Appendix B

Presentation by Laurie Lachance, State Economist

Vision	A high quality of life for all Maine people - measured in part by a per capital income with a goal for Maine to rank 25th in the nation
Goals of Tax Reform	
Short Term Goals	Resolve the current structural gap, make the volatility of the current tax system no worse, and preserve investment in the highest priority public goods and services.
Short Term Means	A series of expenditure cuts and, if necessary, tax increases
Long Term Goal	A tax structure that provides stable revenues that is adequate for funding high priority public goods and services and that minimizes the distortion of economic investment in Maine.

Principles of Taxation	**Tax Burden**	**Tax Mix**	**Stability**	**Fairness**	**Competiveness**	**Exportability**	**Efficiency**
Current Situation	13.5% - Among highest in nation	Dependent on Property tax (32%), income taxes (31%), Sales taxes(20%), Other (17%)	Highly volatile revenues - 3 times rate of personal income. Very narrow sales tax base. Highly progressive income tax - top 2% pay $400 million.	Maine is recognized nationally for fairness in taxation	Maine's tax structure is not conducive to capital investment. Very high top marginal income tax rate. Most states do not tax machinery & equipment or at much lower levels.	Maine has highest % of vacation homes and is a tourism state, but it has not fully tapped non-residents.	Maine's administrative costs of levying and collecting taxes are very reasonable.
Goal	Reduce burden to 10.5%	No single tax will account for more than 28% of all tax revenues. Cost $190 million.	% change in state & local revenues will not vary more than 20% from change in personal income	No quintile will pay a larger % of income to state and local taxes than the next higher quintile	Taxes affecting investment decisions, especially creation of wealth, will be reduced to lowest level.	Export more of Maine's tax burden	The cost of collecting taxes will not exceed 1% of the revenues generated.
Means	Reduce Gov't Spending	Broaden tax base	Reduce reliance on auto and building supply sales. Reduce progessivity of income tax.	Evaluate proposed tax changes by this goal.	Encourage business investment.	Increase taxes or broaden tax bases that will impact non-resident taxpayers	Avoid tax changes that significantly add to administrative burden and costs.

	Raise Income by: Investing in education, R& D, and technology. Encourage investment in Productive capacity	Apply sales tax to: consumer services (not medical) = $200 million. Food = $110 million. Snacks = $16 million. state & local entities = $115 million. Business services = $300 million. Increase sales tax to 6% = $140 million.	Broaden sales tax base to include consumer or business services, or food Replace sales tax with a gross receipts tax. Reduce highest marginal income tax rate.		Eliminate personal property tax on machinery & equipment. Reduce highest income tax rate. Avoid taxing business services. Create stable investment climate.	Increase meals & lodging tax [1% = $20 million]. Tax amusements and services = $30 million. Higher tax rate on second homes & offer higher homestead exemption.

Presentation by Laurie Lachance, State Economist

Obstacles to Prosperity	**Slow population Growth**	**Drop in Manufacturing**	**Low Per Capita Income**	**Low Investment in R & D**
Explanation	Very slow growing and an aging population. By 2025, 25% of the population will be over 65 yrs of age. The 18-44 yr old category will decrease. Maine residents are moving to rural areas and thereby increasing the costs of delivering services. In 1960, 36% lived in rural areas - now it is 56%. Duplication of services adds $50 - $75 million each yr to Gen. Fund Budget	Manufacturing employment has dropped from 22% in 1980 to 12% in 2002. It is still important today. In Portland its 17% of the wealth. US and New England worker productivity is greater than worker productivity in Maine. The problem lies with the educational level and job skills of the labor force and the level of investment in production and equipment. The value added by manufacturing- ring jobs is greater than non-manufacturing jobs.	Maine ranks 35th in the nation with respect to per capita income. The goal is to raise this to 25th. Only 2/3 of the jobs in Maine pay a livable wage. Livable wage is loosely defined as wages that provide household income equivalent to 185% of poverty. Over the past decade, the national average of multiple job holdings has remained about 6%. In Maine, this variable has increase from 6% to slightly over 8%.	The US and New England spend far more than Maine on research and development. Maine ranks 46th in the nation with respect to research and development.

Presentation by Paula Valente - Pres. Institute For A Strong Maine Economy

Economic Realities	Change is Constant	Competition is tougher	Winners are fast, agile, forward thinking, responsive, & innovative	Globalization is a Fact	Lead change - or be a victim of it.
Obstacles to Growth	Chronically low per capita income	Maine is # 2 in tax burden	Maine ranks 43rd in preparedness to succeed in the new economy	It is expensive to do business in Maine	An aging population and a stagnant and less educated work force.
Explanation	Maine's per capita income is 33% below the national average.	Maine's income tax is too steeply progressive	Maine gets a "D" for development capacity & an "F" for innovative assets. Maine export activity is 60% of the national average There are warning flags in 2002 for income growth, R & D, new product development, and educational achievement.	Maine workers' productivity is 80% of national average	The population in Maine is rapidly aging, and there is an out-migration of young people. The labor force is not growing, and it is less educated
Remedies	Control Spending	Reduce Maine's tax burden	Balance of investment , Service delivery, and tax reduction	Promote a culture of lifelong learning through a seamless educational system -- preschool to university to adult education.	

Elaboration of Remedies	Reduce the cost of government by restructuring the delivery of regional and local government services	Reduce Maine's tax burden closer to the US average. Restructure Maine's tax system to promote investment, exports, & business competitiveness
	Limit the growth in government spending to the growth in gross state product, income, or some other benchmark.	

Presentation By Geoffrey Herman, Maine Municipal Association

Definition of the Problem	Reliance on the Property tax as the predominant source of school funding. Currently the property tax funds 56.4% of the total cost of K-12 education, and the state funds 43.6% of the total cost.
Explanation	Although state funding of education has increased over the last 10 years, it has not increased nearly as much as the cost of education. The average annual total cost of education has increased 7.1% each year since 1985. From 1992 to 2002, state aid to education has increased at an average annual rate of 3.2%. Since 1994, the cost of K-12 education has increased at a rate greater than inflation, which has also been 3.2% per year. Between 1991 and 1997, the Legislature's annual appropriation to GPA increased by $33 million. Over the same time period, annual property tax appropriations for education increased by $224 million or 45 percent. As a result, reliance on the property tax to fund greater and greater percentages of the cost of education has brought the property tax to a crisis situation. The property tax is no longer a tax to protect property by funding services necessary to preserve it. The property tax has become the major source of funding a basic statewide service.
Cost drivers in Education	Teacher contracts, and federal and state mandates. The state's educational performance standards, known as "learning results," will add 10% to the overall cost of education or approximately $160 million a year once it is fully implemented. Recently enacted federal educational mandates will require increased levels of educational testing at a significant cost to local school systems. Another mandate, Special Education is growing at an average annual rate of 8.5%. The total cost of Special Education in the year 2001 was $243 million. The federal government provided $25 million (10%), the State contributed $123 million (50.7%), and the property tax provided $95 million (39%).
Other Contributing Factors	Maine has an antiquated tax system that reflects an economy and tax system that existed 50 years ago. At that time, the production and purchase of goods was the predominant factor of the economy and tax system. Today, services comprise the major economic factor, but many services are exempt from taxation. In addition, the sales tax is highly volatile, and unpredictable economic upturns and downturns raise havoc with state revenues. The property tax is, by default, shoring up the inadequacies of the state's antiquated tax system. Today, 30% of Maine's population lives in 50 municipalities with property tax rates in excess of 20 mills. There is also a migration of more mobile and affluent residents into less developed areas, which reduces the tax base, reduces the state subsidy, and greatly increases the costs of services.

