POLICY BRIEF
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THE MAINE HERITAGE POLICY CENTER

A LOST CAUSE: THE LOCAL OPTION SALES TAX

KEY findings

> As long as consumers are within a reasonable commuting distance, local option sales taxes increase cross-border shopping from high-tax jurisdictions to low-tax jurisdictions by **10 to 14 percent**.

> Sales taxes disproportionately harm low-income individuals who spend a larger share of their earnings on the tax. The lowest 20 percent of income earners in Maine pay an effective sales and excise tax rate of **6.1 percent** whereas the top one percent of Mainers pay **0.7 percent**.

> If all municipalities implemented a LOST in Maine, **10 jurisdictions would generate approximately 42 percent** of all LOST revenues collected statewide.

> There is nothing in state law or within LD 1254 that requires municipalities to lower property taxes in exchange for LOST revenue.

> Only five states and the District of Columbia have a higher combined lodging tax rate than Maine.

Introduction

In the First Session of the 129th Legislature, several bills were introduced to allow Maine municipalities to implement a local option sales tax (LOST). While most of the bills did not make it through the legislative process, one was carried over to the Second Session and will be considered when the legislature reconvenes in January 2020.

The bill, LD 1254, would allow municipalities to impose a one percent LOST on prepared foods and short-term lodging, pending resident voter approval. According to the original language of the bill, 85 percent of the revenue generated would be distributed to the municipality and the remaining 15 percent would go to other jurisdictions to prevent and treat opioid use disorder.[1] The bill allows the tax to be assessed seasonally or year-round. In addition, the funds generated cannot be used to reduce the amount of state aid municipalities receive, including revenue sharing funds.

Nonetheless, the imposition of LOSTs across the state would be detrimental to businesses and consumers alike. The purpose of this brief is to inform lawmakers, media, and the public about the flaws and unintended consequences of allowing municipalities to implement LOSTs in Maine.

What is a LOST?

In contrast to the sales tax levied by the State of Maine, a LOST is imposed by municipalities. LOSTs are paid by consumers in addition to what is paid through the state sales tax. For example, if the City of Portland imposed a one percent LOST, consumers would pay this rate on top of the current 5.5 percent state sales tax, for a total of 6.5 percent. LOSTs are currently imposed in 38 other states.[2]

The goal of a LOST is to increase and diversify municipal revenue streams, especially for those that are struggling to pay for essential services. Mayors and municipal officials from across the state have claimed a LOST would allow them to reduce or mitigate the increase of property taxes on their residents. In his testimony to the Taxation Committee in 2019, Former Portland Mayor Ethan Strimling suggested a one percent LOST in Portland would have the potential to lower the city's mil rate by 9.5 percent.[3]

However, these assertions are mostly empty political rhetoric and may not come to fruition if municipalities are afforded the opportunity to implement a LOST. There is currently nothing in state law or within the language of LD 1254 that would require municipalities to lower property taxes in exchange for the ability to generate LOST revenues. Further, LOSTs are an expedient way for politicians to fund their promises without having to make difficult budgetary decisions. Municipalities should consider making adjustments to their current budgets to control spending instead of advocating for a new tax on Maine people.

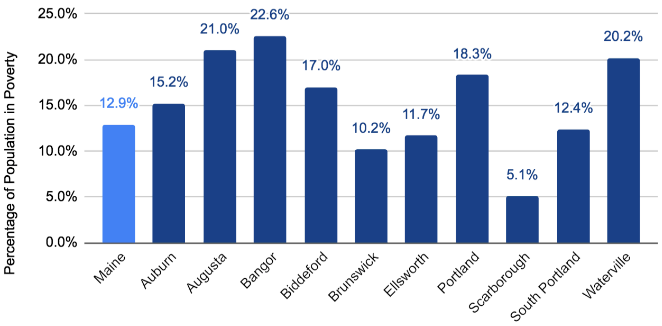
While some of the proposals introduced this legislative session would have allowed municipalities to implement a broad-based LOST, LD 1254 specifically focuses on meals and lodging. Maine's lodging tax is currently nine percent and our tax on prepared foods is eight percent.[4] According to the Tax Foundation, only five states and the District of Columbia levy a higher combined lodging tax than the State of Maine.[5]

