

**TESTIMONY OF  
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DEPARTMENT OF ADMINISTRATIVE AND FINANCIAL SERVICES**

**BEFORE THE JOINT STANDING COMMITTEE ON TAXATION  
HEARING DATE: FEBRUARY 6, 2020**

**LD 2011 – "AN ACT TO UPDATE CERTAIN PROVISIONS IN THE INCOME TAX AND SERVICE  
PROVIDER TAX LAWS"**

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Senator Chipman, Representative Tipping, and members of the Taxation Committee – good afternoon, my name is Michael Allen, Associate Commissioner for Tax Policy in the Department of Administrative and Financial Services. I am here today at the request of the Administration to testify in support of LD 2011, “An Act To Update Certain Provisions in the Income Tax and Service Provider Tax Laws.”

LD 2011 is legislation submitted by the Department of Administrative and Financial Services. As you know, Maine Revenue Services prepares one or more bills each year that proposes changes to various existing provisions of Maine law, primarily in Title 36. The Department has also submitted LD 2008, “An Act Making Technical Changes to the Maine Tax Laws” and LD 2047, “An Act To Amend the State Tax Laws.” The Act to Amend bill makes technical and minor, but substantive, changes to Maine’s tax laws. This bill, on the other hand, makes more significant, substantive updates to Maine’s tax laws for sales tax, service provider tax (SPT), corporate income tax, and individual income tax. These updates address five current issues facing the State by providing consistency among similarly situated taxpayers and among similarly situated transactions, while clarifying and simplifying Maine’s tax laws.

Part A of this bill addresses the accelerating technology and consumption shift in the digital products industry. Maine has historically taxed traditional forms of audio, video and

digital media consumption, including cable or satellite television and radio, DVD rental, etc.

Taxpayers have been shifting from these traditionally consumed products to accessing the same media through online digital streaming services. While Maine tax law has kept up relatively well with changing technology, the increasing prevalence of streaming services means the law now needs to be updated again.

The table below, prepared by MRS, compares the various ways digital and audio content are consumed and the way they are currently taxed in Maine under the sales and service provider taxes. As you can see, Maine taxes the purchase and rental of video content in a variety of forms – but not in its latest iteration, digital streaming. Likewise, Maine taxes the purchase of audio content in a variety of forms (and the rental in limited situations) – but the State currently does *not* tax digital streaming.

Table 1. Maine’s current taxation of video and audio media.

	Physical Sale	Online Sale (permanent rights)	Cable & Satellite Industries	Physical Rental	Online Digital Streaming	
					Rental (available once)	Subscription
<b>Video Content</b>	<b>Taxable</b> (Sales Tax)  (DVDs)	<b>Taxable</b> (Sales Tax)	<b>Taxable</b> (SPT)  (cable or satellite TV)	<b>Taxable</b> (SPT)  (DVDs)	<b>Not Taxable</b> (Exempt)	<b>Not Taxable</b> (Exempt)
<b>Audio Content</b>	<b>Taxable</b> (Sales Tax)  (CDs)	<b>Taxable</b> (Sales Tax)	<b>Taxable</b> (SPT)  (satellite radio)	<b>Taxable</b> (SPT)  (cassette tapes in some scenarios)	<b>Not Taxable</b> (Exempt)	<b>Not Taxable</b> (Exempt)

As the industry shifts to digital streaming, two significant issues arise. The first issue relates to equity. The tax code is treating the new streaming platforms more favorably than similar older distribution models – thereby distorting the market. As I am sure you have heard,

one of the goals of a modern tax system is to be as neutral as possible – meaning in this case, that it does not favor one product delivery method over others. The second issue is Maine’s tax base. As the market changes – shifting from taxable products to untaxed digital streaming, the State’s tax base is being eroded. During the last two fiscal years the General Fund portion of the service provider tax has declined by an average of 1.3 percent, and the current baseline forecast for the FY2020-21 biennium assumes it will continue to decline annually by 0.8 percent.

