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Issues in Tax Reform in Maine

by Richard Woodbury

Tax reform has been prominent in public policy discussions in Maine for many years. However, there has yet to be comprehensive reform. Richard Woodbury notes that critics have described Maine's tax system "as some combination of imbalanced, burdensome, unfair, uncompetitive, complex, archaic, and volatile." He presents some of the features of the state's current tax system and the approaches to reform that have been considered in recent years. He discusses how alternative approaches to reform might be evaluated and structured to achieve different goals, and highlights different ways to distribute taxes between residents and nonresidents.

In a 2009 study for the Federal Reserve Bank of Boston, "The Struggle for Tax Reform in Maine, 2003–2009," I described the motivations for tax reform in Maine and reviewed the tax reform initiatives that were considered over this seven-year period (Woodbury 2009). My aim in this follow-up paper is to update the tax-related data from the earlier study, accounting for the tax policy changes that have been enacted since 2009, and to elaborate on the differential impact of alternative approaches to reform.

The last major statewide commission on tax reform completed its work in 2003. Made up of a former governor, former chief justice, former speaker of the House, business leaders, tax accountants and economists, the commission recommended substantial changes to a system they characterized as outdated.

> For the past 20 years, the general public and the private sector have voiced concerns about the impact of state and local tax structures on Maine citizens and businesses. While the Maine economy has been undergoing substantial change from a natural resource based and manufacturing economy to a service based economy over the last 25 years, Maine's tax structure has not changed significantly since Governor Curtis reformed it 33 years ago (Speaker's Advisory Committee on Tax Reform 2003).

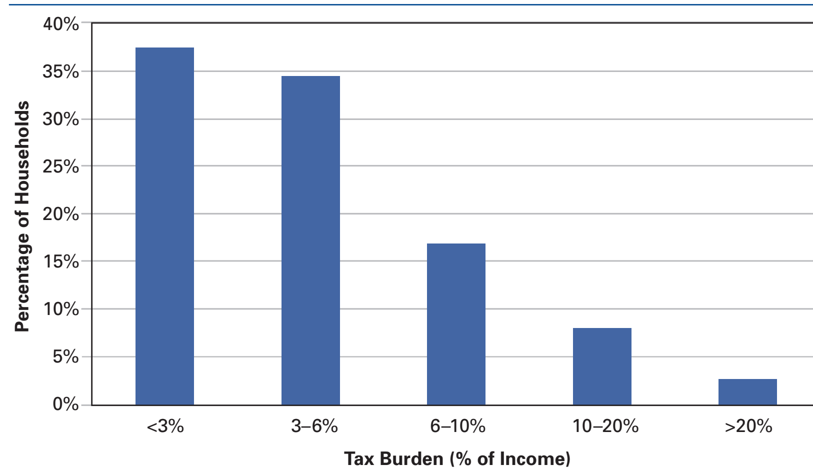
In the decade since their report, tax reform has remained a prominent topic of policy discussion and advocacy. Though changes have been made to aspects of Maine's tax structure, reforms have been piecemeal rather than comprehensive. Maine's tax system continues to be described by critics as some combination of imbalanced, burdensome, unfair, uncompetitive, complex, archaic, and volatile.

Although support for some type of tax reform is nearly universal in Maine, there is no clear agreement on what it should entail, or even on the problems tax reform is designed to fix. To some, the key problem is the burden of property taxes. To some, it is the total of all Maine's taxes that is the problem and its relationship to the size of government. To some, the key issue is how the system treats lower-income versus higher-income taxpayers—the progressivity (or regressivity) of taxes (see Johnson, this issue). To some, the key problem is economic incentives that drive people or businesses to locate elsewhere. To some, the problem is too many complicating exemptions, deductions, exclusions, credits, and reimbursements. And to still others, the problem is revenue volatility and its disruptive impact on state spending.

In discussing the differential impact of alternative approaches to tax reform, the distribution of taxes between residents and nonresidents is among the issues highlighted in the study presented here. This has particular relevance for Maine because of the many nonresidents who spend time in the state. Since some taxes are imposed on residents only, while others are collected from both nonresidents and residents, there are opportunities through tax reform to change that distribution. Tax relief measures can also be administered in ways that disproportionately benefit residents over nonresidents.

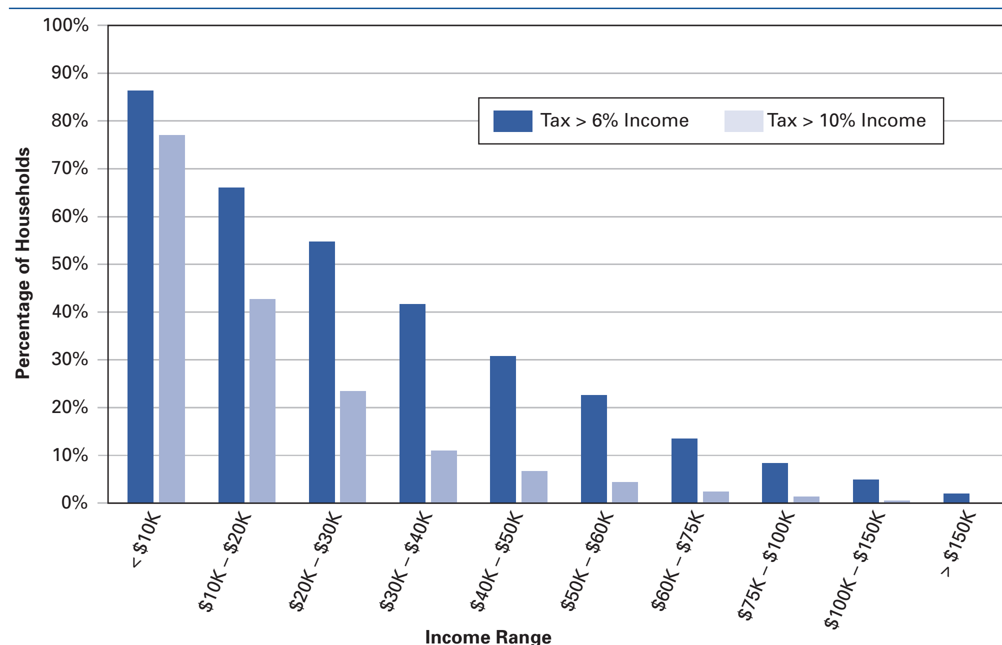
In the remainder of this paper, I consider issues in property tax reform, income tax reform, and sales tax

Figure 1: Gross Property Tax Burden as Percentage of Income across Maine Households, 2013



Source: Maine Revenue Services estimates, October 2013

Figure 2: Percentage of Households with High Property Tax Burden, by Income, 2013



Source: Maine Revenue Services estimates, October 2013

reform, respectively. Specifically, I examine how alternative approaches to reform might be evaluated and structured to achieve different goals, such as progressivity, growth, revenue stability, and exportability.

PROPERTY TAX REFORM

Property taxes differ from most other forms of taxation because they are imposed on an asset value rather than on a payment stream, such as income or spending. As a result, property taxes may represent a small, moderate, large, or very large fraction of income, depending on the circumstances of the individual homeowner. The wide variability in tax burdens across households, the very high burden imposed on some households, and the payment of the tax in large annual or semiannual billings make property tax burdens particularly visible. Figures 1 and 2 illustrate the degree to which property tax burdens vary across the population, as estimated by Maine Revenue Services for 2013.

An estimated 38 percent of resident homeowners pay less than 3 percent of their income in property taxes, and 35 percent pay between 3 percent and 6 percent of their income. Some 28 percent of households pay more than 6 percent of their income; 11 percent of households pay more than 10 percent of their income; and 3 percent of households pay more than 20 percent of their income. The proportion of households with high property tax burdens is particularly high at lower income levels, as illustrated by Figure 2.

Though property taxes are collected and spent locally, rather than by the state, there are several things that the state can do to relieve property taxes. One is to provide targeted property tax refunds to taxpayers who face a particularly high property tax burden. These are often referred to as property tax circuit breaker programs. A second is to create a property tax exemption, such as the current $10,000 exemption on primary residences in Maine. In Maine,

such exemptions generally require the state to reimburse municipalities for at least half of their lost revenues from the exemption. A third approach is to transfer more of the revenues from statewide sources (primarily income and sales taxes) to local governments and local school districts, lessening the amount that needs to be made up through local property taxes. Each of these approaches has costs to the state. Their distributional effects differ.

