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## State of Maine Property Tax Reform

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# STATE OF MAINE PROPERTY TAX REFORM

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A PROPOSAL PREPARED BY THE GOVERNOR'S  
SELECT COMMITTEE ON PROPERTY TAX REFORM

MAY 1997

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## Summary of Recommendations

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The following is the list of the recommendations proposed by the Governor's Select Committee to relieve the property tax burden in the State of Maine:

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- A. A \$20,000 homestead exemption.**  
This will exempt the first \$20,000 in valuation of all owner-occupied, primary residence property from property tax, resulting in a \$338 average reduction in each household's property tax bill.
- B. A 3.5% sales tax on services.**  
To fund the Homestead exemption, we recommend a 3.5% sales tax on all services with the exception of construction, medical services and childcare.
- C. Increased awareness of the current circuit breaker program.**  
We recommend the circuit breaker program application be included in the current Income tax form to increase the efficiency and effectiveness of this tax relief program. We also recommend exploring other methods of reaching individuals who do not file taxes.
- D. Funding to support and encourage regionalization and consolidation efforts with regard to municipal services.**  
Regionalization and consolidation of municipal services are proven methods of reducing municipal expenditures.

## INTRODUCTION

In January, 1997, Governor Angus King established a 10 person committee representing a broad cross-section of citizen interests to investigate what changes are needed in the Maine tax system to address the issue of high property taxes. The Governor's Select Committee on Property Tax Reform (the "Committee") was charged with examining how to reduce the burden of the property tax. The Committee was asked to recommend steps the State and local governments in Maine could take to reduce the burden of the property tax as well as changes in the way that the property tax is administered and collected to relieve the apparent burden of the tax. The Governor charged the Committee not to consider drastically reducing state government expenditures in favor of local governments and not to increase the overall burden of taxes. The Committee was advised to keep in mind the relatively high taxes Maine imposes on businesses, compared to neighboring states.

This report of the Committee was prepared following a review of several general strategies to relieve the property tax burden. The Committee met several times between January and April and broke into working subcommittees to examine the following strategies;

- fewer exemptions to property tax,
- service fees on tax exempt property,
- extension of sales tax to services,
- municipal consolidation of services,
- homestead exemption,
- circuit breaker program,

- tax postponement and deferral,
- a change in the revenue sharing formula and
- local option taxes.

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This report is divided into three sections. Section 1 covers the objectives we set out to accomplish. Section 2 provides an overview of our recommendations. Section 3 discusses other options considered but rejected by the Committee.

## I. OBJECTIVES

The Committee agreed upon three principle objectives in choosing a strategy to reduce the property tax burden.

1. *Control rising property taxes -- ensure that property taxes do not rise as a percent of income.*
2. *Avoid disincentives to economic growth -- consider strategies that will not change consumer behavior and/or drive business development out of state.*
3. *Produce adequate revenue -- raise sufficient funds to finance budgeted expenditures.*

The three objectives that the Committee agreed upon were drawn from a more general discussion about the characteristics of a sound tax system. The following is a summary of these ideas.

- Equity--both horizontal and vertical
  - Horizontal equity refers to taxpayers with similar incomes paying similar taxes
  - Vertical equity refers to taxpayers of different incomes. Taxpayers of lower income should not have to pay a higher percentage of their income in taxes than taxpayers of higher incomes.

- Stability--tax system should neither rely overly on taxes that do not grow when the economy is expanding (inelastic tax) nor on taxes that shrink too severely when the economy slows (elastic tax).
  
- Balance between major tax sources-- sales, property, and income. No one tax should provide more than 35% nor less than 25% of total tax revenue.<sup>1</sup>

In addition to these generally accepted characteristics of what a tax system should look like, we also considered the current situation of Maine. Although Maine has not yet enacted any state wide tax cap measures, local municipalities have heard the rumbling of citizen discontent and several have had tax caps imposed to hold down property taxes. Even though most of these tax caps have been repealed. The sentiment of the taxpayer remains rebellious and the property tax, in particular, is resented. With this in mind, we discussed the following goals:

- Decrease the property tax burden for the average taxpayer.  
(Burden is the percentage of a household's income paid in taxes.)
- Decrease the overall reliance on property tax revenue.
- Realize a tax system that reflects the actual economic conditions of the individual taxpayer.