Sales taxes are regressive

Sales taxes are regressive, regardless of whether they are imposed at the state or local level. In other words, wealthy consumers spend less of their income on the tax than those who have lower incomes. For example, if a person earns $25,000 annually and spends $7,000 on items on which the general sales tax is levied, they would spend an extra $70 on a one percent LOST, in addition to $385 on the state sales tax. This amounts to $455 total, or 1.8 percent of the individual's income. In contrast, a person who earns $70,000 annually and spends the same amount on taxable items would spend 0.7 percent of their income combined on a LOST and state sales tax.

While elected officials claim a LOST would improve local government services, there are plenty of Mainers who would further struggle from its implementation because more of their income would be consumed for the sole purpose of increasing local government revenue. Therefore, a LOST would be harmful to those who already live in poverty. According to the US Census Bureau, 12.9 percent of Mainers were estimated to live in poverty in 2017.[6] Figure 1 highlights the percentage of individuals in poverty in the 10 municipalities that generated the most revenue from taxable sales in 2018.

Figure 1: Percent of Population in Poverty in the 10 Municipalities that Would Generate the Most Revenue with a One Percent LOST

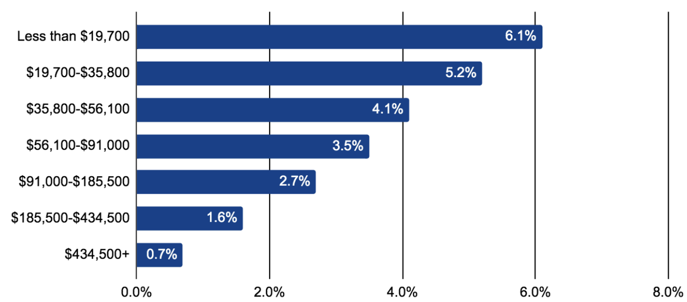


Source: US Census Bureau, 2013-2017 American Community Survey 5-Year Estimates

Six of the 10 municipalities that would generate the most revenue from LOSTs also have a higher percentage of people living in poverty than the overall percentage statewide. Three of the 10 municipalities that would generate the most revenue also have more than one-fifth of their residents living in poverty. If these jurisdictions adopt a LOST, it would largely harm individuals and families who already struggle to make ends meet.

Further, the lowest 20 percent of income earners in Maine pay an effective sales and excise tax rate of 6.1 percent, whereas the top one percent of Mainers pay 0.7 percent. Put differently, Mainers with the lowest incomes already spend approximately 8.7 times more of their earnings on sales and excise taxes than the highest income earners in the state.[7] A LOST would only serve to exacerbate this disparity.

Figure 2: Sales and Excise Taxes as a Percent of Family Income



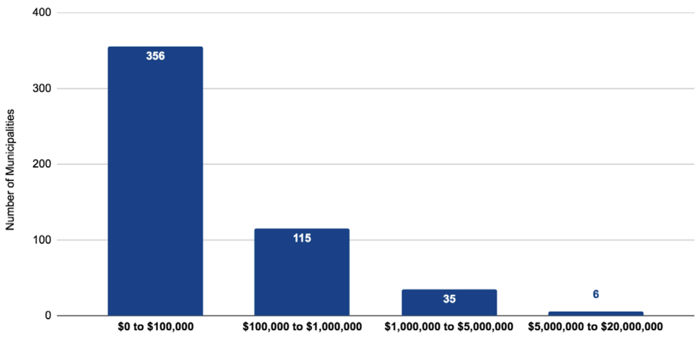
Source: Institute on Taxation and Economic Policy

Effects on municipalities

If Maine allows municipalities to implement LOSTs, there would likely be a patchwork of different tax rates and structures across the state. In examining the revenue already collected from taxable sales in each jurisdiction, it becomes clear that some municipalities would generate millions in revenue while others would have little to gain from implementing a LOST. This disparity in generated revenue would inevitably lead to some municipalities adopting a LOST and others forgoing the decision.

