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This is a draft of the report of the Tax Expenditure Review Task Force. The Task Force was required to complete its work by December 4, 2013. The Task Force believes that its work would be greatly assisted by the availability of reports from other groups that are due between December 1, 2013 and February 1, 2014 and unavailable to the Task Force during its assigned timeframe. The Task Force will continue to monitor those efforts and may have additional comments to provide in February 2014.

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TAX EXPENDITURE REVIEW TASK FORCE
REPORT

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EXECUTIVE SUMMARY

Background

The Tax Expenditure Review Task Force was created in Public Law 2013, chapter 368, Part S. The Task Force was directed to examine and evaluate tax expenditures under Maine law, review the procedures used to evaluate tax expenditures in other states and identify best practices in tax expenditure review, develop a process for on-going evaluation of tax expenditures and recommend the repeal or reduction of tax expenditures to achieve a savings of at least $40,000,000 in fiscal year 2014-15. The legislation creating the Task Force also provided that if legislation generating an increase in budgeted General Fund revenue of at least $40,000,000 was not enacted into law before July 1, 2014, the amount transferred from the Local Government Fund to the General Fund for state and local revenue sharing in fiscal year 2014-15 would be decreased by $40,000,000.

The Task Force was directed to submit a report of its findings and recommendations and implementing legislation to the Joint Standing Committee on Appropriations and Financial Affairs by December 4, 2013. The committee was authorized to submit legislation to the Second Regular Session of the 126th Legislature.

The Task Force was composed of 13 members, including 4 legislators and 8 members of the public selected by the President of the Senate and the Speaker of the House and the Commissioner of Administrative and Financial Services, or the commissioner’s designee. Senator Anne M. Haskell and Rep. Adam A. Goode were designated as chairs of the Task Force.

Framework of tax expenditure review

Maine law currently provides several different processes for review of tax expenditures. The term is generally defined to include provisions of Maine tax laws that reduce state revenues through the allowance of an exclusion, exemption or deduction or a credit, preferential rate of tax or deferral of tax liability. Ongoing reviews are conducted by the Joint Standing Committee on Taxation in response to the biennial tax expenditure report prepared by Maine Revenue Services, by the Joint Standing Committee on Appropriations and Financial Affairs in considering the tax expenditure information required to be submitted by the executive branch as part of the biennial budget process and through periodic reviews of economic development incentives pursuant to contracts.
by the Department of Economic and Community Development and other executive and legislative branch entities.

Other current activities

The Task Force worked on a parallel course with separate Task Forces established during the First Regular Session to recommend a process for transition of the BETR program to the BETE program and to identify options for imposing an assessment on nonprofit entities benefiting from tax exemptions. In addition, by the time the Task Force was appointed, the Office of Program Evaluation and Government Accountability (OPEGA) was already working on developing a proposal for ongoing legislative review of tax expenditure programs as required by a special project assigned to OPEGA by the Legislature’s Government Oversight Committee (GOC). OPEGA kept the Task Force informed of GOC activities and sought input from the Task Force on key elements in designing a reasonable, efficient and effective process. That work continues.

Activities of the Task Force

The Tax Expenditure Review Task Force met 6 times. The Task Force monitored the work of groups working on a parallel course on issues related to the review of tax expenditures. The Task Force received presentations from staff of the Office of Program Evaluation and Government Accountability and the Pew Center on the States under the auspices of Pew Charitable Trusts regarding the experiences of Maine and other states in the evaluation of tax expenditures. The Task Force reviewed tax expenditure review spreadsheets developed by the OPEGA based on the Maine Revenue Services State Tax Expenditure Report and narrowed its focus to those expenditures for which repeal or adjustment might meet the obligation of the Task Force to identify $40,000,000 in General Fund savings in fiscal year 2014-15. The Task Force received additional information from Maine Revenue Services regarding particular aspects of individual tax expenditures under review. The Task Force devoted a portion of one of its meetings to a public comment period and received many useful suggestions from invited participants as well as other members of the public.

The Task Force emphasizes that the development of a process for independent evaluation of tax expenditures is necessary in order to permit an effective evaluation by the Legislature of tax expenditures. The lack of an effective process has stood in the way of many previous attempts to complete this important work. The Task Force dedicated a substantial portion of its activities to discussions with OPEGA and the Pew Center and its monitoring of the work of the Government Oversight Committee in the design of an
evaluation process and believes this effort to be one of its most important accomplishments.

Recommendations:

1. **On-going evaluation process.** The Task Force recommends that the Joint Standing Committee on Appropriations and Financial Affairs continue work with OPEGA, the Government Oversight Committee and the Joint Standing Committee on Taxation in the development of an ongoing process for evaluation of tax expenditures and report out legislation to implement this process to the Second Regular Session of the 126th Legislature.

2. **General Fund savings.** The Task Force recommends that the Appropriations Committee consider the following modifications of tax expenditures:

   a. Amend the income tax law to provide nonconformity with federal income tax election of LIFO inventory accounting ($10M);

   b. Use funds in the Tax Relief Fund ($4M);

   c. Amend the BETR program to provide that property first placed in service on or after April 1, 2014 at a retail sales facility not be eligible for reimbursement of property taxes ($1M to $3M);

   d. Explore sales tax modifications on:
      i. treatment of the taxation of sales of lodging through online travel companies; and
      ii. treatment of sales of online digital streaming of video and audio media;

   e. Cap the historic rehabilitation income tax credit at $5M in fiscal year 2015 ($2.9M);

   f. Restore the original 12-year eligibility term under the BETR program;

   g. Eliminate the Pine Tree Development Zone income tax credit for future entrants to the Pine Tree Zone program ($3.3M);
h. Eliminate certain research and technology income tax credits
   - Research expense credit ($0.8M)
   - Supercredit for substantially increased research and development ($4.0M)
   - High-technology investment tax credit ($1.0M);

i. Change treatment under the sales tax of certain vending machine sales from wholesale to retail level application. ($0.4);

j. Reduce ETIF reimbursements by 20% in fiscal year 2014-15 ($1.5M);

k. Amend the income tax law to cap the credit for educational opportunity at 2014 levels ($1.7M);

l. Reduce sheltering of income from taxation through use of “tax havens” ($?).

