



# 2016-2017 State of Maine Biennial Budget Briefing

*January 9, 2015*

**Governor Paul R. LePage**

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## Governor Paul R. LePage's Vision for Maine

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January 9, 2015

Honorable Members of the 127th Legislature and Citizens of Maine:

When I first took office four years ago, the challenges were many and the work ahead of us was immense. Maine was in the midst of the Great Recession, the economic outlook was bleak, and our government was in desperate need of reform.

Instead of hiding from our state's challenges, our administration faced them head on. This was an important departure from "business as usual" in Augusta. My priority as governor has always been to tackle our long-term fundamental challenges so we can improve Maine's future.

During my first term, we took the first step toward significant tax relief. We also reduced the state's unfunded public pension liability from \$4.1 billion to \$2.4 billion—a decrease of 41 percent. We paid off, in its entirety, the long overdue welfare debt of \$748 million to Maine's hospitals. These actions, along with a careful approach to bonding and insistence on increasing the balance of the Budget Stabilization Fund, have improved Maine's standing with credit rating agencies such as Moody's Investor Services and Standard & Poor's.

The progress of the last four years has resulted in more Mainers finding work and an overall improved economy, but there is much more work to be done.

My long-term vision is a Maine without any income tax. When I first took office, Maine's top income tax rate of 8.5 percent was one of the highest in the nation; this made Maine unattractive for individuals to live and work here. We have reduced that rate to 7.95 percent. Today I am proposing that we modernize our out-of-date tax code to make Maine more competitive with other states. I plan to reduce the top tax rate even further to 5.75 percent, dramatically improving our competitive position in this global economy.

This budget also provides real tax relief for Maine families and small businesses. In all, Maine families and small businesses can expect to see a reduction in their tax burden of more than \$300 million. We will achieve this significant reduction by transitioning our tax code from one dependent on taxing earnings to a more modern tax model based on consumption.

In this budget, I am proposing elimination of the estate tax. Maine is one of only 19 states left that still imposes this tax. The estate tax punishes our small and medium-size multi-generation businesses in Maine. Family businesses are the backbone of our economy. We must keep them alive and well.

In addition, this budget increases the amount of pension income exempt from income tax. It also completely exempts military pension income, honoring our veterans and elderly by helping them keep money in their already stretched budgets.

These essential reforms will reduce the tax burden on working families and retirees while ensuring that our most vulnerable continue to receive the care that they need. My administration has realigned the Medicaid program in a way that allows us to chart a new course, prioritizing the elderly, the disabled and those with intellectual disabilities while advancing common-sense welfare reforms.

This budget provides the necessary resources to care for the disabled Mainers who have been waiting in line for services they have long been qualified for, but were not funded. I also propose increased funding for nursing homes to make sure that Maine citizens continue to have access to quality long-term residential care.

This budget addresses the illegal drug problem here in Maine by funding additional agents in the Maine Drug Enforcement Agency, as well as more prosecutors and judges to adjudicate the increased caseload. We cannot allow these vicious drug traffickers to keep using our state as their marketplace, and my plan will hold these criminals accountable.

A good education is the best tool for future prosperity. With the increased cost of a post-secondary education, this is becoming harder to achieve for the next generation. Maine already has a tax credit that provides financial support to college graduates, but it is virtually unknown and underutilized. Over the next year, I will be hitting the road and traveling across Maine to share the benefits of this program. This not only helps Maine residents, but also could be used as a tool to encourage young people to come to school in Maine and stay here to have a career and raise a family.

Additionally, this budget provides funding to increase access to student loans through FAME and more investment in our public post-secondary systems, as well as funding to help local school districts collaborate with their neighbors.

I am fortunate that Maine has given me the opportunity to live the American Dream. I want every Mainer to prosper. I want to create an economy that allows Maine families to thrive and succeed. I want them to have a chance to achieve their American Dream.

Our state needs bold initiatives to make it a place where Mainers want to live and work and to make it an attractive destination for young families from across the country. Together, I am confident we can make this vision a reality.

