

## Maine Policy Review

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Volume 5 | Issue 3

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1996

# Overhauling Maine's Tax System

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### Recommended Citation

Valente, Paula. "Overhauling Maine's Tax System." *Maine Policy Review* 5.3 (1996) : 77 -80, <https://digitalcommons.library.umaine.edu/mpr/vol5/iss3/10>.

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# **News and Commentary: Overhauling Maine's Tax System**

**Maine Policy Review (1996). Volume 5, Number 3**

*by Paula Valente*

Maine needs "a major overhaul of its entire tax system," according to 77 percent of Maine citizens surveyed by the Maine Municipal Association (MMA) last summer. Citizen unrest about taxes in general, and property taxes in particular, has been growing steadily. That unrest has been mobilized during the past two years by the Maine Taxpayers' Action Network. This group has been working to gather signatures to place a citizen-initiated referendum on the ballot to cap local property taxes statewide at 1 percent of assessed valuation (or 10 mills per \$1,000 of valuation). If this measure is enacted, it would devastate basic municipal and education services in Maine. This proposal means the elimination of \$430 million from local property tax collections, which represents virtually half the property taxes collected in Maine in 1995. Although proponents failed to garner enough valid signatures to get this question on the 1996 ballot, their efforts continue, as evidenced by their presence at polling places on November 5.

Since the inception of this petition drive in 1994, the MMA has been alarmed by the popular response it has elicited. Early polling showed citizens supported such a tax cap by a 3-to-1 margin. This petition drive, coupled with the threat of another major shortfall in state revenues going into the next biennium (the seventh in as many years), convinced MMA's executive committee that the organization needs to give its highest priority to pursuing a constructive solution to the continuing crisis in government finances in Maine.

To launch this effort, the MMA commissioned a statewide citizen survey last summer to gauge public attitudes about a wide range of tax issues. Six hundred Maine citizens were surveyed. Based on these numbers, the poll has a margin of error of plus-or-minus 3 percent at the ninety-fifth level of confidence. The survey revealed three major findings:

- Seventy-seven percent of citizens polled believe major changes in our tax system are needed;
- Property tax is rated the most objectionable tax by a margin of 2.5-to-1 as compared to either the income or sales tax; and,
- Seventy-four percent of those polled want to have the final say on any tax restructuring proposal.

These findings, together with other attitudes about taxes revealed in the survey, highlight how strongly citizens feel about the need for broad change in our tax system and their sense of the general direction of that change. This survey also shows that citizens understand intuitively what statistics long have been indicating: that the mix of taxes in Maine is seriously out of balance, with far too much reliance on the local property tax to fund essential services, particularly

education. Of Maine's major taxes--sales, income, and property-- property taxes raise 43 percent of total revenues, while income taxes account for 28 percent and sales taxes are at 29 percent.

While reliance on property taxes has increased steadily, its capacity to raise the money needed to fund education and all the other municipal and state services it supports has been eroded steadily through the relentless shifting of state responsibilities onto localities. The state's continuing fiscal problems, coupled with structural problems in the tax system, have resulted in such events as the following:

- In 1991-1992, the Legislature solved its budget crisis in part with an \$18 million, one-time cut and a \$2.9 million permanent annual cut to municipal revenue sharing.
- General Purpose Aid to Education was frozen for three years, despite changes in local valuation and the number of students. Since then, despite some modest funding increases, the state largely has insulated itself from rising costs, leaving local taxpayers to pick up the shortfall. Local-option spending for education has nearly doubled statewide during the last five years.
- The value of property exempt from local property taxes has increased steadily, taking millions of dollars off local tax rolls and continuing the shift of costs to other, non-exempt taxpayers.
- County jails, deprived of promised state funding, have looked to municipal taxpayers to make up the losses for housing state prisoners.

Municipalities want this cycle to stop, and it is clear citizens also want relief from the mounting burden of property taxes. The MMA is committed to working with the Legislature and the governor to formulate a comprehensive tax reform proposal that can be considered during the first session of the 118th Legislature and then submitted to the voters in November 1997.

