DATE: April 26, 2023

TO: Government Oversight Committee

FROM: Kari Hojara, OPEGA Analyst

RE: GOC Reclassification of the Deduction to Capital Construction Funds for Maintenance or Replacement of Fishing Vessels for the Purposes of Tax Expenditure Evaluation

**Proposal for Committee Discussion**

Enclosed is a proposal for Committee members to consider for the purpose of reclassifying the Deduction from the full evaluation tax expenditure review category to the expedited review category.

The Deduction is currently assigned to receive a full evaluation. The 130th GOC received proposed evaluation parameters for the Deduction in June 2022 from OPEGA and approved those parameters. OPEGA began work on the Deduction recently and found information suggesting that the Deduction may be more appropriately classified for expedited review with other similar expenditures. OPEGA paused work on the review pending GOC consideration.

The proposal attached describes the logic behind OPEGA's recommendation to reclassify the expenditure. Also attached is a flowchart to illustrate the effects of classification decisions.

**Committee Process for Reclassification – Vote Required**

Since the category assigned to tax expenditures guides the type of review they will receive, it is important that any reclassification by the Committee is stated clearly and supported by an affirmative vote.

- The Committee may move to reclassify the Deduction as proposed.

**Proposal for Re-categorization and Re-classification of the Deduction for Contributions to Capital Construction Funds for Maintenance or Replacement of Fishing Vessels**

| Enacted | Statute(s) | Taxpayers Affected | Revenue Loss |
|---|---|---|---|
| 1996 | 36 MRSA §5122(2)(I) | Approximately 35 | $287,000 |

*Source for Revenue Loss and number of affected taxpayers: Maine State Tax Expenditure Report (February 15, 2023).*

### Program Description

This tax expenditure is an income tax deduction for contributions to a capital construction fund (CCF) for maintenance or replacement of fishing vessels. This deduction is available only to individual and fiduciary taxpayers and allows fishermen to construct, reconstruct or acquire commercial fishing vessels with pre-tax dollars.[1]

### Proposed Re-categorization and Re-classification

This deduction was originally classified for evaluation purposes as a Business Incentive and scheduled for a Full Evaluation. OPEGA initially recommended this classification as part of a high-level effort to categorize hundreds of tax expenditures. Now that we have gathered additional information about this deduction, OPEGA believes the deduction was implemented as a matter of conformity with the federal tax code. Consequently, OPEGA recommends that a Full Evaluation of the deduction should not be completed. Instead, we recommend the deduction be reclassified for evaluation with other federal conformity matters for Expedited Review under the Rationale category of Conformity with Internal Revenue Code (IRC).

### Evidence to Support the Deduction as a Conformity Matter

Prior to 1991, Maine automatically conformed to the federal tax code for this deduction because the deduction was included in the federal adjusted gross income (AGI). The federal government made an adjustment where, beginning in the 1991 tax year, the deduction was taken from taxable income rather than from AGI.[2] Consequently, for Maine to continue to conform with the federal tax code, the 117th Legislature added a subtraction modification of federal AGI under PL 1995 c.639.

### Precedent

There is precedent for the Government Oversight Committee adjusting the classification of tax expenditures upon gaining further knowledge. In the spring of 2020, the GOC also reclassified the New Machinery for Experimental Research Sales Tax Exemption to require an expedited review by the Taxation Committee in lieu of a full OPEGA evaluation.

[1] See "Capital Construction Fund Frequently Asked Questions" from the NOAA National Marine Fisheries Service (https://media.fisheries.noaa.gov/dam-migration/capital-construction-fund-frequently-asked-questions_508c.pdf). This deduction essentially allows fishermen to defer taxable income from operation of their fishing vessels. Instead of being captured when the income is earned, income taxes deferred via this deduction are captured over the life of the vessel, by adjusting depreciation, and thus increasing taxable income, when CCF dollars are used to fund capital investments in fishing vessels.

[2] IRS Publication 595. 1991. Tax Guide for Commercial Fishermen. Internal Revenue Service Catalog Number 15171E.

**Full Evaluation of Tax Expenditures:**
**Deduction for Contributions to Capital Construction Funds for Maintenance or Replacement of Fishing Vessels**
**Background Presented to the Government Oversight Committee on June 15, 2022**

| Enacted | Statute(s) | Taxpayers Affected | Est. Revenue Loss |
|---|---|---|---|
| 1996 | 36 MRSA §5122-(2)(I) | Approximately 30 taxpayers | FY22 $520,000<br>FY23 $520,000 |

*Sources: Maine Revised Statutes and Maine State Tax Expenditure Report 2022 – 2023.*

## Description

This tax expenditure is an income tax deduction for contributions to a capital construction fund (CCF) for maintenance or replacement of fishing vessels. This deduction is available only to individual and fiduciary taxpayers and allows fisherman to construct, reconstruct or acquire commercial fishing vessels with pre-tax dollars.[1] It mirrors the same deduction in the federal tax code.