Sincerely,



Paul R. LePage  
Governor



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## 2016-2017 Budget Highlights

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### MODERNIZING MAINE'S TAX CODE

- Reduce top individual income tax rate from 7.95 percent to 5.75 percent.
- Reduce top corporate income tax rate from 8.93 percent to 6.75 percent.
- Cut taxes on all pensions and eliminate tax on military pensions.
- Modernize Maine's sales tax rates and base, while continuing competitive rates nationally.
- Repeal Maine's estate tax to preserve Maine's family businesses.

### WELFARE THROUGH INNOVATION AND SENSIBLE SOLUTIONS

- Provides funding to assist thousands of Mainers currently on waitlists to receive services.
- Prioritizing the elderly and supporting nursing homes by providing ongoing funding.
- Increased access to primary care and preventive services.

### EDUCATING AND ATTRACTING YOUNG PEOPLE TO MAINE

- Investing in our next generation by providing additional funding to the University of Maine System to keep a quality education affordable for all Mainers.
- Completing long overdue infrastructure improvements at our public campuses.
- Increasing funding to the Finance Authority of Maine's state grant program, making college more affordable for Mainers.

### INVESTING IN PUBLIC SAFETY

- Increased funding for seven new agents in the Maine Drug Enforcement Agency.
- Creation of four new assistant attorney general positions to focus exclusively on drug crime prosecution.
- Relieving the burden on our county district attorneys by providing funding for 22 additional assistant district attorney positions.
- Providing additional resources necessary for the judicial branch by funding four new district court judge positions.



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## Modernizing Maine's Tax Code

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Maine's state and local tax system has been essentially unchanged since the introduction of the income tax in 1969. The economic transition over the last 40 years, which was in its early stages at that time, has made the current tax system out of date and uncompetitive with other states.

A modernization of the sales and income tax bases, a lowering of income tax rates, and elimination of the estate tax will align Maine's state tax system with the 21st century economy, make the state more competitive, contribute to long-term economic growth, protect lower and middle income households from shouldering more of the tax burden, and provide a simpler, more stable revenue base to meet the state's spending commitments. All of this can be accomplished while providing over \$300 million of direct tax relief for Maine resident families.

The following is a summary of the bold reforms necessary to simplify and stabilize Maine's tax code, to bring fairness for all taxpayers at both the local and state levels, and to provide our hardworking Maine families and businesses - small and large - the opportunity to compete and thrive in today's economy. *Independent analysis conducted by the Tax Foundation noted that these reforms, if fully implemented, would improve Maine's ranking in the Tax Foundation State Business Tax Climate Index from 33<sup>rd</sup> to 23<sup>rd</sup>.<sup>1</sup>*

### **REDUCE INDIVIDUAL & CORPORATE INCOME TAX RATES**

The income tax was enacted at a time when large corporations, often headquartered in Maine, with significant investments in plants and equipment were utilizing our natural resources and productive workforce to manufacture goods. Since that time these natural resource based industries have consolidated or moved their production to lower cost locations around the world. These large natural resource based manufacturers have been supplanted by high-tech manufacturing and service based businesses that tend to be smaller, capital intensive operations that depend on an educated workforce and can quickly

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<sup>1</sup> The Tax Foundation is a non-profit, non-partisan tax research organization based in Washington, D.C. ([www.taxfoundation.org](http://www.taxfoundation.org))

of taxable income per year. In a state that is in need of highly skilled workers, the current income tax system provides no incentive for these people to reside in Maine or for families to raise their children here.

*An individual and corporate income tax structure that encourages highly skilled workers, families and corporations to locate here begins with lowering the top marginal tax rate. In the case of the individual income tax, a top statutory marginal tax rate of 5.75 percent will make Maine competitive with the rest of the nation. Similarly a top statutory marginal tax rate for corporate income tax filers of 6.75 percent (currently 8.93 percent) will be very competitive relative to other Northeastern states and competitive with other regions of the country.<sup>2</sup> According to analysis conducted by the Tax Foundation, the proposed modifications to the corporate income tax would cause Maine to leapfrog from 45<sup>th</sup> to 17<sup>th</sup> in the corporate tax ratings.*

## **ELIMINATE THE ESTATE TAX**

Federal passage of the 2001 Economic Growth and Tax Relief Reconciliation Act significantly changed the structure of estate taxes. Prior to the law change, every state used the federal death credit as their estate tax, and there was no tax competition among the states. Regardless of a person's state of residence at death, the estate tax was the same. However, the 2001 changes to the federal law forced states to create their own estate tax or repeal the tax altogether. Over time, the majority of states have chosen to repeal the estate tax. Only 19 states currently have some form of estate or inheritance tax, most in the Northeast and Midwest.