Goal of Tax Reform	Balance the tax burden and reduce the tax burden. This must be a short-term goal. If the State funded the total cost of education at 55%, approximately $200 million in property tax revenues would be saved.
Comparison of Tax Burden	There must be an agreement on measures of the total tax burden. Compare Maine with other similar states with respect to population and geography. Some low-tax states, such as Alaska (oil) and Nevada (gambling) are actually high spending states when revenues from oil and gambling are considered in the state government spending picture.
Steps to be Taken	Restructure the Income Tax, broaden the Sales Tax base, increase the Meals & Lodging Tax (compared to other states, Maine's tax is significantly less), tax amusements and recreation, and provide municipalities with a stable and predictable revenue source that pays a greater and more reasonable share of education. Establish a different tax rate on second home properties. Expand the Homestead Exemption - increase the cap and eligibility. Broaden the property tax base, which is too narrow (look at Pennsylvania). If regionalization of services is to be implemented, it must be incentive based.
Step <u>Not</u> to be taken	Do not repeal the personal property tax. Currently, this tax comprises 10% of the local tax base. In Jay, the personal property tax produces 80% of local tax revenues. Maine cannot afford to repeal the personal property tax. Most states tax personal property, including machine and equipment. Those who propose repealing this tax have a business agenda, and their principles of taxation are highly geared to business. Do not repeal the Homestead Tax exemption.

Presentation By Mark Gray, Maine Education Assoc.

Goals of tax reform.	First and Foremost, provide an adequate and stable source of income to fund public schools. Second, reduce the property tax burden.
Problems of Current Funding Situation	The cost of K-12 education is increasing dramatically, driven, in part, by federal mandates. The State share of the total cost of education is declining.
1997 Polling results	In 1997, 80% of likely voters said taxes are too high, and 39% said taxes are much too high. In Massachusetts, when 30% of respondents say taxes are too high, the situation is deemed a crisis, and action is taken. In 1997, when there was a $145 million budget surplus, 53% aid it should be used to reduce taxes. Of this number, 41% said the property tax should be reduced, 27% said the income tax should be reduced, 27% said the sales tax should be reduced, and 8% said repeal the Snack Tax.
2002 Polling Results	In 2002, 80% of likely voters said taxes are too high, and 45% said taxes are much too high. When respondents were asked to which tax they would least object to raising, 59% cited the sales tax, 18% cited the income tax, and 13% cited the property tax. When respondents were asked for which purposes they would agree to raise taxes, 53% cited education, and 57% cited health care. A total of 58% of respondents agreed to raise the sales tax by 1 cent if it were dedicated to education.

Presentation by Christopher St. John, Maine Center for Economic Policy

Goals of tax reform.	First and Foremost, provide adequate state revenues to support the demand for state and local services. Secondly, establish a state tax system based on fairness.

Principle of Fairness	Fairness or the Ability To Pay is a very important principle, which should be measured by using the income variable, and not "net worth", which is very difficult to measure. It is very difficult to obtain consensus on the definition of "net worth." Current income is one factor, but the" wealth in property " factor creates difficulty. It raises the question of how to measure net worth.
Tax burden comparisons	Tax burden comparisons among the states produce simplistic and misleading results. These comparisons take total income and divide it by total taxes collected. The comparisons do not look at more important factors including: tax exemptions and tax reimbursements to taxpayers, the proportion of taxes that is exported, or the provision in state tax returns that provides for the deduction of state income and estate taxes paid. Maine does export a significant amount of its total tax burden. A total of 15% of Maine property is owned by non-residents. Maine has a relatively progressive tax system compared to most states which have a highly regressive tax structure.
Property Tax Relief	Property tax relief is best provided through targeted relief, not a general reduction that is applied to everyone, including those who pay a low property tax mill rate. Relief should be targeted to those who need it. This can be best accomplished through the Circuit Breaker. The eligibility provision can can be raised to $70,000 or $80,000 to ensure relief for the middle class. The current reimbursement cap should be raised from the current $1,000 cap to one that provides meaningful relief. Revenue Sharing 2 should be enhanced because it targets those municipalities with the highest property taxes.
Steps <u>Not</u> To Be Taken	Do not provide property tax relief to the entire property taxpayer base. Do not place a cap on growth in government spending. There are considerable costs that are being passed on to the public sector, such as health care, that impact the elderly and children. Revenue stability should not be a primary goal. For example, if elimination of the capital gains tax would remove volatility, Maine would lose a substantial amount of revenue, and the State's tax system would become less progressive. In addition, broadening the tax bases often hurt the low-income and working class populations the most.
Steps To Be Taken	Target property tax relief, establish a budget stabilization fund with a cap of 10% as a means of addressing revenue volatility, and target relief to municipalities through Revenue Sharing 2.
Presentation By Senator Mills	
Proposal	Double the appropriation to the Circuit Breaker Property Tax Relief Program from $20 million to $40 million. Convert present Revenue Sharing entirely to Revenue Sharing 2 at a 15 mill threshold. Shift all state subsidies to reduce high mill rates in service center communities. Reduce BETR reimbursement to 80% of the property tax paid and eliminate the BETR?TIF double dip. Increase the cap on the Rainy Day Fund from 6% to 10% of revenue. Repeal the current homestead exemption. Amend the Constitution to allow towns to assess the primary homes of Maine residents at values up to 50% less than "just value."
Explanation	Property Tax relief should be targeted to those who need it the most. The best way to do this is to use the Maine Residents Property Tax Relief Program, better known as the Circuit Breaker. The $1,000 cap should be raised and eligibility standards expanded. Revenue Sharing I, which provides funding to towns with low tax rate assessments as well as high tax rate assessment towns should be repealed. Revenue Sharing II, which provides tax relief to high tax rate towns should be expanded. The Homestead Exemption should be repealed. It is deducted as income from the federal income tax, and the money goes to Washington, at the expense of the General Fund. It provides no relief for renters or landlords, and its administrative costs are too high. All too often, this program subsidizes homeowners in Maine's suburbs and wealthy waterfront retirement communities. The BETR program provides personal property tax relief for 12 years, which is longer than the lifespan of most personal property. The business owner has no inducement to limit or reduce its property tax liability as long as the BETR subsidy lasts. In addition, the BETR reimbursement from the State can also be duplicated by a tax increment financing tax reimbursement from the town, and thereby double its property tax reimbursement.

Presentation By Rep. Bernard McGowan

Proposal	In LD 2086, presented by Rep. McGowan in the 120th Maine Legislature to reduce the property tax portion of K - 12 Educational funding, he proposed the following: 1) Establish a two tier property tax assessment system consisting of a 6 mill property tax cap and a 12 mill tax cap; 2) Expand the Sales Tax base and increase the Meals and Lodging Tax to 8% to produce $385.6 million in revenues; 3) Of this amount , $186.2 million would be used to adjust (lower) individual income tax brackets and rates, and to conform to the federal personal exemption; and 4) Provide $200 million for education.
Benefits	Preserves the Homestead Exemption and BETR programs, increases revenue sharing to high mill rate, service center towns, provide substantial property tax relief to Maine residents and businesses, stabilizes state revenues, ensures the implementation of the "Essential Programs and Services" program, and creates an educational Rainy Day Fund to ensure the state's capacity to fund education in lean economic times.

