



Testimony in Opposition of

**LD 1088 – An Act to Modernize the Tax Laws and Provide over \$75,000,000 to Residents of the State in Tax Relief**

by

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Senator Perry, Representative Watson and members of the Joint Standing Committee on Taxation. Thank you for the opportunity to testify this afternoon. My name is Scott Moody and I am the Chief Economist for The Maine Heritage Policy Center.

I want to start by telling a quick story about a Canadian province and their recent tax reforms efforts. Based on a report from the Fraser Institute, this province flattened its personal income tax rate structure from four brackets to two with a top marginal tax rate of 12 percent—down from 18 percent. They now have the second lowest top marginal tax rate in Canada.

This province is also dropping its corporate income tax rate to 8 percent from 13 percent and will be the lowest rate in Canada.

More importantly, there are no offsetting increases in their consumption taxes in order to reduce the fiscal impact of these income tax cuts. As such, the taxpayers of this province will enjoy real tax relief.

In the short-term, this province will run a budget deficit as a result of this tax relief. However, the government has put into place a plan to limit spending increases to an average of 2.5 percent over the next four years in order to close the deficit. As part of the plan they will also freeze government wages for two years and eliminate 700 public sector jobs.

What is the name of this province? New Brunswick—Maine's next door neighbor and economic competitor.

There are several important lessons in this story that pertain directly to the debate over LD 1088. The first lesson is that tax reform is a two-step process. Unlike New Brunswick, Maine is constitutionally forbidden to run budget deficits. New Brunswick has the luxury of reducing taxes now and paying for it later. Maine must take the opposite approach by reducing spending first and reducing taxes later.

As such, Maine must first put into place a meaningful tax and expenditure limitation such as the Taxpayer Bill of Rights which will be heard before this committee in the near future. Once such spending restraints are in place, then, and only then, should major modifications be made to the tax code.

The second lesson is that the best tax reform is tax reduction. LD 1088 relies on sleight-of-hand notions of “tax exportability” in order to claim that it provides relief to Maine taxpayers. Instead, taxpayers want to see real, tangible tax reductions. For instance, Maine not only taxes too much, but also too many times. In other words, there are just too many different types of taxes in the tax code. Tax reform and tax reduction could go hand-in-hand by simply eliminating the most economically damaging taxes such as the capital gains tax, the death tax or the corporate income tax. These are relatively inexpensive taxes to eliminate, but would infuse the Maine economy with new vitality.

The third lesson is that the world does not stand still. Maine’s neighbors, both near and far, are reforming and reducing their tax systems. Since LD 1088 does not provide real tax relief, it will not boost Maine’s global competitiveness.

Finally, I would like to conclude with a few points based on my own research relevant to LD 1088. First, last Tuesday, the Tax Foundation released its annual Tax Freedom Day study showing that Maine’s Tax Freedom Day arrived earlier this year by seven days and will fall on April 6<sup>th</sup>. This would seem to be a good thing, except that the result was driven by lower federal taxes. Since Maine is a relatively poor state, we pay less in federal taxes than in other wealthier states.

Unfortunately, LD 1088 will raise Mainer’s federal tax liability by reducing income taxes—which are tax deductible—toward sales taxes—which are not tax deductible. The hyper-focus on the tax exportability of sales taxes should be tempered by this fact.

Second, the issue of tax compliance costs is a serious one. Maine’s economy is dominated by small businesses which have the most difficulty in complying with the tax code. Sales taxes are particularly onerous since the taxability of goods and services can vary greatly—even within a single business establishment.

Finally, the more goods and services that become subject to the 5 percent sales tax the greater the incentive for Mainer’s to cross-border shop in sales tax-free New Hampshire. My research suggests this already costs Maine’s state and local governments hundreds of millions of dollars in lost taxes. And if New Brunswick continues its tax cutting ways, Maine may lose its own Canadian cross-border shoppers.

Thank you again for the opportunity to testify. I am happy to answer any questions.