Property Tax Circuit Breakers

Property tax refund programs, or circuit breakers, are the most narrowly targeted approach to property tax relief, because the funds allocated to them are concentrated entirely on resident taxpayers with the highest individual burden of property taxes. This includes renters, who qualify by apportioning a certain percentage of their rent as the "property tax equivalent" cost of their housing. Some form of circuit breaker program has been in effect in Maine for decades, though program modifications have been frequent. The most significant circuit breaker expansion was enacted as part of the LD 1 reforms in 2005. The amount of the refunds has been cut back since 2005, and the program was replaced by a much smaller program in 2013. Maximum property tax refunds reached a peak of $2,000 following LD 1, and are just $300 (or $400 for those over age 70) now.

In earlier work with Michael Allen (Allen and Woodbury 2006), we demonstrated the potential for circuit breaker programs to offset the very high property tax burdens imposed on some households in Maine. Specifically, we analyzed the impact of the LD 1 reforms enacted by the legislature in 2005, including an increase in the maximum refund to $2,000, expanded eligibility to middle-income households, and a phasing out of the benefit at higher income levels. Our study looked at the proportion of households with a high net burden of property taxes—first, without circuit breaker benefits; second, based on the circuit breaker program in effect before LD 1; and third, based on the reformed program after LD 1.

The results of our study, reproduced in Figures 3 and 4 and based on data from the early to mid-2000s, examined the program's potential tax relief if all eligible households applied for benefits. We showed dramatic potential reductions in the proportion of households with high property tax burdens when using a generous circuit breaker refund program. The reductions in tax burden were particularly significant among lower-income taxpayers, as shown in Figure 4. As a frame of reference, the cost to state government of the LD 1 circuit breaker program was about $45 million annually following its enactment in 2005.

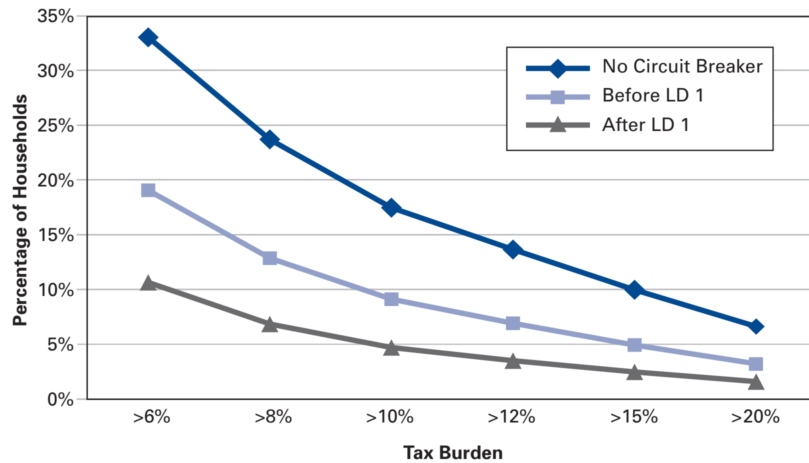
Despite a significant scaling back in the circuit breaker formula for 2014, including much smaller maximum refunds, the estimated annual cost of the program is still projected by Maine Revenue Services at about $35 million annually. There are at least two reasons for this. One is that the application process for property tax refunds will be integrated with the filing of state income tax returns. Formerly, only about half of households eligible for circuit breaker refunds applied to receive them. With an integrated and simplified application process, higher participation is projected in the reformed program. Second, the income measurement used to determine program eligibility now conforms to Maine's definition of adjusted gross income, which excludes Social Security and other previously counted income sources. Under the reformed program, more Social Security beneficiaries in particular are likely to qualify for property tax refunds.

> ... circuit breakers are the most narrowly targeted approach to property tax relief because [funds] are concentrated entirely on resident taxpayers with the highest ... burden of property taxes.

Homestead Exemptions

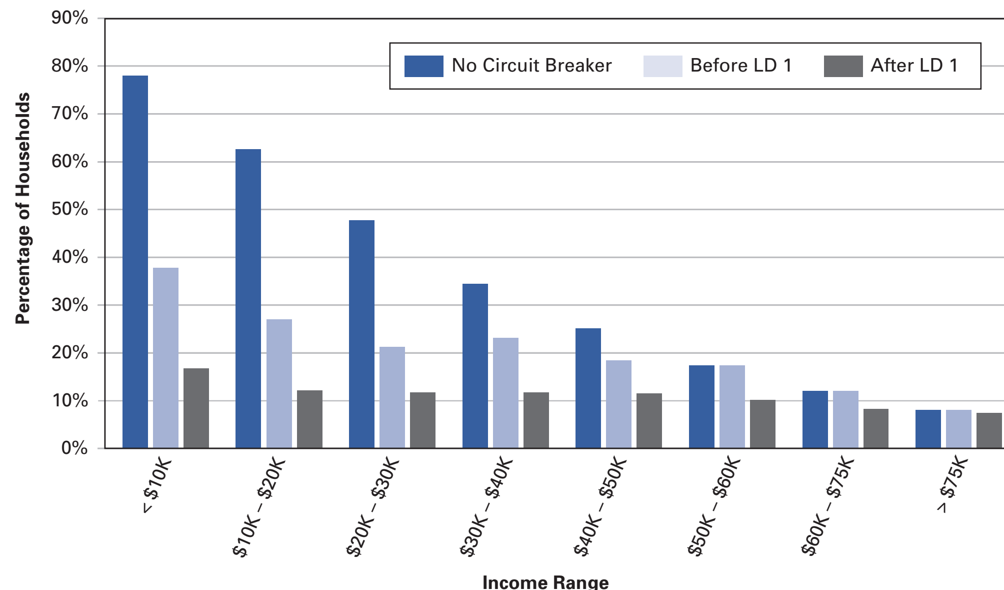
Homestead exemptions, though not means tested, are another form of property tax relief that targets Maine residents only. It is available to resident homeowners on their primary residence, but is not available to renters and does not apply to vacation property. As noted, the current homestead exemption in Maine exempts the first $10,000 in the value of one's principal residence from being taxed. The level of Maine's homestead exemption has also been

FIGURE 3: **Effect of Circuit Breaker on Percentage of Maine Households with Higher Property Tax Burden**



Source: Allen and Woodbury 2006

FIGURE 4: **Percentage of Maine Households with Property Tax Burden above 6 Percent of Income**



Source: Allen and Woodbury 2006

adjusted in past reforms, reaching a level of $13,000 following the LD 1 reforms.

There are at least three distributional implications of the homestead exemption. First, it is worth proportionately more to owners of lower-valued homes than it is to higher-valued homes. For example, today's $10,000 homestead exemption reduces by just 1 percent the taxable value of a $1 million homestead, but it reduces by 20 percent the taxable value of a $50,000 homestead. Second, the exemption is worth more in communities that already burden taxpayers with high property tax rates. In a community with a high property tax rate, say 25 mils for example, Maine's current homestead exemption translates roughly into $250 in property tax relief. In a community with a low property tax rate, say 8 mils, the relief would be just $80. Third, because the homestead exemption is only partially reimbursed, non-homestead property owners may pay higher taxes to make up for lost revenues that are not reimbursed. Higher taxes will generally be paid on property owned by nonresidents, commercial property, and vacation property.

To summarize, the homestead exemption provides more concentrated property tax relief to resident homeowners (relative to nonresident and commercial taxpayers), to lower-valued homes (relative to higher-valued homes), and to communities with higher tax rates already.

