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An Outcome-Based Approach
To a Rational Tax System

Presentation of:
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To:
Speaker’s Advisory Committee
On Tax Reform

August 16, 2002

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VISION

A high quality of life for all Maine People

Measured, in part, by:

Maine per capita income rank

Goal - 25th in nation
National Rank on Per Capita Income, 1980-2000

Percentage of Maine Jobs that Pay a Livable Wage, 1995-2000
GOALS OF TAX REFORM

**Short term**: To put in place a series of expenditure cuts and, if necessary, tax increases that resolve the current structural gap and which, at a minimum, make the volatility of the current structure no worse and which preserve, to the fullest extent possible, the investment in the highest priority public goods and services.

**Long term**: To create a tax structure that provides a stable stream of revenues that is both adequate for funding the sustained investment in high priority public goods and services and minimizes the distortion of economic investment in Maine.
PRINCIPLES OF TAXATION

1. Burden
   - Fiscal Discipline
   - Income

2. Mix

3. Stability

4. Fairness

5. Competitiveness/Neutrality

6. Exportability

7. Efficiency
**Principle:** Tax Burden

**Current Situation:** Among Highest in nation at 13.5%

**Why an issue:** Stifles investment in Maine

**Goal:** Reduce Maine’s Tax Burden to the National Average (currently 10.5%)

**Choice of Actions:**

NOTE: Not all of the “choices” presented in this document are recommended by the author. They are presented for discussion purposes, only.

1. **Reduce State and Local Government Spending**
   - Elimination of Programs/Services
   - Direct Cuts
   - Consolidation/Regionalization/Efficiencies
   - Fiscal Discipline

2. **Raise Income**
   - Invest in Education K-16 (emphasis post secondary)
   - Invest in R&D
   - Invest in Technology
   - Encourage Investment in Productive Capacity
**Principle:**  Tax Mix

**Current Situation:**  Heavily dependent on Property Tax (32%) Income Taxes (31%), Sales Taxes (20%), other (17%)

**Why an Issue:**  Property Tax Burden excruciating for some Maine residents, State nearing revolt

**Goal:**  A broad mix of taxes – no single type of tax will account for more than 28% of all tax revenues raised at the State and local levels.

**Choice of Actions:**
In a revenue neutral scenario, reducing Property Taxes from 32% to 28% would cost approximately $165 million and reducing Income Taxes from 31% to 28% would cost approximately $125 million

- Broaden Sales Taxes to Consumer Services (excluding medical)  +$200 million
- Broaden Sales Taxes to Food (at 5%)  + $110 million
- Reinstate Snack Tax  + $16 million
- Broaden Sales Taxes to State & Municipal Entities  +$115 million
- Broaden Sales Taxes to Business Services  +$300 million
- Increase Sales Tax to 6%  +$140 to $150 million
Maine's 2001 Tax Mix

- **Sales Tax**: 20%
- **Income Tax**: 31%
- **Property Tax**: 32%
- **Other Taxes**: 17%
**Principle**: Stability

**Current Situation**:  
- Highly Volatile Tax Structure  
- State Tax Revenues grow/decline at as much as 3 times the rate of personal income  
- Very narrow sales tax base (Full 1/3 derived from auto and building supply sales)  
- Highly progressive Income Tax (Top 2% taxpayers 1/3 total or 10,000 people pay $400 million)

**Why an issue**: Impedes wise investment and expenditure decisions by Government and destabilizes private investment environment

**GOAL**: The percent change in state and local tax revenues, separately and jointly, will not vary from the percent change in total personal income by more than 20% (measured as an average over a 2-year period).

**Choice of Actions**:
1) Reduce reliance on auto and building supply sales  
   • Broaden sales tax base to include consumer and/or business services or food  
   • Replace sales tax with a gross receipts tax

2) Reduce progressivity of income tax structure and, more specifically, reduce dependence on tax revenue derived from Capital gains  
   • Reduce highest marginal tax rate, re-do and fully index brackets
Maine Personal Income & General Fund Revenue
Fiscal Year to Fiscal Year Percent Change

-5%  0%  5%  10%  15%  20%

81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 00 01

Personal Income

- General Fund Revenues
Principle: Fairness

Current Situation: Recognized nationally for fairness

Why an issue: Fairness is a deeply held value of Maine people

GOAL: No quintile (of median household income) will pay a larger percentage of income to state and local taxes than the next higher quintile.

Choice of Actions:

- Evaluate any proposed tax change by its adherence to the above stated outcome-based goal.
**Principle**: Competitiveness / Economic Neutrality

**Current Situation**: Maine’s tax structure is not conducive to capital investment
- Very high top marginal income tax rate
- Most states either do not tax machinery and equipment, or tax at much lower levels

**Why an issue**: Maine’s economic vitality, productivity and income are directly dependent on our ability to attract private investment.

**Goal**: Taxes that alter decisions about economic investments, particularly taxes on the creation or wealth, will be reduced to their lowest possible level, preferably to 0%.

**Choice of Actions**:
- Eliminate the personal property tax on machinery and equipment
- Reduce the highest marginal income tax rate
- Avoid the taxation of business services
- Create a stable investment climate (avoid tinkering with incentives)
**Principle:** Exportability

**Current Situation:** Given that Maine has the highest percentage of vacation homes and is a tourism state, it has not fully tapped non-residents.

**Why an issue:** Many tourists and non-resident home owners enjoy the natural beauty of Maine and utilize our infrastructure and services without fully contributing. Taxes raised from non-residents will directly reduce the burden on Maine residents.

**Choice of actions:**
- Increase meals and lodging tax (each percentage point adds $20 million, 30% of which is borne by non-residents).
- Broaden sales tax base to include amusement and recreational services (+ $30 million)
- Seek a constitutional change to charge a higher rate on 2nd homes (offset with higher homestead exemption if Maine residents).
**Principle:** Efficiency

**Current Situation:** Maine’s administrative costs of levying and collecting taxes are very reasonable.

**Goal:** The cost of collecting taxes will not exceed 1% of the revenues generated

**Choice of Actions:**
- Avoid tax changes that significantly add to administrative burden and costs.