Resolves 2009, Chapter 199, Resolve, To Increase Transparency and Accountability and Assess the Impact of Tax Expenditure Programs

Report of Working Group

November 3, 2010

In 2010, the Maine Legislature enacted Resolves 2009, Chapter 199, *Resolve, To Increase Transparency and Accountability and Assess the Impact of Tax Expenditure Programs.* This Resolve called for the Executive Branch to carry out the following work:

- The Commissioner of the Department of Administrative and Financial Services (DAFS) was directed to convene a working group comprising representatives of Maine Revenue Services (MRS), the Department of Economic and Community Development, the Executive Department and the State Planning Office, as well as any other state agency considered appropriate;
- The working group was charged with identifying tax expenditure programs for review and to define the purpose of each such program;
- After considering practices in other states, the working group was to design a data collection method that would facilitate measurement of the economic impact of tax expenditure programs, including but not limited to a comparison of economic gain to revenue losses arising from each program, jobs created or lost, and the potential administrative burden associated with the program;
- The working group was to develop recommendations regarding a regular reporting schedule for provision of measurement data to the Legislature, as well as recommendations for a regular review schedule of these data by appropriate legislative committees.

The Resolve requires the Commissioner of DAFS to submit a report on the working group's activities and recommendations on or before November 3, 2010. This report, submitted to the joint standing committees having jurisdiction over taxation, appropriations and financial affairs and business, research and economic development, is intended to fulfill our charge under the provisions of the Resolve.

Working Group

The Commissioner of the Department of Administrative and Financial Services convened the Tax Expenditures Working Group, reaching out to the Governor's Office, the Department of Economic and Community Development, the State Planning Office and the Department of Labor for participation. The leaders of each of those agencies assigned the following individuals to collaborate in this process:

- Ellen Jane Schneiter, Commissioner, Department of Administrative and Financial Services
- Jerome Gerard, Acting State Tax Assessor, Maine Revenue Services

- Michael Allen, Director of Economic Research, Maine Revenue Services
- Michael LeVert, State Economist, State Planning Office
- Brian Hodges, Deputy Commissioner, Department of Economic and Community Development
- John Dorrer, Director, Center for Workforce Research and Information, Department of Labor
- David Farmer, Deputy Chief of Staff, Office of the Governor

This group was convened in the summer of 2010. In addition to the working group leads listed above, David Gunter and Jerome Stanhope of Maine Revenue Services, Earle Shettleworth of the Maine Historic Preservation Commission, as well as Jeanne St. Pierre of the Department of Economic and Community Development contributed to the group's efforts.

Background

Maine law defines a tax expenditure as any provision of state law that results in a reduction of tax revenue arising from special exclusions, exemptions, deductions, credits, preferential rates or deferrals of liabilities.[1] In common parlance, these are known as "tax breaks" or "tax preferences" and represent a form of government spending. In contrast to direct spending, which is subject to the appropriations process, tax expenditures are run largely "off budget" – while they impact the revenue budget, the Legislature does not routinely review tax expenditure items once enacted.

Often the same policy outcome that serves as the objective of a tax expenditure program could be realized through a direct spending initiative. For example, a subsidy to encourage the construction of certain types of industry might be administered as either a tax expenditure or a grant program.[2] The direct spending initiative – in this case, the grant program – though, would be subject to the appropriations process, thus commanding a certain level of attention by both the Administration and the Legislature each budget cycle. Granted, direct spending programs do not always receive the level of scrutiny merited, but tax expenditures are less likely to receive meaningful review. Unless a sunset date is imminent or a change to a tax expenditure is proposed, such provisions are unlikely to receive substantial scrutiny during the budget process because it does not trigger consideration of any direct appropriation of revenues; instead, these provisions of the tax code impact the revenues flowing into state coffers.

Rigorous review of tax expenditures can be difficult both from a political and a practical perspective. Politically, critical reviews of these programs that result in recommendations for reduction or elimination of the provision can be framed as moves to raise taxes. Contrast this situation with review

[1] 36 MRSA §199-B.

[2] This simplification does not, however, fairly recognize that one approach might be more efficient at achieving the desired policy objective than the other. *See,* for example, Weiner J. State Business Tax Incentives: Examining Evidence of Their Effectiveness. Federal Reserve Bank of Boston. December 2009. http://www.bos.frb.org/economic/neppc/dp/2009/neppcdp0903.pdf; Lynch RG. Rethinking Growth Strategies – How State and Local Taxes and Services Affect Economic Development. EPI. 2004. http://www.epi.org/publications/entry/books_rethinking_growth/#exe

and recommendation to reform a directly appropriated program, which can be framed as reining in government spending and the challenge is obvious. From a practical perspective, critical review is limited by the availability of detailed information regarding program effectiveness. There is little in the literature, for example, to suggest that many of the more popular business development tax expenditure provisions are the deciding factor in a business' decision to locate in a certain area, or to add jobs to its employee base.[3] However, the ability to attract businesses into Maine or into particular regions of the state is enhanced by having such programs available in the economic development "toolbox." Data often become available only several years delay (as tax returns are filed) and, even with good data, analysis – and the findings that follow – will only be as good as the assumptions used to interpret those data.

The State of Maine currently has 141 personal and corporate income tax and property tax reimbursement programs, as well as 133 sales and excise tax exceptions. Not included among these programs and exceptions are provisions for deductions, credits or reimbursement that arise as a consequence of a federal mandate or to maintain conformity with traditional tax provisions when the federal government moves away from such provisions. The 274 provisions referenced above include significant provisions like the sales tax exemption on food and medicine, as well as more narrowly focused provisions like tax credits for certain shipbuilding facilities and the rehabilitation of historic properties.

Up until the early part of this decade, the Legislature's Taxation Committee was required to review tax expenditures on a rolling basis. One year, review focused on income tax, two years later it was sales tax and two years after that, property taxes. As a practical matter, little was gained from this effort. Approximately eight years ago, that approach was replaced by the requirement now placed on Maine Revenue Services to produce a more extensive tax expenditure report on a biennial basis.

In January of each odd-numbered year, concurrent with presentation of biennial budget, Maine Revenue Services submits two tax expenditures reports to the Legislature. The first is required by 5 MRSA §1664 and is released as part of the documentation for the biennial budget recommendations. This report provides the estimated revenue loss from each tax expenditure program during the most recently completed fiscal year and the year in progress, as well as projected losses for each fiscal year of the coming biennium.

The second report is prepared pursuant to 36 MRSA §199-B; this report is submitted to the Legislature's Joint Standing Committee on Taxation and provides more detail than the summary report included with the budget documents. The information provided includes a summary of each tax expenditure, a statement of purpose and background on each provision, information regarding beneficiaries, estimates

---

[3] *See,* for example, Weiner J. State Business Tax Incentives: Examining Evidence of Their Effectiveness. Federal Reserve Bank of Boston. December 2009. http://www.bos.frb.org/economic/neppc/dp/2009/neppcdp0903.pdf; Lynch RG. Rethinking Growth Strategies – How State and Local Taxes and Services Affect Economic Development. EPI. 2004. http://www.epi.org/publications/entry/books_rethinking_growth/#exe

of the cost (revenue losses) associated with each expenditure and any issues or recommendations MRS might have regarding a particular provision. Historically, MRS has not offered recommendations regarding the amendment, repeal or replacement of any tax expenditure, instead leaving such recommendations to the discretion of the Governor and the Legislature.

Practices in Other States

More than 40 states currently produce tax expenditure or tax preference reports. Of this total, 34 include estimates of fiscal impacts for each expenditure item, 16 include a description of the expenditure and the intended beneficiaries and 12 include a statement of purpose for each expenditure. Most states do not incorporate tax expenditure reports into their budgeting process and only two states – Washington and Oregon – provide recommendations for amendment, repeal or reauthorization into their reports. Most states do not incorporate tax preference reviews into their budget process and no state has a uniform approach or method for analyzing all tax preferences.

A review of the authorizing legislation for tax expenditures reviews in these states, as well as a review of the reports along with readily available back up documentation revealed that most states are undertaking efforts that are substantially the same as Maine's. Only a handful, though, include an evaluation of the effectiveness of the expenditure under review; these "model" states include California, Delaware, Iowa and Washington.[4]

The tax expenditure reports published by most states include a standard set of information regarding each program:

- A statement of purpose or declaration of policy for each tax expenditure, along with its statutory authority;
- An estimate of the revenue loss to the state associated with each tax expenditure;
- A description of the groups likely to benefit from the tax expenditure; and
- A statement of any issues regarding the tax expenditure that might be considered by the Legislature.