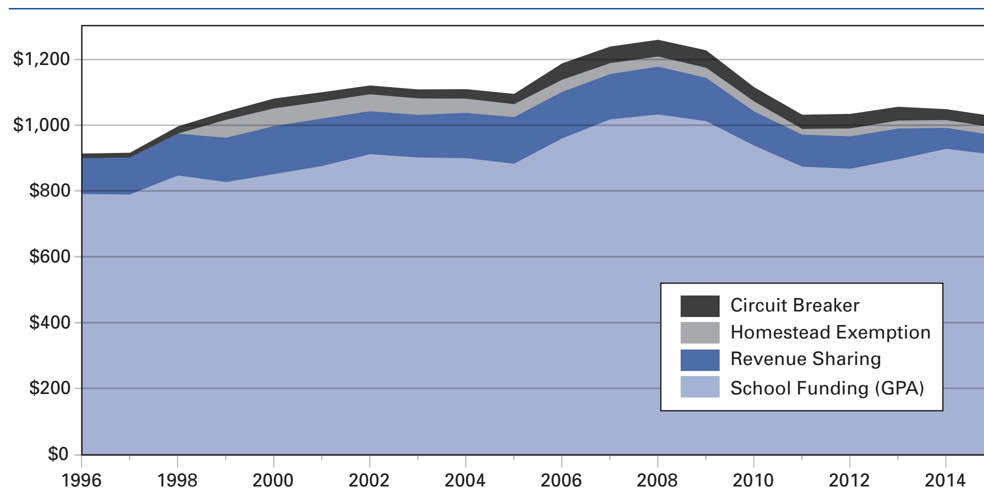
School Funding and Municipal Revenue Sharing

Transfers from state revenues to municipalities and school districts are a broader form of property tax relief. The way the school-funding formula works, the state first determines the total amount that it will transfer to local school districts in general purpose aid to education (GPA). Based on that allocation, the state then calculates a statewide property tax "mil rate expectation" that will raise sufficient additional funds to fully support "essential programs and services" (EPS) at all of Maine's public schools. When more state resources are allocated to school funding, the statewide mil

rate expectation is reduced, thereby lowering property taxes.

A similar substitution of state funds for local funds occurs when the state allocates money for municipal revenue sharing. Given a fixed local budget, more municipal revenue sharing translates into less being required from local property taxes. Of course, the dollars spent by the state on school funding and municipal revenue sharing need not all translate into property tax relief. It may also allow municipalities and school districts to spend more than they otherwise would. There is no broad consensus on the extent to which incremental funding for these programs lowers property taxes, as compared with increasing local spending.

FIGURE 5: **State Expenditures Related to Property Taxes ($ millions, inflation-adjusted)**



The stated aim of state government is to distribute 5 percent of its revenues to municipalities in the form of municipal revenue sharing and to support 55 percent of the EPS cost of K-12 education. In practice, however, budgetary pressures and other legislative priorities have reduced these allocations. Figure 5 shows real spending by the state on the circuit breaker program, homestead exemption, revenue sharing, and general purpose aid to education, respectively, for fiscal years 1996 through the recently approved 2014 and 2015 budgets. (The historical amounts are inflation-adjusted to fiscal year 2013 dollars.)

Figure 5 shows an increase in inflation-adjusted state spending for these purposes from 1996 to 2008, particularly following the enactment of LD 1 in 2005, and then a pronounced drop in funding precipitated by economic conditions and other factors since 2008. (It is worth noting that school enrollment has also declined over this period, from about 214,000 public school students in 1996 to about 185,000 today.) The article by Shaw (this issue) provides further discussion about the changes in revenue sharing and school funding, and the municipal responses to these state revenue changes.

Who Benefits from Each Approach?

Throughout this discussion is an implicit trade-off between the depth and breadth of property tax relief associated with different funding measures. The circuit breaker program is the most narrowly targeted, benefiting resident homeowners with high property tax burdens and resident renters with high housing cost burdens. The homestead exemption is the next most targeted, benefiting resident homeowners only, and with larger proportionate benefits to those with less valuable homes and to those with higher property tax rates already.

Incrementally increasing municipal revenue sharing or school funding are broader forms of property tax relief, but their impact across communities is uneven. Within any community, their effect is to reduce the property tax mil rate across the board for all property tax payers, whether resident or nonresident, primary home or vacation home, residential or commercial. The relief is proportional to what taxpayers pay already. Comparing across communities, however, there are distinct differences between the effects on property taxes of revenue sharing and school-funding support.

For most communities throughout Maine, an increase in general purpose aid to education lowers the EPS mil rate expectation by the same amount—about 0.1 mil per $10 million in incremental state funding—regardless of the existing property tax rate in each community. The exceptions are those communities in Maine, referred to as "minimum receivers," that have enough property value to raise the full cost of EPS with a tax rate lower than the mil rate expectation. These communities benefit little or not at all from an increase in state funding for education. Though they are a minority of communities in the state, a disproportionate

number of Maine's vacation properties are located in minimum receiver communities.

Municipal revenue sharing is allocated across communities using a different formula, where communities with higher property tax mill rates receive larger allocations. Thus, higher-mil-rate communities, including so-called service center communities, are more explicitly targeted. The municipal revenue sharing formula works in a continuous way—the higher the mil rate, the greater the relief provided. The school-funding formula has more of a kink in the formula, where communities on one side of the kink (the minimum receivers) get virtually nothing, whereas communities above the kink (those paying the EPS mil rate expectation) get essentially the same mil rate relief, regardless of overall tax rate.

Illustrative Effects of State-Funded Property Tax Relief

To further illustrate these implications, I estimate the impact on property taxes of allocating an additional $50 million in state resources to four alternative property tax relief measures. The first approach would add $50 million to general purpose aid to education, raising the allocation from $947 million to $997 million, and bringing Maine closer to its stated goal of 55 percent. The effect of this reform is to lower the statewide mil rate expectation for K-12 education from 7.86 mils to about 7.34 mils, or by about 0.52 mils in most Maine communities. The property tax savings would be about $50 on a $100,000 home, $100 on a $200,000 home, and $500 on a $1 million home. There would be no property tax savings in minimum receiver communities.

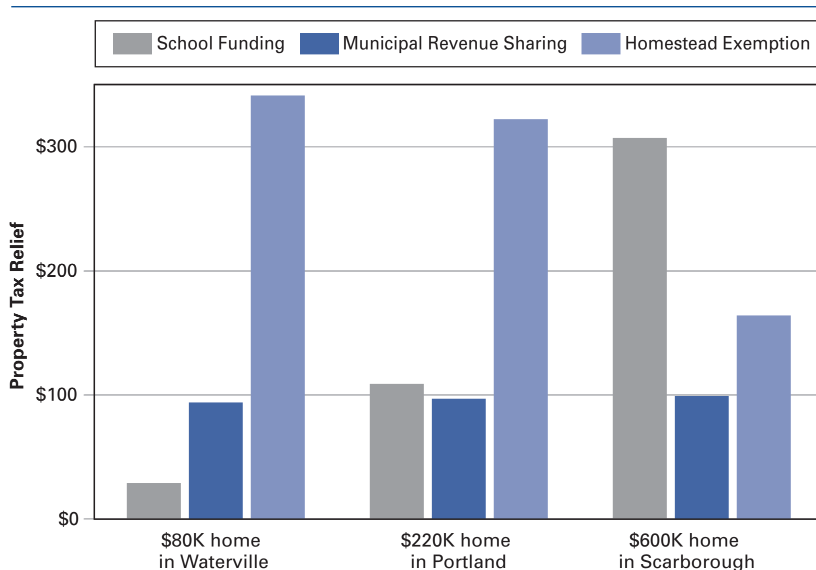
The second approach would add $50 million to municipal revenue sharing, raising the allocation from $65 million to $115 million, and approaching the stated public policy goal of 5 percent. The effect of this policy is to lower the mil rate for all taxpayers throughout the state, but more significantly in communities with higher property tax mil rates already. For example, the 50,000 resident homeowners paying the highest property tax rates would see an average reduction of about 0.96 mils, from 20.61 to 19.65, translating to about $100 in property tax savings on a $100,000 home, $200 on a $200,000 home, and $1,000 on a $1 million home. The 50,000 resident homeowners paying the lowest property tax rates in the state would see an average mil rate reduction of 0.14 mills, from 9.16 to 9.02, or about $15 in property tax savings on a $100,000 home, $30 on a $200,000 home, and $150 on a $1 million home.

The third approach uses the $50 million to increase the homestead exemption from the current level of $10,000 to $30,000. Because municipalities are reimbursed for only half of the lost tax base, this results in an average increase in mil rate of 0.31, from 13.32 to 13.63. This draws a modestly increased property tax share from nonresident and commercial taxpayers. For all but the most valuable homestead properties, the increase in the exempt amount far outweighs the increase in rate. The property tax savings in an "average" community, therefore, would be about $250 on a $100,000 home, $210 on a $200,000 home, and no savings on a $1 million home.