Finally, we remained mindful in our discussion that the Governor has heard from businesses that Maine's tax burden on them is high. This provided us with a final goal:

- Neutrality -- revenue policies that do not distort consumer behavior or location decisions of businesses and households. We did not want to recommend a strategy that would drive businesses out of Maine.

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<sup>1</sup> Report of Gov. John McKernan Jr.'s Tax Policy Study Committee, Nov 1987 pg.5

## II. Overview of Recommendations

### Homestead Exemption

The Governor's Committee is proposing a flat \$20,000 homestead exemption for all owner occupied primary residence property in the State of Maine. This option was chosen for three reasons; (1) it makes the property tax structure less regressive, (2) it has a large impact on many households in the state, and it could improve the economy, and (3) it improves the balance among the three major types of taxes in the state when coupled with a sales tax on services.

The \$20,000 homestead exemption was chosen as a method for relieving the tax burden in the State of Maine because it has a tremendous impact on the individual tax bills of the citizens in the state. The average property tax bill will be decreased by \$338 (based on the average mil rate in the Maine in 1995 of 16.9) for owner-occupied property. Residents whose income is below \$20,000 annually could experience up to a 40% reduction in the amount of their tax bill (see Table 1). This improves the vertical equity of the tax structure without impacting horizontal equity.

A flat \$20,000 exemption will be widely accepted because everyone receives a benefit. Approximately 380,000 households will fall under this state relief program - households that will have a larger percent of disposable income to spend on other things. This type of relief is good because people with higher incomes enjoy some benefit while people with lower incomes enjoy a greater benefit. This is due to the fact that property taxes are a larger share of the income of lower income individuals than those of higher income. On average, a property tax bill in the

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State of Maine may be as high as 13.97% of an individual's income if they earned less than \$10,000 annually prior to implementation of the homestead exemption. After the homestead exemption is implemented, on average, that bill will be reduced to between 1.38% and 11.46% of their annual income. [see Table 1] This change will have a greater impact on the lower income segments of the population while still decreasing the burden on the higher income segments.

The final reason for adopting the homestead exemption is that it will increase the balance among the three major types of taxes that produce revenue in the state. There will be a significant shift in the reliance upon property taxes to sales taxes. The reason we rely disproportionately on property taxes is because it is a stable source of revenue for the state, it doesn't change with the changing economic conditions. This is precisely the reason that the burden has become so great on Maine's taxpayers. Economic conditions have changed for many individuals in the state, yet their property tax bills do not reflect that change. We need to rely less on the regressive property tax and increase our reliance on taxes that are less regressive and more fair.

### **Sales Tax on Services**

This Committee supports (with some modifications) the Maine Municipal Associations proposal to fund the homestead exemption discussed above with a sales tax on services. Funding is necessary because, according to the Maine State Constitution, the State must reimburse municipalities for revenues lost from properties granted tax exempt status after 1978.

It is estimated that if this homestead exemption had been in effect in 1996 it would have cost approximately \$110 million<sup>2</sup>. A 3.5% sales tax on all services excluding construction services, medical services and child care services will currently provide the necessary revenue (approximately \$12 million) to fund the homestead exemption [see Table 2]. In addition, the growth in revenue provided by a sales tax on services is expected to exceed the growth in property tax lost as a result of the homestead exemption; therefore the sales tax on services is also expected to provide adequate revenues to fund this homestead exemption in the future.

To achieve an overall tax system that minimizes the tradeoffs between equity and adequacy, public finance experts recommend that governments not only employ a diversity of tax types but that they additionally seek balance in their use of taxes. Public finance experts suggest that a tax balance is achieved when each of the "Big 3" tax types (income, property, and consumption taxes) contributes relatively equivalent shares towards funding government<sup>3</sup>. The State of Maine relies disproportionately on property taxes to fund public expenditures.<sup>4</sup> In fiscal year 1992-1993, property taxes provided 40% of the total revenue generated by the "big three" tax types, while sales taxes provided 34% and income taxes 26%. By 1995-1996, reliance on the property tax increased to 45% of the total revenue generated by the "big three" tax types.<sup>5</sup> Although the proposal to adopt a \$20,000 homestead exemption to be funded by sales tax on services does not impact the revenues provided by income taxes, it does significantly improve

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<sup>2</sup> Estimate provided by Professor Charles Colgan

<sup>3</sup> Josephine M. LaPlante, Ph.D. "Funding of Government", Survey of Social Science: Government and Politics (Pasadena: November 1995) 6.