3. Additional recommendations regarding expansion of the sales tax to certain services
   a. Amusement, recreation and entertainment services ($22.6M);

   b. Other service expansion:
      i. Basic cable and satellite TV services ($4.4M);
      ii. Certain personal care services ($22M);
      iii. Trust fiduciary and custody services ($2.3M);
      iv. Other direct commissions ($3.5M).
I. Background

A. Creation of the Task Force

The Tax Expenditure Review Task Force was created in Public Law 2013, chapter 368, Part S. The Task Force was directed to:

1. Examine tax expenditures as defined in the Maine Revised Statutes, Title 36, section 199-A and evaluate specific tax expenditures that provide a direct benefit to business as a catalyst for economic growth or that exempt property from municipal taxation;
2. Review best practices and standardized criteria used by other states for measuring the effectiveness of tax expenditures;
3. Determine the purpose of each tax expenditure identified by the task force for evaluation and the data required to measure the economic impact of each tax expenditure, including, but not limited to, revenue loss compared to economic gain, jobs created or retained and administrative burden for taxpayers and the State;
4. Prioritize tax expenditures and give highest priority to those tax expenditures that reduce the tax burden on necessities of life, that avoid pyramiding of taxes or that are essential to Maine's economic growth and job creation;
5. Develop a process, including a time frame and criteria, for ongoing evaluation of tax expenditures that may include the establishment of an independent commission, tax expenditure budgets, tax expenditure caps and sunset reviews; and
6. Recommend the repeal or reduction of tax expenditures to achieve a savings of at least $40,000,000.

PL 2013, c. 368, §S-5

The legislation creating the Task Force also provided that if legislation was not enacted into law before July 1, 2014 generating an increase in budgeted General Fund revenue of at least $40,000,000 in fiscal year 2014-15, the amount transferred from state-municipal revenue sharing to the General Fund in fiscal year 2014-15 would be increased by $40,000,000 thereby reducing revenue sharing by that amount.

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1 See Appendix A.
2 § 5 MRSA §199-A, subsection 2 defines “tax expenditure:
2. **Tax expenditure.** "Tax expenditure" means any provision of state law that results in the reduction of tax revenue due to special exclusions, exemptions, deductions, credits, preferential rates or deferral of tax liability.
The task force submits this report to Joint Standing Committee on Appropriations and Financial Affairs pursuant to its charge. The task force wishes the Appropriations Committee to know that its charge has been a difficult and unpopular one, but the members struggled mightily and in good faith to carry it out. The recommendations of the task force reflect serious debate and consideration, albeit in the absence of adequate data on which to base them. The members used available data and applied their judgment in an effort to be fair and protect the interests of all Mainers. While the task force recognizes that repealing or reducing tax incentives will have a negative impact on those taxpayers affected, the members also recognize that our task is to achieve budget savings, and that task will always involve a negative impact on some individual or group.

**B. Membership**

The Task Force was composed of 13 members, including 4 legislators and 8 members of the public selected by the President of the Senate and the Speaker of the House and the Commissioner of Administrative and Financial Services, or the commissioner’s designee. The members of the Task Force can be found in Appendix B. Senator Anne M. Haskell and Rep. Adam A. Goode were designated as chairs of the Task Force.

The Task Force received staff assistance from legislative staff in the Office of Fiscal and Program Review and the Office of Program Evaluation and Government Accountability.

**II. Framework of tax expenditure review**

Maine law currently provides several different processes for review of tax expenditures. The term is generally defined to include provisions of Maine tax law that reduce state revenues through the allowance of an exclusion, exemption or deduction or a credit, preferential rate of tax or deferral of tax liability. Ongoing reviews are required in the following contexts.

**A. Joint Standing Committee on Taxation**

The Maine Legislature recognized the importance of tax expenditures in the budget process as early as 1978. Public Law 1977, chapter 696 established a process that required the Joint Standing Committee on Taxation to undertake a 4-year rotating cycle of review and make recommendations to the Legislature regarding the retention, repeal or amendment of tax expenditures and property tax
exemptions. This process continued until 2002 when the law was amended to direct Maine Revenue Services to submit to the Joint Standing Committee on Taxation a biennial report regarding tax expenditures including recommendations for amendment, repeal or replacement of each expenditure during each odd-numbered year. The committee was authorized to review the report and submit legislation to the Legislature to implement its recommendations. In even-numbered years the committee is also authorized to identify and review areas of tax policy, including tax expenditures. In the last 10 years, the committee has also conducted in-depth reviews of tax expenditures in the context of several tax reform proposals.

B. Budget process

Laws governing the submission by the Governor to the Legislature of the biennial unified budget require the inclusion within the budget document of a part identifying and describing tax expenditures and asking the Legislature whether it wishes to continue funding for those expenditures. The list of tax expenditures and the fiscal impact of each that is provided as part of the budget process is the same as the information provided to the Legislature in the tax expenditure report required under Title 36, chapter 10. Originally, the entire list of tax expenditures was included as a lettered Part in the budget bill. In recent years, the Part simply includes a statement authorizing the continuation of the tax expenditures listed in the budget document. The inclusion of the tax expenditure provisions in the budget are considered by the Joint Standing Committee on Appropriations and Financial Affairs and the Joint Standing Committee on Taxation as part of regular budget deliberations.

C. Economic development incentives

In 1998, the Legislature created a process to set in place an in-depth evaluation of certain economic development incentives including 5 incentives that were also included on the list of tax expenditures. The Economic Development Incentive Commission (EDIC) was established to gather data, analyze the impact of identified economic development incentives on the number and quality of jobs.

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3 36 MRSA c.10.
4 5 MRSA §1666.
5 See PL 2013, chapter 368, Part T.
6 PL 1997, c. 761 included among the provisions subject to review municipal tax increment financing, employment tax increment financing, the jobs and investment income tax credit, the research expense income tax credit and the business equipment tax reimbursement program (commonly referred to as the BETR program).
created by those incentives and report biannually to the Legislature, the Governor and the Commissioner of Economic and Community Development regarding the rate of return to the State on its economic development investments. Businesses benefiting from incentives were required to report information to the Department of Economic and Community Development (DECD) annually to facilitate analysis.