The fourth approach uses the $50 million to restore the circuit breaker benefit formula enacted in LD 1 in 2005. The effect of this policy varies with the individual circumstances of the property owner or renter. For those without a high burden of property taxes (or rent), there would be no property tax savings from the increased funding. For those with the greatest burden of property taxes (or rent), savings are as much as $2,000 per household.

To further analyze these impacts, I consider three illustrative homesteads and three illustrative nonresident properties, shown in Figures 6 and 7, respectively. (The circuit breaker is not included in these illustrations because its effect—though the

FIGURE 6: **Impact of $50 Million in Property Tax Relief (Residents)**



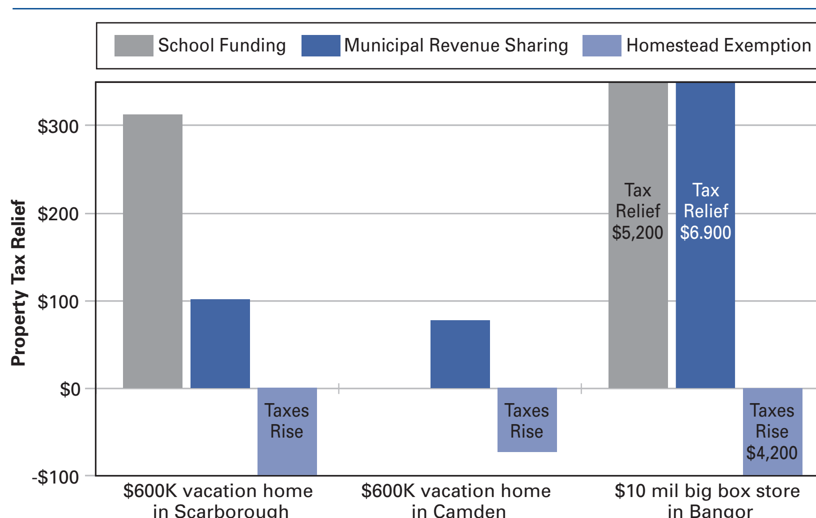
largest of all for residents with high property tax burden—cannot be generalized across properties in the same way.)

In Figure 6, the Waterville residence is illustrative of a modest home in a high-tax-rate community. The Portland residence is illustrative of a typical home in Maine's largest city. The Scarborough residence is a higher-valued home in a coastal community. Because the homestead exemption benefits high-mil-rate communities and lower-valued properties more, its biggest impact is in the Waterville and Portland illustration. The more valuable Scarborough home benefits most from the lower-mil-rate expectation created by increased school funding.

The nonresident and commercial illustrations in Figure 7 are also instructive. For example, the first illustration is for the same $600,000 Scarborough home included in Figure 6, but owned by a nonresident rather than a resident. The nonresident receives essentially the same property tax relief from additional school funding as the resident, and the same property tax relief from additional revenue sharing as the resident. The homestead exemption, however, increases taxes on the nonresident and commercial taxpayers, while decreasing them on the resident.

Figure 7 also compares two identical homes in Scarborough and Camden owned by nonresidents. The effects of an increase in revenue sharing or the homestead exemption are comparable across these properties. The effects of school funding, however, are dramatically different. Scarborough is subject to the statewide EPS mil rate expectation, which declines with additional school funding, thereby lowering property taxes. Camden, on the other hand, is a minimum receiver, able to support EPS costs at a mil rate that is already lower than the statewide rate. Therefore, additional school funding has no impact in Camden. Camden is illustrative of the most highly valued recreational areas of Maine's coast, lakefront, and mountains where a lot of Maine's vacation properties are concentrated.

FIGURE 7: **Impact of $50 Million in Property Tax Relief (Nonresidents)**



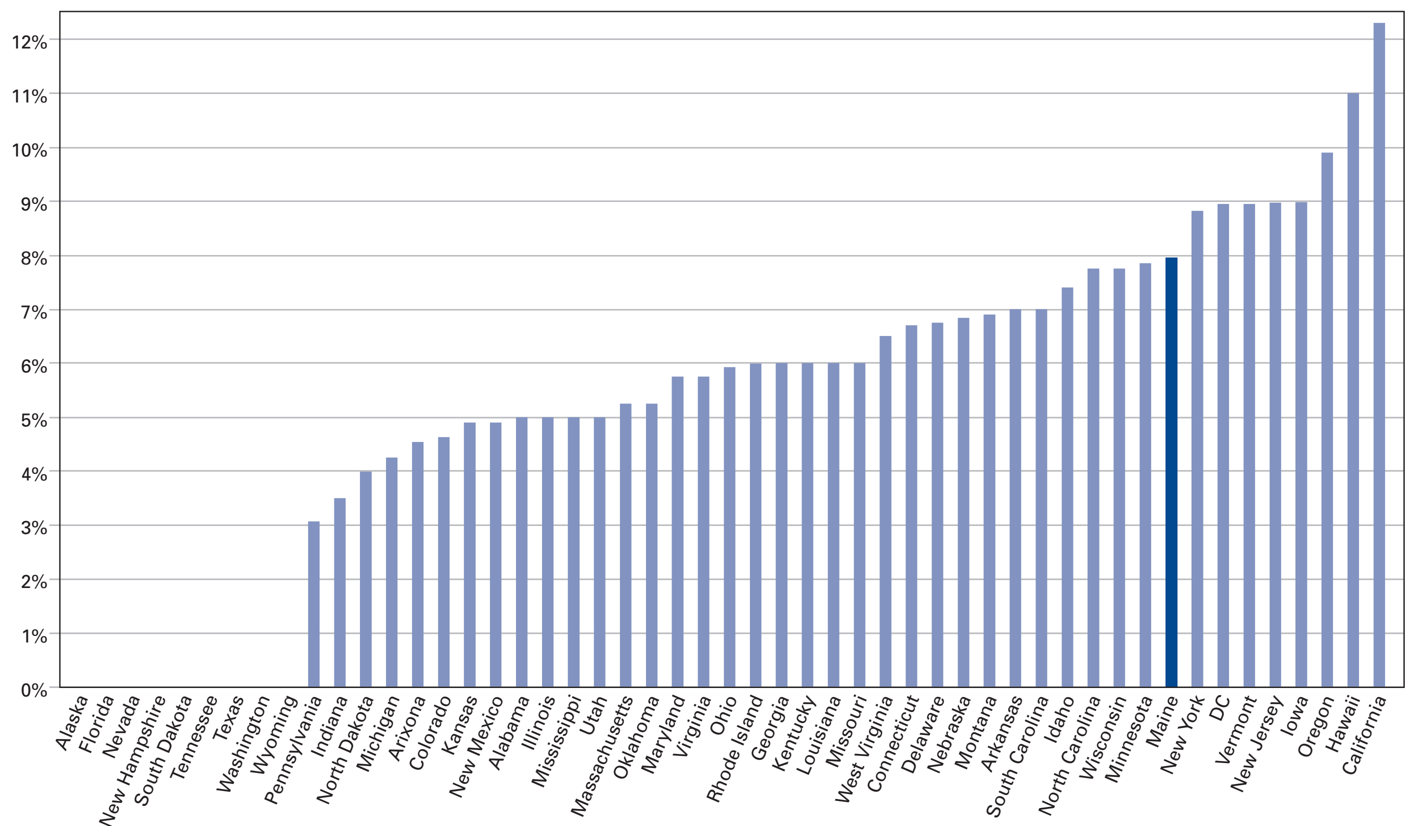
INCOME TAX REFORM

Three issues have dominated discussions of Maine's income taxes. The first is the top tax rate. Because it is higher than most states, it may discourage some individuals and businesses from locating in Maine, thereby dampening Maine's economic performance. The magnitude of this effect, however, is a subject of considerable controversy. The second issue is the progressivity of the income tax, particularly in conjunction with other taxes that burden lower-income households disproportionately. The income tax formula can be calibrated to achieve nearly any progressivity objective. The third issue is the cost of Maine's many tax exemptions, deductions, credits, and reimbursements that have been incorporated in the system over time. Although each advances some public purpose, they also reduce revenues or require higher tax rates to maintain the same revenues.