The estate tax in Maine punishes family businesses, particularly the multi-generational job creators in many of our rural areas, such as farming and forestry. After the death of a family member, a family can be forced to either sell the business outright or to unload capital equipment to pay the looming estate tax liability. Often this results in a residual impact of loss of good paying, private sector jobs at those family businesses. In addition, combining an estate tax with a high individual income tax has forced more wealthy Maine residents to change their state of domicile in retirement. Maine not only loses significant income tax revenue from these former residents but other benefits that these individuals provide in

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<sup>2</sup> Budgetary requirements necessitate that initial reductions in income tax rates leave the top marginal tax rates in excess of six percent. A scheduled phase-down of rates are included in the tax reform legislation.

retirement, such as donations to Maine charities and, most importantly, continued civic engagement in Maine's religious, educational and business institutions.

*The Maine estate tax will be repealed to preserve Maine multi-generational family businesses, encourage current Maine residents to maintain their residency in retirement, and provide an additional incentive to non-resident retirees to move to Maine.*

### **CUT TAXES ON PENSIONS AND ELIMINATE TAX ON MILITARY PENSIONS**

Similar to the estate tax, many Mainers change their residence to other states after retirement due to the high taxes on pension benefits relative to other states. To make it more affordable for Mainer's to stay here in retirement, pension income, up to \$35,000, will be exempt from state income tax.<sup>3</sup>

Most importantly, our veterans earned their pensions and our respect through a career of public service and sacrifice. Military pension benefits will be completely exempt from state income tax beginning in 2016. With this reform, Maine will join the 22 other states which honor their veterans by not taxing their pensions.

### **MODERNIZE THE SALES TAX**

One area where Maine has a competitive advantage is the sales tax rate. The current 5 percent service provider tax rate, 5.5 percent sales and use tax rate, and the 8 percent tax rate on meals and lodging are very competitive compared to the combined state and local rates in other states. An increase to 6 percent in the service provider tax, 6.5 percent in the general sales and use rate, a reduction in the prepared meals rate to 6.5 percent, and

<b>Current Sales Tax Rates</b>		<b>Governor's Proposed Sales Tax Rates</b>	
Service Provider	5.0%	Service Provider	6.0%
Sales and Use	5.5%	Sales, Use and Meals	6.5%
Meals and Lodging	8.0%	Lodging and Auto Rental	8.0%
Auto Rentals	10.0%		

maintaining the current 8 percent rate on lodging will keep Maine in a very competitive posture nationally.

<sup>3</sup> Budgetary requirements necessitate that the pension income exemption is incrementally implemented. A scheduled phase-in of the exemption is included in the tax reform legislation.



The sales tax was developed during the mid-1950s when the economy was primarily based on the sale of goods and is becoming difficult to administer and comply with as the economy has increasingly become based on the sale of services. Services represent over 60 percent of current household budgets and tend to be less volatile than purchases of durable goods. A 2007 study by the Federation of Tax Administrators showed that Maine has the 11th narrowest sales tax base in terms of the taxation of services. Automobiles and building supply materials represent 30 percent or more of taxable sales in most years, leaving sales tax revenues vulnerable to changes in the economy that impact consumer purchases of big-ticket items like cars and home furnishings. The latest recession is a good example of how volatile our narrow sales tax base is to economic conditions. Starting with the second quarter of 2008, taxable sales decreased on a year-over-year basis for six straight quarters, often times by over 8 percent. In three of those quarters, automobile sales fell by over 15 percent.

Consumers' ability to purchase online or to use alternative means to purchase identical goods or services has also led to an erosion of the tax base. While administrative and statutory changes have been made to address these activities, the state continues to lose significant revenues every year. In addition, definitions and statutory language developed years ago no longer reflect the technological changes and innovations that have been introduced into the marketplace. For example, watching a movie can result in completely different levels of taxation depending on the method used to view the movie. A taxpayer visiting a movie theater or streaming a movie over the internet currently pays no sales tax; however, an individual purchasing or renting a DVD of the movie or ordering the movie through their cable or satellite provider pays sales tax.