<sup>4</sup> Bureau of Census; <http://www.census.gov./ftp/pub/govs/estimate/93stlme.txt>

<sup>5</sup> "Briefing on Tax Burden and Tax Policy in Maine", Evan Richert, Director Maine State Planning Office, 1997

the balance between property and sales tax revenues such that these two tax types virtually contribute equally to the funding of public expenditures at 35.5% each. The proposal to fund a homestead exemption with revenues from sales tax on services not only provides adequate revenues but significantly improves the balance between the "Big 3" tax types deemed essential by public finance experts.

Maine Municipal Association's (MMA) proposal, "An Act to comprehensively Realign the Tax Structure of the State", includes a sales tax on services excluding construction services and services of health care practitioners. MMA places its emphasis on those services purchased with discretionary dollars and otherwise not directly related to the manufacturing of a product.<sup>6</sup> This Committee recommends the exemption of child care services as well as construction and health care services from sales tax. Both affordable child care and health care services provide for the public good; we believe a tax on either of these two services would be detrimental to the public welfare and would be extremely unpopular. The Committee also recognizes the importance of economic growth in the State of Maine in producing jobs and decreasing the overall long term tax burden (total taxes as a percent of income) on Maine citizens. Therefore any and all tax strategy must not result in a disincentive to economic growth. We believe that the exemption of construction services from sales tax is essential to ensuring that economic growth in the state is not adversely impacted by the proposed sales tax on services.

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<sup>6</sup>"Major Tax Reform Proposal Ready" Legislative Bulletin, a publication of the Maine Municipal Association, Vol. XIX No. 6. (February 14, 1997).

We recommend a sales tax on all services except for those specifically excluded above. The wide tax base will provide for greater revenue stability and easier administration (because there will not be confusion over what services are taxable) than if only a narrow range of services were taxed. Furthermore, because the base is so wide, a sales tax rate of 3.5% provides adequate revenue to fund the homestead exemption. We believe this rate is low enough to minimize any adverse impact on the service providers. This will not distort consumer decisions, or drive businesses out of Maine.

### **Circuit Breaker Provision**

In addition to the Homestead Exemption and a 3.5% sales tax on services, the Governor's Committee on Property Tax Reform proposes that efforts be made on behalf of the Maine State Government to promote greater awareness of the Circuit Breaker provision.

The circuit breaker, as it is designed now, provides relief for both property owners and low income renters who have resided in Maine for 12 months or more. For owners, whose property tax bill exceeds 5% of their annual income, the state will reimburse 50% of the excess up to \$700. For renters whose rent exceeds 33% of their annual income, the state will reimburse 50% of the excess up to \$700. In order to qualify, the maximum income for both renters and owners cannot exceed \$25,700 annually for a one-income household and \$36,000 for a one-income household with a dependent (these are the 1995 criteria). The criteria for eligibility for the elderly (age 65+ or disabled 55+) is different. Income must be \$10,000 or less for those living

alone or \$12,400 or less with a dependent. The state will pay up to \$400 for elderly qualified applicants.

In 1995, \$16 million was budgeted for the circuit breaker, but only \$8.6 million was spent, leaving \$7.4 million to revert back to the General Fund. We believe that if there were a greater awareness of the program among the citizens of Maine, this budgeted relief would realize its full potential. We propose that the application for the circuit breaker allowance be included with the State Income Tax Form and that other methods for reaching those who do not file tax returns (due to low income) be explored. This will improve the efficiency and effectiveness of providing this form of tax relief.

This Committee recognizes that this provision reflects the economic conditions of the Maine taxpayer and provides additional relief to low income homeowners, renters and the elderly that are not specifically addressed by the Homestead Exemption.