Maine's new income tax formula has tax rates of 6.5 percent and 7.95 percent. Table 1 shows the total income ranges in which a "typical" taxpayer is subject to these marginal tax rates in 2013, assuming they use the standard deduction and earn all income from nonexempt sources.

Those concerned with the competitiveness of Maine's income tax structure focus on both the 7.95 percent rate and the moderate income level at which that rate is imposed. Figure 8 compares Maine's 7.95 percent tax rate with the highest rates used in other states, using tax information compiled by the Federation of Tax Administrators for 2013. The figure shows that the 7.95 percent top marginal tax rate in Maine is the ninth highest among the 50 states. The median state has a top marginal income tax rate of 6 percent. Among the states with the highest marginal income tax rates (above 8 percent), New York imposes its highest rate only on individual taxable income above $1 million; California

FIGURE 8: **Highest Income Tax Rates by State, 2013**



Source: FTA 2013a

TABLE 1: **Total Income Threshold for Each Income Tax Rate in Maine, 2013**

Tax Rate	Individual	Married Couple	Four-Person Family
No Tax	<$15,200	<$28,400	<$36,200
6.5% Rate	$15,200–$30,900	$28,400–$59,800	$36,200–$67,600
7.95% Rate	>$30,900	>$59,800	>$67,600

Source: Maine Revenue Services

and New Jersey, above $500,000; Vermont, above $388,350; Washington, DC, above $350,000; Hawaii, above $200,000; Oregon, above $125,000; and Iowa, above $67,230. By contrast, Maine imposes its highest rate on more modest incomes.

Approaches to Reform

Proposals for income tax reform in Maine have encompassed two distinct approaches and multiple specifics. The first would retain the basic structure of the state's current income tax, which parallels the federal tax system to a significant extent. That is, the state income tax features a progressive rate structure, personal exemptions for filers and dependents, and a choice of standard or itemized deductions. This traditional approach to tax reform involves reducing income tax obligations within the existing framework, such as by adjusting tax rates or tax brackets. This was the approach used in 2011, when the legislature enacted an income tax reduction that took effect in 2013. The reform increased the level of income one needs to earn before being subject to any tax and replaced the four marginal tax rates that existed previously (2.0 percent, 4.5 percent, 7.0 percent, and 8.5 percent) with the current two-rate system of 6.5 percent and 7.95 percent. Figure 9 shows the impact of the reform on taxpayers at different income levels, illustrated by the total tax rate paid by a four-person family using the standard deduction under the old and new systems, respectively.

The second approach to reforming income taxes would fundamentally change the structural foundation of the system, typically by applying a lower flat-rate tax, eliminating personal exemptions and (standard or itemized) deductions, and replacing them with a tax credit that phases out at higher income levels. By choosing the flat-tax rate and calibrating the magnitude and phase-out of the household credit, one can accomplish virtually any distribution of tax burden across income groups. The level of the flat rate determines the highest average tax rate that any taxpayer will pay in the reformed system. The design and calibration of the household credit determines the distribution of reduced tax burden below the flat rate.

In the current legislative session, a bipartisan group in which I participated presented versions of a more comprehensive income tax reform plan that illustrates this second approach. The so-called gang-of-eleven plan dropped the top income tax rate by as much as half, eliminated many tax expenditures, and made up for lost revenues from increased sales and excises taxes. Three versions of the gang-of-eleven plan are presented in Figure 10, one with a top income tax rate of 4.95 percent, one with a top rate of 4.5 percent, and one with a top rate of 4 percent.

An innovative feature of the plan was a new "sales tax fairness credit," integrated into the income tax formula, that was designed to offset the disproportionate burden of sales taxes on lower-income resident households. The negative tax rates at the left of Figure 10 correspond to these refundable tax credits. Depending on the calibration of the plan formulas, the integrated system could moderate, or even eliminate, the overall regressivity of sales taxes and reestablish progressivity within a flat-rate income tax structure.

What are the relative merits of the traditional progressive rate structure versus the more innovative flat tax with a progressive credit? One clear difference is the visibility of the top "published" tax rate. In the current system, for example, the top tax rate of 7.95 percent is a highly visible component feature of Maine's system and likely deters some individuals and businesses from locating in Maine. An important insight in designing the flat-rate alternative systems is that nobody actually pays a full 7.95 percent of their income in taxes, after accounting for personal exemptions, standard or itemized deductions, and the portions of income that are

Figure 9: **Income Tax Reform Taking Effect in 2013 (total tax rate for a four-person family using the standard deduction)**

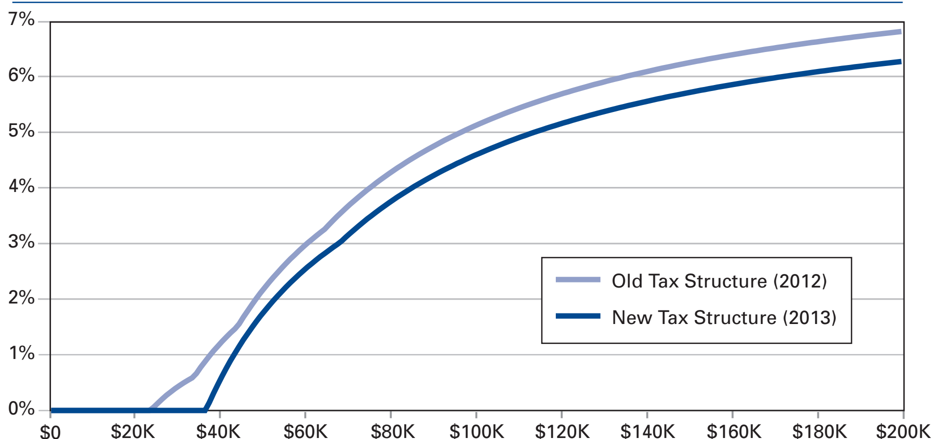
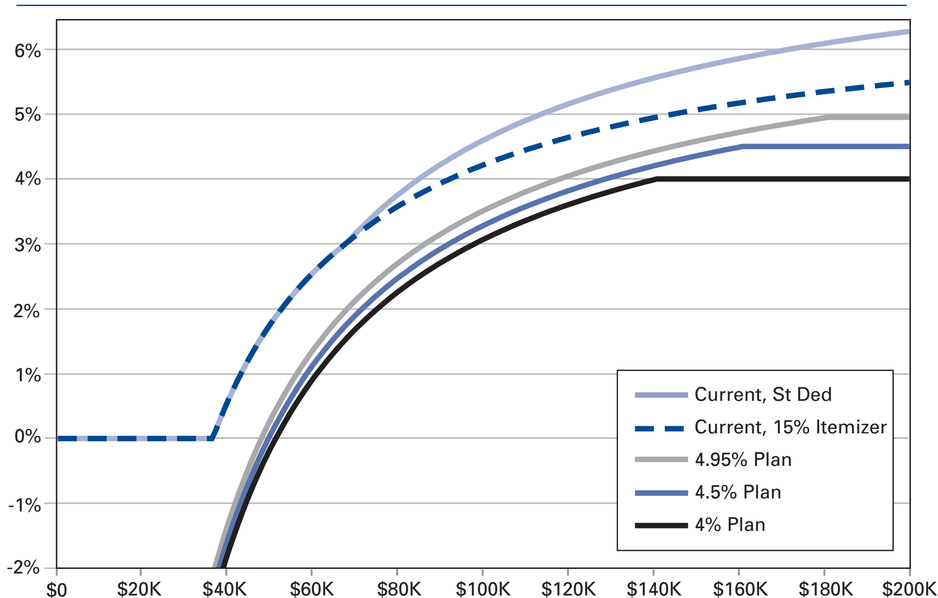


Figure 10: **"Gang-of-Eleven" Tax Reform Plans (total tax rate for a four-person family)**



taxed at a lower rate. A four-person family with income of $200,000 and itemized deductions of $30,000, for example, now pays about $10,989, or 5.5 percent of its income, in Maine income taxes. The family's average tax rate of 5.5 percent is much lower than its marginal tax rate of 7.95 percent. A flat tax with a phased-out credit allows the published top tax rate in Maine to reflect the highest average rate, rather than the highest marginal rate. The extent to which economic activity is driven primarily by the published tax rate, the average tax rate or the marginal tax rate, is a subject for another study.

