

TAXTOPICS

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TAX TASK FORCE REPORT DELIVERED

TASK FORCE MEMBERS

Mr. Guy S. Hobbs, Chairman
Appointed by Governor

Mr. Russ Fields
Appointed by Senate Majority Leader Raggio

Eva Garcia-Mendoza
Appointed by Governor

Mr. Brian Greenspun
Appointed by Assembly Speaker Perkins

Mr. Kenneth B. Lange
Appointed by Assembly Speaker Perkins

Dr. Luther Mack, Jr.
Appointed by Senate Majority Leader Raggio

Mr. Mike Sloan
Appointed by Governor

Ms. Nancy C. Wong
Appointed by Governor

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On November 15, 2002 the Task Force on Tax Policy in Nevada delivered its Report to the Legislative Counsel Bureau and the Governor as directed by Assembly Concurrent Resolution 1. Even before the delivery of the Report by the Task Force, the media, NTA members and citizens have primarily focused on the taxes being considered, particularly the proposal for the imposition of a gross receipts tax based on a modification of the Washington State Business and Occupation Tax. While there has been general acknowledgment of the need to have Nevada's revenue structure better reflect the economic structure of the State, there has been overwhelming opposition from the general business community to the inclusion of the gross receipts tax as part of the revenue mix. Gaming and the Culinary Union appear to be among the only vocal supporters.

Accolades are due

What should also be receiving not only equal discussion, but accolades is the work done by the Technical Working Group, chaired by Jeremy Aguero and undertaken at the direction of the Task Force, chaired by Guy Hobbs.

The chairman with the concurrence of Task Force members agreed that a solution could not be crafted until there was a validation of the shortfall. To that end the State has become the beneficiary of a most extensive revenue and expenditure data base. This data base contains not only a history (from 10 to 20 years) of revenue receipts, expenditures, fiscal comparisons of the 50 states, federal funds comparisons and a most impressive revenue model that contains over 850 variables. All of this provided by the dedication of these volunteers, since no funding was provided to the Task Force, although funds were finally found to cover the hard costs.

For this effort which has been largely unsung except by those that attended the meeting we say . . .

THANK YOU!

What happens now

With the Report officially delivered what happens now is in the hands of the Governor and the 2003 Legislature. Issues they will have to balance are the wisdom of increasing tax rates and imposing new taxes at a time when business and residents are also feeling the effects of a slowed economy, with the calls for additional expenditure efficiencies, reforms and accountability. The latter hopefully to be enacted at the same time, if not before, any revenue raising occurs.

ANALYSIS OF FISCAL POLICY IN NEVADA
Governor's Task Force on Tax Policy
EXECUTIVE SUMMARY
November 15, 2002

(Editor's Note: The following is a partial reprint of the Executive Summary issued by the Task Force. Not included are the acknowledgments which precede the Summary and exhibits which follow. To access the complete Executive Summary and the eight sections of the Report see page .)

It is a common belief that the issues under study by the Governor's Task Force on Tax Policy in Nevada (the "Task Force") began with the Legislature's passage of Assembly Concurrent Resolution 1 ("ACR 1") during the 2001 Special Session. In fact, these issues have their origins in past Legislative sessions. The state of the State's current fiscal condition is a product of all revenue and expenditure decisions made throughout the years, coupled with periodic cycles of economic growth and slowdown. Thus, ACR 1 was not the signaling of changing forces and dynamics within the State's fiscal system. Rather, it was an attempt to quantify and address the cumulative effects of decisions that have been made over the years. However, recent changes in the economy which have had negative impacts upon revenue growth, combined with continued increases in demands for services, have brought these issues into greater current focus.

BACKGROUND

As background information, ACR 1 embodied certain underlying assumptions regarding the current and future demographics and financial status of the State, and, further, gave specific direction and authority to the Task Force. Among these directions are the following:

- That there be a focus on broader tax policy issues such as optimal tax rates, structural budgetary deficits, and reduced budgetary reliance upon cyclical revenues.
- That there be a review of various fees charged by agencies of the State that have not been increased for a substantial length of time.
- That the Task Force solicit the state executive branch, businesses, labor organizations and local governments for comments and suggestions for changes to Nevada tax policy with the intent being to gather public spending recommendations for support of K-12 education and long-term care needs of the general public, including our growing senior population.
- That consideration be given to the reduction of the State's sales and use taxes as new revenues become available.
- That the Task Force is entitled to submit five bill draft requests.
- That any recommended legislation must include a plan to broaden the tax base so that it is reflective of the diversity of the state's economy.
- That the Task Force develop one or more definitive proposals to generate additional revenues for state programs, stabilize the tax base, and reduce long term structural deficit of the state budget.
- That the Task Force submit a report, on or before November 15, 2002, to the Governor and the Director of the Legislative Counsel Bureau for transmittal to the 72nd session of the Nevada Legislature.

