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TO: Alexander E. Porteous, Commissioner, DAFS
FROM: Jerome D. Gerard, Executive Director, MRS
Michael J. Allen, Associate Commissioner for Tax Policy, DAFS
DATE: June 11, 2018
SUBJECT: Technical Analysis of Initiated Bill (IB) 3

Overview

Citizen initiative bill IB 3 would establish the Universal Home Care Program to provide in-home and community support services to seniors and all persons with disabilities living in Maine who require assistance with an activity of daily living, without regard to income. The initiative establishes the Universal Home Care Trust Fund and the Universal Home Care Trust Fund Board to oversee and manage the fund and its use under the program.¹ IB 3 (“the measure” or “the bill”) is scheduled for referendum vote on November 6, 2018.

The Fund would receive revenue from three tax revenue sources:

- (1) a 1.9% excise payroll tax on employers in Maine on wage income paid to high earner employees that exceed a threshold (\$128,400 in 2018)²;³
- (2) a 1.9% wage income tax on high earners on the high earner’s wage income that exceeds the same threshold;⁴ and
- (3) a 3.8% income tax on high earners on the taxpayer’s Maine adjusted gross income (MAGI) above the threshold, reduced by a credit for the two 1.9% taxes (the amounts “paid by an employee” and “owed by the taxpayer’s employer”).⁵

MRS Office of Tax Policy estimates that these tax provisions, if interpreted consistently with conclusions 1 and 2 of this memo, will generate approximately \$310,000,000 annually. This figure is in agreement

¹ I.B. 3, L.D. 1864 (128th Legis. 2018) “An Act To Establish Universal Home Care for Seniors and Persons with Disabilities,” available at http://www.mainelegislature.org/legis/bills/display_ps.asp?id=1864 (last visited June 6, 2018).

² The threshold amount is defined by reference to federal law to mean the maximum wages subject to social security employment taxes, \$128,400 in 2018.

³ *Id.* §4, enacting 36 M.R.S. c.723 (§§5001 – 5004), “Employer Contribution to Universal Home Care Through Tax on High Earner Wages.” The new chapter 723 is in Title 36 within Part 7, “Special Taxes.”

⁴ *Id.* §5 enacting 36 M.R.S. §5204-C. This new section is in Title 36 within Part 8, “Income Taxes,” and chapter 818, “Additional Taxes.”

⁵ *Id.* enacting 36 M.R.S. §5204-D. This section is also in Title 36 within Part 8, “Income Taxes,” and chapter 818, “Additional Taxes.”

with the \$310,000,000 annual revenue estimate listed in the initiative petition.⁶ The tax provisions of the bill would apply to tax years beginning on or after January 1, 2019.

Technical Analysis of Tax Provisions

1. “High Earner” Individuals: MAGI and Married Individuals Filing Joint Returns

A key question is whether MAGI under IB 3 is determined on a single individual or married joint return basis. For all three tax provisions, a “high earner” is defined as “a taxpayer with [MAGI] exceeding the universal home care tax income threshold in a tax year.”⁷ In addition, the 3.8% tax “is imposed on that amount of the high earner’s [MAGI]” that exceeds the threshold for the tax year.⁸ Although some of the language and structure of IB 3 points in different directions on this issue, the use of the defined term “Maine adjusted gross income” provides a stronger reading of IB 3 as imposing the tax on a married joint return basis when such a return is filed by the employee-individual.

Maine adjusted gross income (MAGI) is defined for Part 8 income taxes as follows:

1-C. Maine adjusted gross income. “Maine adjusted gross income” has the following meanings.

A. “Maine adjusted gross income” means, for a resident individual, the federal adjusted gross income of that individual, as modified by section 5122.

B. “Maine adjusted gross income” means, for a nonresident individual, that part of his federal adjusted gross income derived from sources within this State, as determined under section 5142.⁹

Federal AGI, in turn, is a defined term under the U.S. Internal Revenue Code: federal gross income (income from all sources with certain exclusions) less certain deductions.¹⁰ Federal AGI is determined on a single individual basis for single individual returns, and on a married joint basis on married joint returns. Thus, if a married couple files a federal income tax return on a married filing joint return basis, they report their joint AGI, both individuals are liable jointly and individually for the entire amount, and the reported AGI is the federal adjusted gross income for *both* individuals.¹¹

The IB 3 provisions for all three taxes are linked structurally to existing income tax provisions within Title 36. The 3.8% tax is within Part 8, the Maine Income Tax Law.¹² Chapter 823 of Part 8 sets out the

⁶ *An Act To Establish Universal Home Care for Seniors and Persons with Disabilities*, Citizen Initiative Petition.

⁷ *Id.* §5204-C(1)(A & B). The threshold in 2018 would have been \$128,400, see fn. 2, *supra*.

