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Decision on Personal Property Repeal Imminent

Presumably by the end of this week, the Legislature will make a decision on LD 2056, the bill that would prospectively repeal the tax on most personal property taxes. That vote will be one of the last decisions the 122d Legislature makes. The debate over LD 2056 has frustrated many lawmakers. Attempts by legislators to get a clear understanding an impact of the bill have been very difficult given the competing information of the lobbyists on each side – The Chamber of Commerce and the Governor's Office of Department of Economic and Community Development (DECD), both of whom are in support of LD 2056 as printed, and the Maine Municipal Association and hundreds of individual municipalities and municipal leaders, who are strongly opposed to the printed bill.

This article will identify three sources of the conflict — three underlying assumptions held by each side — that help to explain why the financial impact analyses are so different. Those three areas of analytical difficulty are: (1) the prospective nature of the exemption, which clouds impacts and pushes them into the political future; (2) competing observations about the claim that LD 2056 somehow "preserves the existing tax base"; and (3) the reliability or lack of reliability with respect to state reimbursement promises.

Hopefully, understanding the underlying source of the conflict will help legislators develop their position on the bill.

Issue #1. LD 2056 is undeniably complicated and its prospective application pushes impacts into the future.

There are very few people in Maine who can read LD 2056 and explain what it does. It is written in the dense legalese that requires an independent familiarity and understanding of the Business Equipment Tax Reimbursement program (BETR), which is itself an enigma to many people. A solid understanding of Tax Increment Financing programs, the make-up of municipal tax bases, and the relative rates by which different types and classifications of property depreciate and are replaced is also necessary in order to have a good sense of the impacts of LD 2056 over time.

The BETR model, upon which LD 2056 is based, was enacted 10 years ago and created what amounts to a 12-year exemption for business personal property taxes. With just two years to go on that original program, LD 2056 comes along in order to extend the BETR model permanently, so that the original 12 year agreement becomes a forever agreement.

LD 2056 is widely characterized as a "prospective" repeal, meaning that it only exempts newly installed property rather than property that is already on the tax rolls. From the proponents' point of view, that characterization makes a good sound-bite, because it suggests that the only loss is phantom, unsubstantial, unreal. Legislators are safe, at least for the short term, because there won't be harsh impacts in the early years.

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Bill That Mandates Minimum Teacher Salary Up for Vote

The January 27th *Legislative Bulletin* described in some detail the Governor's proposal to increase starting teacher salaries to $30,000. The proposal was originally in the supplemental budget bill (LD 1968). Now it is in a spin-off bill, LD 1381, *An Act to Update Teacher's Minimum Salary*. In that article, MMA predicted that if the state mandates an increase in the starting salary for teachers, that increase would eventually "ripple" or "cascade" through the system such that all teachers would receive a pay increase.

LD 1381 is very similar in both design and financial impact to LD 2056, the repeal of the personal property tax that is discussed in a separate article in this edition of the *Legislative Bulletin*. Both bills push their fiscal impacts into the future, so the political benefits of the two bills can be maximized on the short term, and the negative impacts can be pushed out in time and politically minimized. Both bills have the similar effect of making property tax relief associated with LD 1, or its predecessor "Question 1A", difficult if not impossible to achieve.

And both bills seek to remove municipal autonomy: LD 2056 by narrowing the tax base and making municipalities heavily dependent on the char-

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The “prospective” approach is extremely problematic from an analytical point of view, which is also advantageous from the proponents’ perspective. Without a careful impact analysis, the proponent’s of LD 2056 can simply claim that the effects of LD 2056 are all good, it’s impacts will all be positive. That anything negative will get lost in the sauce.

Municipal people don’t think like that. They don’t have the luxury of treating their tax structure cavalierly or dismissing various tax impacts just because they won’t materialize for a few years. They keep a sharp eye on even the slightest changes to their tax base and tax rate. Just last year, this same Legislature enacted the 50% unreimbursed property tax homestead exemption, which is considered by most municipal leaders as a universal flop in tax policy. Now, the Legislature is about to repeat itself with LD 2056.

What follows is a quick primer on LD 2056, which is provided in the attempt to describe both the complexity of the bill and the challenges to projecting its impacts. The bottom line is that you cannot remove billions of dollars of taxable value from the municipal tax base without significant repercussions in the municipal tax rate.