### **Regionalization and Consolidation of Municipal Services**

This Committee's charge was to investigate what changes are needed in Maine to reduce the burden of the property tax. As a result we agreed on several objectives with the most important being to control rising property taxes, provide adequate revenue and not create a disincentive to economic growth. The three recommendations discussed above result in a shift from one tax to another. They do not reduce the total burden of all taxes nor do they control the rise in property taxes because they do not reduce municipal expenditures. The only way to

control the overall burden of property taxes is to control expenditures or grow the economy. The regionalization and/or consolidation of services provides an opportunity to reduce expenditures.

Significant regionalization has already occurred in Maine especially in the areas of education, water, sewer, solid waste and public safety. A 1996 survey of Maine municipalities conducted by the Maine Development Foundation revealed that the number one reason for cooperative agreements between municipalities is to save money. Some examples of savings or potential for savings include a consolidated 911 dispatch program for Lewiston/Auburn which is expected to save \$250,000 per year in personnel costs, a proposed model for a county wide 911 dispatch program for Penobscot county estimated to save \$750,000 and a cooperative agreement regarding firefighting equipment and facilities between Windham, Scarborough and Gorham that saved Gorham alone \$1,200,000 in capital expenditures. The regionalization and consolidation of services may take many forms including the creation of special purpose districts, formal intergovernmental agreements, memos of understanding and mutual aid.

The most significant obstacle to regionalization and/or consolidation is determining how costs and control should be shared between the communities involved. The Maine Development Foundation survey revealed that the number one condition that prevented municipalities and counties from entering into intergovernmental agreements was "unfavorable discussions with other municipalities and/or counties".

Nevertheless, when the State Planning Office budgeted \$100,000 in 1996 to fund local studies on the feasibility of regionalization, it received 46 applications for funding. This is a clear indication of communities' desire to explore options for teaming up with other communities to reduce the cost of providing services. The State Planning Office was only able to fund 7 of the 46 requests (per the State Planning Office, the estimated cost to fund all 46 requests was \$650,000).

Given the proven opportunity to reduce expenditures through the regionalization and consolidation of services and the desire of Maine municipalities to explore these opportunities we recommend that the State continue to support and encourage regionalization and consolidation efforts. Specifically, we support LD#361: An Act to Encourage Regionalization of Municipal Services. This act effectively continues the State Planning Office's program to provide funding to assist municipalities in planning for regional service delivery.

### **III. Other Options Considered**

The Committee considered but failed to reach consensus on several other strategies to reduce property taxes. These options are not recommended because one or more members or the Committee believed they either did not meet the goals set out by the Committee or because they would be too difficult to administer. The strategies considered but rejected included;

- Local option taxes,
- Repealing the tax exempt status of certain types of property,
- Service fees on tax exempt properties,

- Tax postponement/deferment and,
- Changing the general revenue sharing formula.

Two types of local option taxes were discussed: sales and wage taxes. A local option sales tax would allow municipalities to charge sales tax, in addition to the state sales tax, on goods sold within that municipality. A wage tax is a tax imposed on all individual gross wages which is generally deducted from gross pay similar to income taxes. Local option taxes would raise additional revenue for municipalities to offset any reduction in the property tax burden. Local option taxes are not recommended because the committee felt it would be extremely unpopular, difficult to administer, and would not reflect the economic conditions of the taxpayers. It is likely that the wealthy communities would not opt for local taxes while poor communities might. Administration of the tax would either fall on municipalities who may not have the resources to administer it or the state who would need to keep track of all the differences between municipalities. Most importantly, the local option tax has the potential to affect the location of businesses and consumer choices. This impact on neutrality (consumer and business choices influenced by a tax strategy) is not considered sound tax policy.

The Committee examined the possibility of repealing certain types of tax exempt property. In 1995, tax exempt property was valued at \$10.2 billion. The State therefore loses approximately \$183 million in property taxes annually. Sixty-six percent of all exempt property is government owned. Therefore, repealing the tax exempt status of all other types of tax exempt property would generate significantly less total revenue. In addition, repealing the

exempt status of non-government property such as churches and charitable organizations would likely lead to strong political opposition.

