increased substantially in recent years, most recently by this Legislature last year. These changes should be allowed to settle before further changes to the pension deduction are made.

Deduction phaseouts cause the marginal tax rate on income within the phaseout range to exceed the rate on income earned above the phaseout range. That is, for every additional dollar of income earned within the phaseout range, the taxpayer pays a higher tax rate than they do for income earned above the phaseout range. Layering multiple phaseouts over the same income range, as proposed by this bill, increases this rate differential. If the Committee is interested in addressing this

issue, existing phaseouts, and any new phaseouts, could be better coordinated to lessen this impact. While the concept of phasing out the deduction for high-income taxpayers may have merit if included in a package with tax rate reductions, the Administration opposes the proposed tax increase.

The Administration would like to note that the amendment requires significant redrafting to function properly. Instead of referencing the standard deduction phaseout, new phaseout language is necessary addressing or clarifying the following issues:

- Whether the full pension deduction (as indicated in the summary) or only the portion of the pension deduction related to nonmilitary pensions is being phased out.
- The amendment uses Maine Adjusted Gross Income (MAGI) to calculate the new phaseout. Phasing out the pension deduction using MAGI creates a mathematical loop because the pension deduction itself is part of the MAGI calculation. Instead, Federal Adjusted Gross Income could be used.
- The amendment should phase out the pension deduction amount, not the pension deduction cap.
- The application of annual inflation adjustments to the phaseout range should be clarified.

If the full Maine pension deduction is phased out using Federal Adjusted Gross Income and the same phaseout range as the Maine standard deduction phaseout then the estimated revenue increase in the first year is \$21.3 million. Alternative choices for the phaseout income or the quantity being phased out would change the revenue estimate.

Estimated administrative costs continue to be under review. The proposed phaseout will result in additional printing costs to separate the current pension income deduction worksheet and instructions from the Form 1040ME, Schedule 1S, and to add a new phaseout worksheet. Additionally, depending on the number of affected taxpayers, an additional Tax Examiner may be required to provide additional taxpayer assistance.

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.