"Model" states like California, Delaware, Iowa, Oregon and Washington appear to engage in a more extensive review of each expenditure program, designed to improve accountability and transparency, which are considered important characteristics of good tax expenditure policy.[5]

The State of **Iowa** issues a review of tax credit programs on a regular, cyclical basis. Currently, the Iowa report includes much of the same information as appears in Maine's tax expenditure report. For each program, a description of the credit is provided, along with an estimate of annual revenue impact and

---

[4] Welsh M. "Practices of Other States: Treatment of Tax Preferences in Budgeting." Joint Legislative Audit and Review Committee, State of Washington. August, 31, 2010.

[5] Chi KS and Hoffman DJ. State Business Incentives: Trends and Options for the Future. Second Edition. The Council of State Governments. 2000. http://www.csg.org/knowledgecenter/docs/Misc00BusinessIncentives.pdf

the number of claims made. Earlier this year, a special panel convened by Governor Culver to conduct an in-depth review of Iowa's tax credit programs issued its report, detailing the group's findings and recommendations regarding such programs.[6] While some of the recommendations offered related to overarching policies regarding tax credits, the Panel stressed the importance of increasing and enhancing the transparency of tax expenditure programs, on par with direct spending initiatives considered during the General Fund budgeting process. They also recommended the development of an effective return on investment calculation for each tax expenditure, as such a calculation currently exists for some programs and not others. Importantly, the Panel recognized that this type of analysis is quite challenging, but pointed out that without ROI information, it is difficult to assess a program. Finally, the Panel recommended that a five-year sunset be adopted for each tax credit, arguing that such a policy will provide for the regular review and consideration of tax credit programs by the Administration and the Legislature.

Delaware's Department of Finance, Division of Revenue Services issues that state's Tax Preference Report in November of each odd-numbered year. The report covers tax deductions, exclusions, credits, exemptions and deferrals. It excludes consideration of variations in the rate of income tax, standard deductions and personal exemptions. The Delaware report sets out for each tax expenditure-item, the purpose for the allowance, the estimated revenue loss associated with the preference for the most recently completed and the current fiscal years, information regarding its effectiveness in achieving stated objectives, including whether or not it is the most fiscally effective means of achieving those objectives, its beneficiaries, its impact on fairness and equity in terms of the distribution of the tax burden and the public and private cost of administering the particular tax expenditure program. The intent of this information is to facilitate efforts by policymakers to review tax expenditures and their effect on state revenues.

In reviewing the most recent version of the report accessible on-line,[7] the Delaware publication closely resembles Maine's tax expenditure report. The Delaware report includes a relatively detailed description of the method used to measure the revenue impact of each tax expenditure. A review of that information indicates that the methods laid out in the report simply summarize the modeling approach utilized for analyses. As is the case in Maine, estimates of revenue impact rely in some instances on extant administrative data and, in other cases, on micro-simulation modeling; Maine's report omits a discussion of how those estimates are derived. It is not clear that such information provides added value to a reader who is not conversant in economics.

Delaware's report does, however, include a rather lengthy *qualitative* assessment of each tax expenditure, as well as a discussion of inadvertent effects and limited recommendations regarding certain programs.

---

[6] State of Iowa Tax Credit Review Report. Iowa Tax Credit Review Panel. Iowa Department of Management. January 8, 2010.

[7] http://www.finance.delaware.gov/publications/two007_tax_prefer/toc_1.shtml)

The Franchise Tax Board (FTB) in the State of **California** employs an approach very similar to Delaware's.[8] For each tax expenditure, the FTB report provides a description of the tax program, estimates the cost or revenue impact of the program and the number of taxpayers – by income class – affected by it. The FTB report also includes a detailed discussion of the policy motivation for each expenditure item.

Of the state practices reviewed, the most notable approach to tax expenditure review and reporting is held by the state of **Washington**. In that state, all tax expenditures are subject to an in-depth review on a ten-year cycle;[9] the order of review generally tracks the chronological order in which the tax preferences were enacted into law, although there may be exceptions to this rule. A legislative team known as "JLARC" (Joint Legislative Audit and Review Committee), akin to Maine's Office of Program Evaluation and Government Accountability is responsible for this analysis, which is to address these considerations:

- A description of the policy objectives that serve as the justification for the tax expenditure, along with documentation of such stated purposes;
- Whether any evidence exists to demonstrate the tax expenditure has, in fact, contributed to a realization of the stated policy objectives;
- Whether continuation of the tax expenditure will further the underlying policy objectives;
- If the policy objectives are not being realized, can the expenditure program be modified to improve the feasibility of realizing the objectives;
- Who are the taxpayers directly affected by the expenditure program;
- To what extent is the program conveying unintended benefits to other entities not the object of the expenditure program;
- What are the past and future revenue and economic impacts of the program to the taxpayers and to the government, including an analysis of the general effects of tax expenditures on the state's overall economy;
- Any negative effects that would likely be generated if the tax expenditure were to be terminated and the effect termination would have on the distribution of liability for payment of state taxes;
- The use of similar tax expenditure programs in other states; and, finally,
- Any recommended modifications to the program including a schedule for sunset review in the future or immediate termination.

Once JLARC has completed its review, its findings are reported out to the Citizen Commission for Performance Measurement of Tax Preferences. The seven-member Commission comprises members appointed by the Governor, the House of Representatives and the Senate, along with the State Auditor and the Chair of JLARC. The Commission conducts public hearings on the JLARC report and the associated tax preference provision, providing additional information for the review process. The

[8] California Income Tax Expenditures – Compendium of Individual Provisions. State of California Franchise Tax Board. December 2008. http://www.ftb.ca.gov/aboutftb/taxExp08.pdf

[9] Tax expenditures that carry an estimated biennial fiscal impact of less than $10,000,000 may undergo a less rigorous, expedited review process.

Commission then formulates its own recommendations which are forwarded, along with the JLARC reports, to the relevant legislative committees for consideration.

The Washington approach appears to be the most comprehensive of all states reviewed. At the same time, the state has convened a Task Force on Tax Preference Reform. This Task Force is responsible for recommending a set of reforms for how state government approaches the proposal, consideration and evaluation of tax expenditures. This group is scheduled to report out its findings in November 2010; those recommendations may impact the manner in which Washington's tax expenditure reviews are conducted in the future.

The current Washington approach has several characteristics that are interesting. First, only a handful of reviews are conducted each year. This circumspect scope of work is better able to be handled by a small staff, which is also assigned other responsibilities. The degree of difficulty associated with this type of evaluation is considerable; it seems best to limit the number of such evaluations undertaken in any given year, to ensure that the best possible product comes from that effort.

While progress at implementing a meaningful review process at the federal level has not made substantial progress over the past decade, the Obama Administration has expressed its intent to move ahead with incorporating such review into its own budgeting process.[10] The experience of other states with the review of tax expenditures is mixed, at best, but practices in states like Washington are instructive to those interested in improving the review process and the enhanced transparency and accountability that accompanies such reviews.

Tax Expenditures Subject to Closer Review

Resolves 2009, Chapter 199 tasked the working group with identifying a set of tax expenditures to subject to greater level of review and to define each such tax expenditure.

When considering the list of 274 current tax expenditures, it seemed reasonable to exclude those that are unlikely to be subject to reconsideration by the Administration or the Legislature. These include allowances for itemized deductions and sales tax exemptions for food, prescription drugs and services. Taking into consideration that the Resolve requires us to submit recommendations to the joint standing committees on taxation, appropriations and business, research and economic development, it appeared most reasonable to narrow the focus of increased scrutiny to those tax expenditures that are viewed as contributing to Maine's economic development. A list of 11 Maine tax expenditure programs suggested for focused review is presented below, along with a definition of the purpose of each program. Note that some of the programs are overlapping; in other instances, participation in one precludes eligibility for another program.

