Legislative BULLETIN
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Tax Reform Resurfaces

In early April the Taxation Committee held a public hearing on LD 1088, *An Act to Modernize the Tax Laws and Provide over $75,000,000 to Residents of the State in Tax Relief*. The bill is the vehicle for comprehensive tax reform in 2009. In a variation from the normal process, LD 1088 went underground after its public hearing for nearly two months, and just resurfaced this week for the first Committee work sessions. During that seven-week period, and even as this is being written, a number of adjustments were and are being drafted by the bill's chief architect, Rep. John Piotti of Unity. The changes address technical and substantive issues that were raised at the public hearing, and also address the fact that the negative economy and ever-shifting state revenue picture have changed the quantifiable scope of the legislation in terms of dollars.

Simply put, LD 1088 expands the sales tax base, increases two sales tax rates and establishes a special real estate transfer tax that applies to the sale of high-value residences. In combination these changes generate an additional $120 million a year for the state. At the same time, LD 1088 reduces the income tax rate by two full percentage points, from 8.5% to 6.5%, which reduces state tax revenue by $120 million a year.

Sales tax changes. For more specifics, the bill expands the base of the general (5%) sales tax by applying that rate to a variety of services that have previously been excluded from the sales tax, such as "amusement, entertainment and recreation" services (ski lift tickets, golf fees, movie tickets, etc.), "installation, repair or maintenance" services (labor costs to repair all types of household personal property, shoes, jewelry, clothing, lawn and garden equipment, labor on car repair, etc.), "personal property" services (laundry, car washing, pet services, interior decoration, non-business-related storage and warehousing, etc.); and certain transportation services (limousine and courier services, but not general taxicab services).

The bill also increases the meals and lodging tax from 7% to 8.5%, and the sales tax on short-term auto rentals from 10% to 15%.

In addition to the .44% real estate transfer tax that is currently applied to the sales price of any real estate, LD 1088

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Committee Supports 11-Cent Fuel Tax Increase

On Thursday this week, the Transportation Committee voted by a margin of 8 to 3 to support a fuel tax increase. The after-deadline bill, which has not yet been assigned an LD number, proposes to eliminate fuel tax indexing and replace it with an increase to the fuel tax rate of 11 cents per gallon to be implemented over the next four years.

As developed by a subcommittee including representatives of the Transportation Committee, the Department of Transportation, and industry professionals, including the Maine Better Transportation Association, Maine Motor Transportation Association and Maine General Contractors, the Highway Fund

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Legislative Session in Final Weeks

The legislative session is drawing to a close. Although the adjournment date by statute is June 17th, it appears that the Legislature will adjourn before that date, possibly around June 12th.

This edition of the *Legislative Bulletin* will likely be the last for this year. The most significant municipal issues that are still before the Legislature are tax reform (LD 1088), the Highway Budget bill (LD 333), the proposed 11-cent increase to the motor fuel tax, along with several other bills that could impact municipalities in certain ways.

Over the last few days of the legislative session, we will be communicating to our municipal membership through our email "action alert" system about these issues. A complete wrap-up of the 2009 legislative session, including complete descriptions of all the municipally-related legislation that is enacted, will be provided in the June issue of the *Maine Townsman* if the Legislature adjourns in a timely manner. If not, the July issue of the *Townsman* will contain the 2009 legislative wrap-up.

As always, our thanks go out to all municipal officials who constantly surprise us with their deep capacity for and interest in keeping up-to-date and involved with respect to legislative issues.

TAX REFORM (cont'd)

applies a .56% additional transfer tax rate to the value of a sale of residential property that exceeds $500,000. For example, under the terms of LD 1088, if a single family residence is sold for $600,000, the .44% transfer tax would apply to the first $500,000 in value and a 1% rate would apply to the $100,000 of value that exceeds the $500,000 threshold.

Income tax changes. As indicated, the $120 million generated by the sales tax changes is offset by reducing the income tax rate from 8.5% to 6.5%, a goal which many people in certain business and economic development communities believe needs to be achieved in order to attract entrepreneurial activity to the state.