Part A of this bill would align the taxation of these various forms of consumption of essentially the same content by taxing digital audio and video content, regardless of the method in which it is consumed. It would do so by applying the service provider tax to the sale of digital audio-visual and digital audio services, thereby aligning Maine with the twenty-two states and the District of Columbia which, as of our research performed this summer, tax streaming video or audio media

This bill would provide more equal taxation, clearer guidance for taxpayer compliance, simpler tax administration, and tax revenue base preservation. In response to input from interested parties, the attached amendment revises the sourcing of these services. This Part applies to sales occurring on or after October 1, 2020.

Part B clarifies and simplifies Maine’s corporate income tax by establishing objective, clearly defined nexus thresholds as a practical structure for the current general “economic nexus” standard.

As some of you may remember, the State was long prohibited from collecting sales tax from vendors with no physical presence in the State. In June 2018, this prohibition was removed by the U.S. Supreme Court decision in *South Dakota v. Wayfair* – wherein the Court approved

South Dakota's sales tax nexus law applying clear, objective nexus thresholds without regard to physical presence. Maine, and nearly all other sales tax states, followed suit.

However, for income tax purposes, Maine and many other states have long taken the position that economic nexus, even in the absence of physical presence, is sufficient for corporate income tax jurisdiction. Broadly speaking, under Maine's economic nexus standard a taxpayer has nexus with the State based on the taxpayer's purposeful direction of business activity toward the State. This economic nexus approach to corporate income tax in Maine, and other states, significantly predated the *Wayfair* decision.

Prior to *Wayfair*, some states took the approach of using nexus thresholds, often referred to as "factor presence" thresholds, bringing greater clarity, objectivity, and consistency to their nexus standards. The *Wayfair* decision, approving the use of nexus thresholds for sales tax, highlights the benefits of adopting clear nexus thresholds and lends support to the broader adoption of nexus thresholds in corporate income tax. According to a recent Checkpoint analysis, nine other states have adopted factor presence standards for corporate income tax and two other states use a factor presence standard for gross receipts or gross margins business taxes.

This bill applies so-called "factor presence" thresholds clarifying the minimum activity, which, when surpassed by a corporation, subject the corporation to the Maine corporate income tax. In addition, the thresholds create a "safe harbor" for corporations with modest activity in the State that would nonetheless have nexus under current law. The annual minimum thresholds for multistate businesses established by this Part are \$250,000 of property, \$250,000 of payroll, or \$500,000 of sales in Maine, or, alternatively, 25% of total annual property, payroll or sales in Maine, as determined under the State's current apportionment law. In order to give taxpayers sufficient time to react to this change, the annual minimum thresholds apply to tax years

beginning on or after January 1, 2021. The attached amendment makes technical changes this Part.

These clear income tax nexus thresholds will benefit taxpayers by allowing them to more confidently ascertain their compliance requirements and by providing safe harbors for activity below the threshold amounts. In addition to providing increased clarity and predictability to taxpayers, these thresholds will provide a simpler basis for efficient tax administration while having only a minor impact on State revenue.

It is important to note that a federal law, commonly referred to as P.L. 86-272, prohibits state income taxation in certain circumstances defined in the law and described in more detail by State rule. Maine provides a subtraction modification for income the State is prohibited from taxing under the U.S. Constitution, including income that is protected under P.L. 86-272. P.L. 86-272 is *unaffected* by this legislation and would continue to apply in accordance with federal law and the corresponding State subtraction modification.

As I testified at the public hearing for LD 1993, “An Act To Clarify the Law Relating to Corporate Income Tax Nexus and the Shipment of Spirits into the State,” the Administration is willing to work with the sponsor of that bill to incorporate a similar bailment exclusion in this bill, that would exclude State mandated bailment property from the property threshold determination.