As discussed above, under current law the property taxes paid on most personal property put into service after 1995 is eligible for reimbursement pursuant to the Business Equipment Taxation Reimbursement program (BETR) for the first 12 years of that property’s life. The general standard of eligibility is any type of personal property (and some types of real estate) that as a category of property are “depreciable” for income tax purposes. Business owners understand the very wide breadth of that exemption. Eligible property is all of that business machinery, equipment and random personal property except: office furniture and fixtures, utility property (teleco property, gas pipelines, certain power plants, etc.), gambling machines, and the personal property in the super-size retail stores that are over 100,000 square feet in dimension. Also ineligible for exemption is all property purchased before 1995.

To get a sense of its complexity, 2056 would provide the following:

1. no exemption for pre-1995 property; it will continue to be taxed as it depreciates, until retired;

2. no exemption for post-1995 BETR-eligible property that could have been enrolled and receiving BETR reimbursement but wasn’t; it will continue to be taxed until retired;

3-A. no immediate exemption for property in BETR; it will remain taxable and in the BETR program until the existing schedule for that property expires;

3.B. a new, permanent exemption for property leaving BETR once the BETR schedule expires; and

4. a new, permanent exemption for new property that is put in service after April 1, 2007, whether completely new installations of personal property or the replacement of worn-out and retiring property that already exists.

In terms of reimbursements, LD 2056 provides:

A. No reimbursement for (1) since it remains taxable,

B. No reimbursement for (2) since it remains taxable,

C. No reimbursement for (3A) as long as it remains taxable,

D. Statutory promise of 100% reimbursement for (3B),

E. Constitutionally guaranteed 50% reimbursement for (4),

F. Relatively minor statutory supplement to the 50% reimbursement provided for (4), insubstantial in size and provided after the municipality has experienced substantial losses in tax base.

A town-by-town analysis of LD 2056 is difficult because there are three tax impacts to estimate for each future purchase of equipment: (i) how much tax revenue did the municipality “lose” when the old equipment was replaced, (ii) how much reimbursement will a municipality receive from the state as compensation for the exemption on the new replacement equipment, and (iii) how much tax revenue could the municipality have received if the law were not changed at all.

An additional factor complicating

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Updated LD 2056 Impact Analysis

An updated town-by-town impact analysis of LD 2056, based on an impact model developed by MMA, has been distributed to all municipalities. The model is very similar in design to the first impact model MMA applied to this complex legislation when LD 2056 was first printed 43 days ago. Three inputs to the model have been revised, and a complete description of the model, its entire methodology, assumptions and data sources, and the “full-value” property tax rate increases predicted by the model eight years after the enactment of LD 2056 can be found at MMA’s website (www.memun.org)

At its bottom line, the model predicts that eight years after the enactment of LD 2056, the statewide municipal tax base will have $2.25 billion less in taxable value than would otherwise be the case, which squares with statewide independent fiscal impact analyses done by Maine Revenue Services. The removal of $2.25 billion worth of tax base will have the obvious effect of increasing property tax rates throughout the state. The MMA model predicts the range of property tax rate increases to vary according to the nature of each municipality’s tax base. Maine’s industrial towns and service center communities will experience the highest increases in tax rate.

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the analysis is that property tax exemptions impact a community's valuation for state education aid formulas and county taxes. Therefore, if a community has a large amount of equipment that becomes exempt, the municipality's share of county taxes goes down since its relative taxable base has decreased. The community's share of education aid goes up for the same reason. Surrounding communities with relatively little personal property tax base will correspondingly see their share of county taxes increase and education aid decrease.

This impact of this subsidy-shifting phenomenon is highly dependent on the degree to which the state honors its various reimbursement promises. To the extent those statutory promises are not honored in the future, the county tax and school subsidy shifting is intensified. When the business representatives promoting LD 2056 claim that the county tax and school subsidy shifts will be negligible, that claim is dependent on their belief that the state's reimbursement obligation to the municipalities will be honored, which is a claim they cannot make with straight face.

Simply determining how much BETR-eligible personal property each municipality has is difficult from a distance because one needs to know how much of each community's personal property value is BETR-eligible versus how much is not. Generally, 80%-85% of any municipality's personal property tax base is of a type or category that is eligible for the exemption. The best way to do figure out a municipality's exposure to LD 2056 is to review that community's actual assessing records.

Another issue that should be reviewed in order to get an accurate estimate of the impact is Tax Increment Financing (TIF) agreements (if the municipality has entered into any) and how they are structured. TIF agreements are dedicated appropriations enacted by the town meeting or town or city council that, with respect to business equipment investments, LD 2056 and its proponents would like to do away with. In particular, the question is whether the community has voted to use the TIF revenue for infrastructure investments and other local economic development programs, or as "credit enhancements" (returning the money to the taxpayer)?