*Modernizing the sales tax base to include both goods and services and updating the rates to be competitive nationwide will export more of the tax burden to non-residents and provide stability to state revenues. A refundable sales tax credit administered through the individual income tax will offset the additional sales tax burden on lower- and middle-income households.*

## **SIMPLIFY AND STREAMLINE THE TAX CODE**

Maine income tax bases will be streamlined to eliminate income modifications that provide little benefit to taxpayers. The individual income tax base must be simplified by repealing

Current state telecommunications excise tax revenue collection will be transferred to municipalities to assist them in broadening their property tax base. Municipal revenue sharing will be eliminated and municipalities will instead be given the authority to collect tax revenue from large non-profit entities. In the first case, a state level tax that generates approximately \$9 million per year will be transferred to the local level with little or no burden on current taxpayers. The second initiative recognizes the growth of nonprofit organizations in our communities and requires large nonprofits to contribute to municipal coffers.

*According to analysis conducted by the Tax Foundation, the proposed real and personal property tax reforms would improve Maine's property tax ranking from 40<sup>th</sup> to 35<sup>th</sup>.*

## **SUMMARY**

The state's tax system is antiquated and long overdue for major reform. A modernization of the tax system recognizing the challenges of the current economic environment is vital for the state's economy to prosper. A shift away from income tax reliance to an end user consumption tax is a key component of this modernization. While tax relief for Maine families will provide an important boost to the state's economy, bold tax reform will encourage businesses to locate and expand here, people to retire here and individuals to work and raise their families here. It will spark job creation and lead to a prosperous Maine for future generations.

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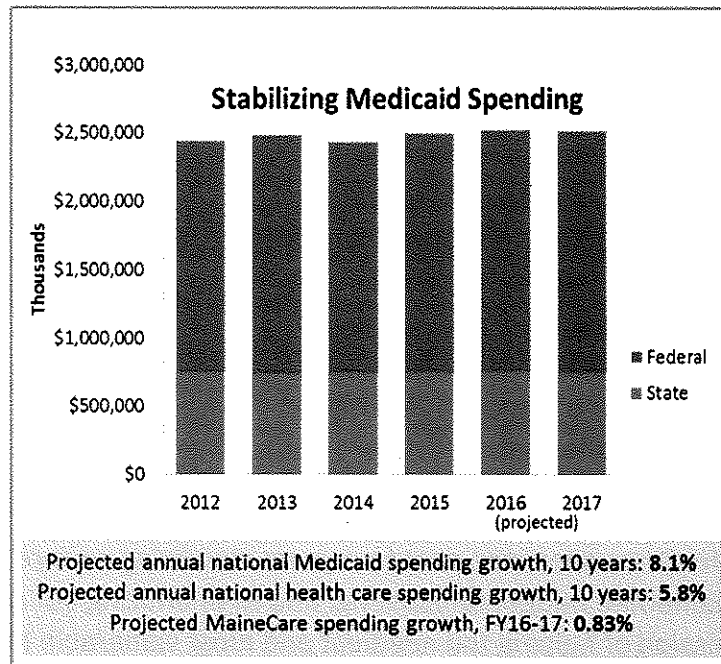
# Welfare Through Innovation and Sensible Solutions

## EXECUTIVE SUMMARY

For too long, DHHS has been too busy bailing out the boat to chart a course for Maine's future. In the upcoming biennium, we are pleased to be in a position where the state's Medicaid budget is under control; program enrollment and expenditures are at a sustainable level; and the Department can redirect General Fund dollars to other key priorities, such as funding the wait lists for services for the elderly and disabled, continued support for Maine's nursing homes, and expanding access to primary care.

### Medicaid Spending Stabilized

- Spending and enrollment doubled from 2000 to 2011; spending grew by more than \$1 billion, increasing Maine's tax burden and taking state General Fund resources from other state priorities.
- Governor LePage has moved us from decades of financial crisis in Medicaid to financial stability.
- Hospital debt of \$750 million was paid and bills are now paid on time.
- Maine's Medicaid program is no longer staring at a sea of red ink.



