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Special Session Likely for Tax Reform

Legislature Poised to Adjourn

As this edition of the *Legislative Bulletin* goes to press, it appears likely that the lawmakers will be finishing up almost all their regular business for this legislative session and adjourning within the next 24 hours or early next week.

At least two issues remain for legislative consideration: the bond package to be presented to the voters on November 4 and tax reform. Details are sketchy at the moment. It is possible the Legislature will work into next week in an attempt to finish all its business, or lawmakers may take a break and come back to Augusta in late June to take up these two remaining matters.

Bonds. Maine's voters endorsed the $60 million economic stimulus bonds last Tuesday. The major elements of Governor Baldacci's bond priorities are a sizable transportation bond, a financial support package for University of Maine and the Community College System infrastructure, and an environmental bond for wastewater and drinking water capital improvements. Dozens of other bond proposals have been advanced by various legislators during the last 6 months.

The size of the total November package is the current matter under discussion among legislative leaders and the Governor's Office. Whatever level of bonding is ultimately agreed upon, the transportation bond will likely fill out a large share of that package, squeezing down the size of other bond proposals. Under particular threat are the proposed wastewater system grants (rather than mere loans) that could be provided in the Environmental Bond to the wastewater districts in the most economically disadvantaged areas of Maine. Since the grants in the bond package do not leverage federal funds (as the loan program does) they become susceptible to being cut as the several elements of the bond package get whittled down.

Tax Reform. The Taxation Committee finally reported out its tax reform recommendations on Wednesday night this week. As detailed below, the work of the Taxation Committee has resulted in a three-way report with respect to the recommended tax reform measure that is designed to be placed on the ballot to compete with the citizen initiated *School Finance and Tax Reform Act of 2003*. The Democrats have sided with one version of Governor Baldacci's proposed competing measure. The Republicans have sided with a different version of the Governor's plan. Three members of the panel also signed onto an alternative competing measure that represents a much broader tax reform proposal than either version of the Governor's proposal.

It is not clear at this point when the various competing tax reform proposals will be taken up by the Legislature. The Taxation Committee has certainly struggled with the development of a consensus proposal, and many State House observers are of the opinion that the several plans described below that came out of the Committee Wednesday night will be held over for further development and legislative consideration at a special session scheduled for sometime later in June.

Tax Reform Specifics. LD 1629, Governor Baldacci's "fiscal reform" competing measure, is the vehicle for the two major competing "competing measures". As indicated above, the Democrats on the Committee voted for one version of this bill, and the Republicans voted to support another version. Each element of the two plans is described below, with an indication as to which Committee report supports which element.

Element #1, regarding "munici-

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Last Regular Edition of the Bulletin for 2003

Because the Legislature is poised to adjourn, at least until a special session later in the month or later this summer, this will be the last regular edition of the *Legislative Bulletin* for 2003. Special editions of the *Bulletin* may be issued from time-to-time in an attempt to keep municipal officials apprised of tax reform developments.

A complete wrap-up of the Legislature's work this year will be provided in the July edition of the *Maine Townsman*. Also, MMA's State and Federal Relations staff will be providing interested municipal officials with regular e-mail updates of important legislative and tax reform events. If you a not receiving our legislative alerts or updates by e-mail but would like to, or if you would like to receive those e-mail updates by FAX or regular U.S. mail, please contact MMA's Laura Veilleux at 1-800-452-8786 or lveilleux@memun.org.

pal spending reform", is supported by both reports. This element is designed to establish the "Regional Service District" (RSD) framework for the purpose of achieving savings at the local level through voluntary municipal cooperation and consolidation, encouraged by state incentives apparently funded from the state's savings associated with eliminating the personal property tax in a going-forward manner and thereby converting the state's 100%-to-the-business obligation (BETR program) to a 50%-to-the-muncipality obligation, which is required by Maine's constitution. The actual language regarding this element of the competing measure plan would be as follows:

Regional Service Districts

Purpose. The purpose of this chapter is to enhance the ability of municipalities to cooperate and consolidate on the basis of mutual advantage in the efficient and effective exercise of municipal obligation and home-rule authority pursuant to this Part through voluntary creation of and delegation to regional service districts or through other cooperative agreements, including but not limited to cooperative agreements with county governments, that achieve similar cost savings. The goal and results of the cooperation and consolidation are to achieve significant property tax relief and to increase municipalities' ability to fund public education needs.