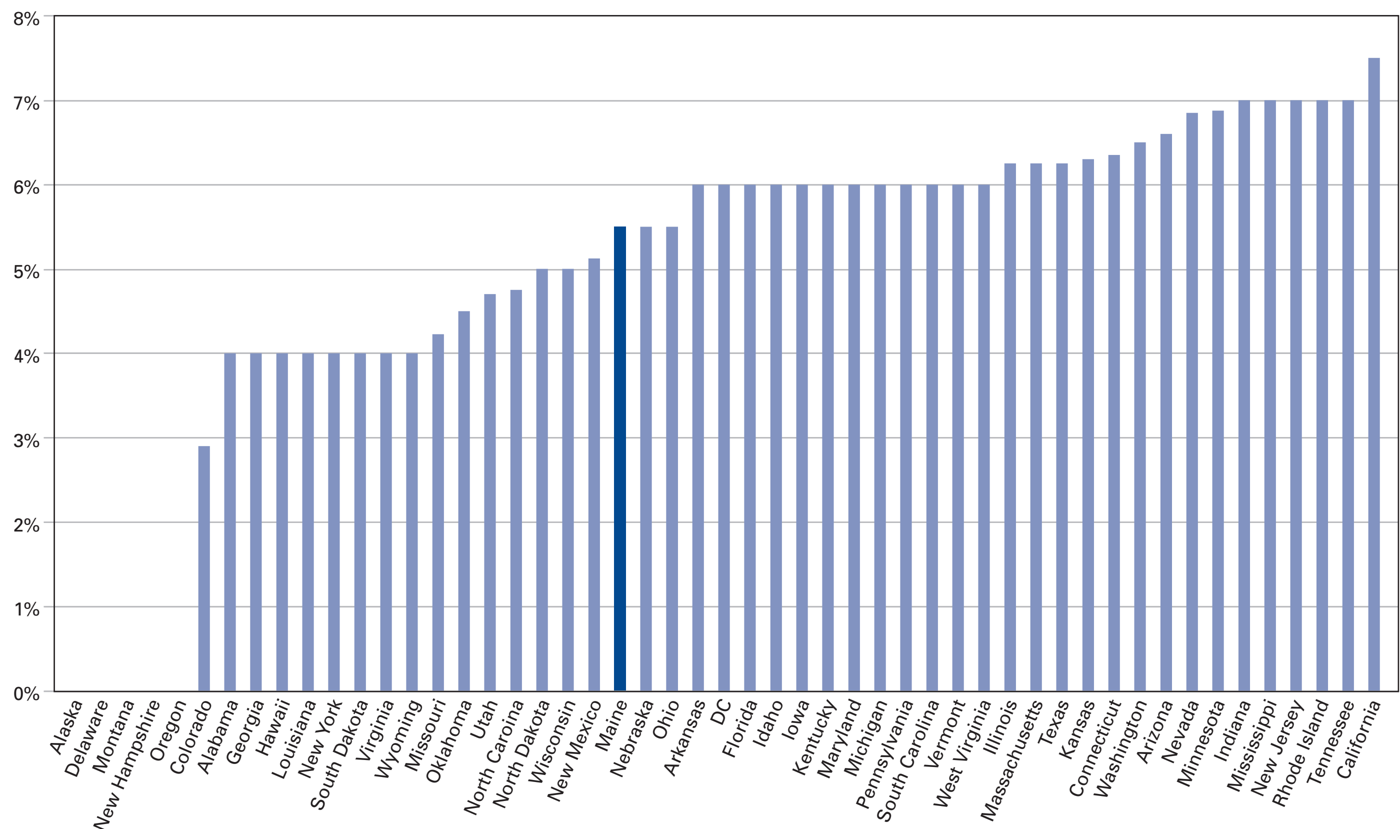
SALES TAX REFORM

Maine imposes a 5 percent general sales tax (temporarily increased to 5.5 percent), a 7 percent tax on prepared meals and lodging (temporarily increased to 8 percent), a 10 percent tax on rental cars, and a 0.44 percent tax on real estate transfers. Maine also imposes an excise tax on cigarettes at $2.00 per pack, beer and hard cider at $0.35 per gallon, wine at $0.60 per gallon, and sparkling wine and low-alcohol spirits at $1.24 per gallon. (Those rates include both the base tax rate and a supplementary premium tax.)

Two issues have motivated interest in reforming sales and excise taxes. First, sales and excise taxes have been suggested as the area where the state could increase revenues to offset lower income and property taxes. Although income and property taxes are generally considered high in Maine, sales taxes are considered at or below the average of states. Thus, sales and excise tax reform is usually advanced as part of an umbrella of reforms that aim to rebalance Maine's tax system more comprehensively. Figure 11 compares the sales tax rate across states, based on summary data from the Federation of Tax Administrators.

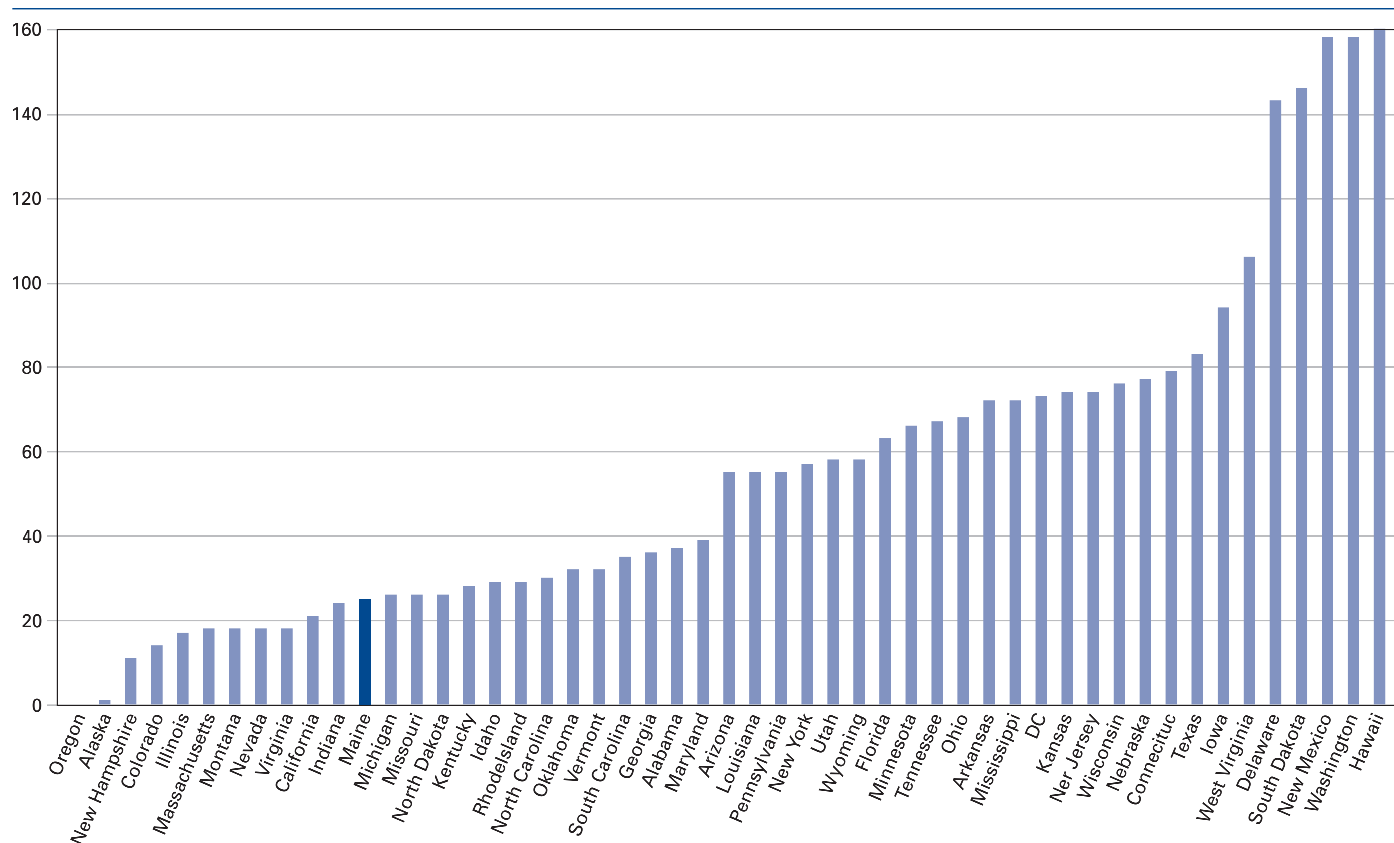
At the temporarily raised rate of 5.5 percent, Maine is near the median of states. It is worth noting that

FIGURE 11: **Sales Tax Rates by State**



Source: FTA 2013b

Figure 12: **Number of Services Taxed by State**



Source: FTA, 2007 Survey

roughly half of states allow local sales taxes on top of the statewide rates. If we include these additional local rates in the comparison, Maine's rate might be considered that much lower by comparison.

