Information Brief

Deductions for interest and dividends on Maine state and local securities

Prepared for the Government Oversight Committee

by the Office of Program Evaluation & Government Accountability

August 2026

Why an information brief?

After gathering information about the deductions for interest and dividends on Maine state and local securities (36 MRS §5122(2)(N) & §5200-A(2)(K)), OPEGA is recommending that the full evaluation that was initially planned should not be completed. This information brief provides contextual information that explains our recommendation which may also be of use to policymakers in any future discussions on this topic. OPEGA's information gathering to date included:

- Identifying and analyzing the population of publicly registered Maine state & local bonds that were federally taxable for the last 10 years– 51 bond issues
- Analyzing the 51 bond issues identified and reviewing related disclosure documents for each
- Reaching out to agencies and bond counsels involved in a selection of those 51 bond issues to better understand any role that 36 MRS §5122(2)(N) & §5200-A(2)(K) played in the issues
- Gathering information and input from representatives of state agencies involved in state and local bonding, including the State Treasurer's Office, Maine Municipal Bond Bank, Maine Health & Higher Education Facilities Authority, Maine Revenue Services, the State Attorney General's Office, the Finance Authority of Maine and Maine State Housing Authority
- Reviewing federal and state statutes, policy papers and tax forms
- Gathering information about other states' treatment of interest and dividends from state and local bonds

Based on this information, OPEGA determined that Maine typically exempts from state taxation the interest and dividends earned on Maine state and local bond issues.[1] The specific sections of statute initially included in this evaluation (36 MRS §5122(2)(N) & §5200-A(2)(K)) are a small piece of the complex network of state and federal laws that together create the framework to implement this policy. Evaluating the effects of this small piece of the network would be inconsistent with how the other tax exemptions for state and local bonds are treated in the review process. Isolating the effect of these exemptions would also be challenging and hence may be more resource-intensive than warranted based on their estimated fiscal impacts and the small number of affected taxpayers.[2]

[1] Although there are technical legal differences between 'deductions,' 'exemptions' and 'exclusions,' for the purposes of this information brief the words will be used interchangeably.

[2] In the 2026-2027 Maine State Tax Expenditure Report, Maine Revenue Services estimated FY26 revenue loss of $340,000 and 3,100 impacted taxpayers for §5122(2)(N) and FY26 revenue loss of between $20,000 and $100,000 with an uncertain number of impacted taxpayers for §5200-A(2)(K). MRS does not have actual aggregate figures for these deductions, because they are claimed on lines that also include other deductions.

For these reasons, OPEGA recommends that these deductions be removed from the full evaluation schedule and reclassified for no further review. Based on that recommendation, OPEGA has ceased work on the evaluation, pending direction from the GOC. What follows is a high-level summary of the information OPEGA gathered in coming to this recommendation.

Interest and dividends earned on most state & local bonds are federally tax exempt.

Most state and local bonding projects have federal tax-exempt status, and the rules are complicated

The federal government subsidizes the cost of state and local projects by making debt instruments or bonds tax-exempt.[3] Most state and local bonds are federally tax-exempt—this figure in Maine from 2016 to 2025 was about 89% of the publicly registered state and local bonds issued.[4]

Whether or not a particular state or local bond will be federally tax exempt is generally determined by the purpose of the bond. Public purpose bonds are those that meet a public purpose for which taxpayers will receive a benefit. Private Activity Bonds are determined according to the IRS's private business tests and private loan financing test, and they are generally taxable.[5] However, Qualified Private Activity Bonds, which meet certain allowed purposes, may be tax-exempt.[6]

State and Local Bonds by Federal Tax Status
Tax-exempt • Public Purpose Bonds/Governmental Bonds • Qualified Private Activity Bonds that are for allowed purposes
Taxable • Private Activity Bonds that don't comply with federal requirements • Private Activity Bonds issued above a state's volume cap • Advance refinancing bonds[7]

In practice, the determination of federal taxability of a particular bond can be complicated. There are some activities that might fail both private business tests but still be eligible for tax-exempt status. States are also allotted "volume caps" under which they can issue tax-exempt private activity bonds that might otherwise be taxable.[8] The Internal Revenue Service (IRS) provides extensive guidance on

