

Legislature Poised to Adjourn

State budget and tax reform up for final votes

Bond proposals put off until a later date

The Legislature appears to be within 24 hours of adjourning this legislative session and going home. The two major issues that have yet to be decided are how to close the two-year state budget and whether 2005 is the year for the Legislature to finally engage in comprehensive tax reform.

The House of Representatives began the debate on both fronts yesterday (June 16) before tabling the two bills and adjourning for the night.

The budget bill is LD 1691, *An Act to Eliminate Pension Cost Reduction Bonding and Provide Replacement Budgeting Measures*.

The tax reform bill is LD 1595, *An Act to Rebalance Maine's Tax Code*.

What follows is a snapshot summary of the House debate on the two bills thus far, as well as a description of the substance of each bill.

The time for information gathering, bill development, and lobbying is over. At this point, the outcome of these two fundamentally important matters of public policy rest entirely in the hands of the Legislature. For those readers who do not receive the *Legislative Bulletin* electronically, the final votes have probably been cast.

This will be the last edition of the *Bulletin* for this legislative session. It is our understanding that the Legislature will be convened at a later date to develop a bond recommendation to be sent

out to the voters in November. At this writing, it is not known if the bond session will be scheduled within a couple of weeks, or a month or more into the future. Whenever the Legislature's bond session occurs, either the *Bulletin* will re-

sume publication or targeted action alerts will be issued to *Bulletin* subscribers in order to inform municipal officials about the development of the borrowing proposal.

A thorough wrap-up of this legislative session, including complete summaries of all the new laws affecting municipalities, will be provided in the July edition of the *Maine Townsman*.

Preliminary Debate on Budget Bill

Municipal officials are well aware of how we got from there to here.

In late March, the Legislature enacted a budget to fund state government over the next two years, including the increased education funding and expanded "circuit breaker" benefits previously enacted in January as part of "LD 1". That budget enactment included \$250 million in borrowing to fill-out the state's operating budget. The borrowing proposal was challenged by the Republicans, became unpopular with the general public, and then became subject to replacement, especially after the military base closings were announced in May, dampening state revenue expectations.

LD 1691 is the Democrats' replacement proposal, which would implement roughly \$125 million in cuts to state and local government and various programs affecting nonprofit organizations and businesses. LD 1691 fills the other half of the budget hole with \$125 million of new tax revenue, generated almost entirely by increasing taxes on tobacco products.

The Republican alternative would not cut tax rebate programs to businesses and would not raise any additional taxes. Instead, the Republican plan would cut the full \$250 million from state and local government, go-

ing beyond the cuts agreed to by the Democrats largely the area of social service programs.

Last night, the debate was opened up with a preliminary hour-long debate on the competing proposals. The Republicans endorsed directly addressing what they perceive as a governmental "spending problem" and the Democrats argued that \$250 million worth of program reductions cuts too severely into the core functions of state government, particularly with respect

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Tax Reform

Although the tax reform debate is divided along party lines just as cleanly as the budget debate, it is in all other respects less predictable.

LD 1595, the tax reform bill, dusted-up out of the Taxation Committee in just the last few days, contrary to all expectations. It is also unclear as the session comes to a close what the relationship is between the tax reform bill, as described below, and the budget bill. The two bills don't fit together very well, nor do they work well if separately enacted. It is difficult to

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BUDGET (cont'd)

to the poor and the ill. The Republican version was rejected by a vote of 77-74, almost purely along party lines.

The Democrats' version of the bill is now before the House for debate and enactment. As described below, LD 1691 contains a broad range of cuts throughout all state departments. The theme of the budget cutting plan is "share the pain", where the range of budget reductions is as broad as possible so the impacts will be as shallow as possible for each affected agency.

What follows is a description of just 30% of the full range of the proposed cuts. This 30% slice of the full reduction pie represents the proposals that have a direct or indirect impact on municipal government.

As presently before the House, LD 1691 would:

- **Eliminate the Local Government Efficiency Fund for the next two years.** The Local Government Efficiency Fund was created by the voters on June 8, 2004 and would set aside \$4.8 million of revenue sharing funds over the biennium to fund a competitive grant program for municipalities to redesign service delivery systems. LD 1691 would take that two-year revenue to balance the state budget.

- **Reduce municipal revenue sharing in FY 07 by \$5 million.** LD 1691 would directly cut \$5 million out of the FY 07 municipal revenue sharing distribution, a 4% cut.

- **\$6.3 million Tree Growth and Veterans' Exemption reimbursement "push".** Under LD 1691, the state reimbursements to municipalities under the

Tree Growth and Veterans' Exemption tax law would be delayed. Instead of being provided within FY 06 and FY 07, the payments would be made a month late, pushing them into each subsequent fiscal year. The delayed payments will result in increased property taxes this upcoming September for communities with fiscal years that begin on July 1.

- **\$460,000 reduction in State Park fee sharing program.** Currently the state shares 15% of state park fee revenue with the municipalities that host the state parks. This proposal would cut the municipal share down to 7%, costing municipalities (and saving the state) \$230,000 a year.

- **\$250,000 cut to state support for county jails.** LD 1691 will cut state support for county jails by \$55,000 a year. Another \$150,000 will be taken from county jail support in FY 06 in order to fund a legislative study regarding the funding and operations of county jails.