Item	Variables/Questions/Models			
Definition	Tax Burden is the total amount of taxes paid divided by total income			
Questions raised by the Definition	What is included in taxes?	What is the definition of income?		
Questions that "tax burden" estimates try to answer	What is the burden imposed by Maine taxes on Maine residents?	How is that tax burden distributed across the income distribution?	How does Maine's tax burden compare to that of other states?	
Types of Tax Burden Estimates [Models]	Aggregate Tax Estimate: Census Bureau	Aggregate Economic Incidence Estimate: Tax Foundation	Micro-Simulation Economic Incidence Estimates: Citizens for Tax Justice (CTJ), Congressional Budget Office, U.S. Treasury, State of Minnesota, & Maine Revenue Services (MRS)	Representative Household or Firm Estimates: D.C. Study, Bloomberg Personal Finance Ranking, Tannenwald Study, & PWC State of Maine Tax Competitiveness Study

Explanations of Each Model	Used by the U.S. Census Bureau - The most commonly discussed measure. For FY 1999, Maine ranks 2nd in the nation with state and local taxes equal to 13.9% of personal income. Tax burden is established as total tax collections divided by personal income. Maine's ranking moves with the economy - volatility. Easy to compare states with respect to tax burden.	For Calendar Year 2000, state and local taxes in Maine are 12.7% of per capita - the highest in the nation. A 10 year history shows Maine consistently in the top 5. Tries to account for "exporting" and "importing" of taxes. Model finds that Maine exports as much of its tax burden as is imported.	The most comprehensive method of determining tax burden and the distribution of the burden among income groups. For Tax Year 2,000, MRS estimates Maine's average tax burden at 10.6% of personal income. In 1995, CTJ estimated the tax burden of the middle 20% of taxpayers at 9.9% of personal income - 11th highest in nation. Adjusts for direct and indirect taxes paid by nonresidents, Provides information on progressivity of tax system, Estimates changes in distribution.	Bloomberg and D.C. studies rank Maine in top 10 states regardless of income level and/or sources of income. District of Columbia Study estimates Maine has 13th most progressive state and local tax system in year 2000. There is less agreement among representative Firm studies, but there are indications that "flow-through" businesses bear a higher burden in Maine.
Types of Tax Burden Estimates [Models]	Aggregate Tax Estimate: Census Bureau	Aggregate Economic Incidence Estimate: Tax Foundation	Micro-Simulation Economic Incidence Estimates: Citizens for Tax Justice & Maine Revenue Services	Representative Household or Firm Estimates: D.C. Study, Bloomberg Personal Finance Ranking, Tannenwald Study, & PWC State of Maine Tax Competitiveness Study

Criticisms of Each Model	Includes taxes paid directly & indirectly by non-residents. Personal Income doesn't include capital gains income. The model does not allow for differences in tax burden by income class. Property taxes are based on actual taxes every 5 years and on estimates in other years. BETR and the Circuit Breaker are not included in calculations	Includes taxes imposed by other states that are borne by Maine residents. Capital gains are excluded from the income measure. Does not allow for differences in tax burden by income class. Property taxes are based on a 10 year moving-average growth rate. BETR and the Circuit Breaker are not included in calculations.	Assumptions regarding incidence of business taxes are controversial. Questions regarding the measure of income that is used. Difficult to estimate exporting of sales and property taxes to non-residents. Data problems, particularly at the bottom end of the income distribution. Impossible to determine Maine's tax burden & Progressivity in comparison to other states.	Cannot provide comprehensive picture of the distribution of tax liabilities. Household estimates do not take into account incidence of business taxes.

Other Issues	Volatility	Per Capita Income	Maine Tax Incidence Study	Maine Tax Incidence tables
	The volatility of Maine's tax system is often discussed, but not quantified or compared to other states. Dye & McGuire estimate a measure of sensitivity of each state's revenue system to the business cycle, assuming constant tax law. Their findings show: Maine had the 11th most volatile tax base (income & sales taxes) between 1976 and 1995.	Maine has a goal to rank 25th in the nation in terms of per capita income. If Maine did rank 25th in per capita income, the FY 1999 tax burden ranking by the Census would have been 12.1%, or 9th in the nation. Taxes and per capita income are not independent of one another. From 1985 to 1989, Maine went from 37th in the nation to 27th with respect to per capita income ranking. At the same time , the tax burden rose from 10.8% to 12.0%. From 1991 through 2001, Maine ranked between 34th and 36th in the nation with respect to per capita income. The tax burden has fluctuated throughout this same time period from a low of 11.8% to 13.6%.	Maine is one of only three states that is required to publish a tax incidence report. The first study was completed in 2000, and the second one is due this year. The law also requires Maine Revenue Services to estimate the impact of certain legislation on various income tax ranges. Maine's multi-tax macro-simulation models include the Individual & Corporate Income taxes, the Sales and Excise taxes, the Property Tax, and the Incidence module. Statutory Incidence - Who is legally responsible for the tax? Economic Incidence - Who ultimately bears the burden of the tax? The economic burden could be borne by consumers through higher prices, by Labor through lower wages, or by owners of capital through lower after-tax returns.	Of the $3.824 billion in state and local taxes collected for liabilities incurred in calendar year 2000, $2.428 billion or 63% is attributed to the State and $1.395 billion is attributed to local governments. Of the entire collection of state and local taxes in the year 2000: 30.6% was derived from state income taxes, 30.9% was derived from taxes on consumption (Sales, Excise, Liquor, tobacco, insurance, & motor fuel taxes), 0.6% was derived from the Estate tax , and 37.9% was derived from property taxes. It is estimated that just under 8% of general sales tax collections is from non-resident consumers (11% of consumer taxable sales), and that 20% of residential property taxes are paid by non residents

Conclusion	The Micro-Simulation Economic Incidence approach is best at answering the following questions: "What is included in taxes?" and "What is the definition of income?"
Conclusion	No matter the approach, Maine's tax burden is certainly in the top 10 and probably the top 5 of all the states.
Conclusion	Any distributional analysis should be viewed as one piece of overall analysis of any proposed legislation.

Minutes of the September 20, 2002 Meeting

The Speaker's Advisory Committee on Tax Reform met on Friday, September 20, 2002 from 9:00 AM to Noon in the Legislative Council Chamber. A panel composed of Mr. Robert Tannenwald, Vice President of the Boston Federal Reserve Bank; Professor Mathew Murray, Chair of the Economics Department at the University of Tennessee; and Professor Josephine LaPlante of the Muskie School of the University of Southern Maine, made presentations to the Tax Reform Committee. The presentations focused on the important features and principles of a well-balanced tax system.

Presentation - Mr. Robert Tannenwald

Mr. Tannenwald referred to himself as a tax expert, but not a policy specialist. He stated that he would not make any recommendations because the Tax Reform Committee must come to their own recommendations after reviewing all the facts and information. Mr. Tannenwald stated that he would address a number of issues on which he has conducted research and explain the findings derived from this research. In a number of cases, his findings do not support some long-held theories of taxation and economic development. Some of the major issues that he discussed include the following:

1. **High Cost of Government**. Every sector of society is faced with high costs. There is no reason why government should not be costly. Massachusetts has high costs in every sector, and Massachusetts' governmental costs are also high for the same reasons.