Part C makes two changes to income tax inflation adjustment indexing. The bill amends the individual income tax law to index the recently enacted Maine Dependent Exemption Tax

Credit for inflation. This change follows up on the Internal Revenue Code (IRC) Conformity Bill from the 128<sup>th</sup>, 2<sup>nd</sup> Regular Session, Public Law 2017, c.474 (effective September 12, 2018), which enacted the Maine Dependent Exemption Tax Credit as a replacement for the personal exemption for dependents. Indexing this credit for inflation would maintain the credit's value over time. In addition, the bill aligns inflation indexing for the lowest and highest income tax brackets by allowing an additional one-year inflation adjustment for the highest income tax bracket. This Part applies to tax years beginning on or after January 1, 2021.

Part D conforms Maine income tax with the federal net operating loss (NOL) limitation. This change also follows up on the IRC Conformity Bill from the 128<sup>th</sup> 2<sup>nd</sup> Regular Session which decoupled Maine income tax from the federal NOL limitation. The federal Tax Cuts and Jobs Act of 2017 (TCJA) repealed the federal corporate alternative minimum tax (AMT), which contained a limitation on the use of NOLs, but added a similar limitation to the federal corporate income tax.

When Maine conformed to the TCJA, the State ended its corporate AMT. However, Maine did not adopt the federal NOL limitation as part of the State's corporate income tax. This nonconformity adds complexity that increases taxpayer and MRS administrative burdens while reducing tax revenue. This nonconformity applies to NOLs generated in tax years beginning on or after January 1, 2018, but first impacts the amount of Maine income tax due when the carryforward of those NOLs are claimed in tax years beginning on or after January 1, 2019. This delayed impact means the issue of nonconformity can still be timely addressed by legislation *this Session* – before corporate income tax returns for tax year 2019 are filed. This Part brings Maine into conformity with the federal NOL limitation enacted by the Tax Cuts and Jobs Act.

In addition to the four issues above, the administration is proposing a simple "blanket" sales and service provider tax exemption for 501(c)(3) nonprofit organizations. The attached amendment exempts from the State sales, use and service provider taxes the sales made to a nonprofit organization that has been determined by the United States Internal Revenue Service to be exempt from federal income taxation under Section 501(c)(3) of the Code, if the property or services sold are to be used primarily for the purposes for which the nonprofit organization was organized.

Every year, nonprofit organizations come before the administration and the Legislature requesting narrowly-tailored sales tax exemptions addressing their specific situation. Meanwhile, in terms of State revenue, most nonprofit organizations are already exempt. When faced with the three new sales tax exemptions for nonprofit organizations enacted last session, the Governor requested the Office of Tax Policy to review Maine's sales and service provider tax taxation of nonprofits in relation to that of other states.

Of the one hundred and six separate statutory sales tax exemptions, thirty-two are for nonprofit organizations, exempting forty-five distinct types of nonprofits. Not only are many nonprofit organizations already exempt, the ones that are not exempt are often unaware of this fact. This confusion is understandable – these organizations are generally exempt from income and property taxes. Furthermore, Maine is the only state in New England with a sales tax that does not broadly exempt all 501(c)(3) organizations. In fact, Maine is one of only a few states nationally without such an exemption. This amendment would simplify Maine's sales and service provider taxes while equitably treating all 501(c)(3) organizations the same – instead of

the current patchwork of nonprofit exemptions that exists as a result of solving the problem for one organization at a time.

The amendment would also require the Office of Tax Policy to study the existing sales and service provider tax exemptions and return with legislation repealing, or otherwise modifying, any duplicative or unnecessary exemptions. The 501(c)(3) exemption would apply to sales occurring on or after October 1, 2020.

The estimated revenue impact of this bill and the proposed amendment is attached to this testimony. I and others from MRS, will be available at the work session to assist the Committee. I would be happy to take any questions you have now. Thank you.