[10] Judging Tax Expenditures. Citizens for Tax Justice. November 13, 2009. http://www.ctj.org/pdf/judgingtep1109.pdf

- **Business Equipment Tax Reimbursement Program (BETR)** – The statutory authority for this program may be found at 36 MRSA, Chapter 915. This tax expenditure program allows for reimbursement of property taxes certain businesses pay on qualified, tangible, personal, depreciable property first placed into service within Maine on or after April 1, 1995 and is meant to encourage business development and, in turn, foster economic development.

  Certain businesses are ineligible for the program; these include public utilities, cable television companies, and providers of radio paging, mobile communications, satellite TV or television distribution services. Equipment used in retail sales activity at retail businesses larger than 100,000 square feet (so called "big box" stores) is ineligible for the program, with the exception of equipment used in such businesses that are Maine-based and which derive less than half of their total revenue from sales subject to Maine sales tax.

  Certain items – including furniture, lighting, buildings and land and certain gambling equipment – are excluded from the allowance. The program allows for reimbursement of 100 percent of taxes paid, limited to a period of 12 years; after 12 years, the tax reimbursement phases down until it reaches 50 percent in year 18, remaining at 50 percent for the remaining life of the program.

  Taxpayers who take advantage of the High Technology Tax Credit are not able to claim reimbursement for the same equipment under the BETR program.

  PL 2009, Chapter 496 reduces BETR reimbursement to 90 percent of eligible taxes for fiscal years 2010 and 2011. The same law makes property located in retail facilities larger than 100,000 square feet ineligible for reimbursement under the BETR program. Eligible property put into service on or after April 1, 2008 is eligible for the BETE program, which exempts all eligible non-retail equipment from the property tax.

  Maine Revenue Services estimates that approximately 2,000 taxpayers are affected by the BETR program. Estimated revenue losses associated with BETR in the current biennium are $57,600,000 in FY10 and $51,500,000 in FY11.

- **Business Equipment Tax Exemption Program (BETE)** – The statutory authority for this program may be found at 36 MRSA §691. The program is intended to provide incentives for businesses to make new investments that will spur economic development.

  The BETE program reimburses municipalities for loss of tax revenue arising from the exemption of qualified business equipment from the property tax. Only qualified equipment first subject to Maine property tax assessment on or after April 1, 2008, is covered under the program. Generally, the same types of businesses and equipment eligible for the BETR program are eligible under the BETE program. However, equipment used in the retail sale of either good or services in any size retail establishment (not only those exceeding 100,000 square feet) is ineligible for the program.

Taxpayers apply to and are granted tax exemptions by municipalities. The State, in turn, reimburses the municipalities for the associated loss of property tax revenue according to a phase-down schedule. In 2008, 100 percent of lost revenue is reimbursable, 90 percent in 2009, 80 percent in 2010, 70 percent in 2011 and 60 percent in 2012. In year 2013 and after, the State will reimburse 50 percent of the value of lost revenue. In certain instances where business equipment exceeds 5 percent of a town's total value of taxable property, municipalities may receive reimbursement made in accordance with an alternate methodology, which results in a higher rate of reimbursement. Additional reimbursement is also made to municipalities related to tax increment financing (TIF) revenues used by cities and towns on their own TIF projects.

Maine Revenue Services estimates that approximately 3,000 taxpayers are affected by the BETE program. The estimated losses in state revenues arising from the BETE program in the current biennium are $14,500,000 in FY10 and $17,500,000 in FY11.

- **Jobs and Investment Tax Credit (JITC)** – The statutory authority for this program may be found at 36 MRSA §5215. This program is intended to encourage businesses to make substantial investments in personal property in Maine that result in real growth in the number of jobs that pay at or above prevailing wage rates and that provide access to health and retirement benefits.

  Maine's Jobs and Investment Tax Credit (JITC) provides a credit of 10 percent of the value of an investment of at least $5,000,000 in personal property that creates at least 100 new jobs within two years of the date of the investment. Public utilities along with retail facilities are excluded from taking the credit. In any given year, the amount of the credit used is limited to the lesser of $500,000 or the tax liability of the taxpayer. Unused portions of the credit may be carried forward for up to seven years; the maximum credit that may be claimed is $3,500,000. A business is not able to take advantage of both the Jobs and Investment Tax Credit and the Employment Tax Increment Financing (ETIF) program simultaneously, with the exception of ETIF payments related to a Pine Tree Development Zone designation that is for investments and jobs unrelated to the JITC project.

  Maine Revenue Services estimates that the JITC program affects fewer than 10 taxpayers each year. Estimated revenue losses associated with the JITC in the current biennium are between $1,000,000 and $2,000,000 in each of FY10 and FY11.

- **Research and Development Tax Credits** - The State of Maine offers three tax credits related to research and development: the research expense tax credit; the super-credit for substantially increased research and development; and the high-technology investment tax credit.

  The *research expense tax credit* is authorized by 36 MRSA §5219-K and is intended to spur increased investment in research activities within the state. A taxpayer is allowed a non-refundable credit equal to 5 percent of the expenses related to qualified research activity exceeding the average expenditure made by that taxpayer on qualified research (in Maine) during the three preceding tax

years, plus 7.5 percent of the basic research expenditures made during the tax year for which a claim is being made.

Maine Revenue Services estimates that approximately 75 taxpayers are affected by this program each year. The state's estimated revenue losses associated with this program in the current biennium are $500,000 to $1,000,000 in both FY10 and FY11.

The *super-credit for substantially increased research and development* is governed by 36 MRSA §5219-L and is available to taxpayers qualifying for the basic research expense tax credit, described above, who have qualified expenses exceeding a "super credit" base amount, providing an incentive for substantial increases in investment. Like the research expense tax credit, it is only applicable to R&D expenditures related to Maine-based activities. The super-credit base is equal to 150 percent of the average research expense incurred by the claimant in the three immediately preceding tax years. The credit allowed is equal to the amount of qualified expenses exceeding the super-credit base or 50 percent of the tax liability remaining after all other credits is applied. In no case may the application of this credit result in a current year tax liability that is less than the tax liability of the previous year, after all credits are applied. This credit may be carried over for a total of five years.

Maine Revenue Services estimates that about 54 taxpayers are affected by this program each year. Estimated state revenue losses associated with this program in the current biennium are $2,000,000 in FY10 and $2,200,000 in FY11.

The statutory authority for the *high-technology investment tax credit* is found in 36 MRSA §5219-M; this credit is intended to provide incentives for businesses to invest in equipment used in high tech business activities. This non-refundable credit is available to taxpayers purchasing or leasing – and putting into service – eligible pieces of equipment. High technology activities are defined as including the design and production of software, computer hardware and other related accessories. These activities also include the provision of internet services and advanced telecomm service.

Qualifying equipment comprises equipment used in high tech activities and includes computers, electronic components, communications equipment and software placed into service within Maine. The amount of the credit is dependent on the adjusted basis of the qualifying equipment that is placed into service within the state during the tax year, less any lease payments received during the same year. Like the super-credit, the application of this credit in a current year tax may not result in a liability that is less than the tax liability of the previous year, after all credits are applied. The maximum credit in any given year is $100,000, but unused portions of the credit may be carried over five years. This credit is not available to taxpayers making a claim under the Business Equipment Tax Reimbursement program.

Maine Revenue Services estimates approximately 24 taxpayers are affected by this tax credit program each year. Estimated state revenue losses associated with the high technology investment tax credit in the current biennium are $1,000,000 in FY10 and $1,100,000 in FY11.

- **Credit for the Rehabilitation of Historic Properties** - Maine offers a credit to taxpayers making qualified historic rehabilitation investments to properties located in Maine. There are several different types of credits available under this program; relevant statutory authorities may be found at 36 MRSA §5219-R and 5219-BB.

  A nonrefundable tax credit equal to the federal rehabilitation credit is available for expenditures for qualifying rehabilitation projects involving properties located within Maine. The annual limit on this credit is $100,000.

  Alternatively, qualified national historic landmark developers may opt for a refundable credit equal to the federal rehabilitation credit, for tax years 2006-2009. This annual limit on this particular credit is $500,000.

  The law includes a tax credit for rehabilitation of a specific building in the Lockwood Mill Historic District of Waterville, in lieu of the credits outlined above. This credit, too, is equal to the federal rehabilitation credit and applies to tax years 2008-2013; the annual limit for this credit is $1,000,000.