The EDIC process was unraveled and transformed over the next 10 years. The commission was repealed in 2001 pursuant to its own recommendations based on the practical difficulties involved in expecting a politically appointed body to agree on evaluation parameters and process and the lack of funding for independent analysis. The business reporting requirement was repealed in 2009 making unavailable even the minimal level of data that had been collected previously.

In the early 2000s the Legislature focused general attention on providing incentives to spur economic development, especially in the area of research and development. In 2004 legislation was enacted requiring the Office of Innovation within DECD to contract with independent reviewers to evaluate the impact of research and development activities on economic development in the State.\(^7\) Originally required every 5 years the review is now required every 2 years and is due February 1\(^{st}\) of even-numbered years. In 2007 DECD was required to contract for a similar evaluation with regard to certain tax expenditures and other programs identified in statute and by the department as having an impact on economic development. Funding for the evaluation was problematic; however, in 2013 sufficient funding was identified to contract for the evaluation, and a report to the Legislature is anticipated February 1, 2014.\(^8\)

III. Related legislative initiatives currently underway

In addition to the establishment of the Tax Expenditure Review Task Force, the Legislature initiated several other interim studies that have an impact on the work of the Task Force. The Task Force has followed the work of these groups and taken into consideration the direction of their work. These efforts include the following.

A. Government Oversight Committee Special Project on Tax Expenditure Programs.

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\(^7\) 5 MRSA §13107.
\(^8\) 5 MRSA §13056-A.
By the time the task force was appointed the Office of Program Evaluation and Government Accountability (OPEGA) was already working on developing a proposal for ongoing legislative review of tax expenditure programs as required by a special project assigned to OPEGA by the Legislature’s Government Oversight Committee (GOC). OPEGA was also already drawing on the expertise of the Pew Center on the States in developing a proposed process. Consequently, the Task Force has drawn on the work and expertise of OPEGA and the Pew Center in addressing the portion of its duties related to developing an ongoing legislative review process.

OPEGA has kept the Task Force apprised of the status of its work and involved in the development of its proposal. OPEGA sought input from the Task Force on key elements in designing a reasonable, efficient and effective process. For example, the Task Force served as a forum for discussion and guidance on which entities were most appropriate for particular roles and responsibilities under the proposed legislative review process. OPEGA shared the Task Force’s input with the Government Oversight Committee in the course of also seeking that Committee’s input on the process design of an evaluation process.

OPEGA, with assistance from the Pew Center, has incorporated the input from the Task Force and the GOC in designing a proposed process for ongoing legislative review of tax expenditures, and has drafted the outline of a bill to establish this process. A preliminary draft of an outline of a bill is included as Appendix C. Further refinements may be developed over the next few months as the work of the GOC is this area continues.

B. BETR/BETE Task Force

Public Law 2013, chapter 368, section K-2 required the Commissioner of Administrative and Financial Services to convene a task force to study the most efficient and economical way to transition the Business Equipment Tax Reimbursement (BETR) program providing state reimbursement for property taxes on certain business equipment to the Business Equipment Tax Exemption (BETE) program providing a local property tax exemption. A transition proposal contained in the Governor’s budget was deemed to require further analysis to address identified complications.

Because the BETR and BETE programs are significant components of the tax expenditure environment, the Tax Expenditure Task Force has followed the
work of the BETR/BETE task force. Given that the BETR/BETE task force appears to be focusing on the transition process rather than the retention or modification of the programs, the Tax Expenditure Review Task Force has maintained those programs within its purview.

The BETR/BETE task force is required to submit a report and recommended legislation to the Joint Standing Committee on Taxation by December 1, 2013. The Committee is authorized to submit a bill related to the subject matter to the Second Regular Session.

C. Nonprofit Tax Review Task Force

Public Law 2013, chapter 368, Part AA required the Commissioner of Administrative and Financial Services to convene the Nonprofit Tax Review Task Force to evaluate the potential for imposing a temporary assessment on certain nonprofit organizations that would generate approximately $100,000,000 in annual revenue and to examine how other states and municipalities require services charges or payments in lieu of taxes from owners of property that is exempt from property taxes. In addition to examining a process and parameters for such an assessment, the task force was directed to recommend a process to transfer the revenue from the assessment to municipalities. Given that the direction of the nonprofit task force appears to be focused on the impact of property tax exemptions, the Tax Expenditure Review Task Force maintained within its purview, sales tax expenditures that benefit nonprofit organizations.

The Nonprofit Tax Review Task Force is required to submit a report and recommended legislation to the Joint Standing Committee on Appropriations and Financial Affairs and the Joint Standing Committee on Taxation by December 1, 2013. The Appropriations Committee is authorized to submit a bill related to the subject matter to the Second Regular Session.

IV. Activities of the Task Force

The Tax Expenditure Review Task Force met 6 times.
The task force reviewed reports of the work of the Government Oversight Committee in the development of an on-going process for evaluation of tax expenditures and received presentations from staff of the Office of Program Evaluation and Government Accountability and the Pew Charitable Trusts regarding the experiences of Maine and other states in the evaluation of tax expenditures. The task force reviewed tax expenditure review spreadsheets developed by the OPEGA based on the Maine Revenue Services State Tax Expenditure Report and narrowed its focus to those expenditures for which repeal or adjustments might meet the obligation of the task force to identify $40,000,000 in General Fund savings in fiscal year 2014-15.

The task force received additional information from Maine Revenue Services regarding particular aspects of individual tax expenditures under review. The task force invited the Commissioner of Economic and Community Development and his staff to meet with the Committee to discuss the progress of the department’s contract with an independent contractor for review of certain tax expenditures and to provide insight into the department’s experience with the impact of Maine’s tax expenditures on business decision making. Those invitations were declined. A subsequent task force invitation to staff from Maine Revenue Services to assist the task force in the understanding and discussion of certain tax expenditures was also declined.

The task force devoted a portion of one of its meetings to a public comment period and received many useful suggestions from invited participants as well as other members of the public.

V. Recommendations:

A. Process for on-going evaluation

1. The task force recommends that the Joint Standing Committee on Appropriations and Financial Affairs continue work with OPEGA, the Government Oversight Committee and the Joint Standing Committee on Taxation in the development of an ongoing process for evaluation of tax expenditures and report out legislation to implement this process to the Second Regular Session of the 126th Legislature.