It is important to stress that the Task Force was bound by the directives of ACR 1, as described above, and charged with satisfying the objectives contained therein. The guidance and direction provided by the Governor and the Legislature was made clear in the resolution, and it is important for the reader to understand that the tasks undertaken during the study period were strictly prescribed within the legislation. Please see ACR 1 at Exhibit 1 at the end of this summary.

METHODOLOGY

In furtherance of the mission set forth in ACR 1, the Task Force held 15 public meetings, providing for dozens of hours of public discussion and deliberation, including roughly 30 hours of public testimony from dozens of individuals and organizations. In addition to the time dedicated to public meetings, approximately 3,000 hours of volunteer professional time has been dedicated to the analytical and research tasks associated with the work of the Task Force. This effort has produced more than 6,000 pages of directly relevant primary and secondary research during this study period. Additionally, considerable time and effort has been dedicated to the creation of a comprehensive State fiscal model, which allows for the type of analytical capabilities that a project like this demands. The creation of this model was a collaborative effort, involving members of the Task Force's Technical Working group (comprised of volunteer experts from both the public and private sectors).

Much of the initial time and effort was directed toward an evaluation of the gap that may exist between future revenues and future expenditures. Although ACR 1 presupposed the existence of a "structural deficit," it was essential that the Task Force validate and quantify the existence of any such gap between future revenues and expenditures. This was an extremely complex undertaking, yet it was prerequisite to the discussion of any potential solutions. Simply put, a problem cannot be solved unless it is fully understood.

Our analysis concludes that, **if the State is to continue to afford the levels of services that it provides today, the current revenue mix of the State will not be sufficient to support that level of services.** The amount of the gap between current revenues and expenditures, as forecast into the future, has been quantified to approximate \$700 million over the '04-'05 biennium (rising to approximately \$1.3 billion over the '10-'11 biennium). These amounts are expressed as dollar differences between future expenditures, and the revenues available to sustain them. In other words, they represent the deficiency of revenues as compared to expenditures under the assumptions noted above. These projections, as previously mentioned, are based upon **current service levels only** and, thus, **do not include consideration of the addition of any new programs or the elimination of any existing programs.**

There are a number of ways that the projections proffered by the Task Force can be viewed. However, it is essential that anyone considering these projections, while intending to form an opinion, fully consider the assumptions used to make them. As described above, the projections are based on status quo spending and a status quo revenue mix. Inherently, then, there will be those that view the projections as either too high or too low, depending upon their viewpoint regarding current service levels. If one feels that the State is currently spending more than is necessary, either in whole or in a particular area, then he/she may believe that the projections are an overstatement of need. Conversely, if one believes that the State is not currently providing for acceptable services, in whole or in part, then he/she may believe that the projections are an understatement of need. Members of the Task Force encountered both viewpoints during the course of study.

It should also be clearly recognized that deviation from the methodology used to project future revenues and expenditures would have required the Task Force to make policy level assumptions, which is more clearly within the purview of the Legislature. For example, if current service levels were not used to drive the expenditure projections, the Task Force would have been required to suggest funding levels for State programs that are different than those currently in force. This is not a task that was delegated to the Task Force by ACR 1. The same is true on the revenue side of the projections. Where a revenue source is associated with a more speculative series of events (i.e., federal funds for mitigation of specific impacts, potential revenue arising from the passage of certain initiatives, etc.), the Task Force did not make an assumption regarding the probability of revenue materializing from these sources.

While not tasked with determining "optimal" service levels – that is, those that strike the perceived optimal balance between minimizing spending and maximizing services – the Task Force was specifically charged with the responsibility of soliciting input from local governments, businesses and trade organizations and the State regarding public spending requirements for K-12 education and long-term care needs. This task was completed, and the results

of the solicitation segment can be viewed in Appendix 8. The Task Force accepted the information as submitted, and did not pass judgment on the accuracy or applicability of the information

Detail regarding the projections of future revenues and expenditures is presented in Exhibit 2 at the end of this summary. These projections were not developed in a vacuum. The revenue and expenditure projections are each supported by an extensive historical database, coupled with specific attention to the individual factors that may affect each variable in the future. Further, the various departments of the State with more specific knowledge regarding trends and data reliability were consulted both during the preparation of the projections and upon completion of the modeling. It is also worth noting that the revenue projections released in late October 2002, by the Economic Forum compare very favorably to those made by the Task Force. As a consequence of both the level of effort expended in preparing the projections, and their correlation with other similarly intended efforts, we feel very confident that the projections are as good a measure of where the State may be heading (under the assumptions utilized) as can reasonably be produced.