2. **Tax Burden.** Tax burden comparisons are misleading because they fail to include a number of factors that can have a significant impact on a state's rating. For example, fees and charges are omitted, and when these are included in the tax burden, Maine's rank is lower. Property tax relief payments are also excluded in measurements of the tax burden. In Maine's case, the BETR and Circuit Breaker programs reduce the tax burden of Maine families and businesses, but these programs are not taken into account as part of tax burden determinations.

3. **Impact of State and Local Taxes.** State and local taxes, as part of the total picture and cost of doing business, are not necessarily more of a deterrent to business growth and economic development than some other factors, such as government regulation. The difference among states with respect to state and local taxes as a factor in business relocation is incremental. There are other important factors as well, such as skilled workers for specific industries. The state of Georgia trains workers for specific businesses and industries, which has at least as much of an impact on business growth as taxes.

4. **Property Tax.** Traditional theory paints the property tax as a very regressive tax, especially on low-income households. In a 50 state survey of property taxation used for comparison purposes, the model used for the survey excludes unmarried and elderly households from the survey. Many low-income renters are also excluded from the survey. The property tax may not be as regressive as traditionally thought.

A. The Department of Housing and Urban Development conducted a survey of landlords who rent to low income households in the Northeast. The survey results showed that rents comprised 30 percent of property values and that rents do not cover 100 percent of costs. The property tax burden, on the average, for rental property is 3.5 percent in the Northeast. In Portland, Maine, the property tax as a percentage of income for a low-income rental could be 4 percent based on a hypothetical rental unit. This example is based on a $800 per month rental, a landlord profit of 30 percent of gross rent, a 12 percent rate of return to the landlord, a property tax bill of $600 per unit, tenant income of $15,000, and the unusual practice of passing the tax entirely through to the renter.

B. Unlike some other broad-based taxes, the property tax produces stable revenues.

5. **Competitiveness and the Business Tax Burden.** Beware of simplistic formulas that measure competitiveness and the business tax burden. It is very difficult to allocate business profits by state. A crude formula to measure this burden indicates that Maine ranks 10th in the nation and about average in New England. Maine's business tax burden is a little high. While the sales tax is passed onto the consumer, it is the property tax that is the most onerous of the taxes for business.

6. **A Changing Economy and An Antiquated Tax System.** There is a dramatic change occurring in the national economy in which a shift from manufacturing and production to services and technology has taken place.

A. The Sales tax, which is derived from consumption of goods and services (destination based), is at risk from electronic commerce and catalogue purchases.
B. The Corporate Income Tax can be easily avoided and exported. Through careful tax planning, corporations are moving to foreign jurisdictions and avoiding taxes.
C. The Personal Income Tax is at risk from high-income taxpayers who are highly mobile.

7. **Designing a Tax Structure.** Define the goals of a tax system. Identify, quantify, and determine the consequences and trade-offs of different goals and alternatives. Define the economic development goals and try to reconcile both sets of goals without seriously jeopardizing either set of goals.

A. Piecemeal reform does not work well.

B. Some tax incentives can reduce the tax burden, raise the rate of return, and help retain business. Massachusetts has reduced its tax burden on business.

8. Other Points to Keep-in-Mind.

A. **Sales Tax.** The sales tax exemption for food has good intent – to ease the burden on low-income households. But, this exemption makes it more costly to administer and contributes to the instability of sales tax revenues. Through an income tax credit, the burden of this tax on low-income households can be reduced.

- The sales tax could be expanded to consumer services, but expansion of this tax to business and professional services should be discouraged because it would become distortionary.

B. **Gross Receipts Tax.** A low-rate gross receipts tax on a broad base would not be onerous or distortionary. Preferably, a gross receipts tax would be levied at the wholesale level and not on the retail level. A gross receipts tax on the wholesale level would help the service center communities.

C. **Vertical equity.** Rely on the Personal Income Tax to achieve vertical equity.

D. **Property Taxes.** Property tax rates are comparatively high. The BETR program does not truly serve as an incentive program. It only lowers high taxes. There is only limited evidence that these types of programs work. At the local level there is very little flexibility with respect to taxation and little accountability.

A summary of an article, authored by Mr. Tannenwald, on state and local revenue systems is provided at the end of the minutes of the September 20 meeting.

Presentation - Professor Mathew Murray.

For more of a complete rendition of Professor Murray's findings, recommendations, and other proposals, please refer to the document that summarizes Professor Murray's most recent publication, "Tax Policy and Economic Development in Maine: A survey of the Issues," produced in conjunction with the Margaret Chase Smith Center at the University of Maine.

Professor Murray preferred to respond to questions posed by members of the Advisory Committee on Tax Reform. Prior to the questions and throughout the discourse, Professor Murray emphasized the following:

A. Tax system progressivity can jeopardize economic development goals.

B. Easing the tax burden for low-income households is better done through refundable credits provided under the income tax.

C. The Sales tax should be applied to food, and relief provided to low-income households through an income tax credit. The administrative cost of special exemptions is extremely costly.

D. Taxes can be used to achieve goals, but a lot leaks out. Many incentives are not target effective, such as tax exemptions or tax breaks that go to firms or households that do not need the assistance.

E. There is some evidence that high-income taxpayers are mobile and respond to high income tax rate states by avoiding them. A study by Martin Feldstein describes the correlation between income tax rates and taxpayer location decisions.

F. A flat rate income tax could be less onerous, especially for high-income taxpayers.

G. Today, jobs are going to where the people are. It is important therefore, to support quality education, quality of life, and amenities.

H. Maintain fairness with respect to the personal income tax, but do not extend this to other taxes.

Professor Vail asked for more information on the Feldstein study and suggested that services and quality of life can help offset high taxes. Professor Vail also questioned the impact of a flat income tax, which could make this tax regressive.

Mr. Robert Tannenwald responded to the Feldstein citation and said this study showed migratory responsiveness to tax systems to be far greater than any other studies have demonstrated. Mr. Tannenwald proposed that a tax system that is either too regressive or too progressive could impact location decisions. An average progressive tax structure overall, however, is best and would have little impact on location decisions.

Presentation – Professor Josephine LaPlante

Professor LaPlante explained that it is necessary to look at the "expenditure" side of State government as well as the tax system. The problem is not confined to a tax issue. In addition, there are structural economic changes that will have a significant impact over the long-term. Professor LaPlante presented the following findings to the Tax Reform Committee:

Maine does a poor job of budget planning and engages in reactive budgeting. Maine spends more on welfare per capita than any other state, but cash assistance is low compared to the rest of the nation.

Maine has the highest taxes in the nation. In 1990, taxes comprised 12% of personal income, and Maine ranked 12th in the nation. The ratio of taxes to personal income has steadily increased to 14% in the year 2000, and Maine ranks first in the Nation.

The failure to project economic downturns and budget shortfalls is difficult to understand. Every 10 years there is a national recession that extends down to the local level.