The Executive Office (i.e., State Planning Office) shall propose legislation to carry out the provisions and intent of this chapter by January 2004. The joint standing committee of the legislature having jurisdiction over state and local government matters shall review the proposed legislation.

Element #2, regarding education funding, is supported by both reports. The state's obligation to fund 55% of the "Essential Programs and Services" (EPS) education funding model would be phased in over 5 years, beginning in FY 06. For the first year out, the state would agree to commit to paying 49% of 84% of the total "EPS" allocation, and each year thereafter, according to this proposal, the state percentage share would work up toward 55% and the "percentage reduction" of EPS would be narrowed from 84% toward 100%. In the short term, there would be no significant increase in education funding from the state. What increase there would be, apparently, will be provided by refinancing the state's bonds to cover the state contribution to school construction debt service, although we do not know as of yet how much saved revenue that refinancing would provide.

Element #3, regarding the repeal of business personal property taxes, is supported by both plans. Starting with tax year 2004, all personal property first installed in the state that would qualify under current law as being eligible for the BETR program will be exempt from property taxation. Also, property that is currently enrolled in the BETR program will be tax exempt after it comes out of the BETR program. Under current law, the state reimburses the businesses paying the tax for 100% of their tax payments. Under this proposal the state would reimburse the affected municipalities for 50% of the lost municipal tax revenue and save the other 50%, apparently to fund the incentive programs to form Regional Service Districts.

Element #4, providing for local option sales taxation, is supported only in the Democrats' plan. Regional Service Districts and municipal "Service Center" communities would be authorized to adopt a local option sales tax of up to 1% across the general (5%) sales tax base and/or the meals and lodging (7%) base and/or the short-term auto rental (10%) base. The local option tax would be adopted by referendum vote, for renewable 5-year periods, and the sales tax revenue would be available for non-educational purposes. 15% of the revenue generated by the local option tax would be transferred to the state to fund the Circuit Breaker program.

Element #5, creating changes to the Homestead property tax exemption and Circuit Breaker program, is supported only in the Democrats' plan. Starting with tax year 2004, the state would only reimburse municipalities for 50% of the municipal revenue that is lost because of the property tax homestead exemption, which is currently set at $7,000 exemption for homesteads worth less than $125,000, $5,000 for homesteads worth between $125,000 and $250,000, and $2,500 for homesteads worth more than $250,000. The municipalities would have to shift the burden associated with the unreimbursed exemption over to the remaining, non-exempt property tax base. The state would use the $18 million of "savings" (as well as 15% of the local option sales tax revenue) to expand the eligibility criteria for the Circuit Breaker property tax and rent rebate program.

The Third Plan. LD 1372 is the citizen-initiated *School Finance and Tax Reform Act of 2003*. On Wednesday night, LD 1372 received a 9-3 "ought not to pass" report from the Taxation Committee. The three dissenting members (Reps. Arthur Lerman of Augusta, Ed Suslovic of Portland, and Senator Ethan Strimling of Cumberland Cty.) voted "ought to pass as amended", which with respect to citizen-initiated legislation is another way to create a "competing measure". The amended tax reform plan endorsed by this minority report contains the following elements:

Expenditures: The Plan

• Implements the Essential Programs and Services (EPS) school funding system at 100% starting in the first year out, and establishes a 9 mill property tax expectation as the maximum local contribution. A 9 mill property tax cap for education, with the state providing the rest of the full EPS allocation, delivers a 55% state share for

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Legislative Bulletin

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Supplemental Budget Enacted

On Wednesday this week the Legislature enacted the supplemental biennial budget that is designed to balance state revenues and expenditures over the next 2-year period. Many of the elements of the supplemental budget identified in the May 9, 2003 edition of the *Bulletin* are largely the same today, although there is one significant surprise. The following are four elements of the enacted budget of interest to municipalities:

Budget Spending Cap / Stabilization Fund. This so-called "Part II" state budget places a cap on the amount of General Fund revenue the state can spend in any year. This cap is adjusted annually using a formula based on the average percent increase in real personal income and projected consumer price index (CPI). As enacted, the ten-year average growth in the real (i.e., inflation adjusted) personal income in Maine, as identified by the federal Bureau of Economic Analysis, is added to the projected CPI calculated by Maine's Revenue Forecasting Committee. That calculated percentage would control any increase in state spending.

For example, if the ten-year average growth in real personal income was 2.5% and the projected CPI was 2.7%, the state could increase its General Fund expenditures in the next fiscal year by the sum of those two numbers, or 5.2%.

As was reported in the May 9, 2003 *Bulletin*, the state's existing Rainy Day Fund has been renamed the Maine Budget Stabilization Fund. In any year for which there are unappropriated state revenues at the close of each fiscal year, 32% of these revenues would be transferred into the Stabilization Fund.

The revenues dedicated to the Stabilization Fund would be capped at 10% (not 20% as was originally proposed) of the total General Fund revenues generated in the previous fiscal year and could not be reduced below 1% of that General Fund aggregate, absent extraordinary circumstances. If the Legislature has adjourned prior to the close of a fiscal year and it is determined that the available General Fund revenue will not meet General Fund appropriations, the Governor would be authorized to reduce the Stabilization Fund below the 1% minimum in order to balance the budget. The 10% cap creates a larger stabilization fund than the current Rainy Day Fund, which is capped at 6% of General Fund revenues. At a 6% cap, the existing Rainy Day Fund could contain as much as $145 million. At a 10% cap, the Stabilization Fund could contain as much as $240 million. Because of recent state revenue shortfalls, the state's current Rainy Day Fund is empty.

IF&W Fees <u>Not</u> Indexed. The March 21, 2003 *Bulletin* reported that the Part I Budget not only increased a myriad of IF&W fees but also provided that the fees could be automatically indexed in subsequent years to account for inflation. The Part II Budget undoes that indexing, however the original fee increases are preserved.

LURC Assessments. One of the biggest surprises in the final Part II budget is that towns and plantations within the Land Use Regulation Commission's (LURC) jurisdiction must pay an assessment to LURC in the amount of 0.1% of their equalized value. This element of the budget was not part of the printed budget bill, but was added during the Appropriations Committee's work sessions. The assessments begin in FY 04, which begins on July 1, 2003. Municipalities subject to the assessment may opt-out of the assessment by accepting certain land use responsibilities. There are 39 plantations and municipalities affected by this new assessment, which will generate over $62,000 from their property taxpayers to support LURC. The assessments range from $335 (Codyville) to $8,755 (Rangely Plantation).

Pine Tree Zones. Lastly, the wayward Pine Tree Zone bill (LD 1385) was merged into the final section, of the Part II Budget. The Part II Budget version of the bill is almost completely unchanged from the final amended version. The one difference is that the effective date for some of the tax benefits has been moved one year from January 1, 2003 to January 1, 2004.