The second issue motivating discussions of sales tax reform involves the appropriate breadth of the sales tax base, and particularly its exclusion of most services. As the composition of consumer purchases has evolved over time to include more services, advocates of reform contend that the sales tax base should also expand. Advocates of sales and excise tax reform also emphasize the volatility of revenues that results from a narrower tax base. For example, roughly a third of sales tax revenues are attributable to sales of automobiles and construction materials, both of which are highly cyclical industries.

Comparing the sales tax base across states is more complicated, as the definitions of product and service categories that may be subject to tax can differ considerably. The Federation of Tax Administrators, however, conducts a periodic survey of states on 168 potentially taxable services (FTA 2008). The services included in the survey are not intended to be comprehensive or complete. Nevertheless, they give some sense of the scope of services that may be taxed and of the broad variation among states in the number of such services taxed. Based on data from the last survey in 2007, Figure 12 illustrates the variation across states in the number of service categories taxed in different states. Based on this measure, Maine appears to have a sales tax base that is narrower than that of most states, taxing 25 of the categories in the survey, compared with 55 at the median (among states with a sales tax), and up to 160 at the extreme.

Sales tax reform proposals include both rate changes and changes to the sales that are subject to tax. The simplest reforms would raise one or more sales or excise tax rates. For example, increases in the cigarette tax and/or the lodging tax are proposed in nearly every legislative session. More complicated reform proposals would expand the base of the sales tax, most commonly

Illustrative Services in 2007 FTA Survey: Services Taxed in at Least 10 States but Not Taxed in Maine

Admissions & Amusements	
Admission to professional sports events	37
Amusement park admission & rides	36
Circuses and fairs—admission & games	34
Admission to cultural events	31
Pari-mutuel racing events.	29
Billiard parlors	27
Bowling alleys	27
Membership fees in private clubs.	23
Admission to school & college sports events	22
Pinball & other mechanical amusements	19
Coin operated video games	17

Agricultural Services	
Landscaping services (including lawn care)	21
Pet grooming	18

Automotive Services	
Auto service. except repairs, including painting & lube	25
Automotive rustproofing & undercoating	25
Automotive washing & waxing	21
Parking lots & garages	21
Automotive road service and towing services	19

Business Services	
Commercial linen supply	33
Tire recapping & repairing	28
Exterminating (includes termite services)	21
Telephone answering service	20
Maintenance & janitorial services	19
Window cleaning	19
Security services	18
Armored car services	16
Private investigation (detective) services	16
Credit information, credit bureaus	13
Employment agencies	11
Packing & crating	11
Interior design & decorating	10
Temporary help agencies	10

Computer	
Software—modifications to canned program	29
Software—custom programs—material	24

Computer (continued)	
Software—custom programs—professional serv.	14
Information services	13
Internet Service Providers-DSL or other broadband	12
Mainframe computer access & processing serv.	11

Construction	
Carpentry, painting, plumbing & similar trades	13
Gross Income of Construction Contractors	12
Construction service (grading, excavating, etc.)	12
Water well drilling	10

Fabrication, Installation and Repair Services	
Service contracts sold at the time of sale of TPP	32
Repair labor, generally	24
Labor on radio/TV repairs; other electronic equipment	24
Labor charges—repairs other tangible property	24
Installation charges by persons selling property	23
Labor charges on repairs to motor vehicles	21
Labor charges—repairs to intrastate vessels	20
Installation charges—other than seller of goods	18
Labor charges on repair of aircraft	16
Labor—repairs to commercial fishing vessels	15
Labor—repairs or remodeling of real property	15
Custom meat slaughtering, cutting & wrapping	14
Labor charges—repairs to interstate vessels	11
Labor charges on repairs to railroad rolling stock	11

Leases and Rentals[1]	
Personal property, short term (generally)	45
Personal property, long term (generally)	45
Bulldozers, draglines & const. mach	45
Rental of hand tools to licensed contractors	45

Leases and Rentals[1] (contd.)	
Aircraft rental to individual pilots, short term	40
Aircraft rental to individual pilots, long term	39
Limousine service (with driver)	16

Personal Services	
Tuxedo rental	38
Diaper service	23
Health clubs, tanning parlors, reducing salons	22
Laundry and dry cleaning services, non-coin op	22
Gift and package wrapping service	21
Garment services (altering & repairing)	20
Shoe repair	20
Carpet and upholstery cleaning	19
Swimming pool cleaning & maintenance	17
Income from funeral services	13
Water softening & conditioning	13
Fishing & hunting guide services	11
Massage services	11

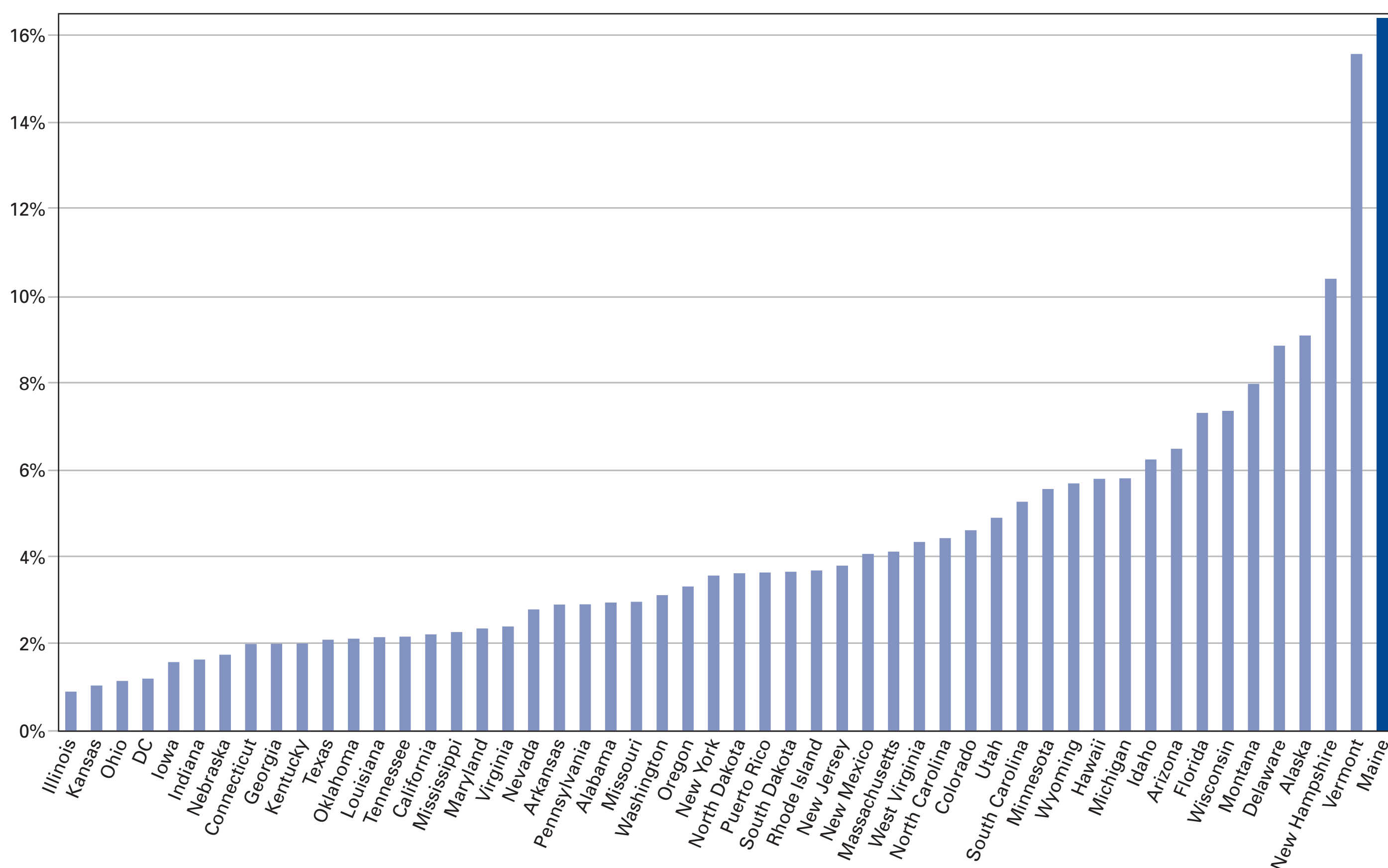
Storage	
Automotive storage	19
Marina Service (docking, storage, cleaning, repair)	17
Fur storage	16
Mini-storage	14
Household goods storage	13
Cold storage	13
Food storage	10
Packing & crating	10

