TESTIMONY OF
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Before the Joint Standing Committee on Taxation
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LD *221 – "An Act to Address the Effect of Changes to Federal Income Tax Laws on Maine Income Tax Laws*"

Senator Grohoski, Representative Cloutier, and members of the Taxation Committee – good afternoon, my name is Daniel D'Alessandro, Deputy Tax Policy Counsel in the Department of Administrative and Financial Services. I am testifying at the request of the Administration in Support of LD *221*, "*An Act to Address the Effect of Changes to Federal Income Tax Laws on Maine Income Tax Laws.*"

This Department of Administrative and Financial Services department bill provides a statutory framework for the State Tax Assessor, at the direction of the Governor, to administer the tax filing season when federal tax law changes have been enacted that affect the State tax filing season, and the Maine Legislature has not yet acted upon them.

Maine's income tax law generally conforms to the Internal Revenue Code and other federal laws related to income tax as of a certain date that is specified in the Title 36 statutory definition of "Code." This conformity has particular importance in the calculation of Maine taxable income and certain deductions and tax credits. Nonconformity with specific federal income tax laws is expressed through statutory provisions that address the specific items.

As I discussed in the Internal Revenue Code Conformity topic discussion, federal tax law changes are incorporated into Maine tax law through State statutory enactment, however, federal changes are often automatically incorporated by the Maine income tax forms and require specific changes to those forms, for instance, the creation of a new modification line on the form, to remove them. These items are usually addressed in the statutory provisions that require federal income to be modified in certain ways or that describe Maine deductions or tax credits by reference to specific federal deductions or federal tax credits.

Broad conformity to the federal income tax, with nonconformity limited to important and specific areas, greatly simplifies the state income tax thereby simplifying compliance for taxpayers and administration for the State.

In years where federal changes that impact the upcoming filing season are enacted late in the calendar year and the Legislature has not acted (or had the opportunity to act) before Maine Revenue Services publishes returns, forms and instructions and before taxpayers begin to file returns, special issues are raised concerning administration of the Maine tax system. When federal legislation is enacted after form design is complete, the forms are created without the specific modifications necessary to decouple from the late enacted federal changes – thereby functionally conforming to those changes. These late-enacted federal changes are of particular concern to the administration of the income tax filing season.

To meet its obligations to allow taxpayers to file timely tax returns and receive tax refunds and for the State of Maine to receive timely tax payments, MRS must develop and issue forms and instructions that anticipate final action on conformity or nonconformity by the Legislature and Governor. If the Legislature does not act before the beginning of filing season MRS faces the problem of beginning the filing season using anticipatory forms.

Our review of such situations that have arisen in prior years across Administrations, provided to this Committee in the IRC Conformity topic presentation, provides a basis for drawing upon best practices used to develop forms and begin the filing season based on the Administration's conformity proposal. However, beginning an upcoming filing season based on expected future legislation raises important questions on the proper roles of the Executive and Legislative branches.

The tension inherent in this process would be best ameliorated by this statute expressly authorizing MRS' filing season implementation process, including authority to require taxpayers that choose to file to use the MRS issued forms, to allow MRS to issue refunds, and to waive any interest or penalties that might result from differences between the forms and any ultimate conformity legislation.

This bill requires the DAFS Commissioner to report in writing to the Governor and certain legislative leaders a description of the federal changes, their potential effect on Maine income tax laws and the State budget. After receiving the report, the bill would authorize the Governor to direct the State Tax Assessor to temporarily administer the tax filing season based on some or all of such federal income tax law changes. It would then require reporting of the Governor's direction to those legislative leaders and outlines the procedural steps for MRS administration and taxpayer filings during the tax filing season, including in the case where the Legislature passes conformity legislation at odds with the Governor's proposal.

By codifying the existing conformity process that has been developed across Administrations over the years, future Legislatures, Administrations, and MRS leadership and staff will have a process that can be relied on year to year as conformity issues arise. The process provides clear, statutorily required, information flows to the Legislature, allows for timely and preemptive action by the Legislature through statutory enactment, provides *temporary* authority to MRS should the IRC Conformity legislation be delayed, and provides corrective methods, including taxpayer relief, should the Legislature enact legislation at odds with that temporary authority.

Turning to a related, but conceptually distinct topic, the bill would also require any income tax extension of time for payment or filing that causes a material budgetary impact to be approved by the DAFS Commissioner and reported to the Governor and certain legislative leaders. In recent years, these extensions have become more common and stemmed from widespread disasters that have impacted the State.

Because these extensions can result in large numbers of tax returns being shifted between fiscal years, they have the potential to have a significant impact on the State's budget and the so-called "cascade" of funds resulting at the end of a budgetary period.

This bill would increase the transparency around income tax extensions that cause a material budgetary impact, require that they receive consideration and approval at the appropriate levels of the Administration, and require that the Legislature is timely informed of the extensions.

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.