### Investing in Critical Priorities – Key FY 16/17 Budget Proposals

- **\$46 million** to fund vital services for the elderly and disabled.
- **\$24 million** in additional funding for nursing homes.
- **\$28 million** to ensure quality access to Primary Care.
  - Replaces expiring federal funds with state funds to reimburse Primary Care Providers at 100% of Medicare rates and supports continuation of Health Homes.
- **\$14 million** to fund mental health services required under the Consent Decree.

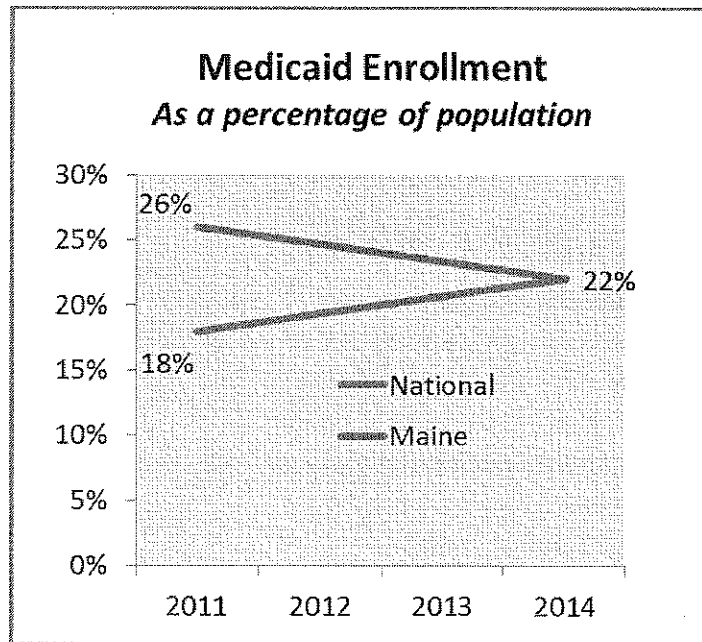
## WHERE WE'VE BEEN

### Out-of-Control Medicaid Spending

Due to repeated expansions to able-bodied adults, Maine's Medicaid program more than doubled in size from 164,000 enrollees in 2000 to 355,000 in 2011. The cost doubled, as well, from \$1.2 billion in 2001 to \$2.4 billion in 2011. Maine ranked third in the nation for Medicaid enrollment, and welfare spending consumed more of the state budget in just one other state. Meanwhile, elderly and disabled Mainers faced long waitlists for essential services and inadequate nursing home funding.

### Massive Debts and Shortfalls

Prior to the LePage Administration, Maine covered its unsustainable welfare spending by leaving hospital bills unpaid, cutting reimbursement levels to providers, increasing taxes and neglecting other priorities such as roads and bridges, schools, natural resources, and economic development. In state fiscal year 2012, Maine faced a \$220 million Medicaid shortfall.



Source: DHHS, CMS and U.S Census data

### This Year, It's Different

DHHS has spent the past four years stabilizing welfare spending, instituting sophisticated MaineCare budget forecasting, and re-prioritizing our resources to get back to our core mission of helping the neediest and most vulnerable Mainers.

We are proud to report that DHHS now faces a minimal structural budget gap for fiscal years 2016-2017, allowing us to invest in key healthcare and social service priorities rather than managing a crisis and rushing to fund a shortfall. This also supports the State's ability to evaluate and manage other critical priorities elsewhere in state government.

## WHERE WE'RE GOING

*The primary mission of DHHS is to care for Maine's most vulnerable citizens. This budget contains several bold initiatives to turn that promise into a reality. To date, DHHS has reduced the number of individuals on waitlists for home and community based services by more than 1,000 individuals. In this budget, we provide funding to provide these critical*

### **Funding Services Under the Consent Decree**

This budget fully funds services required under the Consent Decree for mental health services. It also provides additional funding for the Bridging Rental Assistance Program (BRAP) to help former mental health patients live independently.