In addition, some proponents of LD 2056 use the "dynamic analysis" argument to claim that the exemption will generate more investment in Maine that has occurred under BETR. They believe that the positive impact of the hoped-for additional investment should be included in any fiscal impact analysis.

Going into next year, the annual cost of the BETR program is approaching $80 million. If the state simply exempted all property currently in the BETR program, and reimbursed municipalities the constitutional minimum of 50%, the statewide loss of tax revenue would be nearly $40 million. That impact analysis is indisputable. By phasing-out the tax, a municipal loss of that magnitude is correspondingly phased-in.

Maine Revenue Services estimates that in ten years the municipal loss from new investments (4 above) is $40 million. If the Legislature does not keep the statutory promise to reimburse municipalities 100% for BETR expired property (3B above), the municipalities will lose another $3.3 million according to the MRS analysis.

No state agency has provided a town-by-town estimate of impact. The Legislature has not provided a town-by-town estimate of impact. No proponents have provided a town-by-town estimate of impact.

Maine Municipal Association has developed a model to predict the town-by-town impacts. For all the comments in the halls of the Legislature that MMA's estimate is full of "doom and gloom" or "worst case scenarios", the MMA estimate on a statewide level is remarkably congruent with the MRS analysis.

The bottom line is that this is a complicated bill with several moving parts, all of them predicated on future behavior. A primary reason for the competing claims about LD 2056 is due to the complexity of the bill itself, and its design as a "prospective" tax repeal. The next two issues relate to differing perspectives on the municipal "tax base."

Issue #2. By comparing LD 2056 with current law, MMA counts the reduction of revenues that will be received with respect to new investments in business equipment as a loss, the supporters of LD 2056 do not.

The fact that LD 2056 is prospective presents not just an analytical challenge, but also a semantics challenge.

MMA and other opponents of LD 2056 believe that municipalities are reasonable when they count on the growth of personal property value as part of their tax "base" and to rely on the existence of future taxes from this base. Thus, if the Legislature exempts future property investments from taxation, and only provides 50% reimbursement, that action is appropriately deemed a "cut" to the municipal tax base.

The Chamber of Commerce and other supporters of LD 2056 do not include future investments as part of the municipal tax "base." Since that property is not taxed now, they argue, it's not in the base. Therefore, any reduction to future tax revenues from future investments should not be characterized as cuts.

Who is right?

It's probably impossible to determine who is right, but it is possible to determine who is reasonable.

New property pursuant to LD 2056 is not simply new equipment purchased and put into service for the first time (e.g. a brand-new factory). The bill defines new property to also include, "*repair parts, replacement parts, replacement equipment, additions, accessions and accessories.*"

Take a large paper mill as a large mass of personal property. Paper mills are generally not constructed from the ground-up as brand-new factories. Instead, different parts of the mill are repaired and replaced each year. As long as those new parts and replacements are readily identifiable, municipalities tax those new parts and replacements as new property. From the

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outside, the mill looks essentially like the same mill it's been for a long time.

But, on the inside, the valuable business equipment is constantly repaired, improved and replaced. This is true of all industries and commercial facilities with business equipment, not just mills. MMA believes it is inaccurate to say of LD 2056 that it protects the base or that existing revenues are not cut when that tax base will constantly be depreciating and replaced with exempt value.

Another way to think about this issue is to imagine legislation that would cut the sales tax rate in half beginning next year for the purchase of new or replacement motor vehicles? Since those transactions are in the future, has the bill "cut" revenues? Of course. Has it "protected" the base? Of course not. The personal property tax is no different.

Thus, it is literally true that the LD 2056 exemption does not apply to existing property (except for the property currently in the BETR program that is currently taxable but will become exempt when its 12-year BETR cycle expires). But, the tax revenues from the "preserved" tax base are certainly not protected, and decline away rather quickly.

According to the Maine Revenue Services, the net value of personal property grew by 7% from 2000 to 2004 ($8.3 billion to $8.9 billion). The actual amount of "new" personal property put in service for the first time during that period is far more than 7%. This must be true because the value of new investment must make-up for the depreciation on existing equipment. It's almost impossible to know how much "new" investment took place. It is reasonable to assume its well in excess of 10% from 2000-2004.

Based upon historical trends under the current BETR program, MMA believes municipalities are justified in counting a certain amount future personal property growth as part of their future tax base. MMA does not believe LD 2056 protects that base. At its bottom line, it cuts municipal revenues on new investments/future base by 50%.