[3] Congressional Research Service. 2018. "Tax-Exempt Bonds: A Description of State and Local Government Debt." RL30638. https://crsreports.congress.gov

[4] OPEGA analysis of state and local bonds from EMMA (Electronic Municipal Market Access) database, a service of the Municipal Securities Rulemaking Board. https://emma.msrb.org. EMMA is the repository for official filings for publicly registered bonds. Although it does not include all municipal bond issues in Maine, because some issues are not required to be publicly registered, it is the best existing data source for state and local bonds. For a summary of the registration requirements from the National Association of Bond Lawyers, see https://www.nabl.org/wp-content/uploads/2023/05/General-Securities-Law-2023.pdf.

[5] Internal Revenue Service. "Tax-Exempt Governmental Bonds." https://www.irs.gov/pub/irs-pdf/p4079.pdf. See page 3.

[6] Internal Revenue Service. "Tax-Exempt Private Activity Bonds." https://www.irs.gov/pub/irs-pdf/p4078.pdf pg. 2-7.

[7] There was a tax exemption for these bonds until the Tax Cuts and Jobs Act of 2017, which removed the exemption.

[8] See Internal Revenue Service. "Tax-Exempt Private Activity Bonds." Publication 4078. https://www.irs.gov/pub/irs-pdf/p4078.pdf pg. 2-4.

the types of activities and bonds that generally qualify for federal tax-exempt status, which OPEGA summarized in the table above. Lawyers specialized in these regulations assess tax status on a case-by-case basis in the role of Bond Counsel for a particular bond issue.

The federal tax exemption benefits state and local governments but also results in revenue loss for the federal government

According to the Congressional Research Service (CRS), in the 2017 to 2026 budget forecast window, federal revenue loss on the outstanding tax-exempt bonds was expected to be the 15th largest federal tax expenditure. The federal government is forgoing tax revenue each year that a bondholder is earning interest and dividends on an exempt bond.[9] The current figures, reported in the *Analytical Perspectives* section of the federal budget, are about $52 billion for FY2025 and $53 billion for FY2026.[10]

This federal tax expenditure aims to subsidize the cost of state and local debt based on the economic premise that states and localities would underprovide needed public goods otherwise.[11] State and local bond issuers benefit from the federal exemption because purchasers of tax-exempt bonds are willing to accept a lower interest rate than purchasers of comparable taxable bonds, reducing the bond issuer's borrowing costs.[12]

The Congressional Research Service reports there has been interest federally in changing the tax treatment of state and local bonds, often focused around finding a more efficient subsidy with a lower cost. The CRS points to three types of proposals that have been made including (1) capping the amount of subsidy provided, (2) eliminating the tax exemption entirely, and (3) changing the way a subsidy is provided, to the issuer instead of a taxpayer/bond purchaser.[13]

OPEGA notes that if there are ever changes by the federal government in this area, Maine will need to decide how to respond since much of the state policy towards state and local bonds rests on the federal treatment.

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[9] Congressional Research Service. 2018. "Tax-Exempt Bonds: A Description of State and Local Government Debt." RL30638. https://crsreports.congress.gov

[10] https://www.whitehouse.gov/omb/information-resources/budget/analytical-perspectives/ See #10 "Tax Expenditures," "Tables 10-1 to 10-4 (Excel)." Table 10-1, rows 227-237.

