

UNDERSTANDING MAINE'S TAX BURDEN AND BUSINESS CLIMATE

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TALKING POINTS

- ❖ Nothing could be more important to Maine families and households than raising our income levels.
- ❖ Maine’s approach to attaining this goal must be a balanced approach. Maine’s commitment to education, environment, and access to health care along with economic development must be sustained. Each area of commitment is important and contributes to the long-term health of the Maine economy and Maine families.
- ❖ There is no one simple measure that adequately measures Maine’s business competitiveness.
- ❖ Macro, statewide tax burden measures such as total state and local taxes as a percent of income do not adequately reflect businesses competitiveness; when viewed in isolation, these measures are misleading.
- ❖ Based on examinations of tax burdens on representative firms and industries, Maine is in the middle of the pack.
- ❖ There are many factors that impact a state’s competitiveness. Some of these, regulations for instance, can be impacted by state policy; others, such as climate and proximity to major markets, cannot be impacted by state policy.
- ❖ In general, Maine is competitive with regard to land, labor, and building costs for businesses. Furthermore, Maine is a leader with regard to telecommunications infrastructure. Maine’s challenges with regard to competitiveness include lack of proximity to major markets; the need to maintain an extensive, mostly rural road network; a cold climate which requires energy costs higher than in warmer climates; workers’ compensation costs; and lack of “thick” labor markets in some industries.
- ❖ Maine has put in place many programs that are making significant progress on improving business competitiveness and growing the state’s economy.
- ❖ Maine needs to continue making progress in fostering a positive business environment and investing in economic growth, but success will not occur overnight and long-term sensible policies are better than quick fixes. Businesses prefer long-term stability and predictability over one-time support.

ISSUE OVERVIEW AND FINDINGS

Maine is often mentioned as having one of the highest state and local tax burdens among the states. Maine is also often compared negatively with New Hampshire in terms of taxes and business environment, with the question being: Why can't Maine be more like New Hampshire in terms of fostering a friendly business climate? The following overview examines issues surrounding Maine's tax burden and business climate and how they relate to Maine's competitiveness compared to other states. Based on the information provided there is no one simple tax burden measure that tells the complete story. Furthermore, while Maine needs to continue to work at creating a positive business environment, gains have been made and there are many positive reasons for doing business in Maine. Looking to the future, state economic development strategies must be based on a balanced long-term approach, rather than on single-item quick fixes.

Macro-Tax Burden Measures

Tax burden comparisons tend to focus on macro indicators such as total statewide tax amounts per income and per capita. As indicated in Table 1, Maine does not fare well on these macro indicators, particularly with regard to taxes as a percent of income.

Table 1: State and Local Tax Burden - Maine Compared to Other New England States on "Macro" Indicators		
State	State and Local Combined Tax Burden – 2004	
	Taxes per Capita	Taxes as % of Income
Connecticut	\$5,119	10.6%
Maine	\$3,907	12.3%
Massachusetts	\$4,117	9.4%
New Hampshire	\$2,906	7.5%
Rhode Island	\$3,976	11.1%
Vermont	\$3,527	10.4%
U.S.	\$3,490	10.0%

Source: Bureau of Economic Analysis and Tax Foundation

But these macro indicators do not tell the full story and can be misleading if considered in isolation, which they usually are. There are several reasons for this. According to the former State Economist, Laurie LaChance in her 2002 presentation to the Greater Portland Chamber of Commerce, taxes paid as a percent of personal income are misleading because:

- Maine is a relatively poor state.
- Maine is highly rural – with 22,000 miles of roads to maintain.
- Other states make greater use of fees which don't show up in tax burden measures.
- Maine's cold climate makes services more costly.

- A number of programs have been put in place in Maine to provide direct tax relief but these programs such as the Business Equipment Tax Reimbursement (BETR) program; don't show up in tax burden measures.

To this should be added two more factors: First, since Maine is sparsely populated and has low income levels (as indicated in Table 2), almost any macro level indicator that compares statewide taxes to population or income is going to indicate a high burden in Maine. Secondly, taxes are paid by individual people and businesses, and the amount of tax paid and the burden it places on the individual or business varies based on individual circumstances.

State	2000 Population	2000 Density	2003 Per Capita Personal Income
Connecticut	3,405,565	702.9	\$43,292
Maine	1,274,923	41.3	\$28,935
Massachusetts	6,349,097	809.8	\$39,409
New Hampshire	1,235,786	137.8	\$34,703
Rhode Island	1,048,319	1,003.2	\$31,937
Vermont	608,927	65.8	\$30,534
New England	13,922,517	221.7	\$38,018
U.S.	281,421,906	79.6	\$31,459

Sources: Population & Density - US Census Bureau: State and County Quickfacts derived from 2000 Census of Population and Housing; Income – Bureau of Economic Analysis.