Maybe the exemption will spur so much new investment that even at reduced rates the municipalities will be better off. That is, instead of growing at a clip of 7% over 4 years, the net value will grow by 35%. That would be great. No study was done to support such claims and Maine Revenue Services didn't include any such dynamic growth in its estimates.

Policymakers need to decide whose assumption about the municipal reliance on the growth of personal property value is reasonable.

Issue #3. MMA asserts that the reimbursement systems in LD 2056 to provide municipalities replacement revenues over constitutionally-required levels are unreliable.

The Constitution obligates the State to reimburse municipalities for 50% of lost revenues due to new tax exemptions. As discussed above, municipalities will receive this level of reimbursement for new investments. For equipment currently in the BETR program, LD 2056 contains promises to reimburse municipalities 100% for lost tax revenues on personal property when that property comes out of BETR and becomes exempt.

Are proponents being reasonable when they point to this reimbursement language as proof that LD 2056 protects the base?

Its odd that there is even a dispute on this point. The primary argument in favor of LD 2056 put forth by the proponents is that BETR reimbursements are <u>not</u> reliable. They effectively point to the recent cut in their reimbursement from 100% to 90% as evidence that businesses can't make long-term investment plans in Maine because of BETR reimbursement instability.

Shouldn't municipalities be able to point to that same fact as proof that municipal reimbursements will be no more secure; that the only real security is the constitutional guarantee of 50% reimbursement? Aren't there plenty of examples of "dedicated" revenues being diverted during tough times?

Opponents of LD 2056 appreciate that the bill acknowledges municipalities should be compensated more than the 50% guaranteed by the Constitution.

Furthermore, the 100% reimbursement promise is a concession by proponents that there is no policy justification to exempt BETR-expired property. That is, the policy argument in support of LD 2056 — that it will spur new investment in Maine – can not possibly be used to justify the exemption of equipment that was purchased years ago. In fact, exempting BETR expired property undercuts the incentive-value of exempting new investments.

Policy makers need to decide who's assumption about the reliability of statutory promises of reimbursement is reasonable.

Since the conflicting statements being made by lobbyists on either side of LD 2056 have confused some lawmakers, hopefully this article which explores the assumptions behind those statements will give them some sense of which side is making the more reasonable set of assumptions.

TEACHER (cont'd)

ity of state reimbursements; LD 1381 runs roughshod over the local labor negotiation process. For reasons that are entirely unclear, the teachers union is not simply being advised to start negotiating harder for higher starting pay at the local level. It is commonly the practice to negotiate teacher contracts at the top of the pay ladder rather than bottom. The union's strategy appears to be to continue to work the top of the pay scale at the local level but then periodically get the Legislature to push up the starting pay, rather than bothering to genuinely negotiate in the interests of Maine's rookie teachers.

MMA produced a revised EPS salary matrix that showed the cost of the 'ripple" effect as somewhere between $50 million and $75 million over time, as the local step-based salary schedules respond the mandated new minimum. A subsequent fiscal note on the bill prepared by legislative analysts confirmed this magnitude of cost over time, but the first year costs are substantially less, and the first-year costs

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Moratorium Would Not Affect LD 1481 Deadline

As we have reported in several previous editions of the *Legislative Bulletin*, both the House and Senate have given preliminary support for an amended version of LD 1481, *An Act to Amend the Laws Governing the Enactment Procedures for Ordinances.* As amended, LD 1481 would prohibit municipalities from nullifying or changing a land use permit through the amendment or repeal of an ordinance 75 days after the permit has been issued. By directly limiting municipal authority in this manner, the legislation also places the same time limitations on citizens who might try to use the initiative process to amend the local development standards in the face of a high impact development proposal. In many respects, LD 1481 is specially targeted to limit the local citizen initiative process.

The biggest disconnect in LD 1481 is where the bill holds citizens accountable for initiating and completing a process that is not within their control. As given initial approval by the House and Senate, the bill would not only require citizens to initiate, circulate and submit petitions for changing an ordinance, but also require the citizens to ensure that an election is scheduled and held within the 75-day period. The scheduling of an election includes many factors and logistical considerations, and the scheduling of an election is not determined by the petitioners.