The task force reviewed current and prior procedures in state government related to the evaluation of tax expenditures. Staff from OPEGA prepared detailed spreadsheets incorporating information from the most recent Maine State
The task force received regular reports regarding the activity of the Government Oversight Committee and OPEGA in the development of a process for on-going evaluation of tax expenditures. An outline of that process can be found in Appendix C. While the process is not sufficiently developed to permit a draft of comprehensive legislation in time for its December 4th reporting date, the task force has directed staff to provide a comprehensive draft to the Appropriations Committee for consideration in January.

The task force believes that the development of a process for independent evaluation of tax expenditures is necessary in order to permit an effective evaluation of tax expenditures. The Task Force is generally supportive of the draft process that OPEGA has outlined and recommends that AFA give it serious consideration. Members of the Task Force offer the following questions for AFA’s further consideration as the details of any proposed legislation are developed:

- Is the GOC the appropriate body to be approving the goals and performance metrics that will be used in evaluating tax expenditures or should it be the Taxation Committee?
- Is there enough flexibility provided in the process to allow for reviewing and evaluating a particular tax expenditure in a year other than when it is scheduled to be reviewed?
- Is there sufficient provision for coordination between OPEGA, DECD and other relevant agencies to ensure there is not duplication of effort and resources among the various ongoing evaluations that include tax expenditure programs, i.e. evaluations of economic development and research and development programs?
- What can be done within or outside this process to ensure that data and information needed to evaluate any particular tax expenditure is already being collected and available prior to when its evaluation is scheduled for, i.e.
should businesses be required to disclose or report certain data on a prescribed form and timeframe?

The Task Force notes that establishing a new process for ongoing legislative review of tax expenditures will require additional resources for the entities involved in the process. As the process is currently designed, the bulk of those resources would be needed in the Office of Program Evaluation and Government Accountability. The task force does not intend for OPEGA to absorb this additional work within existing resources which would have a significant impact on the office’s current capacity to respond to legislative requests and interests. An accurate estimate of the level of additional resources needed, however, has not yet been developed.

B. General Fund savings

The most difficult part of the duties of the task force was the development of recommendations to achieve General Fund savings in fiscal year 2014-15 of at least $40,000,000. The task force began the task of identifying additional revenues by considering all tax expenditures. It refined its review based on the considerations listed below. That process resulted in the following recommendations. The list below includes estimates of the revenue increase resulting from implementing most recommendations. There are a few recommendations for which no fiscal information was available in time for this report. It should be noted that estimates are preliminary and were based upon work that was done for the MRS tax expenditure report or preliminary estimates for previous legislation. Further analysis will be necessary to determine the actual amount of revenue that may be projected and will depend on the effective date of the legislative changes. Estimates are for a full fiscal year. Actual savings will depend upon the effective date of any changes.

Members of the Task Force want to make it very clear that our charge was not to determine whether or not we think these tax expenditures should be eliminated. Our task was to determine that, if we are going to eliminate tax expenditures, which ones are the best to eliminate. In a perfect world, we would give tax breaks to everyone while still providing government services to everyone and manage the functions of the State with ample resources.

To maximize the use of the time available to complete its duties, the task force excluded from its review tax expenditures having an estimated impact of less than $250,000.
The activities of the task force were conducted with recognition of the following considerations.

1. **Constraints.** The work of the task force was hindered by the following constraints.

   a. **Lack of useful data.** The Task Force did not have adequate data to evaluate most tax expenditures. While the biennial MRS tax expenditure report forms an excellent starting point for review of tax expenditures, it does not in many instances contain the kind of information necessary either to evaluate the effectiveness of a tax expenditure or to provide the kind of information necessary to determine the fiscal impact of the repeal or reduction of a particular tax expenditure. Estimates of fiscal impact in the report are frequently based on economic assumptions and modeling rather than specific experience. Identifying and gathering such information is an enormous task which awaits the development of a process for on-going evaluation.

   The task force had hoped to discuss with the Department of Economic and Community Development its experience with administration of some of the tax expenditures being considered by the task force, its insights on the role of tax expenditures in the promotion of economic activity in the State and the work of the independent contractor hired by the department to conduct a comprehensive evaluation of a variety of tax expenditures, among other economic development incentives. While the department responded to written questions from the task force, the task force felt the need for a conversation with the department that permitted the opportunity to explore options and ask follow-up questions. The department declined to send a representative to the meetings of the task force.

   b. **Difficulty of evaluating the impact of tax expenditures on business or consumer decisions.** When a new tax expenditure or modification of an existing tax expenditure is proposed to the Legislature, claims frequently are made regarding the effectiveness of the tax expenditure in promoting job creation, increasing business investment and improving the ability of the state to attract or maintain business activity. Imposing taxes on business or consumer activity are criticized for the potential to damage the competitiveness of instate businesses and divert purchasing to out-of-state sources to avoid taxation. Reference is frequently made to the importance
to taxpayers of consistency and predictability. The Task Force does not discount any of these factors; however, they are very difficult to evaluate without extensive data and economic analysis.

2. **Additional considerations.** The recommendations of the task force should be viewed in the following context.

a. **No choices are completely desirable.** All options to repeal or reduce tax expenditures reviewed by the task force are undesirable to at least some members of the task force; however, if the task force is to complete its duties, some choices must be made. If the Legislature does not enact General Fund savings of $40,000,000 in fiscal year 2014-15, state-municipal revenue sharing will be reduced by that amount, which is also an undesirable result.

b. **The task force focused on avoiding new taxes and increasing rates of existing taxes.** While some members of the task force prefer to identify revenue to fund state-municipal revenue sharing by increasing tax rates on some items such as tobacco products, beer and wine or meals and lodging, other members of the task force consider the repeal of existing exemptions and credits as a tax increase, at least for those taxpayers who were previously exempt. While not discounting those preferences, the task force attempted to walk a middle path that addresses existing exemptions and credits. The task force includes in the report options that would extend the sales tax to certain previously untaxed services. The task force does not include them as recommendations, but as options considered by the task force in case the Appropriations Committee might want to explore them. In its discussions, the task force emphasized the goals of lessening the burden of taxation on low income residents, maximizing the exportability of taxes to nonresidents and choosing services that were in large part discretionary. The task force considered whether persons not previously collecting sales tax would be required to do so. The task force also considered the work of the Legislature during the First Regular Session on **LD 1496, An Act To Modernize and Simplify the Tax Code,** sponsored by Rep. L. Gary Knight.