<b>Funding for Consent Decree Services:</b>	<b>FY16: \$5.80 million</b>	<b>FY17: \$5.80 million</b>
<b>Additional BRAP funding:</b>	<b>FY16: \$1.23 million</b>	<b>FY17: \$1.23 million</b>

### **Riverview Psychiatric Recovery Center**

The LePage Administration is committed to continuing with the critical improvements necessary for the transformation of Riverview Psychiatric Recovery Center into a center of excellence for the treatment and care of Maine's most psychiatrically challenged citizens. Progress is well underway, and the Governor's budget proposal reflects many of these changes to make the hospital safer and more effective in the delivery of evidence based treatment options. Among other initiatives, the hospital will be adding 12 new acuity specialists, expanding its psychology program through the addition of post-doctoral fellows in psychology, and maintaining its strong historical ties with Dartmouth University's Medical School.

### **HOW WE'LL GET THERE**

*Paying for the critical reforms described above requires the innovative measures and sensible spending proposals outlined below. We have identified areas where bringing Maine toward the national mainstream for program eligibility can free up resources to provide Maine's most vulnerable citizens with the services they need.*

### **Reducing Reimbursement for Non-Emergency ED Visits**

As part of a larger effort to reduce health care costs, this budget would reimburse providers for non-emergent Emergency Department visits at a rate equal to that of primary care visits. This encourages providers to focus on primary care while bringing parity to Medicaid reimbursement.

<b>ED Reimbursement Reform:</b>	<b>FY16: (\$1.16 million)</b>	<b>FY17: (\$1.53 million)</b>
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### **Further Reforming Maine's Welfare System**

In an effort to curb massive *post-recession* growth in General Assistance (GA) spending, this budget reforms GA payments to municipalities to provide a larger, 90 percent match up front and a smaller, 10 percent match once the municipality reaches 40 percent of its six-year GA spending average. This eliminates a perverse incentive among cities to pay out more in welfare benefits and institutes a new incentive to contain welfare spending. Savings realized from this reform will be directed to fund the Section 21 waitlist for developmentally

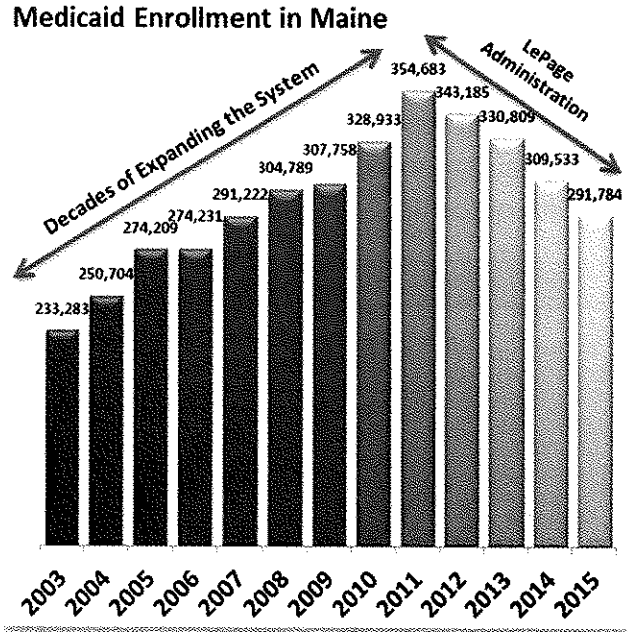
disabled individuals. The budget also includes the elimination of TANF and General Assistance benefits for non-citizens.

<b>Reforming General</b>	<b>FY16: (\$5.43 million)</b>	<b>FY17: (\$5.43 million)</b>
<b>Eliminating Welfare for Non-Citizens</b>	<b>FY16: (\$1.76 million)</b>	<b>FY17: (\$2.35 million)</b>

**Parity for Physician Reimbursement**

This budget brings parity to Medicaid’s system of reimbursing physicians by eliminating “separate facility” fees paid to hospital-compensated physicians. All doctors will be reimbursed the same amount by Medicaid, whether they work in a hospital or in a family practice.