⁸ 36 M.R.S. §5204-D(2).

⁹ *Id.* §5102(1-C).

¹⁰ IRC §62. This definition is incorporated by reference in Title 36. See 36 M.R.S. §111(1-A) (“Code”); §5102(1-D) (“Laws of the United States”); §5102(11) (Other terms). Maine income tax law, Title 36 M.R.S., conforms to the United States Internal Revenue Code of 1986 and amendments to that Code as of December 31, 2016, 36 M.R.S. §111(1-A), and applies the definitions contained in the Code “unless context otherwise indicates,” or a different definition is provided in §5102, or “different meanings are clearly required,” *Id.* §5102(11).

¹¹ See Treas. Reg. § 1.6013-4 (“If a joint return is made, the gross income and adjusted gross income of husband and wife on the joint return are computed in an aggregate amount and the deductions allowed and the taxable income are likewise computed on an aggregate basis. . . . Although there are two taxpayers on a joint return, there is only one taxable income.”). See also I.R.C. § 6013(d)(3) (“if a joint return is made, the tax shall be computed on the aggregate income”).

¹² §5101.

provisions for the filing of income tax returns under Part 8.¹³ Because the 3.8% tax is located in Part 8, the joint filing requirements are applicable.¹⁴ Thus, a couple filing a joint federal return will file a Maine married joint income tax return, reporting their federal AGI that they reported on their married joint federal return, and the computed Maine income tax, including the additional 3.8% income tax imposed by this bill, is the joint and several income tax liability of each of them. Thus, for the two income tax provisions in IB 3, federal AGI filed, and thus MAGI, includes the income from both spouses filed on a joint return basis, with no provision of state law allowing their separation.¹⁵

The 1.9% wage income tax is also in Part 8, therefore, the definition of MAGI and the above analysis also apply to this tax. Further, a taxpayer should logically have the same MAGI for all taxes imposed by Part 8. Finally, the 1.9% tax is functionally included within the 3.8% tax by way of the credit provision.

The analysis for the 1.9% employer excise tax is less clear: the tax is an excise tax and not in Part 8, thus the joint filing provisions and corresponding definition of MAGI do not expressly apply. However, the employer tax does link to Part 8 through the §5001 definitions and the two 1.9% taxes are structured to mirror each other. Likewise, the bill does not create an alternate definition for MAGI. The stronger reading is that the same MAGI definition should apply for this tax as well.

It is worth noting that there is some risk to the interpretation of all three tax provisions. Courts sometimes construe technical definitions in a bill differently from the apparent meaning of the text in order to better effectuate the will of the legislative body. The bill can seem to focus on the individual in various provisions.¹⁶ Furthermore, the use of joint return MAGI raises other tax administration and compliance issues with respect to the 1.9% employer excise tax that is not clearly addressed by IB 3 (e.g., confidentiality issues and return due dates).

2. MAGI and Wage Income: Application to Nonresidents

Maine income tax is generally applied to nonresidents using a method that first calculates the tax on the taxpayer's entire income and then apportions the amount of the tax that corresponds to Maine source income (i.e., multiplying the total taxable income tax by the ratio of Maine source income to total

¹³ §5220.

¹⁴ SPECIAL NOTE: In situations of general non-conformity between the Code currently in effect as federal law and as adopted by specific Code date in Title 36 for state law, as is currently the case, there is arguably a degree of ambiguity with respect to a 2018 Code filing status election at the federal level and its effect on filing status required under Title 36. However, the Title 36 purposes of joint filing linkage at the federal and state levels provides the stronger reading that federal filing status *as actually filed* is the correct reference point with respect to 36 M.R.S. §5221(1)(C).

¹⁵ Special provisions address certain nonresident and equitable relief situations. It should be noted that attempting to separate out each spouse's respective share of income from their married joint AGI and then applying some respective share of state modifications, deductions, exemptions and credits would be problematic and burdensome for both MRS and the taxpayer. As to application of tax credits against the additional tax, see §5219-H.

¹⁶ The final wording of the ballot question is also an element that would be considered in an assessment of legislative intent. Similarly, the Attorney General's explanatory statement to be provided pursuant to 1 M.R.S. §353 would be a significant element in a court's interpretation of the initiated bill. See *League of Women Voters v. Secretary of State*, 683 A.2d 769 (Me. 1996). The "explanatory statement" has not yet been posted on the Secretary of State website (as of a.m., June 7, 2018).

income).¹⁷ This method is important in a system with deductions or graduated income tax rates; it applies an effective tax rate on the Maine source income of a nonresident that is comparable to that of a resident with the same total income.