The 6.5% rate might at first appear as a "flat tax" because 6.5% of the household's federally adjusted gross income (AGI) would be the starting point in every individual or household's income tax calculation. To put it another way, 6.5% of the AGI would represent the filer's maximum exposure to the state income tax. In conjunction with the single tax rate, however, a system of tax credits replace the current system of both standard and itemized deductions, so that Maine resident taxpayers can subtract the value of the credits they qualify for from the 6.5%-based tax obligation. The application of the credits allows the structure of progressivity in the current state income tax to be retained. As a result, even though the *nominal* income tax rate would be set at 6.5% for all filers, the *effective* income tax rate for the vast majority of Maine residents would be less than 6.5%, and increasingly less than 6.5% the lower the household income. These tax credits phase out as household income increases. The level of income where credit phase-out begins depends on the structure of the filing household. For example, the basic "household credit" for individuals filing joint returns would be $1,200. That credit would phase out at the rate of $1.50 for every $100 of household income that exceeds $56,000.

Property tax changes. There are no property tax changes in LD 1088. In that sense, there is a two-dimensional aspect to this tax reform proposal from the municipal point of view. Although the bill: (1) does a good job of achieving improved balance between the sales tax and income tax burdens; (2) effectively pushes approximately $50 million of burden off of Maine residents in the process; and (3) undoubtedly improves the stability of sales tax revenue by expanding its base, the state's heavy reliance on the property tax is not addressed in this bill. The only property tax element of LD 1088, which was not a part of the original bill, is found in a set of proposed amendments to the "Circuit Breaker" program.

Circuit Breaker changes. A major addition to LD 1088 since the bill was given its public hearing is a sweeping set of amendments to the Circuit Breaker property tax and rent program. "Circuit Breaker" provides financial rebates to qualifying applicants if it is determined that their property taxes or their annual rent payments exceed 4% of their income. The goal of the LD 1088 amendments is to merge the Circuit Breaker application process with the state income tax filing process. The proponents of these changes believe that if the two filing procedures were aligned, more people who are eligible for Circuit Breaker benefits would be made aware of those benefits and apply for them.

Although it may seem a simple task to align the Circuit Breaker application process with the income tax filing process, it turns out to be quite complicated. Currently, a person can file an application for Circuit Breaker benefits in August with respect to the property tax or rent obligation and household income of the previous calendar year. Income tax filings can begin in January and are (generally) concluded in April, and also pertain to the previous calendar year's data. For years there has been some resistance to unifying the two programs administratively because their separation tends to balance the year-long administrative workload at Maine Revenue Services. In addition, the definition of "income" for income tax purposes is different from the definition of "income" for Circuit Breaker purposes, and so the analytic and data verification procedures for the two programs are very different. Finally, if the distribution of approximately $45 million in Circuit Breaker benefits is going to be done 6 months before it is done presently, the state would need to have $45 million more in that fiscal year than would otherwise be in the state budget; that is, the state appropriations for Circuit Breaker would have to double for that year.

With all that in mind, the changes in the Circuit Breaker program that are now found in LD 1088 are as follows:

Current law defines the Circuit Breaker "homestead" as the principal residence and the first 10 acres of land, so the property taxes that are paid on all acreage in excess of 10 acres is not recognized as a property tax obligation when calculating the Circuit Breaker benefit. LD 1088 does away with that standard, so all the property taxes on the homestead property count toward eligibility regardless of how large the house lot upon which the residence is located.

Current law requires certain types of real-life income to be added back into the base amount of Maine "adjusted gross income" before the calculation of eligibility for Circuit Breaker benefits. LD 1088 eliminates some of those "add backs", including: (a) all income earned by minor dependents in the household; (b) all inheritance income; and (c) the following forms of non-taxable "add-back" income if the aggregate annual income from these sources does not exceed $5,000: life insurance proceeds; jury duty payments, alimony payments, prizes and awards, and lawsuit awards. These categories of income would be sheltered from the Circuit Breaker eligibility determination.

With respect to the timing of applica-

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Legislative Bulletin

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State Budget Puts $140 Million Worth of Pressure on Property Taxes

The final state General Fund budget, which includes "supplemental" changes to the current fiscal year's budget (FY 09) as well as the proposed biennial budget for FY 2010 and 2011, was enacted by the Legislature this week and signed into law by the Governor. For municipal officials who followed the development of the budget over the last five months, there should be no major surprises.