[11] CRS 2018. pg. 3

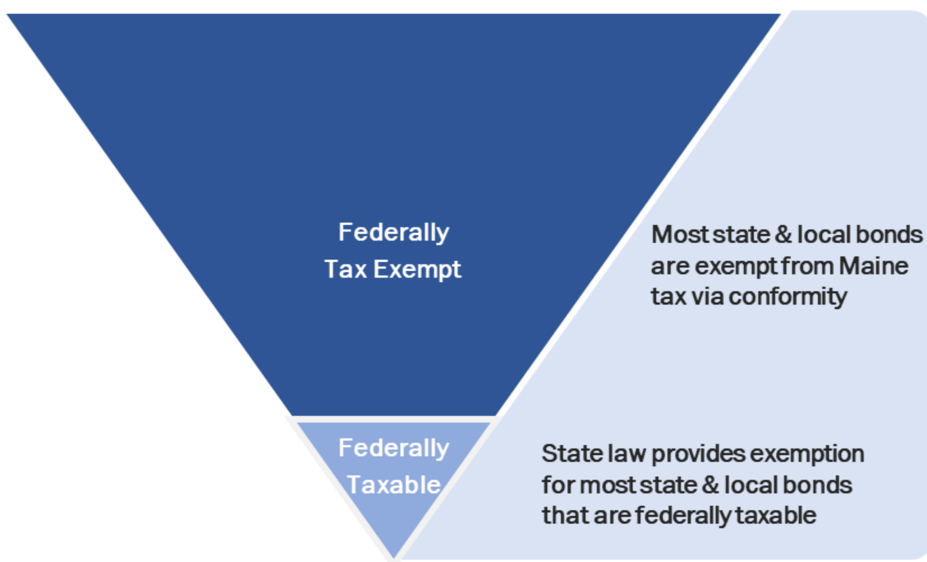
[12] See "Subsidizing Infrastructure Investment with Tax-Preferred Bonds." *A Joint CBO/JCT Study*. October 2009: viii. https://www.jct.gov/publications/2009/a-joint-cbo-jct-study%E2%80%94subsidizing-infrastructure-investment-with-tax-preferred-bonds/. This publication and 2018 CRS report provide a wealth of information about the impact of federal exemption on state and local bonds.

[13] CRS 2018. pg. 13

Maine generally exempts interest and dividends on Maine state and local bonds from income taxes, consistent with other states.

Maine exempts most income and dividends earned on Maine state and local bonds from taxation, regardless of federal taxability

Maine conforms to the federal treatment described on the previous pages. Consequently, for most interest and dividends earned on Maine state and local bonds, there is a state tax exemption "baked in" given the federally tax-exempt status. There is therefore no mechanism needed to implement this exemption during Maine tax filing, because it is already accounted for in federal adjusted income.[14] This scenario likely encompasses most state and local bonding in Maine.



Using the Electronic Municipal Market Access (EMMA) database,[15] a repository for filings from publicly registered bonds, OPEGA identified 51 publicly registered Maine state and local bond issues that were federally taxable between 2016 and 2025 (representing 11.26% of the 453 issues in that timeframe).[16]

[14] Interest income and dividends on federally exempt bonds from *other* states' bonds would need to be added back in for Maine tax filings (see 36 MRS §5122(1)(A) & §5200-A(1)(I)).
[15] https://emma.msrb.org/
[16] The figure is even fewer for individual securities within issues—372 out of 6028 issued from 2016 to 2025 were taxable, or 6.17%. Also, see footnote 4 regarding the limitations of the EMMA database.

OPEGA reviewed public disclosure documents for these 51 federally taxable bonds. Of those with available disclosure statements that specifically addressed state taxability (44 issues), almost all except those issued by MSHA were considered exempt from state taxation despite their federal taxability.[17] Appendix C provides additional information on these 51 taxable bonds issues.

Maine has a general policy of exempting interest and dividends on state and local bonds from income taxes, even if they are federally taxable. It is also the policy of many other U.S. states. Of the 43 jurisdictions that had a personal income tax in 2025, only 4 did not exempt interest and dividends from the state's own bonds. For corporate income taxation, interest was taxable in 15 states, though 5 of those states exempted bond interest for certain, named bond issues.[18]

In Maine, bonds are exempted from income tax via a complex network of discrete sections of statute (see Appendix A for a list of some of the relevant sections of statute). For Maine state and local bonds that are federally taxable, Maine Revenue Services (MRS) states that 36 MRS §5122(2)(N) & §5200-A(2)(K)—the sections of statute initially slated for full OPEGA evaluation—are necessary when the state wishes to allow a state tax exemption on interest and dividends earned. MRS reports that when tax considerations exist outside of Title 36, like most of statute regarding state and local bond treatment, MRS finds it necessary to have pieces of statute in Title 36 to implement them. This has created a situation for which having the deductions in Title 36 might make them appear as a discrete tax expenditure, but they are part of a complex web of statutory provisions that work in combination to implement the state's approach to state and local bond taxation.