c. **The role of consistency.** The task force endeavored to provide that tax changes would not affect business investment decisions that were previously made. The task force recommends, with regard to business tax expenditures, that modifications provide that the benefit of those
expenditures be repealed or reduced prospectively, only, and permit the credits to continue to be available for investments made by businesses before the date of the modification. When taxpayer expectations cannot always be maintained, the members recognize that many other budget decisions have resulted in hardships for individuals who have depended on the availability of certain government programs, for municipal governments that have depended on state funding of certain activities and for property taxpayers who have depended on a stable level of property tax payments.

d. **Potential for additional revenue from enforcement.** Some members of the task force might suggest that additional revenue might be obtained under existing laws through increased enforcement activities. While this potential opportunity is outside of the purview of the task force, it may be a resource that the Appropriations Committee should explore if other options are not chosen.

e. **Caps on tax expenditures.** The task force considered suggesting that caps be adopted on certain tax expenditures, mainly income tax expenditures. Although some potential may exist in this area, not all income tax expenditures lend themselves to this type of limitation. The task force did not have sufficient time to explore this category.

**Group 1. Tax expenditures (other than expansion of sales tax to previously untaxed services):**

*The task force recommends that the Appropriations Committee consider the following modifications of tax expenditures.*

The task force experienced particular frustration with making recommendations in this category due to the lack of data necessary to make a considered evaluation of the effectiveness of tax expenditures intended to provide an incentive for business or other activity. It is in this area that the task force especially hoped to look to the work being done by the independent contractor working for DEDC to evaluate business tax incentives; however, it appears that the results of that evaluation will not be available to the Legislature until DECD submits its comprehensive evaluation of state investments in economic development to the Legislature as required under 5 MRSA §13056-A.
While the task force does not want to discourage business investment in the state, the members recognize that all sectors of the economy are suffering in the current economic environment and that cuts in state support must be apportioned, in some part to all sectors.

The following recommendations are presented in order of priority as ranked by members of the task force.

1. **Amend the income tax law to provide nonconformity with federal income tax election of LIFO inventory accounting ($10M)**

Information provided to the Task Force indicates that oil and gas companies are the primary beneficiaries of this accounting rule, regarded unacceptable outside the United States, that allows them to deduct the most recent (and therefore expensive) commodity purchases to determine their corporate income tax liability. The savings indicated is based on an estimate of how national data applies in Maine.

Under federal income tax law (incorporated into Maine income tax law) businesses may choose between different methods of writing off the cost of inventories against income. Federal law permits the use of LIFO (last-in-first-out) accounting to businesses that choose that method under appropriate circumstances. This option reduces income taxes for the business below what they might pay using other accounting methods. It is reportedly of value to a relatively small number of businesses.

This proposal would deprive businesses in Maine of the option to use LIFO accounting methods and result in additional income tax revenue resulting from the requirement to update the cost of inventory to meet new requirements.

2. **Use funds in the Tax Relief Fund ($4M)**

While the revenue in the Tax Relief Fund is not technically a “tax expenditure” it does constitute a portion of the unappropriated surplus of General Fund revenue collected in fiscal year 2012-13. Current law requires that 20% of that surplus be transferred to the Tax Relief Fund to be used eventually to reduce income tax rates. The Tax Relief Fund currently contains approximately $4,000,000.

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9 5 MRSA §1536, subsection 1.
10 5 MRSA §1518-A.
This option would use the surplus revenues in the Tax Relief Fund to help restore state municipal revenue sharing. This choice would be preferable to the repeal of any tax expenditure in that it helps alleviate the burden on the property tax without any taxpayer being required to pay additional taxes.

3. **Amend the BETR program to provide that property first placed in service on or after April 1, 2014 at a retail sales facility not be eligible for reimbursement of property taxes. ($1M to $3M)**

The Business Equipment Tax Reimbursement (BETR) program reimburses businesses for eligible personal property placed in service after April 1, 1995 in a qualified business activity. The Business Equipment Tax Exemption (BETE) program replaced most BETR reimbursement for new property with a property tax exemption for eligible property placed in service on or after April 1, 2008. The BETE program does not exempt property located at a retail sales facility; however, eligible property placed in service at a retail sales facility after April 1, 2008 may continue to be eligible for reimbursement under BETR if not located at a retail sales facility larger than 100,000 square feet. While technically not a tax expenditure, the BETR and BETE costs are treated for budget purposes as revenue adjustments and funded by a transfer from General Fund revenues rather than by a General Fund appropriation.

The BETR/BETE programs are generally identified as programs provided to encourage capital investment in the state. Many observers believe that investments in retail activity depends more on customer demand than tax incentives and that state support for investment in retail businesses is not warranted.

The savings attributable to this recommendation need further refinement.

4. **Explore sales tax modifications on:**
   a. **Treatment of the taxation of sales of lodging through online travel companies**

   This option is not a tax expenditure included in the MRS tax expenditure report; however, it is a provision of Maine sales tax law that results in reduced sales tax revenue.
Travelers wishing to spend time in Maine frequently book lodging through online travel companies such as Travelocity and Expedia. The online travel companies typically contract with the operator of the lodging for the use of rooms and then sell the rooms online to travelers at a higher price than the travel company paid the lodging operator. Under current Maine law, the taxable sale is considered to be the sale from the lodging operator to the online travel company and the taxable sales price is the lower price charged by the lodging operator to the travel company rather than the price paid by the traveler to the travel company.

This proposal would change the law to provide that the retail sale is the sale to the traveler and calculate sales tax based on the higher price paid by the traveler. Other states are also pursuing this type of treatment of the sale. In fact, New Hampshire’s Attorney General has filed a law suit alleging that online travel companies are required under New Hampshire law to collect the higher level of sales tax.\textsuperscript{11}

\begin{itemize}
\item[b.] Treatment of sales of online digital streaming of video and audio media
\end{itemize}

Maine’s sales tax law applies to the sale of tangible personal property (with exemptions and exclusions) and to specified services. Tangible personal property covered under the sales tax includes non-custom computer software but does not include other digital products. The parallel service provider tax imposes a sales tax on the sale of other specified services including the rental of video and audio media but does not include streamed delivery of those products.