In examining sales tax revenue by town from 2018, only 41 municipalities, or eight percent, would have generated $1 million or more from implementing a broad-based one percent LOST. Only six municipalities would have generated more than $5 million from its implementation whereas 356 jurisdictions, or 70 percent, would realize revenue less than $100,000. Figure 3 categorizes jurisdictions based on the amount of revenue they would generate from the implementation of a broad-based one percent LOST.

Figure 3: Revenue Generating Capacity from a One Percent LOST among Maine Jurisdictions (annually)



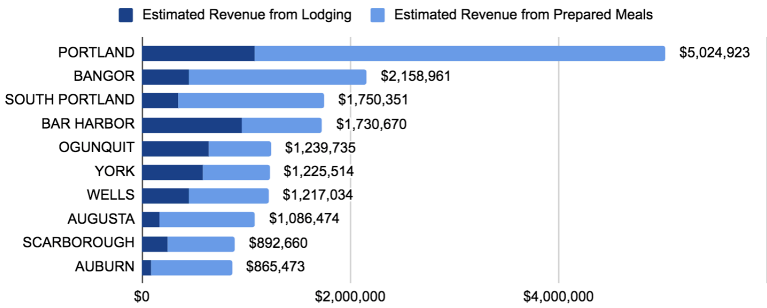
Source: Maine Revenue Services and The Maine Heritage Policy Center

If every municipality enacted a LOST, ten municipalities would collect more than 42 percent of the revenue it generates statewide.[8] These are primarily jurisdictions that have large populations and attract visitors from outside of their boundaries.

Portland would have generated more than $18 million from implementing a broad-based one percent LOST in 2018 whereas the Town of Durham, for example, would have collected approximately $56,000. In this scenario, Durham would have increased its revenue by only 0.6 percent whereas Portland's revenue would have increased by a whopping nine percent.[9]

Similarly, a LOST focused solely on prepared meals and lodging would do little to help the average municipality in the state. According to 2018 meals and lodging sales data from Maine Revenue Services, a one percent increase to the prepared meals and lodging taxes in all municipalities would generate approximately $38.4 million in revenue statewide. Portland would generate $5 million, or 13 percent, of the revenue from the LOST whereas the Town of Durham would collect less than $5,500 from its implementation.[10] The 10 municipalities that would generate the most revenue from a one percent LOST on meals and lodging are highlighted in Figure 4.

Figure 4: The 10 Municipalities That Would Generate the Most Revenue from a LOST on Meals and Lodging (2018)



Source: Maine Revenue Services and The Maine Heritage Policy Center

Because some municipalities lack the tax base to generate significant revenue from a LOST, they may decide it is not feasible upon conducting a cost-benefit analysis. This would lead to a patchwork of tax structures that would ultimately cause consumers to shop elsewhere and businesses to lose revenue if they are near a lower-tax jurisdiction.

In other states that have implemented LOSTs, the net rate for taxpayers varies significantly depending on where they are making purchases. For example, the state sales tax in Arizona is 5.6 percent and the average local sales tax rate is 2.77 percent. However, the maximum local sales tax rate is 5.6 percent. Therefore, on average, a consumer would pay 8.37 percent on their purchases for the net sales tax rate in Arizona, but could pay up to 11.2 percent depending on where they are purchasing products.[11]

Mainers should not have to make decisions on where to shop based on the local tax rates imposed. Consumers should be free to make these decisions based on market criteria, such as the quality and price of goods and services. However, decisions based on tax rates are already being made in border counties because of Maine's uncompetitive statewide sales tax.