## Administration & Reporting

Maine Revenue Services (MRS) administers this deduction through the processing of State income taxes. No other state agencies are involved in administering the deduction.

No reporting specific to this deduction is required under statute. However, information about the estimated revenue loss connected with the deduction, and the estimated number of taxpayers affected by the deduction, is included in the MRS biennial Maine State Tax Expenditure Report.

## Legislative Activity

There have been no substantive statutory changes to this deduction since its enactment, and there are no proposed changes before the current Legislature.

[1] See "Capital Construction Fund Frequently Asked Questions" from the NOAA National Marine Fisheries Service (https://media.fisheries.noaa.gov/dam-migration/capital-construction-fund-frequently-asked-questions_508c.pdf). This deduction essentially allows fishermen to defer taxable income from operation of their fishing vessels. Instead of being captured when the income is earned, incomes taxes deferred via this deduction are captured in the future, in lieu of depreciation, when CCF dollars are used to fund capital investments in fishing vessels.

## Tax Expenditure Review Flowchart – Prepared by OPEGA for the 131st GOC

### Classification of Tax Expenditures
3 MRS §998(1)

| Category A | Category B | Category C |
|---|---|---|
| Full review | Expedited review | No review |

**GOC Reviews Categories & Schedule Annually**
3 MRS §998(3)
- Consultation with TAX Committee
- Adjustments and approval by October 1

### Schedule for Full & Expedited Reviews
3 MRS §998(2)

Sets priorities for OPEGA's work & informs agencies and stakeholders of approximate review timing

### Full Evaluation Process
3 MRS §999

| | |
|---|---|
| **GOC** | approves evaluation parameters, after public comment & consultation with TAX |
| **OPEGA** | conducts evaluation based on approved parameters & prepares report on results |
| **GOC** | receives a presentation of the report from OPEGA & may take public comment<br><br>votes on endorsement of the report<br><br>transmits the report to TAX with record of the GOC endorsement vote & any GOC recommendations |
| **TAX** | reviews the OPEGA report and GOC recommendations<br><br>reports to the Legislature on its review of the report within 90 days of receipt & may submit legislation |

### Expedited Review Process
3 MRS §1000

**ANNUALLY**

| | |
|---|---|
| **OPEGA** | provides TAX with a summary of the required data by December 15 |
| **TAX** | assesses the continued relevance of, or need for adjustments to, the tax expenditures in the cohort & the tax policy area<br><br>reports results to the Legislature by March 1 & may submit legislation |

## §998. Process for review of tax expenditures

**1. Assignment of review categories.** By October 1, 2015, the committee, in consultation with the policy committee, shall assign each tax expenditure to one of the following review categories:

A. Full evaluation for tax expenditures that are intended to provide an incentive for specific behaviors, that provide a benefit to a specific group of beneficiaries or for which measurable goals can be identified; [PL 2015, c. 344, §4 (NEW).]

B. Expedited review for tax expenditures that are intended to implement broad tax policy goals that cannot be reasonably measured; and [PL 2015, c. 344, §4 (NEW).]

C. No review for tax expenditures with an impact on state revenue of less than $50,000 or that otherwise do not warrant either a full evaluation or expedited review. [PL 2015, c. 344, §4 (NEW).]

[PL 2015, c. 344, §4 (NEW).]

**2. Schedule.** The committee, in consultation with the policy committee, shall establish a prioritized schedule of ongoing review of the tax expenditures assigned to the full evaluation and expedited review categories pursuant to subsection 1, paragraphs A and B. To the extent practicable, the committee shall group the review of tax expenditures with similar goals together.

[PL 2017, c. 266, §1 (AMD).]

**3. Annual review of assignments and schedule.** By October 1st of each year, beginning in 2016, the committee, in consultation with the policy committee, shall review and make any necessary adjustments to the review category assignments and schedule pursuant to subsections 1 and 2, including adjustments needed to incorporate tax expenditures enacted, amended or repealed during the preceding year.

[PL 2015, c. 344, §4 (NEW).]

**4. Office responsibilities.** The office shall maintain a current record of the review category assignments and the schedule under this section.

[PL 2015, c. 344, §4 (NEW).]

SECTION HISTORY

PL 2015, c. 344, §4 (NEW). PL 2017, c. 266, §1 (AMD).