This proposal would amend Maine law to provide that online streaming of video and audio content would be subject to taxation in the same manner as rental of video and audio media under the service provider tax.

\section{Cap the historic rehabilitation income tax credit at $5M in fiscal year 2015 ($2.9M)}

Maine law provides a refundable income tax credit equal to 25\% of certified qualified rehabilitation expenditures, as defined under the Internal Revenue Code, for which a federal income tax credit is available for rehabilitation of a certified

\footnote{State Tax Notes, November 11, 2013, p. 345.}
historic structure located in the state. The credit is increased to 30% for certified affordable housing projects. The credit may not exceed $5,000,000 per project and must be taken over four years.\footnote{36 MRSA §5219-BB. The credit is also allowable against the insurance premium tax, 36 MRSA §2534.}

Maine Revenue Services estimates that the amount of revenue lost as a result of this exemption will be $7,900,000 in fiscal year 2014-15. This recommendation would provide that the total amount of the credit be capped at $5,000,000 in that fiscal year. If the total of credits claimed for that year exceeds $5,000,000 each credit would be prorated to maintain the permitted level of revenue loss. Further review of this program should be done to evaluate the effectiveness of the credit, its recent growth and its impact on employment, housing and property taxes.

6. **Restore the original 12-year eligibility term under the BETR program**

When the BETR program was originally enacted in 1995, eligibility for reimbursement of property taxes on eligible business property was limited to 12 years. When the Business Equipment Tax Exemption (BETE) program (with no eligibility term limitation) was enacted in 2006 to replace BETR, it applied to property newly placed in service. To alleviate the disparity between the two programs, the legislation removed the 12 year restriction on property that remained under the BETR program and phased down the percentage of reimbursement to 50% by the 17\textsuperscript{th} year the property is in service. Property remaining under the BETR program is property placed in service before April 1, 2008 and eligible property located at a retail sales facility that does not exceed 100,000 square feet of interior customer selling space regardless of when placed in service.

This option would provide that BETR eligibility return to the original 12 year limitation.

7. **Eliminate the Pine Tree Development Zone income tax credit for future entrants to the Pine Tree Zone program ($3.3M)**

The Pine Tree Development Zone credit provides an income tax credit for a qualified Pine Tree Development Zone business equal to 100% of the income tax that would otherwise be due in the first 5 years of qualified business activity and,
for qualified businesses located in high unemployment areas, 50% of the income tax otherwise due in years 6 through 10 of business activity.

The task force recommends that the income tax credit for Pine Tree Development Zone businesses that qualify after July 1, 2014 be repealed or reduced unless it can be demonstrated that such action will be detrimental to the Maine economy.

8. **Eliminate certain research and technology income tax credits**
   - **Research expense credit ($0.8M)**
   - **Supercredit for substantially increased research and development ($4.0M)**
   - **High-technology investment tax credit ($1.0M)**

Some members of the task force recommend that these income tax credits may be good subjects for repeal or modification. The task force recognizes that the activities subsidized by these credits are among the most desirable for the state to acquire; however, the subsidized activities are also generally eligible for federal income tax credits and other subsidies that may lessen the impact of the income tax credits. Given the lack of available data the task force is unable to determine the efficacy of these credits in attracting new research and development activity. Further analysis is warranted, and additional information may become available after the report of DECD in February 2014. Committee members wanted to clarify that all credit carry-forwards should be permitted as allowed under current law. The repeal or modification would apply to new expenditures made after the effective date of the legislation.

9. **Change treatment under the sales tax of certain vending machine sales from wholesale to retail level application. ($0.4)**

Maine sales tax law provides that food and drinks sold through vending machines by persons who derive more than 50% of their gross receipts from vending machine sales are taxed at the wholesale price rather than the price charged at the vending machine.\(^{13}\)

Maine Revenue Services estimates that the amount of revenue loss as a result of this treatment will be $442,955 in fiscal year 2014-15. This recommendation

\(^{13}\) 36 MRSA §1752, subsection 11, paragraph A and §1760, subsection 34.
would provide that these sales be taxed at the price charged at the vending machine as are other vending machine sales.

10. **Reduce ETIF reimbursements by 20% in fiscal year 2014-15 ($1.5M)**

The Employment Tax Increment Financing program (ETIF) provides payments to employers who hire five or more employees who are provided group health insurance and a qualified retirement program and are paid more than the average per capita income for the county in which the job is located. The payment to the employer is a percentage of withholding taxes withheld by the employer for the eligible employees and paid to the State. The payment lasts for 10 years and is 30%, 50% or 75% depending on the unemployment rate in the labor market where the job is located or 80% for qualified Pine Tree Zone employees.

This option would provide that payments to employers in fiscal year 2014-15 be reduced 20% in a similar manner to reductions in the BETR program during that year under current law.

11. **Amend the income tax law to cap the credit for educational opportunity at 2014 levels ($1.7M)**

Maine law provides an income tax credit for certain educational loan payments for Maine residents who earn an associate or bachelor’s degree from a Maine college or university and who subsequently live, work and pay taxes in Maine. An employer who repays loans for an eligible employee may also claim the credit. Beginning in 2013 the individual credit is refundable for a person whose degree is in science, technology, engineering or mathematics.\(^ {14}\)

Maine Revenue Services estimates that the revenue loss from this credit will be $3,530,000 in fiscal year 2013-14 and $5,210,000 in fiscal year 2014-15. This option would provide that the total revenue loss for this credit for fiscal year 2014-15 be capped at the revenue loss in 2013-14 with each eligible individual’s credit being prorated to achieve the necessary savings.

12. **Reduce hiding or sheltering of income from taxation through use of “tax havens”**

\(^ {14} \) 36 MRSA §5217-D
The income of multistate and international corporations that do business in Maine is apportioned according to a formula that determines the portion of a corporation’s income that may be taxed in a given jurisdiction. When a corporation has international activities, states generally apply a formula that takes into consideration either worldwide activities or United States-only activities (water’s edge apportionment). Maine is a water’s edge apportionment state. Because water’s edge states do not consider income attributable to a foreign jurisdiction, some corporations are able to arrange their activities in a way that locates as much income as possible in foreign jurisdictions with little or no income tax (sometimes referred to as tax havens.)