We believe the time is now to tackle this recurring and, so far, intractable problem, before a frustrated public creates the kind of crisis the property tax-cap initiative represents.

Several key reasons make a compelling case for tax reform now.

1. **Maine's Changing Economy.** During the past twenty-plus years, Maine's economy has changed tremendously, shifting from a predominantly manufacturing base to a service-based economy. Even more dramatic changes are occurring as a result of information technology and the globalization of the economy. Maine's tax system has not kept pace with these changes. It is critical the system reasonably reflect the breadth of current economic activities, to ensure fairness for all taxpayers and to create a sound basis for financing essential government services.
2. **Economic Development.** The current tax structure and major state aid programs often work at cross-purposes with economic development. The State Planning Office's analysis of the weakening vitality of Maine "service center" communities underscores this fact. These communities serve as hubs for our economy, containing 75 percent of the jobs and generating 84 percent of tax revenues; yet typically their property tax rates are significantly higher. Paradoxically, in order for these communities to attract major capital investment projects, they typically are forced to offer property tax breaks. The over-

reliance of municipal governments on the property tax also creates a barrier to undertaking the kinds of regional investments (convention centers, for example) that could spur economic activity.

3. **Incentives and Control.** Tax reform could incorporate incentives for intergovernmental collaboration that are vital to promoting more cost-efficient delivery of services. Citizens continue to register strong concerns about the overall cost of government. Comprehensive tax reform holds the promise of systematically reinforcing efforts already underway to promote greater efficiency and cost-effectiveness at all levels of government. Citizens are demanding no less.
4. **Citizen Dissatisfaction.** The MMA's recent survey clearly indicates citizens are dissatisfied with the current tax system, particularly with its over-reliance on the property tax. Such unrest makes us all vulnerable to a citizen-initiated referendum, whether it be the current property tax-cap referendum or some other proposal that seriously would jeopardize essential public services and wreak havoc with the state's economy.

For years now, talk about the problems with Maine's tax system--its high rates, revenue instability, and over-reliance on the property tax--has abounded. But meaningful action has proved elusive. In the face of both the threat of a property tax-cap movement and the very real economic needs of this state, all of us in policy-making positions are challenged to confront this problem squarely and take responsible action. The MMA is committed to working constructively with the Legislature and the governor to meet this challenge and is committed further to putting a solution to the voters in 1997.

#### **Addendum:**

The other major findings of the July 1996 poll include:

- Only 20 percent believe the tax burden currently is "just about right," while 64 percent say it should be reduced. Thirty-five percent say it should be reduced by 10 percent, while 28 percent want it reduced by 20 percent or more.
- Sixty-five percent believe state and local governments in Maine should rely more on sales and income taxes for funding than on property taxes.
- There is major concern about the property tax and the way it currently is being used to fund education.
- Seventy-two percent say "state income and sales taxes should be used to fund local education instead of relying so much on property taxes."
- Sixty-seven percent agree that "property taxes can no longer pay for most of the cost of education in Maine."
- Sixty-four percent wanted "to make sure that the state's expected \$200-400 million shortfall is not funded by increases in the property tax."

Some possible improvements favored by Maine citizens in 1996 include:

- Have schools and municipalities consolidate functions to achieve savings (73 percent).
- Make tax-exempt organizations pay for local services such as police, fire, and trash (61 percent).

- Close current sales tax exemptions, knowing they cost the state \$100 million annually (58 percent).
- Reduce the number of organizations and non- profits that are exempt from the property tax and tax them the same as others (56 percent).
- Give local government more tax authority and the state government less tax authority (55 percent).
- Let local communities have the option of taxing such tourist services as motels and hotels (50 percent).

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**Full cite:** Valente, Paula. 1996. *Commentary: Overhauling Maine's tax system*. Vol. 5(3): 77-80.