  Beginning in the 2008 tax year, a credit of 25 percent of qualified expenditures, regardless of whether or not the taxpayer claims the federal credit, is available for project expenditures of between $50,000 and $250,000; expenditures incurred after 2013 are not eligible for the credit. Certain affordable housing projects may be eligible for a 30 percent credit. These credits are granted over a four year period, in 25 percent increments, with the maximum credit for any single project being $5,000,000.

  Maine Revenue Services estimates that, taking these credits together, fewer than 10 taxpayers are affected each year. Projected state revenue losses associated with these programs in the current biennium are between $1,000,000 and $3,000,000 in each fiscal year.

- **Shipbuilding Facility Credit** – The statutory authority for Maine's Shipbuilding Facility Credit program may be found at 36 MRSA, Chapter 919. This program is designed to encourage major investments in shipbuilding projects within the State, thereby preserving substantial numbers of good jobs and promoting the general welfare of the State.

  This program allows a tax credit to be applied against withholding liabilities for shipbuilders that own, operate or propose to build a shipbuilding facility within the Maine, that propose to make a qualified investment as certified by the Maine Department of Economic and Community Development, that employ at least 6,500 qualified employees at the time of application for the credit and that cannot otherwise qualify for Maine's Employment Tax Increment Financing program (ETIF).

  Additionally, the credit requires that qualified employees of the shipbuilder making a credit claim must have full-time employment with incomes taxable by the State. These employees must also have the right to participate in an ERISA-governed retirement program, have access to group health

insurance and have individual incomes that exceed the average annual per capita income for the state.

The annual limit on this tax credit is $3,500,000, but it may only be claimed against withholding liability related to the wages of qualified employees paid on or after July 1 of the tax year.

Maine Revenue Services estimate that fewer than five taxpayers are affected by this program in a given tax year. Estimated state revenue losses associated with this program in the current biennium are $3,100,000 in both FY10 and FY11.

- **Seed Capital Investment Tax Credit** – The statutory authority for Maine's Seed Capital Investment Tax Credit program may be found at 36 MRSA §5216-B. This program, which is administered by the Finance Authority of Maine, is intended to encourage investment in Maine small businesses, either directly or through private venture capital. Investors are eligible for tax credits of up to 60 percent of the cash equity provided to an eligible Maine business; [11]such investments may be used to fund fixed assets, research or working capital.

  Only investments in businesses located in Maine, that have gross sales of less than $3,000,000, are engaged in manufacturing, developing or applying advanced technologies, have 60 percent of sales realized outside the State or bring significant, permanent capital to Maine are eligible for the program. Eligible investments will be at risk for five years. Investor eligibility requirements also specify that investors seeking the credit may not include the business' principal owner or a member of the owner's immediate family; further, investors must collectively own less than one-half of the business. There are special rules that apply to venture capital investments.

  Eligible taxpayers may invest up to $500,000 in each business; for purposes of the tax credit, the maximum, aggregate per business investment cap is $5,000,000. Credits are granted in increments of 25 percent of the total allowable credit per year, beginning with the year in which the investment is made. In total, the credit may not exceed one-half of the total tax due from the investor for any given tax year. Unused credits may be carried forward for up to 15 years.

  Maine Revenue Services estimates that 275 taxpayers are affected by this program. In the current biennium, state revenue losses associated with the Seed Capital Investment Tax Credit are projected to be $1,000,000 in FY10 and $1,200,000 in FY11.

- **Employment Tax Increment Financing (ETIF)** – Statutory authority for this program may be found at 36 MRSA, Chapter 917. ETIF is intended to provide incentives to businesses to hire new employees into jobs paying higher than average wages and providing access to group health and retirement benefits. To qualify for ETIF, businesses must certify that the employment expansion for which they are claiming reimbursement would not have happened in the absence of the ETIF incentive.

[11] The value of the credit ranges from 40 percent to 60 percent, with investments made in specific high unemployment areas being eligible for the higher credit value.

Businesses hiring a minimum of five net new employees on or after July 1, 1996, who meet certain criteria are eligible to receive between 30 percent and 75 percent of state income tax withheld, for up to 10 years. In labor market areas where the unemployment rate is at or below the state average, the reimbursement rate is 30 percent; in areas where the unemployment rate is higher than the state average, reimbursement is 50 percent. In labor market areas where the unemployment rate is more than 150 percent higher than the state average, the highest reimbursement rate – 75 percent – is available during the first five calendar years for which reimbursement is requested for qualified employees. The reimbursement rate is based on the unemployment rate for the relevant labor market area at the time the taxpayer initially applies for the program, with an adjustment made for current unemployment rates at the outset of the sixth year.

For employees engaged in a qualified business activity of a qualified Pine Tree Development Zone business, the reimbursement rate is equal to 80 percent of the withholding taxes of qualified employees in a given tax year, for a period of no more than 10 years. The availability of new certifications for reimbursement under this program ends in years beginning on or after January 1, 2019; taxpayers receiving certification prior to the sunset date may continue to claim reimbursement through December 31, 2018.

Reimbursement is not made for any period of time when the level of employment, wages paid or benefits provided fall below the minimum required standards. Businesses participating in the Jobs and Investment Tax Credit program are not eligible to participate in the ETIF program.

Maine Revenue Services estimates that 100 taxpayers are affected by this program. In the current biennium, state revenue losses associated with ETIF are projected to be $6,400,000 in FY10 and $6,800,000 in FY11.

- **Pine Tree Development Zone Tax Credit (PTDZ)** – Statutory authority for the PTDZ tax credit program may be found at 36 MRSA §5219-W. The purpose of the program is to create quality jobs in targeted industries and to support new or expanding Maine businesses, as well as businesses relocating or establishing a Maine presence. The program is not intended to foster job retention, rather the means to this end is to be realized by greatly reducing the state tax burden for certified businesses for a period of up to 10 years.

  Taxpayers engaged in financial services, biotechnology, aquaculture/marine technology, composite materials technology, environmental technology, information technology or advanced forestry/agriculture technologies, operating within a Pine Tree Development Zone may apply for benefits under this program. To be eligible, a business must create at least one net new, full-time job providing higher than average wages and access to group health and retirement benefits. For tax years 2004 and later, a tax credit equal to 100 percent of the Maine tax liability arising from a qualified business activity is available for the first five years and 50 percent of the tax liability for years six through ten. There is a 100 percent personal property exemption from the sales and use tax related to all new tangible personal property purchases related to qualified business activities,

for a period of up to 10 years. Similarly, there is a 10-year, 100 percent reimbursement on real property purchases that are physically incorporated in and become a permanent part of real property used in a qualified business activity.

Qualifying taxpayers are also eligible for ETIF benefits, receiving reimbursement of income tax withholding for qualified Pine Tree Development Zone employees for a period of up to 10 years. Sales tax exemptions, for a period of up to 10 years, are available for the purchase of construction materials and equipment. Finally, qualified taxpayers also enjoy access to reduced rates for electricity. Beginning in tax year 2010, newly certified businesses located in certain municipalities in York and Cumberland counties will be limited to a five-year duration of benefits.

In certain instances, manufacturers located outside of a designated Pine Tree Development Zone may also be eligible for the program. To qualify for participation, manufacturers must make a minimum investment of $225,000 and create at least four net, new qualifying full-time jobs.

In all instances, the taxpayer must certify that the expansion project would not have moved forward but for the benefits of the PTDZ program. Existing jobs that are moved from one location within Maine to another are not considered “new” jobs.

Maine Revenue Services estimates indicate this program affects approximately 50 taxpayers. In the current biennium, state revenue losses arising from this program are projected to be between $500,000 and $1,000,000 each year.

Assessing Tax Expenditure Programs

Resolves 2009, Chapter 199 directed the working group to recommend a method of measuring the economic impact of tax expenditure programs. The approach taken by Washington has much to commend to Maine, giving heightened recognition to the fact that tax expenditures are, in fact, spending programs that merit review, evaluation and an enhanced degree of transparency and accountability.

We recommend limiting the review to those tax expenditures defined in the previous section. This subset of tax preferences focus on those provisions of the tax code intended to foster economic development in Maine. While there are other relevant tax provisions, it is important to note that the BETR and BETE provisions are the most significant such programs; the fiscal implications of all of the other programs are far less substantial.