Here are the elements of the budget that pertain to local government. In summary, over the next two years $140 million in state support for K-12 education and property tax relief programs is being cut. The $140 million impact is evenly split between cuts to education and cuts to municipal and property tax relief programs. The $140 million impact is lopsidedly distributed between the two fiscal years. Approximately $30 million of the total impact will be experienced in FY 2010 and $110 million of the impact will be felt in FY 2011. The size of the cuts to municipal revenue sharing, the Homestead property tax exemption, and K-12 education in the second year of the biennium are unprecedented. The 20% cut to the Circuit Breaker program is also very deep and would be unprecedented, except that the program was whacked very hard once before in the early 1990s.

$44 million cut to Municipal Revenue Sharing. The budget makes a number of changes, both technical and substantive, to the municipal revenue sharing program. On the technical side, the budget simplifies the calculation of the full revenue sharing allotment as well as the system of distributing revenue sharing according to the "Rev. I" and "Rev. II" distribution formulas. Those changes are revenue neutral.

The budget also repeals the 2% set-aside of revenue sharing that was purportedly dedicated to the Local Government Efficiency Fund but habitually taken instead by the Legislature and fed back into the state's General Fund.

The substantive change to revenue sharing in the budget is an $18.8 million cut to property tax relief in FY 2010 and a $25.2 million cut in FY 2011. The budget's summary statement characterizes these "transfers" out of revenue sharing as a 10% reduction for FY 2010 and a 15% reduction for FY 2011. The references to "10%" and "15%" are euphemistic. After all the data settles down, it turns out that $18.8 million represents 15% of what would be distributed to the municipalities in FY 2010 if the Legislature did not interfere with the program, and $25.2 million represents 19% of what would be distributed to the municipalities in FY 2011.

$6.9 million cut to the Homestead Exemption in FY 2011; elimination of administrative cost reimbursements. Although the revenue sharing cut and nearly all the other tax changes being proposed in the budget are designed to be temporary reductions for this upcoming biennium – cuts scheduled to be fully restored in July 2011 – that is not the case with the proposed change to the Homestead property tax exemption. The proposal is to drop the value of the Homestead exemption 23%, from $13,000 to $10,000, beginning on April 1, 2010 and every year thereafter.

Also, when the Homestead property tax exemption was enacted in 1998, the Legislature voluntarily covered 90% of the administrative costs associated with implementing the exemption at the local level. The annual appropriation to cover that expense is approximately $30,000 a year. This budget includes the necessary language to allow the Legislature to eliminate the requirement to pay for those mandated administrative costs.

$17 million cut in Circuit Breaker benefits. If the budget is enacted as proposed, for the next two years all Circuit Breaker property tax and rent rebate benefits will be calculated as they are under current law, but then reduced by 20%.

$12 million cut in Business Equipment Tax Reimbursements (BETR). Although not directly affecting municipal treasuries, the budget reduces all BETR reimbursements to qualifying businesses by 10% for each of the next two years.

$1.2 million reduction in Tree Growth reimbursements. The budget document clarifies that regardless of what municipalities may be scheduled to receive as Tree Growth reimbursement pursuant to the so-called "90%" reimbursement requirement, they are only entitled to receive whatever the Legislature decides to appropriate for that purpose. All reduction in appropriation must be prorated among the municipal recipients. The budget then deappropriates approximately $600,000 from the Tree Growth reimbursement appropriation for each year of the biennium. The $1.2 million cut over the two-

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State Treasurer's Revenue Sharing Projections Now Online

The State Treasurer has posted the FY 2010 municipal revenue sharing projections for each municipality. Those projections can be reviewed at MMA's website (www.memun.org), and here is the direct link to the Treasurer's website: http://www.state.me.us/treasurer/revenue_sharing/docs/2010%20Rev%20Share%20Projections.xls

After the state budget was adopted and all tax-change data were identified, the gross revenue sharing base was $1.4 million less than previously calculated and used by MMA when posting projected revenue sharing numbers over the last several weeks. Accordingly, municipalities will find the Treasurer's final projections to be slightly lower than the projections last posted by MMA.

BUDGET (cont'd)

year period represents a 10% reduction in Tree Growth reimbursement.

$69 million cut to school subsidy in FY 2011. By back-shifting the distribution of $11 million in federal stimulus funds from FY 2011 to FY 2010, the budget delivers the same level of school subsidy (combined state and federal) for the upcoming fiscal year as was projected in late March when the "ED 281" subsidy projections were sent to each school system.