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17 MaineHousing is the only entity OPEGA found that is routinely issuing bonds subject to Maine tax. MaineHousing's Bond Counsel directed us to 30-A MRS Chapter 201, §4871 & §4722 for their treatment of interest on bonds and noted that these statues along with other provisions seem to contradict each other. MaineHousing's Bond Counsel ultimately follows §4722 which states that any federally taxable bonds that MaineHousing issues are state taxable. The Maine Office of the Attorney General was unable to provide OPEGA with a legal opinion about which section should have precedence. MaineHousing did not identify this as an area needing attention.

18 Information from *Wolters Kluwer 2026 State Tax Handbook* supplemented by OPEGA research on state policy. See also Appendix B.

Appendix A. Statute Related to State & Local Bonding and Tax Status

The statutes below are not intended to be comprehensive of all state law related to state and local bonding, but they do include the major areas that OPEGA identified.

State Tax Deductions	Statute	Description
Deductions for interest and dividends on US and other state securities exempt from state taxes under US law (individual)	36 MRS §5122(2)(A)	Provides a deduction from state income tax for interest and dividends on obligations of the US and its territories and possessions or any authority, commission or instrumentality of the US that is included in federal AGI but exempt from state tax under US law.
Deductions for interest and dividends on US and other state securities exempt from state taxes under US law (corporate)	36 MRS §5200-A(2)(A)	Provides a deduction from state income tax income that is included in federal taxable income but is exempt from state taxes under US tax law.
Deduction for income that is taxed federally but exempt from State taxation under the US Constitution or the Maine Constitution	36 MRS §5200-A(2)(F)	Provides for a deduction for income this State is prohibited from taxing under the Constitution of Maine or the United States Constitution to the extent that it is included in the taxpayer's federal taxable income.
Deduction for interest and dividends on Maine state and local securities (individual)	36 MRS §5122(2)(N)	Provides a deduction for interest and dividends on obligations and securities of Maine and its political subdivisions and authorities, that is included in federal adjusted gross income.
Deduction for interest and dividends on Maine state and local securities (corporate)	36 MRS §5200-A(2)(K)	Provides a deduction for interest and dividends on obligations and securities of Maine and its political subdivisions and authorities, that is included in federal taxable income.

Additional Authority for State & Local Bonding	Statute
Municipal Bonding	30-A MRS §5772
State Treasurer	Title 5, Chapter 7
Maine Turnpike Authority	Title 23, Chapter 24
Maine Municipal Bond Bank	Title 30-A, Chapter 225
Maine State Housing Authority	Title 30-A, Chapter 201, Subchapter 5
Finance Authority of Maine	Title 10, Chapter 110, Subchapter 3 §1049
Maine Governmental Facilities Authority	Title 4, Chapter 33, §1606
Airport Authorities	Title 6, Chapter 10
Maine Connectivity Authority	Title 35-A, Chapter 94-A
Maine Space Corporation	Title 5, Chapter 393
Lincoln Mill Facilities District	Unallocated; Private and Special Law, 2023 PS c.023

Appendix B. Other States and State & Local Bond Tax Status

Information in the table that follows, derived from *Wolters Kluwer 2026 State Tax Handbook* and OPEGA research on state policy, covers 50 states and D.C. (51 total jurisdictions). The table demonstrates that it is common practice for states to exempt the interest and dividends earned from their own state bonds from state taxation. Bond interest from a state's own bonds is exempt from corporate income taxes in 32 states and another 4 states do not have corporate income tax. Of the 15 states where this interest is taxable, five have specific obligations that are exempt while other bond interest, not specified, is taxable. One state, Utah, makes interest income taxable but provides a state credit for a percentage of gross interest income from bonds issued by the state and its agencies and instrumentalities. Of the 51 districts, eight do not have personal income tax. Of the 43 remaining, 39 exempt interest from a state's own bonds from personal income tax. The interest is taxable in four states, though in all four states interest from some specific obligations is exempt and the rest taxable.