Some other water’s edge apportionment states, notable Montana and Oregon are attempting to limit the ability of corporations to hide or shelter income in off-shore jurisdictions by providing that income in certain countries most identified as tax havens must be included in the state’s apportionment formula. This proposal would add Maine to those states.

C. Additional recommendations regarding expansion of the sales tax to certain services

The Task Force spent a significant amount of time exploring the expansion of sales tax to categories of services identified as tax expenditures in the MRS State Tax Expenditure Report. There was disagreement among members of the Task Force as to whether the expansion of sales tax to previously untaxed categories of services constitutes a tax increase or the elimination of tax preferences. Many members believe that regardless of how the recommendations are characterized the expansion of the sales tax to these services is the least harmful way to alleviate cuts to state municipal revenue sharing and protect Maine’s most vulnerable residents and the overall economy.

Some members believe expansion of the sales tax to currently untaxed services is outside the direction given to the Task Force or should be considered only in the context of comprehensive tax reform. There was opposition to repealing sales tax exemptions to achieve the $40,000,000 savings in light of the recent budget and its impact on property taxes and sales taxes. Opponents of a sales tax expansion felt it was more balanced to focus on spending on tax incentives and tax credits.

While the supporters of the expansions identified in this section recognize that such expansions may not be popular, they believe strongly that worthwhile
options should not be abandoned because there may be opposition. They believe that these recommendations should be available for consideration by the Appropriations Committee in designing legislation to preserve state-municipal revenue sharing.

1. **Amusement, recreation and entertainment services (as envisioned under LD 1496) ($22.6M)**

In addition to the options recommended in section V.B. above, many members of the Task Force support expanding the sales tax to this category of services that has traditionally not been taxed in Maine. The members of the Task Force supporting this recommendation do so because these services are largely discretionary expenditures that are commonly subject to sales tax in other states and this category involves primarily discretionary spending and is likely more progressive in that higher income individuals are more likely to engage in more costly activities. This category is also highly exportable due to the large number of nonresidents who vacation in Maine.

2. **Other service expansion areas**

There is also both support and opposition from some members of the Task Force for expansion of the sales tax to the following categories of previously untaxed services:

A. Basic cable and satellite TV services ($4.4M)
B. Certain personal care services ($22M)
C. Transportation (limousine and courier services) ($1.0).
D. Certain financial, insurance and real estate services
   i. Portfolio management and investment advice services ($25.9M)
   ii. Trust, fiduciary and custody services ($2.3M)
   iii. Other direct commissions ($3.5M)

The Task Force did not have time to explore all of the categories of financial, insurance and real estate services; however, the three components under this category reflect areas where additional analysis in needed but may be appropriate items to consider.
Some members recommend a more in depth analysis of all of the categories of untaxed services in the MRS State Tax Expenditure Report to determine which may be characterized as discretionary spending with minimal impact on the most vulnerable, as having a high potential for exportability of the tax burden to nonresidents and which are items are commonly taxed in other states. As mentioned previously in this report, other members of the Task Force remain opposed to recommending repeal of sales tax exemptions.
Public Law 2013
Chapter 368

Part S

Sec. S-1. Tax Expenditure Review Task Force established. Notwithstanding Joint Rule 353, the Tax Expenditure Review Task Force, referred to in this Part as "the task force," is established.

Sec. S-2. Task force membership. The task force consists of 13 members as follows:

1. Six members appointed by the President of the Senate, including one Senator from each of the 2 parties holding the largest number of seats in the Legislature; 2 persons who are economists, tax experts or representatives of the business sector; a person who possesses expertise in the area of the state budget process; and a person who possesses expertise in the area of municipal budgeting and property taxes;

2. Six members appointed by the Speaker of the House, including one member of the House of Representatives from each of the 2 parties holding the largest number of seats in the Legislature; 2 persons who are economists, tax experts or representatives of the business sector; a person representing a business enterprise; and a person representing the general public; and

3. The Commissioner of Administrative and Financial Services or the commissioner's designee.

The President of the Senate and the Speaker of the House shall coordinate their appointments to avoid duplication.

Sec. S-3. Chairs. The first-named member of the Senate is the Senate chair and the first-named member of the House of Representatives is the House chair of the task force.

Sec. S-4. Appointments; convening; meetings. All appointments must be made no later than 30 days following the effective date of this Part. The appointing authorities shall notify the Executive Director of the Legislative Council when all appointments have been made. When the appointment of all members has been completed, the chairs shall call and convene the first meeting of the task force. If 30 days or more after the effective date of this Part a majority of but not all appointments have been made, the chairs may request authority and the Legislative Council may grant authority for the task force to meet and conduct its business. The task force may meet up to 6 times to conduct its business.

Sec. S-5. Duties. The task force shall:

1. Examine tax expenditures as defined in the Maine Revised Statutes, Title 36, section 199-A and evaluate specific tax expenditures that provide a direct benefit to
business as a catalyst for economic growth or that exempt property from municipal taxation;

2. Review best practices and standardized criteria used by other states for measuring the effectiveness of tax expenditures;

3. Determine the purpose of each tax expenditure identified by the task force for evaluation and the data required to measure the economic impact of each tax expenditure, including, but not limited to, revenue loss compared to economic gain, jobs created or retained and administrative burden for taxpayers and the State;

4. Prioritize tax expenditures and give highest priority to those tax expenditures that reduce the tax burden on necessities of life, that avoid pyramiding of taxes or that are essential to Maine's economic growth and job creation;

5. Develop a process, including a time frame and criteria, for ongoing evaluation of tax expenditures that may include the establishment of an independent commission, tax expenditure budgets, tax expenditure caps and sunset reviews; and

6. Recommend the repeal or reduction of tax expenditures to achieve a savings of at least $40,000,000.

Sec. S-6. Staff assistance. The Legislative Council shall provide necessary staffing services to the task force, including from the Office of Program Evaluation and Government Accountability and the Office of Fiscal and Program Review. The presiding officers shall request the assistance of the Department of Administrative and Financial Services, Maine Revenue Services in providing information and expertise to facilitate the work of the task force.