The deep cut in school subsidy is scheduled for the second year out. Working from a flat-funding baseline of $956.5 million, which was the state share of school subsidy in the current fiscal year (not counting federal stimulus funds), the state share of school funding for FY 2011 in this budget is $887.5 million, a $69 million reduction. For those who try to keep track of the state share of school subsidy, the budgeted levels of state support for K-12 education are quickly dropping away from the never-achieved 55% level that the voters of Maine directed the Legislature to achieve five years ago. Even when buttressed with the federal stimulus funding allocated for K-12 education, the total state-plus-federal support for K-12 education for FY 2011 is projected to be just 48.5% of the total EPS allocation. The state share by itself is projected to be just 45.5% of the total EPS allocation.

Compared to actual state-and-local spending on K-12 education, as that sum has been defined for this purpose over the last 30 years, the state share in FY 2011 will probably represent something like 42% of the total, which is where we were in 2002 when the initiative began to direct the state to fund K-12 education with state revenue at the long-established 55% level.

Other education issues. There are two other K-12 education issues in the proposed budget which could have very far-reaching impacts on the property tax.

First, the budget creates an ongoing role for the Appropriations Committee to meet over the summer and fall and identify $30 million in additional state savings by "streamlining" state government operations. A final addition to the charge given the Appropriations Committee was included at the very end of the budget development process. That charge requires the Committee to review: "*…the portion, if any, of the employer's share of teacher retirement costs, including the normal cost component and the unfunded actuarial liability that is currently funded by the State to be included as part of the total state and local cost of essential programs and services and the portion to be funded through the Teacher Retirement program within the Department of Education.*"

In other words, the move is afoot to shift at least some of the costs of the Teacher Retirement system onto the property tax base, including a piece of the staggering unfunded actuarial liability.

Also, another part of the budget directs the State Treasurer to convene a working group to review the unfunded actuarial liabilities associated with the Retired Teachers Health Insurance program. The overview charge to the working group is to identify all the governmental obligations to report the health insurance liabilities according to the Governmental Accounting Standards Board Statements (or GASB) requirements. The working group is also charged with recommending one or more methods and timelines for actually addressing the billion dollar-plus unfunded actuarial liability that has been generated by this state-provided health insurance benefit to retired school teachers.

Telecommunications Tax and the Telco Tax Study. Although it is not an issue that directly affects municipal government, the budget holds the state-level property tax rate on interactive telecommunications personal property at 22 mills for each year of the biennium instead of allowing that tax rate to drop down to 19 mills according to the statutory schedule. Unlike the personal property of cable television providers, which is taxed at the municipal level, the personal property of telephone companies and some Internet providers is taxed at the state level at statutorily prescribed mill rates.

Because technology is blurring the line between these two types of personal property, an increasing amount of attention is being paid to the disparate way each property is being taxed, one type at the town level at the local municipal mill rate, the other type at the state level at the statutory rate. The budget begins to address that disparity by directing the Taxation Committee to review the way telecommunications property is being taxed in this state and other states and submit a report to the Legislature by January 15, 2010 that recommends changes to the tax law to *"ensure equitable tax treatment of telecommunications providers in a revenue-neutral manner"*.

Code Enforcement Training. As originally proposed by the Governor, all municipal Code Enforcement Officers would become personally responsible to pay for the training programs provided by the State Planning Office and required in order to maintain certification. That idea got scrapped. Instead, the State Planning Office will still have the dedicated plumbing fee revenue to train Local Plumbing Inspectors, and certain development-review revenue to train municipal building inspectors, but if the SPO does not have sufficient revenue to provide basic CEO training, then the required CEO training program will be suspended. During any period of time that the training programs are suspended, the SPO will keep of registry of active CEOs that meet certain standards of qualification, but the formal training and certification process will not be applied.