States	State's Own Bonds (Corporate Income)	State's Own Bonds (Individual Income)
Alabama	Exempt	Exempt
Alaska	Exempt	N/A[3]
Arizona	Exempt	Exempt
Arkansas	Exempt	Exempt
California	Exempt[1]	Exempt
Colorado	Exempt	Exempt
Connecticut	Taxable	Exempt
Delaware	Exempt	Exempt
D.C.	Exempt	Exempt
Florida	Taxable	N/A[3]
Georgia	Exempt	Exempt
Hawaii	Exempt	Exempt
Idaho	Exempt	Exempt
Illinois	Taxable[2]	Taxable[2]
Indiana	Exempt	Exempt
Iowa	Taxable[2]	Taxable[2]
Kansas	Exempt	Exempt
Kentucky	Exempt	Exempt
Louisiana	Exempt	Exempt
Maine	Exempt	Exempt
Maryland	Exempt	Exempt
Massachusetts	Taxable	Exempt
Michigan	Exempt	Exempt
Minnesota	Taxable	Exempt
Mississippi	Exempt	Exempt
Missouri	Exempt	Exempt
Montana	Taxable[2]	Exempt
Nebraska	Exempt	Exempt
Nevada	N/A[3]	N/A[3]
New Hampshire	Exempt	N/A[4]
New Jersey	Taxable	Exempt
New Mexico	Exempt	Exempt
New York	Taxable	Exempt

States	State's Own Bonds (Corporate Income)	State's Own Bonds (Individual Income)
North Carolina	Exempt	Exempt
North Dakota	Exempt	Exempt
Ohio	Exempt	Exempt
Oklahoma	Taxable[2]	Taxable[2]
Oregon	Taxable	Exempt
Pennsylvania	Exempt	Exempt
Rhode Island	Exempt	Exempt
South Carolina	Exempt	Exempt
South Dakota	N/A[3]	N/A[3]
Tennessee	Taxable	Exempt
Texas	Exempt	N/A[3]
Utah	Taxable[5]	Exempt
Vermont	Exempt	Exempt
Virginia	Exempt	Exempt
Washington	N/A[3]	N/A[3]
West Virginia	Taxable	Exempt
Wisconsin	Taxable[2]	Taxable[2]
Wyoming	N/A[3]	N/A[3]

[1]Exempt for corporation income tax purposes. Taxable for corporation franchise tax purposes.
[2]Income from certain specified obligations is exempt. Interest from all other obligations is taxable.
[3]Not applicable because the state does not tax general business corporation income and/or individual income.
[4]New Hampshire, despite not having personal income taxation, previously had a specific Interest & Dividends Tax. This tax was repealed starting in 2025. https://www.revenue.nh.gov/taxes-glance/interest-dividends-tax
[5] Interest income is taxable but the state provides a credit for a percentage of gross interest income from bonds issued by the state and its agencies and instrumentalities.