<b>Eliminating Separate Facility Fee:</b>	<b>FY16: (\$4.37 million)</b>	<b>FY17: (\$4.35 million)</b>
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**Aligning MSP/DEL Eligibility to Federal Standards**

In order to fully fund nursing homes and improve care to Maine’s elderly, this budget proposes to align Medicare Savings Plan and the Drugs for the Elderly program eligibility with federal standards. Currently, Maine is one of only **two states** to pay higher than the federal minimum. Aligning this benefit with nationwide norms will pay for our entire nursing home initiative, plus all waitlists outside of Section 21.

<b>Re-aligning MSP/DEL from Outlier Status to Federal Norms:</b>	<b>FY16: (\$21.89 million)</b>	<b>FY17: (\$26.14 million)</b>
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## Educating and Attracting Young People to Maine

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### FINANCE AUTHORITY OF MAINE - MAINE STATE GRANT PROGRAM

The Maine State Grant program is a need based educational grant program with an average grant of \$1,000. Students automatically apply for this grant by filling out the Free Application for Federal Student Aid (FAFSA) prior to enrolling at a Maine based institution of higher education.

#### INITIATIVE

- This budget invests an additional \$10 million to allow for an expansion of grant awardees as well as potentially increasing the grant to cover more of the student's tuition expense.

### UNIVERSITY OF MAINE SYSTEM

The University of Maine System is Maine's largest secondary education system, with enrollment of nearly 40,000 students each year. The system also provides services to hundreds of thousands of Maine citizens each year through their Cooperative Extension services as well as cultural offerings.

#### INITIATIVES

- Making college more affordable for Maine students by increasing the University of Maine System's general fund allocation by 1.7 percent in FY15/16 and 1.93 percent in FY16/17 to offset tuition increases for in-state students. **\$9.45 million**
- Continued funding of \$2.5 million to allow the University System to continue investing in their infrastructure needs. **\$5 million**
- Additional research funding, investing in research and development throughout the entire system, including the five small campuses. This additional funding will help bring about innovation and accelerate commercialization to bring products to the marketplace. This initiative increases the state's investment in the research and development of a private public partnership focused on improving Maine's economy. **\$5.3 million**
- Additional funding for the Women Work and Community program, a program that provides educational opportunities, including financial planning as well as providing Mainers with the resources to help them start a business. **\$45,000**
- Additional funding for need-based scholarships for Maine students. **\$428,828**



## MAINE MARITIME ACADEMY

The Maine Maritime Academy is a nationally recognized public college with degree programs in Engineering, Management, Science and Transportation. The college of nearly 950 students annually has a more than 90% job placement rate within 90 days of graduation.

### INITIATIVES

- Additional funding for scholarships for students from dedicated revenue funds. **\$104,408**
- Infrastructure investment to the Curtis Hall dormitory heating systems to improve efficiency. **\$500,000**
- Infrastructure investment to repair Alford Student Center roof. **\$157,000**
- Upgrading the sprinkler system in Leavitt Hall to improve the safety of employees and visitors. **\$150,000**



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## Investing in Public Safety

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### HOLDING CRIMINALS ACCOUNTABLE

Governor LePage has continually highlighted Maine's drug problem and has identified funding for additional MDEA agents, judges and prosecutors to combat drug crimes.

The Maine Drug Enforcement Agency is battling an influx of out-of-state drug gangs, which are directly linked to the number of drug crimes committed in Maine. The total estimated cost of substance abuse in Maine is than \$1.4 billion, translating to over \$1,000 for every Maine resident. Even more disturbingly, hundreds of babies are born drug-addicted each year in our State.

*"Our Administration is focusing on the fact that Maine is subject to ever-increasing numbers of out-of-state drug trafficking organizations establishing drug markets in the state. This disturbing trend tears at the very fabric of our communities and puts our children at risk."*

- Governor Paul R. LePage

This budget includes additional funding to enforce drug trafficking crimes, along with additional resources for prosecution and adjudication.

### INITIATIVES

- Provides funding for seven new Maine Drug Enforcement Agency agent positions. **\$1.791 million**.
- Provides funding for four new assistant attorneys general assigned to the prosecution of drug crimes. **\$786,288**
- Provides funding for four new district court judge positions to hear and decide drug crime related criminal cases. **\$1.458 million**
- Provides funding for 22 new assistant district attorney positions to process cases faster. **\$4.089 million**