In response to concerns that have been raised about LD 1481, the proponents of the bill suggest that the local enactment of a moratorium could be used to provide citizens with the additional time necessary to amend an ordinance in order to affect an issued permit. A legal analysis suggests that this is not the case; that is, the enactment of a moratorium after a permit has been issued would have no impact on the effect of LD 1481. The issued permit would still be permanently viable, even if construction on the permitted project might be delayed. In other words, the use of a moratorium would merely delay the inevitable (i.e., the permanency of the issued permit on the 76th day) rather than provide additional time to amend the ordinance in order to impact the issued permit.

While some proponents might suggest that a moratorium can be enacted overnight, in truth, a moratorium is an ordinance just like any other that must be enacted by the local legislative body. In the 425 municipalities where the residents of the community are the legislative body, the decision to enact a moratorium rests directly with the town meeting. For that reason, in over 86% of the communities in Maine, a significant process must be undertaken in order to enact a moratorium.

In addition, the use of a moratorium is guided by statute. As provided for in Title 30-A, section 4356, a moratorium ordinance is limited to a 6-month period. The purpose of the moratorium is to temporarily defer land use activity or development to provide local officials the time and opportunity necessary to accommodate or manage development. In order to establish the moratorium, the municipality must illustrate that it is necessary to either: 1) prevent a shortage or overburdening of public facilities, or 2) provide the time necessary for municipal officials to address inadequacies in existing plans, ordinance or regulations, if any, to prevent serious public harm. A moratorium would not trump LD 1481.

In a nutshell, a moratorium, as defined by state statute, is a *temporary* or stopgap measure intended only to provide enough time to prepare and implement a *permanent* solution to a problem, such as the enactment of a new ordinance. Under LD 1481, if the solution to the identified problem is a new or amended ordinance and that new ordinance is enacted more than 75 days after a land use permit has been issued, then the newly adopted ordinance cannot affect the permit – moratorium or no moratorium. In order to conform to the restrictions created in LD 1481, under the moratorium scenario, the citizens would need to adopt two ordinances within the 75-day period. Considering that a moratorium process would do nothing to stop the running of the 75-day clock after the issuance of a permit, the use of a moratorium would not appear to be a rational alternative.

MMA's Legal Services Department based its analysis of the LD 1481 interplay with the moratorium process on the Law Court's decision on Larrivee v. Timmons, 549 A.2d 744 (Me. 1988). In Larrivee a proposed 105-unit mobile home park had already received preliminary subdivision approval when the town amended its zoning ordinance to strengthen the standards for conditional use approval (which the park also needed). The developer claimed he was exempt from the new conditional use standards because the subdivision and zoning approvals were both part of one application and review process. The Law Court disagreed. According to the Court, the subdivision and zoning approvals were two separate proceedings, under separate and distinct ordinances, even though they both related to the same proposal and subject matter.

Under the Larrivee rationale a temporary moratorium ordinance and any subsequent "permanent" ordinance would constitute two separate ordinances. Even if the moratorium were enacted within the 75-day period, it would affect the permit only for a short time. Any "permanent" ordinance developed as a result of the moratorium would be a new ordinance and could not affect the permit under the terms of LD 1481 unless enacted within the 75-day period.

TEACHER (cont'd)

seem to be as far as the Legislature is willing to focus.

The original teacher pay proposal – when it was within the budget bill — had its own Dirigo-like "savings offset payment". That version of the teacher pay hike was funded from savings that would be realized from asking the teachers to do less work. That is, teacher requirements to assess student performance were suspended and the money saved from no longer doing that work was going to be used to cover the cost of increasing starting teacher salaries.

The Appropriations Committee rejected the increased teacher pay proposal and effectively assigned the savings associated with the student assessment moratorium to increase transition adjustments to certain school administrative units.

Now that the teacher pay proposal has been split off the budget bill and lost its internal funding sources, the majority report for LD 1381 has a fiscal note of approximately $3 million dollars, which represents the money the state would pay to the specific school systems that would have to increase any teacher's current pay up to the $30,000 level.

Missing from the new fiscal note is any reference to the cost of the "ripple effect" either in those specific school systems or throughout regions and the entire state. The original fiscal note explained that if the teacher salary matrix were immediately changed (as explained in the January 26 *Legislative Bulletin*) the cost to the state would be around $30 million per year and the cost to the municipalities would be an additional $30 million per year.

The way LD 1381 is postured, the comprehensive fiscal impacts are pushed into the future. Even then, it is like taking the 10-year-out impact from LD 2056, the repeal of the personal property tax, and doubling it.

Between exempting billions of dollars in value from the municipal tax base through LD 2056 and imposing a new teacher salary matrix through LD 1381, the vision of property tax relief that began with Question 1A could be quickly extinguished in the close out session of the 122d Legislature.