If experience proves that meaningful reviews are able to be conducted and that policymakers avail themselves of the information provided in those reviews, consideration might be given to broadening the scope of review. Note that this work will not be insignificant and will require financial and personal resources. Assuming that production of quality reviews can be undertaken without the dedication of resources will result in a less than desirable outcome.

These reviews should be carried out on a cyclical basis. While no particular order for reviews is recommended, concurrent review of related or complementary provisions should be undertaken in the same cycle. Assessing the impact of interrelated provisions will be very difficult as they may have interactive effects.

The 10-year cycle employed in Washington serves to allow each in a long list of tax preferences to be reviewed once each decade. As this working group is recommending a much narrower scope of programs for review, this report advises that each be reviewed at least once every four years. If a tax provision is subject to legislative amendment, it may take several years for the impact of such a change to begin to exercise any observable impact. In such cases, a four-year review cycle should not be expected to produce definitive recommendations; instead, the four-year review will provide policymakers with a status check on the program, helping to ensure that appropriate legislative consideration to the policy is demonstrated.

The considerations of review should mirror those included in the Washington approach. While many of the same factors are incorporated in Maine's current tax expenditure report, the assessment-aspect of the Washington review provides a depth of information not currently available to Maine policymakers. We do recommend, however, that reviews not demand the inclusion of recommendations regarding the future of any given tax expenditure. Placing such responsibility on the reviewers may likely detract from the objectivity of the review process. Examples of a potential format for these reviews are attached as an Appendix to this report.

As noted elsewhere, the process of assessment is a challenging one. One limitation to analysis is an ability to assess the impact of those tax expenditure provisions with a policy objective of job creation. We propose using data maintained by the Maine Department of Labor (DOL) – the so-called "202" data – to conduct such an analysis. This work will require that specific employers be identified and tracked, over time, in the DOL database; if a particular tax expenditure program involves an entire industry, all firms in that industry would be flagged in the database. Companies located in a designated Pine Tree Development Zone, for example, would be flagged, with regular reports on employment levels and payrolls at those companies produced, allowing for analysis and review of job creation. Such a tracking system could be developed at a reasonable cost, with on-going systems maintenance and administrative support required. Development and implementation could move forward relatively quickly and promises an effective means to track jobs production against assurances and assumptions made regarding the various tax preference initiatives.

This effort would demand a high degree of coordination between the Departments of Labor and Economic and Community Development, as well as any other state agency identifying specific firms receiving certification for tax expenditure/incentive programs. Firms would be required to agree to allow their quarterly filings under the Maine Employment Security Law to be used for this purpose. This would require statutory authority.

There are stringent confidentiality requirements placed on Maine Revenue Services with regard to taxpayer information and adherence to these requirements is zealously enforced. At the same time,

there are tax expenditure programs that have been developed and enacted specifically for a small number of (or even one) taxpayers; similarly, there are programs that only affect a handful of taxpayers. Many of the provisions included on the recommended list for tax expenditure review fall into this category. The confidentiality requirements can limit the ability of reviewers to access data and report out on findings and would require some type of exception to allow meaningful review to take place.

Finally, we recommend that a non-partisan body be charged with responsibility for conducting the reviews. While Maine Revenue Services is able to provide the public debate with informed, intelligent information regarding tax policy, the role of a non-partisan office in the evaluation process may be desirable. Much of the report's factors would have to be prepared by the revenue office, given that is where the data on payments and claimants reside, along with the tax modeling software. But the evaluation of the effectiveness of the tax expenditures with regard to furtherance of particular policy objectives may be more appropriately carried out by what is viewed by the public as a truly non-partisan office.

Rather than adopting the intermediary procedural step involving reference to a citizen commission as used in Washington, the relevant legislative committees of jurisdiction – the Joint Standing Committees on Appropriations and Financial Affairs, Taxation and Business, Research and Economic Development – should receive report backs from the Office tasked with carrying out the tax expenditure reviews. These Committees should conduct hearings – jointly or separately – on each review, to accept public input on each tax expenditure program. This will ensure legislative consideration of the review and provide an opportunity for public comment.

CONCLUSIONS

After consideration of the practices and experience of other states, it is recommended that Maine adopt an approach of tax expenditure review modeled after that used by the State of Washington. Eleven tax expenditure programs focused on economic development should serve as the focus of cyclical reviews, with each program reviewed at least once every four years. Reviews should be conducted by a non-partisan body, with assistance from the relevant agencies of State government, incorporating the considerations outlined earlier in this report.

Final reviews should be reported out to the Legislature's Committees on Appropriations and Financial Affairs, Taxation and Business, Research and Economic Development. It is recommended these Committees hold public hearings on each report, to ensure sufficient opportunity for public comment and appropriate legislative consideration of the reviews. It will be left to the relevant legislative committees to make recommendations regarding necessary or desirable modifications to the tax expenditure programs under review.

While recognizing the role these programs play in business and economic development in the state, it is important to also recognize the fact that these programs also represent substantial public fiscal investment. The review approach recommended is designed to enhance transparency and accountability of Maine's tax expenditure programs.

APPENDIX ONE

Resolves 2009, Chapter 199

Chapter 199
H.P. 1195 - L.D. 1694
Resolve, To Increase Transparency and Accountability and Assess the Impact of Tax Expenditure Programs

Sec. 1 Commissioner of Administrative and Financial Services to convene working group. Resolved: That the Commissioner of Administrative and Financial Services shall convene a working group consisting of representatives of the Department of Administrative and Financial Services, Bureau of Revenue Services; the Department of Economic and Community Development; the Executive Department, State Planning Office; and any other state agency the commissioner considers appropriate. The working group shall:

1. Define the purpose of each tax expenditure program identified by the working group as subject to the information collection requirements of this resolve;

2. Design a method to collect data that measure the economic impact of tax expenditure programs, including, but not limited to, revenue loss versus economic gain, jobs created or lost and administrative burden. In designing the method, the working group shall examine practices in other states and other issues the working group considers relevant;

3. Recommend a regular reporting schedule for the tax expenditure program economic impact data to the joint standing committees of the Legislature having jurisdiction over taxation matters, appropriations and financial affairs and business, research and economic development matters; and

4. Recommend a regular schedule of review of the tax expenditure program economic impact data by the joint standing committee of the Legislature having jurisdiction over taxation matters; and be it further

Sec. 2 Report. Resolved: That, no later than November 3, 2010, the Commissioner of Administrative and Financial Services shall submit a report containing the working group's findings and recommendations to the joint standing committees of the Legislature having jurisdiction over taxation matters, appropriations and financial affairs and business, research and economic development matters.

APPENDIX TWO

Examples of Potential Tax Expenditure Reports

Jobs & Investment Tax Credit

Current Law

Maine's Jobs and Investment Tax Credit (JITC) provides a credit of 10 percent of the value of an investment of at least $5,000,000 in personal property that creates at least 100 new jobs within two years of the date of the investment. Public utilities along with retail facilities are excluded from taking the credit. In any given year, the amount of the credit used is limited to the lesser of $500,000 or the tax liability of the taxpayer. Unused portions of the credit may be carried forward for up to seven years; the maximum credit that may be claimed is $3,500,000. A business is not able to take advantage of both the Jobs and Investment Tax Credit and the Employment Tax Increment Financing (ETIF) program simultaneously, with the exception of ETIF payments related to a Pine Tree Development Zone designation that is for investments and jobs unrelated to the JITC project.

Legal History

1978 The Legislature enacted PL 1977, Chapter 722, establishing Maine's Jobs and Investment Tax Credit. The Legislature in enacting this law, found the growth of major industry in Maine to be in the public's interest and that the use of investment tax credits to encourage industry to make substantial investments in Maine is necessary to encourage such growth. The original statute, effective for tax years beginning on and after January 1, 1979, required a minimum $5,000,000 investment and an increase in the new job credit base of at least $1,200,000 over the wage base for the highest three preceding years. The law also limited the carry over credit allowed to $300,000 or the amount of tax otherwise due, for a period of up to seven years, inclusive of the year in which the credit was first taken.