A. **Income Tax Structure**. The personal income tax structure is characterized by a tight compression of brackets and a quick contains ratcheting-up of brackets that hurt the low-income households. The middle-income households also bear a heavy income tax burden, and high-income taxpayers pay the highest rates for most of their income.

   1. In two-wage earner households, the first wage earner pays the lower rates and takes all the deductibles. The second wage earner's income falls into the upper tax rates. Some second wage earners working at Walmart for minimum wages pay the 8.5% tax rate, the highest income tax rate.

B. **Sales Tax.** The Sales Tax is more stable than it has been portrayed. Between 1996 and 1998, the sales tax has comprised between 2.6% and 2.8% of personal income. During the good times, consumers purchase one-time big-ticket items. In economic downturns, consumers pay down their debt and cut down on their purchasing, which makes the economic situation even worse.

C. The school funding formula must be reformed. Tax reform will do nothing **School Funding.** for the school funding formula, but the formula encourages sprawl, which increases the cost of delivering education and other services. The school funding formula provides funding that follows the student, which reduces funding for the school losing the student.

1. Consolidation of school systems will not save much money for the State or municipalities.

2. Maine has adopted equalization per student spending, which is a mistake. This provision does not bring poorer rural districts up to the standards of wealthy homogeneous communities.

D. **Suburban Exploitation**. The suburbs exploit the cities. Suburban dwellers who work in cities use city services and do not pay for these services. In cities, which have a heterogeneous population that speaks many languages, education is very costly compared to the more homogeneous suburbs.

1. Economies of scale are lost in large urban school district as a result of such large heterogeneous populations.

2. By funding school teacher retirement in the state budget, the State covers up the real cost of education. This policy helps the wealthy communities and intensifies the inequality among schools. In communities with greater revenues, this policy stimulates salaries for school personnel.

E. **Federal Aid.** The Block Grant for social services hurts state like Maine because funding is based on the previous two years. When a recession hits and social service block grants to Maine are based on recession years, Maine does not receive the revenues it needs to cope with the impact of the recession. Federal aid also stimulates state spending. While block grant funding remains the same, state spending climbs. Prior to the change to the Block grant system, federal money flowed when welfare spending increased. Now there is a significant time lag.

F. **Income Tax.** Between 1996 and 1999, Maine's effective income tax rate went from 2.6% to 3.8%, the highest in the nation.

G. **Strategy to Resolve the Problems.** Maine has a bungee cord tax system, which serves as a disincentive to business to relocate in Maine. Maine needs to:

1. Conduct better budget planning and control spending,
2. Appropriate more money to the Rainy Day Fund,
3. Provide tax relief, but should not scapegoat the nonprofit entities
4. Address the problems created by the school funding formula that provides funding to schools that are growing and hurts Maine's hubs

Other Comments

Judge Wathen expressed his concern about resolving the conflict of building tax reform from accepted principles of taxation and building tax reform from the existing system.

Mr. Tannenwald responded by saying that principles can be used to rationalize any system of taxation. He suggested using principles to design a system that extracts a fair share from all groups without being repressive on the low-income households. Adequacy of revenues should be a high priority, and significant funding must be preserved for local governments. Maintain vertical equity with respect to the personal income tax.

During the question and answer period, it was pointed out that businesses with machinery and equipment pay more taxes than businesses with little or no machinery and equipment. The playing field needs to be level for business, and the problem must be addressed directly and not through BETR.

It was also stated that the best quality jobs go to locations where there are adequate pools of skilled labor. Maine needs to spend more on higher education and on research and development. Business also needs to spend more on research and development.

There are some conflicting values or principles that need to be reconciled, such as:

The degree of progressivity of a tax system v. Economic development
A highly progressive tax system v. Low taxes.

Are State and Local Revenue Systems Becoming Obsolete?
By Robert Tannenwald

"New England Economic Review," Issue #4, 2001, P.27

Findings

1. **The Problem**. The flow of tax revenues into state coffers has decelerated primarily because of the economy and delayed tax cuts enacted in earlier and more prosperous times that have now taken full effect.

   "No solution presents state and local policymakers with a clear win-win situation, in which they could halt or reverse the decline in the revenue productivity of their taxes without sacrificing autonomy, competitiveness, neutrality, or administrative simplicity."

2. **The Strategy**. The most promising strategy to offset or at least slow down the losses in state revenues is greater voluntary coordination among tax jurisdictions in tax design and enforcement. More selective use of business tax incentives would also help raise adequate revenues without significantly affecting other tax policy goals.

3. **Dependence on Federal and State Aid.** States depend on Federal grants-in-aid for a significant proportion of their general revenues, which, from 1977 to 1999, has remained at the average of 26 percent for 22 years. Federal aid has changed over the years, and from 1973 to 1989, the federal government has cut intergovernmental assistance across the board. From 1960 to 1973, grants for capital investment shrank. Most of the growth in federal aid has been in transfers to individuals (Medicaid, etc,).

   A. **Local governments are more dependent than the state governments on intergovernmental assistance, most of which comes to them from their state governments.** In 1999, grants from state governments accounted for 35% of local general revenues. In 1997, 47% of school districts' general revenues came from state aid***. Between 1977 and 1997, state aid as a percentage of local general revenues in Maine fell from 35% to 27 percent.***

4. **Dependence on Broad-based taxes.** In 1999, apart from federal aid, the states rely most heavily on the individual income tax and the general sales tax, each of which accounted for 25% of state general own-source revenues. In states lacking one or both of these broad-based taxes, an imbalance can occur. For example, Washington State has no personal income tax and collects 47% of its general own-source revenues from the general sales tax. Oregon, which does not impose a sales tax, derives 44 percent of its revenues from the personal income tax.

5. **Local own-source revenues** are less diversified than those of the states. In FY 1999, the property tax accounted for 45% of all local own-source revenues. User charges comprised 26% of all local own-source revenues. Local governments have increased their reliance on the sales tax, and the income tax has become increasingly important for cities with a population exceeding 500,000.

6. **Shift from Goods to Services.** In 1960, 42% of U.S. wages and salaries were earned in the good-producing sector compared to 24%, today. During this same time period, wage and salary earnings from the delivery of private services rose from 15% to 37 percent. In 1960, American households allocated 41 percent of their consumption dollars to services, and this percentage increased to 58% in the year 2000.

   A. For a number of administrative and political reasons, the states subjected a limited number of services to the Sales tax, and these services account for a much smaller fraction of the economy than did goods 70 years ago when sales taxes were instituted. Of all the potentially taxable transactions, only items of tax consumption and purchases of taxed items by unsheltered firms actually enter sales tax bases. The amount spent by consumers for purchases of taxed items has fallen largely because they are cheap, and not because of their preference for non-taxed items. In addition, "unsheltered" business purchases of taxed items has fallen from 52% in 1977 to 40% in 1999. ***The change in the mix of production has played an important role in the erosion of sales tax bases.***

7. **Implications for the Property Tax.** The shift away from goods production has also diminished the revenue productivity of the property tax. This shift has slowed the growth in the value of taxable property.

   A. In recent years, the trend among the states has been to eliminate or dramatically reduce taxes on businesses' tangible personal property. Increasingly, the business property tax has become a tax on land and buildings. But the percentage of property comprising machinery and equipment has increased in most sectors, while the ratio of the value of realty nationwide to the gross domestic product has fallen sharply.