Micro Tax Burden Measures

A way of examining the tax burden, which avoids the pitfalls of the macro indicators, is to examine taxes and costs actually paid by similar businesses in different states. This can be accomplished by comparing taxes paid based on a representative firm or industry. In 2001, PriceWaterhouseCoopers (PWC) completed a tax competitiveness study for the Maine Department of Economic and Community Development (DECD). Rather than look at gross tax burdens per capita or per income, the analysis used a representative firm method in which seven representative businesses scenarios were established and their property and income taxes compared. The study compared Maine to eleven other states including: New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, New York, New Jersey, Wisconsin, Wyoming, South Carolina, and Pennsylvania. The business scenarios were developed based on the types of businesses that Maine is reasonably seeking to attract. The states were selected based on one of three factors: proximity to Maine; similarity in population and economy; and reputation for leadership in economic development. The results are summarized in Table 3.

Table 3: Maine's Tax Competitiveness		
Business Scenario	Rank among 12 States Included in the Study with 1 Being Best and 12 Being Worst	
	Maine	New Hampshire
Large Manufacturing (electronics)	7	6
Small/Medium Manufacturing (boat building)	6	7
Small/Medium Manufacturing (precision machining)	5	7
Back Office Operations (banking/financial services)	2	4
Back Office Operations (telephone collections)	5	3
Computer Technology (software developer)	7	9
Microbusiness/Retail (ice cream shop)	3	6
Source: "State of Maine Tax Competitiveness Study", PriceWaterhouseCoopers, October 2001 Includes the states of Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, New York, New Jersey, Wisconsin, Wyoming, South Carolina, and Pennsylvania		

Based on the analysis, PWC concluded that "It is readily apparent upon cursory review of the modeling data that Maine is in the middle of the pack." In terms of Maine compared to New Hampshire, Maine ranked better for five of the seven scenarios including boat building, precision machining, banking and financial services, software development, and microbusiness retail.

Importance of Tax Burden on Business Location and Expansion Decisions

As indicated above, while there is still room for improvement, the business tax burden in Maine is not as bad as a simple look at macro measures would indicate. It should also be pointed out that taxes paid are only one component of business climate.

Reports of tax burden comparisons using macro indicators often overstate the importance that taxes play with regard to business development decisions. Taxes are only one of a great many factors that influence business location decisions and there is ample evidence that taxes, by themselves, are not a significant factor in the location decisions of businesses.

According to Andrew Reschovsky, in his paper prepared for the Wisconsin Tax Policy Colloquium, *The Taxpayer Bill of Rights: a Solution to Wisconsin's Fiscal Problems or a Prescription for Future Fiscal Crises?*, "That which influences business investment and location decisions is the quantity and quality of public services (such as schools, roads and highways, sewer systems, recreational facilities, higher education and health

services). Furthermore, it is a well-trained labor force and high-quality public services that are of equal or greater importance [as opposed to taxes] to businesses.”

The internationally recognized business consulting firm, Deloitte & Touche/Fantus Consulting reported that commercial firms go through a complicated screening process in efforts to decide upon site locations. The factors examined at the initial level of screening among 15 to 100 sites are weighed differently by different types of businesses. Both manufacturing and office-oriented businesses weigh labor costs most heavily. Manufacturing entities then look at transportation and utilities. Office-oriented businesses look next at occupancy opportunities. For both business types, the level of taxes carries a very low weight in the screening process for location decisions.

In the New England Economic Review (March/April 1997), Robert Ady, Executive Consultant of Deloitte & Touche, in his discussion of businesses that have screened their location choices down to a few three to five sites, reported that businesses look to the health of public services and infrastructure. State, county, and local taxes are considered within the context of what they provide in public services, such as police protection and education capabilities. Furthermore, “For our clients, education has been found to be the single most important service, greatly exceeding the value of all other services combined.” Those services that follow in importance are highway adequacy, public safety, and infrastructure. Next are crime prevention and insurance rates, and general quality of life. Ady also states that “The site selection data do not suggest any correlation between low taxes and positive economic growth, or between high taxes and slow growth.”

Other research also downplays the role that taxes play in business location decisions. For instance, according to Robert Lynch of the Economic Policy Institute in *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development*, “The after-taxes rates of profit within industries do not vary significantly by state. The deductibility of state and local taxes from federal taxable income has a great leveling effect, reducing the differentials among states.” Similarly, Robert Tannenwald and James Papke in 1995 in the New England Economic Review found that because of federal taxation, tax burdens and the after-taxes rates of profit for businesses were relatively the same across states. This is due to the leveling effect of the federal tax structure. Therefore, different rates of taxation among states do not significantly affect rates of profit.

Finally, based on statistics from the Internal Revenue Service in *Statistics on Income Bulletin, Spring, 2003*, state and local business taxes create a very small burden on the firms that pay them. “In 2000, state and local taxes paid by businesses reduced their total receipts by 1.1% and amounted to only 1.2% of their costs of doing business. All state and local taxes paid by businesses reduced their revenues by 0.7% and accounted for only 0.8% of their costs, according to the Internal Revenue Service.”