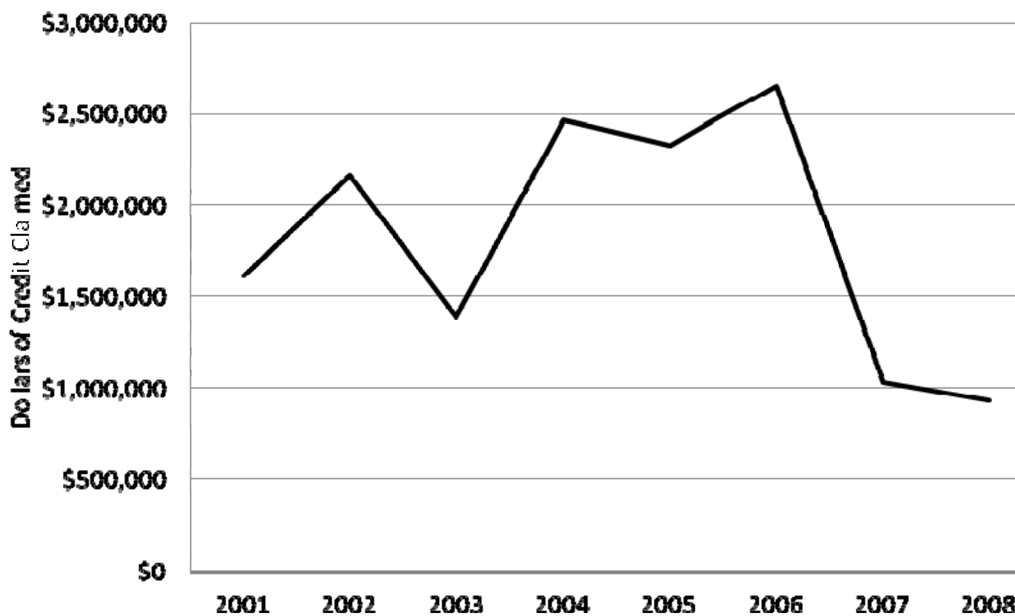
1988 The Legislature enacted PL 1987, Chapter 880, An Act to Clarify the Maine Jobs and Investment Tax Credit Law, as emergency legislation, stating that the current law contained deficiencies that defeated the original intent of the law. This law amended the original statute to require a business applying for the credit to substantiate the creation of at least 200 new jobs attributable to the operation of personal property considered to be a qualified investment, in order to be eligible for the credit. These new jobs had to come on line in the 12 months following the date on which the property was placed into service. The law also raised the required increase in the wage base from $1,200,000 to $1,400,000.

1994 The Legislature enacted PL 1993, Chapter 672, "An Act to Clarify the Jobs and Investment Tax Credit." This law added a definition of "excluded investment" to mean investment related to a retail facility, unless the retailer is able to demonstrate that its project(s) will not have a detrimental impact on existing Maine businesses. The law also lowered the threshold for the number of new jobs that are required to be created as a result of a qualified investment from 200 to 100, and extended the period of time over which those jobs must come on line from 12 months to 24 months. At the same time, the impact on the new jobs wage base was lowered from $1,400,000 to $700,000.

1998 The Legislature enacted PL 1997, Chapter 761, adding a requirement to the JITC law that qualifying investments must generate new jobs that are covered by a retirement program subject to ERISA, must be covered by group health insurance and must be paid wages that are greater, on average, than the annual per capita income in the labor market area in which the employees are employed. This provision applied to jobs created between August 1998 and October 2001.

Other Relevant Information

The chart below shows the level of Jobs and Investment Tax Credit claimed, by tax year, since 2001, the earliest year for which data are readily available. Note that it is possible that not all 2008 tax returns have been received, so credits claimed for that year may be understated. In each year shown, the number of taxpayers claiming the credit is less than 10.



The frequency of claims against this particular credit has declined in recent years. The average size of the credit claimed peaked in the middle of this decade and has declined slightly since that time.

There were a handful of companies that had taken a large credit for many years, which have finally exhausted their credit; other companies have not flowed in to take their place. There are several reasons why this may have occurred.

First, random chance may be at work here. There are never more than a few companies claiming the credit, so even very small changes in the number of companies participating in the program can cause large swings in the dollars involved and the number of jobs created. Second, the full onset of the recession in 2008 may have exercised some impact on businesses' ability to make substantial investments in personal property in recent years; data for tax years subsequent to 2008 will inform that analysis, but will not be available for some time to come. Finally, the influence of the ETIF and Pine Tree Development Zone programs along with the recent implementation of the single sales factor of apportionment of income may be exercising an impact on the JITC program.

A business may not simultaneously take advantage of both the Jobs and Investment Tax Credit and Employment Tax Increment Financing except as previously described. ETIF entitles qualified businesses to reimbursement of up to 80 percent of certain new employees' Maine tax withholdings for a period of up to 10 years.[12] To qualify, the wages paid to new employees must exceed the market area's average per capita income and have access to an employer-sponsored group health plan, as well as an ERISA-qualified retirement program. An MRS review of companies taking advantage of ETIF, however, does not reveal any obvious example of a company opting for ETIF over the JITC. The move to the single sales factor results in corporations with a nexus in Maine but whose sales are primarily out of state having little Maine income tax liability to offset. This phenomenon would increase the attractiveness of ETIF relative to JITC. In addition, Pine Tree Development Zone status provides more than just enhanced ETIF reimbursement; it also provides an income tax credit equal to 100 percent (50 percent in years six – ten) of tax liability associated with PTDZ activity and sales tax exemptions for construction materials and purchases related to PTDZ activity.

Public Policy Objectives

The purpose of the Jobs and Investment Tax Credit is to encourage businesses to make substantial investments in personal property in Maine that result in real growth in the number of jobs that pay at or above prevailing wage rates and that provide access to health and retirement benefits.

Has the tax expenditure contributed to the realization of the policy objectives?

---

[12] The reimbursement percentage is dependent on the unemployment rate in the labor market area of the new jobs relative to the statewide unemployment rate. The percentage is 30 percent for labor areas with an unemployment rate below the state average, 50 percent for labor areas above the state average and 75 percent for labor areas with an unemployment rate greater than 150 percent of the state average. The ETIF reimbursement average is 80 percent regardless of the labor area if the business is a qualified Pine Tree Development Zone business.

From 2001 through 2008, a total of 35 claims were paid under the Jobs and Investment Tax Credit program. Of the 35 total claims, 11 represent new claims, as opposed to carry over payments. Recall that a qualifying business may only claim a maximum of $500,000 per tax year, but may carry forward the balance of the amount it may be entitled to for up to six years following the year in which the investment is made. The 11 new claims must have created a minimum of 100 new jobs each, which means that at least 1,100 new jobs were associated with investments made that qualified for this credit. Note that the minority of businesses claiming the credit in any given year are making new claims as opposed to carrying over claims; this has been the case since 2002.

This observation, however, does not necessarily imply a causal relationship between this tax expenditure program and job creation, only that businesses that made substantial investments and created at least 100 new jobs took advantage of the program. There are no data readily available that would show how many of the newly created jobs still exist today and we can never directly measure how many jobs would have been created in the absence of the program.

States are concerned about economic development and their ability to attract private-sector investments and jobs. Often, state policymakers turn to tax expenditures such as a tax credit to promote such development. The effectiveness of such policy tools, however, is not entirely clear. There are 3 challenging questions that must be answered to assess the effectiveness of this type of tool in a rigorous manner.

- *Would the investment and job creation event have occurred in the absence of the credit?*

It is very difficult to determine the tipping point or deciding factor for a business investment decision; whether or not a business would have otherwise made a substantial investment in the absence of the tax credit program is speculative, at best, often relying on anecdotal reports by beneficiaries rather than expert review.

Generally, the literature indicates that the actual size of the tax credit or tax expenditure or other subsidies is much less important than simply the availability of a program, which evidences a state's hospitality and support of private sector business development. They are important marketing tools, but their size need not be excessive. They are an important tool in a more comprehensive economic development strategy, the cost of which should be proportionate to the benefits they generate.

- *Did the credit partially shift employment from incumbent firms that have not qualified for the credit to the credit recipients?*

The Jobs and Investment Tax Credit, along with most economic development incentives, lowers the cost for businesses that are investing or expanding employment relative to incumbent businesses that are not undertaking those activities. This can result in a shift in employment from unsubsidized to subsidized firms and reduce the credit's net impact on the Maine employment level. If the unsubsidized

firms are more productive then their subsidized counterparts, then the credit's net impact on the Maine employment level could be further reduced.