8. **The Rise of Electronic Commerce**. E-commerce is eroding sales tax bases across the nation. According to Forrester Research Inc., the value of taxable sales conducted via e-commerce will grow from $754 million in 1999 to $1.91 trillion in 2003. Of the total amount in 2003, all but $127 billion consists of business-to-business transactions. Taxing remote sales has been especially difficult, and use tax enforcement has been generally weak among all the states.

9. **Implications for the Corporate Income Tax**. Apportioning a firm's corporate income among states has always been difficult. The traditional factors used to apportion this income have been payroll, tangible property, and sales. A large portion of the property owned by e-commerce companies, however, is intangible property, much of which is not taxed or is taxed at reduced rates. In addition, e-commerce companies can locate their facilities and payroll in states with no corporate income tax, and thereby avoid taxation of their income. It is also difficult to determine the location of economic activity generated by e-commerce companies. The location of the internet server facilitating the sale, the location of the vendor, or the location of the consumer are all possibilities and must be considered if the states agree to an e-commerce tax.

10. **Jurisdiction competition.** Competition among jurisdictions for specific businesses and industries has intensified and escalated into a bidding crescendo that is injuring the winners as well as the losers. Fiscal competition can be beneficial and enhance state and local government operational efficiency, if it is implemented in moderation.

A. Stiffer competition from overseas has motivated states and municipalities to offer whatever inducements are necessary to attract and retain businesses.

B. Critics of fiscal competition state that the greater mobility of new firms and their weak attachment to any particular place make it increasingly successful for them to play one jurisdiction against the other.

C. In 1997, the Council of State Governments found that all 50 states had increased the level and variety of business tax and financial incentives during the previous 20 years.

- 38 states have increased the use of these incentives during the previous five years,
- 25 states expected to increase the use of these incentives,
- 22 states planned not to increase these incentives, and
- 2 states planned a decrease in these incentives.

D. ***In 1995, a survey of more than 200 firms revealed that 73% were offered financial incentives worth more than those they were offered 5 years previously. Michigan offered an $80 million inducement for a paper-recycling mill employing 34 people, a price tag of $2.4 million per job. Alabama offered Mercedes Benz incentives worth $168,000 per promised job***.

E. **Other efforts** that could be taken to dampen mutually destructive competition include the following:

- The federal government could hold back grant money to states and municipalities that implement extremely aggressive, self-defeating competitive measures.

- Voluntary compacts among the states and municipalities to refrain from competition, to create more uniformity in taxation, and to share revenues.

- Require beneficiaries of fiscal incentives to provide information to help the public evaluate these incentives. Information regarding the number of jobs to be created or retained, and the compensation paid to jobholders, among others should be required.

- Require business incentive recipients to meet certain conditions, such as creation or retention of a minimum number of jobs at or above a specified minimum wage for a minimum period of time. If the beneficiary fails to meet the conditions, it must repay the public subsidies it has been given. This requirement is known as “clawback” provisions.

- The hiring of skilled cost-benefit analysts by state and local governments to help evaluate the costs and benefits that competitive financial incentives entail.

- Abandon the corporate income tax, the tax most prone to competitive evasion.

11. **Reduction in the Corporate Income Tax Burden.** While the tax burden of state and local personal taxes has risen and that of state and local revenues as a whole has remained fairly constant, the burden of state and local corporate income taxes has been almost halved.

12. **Tinkering with the Tax System.** Policymakers in the several states have considered including a wider array of services in taxable sales.

    A. Inclusion of services purchased by households would promote neutrality by putting the consumption of goods and services on a more equal tax footing.

    B. Any increase in the taxation of business-to-business purchases discriminates in favor of vertically integrated industries because the pyramiding of the tax as it is shifted forward to successive stages of production does not penalize them.

    C. Including personal services in the sales tax base would be more injurious to customers of services provided by nonprofessionals, who are primarily consumed by low-income and lower-middle income households than the incomes of middle and high-income households.

Speaker's Advisory Committee on Tax Reform
Minutes of the October 4, 2002 Meeting

The Speaker's Advisory Committee on Tax Reform convened at 9:00 AM in the Legislative Council Chamber on Friday, October 4, 2002. The Advisory Committee reserved the first half of the meeting to discuss issues and preliminary tax reform proposals that members have been developing since their first meeting in August. The Speaker asked each member to express his or her issues of greatest interest or concern. Several members expressed their issues and ideas as shown below:

Judge Wathen

- A budget stabilization fund is necessary to reduce revenue fluctuations and instability;
- An index or limit on the growth in state and local government revenues;
- On the municipal side, there may be a need to provide incentives to limit the growth in spending.

Professor Vail

- There is a problem with hard and fast indexing of spending. There are some programs that are going to grow no matter what the economy is doing.
- There is a need to spend more on higher education in order to stimulate significant investment and economic development.
- Indexing will limit investment.
- We must look at the expenditure side. It would be a serious flaw to look at tax reform and propose a plan without looking at the expenditure side of government.

Speaker Saxl

- The Speaker's Advisory Committee may recommend to the Legislature where additional investments are needed or can be made, such as education and health care.
- Rep. Bernard McGowan proposed a 6% cap on municipal property taxes for education purposes. We may want to investigate this issue further.
- Ms. Laurie LaChance, the State Economist, proposed that 2% be taken off the top of State revenues and deposited into a special stabilization fund, which would have a limit of 12 percent.
- Another proposal that may be worth pursuing is an economic trigger by which revenue growth above a certain amount could be used to provide tax relief. Per-capita income, percentage of growth in revenues, or some other measure could be used as the trigger.

Ms. Eleanor Baker

- Higher education is the highest priority.
- The second highest priority is a reduction in the Personal Income Tax down to 6 percent.

Mr. George Campbell

- In order to reduce the overall tax burden, we must restructure services. The delivery of services is extensive and costly. Maine has too many school systems and too many town and city managers and their staffs.
- Property tax relief must be targeted. Property values are escalating and proving to be a hardship on the poor and the elderly.
- Service centers are experiencing demands beyond the pale – Portland has 4% of the population and 40% of the homeless.
- Municipal tax capacity is seriously restricted by exempt properties. Rhode Island now provides state reimbursement to municipalities for tax-exempt property.

Professor Vail

- Reorganization of services – has anyone studied this? How much can be saved?
- Maine's income tax is not progressive because it taxes a larger percentage of the wealth of those households at the bottom of the income ladder. The current system is regressive on the low end. For the second and third quintile, the income tax is basically a flat rate.
- A flat tax can be made progressive with an earned income tax credit equal to 30% of the federal tax. The personal exemption and standard deduction are keys to progressivity. It is important to retain revenues, however, and this may require getting rid of deductions. This would be a political minefield.
- Professor Vail questions the theory of statistically significant mobility of high-income households. There is no hard and fast evidence of this. There is also mobility among low income-households – e.g. Houlton

Judge Wathen

- It is important to look at progressivity of tax structures and alternatives to progressivity. A flat rate removes the incentive to move away.

George Campbell

- While there may not be hard and fast evidence of significant mobility among high-income households, it is an intuitive conclusion that there is a high degree of mobility attributable to this income group.
- Business is not making investments in the workforce because the tax burden discourages such investments.

Tony Neves

- A progressive tax is important. Only the income tax is progressive. It is the top rates, not the entire income tax structure that is driving mobility. Don't confuse progressivity, mobility, and high taxes. Keep the income tax progressive, but lower the top rate.