The Pine Tree Development Zone program will be administered by the Department of Economic and Community Development. Up to 8 Pine Tree Development Zones will be created statewide, four in already-determined locations (Aroostook County, Androscoggin Valley region, Penobscot Valley region, and the Washington County-downeast region) and four in other locations that meet certain criteria. For each Zone, the legislative body or bodies of a municipality or a group of municipalities will have to vote to designate the zone within their respective jurisdictions. If adopted by the municipality or multi-municipal groups, certain qualified businesses in the manufacturing, technology and financial services sectors will be entitled to a cluster of tax breaks if they establish themselves within the designated zones. The tax breaks run for a 10-year period for qualifying businesses, and no tax benefits created by the bill could be provided the qualifying businesses after December 31, 2018. Those tax breaks are: (1) a sales tax exemption for the construction materials to build the facilities; (2) a sales tax exemption for any tangible personal property purchased for use directly and primarily for that business; (3) a 100% premium tax credit (for the first 5-year period) and a 50% premium tax credit (for the second 5-year period) for qualifying insurance companies; (4) a 100% income tax exemption for the first 5-year period and a 50% income tax exemption for the second 5-year period; (5) a reimbursement to the qualifying business for 80% of the employee withholding (income) tax the business would otherwise have to remit to the state; and (6) whatever property tax benefits the municipality with taxing jurisdiction may provide through the Tax Increment Financing (TIF) program. With respect to TIFs, the bill provides that the standard TIF limitations regarding the maximum allowable value created within a TIF district and the maximum allowable land area designated as a TIF district do not apply to TIF programs created within Pine Tree zones.

The Part II budget bill was enacted as emergency legislation and has been signed by Governor Baldacci, so the changes in the law are immediately effective.

Tax Cap Petition

On Tuesday last week, one day before deadline, Carol Palesky of Topsham submitted to the Secretary of State the boxes upon boxes of signed petitions to place her "Proposition 13"-style property tax relief proposal before the Legislature and, ultimately, the voters in 2004. This petition drive represents Palesky's third attempt to place her measure before the Legislature. Her previous two attempts, in 1998-99 and 2001, were rejected by the Secretary of State for lack of sufficient number of valid signatures.

Palesky's plan would establish a maximum property tax mill rate in every municipality in Maine of 10 mills (1% of assessed value) and limit annual increases in assessed value to rates of inflation or 2%, whichever is less. A mill rate cap of 10 mills is estimated to pull $650 million a year out of K-12 education and municipal service delivery systems.

According to published reports, Palesky claims her petitions carry 60,000 valid signatures, as verified by the municipal election officials in all the towns where the petitioners are registered to vote. The minimum number of required signatures according to the state's constitution is 50,519.

Deputy Secretary of State Julie Flynn has told MMA that the Secretary's Office will begin undertaking the task of reviewing the petitions for the purpose of certification later this summer. The Secretary's deadline for certifying the petition to the Legislature is March 3, 2004. If Palesky's petition receives its certification, and presuming the Legislature does not enact the proposed tax cap, the measure would be placed on the ballot on November 2, 2004.

Local Citizen Initiative Process Limited

On Thursday this week, the Senate voted to support LD 389, *An Act to Amend the Laws Governing Municipal Citizen Initiatives and Referenda* by a margin of 18-15. Sponsored by Rep. Ed Suslovic (Portland), the bill prohibits citizen petitions on the municipal level that initiate ordinance or bylaw changes that have certain retroactive impacts if the municipality uses a permitting process that includes at least one advertised public hearing. Specifically, local citizen initiatives will be prohibited that have the effect of invalidating, repealing, revoking or modifying any building permit, zoning permit, land use approval, subdivision approval or site plan approval if the final municipal approval or issuance of the permit was taken prior to the enactment of that ordinance or bylaw. The prohibition created by this initiative does not apply to any final approval regarding the disposal of sludge or septage. LD 389 had previously received support from the House on May 15th.

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education.

• Repeals the Homestead exemption and expands the Circuit Breaker property tax and rent rebate program.

• Repeals in a going-forward way the personal property tax on business equipment, providing a 50% municipal reimbursement for the lost revenue.

• Expands Maine's Earned Income Tax Credit for low-income working households with children.

Revenues: The minority report "competing measure" would also pay for these changes by

• Providing for a local option sales tax.

• Expanding the sales tax base to cover amusement and recreational services.

• Increasing the sales tax rate for general sales from 5% to 6%.

• Increasing the sales tax rate for lodging services from 7% to 10% and for short-term auto rentals from 10% to 12%.

• Increasing the excise taxes on beer, wine, liquor and tobacco.

We will do our best to keep municipal folks completely informed as these various proposals work their way through the legislative process. In the meantime, municipal officials are strongly encouraged to explain the various impacts of these ideas to their legislators.