Several papers in the literature on state investment tax credits and the single sales factor method of corporate income apportionment (which is meant to encourage investment) have found that these policies have a positive impact on investment within a state, but at the expense of investment in other states.

- *If the credit was discontinued, how would the funds allocated for the credit be used?*

Answering this question matters for the desirability of the program, and the Legislature would determine its answer. Many economic impact studies implicitly assume that if a credit did not exist, then the funds used for the credit would have been entirely wasted. This assumption is clearly inappropriate, but the proper assumption that an independent evaluator should make is unclear.

To what extent will a continuation of JITC contribute to the policy objective of the program?

The continuing value of this tax expenditure program is unclear at present. As noted above, there are several factors that may be influencing participation in this program, not the least of which is the current recession. Given the uncertainty of the economic climate and the threshold investment required to qualify for this credit, we would reasonably expect a drop in investment.

As stated earlier, a business cannot participate in both JITC and ETIF simultaneously. The Pine Tree Development Zone (PTDZ) program was introduced in 2003; in 2004, the first ETIF claims for PTDZ participating businesses were able to be filed. As activity and hiring ramped up in these businesses, so, too, did the number of associated ETIF claims, growing from 25 in 2004 to 87 in 2008. The interactions between ETIF, PTDZs, single sales factor and JITC require further analysis to ascertain if modifications to JITC might improve its attractiveness or effectiveness, or a need to continue it.

Beneficiaries

Generally, businesses investing at least $5,000,000 in personal property that results in creation of at least 100 new jobs within two years of the date of investment are eligible for the Jobs and Investment Tax Credit. Public utilities are not eligible for the program. Similarly, retailers are not eligible for the credit, unless they are able to demonstrate that their project does not have a detrimental impact on existing Maine businesses.

In addition to the businesses benefitting from an offset to tax liability, persons coming into the new jobs will benefit to the extent that qualifying jobs must meet or exceed prevailing wage rates and provide access to health and retirement benefits. To the extent employees are attracted into a

JITC-beneficiary workplace and away from another Maine business, the competitiveness of those other businesses may be affected.

Does the JITC create any unintended benefits to entities other than those specifically contemplated by policymakers?

There do not appear to be any unintended beneficiaries of JITC.

Revenue and Economic Impacts

Past/Future Impacts

From 2001 through 2008, the JITC resulted in the following levels of revenue foregone.

2001	$ 1,593,201
2002	$ 2,158,288
2003	$ 1,374,054
2004	$ 2,000,000
2005	$ 2,326,136
2006	$ 2,656,349
2007	$ 1,031,601
2008	$ 926,204

Maine Revenue Services estimates that the JITC will cause a $1,000,000 to $2,000,000 revenue loss per year for each year between 2009 and 2013. In each year, MRS estimates fewer than 10 taxpayers will be affected by the program.

To the extent that the jobs supported by these investments would not otherwise have been created, they represent a net positive gain in employment and economic activity. Each induced investment will also have a multiplier effect as the business' investment and hiring induces others – suppliers, retailers, and so on – to increase their own production and economic activity in response.

At the same time, the annual value of the tax expenditure – roughly $2,300,000 – represents forgone General Fund revenue. All else being equal, this amount will either have to be collected from other taxpayers or be saved through constraints in government spending. Because tax expenditures reduce the tax base, the overall tax rate is generally higher than it would be absent the existence of the credit.

Clearly, the effect of a repeal of this credit on direct beneficiaries would be an increase in tax liability. However, it is difficult to predict what the effect of repeal might be on the overall state economy. If business investments were to continue uninterrupted, the effect would be positive – a reduction in overall tax liability for all taxpayers of slightly more than $2,000,000. If, absent this credit, eligible businesses chose to forego the previously induced investments in personal property, the effect would be lower overall business investment and a reduction in job creation. The most likely scenario lays somewhere in between: investments that make good business sense without the credit will continue; investments that only make sense with the accompanying reduction in tax liability will be foregone.

Other States

Other states do have programs similar to Maine's Jobs and Investment Tax Credit program.

HISTORIC PRESERVATION TAX CREDIT

Current Law

Maine offers a credit to taxpayers making qualified historic rehabilitation investments to properties located in Maine. There are several different types of credits available under this program.

A nonrefundable tax credit equal to the federal rehabilitation credit is available for expenditures for qualifying rehabilitation projects involving properties located within Maine. The annual limit on this credit is $100,000.

Alternatively, qualified national historic landmark developers may opt for a refundable credit equal to the federal rehabilitation credit, for tax years 2006-2009. This annual limit on this particular credit is $500,000.

The law includes a tax credit for rehabilitation of a specific building in the Lockwood Mill Historic District of Waterville, in lieu of the credits outlined above. This credit, too, is equal to the federal rehabilitation credit and applies to tax years 2008-2013; the annual limit for this credit is $1,000,000.

Beginning in the 2008 tax year, a credit of 25 percent of qualified expenditures, regardless of whether or not the taxpayer claims the federal credit, is available for project expenditures of between $50,000 and $250,000; expenditures incurred after 2013 are not eligible for the credit. Certain affordable housing projects may be eligible for a 30 percent credit. These credits are granted over a four year period, in two 5 percent increments, with the maximum credit for any single project being $5,000,000.

Legal History

1999 The Legislature enacted PL 1999, Chapter 401, Part RRR, amending Title 36 – Maine's Tax Code – to include a credit for rehabilitation of historic properties. This language allowed for a nonrefundable credit equal to the federal rehabilitation credit for qualifying rehabilitation projects. The annual limit on this credit was established at $100,000 and applied to tax years beginning on or after January 1, 2000.

2006 PL 2005, Chapter 519, Part H revamped the previous historic tax credit language, adding an option for a refundable credit in certain instances, in lieu of the nonrefundable credit established in 1999. Refundable credits were made available to national historic landmark developer, in an amount equal to the federal rehabilitation credit, for tax years 2006 – 2009, only. The credit carries a total annual limit of $500,000 and relates specifically to the Kennebec Arsenal District National Historic Landmark in Augusta.

2007 In PL 2007, Chapter 240, Part NNNN, the Legislature amended the provisions of the tax code related to the historic preservation credit, adding a credit for historic landmark developers rehabilitating properties in the Lockwood Mill Historic District in Waterville. The language provides a new refundable tax credit again equal to the federal rehabilitation credit, in lieu of the nonrefundable credit established in 1999. The credit is only available in tax years 2008-2013 and is limited to a total of $1,000,000 annually. Unpaid amounts may be carried forward to future tax years, up through 2013.

2008 The Legislature enacted PL 2007, Chapter 539, Part WW, which further amends the Maine tax code provisions relating to the historic preservation credit. This amendment adds an ending date to the original credit provisions established in 1999, stating that no credit may be claimed for expenditures incurred after December 31, 2007.

This language also established new provisions for refundable tax credits for the rehabilitation of historic properties occurring after 2007. This provision, found in Section WW-4, allows a credit equal to either 25 percent of certified qualified rehabilitation expenditures claimed against the federal tax credit or a credit equal to 25 percent (per year for four years) of certified, qualified expenditures of between $50,000 and $250,000 that are not claimed under the federal tax credit. This credit is allowed for tax years 2008-2013 only.

The language boosts the allowable credit to 30percent if the project involved also creates affordable housing meeting certain criteria. The total maximum credit allowed under the new provisions is $5,000,000.

2008 PL 2007, Chapter 615 is enacted, providing ongoing funding for the historic preservation tax credit. The law specifies that, beginning in state fiscal year 2010, taxes paid on sales or use for purposes of construction activities related to qualified historic rehabilitation projects and taxes paid on the transfer of real estate included in such a project are to be transferred to a historic rehabilitation credit fund. The resources of the fund are to be used to offset claims against the historic preservation tax credit.

2009 The Legislature enacted PL 2009, Chapter 1, Part Z, which again amends that portion of the tax code related to the historic preservation credit initially adopted in 2006, applying specifically to the Kennebec Arsenal District National Historic Landmark. This amendment alters the timeframe within which the credit is available, to tax years 2009-2013.