**Act to Update Revenue Estimate***Change in individual income tax revenue unless otherwise noted*

		Fiscal Year (millions)			
		2020	2021	2022	2023
Part A – Digital Streaming	Service Provider Tax		\$3.73	\$5.80	\$6.00
Part B – Factor Presence	Corporate Income Tax	Negligible revenue impact.			
Part C – Indexing	Individual Income Tax			-\$1.04	-\$2.11
Part D – NOL Limitation Conformity	Income Tax		\$2.20	\$1.00	\$1.00
Amendment – 501(c)(3) Exemption	Sales and Service Provider Taxes		-\$2.67	-\$4.00	-\$4.00
<b>Total</b>			<b>\$3.27</b>	<b>\$1.76</b>	<b>\$0.89</b>

**MAINE REVENUE SERVICES**  
**LD 2011, “An Act to Update Certain Provisions in the Income Tax and**  
**Service Provider Tax Laws”**  
**Proposed Committee Amendment**  
**February 6, 2020**

**Replace Section A-8 of the bill with the following:**

**‘Sec. A-8. 36 MRSA §2556-A is enacted to read:**

**§ 2556-A. Sourcing for sales of digital audio-visual and digital audio services**

The sale of digital audio-visual and digital audio services is sourced in this State pursuant to this section.

**1. Sourced to address of purchaser in seller's business records.** The sale is sourced to the location indicated by an address for the purchaser that is available from the business records of the seller that are maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith.

**2. Sourced to address of purchaser not in seller's business records.** For a sale when subsection 1 does not apply, the sale is sourced to the location indicated by an address for the purchaser obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available, when use of this address does not constitute bad faith.

**3. Sourced to address from which service provided.** When subsections 1 or 2 do not apply, including the circumstance in which the seller is without sufficient information to apply subsections 1 or 2, the location is determined by the address from which the service was provided, disregarding for these purposes any location that merely provided the digital transfer of the product sold.

**4. Mobile telecommunications service providers.** Notwithstanding subsections 1 to 3, the sale of digital audio-visual and digital audio services sold by a provider of mobile telecommunications service is sourced in the same manner as mobile telecommunications services pursuant to section 2556.

**On Line 26 of page 3 strike the word “substantial”.**

**On Line 33 of page 3 strike the word “substantial”.**

**On Line 14 of page 4 strike the word “substantial”.**

**Add the following new Part E:**

**PART E**

**Sec. E-1. 36 MRSA §1760, sub-§104, is enacted to read:**

**104. 501(c)(3) nonprofit organizations.** Sales to a nonprofit organization that has been determined by the United States Internal Revenue Service to be exempt from federal income taxation under Section 501(c)(3) of the Code, if the tangible personal property or taxable services sold are to be used primarily for the purposes for which the nonprofit organization was organized.

**Sec. E-2. 36 MRSA §2557, sub-§40, is enacted to read:**

**40. 501(c)(3) nonprofit organizations.** Sales to a nonprofit organization that has been determined by the United States Internal Revenue Service to be exempt from federal income taxation under Section 501(c)(3) of the Code, if the services sold are to be used primarily for the purposes for which the nonprofit organization was organized.

**Sec. E-3. Application.** This Part applies to sales occurring on or after October 1, 2020.

**Sec. E-4. Study; additional legislation.** The Office of Tax Policy shall study the entity-based exemptions provided to qualifying nonprofit organizations from sales tax pursuant to Maine Revised Statutes Title 36, section 1760 and from service provider tax pursuant to section 2557. The Department of Administrative and Financial Services shall submit legislation repealing or otherwise modifying any of those exemptions that are found to be duplicative or unnecessary. Notwithstanding Maine Revised Statutes Title 36, section 191, the Office of Tax Policy may disclose the number of nonprofit organizations not exempt under Section 501(c)(3) of the Code that have active exemption certificates under each sales or service provider tax exemption.

**Summary**

This amendment clarifies the corporate income tax nexus provisions of the bill by referring to “nexus” instead of “substantial nexus.” In addition, it exempts from the sales and use tax and from the service provider tax sales to a nonprofit organization that has been determined by the United States Internal Revenue Service to be exempt from income taxation under Section 501(c)(3) of the Code, if the property or services sold are to be used primarily for the purposes for which the nonprofit organization was organized. And requires a study of certain sales tax

and service provider tax exemptions. Finally, it amends the sourcing of digital audio-visual and digital audio services.