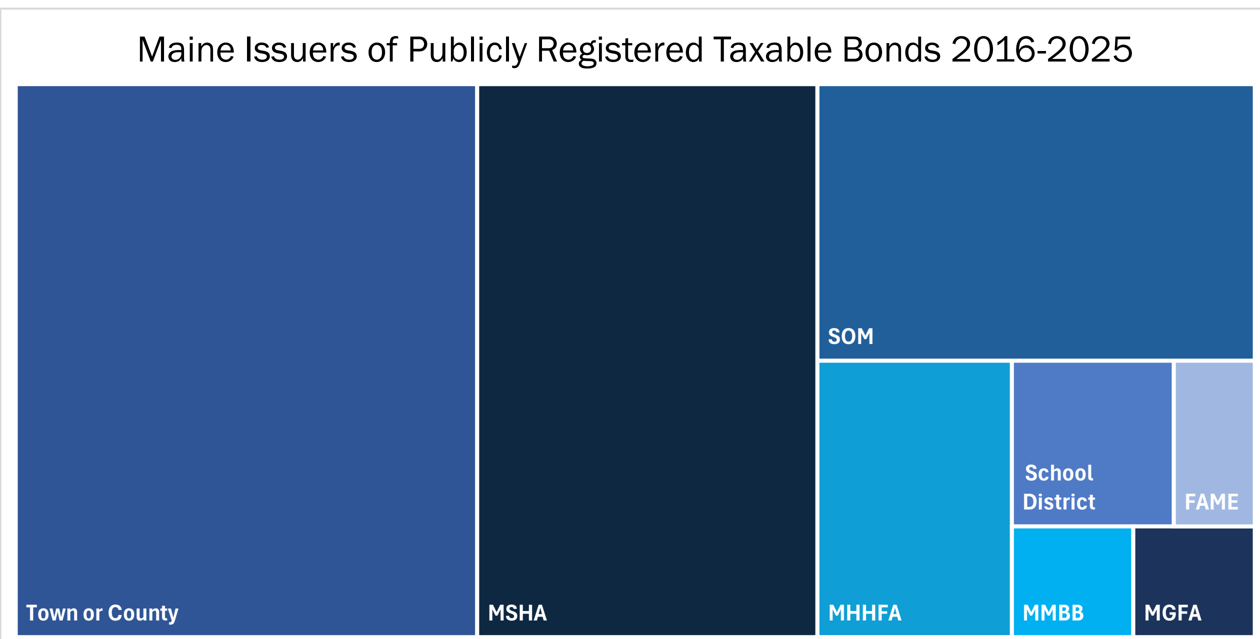
Appendix C. Federally Taxable State & Local Bond Usage in Maine

This Appendix contains information on publicly registered state and municipal bond issues in Maine from 2016 to 2025. As discussed previously, in footnote 4, some issues are not required to be publicly registered and hence will not be included in this summarized data.

Publicly Registered Maine State and Municipal Bond Issues- 1.1.2016 – 12.31.2025

Year	Number of Total Issues	Number of Taxable Issues	Percentage of Total Issues that Were Taxable by Year
2016	49	5	10.20%
2017	67	8	11.94%
2018	51	6	11.76%
2019	44	6	13.64%
2020	53	10	18.87%
2021	47	7	14.89%
2022	40	4	10.00%
2023	34	1	2.94%
2024	32	2	6.25%
2025	36	2	5.56%
Total	453	51	11.26%

OPEGA analysis of information from EMMA (Electronic Municipal Market Access), a service of the Municipal Securities Rulemaking Board. https://emma.msrb.org



Maine State Housing Authority (MSHA), State of Maine (SOM), Maine Health and Higher Educational Facilities Authority (MHHFA), Finance Authority of Maine (FAME), Maine Municipal Bond Bank (MMBB), Maine Governmental Facilities Authority (MGFA)

OPEGA analysis of information from EMMA (Electronic Municipal Market Access), a service of the Municipal Securities Rulemaking Board. https://emma.msrb.org

OPEGA observes that the projects financed with federally taxable bonds that were publicly registered look a lot like the tax-exempt ones. Additionally, OPEGA noted that when there are taxable bonds issued, they are often issued at the same time as bonds that are tax-exempt. This allows towns or issuing agencies to finance projects that may include some elements that may not be eligible for federal tax-exempt financing. Examples of the types of projects financed include:

Date	Issuer	Purpose
2026	Town of Scarborough	Interim financing for a portion of various Town capital improvement projects and School Department capital improvement projects such as IT infrastructure, roof restoration in the school district and a plow truck for the town. [19] The federally taxable notes were issued at the same time as tax-exempt bonds.
2025	City of Augusta	Financing for renovation, reconstruction, improvement and repair of city properties and equipment, including reconstruction and improvement of streets and sidewalks, improvement of an access road for Hatch Hill Historic Park, and replacement of Fire Department cardiac monitors. Roughly 10% of the total bonds in the issue were federally taxable. [20]
2022	MaineHousing	Funding for a MaineHousing account to reimburse amounts used to make Mortgage Loans for Maine Housing's multi-family program. [21]

[19] https://emma.msrb.org/IssueView/Details/P2441838. Particular projects financed by the taxable notes are detailed in the Bond disclosure document.
[20] https://emma.msrb.org/IssueView/Details/P1431801
[21] https://emma.msrb.org/P21530734-P21183508-P21601130.pdf