Sec. S-7. Report. By December 4, 2013, the task force shall submit a report that includes findings and recommendations, including any necessary implementing legislation, to the Joint Standing Committee on Appropriations and Financial Affairs. The Joint Standing Committee on Appropriations and Financial Affairs may submit a bill related to the report to the Second Regular Session of the 126th Legislature.

Sec. S-8. Contingent reduction to municipal revenue sharing. Notwithstanding any provision of law to the contrary, if legislation pursuant to this Part is not enacted into law before July 1, 2014 that generates an increase in budgeted General Fund revenue of at least $40,000,000 as estimated by the Office of Fiscal and Program Review, the amount transferred from the Local Government Fund to the General Fund under the Maine Revised Statutes, Title 30-A, section 5681, subsection 5-C in fiscal year 2014-15 is increased by $40,000,000.

Sec. S-9. Fiscal year 2013-14 year-end unappropriated surplus, 4th priority transfer. The State Controller shall at the close of the fiscal year ending June 30, 2014, as the next priority after the transfers authorized pursuant to the Maine Revised Statutes, Title 5, sections 1507, 1511 and 1522 and after all required deductions of appropriations, budgeted financial commitments and adjustments considered necessary by the State Controller have been made, transfer from the available balance of the unappropriated surplus of the General Fund up to $40,000,000 to the Local Government Fund by offsetting the amount of the reduction in that fund on a monthly basis pursuant to the Maine Revised Statutes, Title 30-A, section 5681, subsection 5-C.
MEMBERS OF THE TASK FORCE

Appointments of the President of the Senate:

<table>
<thead>
<tr>
<th>Name</th>
<th>Role</th>
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<tbody>
<tr>
<td>Sen. Anne Haskell</td>
<td>Senate member</td>
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<tr>
<td>Sen. Roger Katz</td>
<td>Senate member</td>
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<tr>
<td>Merrill Barter</td>
<td>Representing economists, tax experts or</td>
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<td>the business sector</td>
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<tr>
<td>Geoffrey Baur</td>
<td>Representing economists, tax experts or</td>
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<tr>
<td>Nelson Durgin</td>
<td>Person with expertise in state budget process</td>
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<tr>
<td>Ryan Low</td>
<td>Person with expertise in state budget process</td>
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Appointments of the Speaker of the House:

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<tr>
<th>Name</th>
<th>Role</th>
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<tr>
<td>Rep. Adam Goode</td>
<td>House member</td>
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<tr>
<td>Rep. Donald Marean</td>
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<tr>
<td>Charles Lawton</td>
<td>Representing economists, tax experts or</td>
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<tr>
<td>Catherine Lee</td>
<td>Representing a business enterprise</td>
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<tr>
<td>Garrett Martin</td>
<td>Representing economists, tax experts or</td>
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<tr>
<td>Elizabeth Miller</td>
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Designee of the Commissioner of Administrative and Financial Services:

<table>
<thead>
<tr>
<th>Name</th>
<th>Role</th>
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<tbody>
<tr>
<td>Michael J. Allen</td>
<td>Associate Commissioner of Tax Policy</td>
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<td>GOC</td>
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<tr>
<td><strong>Session 2014</strong></td>
<td>Determine resources needed to conduct on-going review</td>
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<tr>
<td><strong>Interim 2014</strong></td>
<td>Develop 8-year rotating schedule for review of tax expenditures</td>
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<td>distinguishing between</td>
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<td>1. program evaluation (OPEGA review)</td>
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<td>2. policy reviews (TAX review) and</td>
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<td>3. de minimum provisions (not to be reviewed)</td>
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<td>Determine goals and metrics for provisions subject to program</td>
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<td>evaluation during cycle 1</td>
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<tr>
<td><strong>January 2015</strong></td>
<td>OPEGA begins program evaluation review cycle 1</td>
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<tr>
<td><strong>Interim 2015</strong></td>
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<td>evaluation during cycle 2</td>
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<td>OPEGA provides info to Tax or other policy Committee RE: policy review</td>
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<td>TAX or other policy committee begins policy review cycle 1.</td>
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<tr>
<td>December 2015</td>
<td>OPEGA submits report on program evaluation cycle 1 to GOC</td>
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<tr>
<td>January 2016</td>
<td>GOC begins review of OPEGA program evaluation cycle 1 report</td>
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<td>OPEGA begins program evaluation review cycle 2</td>
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<td>Interim 2016</td>
<td>GOC submits results of program evaluation review cycle 1 review to TAX and other relevant policy committees GOC determine goals and metrics for provisions subject to program evaluation during cycle 3 OPEGA provides info to Tax or other policy Committee RE: policy review</td>
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<tr>
<td>GOC begins review of OPEGA program evaluation review cycle 2 report</td>
<td>OPEGA begins program evaluation review cycle 3</td>
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<td>Session 2017</td>
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<td>GOC submits results of program evaluation review cycle 2 review to TAX and other relevant policy committees</td>
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<td>GOC determine goals and metrics for provisions subject to program evaluation during next 2-year cycle</td>
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<tr>
<td>December 2017</td>
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<tr>
<td>January 2018</td>
<td>GOC begins review of OPEGA program evaluation review cycle 3 report</td>
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<td>OPEGA begins program evaluation review cycle 4</td>
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<td>Session 2018</td>
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**AND SO IT GOES ……**

**SHORT VERSION**

**Program evaluation review cycle 1**

- **Interim 2014**: GOC Goals and metrics established
- **January 2015**: OPEGA begins review
- **December 2015**: OPEGA reports to GOC
- **January 2016**: GOC reviews
- **Interim 2016**: GOC reports to TAX
- **December 2016**: TAX reports to Legislature
- **Session 2017**: Legislation considered

*A new cycle starts each year on an 8-year rotating cycle. Several cycles may active at different stages at any time.*

**Policy review cycle 1**

- **Interim 2015**: TAX or other policy committee begins review
- **December 2015**: TAX or other policy committee submits report and/or bill
- **Session 2016**: Legislation considered

*A new cycle starts each year on an 8-year rotating cycle. Several cycles may active at different stages at any time.*