Collecting service fees on tax exempt property was considered. The service fees would not be mandatory, but would be at the discretion of the municipalities. It was proposed that a fee be collected for direct benefit services such as fire and police protection, road maintenance, and water, sewerage, and sanitation services. The rate would be calculated using the formula below:

Step 1:

$$\frac{\text{TOTAL ANNUAL MUNICIPAL COSTS OF DIRECT BENEFIT SERVICES}}{\text{TOTAL VALUE OF ALL TAXABLE AND IMPROVED TAX EXEMPT PROPERTY IN THE MUNICIPALITY}} = \text{DIRECT BENEFIT SERVICE CHARGE RATE}$$

Step 2:

$$\text{DIRECT BENEFIT SERVICE CHARGE RATE} \times \text{ASSESSED VALUE OF INDIVIDUAL TAX EXEMPT PROPERTY} = \text{PRORATED CHARGE FOR DIRECT BENEFIT SERVICES}$$

The Maine Municipal Association proposed the use of service fees, but recommended that exempt organizations pay 50% of what they would have paid had they not been exempt from property taxes. Excluding public property, churches, and individual exemptions the state would be able to tax \$3.5 billion in property value. Applying the state average mil rate of 16.9, the provision would generate \$29.7 million in additional property tax revenue (50% of \$59.4 million). It was the feeling of the Committee that the service fees would not raise enough revenue to warrant a change in policy once churches and government-owned property were exempted from paying the fees to warrant a change in policy under this proposal.

The remaining two options considered were an elderly tax deferment program and changing the general revenue sharing formula. The Committee chose not to recommend the tax deferment program because it is not self-supporting and because the elderly are covered under the Circuit Breaker Program. The general revenue sharing formula already considers the economic conditions of communities and would not reduce the overall property tax burden but merely shift the burden among the municipalities within the State.

**Table 1**  
**State of Maine**  
**Impact of a \$20,000 Homestead Exemption**

Avg Income by County	Property tax bill			Property tax as a % of Income	
	Without Homestead	With Homestead	% Change	Without Homestead	With Homestead
<b>Aroostook/Washington</b>					
\$6,464	\$619	\$368	41%	9.58%	5.69%
\$15,379	\$711	\$460	35%	4.62%	2.99%
\$25,044	\$809	\$567	30%	3.23%	2.26%
\$35,811	\$898	\$640	29%	2.51%	1.79%
\$58,901	\$1,060	\$813	23%	1.80%	1.38%
<b>Penobscot-Piscataquis-Hancock-Waldo(Winterport only)</b>					
\$8,034	\$854	\$594	30%	10.63%	7.39%
\$19,123	\$991	\$740	25%	5.18%	3.87%
\$30,189	\$1,075	\$828	23%	3.56%	2.74%
\$42,662	\$1,241	\$992	20%	2.91%	2.33%
\$75,156	\$1,594	\$1,334	16%	2.12%	1.77%
<b>Kennebec-Somerset-Andro(part)</b>					
\$8,773	\$982	\$695	29%	11.19%	7.92%
\$20,176	\$1,090	\$821	25%	5.40%	4.07%
\$30,666	\$1,214	\$937	23%	3.96%	3.06%
\$43,013	\$1,395	\$1,124	19%	3.24%	2.61%
\$75,235	\$1,646	\$1,374	17%	2.19%	1.83%
<b>Sagadahoc-Lincoln-Knox-Waldo(except Winterport)</b>					
\$8,401	\$1,036	\$759	27%	12.33%	9.03%
\$19,421	\$1,114	\$838	25%	5.74%	4.31%
\$29,680	\$1,268	\$1,015	20%	4.27%	3.42%
\$42,609	\$1,399	\$1,138	19%	3.28%	2.67%
\$76,849	\$1,804	\$1,517	16%	2.35%	1.97%
<b>Oxford-Franklin-Andro(L/A MSA)</b>					
\$9,230	\$1,100	\$781	29%	11.92%	8.46%
\$21,146	\$1,165	\$861	26%	5.51%	4.07%
\$30,644	\$1,323	\$1,028	22%	4.32%	3.35%
\$41,450	\$1,354	\$1,059	22%	3.27%	2.55%
\$70,466	\$1,724	\$1,405	19%	2.45%	1.99%
<b>Cumberland</b>					
\$10,127	\$1,415	\$1,161	18%	13.97%	11.46%
\$25,031	\$1,527	\$1,280	16%	6.10%	5.11%
\$39,536	\$1,679	\$1,432	15%	4.25%	3.62%
\$54,047	\$1,841	\$1,592	14%	3.41%	2.95%
\$98,805	\$2,264	\$1,986	12%	2.29%	2.01%
<b>York</b>					
\$11,840	\$1,413	\$1,135	20%	11.93%	9.59%
\$26,136	\$1,413	\$1,146	19%	5.41%	4.38%
\$37,107	\$1,456	\$1,189	18%	3.92%	3.20%
\$48,562	\$1,621	\$1,352	17%	3.34%	2.78%
\$77,499	\$1,877	\$1,591	15%	2.42%	2.05%