Water Quality Improvement Program. In order to help generate the revenue necessary to provide three additional clam flat inspectors at the state level, a number of increases to certain wastewater licensing fees are being advanced in this budget: (1) a surcharge of $15 must be added to the regular, non-engineered septic system installation fee; (2) a $75 surcharge must be added to the annual licensing fees for each of the four categories of "sanitary overboard discharge" systems; (3) a total of $12,000 annually must be assessed against the municipal or district wastewater treatment facilities that have combined sewer overflow

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BUDGET (cont'd)

(CSO) systems that are determined to potentially impact shellfish harvesting areas (allocated on a 3-year-average-annual-flow basis); and (4) a total of $25,000 must be assessed against wastewater treatment facilities that discharge a treated effluent that causes adjacent shellfish growing areas to be closed (allocated on a per-acre-of-closure basis).

Increases to Hunting/Trapping/Fishing/Boat Registration fees. Municipal clerks who act as agents of the state with respect to the issuance of hunting and fishing licenses and boat registrations should become familiar with the new schedule of licensing and boat registration fees, almost all of which are increased by $4 or more in this budget.

FUEL TAX (cont'd)

revenue proposal would:

Repeal the fuel tax indexing law. The indexing law allows for an annual inflation-based adjustment to the fuel tax rate, provided that the indexing provision is biennially approved by the Legislature;

Equalize the gasoline and diesel fuel tax rates. Under existing law, the fuel tax rate on gasoline is 28.4 cents per gallon, while diesel tax rate is 29.6 cents. This proposal would reduce the diesel rate to 28.4 cents;

Implement an 11 cent fuel tax rate increase over a four year period. In FY 10, the fuel tax rate on both gasoline and diesel would be 31.9 cents, a three and one half cent increase. In FY 11, the fuel tax rate would increase by another three and one half cents to 35.4 cents. The increases in FY 12 and FY 13 would be two cents per year, resulting in a finally adjusted fuel tax rate, in FY 13, of 39.4 cents;

Fund and implement a trucker enforcement and education program. Approximately 3% of the revenue generated by the tax on diesel fuel would be set aside annually to fund a trucker enforcement and education program. The purpose of the program is to reduce the number of accidents on federal highways; and

Reduce axle weight fines.

The atmosphere as the Committee debated this proposal could be characterized as somber. While all members of the Committee agree that the state's transportation infrastructure is severely deteriorating, they could not come up with a consensus solution that meets all needs. As members of the Committee gave reports from their respective party and chamber caucuses, it was clear from the onset that a unanimous Committee report on this funding proposal was not possible.

While the Democratic caucuses in both the House and Senate support the revenue plan, they will do so only if the plan receives bipartisan support. It was reported that the House Republican caucus could not support a fuel tax increase, especially in these difficult economic times. The Senate Republican caucus has not had an opportunity to fully vet the proposal.

After much heartfelt discussion, the Committee voted in support of the revenue plan. At the conclusion of the debate, Committee co-chair Sen. Dennis Damon made it clear that the Senate Democrats will be "following the light of the Senate Republicans"; that is, if the Republicans vote against the measure, so will the Democrats.

The Committee will be meeting again this Friday (May 29) to wrap up its work on LD 333, the FY 2010/FY 2011 Highway Fund budget.

TAX REFORM (cont'd)

tion and timing of distribution issues, LD 1088 attempts to phase-in the change.

With respect to the application period beginning on August 1 this year (dealing with eligibility during calendar year 2008), there would be no change to current law. The application may be filed between August 1, 2009 and May 31, 2010.

With respect to the application period beginning August 1, 2010 (dealing with eligibility during calendar year 2009), the application period would be shortened to the August 1, 2010 – November 15, 2010 time period.

On January 1, 2011, the application year would begin with respect to calendar year 2010 eligibility.

In round numbers, the administrative and income-eligibility changes to the Circuit Breaker program will cost the state approximately $800,000 more each year, which the proponents would like to fold into the fiscal note of LD 1088. The increase in the ongoing annual costs of the Circuit Breaker associated with more people applying for benefits, which is the primary goal of all these changes, is projected at $6 million a year. Those increased costs fall outside of the upcoming biennium.

Conclusion. It is hard to know where all of this tax reform legislation is headed. There is pressure on the Committee to make its recommendations to the full Legislature quickly, within the next few days. There are a lot of moving parts and the background information (e.g., economic data, impacts of the recently enacted state budget, etc.) necessary to calculate the impacts of these changes with precision seems to be in a state of motion as well. Tax reform is difficult enough. The task is that much more difficult in a rushed and uncertain environment.