Maine's general method of taxing nonresidents only applies to income taxes imposed by §5111; it does not apply to the new taxes created by this bill because IB 3 does not amend §5111(4) to include these taxes or otherwise provide a cross-reference. As noted above, the 3.8% income tax is imposed on the MAGI of the taxpayer. The MAGI of a nonresident is defined as "that part of [the taxpayer's] federal adjusted gross income derived from sources within this State, as determined under section 5142."¹⁸ This method treats a nonresident with low *Maine source* income the same as a resident with low *total* income. For example, a nonresident taxpayer with \$500,000 total income but only \$100,000 Maine sourced income will not meet the threshold and so will not be a "high earner" subject to the taxes imposed by this bill.

The employer excise tax is imposed on "wage income paid by that employer to any high earner employee in this State that in the tax year exceeds the universal home care tax income threshold."¹⁹ Because the imposition is limited to Maine source income, no further apportionment is required for nonresidents.

Unlike the employer excise tax, the employee wage income tax is imposed on all "wage income of high earners for the taxable year." Neither the general method of apportioning income for nonresidents under §5111(4) or the MAGI definition apportionment method applicable to the 3.8% income tax would expressly apply to the employee payroll tax. In other words, the 1.9% wage income tax is imposed on wage income over the threshold, no matter the source (Maine or non-Maine), if the other requirements are met. However, the United States Constitution limits Maine's authority to tax nonresidents to their Maine source income. Therefore, one of the methods described above would likely need to be applied to the employee payroll-wages income tax.

Other Issues

- The employer excise tax is imposed on the wage income of employees with MAGI above the threshold.
 - Conditioning an employer tax on a tax attribute of an employee raises confidentiality concerns. For instance, the employer would need income information that may include the employee's income from investments, businesses, other employers, and, for joint filers, the spouse's income as well.
 - It also raises several administrative timing issues. For instance, the employee's MAGI is not determined until after the end of the year, presumably after initial excise tax payments are due. To further complicate the issue, the employer and employee may have different fiscal years.
- Federal employer and employees; state and municipal employer and employees. There is no express exception in IB 3 for federal, state, or local government employers. Thus, the State and

¹⁷ *Id.* §5111(4).

¹⁸ *Id.* §5102(1-C) (B). This amount also includes any Maine modifications sourced to the State pursuant to §5142.

¹⁹ *Id.* §5002.

local governments would be required to pay the employer excise tax.²⁰ The federal government is likely exempt from this tax.²¹

- Because no exception is created for nonprofit employers, they would also be subject to the employer excise tax.
- The employer excise tax and employee payroll tax are imposed on wages above the OASDI contribution and benefit base threshold, thus appearing to start where social security taxes leave off. However, the taxable base differs and so, for some taxpayers, there will be a gap between social security taxes and the excise and payroll taxes imposed by this bill.
- The bill is silent on several important issues that would need to be addressed through rulemaking or administrative guidance, including:
 - Creating a schedule for remitting the tax (annual, quarterly, other).
 - Creating a schedule and procedures for depositing the collected tax revenue in the appropriate fund. It is important to note that money cannot be spent under the newly established programs until it is available in the trust fund.²² Thus, these scheduling decisions will have a substantive impact on the bills overall operation.
 - Creating employer excise tax return and refund procedures; fiscal year vs calendar year rules; and employer excise tax refunds or assessments based on employee amended returns or audits.
 - The taxes established by this bill are effective for tax years starting January 1, 2019. If this initiated bill is approved, Maine Revenue Services would need to be begin administering these taxes immediately. At this point no funds have been appropriated for the implementation of these taxes. MRS estimates that the administration costs would total \$211,270 in fiscal year 2018-19.
- This memo represents the preliminary analysis of this initiative and focuses only on the more significant issues that were identified. As the review continues additional issues or concerns may arise.

Conclusion

In sum, our conclusion is that the stronger reading of IB 3 is as follows:

1. For all three tax provisions in IB 3, MAGI includes the income from both spouses filed on a joint return basis;
2. For the two income tax provisions in IB 3, the MAGI for nonresidents will be determined on a Maine-source income basis; and
3. IB 3 raises a number of other significant issues that would need to be addressed by rulemaking or administrative guidance.

²⁰ The impact of the appropriations process should be considered as possibly effectively amending the payroll tax as to the State.

²¹ "The one constant here, of course, is simple enough to express: a State may not, consistent with the Supremacy Clause, U.S. Const., Art. VI, cl. 2, lay a tax 'directly upon the United States.'" *United States v. N.M.*, 455 U.S. 720, 733, (1982) (citing *Mayo v. United States*, 319 U.S. 441, 447 (1943)). Unlike the employer excise tax, the withholding requirements of the employee payroll tax would apply to the federal government in the same manner as other state income tax withholding requirements. See 5 U.S.C 5517 and 31 C.F.R p. 215.

²² 22 M.R.S. §7283.