Data provided by Professor Charlie Colgan

**Table 2**  
**State of Maine**  
**Estimated Revenue from Sales Tax on Services**

<b>Service Category</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
Laundry/Shoe Repair	\$2,090,975	\$2,118,767	\$2,128,949	\$2,139,074	\$2,145,352
Personal Services NEC	\$2,665,458	\$2,754,754	\$2,830,249	\$2,900,985	\$2,967,737
Beauty/Barber Shops	\$2,597,662	\$2,633,273	\$2,654,924	\$2,672,054	\$2,681,690
Funeral Services	\$999,101	\$1,004,002	\$1,005,436	\$1,001,573	\$997,589
Electrical Repair	\$1,027,647	\$1,057,597	\$1,076,997	\$1,098,154	\$1,115,583
Watch, jewelry, furniture repair	\$353,253	\$364,442	\$379,275	\$393,475	\$404,041
Miscellaneous Repair	\$6,176,584	\$6,342,008	\$6,476,297	\$6,624,691	\$6,757,859
Auto parking and repair	\$4,228,337	\$4,351,869	\$4,461,847	\$4,575,043	\$4,680,443
Advertising	\$1,027,647	\$1,050,451	\$1,066,263	\$1,076,691	\$1,086,978
Building Services	\$2,918,802	\$3,022,726	\$3,130,807	\$3,237,228	\$3,343,174
Miscellaneous Equipment Leasing	\$2,219,431	\$2,236,674	\$2,243,446	\$2,246,386	\$2,245,469
Personnel Supply Services	\$6,815,295	\$7,253,114	\$7,674,949	\$8,109,166	\$8,549,228
Computer/Data processing Services	\$4,795,684	\$5,052,169	\$5,295,536	\$5,544,423	\$5,788,875
Miscellaneous Business Services	\$15,293,379	\$16,110,488	\$16,884,887	\$17,652,727	\$18,410,696
Producers, Orchestras, Entertainers	\$1,006,237	\$1,054,024	\$1,094,888	\$1,133,924	\$1,172,792
Bowling	\$296,162	\$296,556	\$293,402	\$289,741	\$289,623
Commercial Sports	\$1,173,943	\$1,200,515	\$1,220,120	\$1,237,658	\$1,255,031
Amusements and Recreation NEC	\$10,429,899	\$10,833,222	\$11,202,921	\$11,550,285	\$11,885,250
Motion Pictures	\$1,159,671	\$1,193,369	\$1,223,698	\$1,251,966	\$1,272,909
Legal Services	\$12,652,898	\$13,044,886	\$13,360,493	\$13,657,166	\$13,937,637
Architecture and Engineering Services	\$6,040,992	\$6,149,068	\$6,254,457	\$6,338,527	\$6,428,905
Research and Testing Services	\$1,751,994	\$1,825,784	\$1,889,218	\$1,970,953	\$2,055,962
Management and Public Relations	\$4,385,339	\$4,451,911	\$4,490,471	\$4,546,427	\$4,594,629
Accounting/Auditing	\$3,718,082	\$3,765,903	\$3,792,749	\$3,827,615	\$3,850,907
Museums	\$1,352,355	\$1,436,331	\$1,509,943	\$1,595,363	\$1,662,648
Agriculture Services	\$6,761,771	\$6,952,985	\$7,123,939	\$7,340,100	\$7,544,488
Forest, fishing, hunting and trapping	\$7,864,351	\$7,935,549	\$7,961,194	\$7,980,392	\$7,973,558
<b>Total</b>	<b>\$111,802,947</b>	<b>\$116,492,439</b>	<b>\$118,727,354</b>	<b>\$121,991,787</b>	<b>\$126,099,053</b>

Data provided by Professor Charlie Colgan

## SOURCES

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