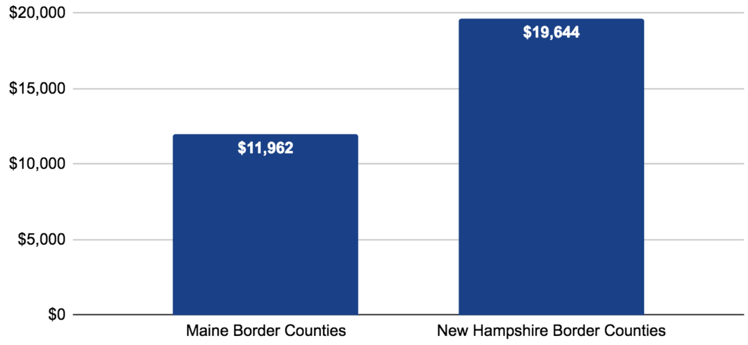
Effects on business and sales

The State of Maine is not isolated from the rest of the world. In fact, Maine borders only one U.S. state — New Hampshire — which does not levy a statewide general sales tax on its residents or visitors. This gives consumers and businesses in New Hampshire several advantages over those that operate in Maine.

The laws of economics show that demand decreases when prices increase for economic goods. Put differently, consumers will typically shop for the lowest price, as long as they are within a reasonable commute.[12] Since a sales tax effectively increases the net price of a product, consumers will try to shop in lower-tax jurisdictions. Because of this, sales tax increases often reduce the volume of sales and the amount of economic activity that occurs in the jurisdictions that impose them.

The Great Tax Divide: Maine's Retail Desert vs. New Hampshire's Retail Oasis, a 2011 publication of The Maine Heritage Policy Center, found that the disparity between per capita retail sales in adjacent border counties in Maine (Oxford and York) and New Hampshire (Carroll, Coos, Rockingham, and Strafford) is primarily due to the sales tax differential. According to the data, per capita retail sales were nearly identical in 1951 but began to diverge after Maine adopted the sales tax that year.[13] The report examined the divergence in per capita retail sales among both states between 1948 and 2007 and estimated that, if Maine had the same level of retail activity as New Hampshire, the state would have generated an extra $2.2 billion in retail sales and created thousands of retail jobs. Today, per capita retail sales in New Hampshire border counties ($19,644) continue to outperform per capita retail sales in Maine border counties ($11,962) by approximately $7,700 per person.[14] This finding is emphasized in Figure 5.

Figure 5: Retail Sales Per Capita by State Border Counties (2012)



Source: US Census Bureau, 5-Year Economic Census (2012) and The Maine Heritage Policy Center

The phenomenon of cross-border shopping (when individuals who live in one jurisdiction shop in another jurisdiction) was measured by Iksoo Cho, an official at the Nebraska Department of Revenue, across 44 mid-sized Nebraska cities that had local sales tax rates between 0.5 and 1.5 percent. The study found that increasing the LOST by one percent had the potential to reduce the demand of taxable goods between 10 and 14 percent, primarily due to cross-border shopping in lower-tax cities. In addition, the effects of cross-border shopping persist until the lower-tax jurisdiction is an unreasonable distance away, which was found to be between 31 and 38 miles.[15]

Therefore, Maine businesses in municipalities that impose a LOST would likely lose net profit to businesses in lower-tax municipalities in Maine and New Hampshire, as long as these businesses are within a reasonable commute. This occurs because businesses in high-tax jurisdictions have to reduce their prices in order to compete with businesses in low- or zero-tax areas, or settle for consumption losses due to their higher net prices. Either way, these businesses are put at a disadvantage compared to businesses in jurisdictions that have an overall lower sales tax and net price.