Other Relevant Information

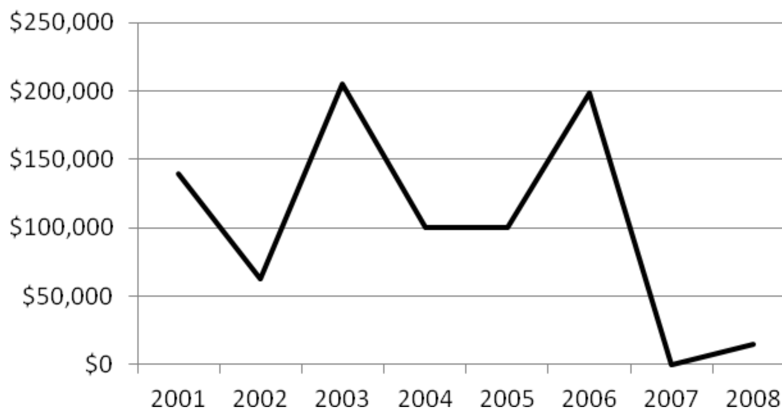
When the expansion of the historic rehabilitation credit to smaller ($50,000 to $250,000) projects was under consideration, the policy argument advanced by advocates rested on encouragement of a substantial increase in investments made under the credit – rising from around $5,000,000 per year to as much as $65,000,000-$91,000,000 per year.[13] An econometric analysis of the proposed credit

[13] The Economic Benefits of an Expanded Historic Tax Credit in Maine. Planning Decisions, Inc. April 2007, revised January 2008.

expansion conducted by Dr. Charles Colgan implied a resulting increase in employment of 800 jobs per year.

The expanded tax credit was expected to first have a substantial fiscal impact in FY10. Importantly, advocates argued that the economic impact (in terms of increased sales and income tax revenues related to the investment spending of developers, suppliers and construction workers, as well as increased valuation of property and the resulting increase in property tax collections by local governments] of rehabilitation projects would be felt in the community long before the impact on state revenues would be observed.

Excluding credits allowed for the rehabilitation of the Lockwood Mill Historic District, only a handful of returns for credits exceeding $5,000 have been granted since 2001; similarly, during the same time period there have been only a handful of credits for less than $5,000 that have been granted. No credits were claimed in tax years 2007; 2009 claims data are not yet final. None of the credits claimed in a given tax year represent carry over claims. The vast majority of these claims were filed as franchise claims; that is, the credit was granted and parsed out to a consortium of parties who worked together on the rehabilitation project.



As noted above, there is a specific tax credit available for rehabilitation projects undertaken at the Lockwood Mill Historic District in Waterville. The annual maximum credit allowed under this provision is $1,000,000, but credits can be carried over future years, up through tax year 2013.

Public Policy Objectives

The overriding objective of the historic preservation tax credit is to encourage the investment of private funds in the rehabilitation and preservation of Maine’s historic properties. Every corner of the state boasts historic districts and there are hundreds of buildings that, while not located within an historic

district, are on the National Register of Historic Places. The preservation of these resources is viewed as integral to enhancing Maine's "quality of place" which some view as key to our economic vitality.

Because historic rehabilitation is labor intensive with 60-70 percent of project costs going to labor (v. materials)[14] tax credit policies are sometimes viewed as job generating policies. Investment in restoration/rehabilitation also tends to result in increased property values, generating revenues at the local level. Finally, state rehabilitation tax credits can leverage federal rehabilitation tax credits, bringing federal revenues into the state.

Has the tax expenditure contributed to the realization of the policy objectives?

The tax credit enacted to incentivize the rehabilitation of the Lockwood Mill Historic District may fairly be characterized as having contributed to the objective of encouraging substantial investment of private monies in the preservation of historic properties within our state. To date, this is the largest historic rehabilitation tax incentive project in Maine, with expenditures exceeding $34,000,000. It has transformed a structure in a relative state of disrepair into vibrant, mixed use space, including retail, office and residential space.[15] Importantly, the developers were approved to receive both state and national historic rehabilitation tax credits, along with federal New Market tax credits, grants from the federal Economic Development Administration, a grant and loan from Colby College and a TIF award from the City of Waterville. It may be argued that the state tax credit facilitated the leveraging of these many funding streams into a large, successful project that holds economic and cultural value for the Central Maine area.

Less can be said about the other historic rehabilitation tax credit provisions. Rehabilitation of the Kennebec Arsenal property has yet to begin. Similarly, activity under the provisions of the small project rehabilitation tax credit has not been substantial; only 23 credits have been claimed to date, totaling less than $1,000,000. Data from the Maine Historic Preservation Commission, however, demonstrates since 2008, $4,700,000 in qualified rehabilitation expenditure projects has been certified. While no such projects were certified in 2008, there were 3 certified in 2009, and 3 additional certifications (with a 4th pending) in 2010; it appears that two of the projects certified include affordable housing stock. While these rehabilitation projects have been certified by the cognizant state agency, there is no indication yet that a taxpayer is claiming the benefit of the credit.

The current economic crisis likely has had a dampening effect on the ability of investors to take on historic rehabilitation projects.

To what extent will a continuation of the historic preservation tax credit contribute to the policy objective of the program?

[14] *Economic Benefits of State Historic Preservation Tax Credits.* National Trust for Historic Preservation. http://www.preservationnation.org/issues/rehabilitation-tax-credits/addtional-resources/nthp_state_tax_credits_model_policy.pdf

[15] Communication from E. Shettleworth, Maine Historic Preservation Commission, October 25, 2010.

It is difficult to predict if a continuation of these programs will contribute to the policy objectives of the program. Refundable credits for large projects must be first claimed in tax year 2013 – economic conditions are unlikely to substantially improve by that time, which may decrease the likelihood that the credits are taken.

The National Trust for Historic Preservation suggests that some state tax credits work better than others, as a function of two factors: limits or caps on the amount of the credit allowed and the transferability of the credit. The Trust argues generally that any annual cap or limitation – regardless of how large that cap might be – has a chilling effect on rehabilitation activities, helping projects that do not really need the credit to proceed and discouraging projects that are unable to be undertaken without the credit. States that have resisted employing aggregate caps have been more successful at attracting investments in historic preservation.

While a cap applied to individual projects helps diffuse the potential problems presented by an aggregate cap, the effectiveness of the incentive is likely related to how high the per project cap is. Maine's $5,000,000 cap is one of the two highest in the nation.

If a developer is unable to make use of the tax credit – if its tax liability is so low as to dilute the value of the credit – the credit is of less use from a policy perspective. Strategies to boost value in this situation include allowing the sale of a credit to a third party having tax liability adequate enough to benefit from the credit. Alternatively, some states allow a partnership owning a rehabilitated property to distribute the credit disproportionately, allowing a local taxpayer to take the state credit and a national partner without nexus in the state to claim the federal credit. Carry back application of portions of a credit not usable in a given tax year is allowed under the federal program, but is a feature in only two state programs. Refundability provisions (which Maine employs in certain cases) allow unused offsets to still accrue to the benefit of the taxpayer in the form of a refund.

Finally, the literature indicates that a credit in the neighborhood of 20-30 percent is high enough to stimulate meaningful activity. Maine's credits are set at that level.

Beneficiaries

This tax expenditure program affects relatively few taxpayers. Most claims filed have been for less than $5,000.

Does the Historic Preservation tax credit create any unintended benefits to entities other than those specifically contemplated by policymakers?

It is not apparent that this tax credit program conveys any benefits other than those specifically contemplated by policymakers.

Revenue and Economic Impacts

This program has a marginal revenue impact; MRS estimates the revenue losses associated with this tax credit will be between $1,000,000 and $3,000,000 in each year of the current biennium. Provisions in the law related to stimulation of affordable housing stock have not yet had any revenue impact.

Tax credits for historic rehabilitation can represent considerable investment in a community. These projects do result in the preservation of an important slice of cultural history and can contribute to the revitalization of a business district. While the construction and rehabilitation phases of the project undoubtedly result in employment of trades people and while restored properties often house businesses that may employ considerable numbers of people, Maine's experience, to date, with these program do not provide insight into how many of these jobs are new jobs, as opposed to simply being relocated jobs.

Other States

As of May, 2010, thirty-one states across the nation offered historic preservation tax credits. The characteristics of these programs vary from state to state both in terms of the details of the credits themselves, and in terms of relative effectiveness. For an overview of state credits, please see the website of the National Trust for Historic Preservation at:
http://www.preservationnation.org/issues/rehabilitation-tax-credits/addtional-resources/nthp_state_tax_credits_model_policy.pdf.