Transportation Services	
Income from intrastate transportation of persons	11

Utility Service	
Interstate telephone & telegraph, ind.	27
Interstate telephone & telegraph, res.	27
Other fuel (including heating oil), res.	23
Natural gas, residential	22
Sewer and refuse, industrial	15
Water, residential	12
Sewer and refuse, residential	11

[1] Maine generally taxes the leasor on the original purchase, but not the consumer leasing the property.

FIGURE 13: **Share of Housing Units that Are Vacation Homes by State, 2010**



Source: FTA, 2007 Survey

to consumer services. Examples are recreational services such as golf, skiing, movies, amusement parks, or concerts; repair services such as for cars, lawn mowers, or appliances; personal property services such as dry cleaning, rug cleaning, car washing, picture framing, or storage; or personal care services such as hair cutting, beauty salons, and massage. The sidebar lists some of the services that the 2007 FTA survey reports as taxed in at least 10 states, but that are not taxed in Maine.

The extent to which Maine could or should expand its sales tax base is a question of considerable political and substantive controversy. No industry now exempt from sales tax wants to lose that exemption. Other policy considerations are avoiding pyramiding (taxing both the inputs to production and the final product); the mobility of business activity across state lines by buyers or providers attempting to avoid the tax (such as those providing professional services); and the potential regressivity of taxing necessities (such as groceries and household utilities).

TAX REFORM AND EXPORTING

As noted in the introduction, there is a large nonresident presence in Maine. Maine's nonresident population includes at least three categories of people living part of the year in Maine. First, there are the nonresident owners of second homes in Maine's ocean, lake, and mountain communities. U.S. Census data show that Maine has by far the highest percentage of second homes of any state in the country—more than 118,000 vacation homes—many of which are owned and used for extended periods by nonresident families (see Figure 13). Second, Maine is a highly visited vacation state, symbolized by its "vacationland" motto. The Maine Office of Tourism estimates that there are nearly 15 million nonresident vacation visitors to Maine annually,

averaging 3.7 nights per visit (Maine Office of Tourism 2013). Third, at least anecdotally, there appear to be sizable numbers of nonresident retirees in Maine, some of whom spend as much as five or six months per year in the state.

The importance of residence to tax policy is best illustrated by two identical retirees, each of whom spends six months in Maine and six months in Florida. One of them remains a Maine resident, but spends an extended period of winter in Florida. The other carefully documents their presence in the two states to be classified for tax purposes as a Florida resident. When in Maine, both retirees look much the same, driving on Maine roads, using Maine's hospitals as needed, and enjoying Maine's communities, environment, and quality of life. One of them is subject to the full weight of Maine's 7.95 percent income tax. The other is fully exempt from all state income taxes. While Maine cannot impose income taxes on these nonresident retirees, it could draw more revenues from the categories of taxes that nonresidents do pay.

Although the exporting of tax burden to nonresidents is viewed favorably by many, ... there are offsetting implications that need to be weighed against these benefits.

Put differently, the weighting of Maine's income, sales, and property taxes is important to how Maine's taxes are apportioned between residents and nonresidents. Nonresidents who spend time in Maine are generally exempt from state income taxes, often reside in high-valuation regions with low property tax mil rates, and devote a large portion of their spending in Maine to purchases that are exempt from sales taxes. By taxing consumption more universally and more heavily, proponents argue, the state can allocate the tax burden in rough proportion to the amount of time people spend in Maine (or the dollars they spend in Maine), rather than whether they are defined as residents or nonresidents. The revenues from consumption taxes, which are imposed on both residents and nonresidents, can then be directed to income tax and property tax relief that benefits Maine residents almost exclusively.

Each of the comprehensive tax reform proposals of the last decade—none of them successfully enacted—has clearly emphasized the goal of exporting more of Maine's taxes to nonresidents. For example, LD 1925 in 2007 was a revenue neutral proposal, explicitly entitled "An Act to Cut Taxes on Maine Residents by over $140,000,000." The pared-down version of tax reform introduced as LD 1088 in 2009, also revenue neutral, was entitled "An Act to Modernize the Tax Laws and Provide over $75,000,000 to Residents of the State in Tax Relief." Maine Revenue Services estimated that the further pared-down tax reform bill that was ultimately vetoed by citizen referendum in 2010, LD 1495 would reduce the tax burden on Maine residents by about $50 million.

The recent gang-of-eleven reform plan proposed an even larger shift away from income taxes and toward sales and excise taxes than any of these earlier plans. It also contained a proposal for a $50,000 homestead exemption that would have provided additional property tax relief targeted at residents. Though the degree of exporting in the plan was not estimated, the intent was to raise about $700 million in additional annual revenues from sales and excise taxes (paid by residents and nonresidents alike), while providing $700 million in resident-targeted tax relief through Maine's income and property tax systems. It relied on both higher sales and excise tax rates, and a substantial broadening of the sales tax base to achieve these aims.

Although the exporting of tax burden to nonresidents is viewed favorably by many, and the reduced tax burden on residents likely has a positive economic impact, there are offsetting implications that need to be weighed against these benefits. Specifically, to what extent do higher taxes on nonresidents discourage them from spending in Maine and how does this negative economic impact compare with the positive impact of lower taxes on residents? Many in the tourism industry, for example, point to the potential of tourism-related taxes (such as an increase in the lodging tax, or a new sales tax on ski-lift tickets) to discourage out-of-state visitors from spending time in Maine. Many in the real estate industry make a similar claim with respect to proposed increases in the real estate transfer tax. They suggest that increasing that tax may discourage purchases of second homes in Maine, or reduce the market value of existing real estate investments.

THE EVOLVING LANDSCAPE FOR TAX REFORM

Few would argue that the failure of comprehensive tax reform over the last decade is an indication that Maine's tax system is in fact perfectly structured as it is now. Differences in policy objectives, however, have so far impeded comprehensive solutions. Still, the piecemeal changes made over the past several years are not insignificant.

The income tax reduction taking effect in 2013 was lauded by advocates as the biggest tax cut in Maine history. That it removed an estimated 77,000 households from owing any income tax was a significant change, as was the lowering of the top rate from 8.5 percent to 7.95 percent. At the same time, the budget pressures that resulted in part from the tax cut were one reason for the temporary increases in the sales tax rate that also took effect in late 2013. Though these changes are real, there is little sense that they have "solved" Maine's tax and budget problems for the long term.

The most significant property tax reform since 2005 was the redesign of the circuit breaker program for 2014. Integrated into the income tax filing, it is expected that many more eligible recipients will now file for property tax refunds under the redesigned program. However, the maximum refund has been reduced from $2,000 following LD 1 to $1,600 in recent years to just $300 ($400 for those over age 70) now. The program also uses a substantially narrowed income measure to determine eligibility, but a significantly higher tax burden threshold to qualify. While simpler to administer, this will increase eligibility to some taxpayers and decrease eligibility for others in ways that may correspond less precisely to need.

Whatever its objectives, it is likely that tax reform will remain a visible and controversial subject of policy discussions. The aim of this paper is to update the tax-related data that I presented in earlier work, accounting for the changes in tax policy of the last few years, and to discuss how alternative approaches to reform might be evaluated and structured to achieve different goals, such as progressivity, growth, revenue stability, and exportability.

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