APPENDIX D

Role of Fiscal Notes in Revenue Recognition

Fiscal Notes or Revenue Forecasting Committee

In addition to providing fiscal information on proposed legislation to improve the decision making process, fiscal notes establish the amounts of revenue in enacted bills that become part of the budget. While the Revenue Forecasting Committee (RFC) determines the official projections for pre-existing or "baseline" revenues based on economic and other factors, the fiscal note process determines the levels of revenue that come (legislatively) from statutory changes in newly enacted legislation. The amount of revenue recognized by the RFC and the amounts recognized through the fiscal note process combine to become the official amount of revenue available for expenditure in the budget for the General Fund, Highway Fund and Fund for a Healthy Maine. On occasion the line between which process, revenue forecasting or fiscal note, should determine a particular level of revenue has become blurred and a brief discussion of this issue follows.

By statute, the RFC estimates baseline revenues twice each year and releases formal reports on these on December 1st and March 1st. These estimates represent what is expected to be collected based on current law. Revenue that may be generated or decreased from changes to current law is booked or "scored" in fiscal notes. Once the revenue impact of a statutory change has been initially booked in a fiscal note, that revenue becomes part of the baseline revenues and any subsequent projection of it is properly accounted for by the RFC. It has occurred in the past that legislation has been proposed that would change an existing estimate of revenue without changing any underlying statute that would cause a revenue amount to change. Such attempts to adjust baseline estimates of revenue legislatively (through fiscal notes) are inconsistent with the role of the RFC and jeopardize the bipartisan acceptance of the RFC process. The RFC does have a mechanism that allows it to convene a meeting to revise revenue when it believes its previous estimate may be substantially incorrect and this is preferable to using legislation to simply state that a particular revenue source shall be booked at a different level than was estimated by the RFC. OFPR will only recognize revenue in a fiscal note that is caused by a legislative change, such as increasing a tax or fee or by adding positions to collect additional revenue.

Static versus Dynamic Revenue Estimates

Revenue estimates that do not take into consideration behavioral changes of any kind attributable to the passage of statutory changes would be considered static estimates. On the other end of the spectrum, revenue estimates that do consider behavioral changes that might be anticipated from statutory changes would be referred to as dynamic estimates. In the State of Maine, OFPR employs a modified form of dynamic forecasting in fiscal notes that could be referred to as "micro-dynamic" estimating, which considers some behavioral changes on individuals directly impacted by legislation but not behavioral changes that might change the economy as a whole, which could be called "macro-dynamic" estimating. This is especially important in evaluating tax legislation, where Maine Revenue Services (MRS), using sophisticated computer modeling, uses a micro-dynamic methodology to provide OFPR with the potential impact of tax legislation. There is no attempt to quantify any secondary or dynamic revenue changes that may come about from the impact of legislation on the overall economy. For example, the fiscal note for a proposed substantial tax rate increase would consider the micro-dynamic effects of behavioral changes to avoid the tax but not try to adjust for any secondary macro-dynamic effects on the economy as a whole. Generally, this is a revenue recognition issue more likely to effect tax legislation than other areas. Proponents of tax proposals are often disappointed to find that a fiscal note will score a revenue loss for tax credits or exemptions but not attempt to offset the loss by booking a potential stimulus to economic growth from the proposal. The consideration of economic consequences in fiscal notes would greatly increase their complexity and move focus away from the direct impact of a proposal. If any bills were to be measured this way, fairness would dictate they all would need to be. Given the generally small impact economic analysis would have on 99.9% of the fiscal notes, OFPR has not invested in the additional resources or additional economic modeling capability that would make it possible.

Compliance/Enforcement Assumptions

Another issue that has created some controversy in the past is the fiscal note treatment of bills that arise from audit adjustments and compliance. As the result of an audit the state may assess a taxpayer for an outstanding tax liability. That taxpayer may seek relief from the legislature, resulting in a bill to change the law retroactively. An argument that often gets made is that there should not be a cost to passage of the bill because the tax was not being collected prior to the audit finding. However, the fiscal note would show a revenue loss because the baseline revenues already assume that there will be collections resulting from bringing taxpayers into compliance through audit adjustments and any retroactive change to tax law would negate the possibility of collecting those taxes.

Timing Issues

Fiscal notes will consider the timing of an impact of a statutory change so that it is consistent with expectations for behavioral changes that result. For example, a bill to cut sales tax rates by 50% on July 1 would be an incentive for taxpayers to delay purchases that would otherwise have occurred prior to July 1. The behavioral change, in this case delay of purchases, would be accounted for in the fiscal note and a revenue loss would be recorded for reduced sales tax collected prior to July 1.

Interaction Effects

Consumers of fiscal notes will be advised that there can be an interaction between various proposals in a legislative session that cannot be accounted for in the fiscal notes for those proposals. Each fiscal note for a proposed piece of legislation will score that proposal against current law without regard for the possibility (or probability) that other proposals could be enacted. Summing the impacts expressed in the individual fiscal notes may not provide the true revenue gain or loss that would be obtained if all the bills pass. The revenue loss from a proposed income tax exemption in one bill would be greater than expressed by its fiscal note if another proposal to increase tax rates is enacted.