Ms. Deirdre Mageean

- We need more information regarding reorganization of governmental services before moving on with this idea.
- Maine's population is changing rapidly. It is aging and the labor force is shrinking. Do we have any information regarding demographic shifts and the impact on revenues?

Tony Neves

- What impact does demographics have on expenditures? As people age, there is a greater risk of flight. We need to look at tax incidence as impacted by changing demographics.

Speaker Michael Saxl

- Tax reform must result in stabilizing revenues, retaining progressivity, and lowering the tax burden over the years in a predictable way.

Judge Wathen

- Maine needs a mechanism by which the amount of property tax exemptions can be reduced. A commission could review the tax-exempt status of properties and provide recommendations to the Legislature in the form of legislation.
- An enhanced circuit breaker program would help with progressivity of the property tax.
- The Advisory Committee should consider exempting machinery and equipment from the personal property tax.
- The Sales Tax base must be expanded
- Revenue sharing may need to be enhanced.

Professor David Vail

- There has been very little discussion focused on the sales tax. It is my understanding that property tax relief would be funded through sales tax reform. Is there a package that would generate $200 million or more that would not be more regressive in order to fund property and income tax reform?

Speaker Saxl

- The sales tax could be marginally regressive or even regressive, but the earned income tax credit could be used to address regressivity. I would not propose taxing health care or professional services.

Professor Vail

- I would propose including both consumer and business purchases in the sales tax base.

Presenters

Senator Brennan and Representative Cummings

- In order to address the inequities in school funding, it is necessary to increase revenues. Targeted property tax relief cannot address the problems with school funding.
- While some would argue that school funding is a problem for service center communities, Senator Brennan and Rep. Cummings disagree.
- Property Tax relief cannot be significant without redoing the school funding formula.
- Fixed costs do not decrease as fast or at all in some cases as enrollment decreases. For example, bus transportation is an example of this situation.
- School construction is a huge cost that must be addressed.
- Portland and Bangor have the state average with respect to household income, and both cities have high property taxes. The school funding formula needs to be revamped to allow a longer period (4 years) over which property values are averaged, and the weighting of the income factor in the formula needs to be increas

The Department of Education & The Chair of the State Board of Education

- Research shows that school units with the least ability to pay have the highest mill rates. Unites with the highest mill rates have the lowest amount of dollars to spend on education.
- School units with the lowest mil rates have the highest amount of fund to spend on education.
- By FY 2008 the State Board of Education and the Education Department hopes to meet the goal of funding essential programs and services.

Regionalization/consolidation

- Maine is losing students and there are major shifts in the location of students. The impact on education is substantial.

- The State Board of Education is concerned about restructuring the school funding formula by "over" averaging any of the variables in the formula.

- It is important to look at governance with respect to the administration of education. Maine has the largest number of school units east of the Mississippi.
- It is important to look at education equity.
- The State Board of Education is reviewing the State's school construction policy, and it has refused to build schools that are too small to be cost effective. Maine cannot afford to replicate an educational system based on a system created 50 years ago.
- The new approach and redesign of the educational system will mean the loss of high schools, longer bus trips, and other politically unpopular results.

- One of the biggest cost drivers in education is the route by which funding follows the students. As the population shifts, tremendous funding dislocations occur. It is hoped that the school funding formula that is used in conjunction with the definition of essential programs and services will address this problem.

Philip Trostel, University of Maine, Margaret Chase Smith Center

- In undertaking a study of the current school structure system in Maine, Mr. Trostel asked two questions:
- Are there economies of scale that can be exploited?
- Is there unnecessary duplication of services?

- The average school district in the United States has 3200 students compared to the Maine average of 754 students. With respect to the average number of students per school district, Maine ranks 46th in the nation.

- The average school in the United States serves 546 students compared to 304 students per school in Maine. With respect to the average number of students per school, Maine ranks 44th in the nation.

- Smaller schools are more costly per student than schools with larger enrollments. In addition, smaller schools have fewer course offerings and opportunities for students than schools with larger enrollments. Schools with larger student populations tend to have more staff with graduate degrees.

- There are potential economies of scale that are lost in Maine.

- There are municipalities that can “tuition-out” students at less cost than the municipal cost of providing education. Tuition schools take advantage of economies of scale.

- There is a difference of $263 per student between operating a school district of 3100 students with average school enrollments of 754 students compared to the average school district and school enrollments in Maine.

- The school funding formula in Maine subsidizes sprawl and smaller school districts as population moves to rural areas, which have fewer opportunities for students.

- One of the tests of education quality is achievement. In schools with larger student enrollments, there is a positive correlation with respect to 4th grade and 11th grade learning result achievement test scores.

- In some states, there is one school system per county, and the county funds education.

Representative Ted Koffman

- Representative Koffman presented ideas that the "Eco-Eco" group is considering. Since this group is still in the research and discussion stage it has not yet come to a consensus package. The Eco Eco group is looking at property tax relief, the growing cost of General Purpose Aid to Education, which, if teacher retirement were included, is funded by the State at 50 percent.

- This group is looking at repealing the Homestead Property Tax Program, removing the cap from the Circuit Breaker, and allowing municipalities to assess second homes at a rate higher than first homes or industrial/commercial properties.

- **Other ideas under consideration are:**

- A 1¢ increase in the Meal and Lodging Tax to realize an additional $23.5 million. This would bring Maine's rate up to the median rate in New England;
- A 50¢ increase in a pack of cigarettes to realize an additional $45 million per year;
- An increase in beer and wine taxes, which have not been increased in 20 years. Tripling the beer tax (add 38¢ to a six-pack) would bring in an additional $19 million;
- Replacement of the Sales Tax with a gross receipts tax that could increase revenues; and
- An increase in the cap on the Rainy Day Fund from 6% to 10%, or 12 percent.

Speaker's Advisory Committee on Tax Reform

Minutes of the October 18, 2002 Meeting

A coalition of six Maine Tourism associations made a presentation to the Speaker's Advisory Committee. Composed of 4500 businesses, the coalition expressed concern about any increase in the meals and lodging tax.

A. According to the coalition, as presented by Ms. Nancy Gray, President of the Haraseeket Inn:

   1. Any increase in the hospitality tax will make the tourism industry less competitive with the tourism industry in other states.
   2. The Tourism industry is not in a position to pas a tax increase along to customers.
   3. Business travel is down and airport traffic at Portland Jetport is down.
   4. Border crossings are down in double digits.
   5. Any increase in the meals and lodging tax will also be borne by Maine people who purchase services from tourist businesses.

B. At 7%, the Meals and Lodging Tax is 40% higher than the Sales Tax, which is 5 percent.

C. Maine residents account for 40% of the Meals and Lodging Tax. In some cases, Maine residents account for 80% of the business of tourist businesses.

D. The Maine tourism industry is competing with major tourism industries in states along the East coast. Maine has been losing market share to these other states, but is just beginning to turn this around.

E. The Maine Tourism Association believes the following:

   1. Substantive tax reform cannot be successful without meaningful spending reductions, and
   2. Tax reform does not mean tax increases.

<u>Mobility of High-Income Taxpayers – The Personal Income Tax</u>.