Business Climate

As indicated above, business climate is based on many factors in addition to taxes. These include:

- Labor
- Utilities
- Workers Compensation Insurance
- Proximity to Markets
- Transportation Infrastructure
- Telecommunications Infrastructure

All of these factors, along with the individual needs and circumstances of a particular industry or firm, go into determining how competitive an area is with regard to business climate. Maine & Company, a private, non-profit corporation that provides site selection assistance to out-of-state companies considering Maine as a business location, tracks several factors related to business location and expansion. Joe Wischerath, Executive Vice President of Maine & Company indicates that Maine compares favorably to New Hampshire in the areas of labor and wage costs, and though Maine has higher tax costs in certain areas, Maine is “not as bad and New Hampshire not as good” as the macro indicators would suggest. This is partly due to the fees and charges in New Hampshire that are often ignored in the indicators.

Furthermore, Maine’s incentive packages, often overlooked in the macro indicators, help make Maine competitive. Wischerath stresses however that state and local incentives are less preferred than direct “bottom-line” lower costs because they are often accompanied by administrative “hoops” and are not guaranteed over the long-term. Wischerath also indicates that Maine, particularly its rural areas, is competitive with regard to land, labor, and building costs. Furthermore, Maine is a leader with regard to telecommunications infrastructure.

Maine is not without its challenges. Maine’s challenges with regard to competitiveness include lack of proximity to major markets; the need to maintain an extensive, mostly rural road network; a cold climate which requires energy costs higher than in warmer climates; workers’ compensation costs; and lack of “thick” labor markets in some industries.

With regard to business factors, it is important to point out that some can be impacted by state policy such as regulation and workers’ compensation rates. However, the state has little or no impact on such factors as proximity to major markets, utility and transportation costs attributable to climate, and costs associated with Maine’s large land area and low density. These factors impact Maine’s competitiveness with other states like New Hampshire, yet there is little that state government can do to change them.

What is Maine Doing?

While there is still progress to be made in Maine to improve the business climate, including reducing the tax burden, the State has put in place several programs which take significant steps towards reducing costs of doing business and supporting business investment. The following is a list of many of the available programs Maine has put in place. Details on each of these are available from the Maine Department of Economic and Community Development and Maine & Company.

Business Equipment Tax Reimbursement Program - The BETR program encourages business investment by allowing companies to recoup local property taxes paid on eligible business equipment and property.

Tax Increment Financing – TIF provides municipalities with a local tool to finance the cost of private development. Maine municipalities may redirect some or all of the new property taxes from an investment project within a designated district to assist in that project's financing.

Sales Tax Exemptions – The following business transactions are exempt from Maine's state sales tax: sales of machinery and equipment used by the purchaser directly and primarily in the production of tangible personal property; sales of machinery and equipment used by the purchaser directly and exclusively in research and development; custom computer programming purchased by a business; and sales of machinery, equipment, instruments and supplies used by the purchaser directly and primarily in a biotechnology application. Also, manufacturers are exempt from paying 95% of the sales tax on fuel and/or electricity used in the manufacturing operation.

Employment Tax Increment Financing - Through ETIF eligible businesses are reimbursed up to 80% of their new employees' Maine income tax withholdings for up to ten years.

Pine Tree Development Zones – This program offers a combination of tax incentives to spur economic development in areas with high unemployment and/or low wages.

Maine Technology Institute - MTI provides funding for private companies and research laboratories to support and promote research and development, and assist innovative Maine companies and inventors in getting their products to market.

Small Enterprise Growth Fund - The SEGF provides up to \$500,000 in venture capital to small businesses with growth potential.

Maine Seed Capital Tax Credit Program – This program provides income tax credits to qualified investors in Maine business.

Research Expense Tax Credit, Super R&D Tax Credit, and High Technology Investment Tax Credit – These programs provide income tax credits for companies that incur qualifying research and equipment expenses in Maine.

Jobs and Investment Tax Credit – This program provides a credit against Maine income taxes equal to 10% of investments in qualifying types of personal property.

Applied Technology Development Centers - These incubation centers provide early-stage technical, business, administrative and financial resources and training for participating firms within the State’s targeted technologies. They also provide state-supported tenant space for eligible businesses.

Small Business Development Centers - Maine SBDC's provide comprehensive business management assistance, training, resource and information services to Maine's micro, small, and technology-based businesses. Maine SBDC is a partnership program of the U. S. Small Business Administration in association with the Maine Department of Economic and Community Development and the University of Southern Maine.

Maine Quality Centers - This program provides state-financed education and training in job creation delivered through the state’s seven community colleges.

Governor’s Training Initiative – This program provides partial reimbursement for the cost of non-routine training that contributes to workforce expansion, and/or the retooling of existing workers for new technologies, processes or markets.