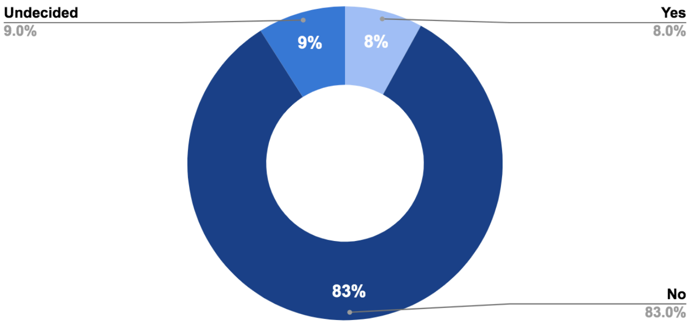
This effect wouldn't be different for a LOST levied on prepared foods and short-term lodging in Maine. For a state whose official slogan is "Vacationland," it would be counterproductive to increase a tax that individuals would pay when they choose to stay here. While local political leaders have an affinity for calling this a tax on tourists and visitors, Maine people go out to eat and vacation in the state as well.

In fact, Mainers comprise approximately 70 percent of meals and more than 30 percent of lodging purchases in the state.[16] Those individuals and families would be subject to the LOST on prepared meals and lodging, and it could steer them away from a particular destination in favor of another restaurant or hotel in a different region of the state (or another state entirely) that chooses not to levy a LOST.

The National Federation of Independent Business (NFIB), an organization that represents and advocates for thousands of small businesses in Maine and across the country, understands that any additional sales tax would have a negative impact on the business community as a whole. This sentiment is echoed in a recent survey of NFIB members in Maine. According to testimony provided by the NFIB in 2019, the survey showed that 83 percent of its members strongly oppose a LOST, eight percent want one, and nine percent are undecided.[17]

Figure 6: Should municipalities or counties be allowed to levy a local sales tax?

Source: National Federation of Independent Business



Additional concerns

While some municipalities expect to accumulate more revenue with a LOST, its implementation could have negative effects on other revenue streams. A 2018 study published in *Public Performance and Management Review* found that a one percent increase to a LOST results in the decline of median housing prices by 0.2 to 0.3 percent.[18] In other words, an increase to, or the allowance of, a LOST might cause the revenue from property tax collections to decline. Therefore, some of the revenue generated from a LOST would supplant lost property tax revenue while supplementing overall revenue collected by the municipality.

According to the Portland Tax Assessor's office, the total value of taxable property in the city is $7.93 billion.[19] A 0.2 to 0.3 percent decrease would equate to a loss of $15.9 to $23.8 million in value. Based on this decrease in value, the city would lose between $370,000 and $555,000 in revenue from property tax collection. While the revenue generated by a one percent LOST would be much larger than the loss in property tax revenue, policymakers should be aware of the consequences of implementing a LOST and that it will likely generate less revenue than what is initially projected.

Conclusion

A LOST would negatively affect consumers and businesses while only generating substantial revenue for a small handful of municipalities that have large retail bases. While the stated goal of a LOST is to lower the property tax burden on Mainers, there is no guarantee that this would occur once municipalities begin generating revenue. Sales taxes are incredibly regressive and the implementation of a LOST in Maine would generate revenue at the expense of individuals living in poverty.

Allowing municipalities to implement LOSTs would likely cause consumers to cross municipal and state borders to purchase taxable items depending on their proximity to lower-tax jurisdictions. Subsequently, businesses would lose revenue by reducing their gross prices to accommodate for the tax, or by allowing the tax to increase the net price of their products, thus driving away consumers.

In addition, imposing LOSTs on Mainers is an expedient way for politicians to fund their pet projects without making difficult budgetary decisions. Municipalities should consider making adjustments to their current budgets to control spending instead of advocating for a new tax on Maine people. Nonetheless, the potential perils of allowing municipalities to implement LOSTs far outweigh the alleged benefits.

ENDNOTES

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