George Campbell. A flat rate Personal Income Tax of 6.5% would be revenue neutral, would reduce the mobility of high-income taxpayers, and would help those businesses that pay the personal income tax and not the corporate income tax. From an intuitive perspective, high-income tax rates cause high-income taxpayers to move to more tax-friendly states.

David Vail. Bob Tannenwald of the Boston Federal Reserve Bank disagrees with the Feldstein study and says it has no evidence to support the theory that high-income taxpayers are highly mobile with respect to tax rates. If a flat rate were adopted, it would be necessary to increase the personal exemption to make it less regressive.

Eleanor Baker. Tax accountants indicate that high-income clients respond to high personal income tax rates and establish residences in states with no or low personal income taxes. She advises high-income clients to establish residences in other states where personal income tax rates are lower or where there are no personal income taxes. If a flat personal income tax is adopted, however, it will be necessary to increase the earned-income tax credit.

Christopher St. John, Maine Center for Economic Policy. A Harvard study conducted in part with the Libra Foundation showed that more people with high income moved into Maine than moved out.

The flat personal income tax and an increase in the personal exemption ($2850 under current state law to $3100 under federal law) do not help the lowest income residents of Maine. **This proposal shifts half the tax burden to the lower income classes, and increases the tax burden for nearly 75% of Maine taxpayers, while reducing the burden for 25% of the highest-income taxpayers.**

Tax Reform and Economic Development.

Deirdre Mageean. Tax reform by itself cannot bring about economic development. In order to generate economic development, tax reform must be tied to education and infrastructure development and improvements.

George Campbell. State programs are not expensive. It is the delivery of services that is expensive. It is necessary to tie taxes to an economic development strategy and to use fiscal discipline with respect to government spending.

Corporate Income Tax

Eleanor Baker. The Corporate Income Tax is in line with the rest of the country.

David Vail. Corporations can move their income around and shelter their earnings and profits.

Speaker Saxl. The Advisory Committee may want to think about removing "S" corporations and "C" corporations from the Personal Income Tax and subjecting these corporations to a rate or rates that are less than the higher Corporate Income Tax rates.

The Remedial Option Selection Process: State Expenditures

Tony Neves. First and foremost, it is important to determine how much the State must spend and then determine how to get there. We need to look at the budget. We cannot disassociate the revenue side from the spending side. The expenditure side is growing faster than the tax system can keep up. It is not possible to have a revenue neutral system taking into consideration the current fiscal situation that Maine is in.

Maine must hold its expenditures down below other states for a while, and Maine's tax burden will fall compared to other states. Maine's tax burden ranking will improve over time. Given the current situation, however, revenues cannot be reduced.

Governor Curtis. There is not much waste in government spending. Look at where the bulk of spending goes! Nearly one-half of the State budget goes to education, which leaves everyone else with very little with which to work. Some areas cannot be cut. Wages are a serious problem. Wages are at a level that cannot produce revenues needed to maintain state government.

Judge Wathen. It is necessary to reconcile the taxing side with the spending side. We must establish priorities and keep within our means. Judge Wathen agreed with the statement that State government does not waste money. We cannot do everything that needs to be done and not raise taxes. That is impossible.

George Campbell speaking to Tony Neves. We need to limit government spending. Tony, "this situation is your whole life."

Tony Neves. "Isn't that Sad!"

Gross Receipts Tax

David Vail. A Gross Receipts Tax is much more effective than a sales tax and realizes more revenues to undertake other reforms.

George Campbell. The Gross Receipts tax is best applied to utilities. It cannot be applied to businesses because it taxes gross revenues, whether the business earns a profit or incurs losses. Vermont looked at a pyramided gross receipts tax and gave it a quick death.

Tony Neves. Under a Gross Receipts Tax, everyone pays the same tax. The principle of fairness is achieved in this approach.

Eleanor Baker. The Gross Receipts Tax would not be fair to businesses with high receipts and low marginal profits, such as food stores.

David Vail. With whom must we be fair? - The citizens? Business? Both?

General Discussion

Speaker Saxl. We need to be as bold in our proposal as possible. The volatility of the current tax system must be addressed.

Tony Neves. It is necessary to broaden the Property Tax and the Sales Tax by repealing exemptions.

George Campbell. It is necessary to put more money into General Purpose Aid to Education and Revenue Sharing II. Do not exempt all non-profit organizations – only those necessary for public safety.

Presentation by Commissioner Albanese, Department of Education

A. Maine is first in the country with respect to the amount of dollars that go into the classroom. Maine has slipped, however, with respect to teacher salaries.

Funding Essential Programs and Services.

A. The Department used FY2000 to analyze the cost of funding "Essential Programs and Services" or EPS. The Department of Education used a preliminary version of the EPS model, which was approved at that time by the State Board of Education.

B. With respect to the total cost of education, there are primarily four (4) variables that determine school funding costs as shown below:

1. Operating costs, which comprise 64% of the total cost,
2. Program costs, which comprise 22% of the total cost
3. Debt Service costs, which comprise 8.5% of the total cost, and
4. Adjustment costs, which comprise 5.6% of the total cost.

C. Only operating costs and program costs are part of the equalization portion of the School Funding Formula.

1. Operating costs under Essential Programs and Services will include:
   - English As a Second Language (currently outside the school funding formula)
   - Early Childhood (K2),
   - Technology Resources,
   - Student Assessment, and
   - Other fundamental operating costs.

D. Program costs, under Essential Programs and Services, will include:

- Transportation costs
- Vocational Education costs
- Special Education costs

E. Debt Service costs (outside the equalization portion of the school funding formula and not part of EPS) is composed primarily of school construction costs.

F. Adjustment costs (outside the equalization portion of the school funding formula and not part of EPS) will include:

1. State wards and State Agency Clients,
2. Out-of-District Placement, and
3. Private School Services.

G. When "Essential Programs and Services" is implemented, the School Funding Formula and the School Finance Act will be completely rewritten.

H. **The total cost of "Essential Programs and Services" in FY 2000 was $1,572,886,302**.

1. The $1.5 billion cost of EPS ***excludes:***

- A subsidy cushion
- Teacher Retirement
- Education costs of the Unorganized Territory and
- Adult Education

I. During FY 2000, federal revenues that could be used to partially offset the total cost of "Essential Programs and Services" amounted to $52,242,962. The balance, or $1,520,643,340, of total EPS costs would be funded with State and local funds.

J. Of the total balance [$1.52 billion], the cost to the State for a 55% share would have been $836,353,837 in FY 2000.

K. In FY 2000, the State provided $625,785,284, but to comply with the 55% rule, the State would have had to provide an additional $210,568,553.

L. The major cost drivers in K-12 education are salaries and benefits (health insurance, etc), which account for 80% of total education costs.

M. The "Essential Programs and Services" approach will differ from the current approach in several ways. Two differences are as follows:

1. EPS will be "resource-based" and not "cost-driven," which is the current basis for funding schools, and
2. Each school district under EPS will have its own per-pupil rate that will take into consideration the number of senior teachers in each school district and the educational level of the teachers in each district.

N. One of the issues that must be addressed concerns property tax relief through additional state funding of education that is offset or counteracted by rising education costs over which the State has little control. **In other words, additional state funding that might initially lower the property tax rate for education could be offset by increased educations costs over time that cause local property tax rates for education to increase.**

O. Most communities will benefit from this new approach to educational funding.