- **Counties to pay state \$100,000 a year for certain prisoners.** In addition to the cuts to county jail funding described above, LD 1691 will require the counties to pay the state \$100 a day for high-risk prisoners that have to be removed from county jails and taken to state facilities. The increased cost to county government on an annual basis is projected to be \$100,000 a year.

- **Increased education costs.** LD 1691 proposes a number of changes to education funding that will have financial impacts on local government.

- **Delay the phased-in increases toward 100% special education funding.** Under the terms of LD 1, the state would phase-in its assumption of 100% of the EPS-determined costs of special education over a four-year period. LD 1691 would freeze that phase-in process in FY 07, saving the state \$1.5 million for that year, with direct negative impacts to the affected school districts.

- **School bus purchases.** Cut state school bus subsidy by \$3.2 million in FY 07.

- **Capture Medicaid reimbursement.** The state would "capture" certain federal reimbursements to schools that provide Medicaid-eligible

services, effectively reducing financial support that would otherwise go to the schools by \$2.5 million in FY 07.

- **Delay new school construction funding.** \$5.1 million in new school construction funding would be effectively "pushed" out of this biennium. Apparently, the financial impact of this "push" on school budgets would be relatively insignificant because the schools could continue the projects through Bond Anticipation Note (BAN) financing, the increased interest of which would be recognized by the state as increased construction costs.

- **Pull \$5.9 million out of the School Revolving Renovation Fund.** Under current law, after a school renovation project partially funded with state funds is completed, the post-construction audit will identify unused state funds and return them to the School Revolving Renovation Fund. LD 1691 would retroactively identify those funds over the last six years, and return them to the state's General Fund, pulling \$5.9 million out of the Fund. The result will be a dramatic reduction in the capacity of that Fund to support renovation projects over the next several years.

- **Increased teacher and non-teacher certification fees.** LD 1691 will double teacher certification fees and create additional certification fees for all non-teacher school employees. This change will increase revenue to the state by \$1 million a year. Presumably, those increased certification fees will either directly or indirectly be borne by the school budgets.

The sum total of all these cuts, pushes, and increased fees is approximately \$36 million, which represents about 30% of all the reductions to overall state spending included in LD 1691. Some of these cuts, obviously will directly increase local property taxes, such as the cuts to revenue sharing, county jail support, state park fee sharing, and the Tree Growth reimbursement "push" for fiscal year municipalities. It is harder to define with precision the property tax impact of the education cuts and delays in education-related capital financing (school bus or construction), either on a statewide or community-by-community basis.

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TAX REFORM (cont'd)

perceive the Legislature enacting comprehensive tax reform with one hand, and raising the excise tax on cigarettes by \$1 a pack with the other.

The preliminary House debate on LD 1595 was characterized by very enthusiastic Democrats, proud of their own boldness, secure in the sense of advancing a long-repressed and long-overdue modernization to the state's tax code, and excited by a capacity to crack the lobbyists' perennial log-jam on real reform.

Even though LD 1595 is designed to be revenue neutral by offsetting tax increases with other tax decreases, the Republicans responded with deep opposition to raising any taxes. Without a constitutional limit giving rights to the minority party to control state spending, the Republicans are not convinced that today's "revenue neutrality" will not evolve into increased spending tomorrow. Also, because part of LD 1595 would flow to schools and municipalities, the Republicans claimed there is no guarantee of tax reduction at the local level.

As its title implies, LD 1595 (*An Act to Rebalance Maine's Tax Code*) is

designed in broad stroke to balance the state's overall tax system. Specifically, LD 1595 would:

- Reduce income taxes in a variety of ways, including reducing the highest marginal income tax rate, conforming Maine's income tax code with the federal code with respect to the personal and standard deductions, and increasing the low-income tax credits.
- Fully fund the new \$13,000 homestead exemption;
- Fully fund the state requirement to pay 55% of the cost of K-12 education, as measured by EPS, by FY 07 (instead of by FY 09);
- Further expand the benefit and eligibility levels under the "circuit breaker" property tax and rent rebate program so that a qualifying household could receive as much as a \$3,000 annual benefit.

To pay for these tax reductions, LD 1595 would:

- Repeal several sales tax exemptions, such as the exemptions on packaging materials and certain short-term rentals.
- Re-impose the sales tax on "snack" food items that was enacted in 1991 and repealed in 1998.
- Expand the sales tax to a broad range of services that were not a signifi-

cant part of the Maine economy in 1953, when the sales tax was first enacted, and the retail consumption of which has never been subject to the sales tax. Those services include amusement and recreation services, personal services, personal property services, home services, and certain contracted services.

- Increase the meals and lodging sales tax from 7% to 8%.
- Increase the sales tax rate on short term auto rentals from 10% to 15%.
- Increase the excise tax on beer and wine.
- Enact an excise tax (at the distributor level) on soft drinks at the rate of 42 cents per gallon.
- Expand the Real Estate Transfer Tax to create an upwardly sliding scale depending on the value of the real estate being sold, but actually reduce the current Transfer Tax rate on properties that are sold which have a value under \$200,000.

If LD 1595 is able to garner a positive vote in the House, it is expected to face much tougher sledding in the Senate, repeating a pattern started in 2002 when the House supported and the Senate defeated the so-called McGowan tax reform proposal.