Since the existence of a projected gap was substantiated, the attention of the Task Force turned to evaluating and analyzing methods that could be considered as viable components of a potential solution. Again, as directed by ACR 1, the Task Force was charged with identifying revenue sources that would simultaneously address the long-run deficit, enhance the stability of the State's revenue system, and provide for a broadened tax base.

The identification of potential funding sources actually began as efforts undertaken to assess the level of funding gap that might exist. This was done to satisfy the requirement within ACR 1 that the Task Force, "at its initial meeting," identify those funding sources that would be considered during the study period. At that initial meeting, and several meetings thereafter, a variety of potential funding sources were identified for further study, including:

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| ➤ Admission / Amusement Tax | ➤ Franchise Taxes and Fees |
| ➤ Business License Tax | ➤ Government Services Tax |
| ➤ Cigarette Tax | ➤ Gross Gaming Tax |
| ➤ Commercial Lease Tax | ➤ Gross Business Receipts Tax |
| ➤ Corporate Filing Fees | ➤ Inheritance Tax |
| ➤ Estate Tax | ➤ Inventory Tax |
| ➤ Federal Funds | ➤ Liquor Tax |
| ➤ Lodging Tax | ➤ Retail Sales and Use Tax Rates |
| ➤ Motor Vehicle Fuel Tax | ➤ Retail Sales and Use Tax Base |
| ➤ Net Proceeds of Mines Tax | ➤ Retail Sales and Use Tax Exemptions |
| ➤ Net Business Profits Tax | ➤ Rental Tax |
| ➤ Payroll Tax | ➤ Short Term Car Rental Tax |
| ➤ Personal Income Tax | ➤ Slot Route Operators Tax |
| ➤ Property Tax Rate Adjustments | ➤ Special Energy Tax |
| ➤ Property Tax Assessment Rates | ➤ Split Roll for Property Tax Assessment |
| ➤ Property Tax Assessment Depreciation | ➤ State Lottery |

As can be seen, the process of identifying potential solutions involved the evaluation of multiple funding sources (and a considerable number of variations of each source). In all more than 100 variations of mixes of potential solutions were ultimately tested.

RECOMMENDATIONS

One thing that became very clear to the Task Force was that the most viable solution to the funding imbalance would involve a mix of sources, each contributing to a blended solution that would reduce the pressure placed upon any single source while also diversifying the impact that any single source might otherwise have. Also, given the near-term nature of the funding challenge, strong consideration had to be given to those sources that could produce near-term revenue. That is, those revenue sources that have a collection infrastructure already in place and those where there is statutory ability to immediately implement, would be viewed as more practical near-term components of a longer-term solution.

The Task Force also utilized a detailed analysis of the comparative characteristics of each existing and potential funding source to better understand how each funding source compared to the others. This important phase of work is thoroughly documented in the full report. Elements of consideration included uniformity, revenue generating potential, simplicity, progressivity/regressivity, transparency, equity (both horizontal and vertical), ease of administration, stability, and several other criteria. After careful and thorough consideration, the Task Force narrowed its list of potential components of a near-term and longer-term solution to:

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|-------------------------|--|
| ➤ Cigarette Tax | ➤ “Passive” revenue generators (involving procedural changes to existing tax collection systems that result in more efficient revenue collections) |
| ➤ Liquor Tax | ➤ Business Tax (various types) |
| ➤ Property Tax | ➤ Broadened sales tax base |
| ➤ Admission / Amusement | ➤ State Lottery |
| ➤ Transaction Tax | |
| ➤ Corporate Filing Fees | |
| ➤ Slot Route Fees | |

While the above revenue sources could indeed help fulfill the ACR 1 mandate to stabilize the revenue base (in part, through the admission/amusement, property tax, and business tax components) and provide additional revenue for State programs (in all cases), the relative characteristics of each compels them to be viewed in groups. By way of example, the cigarette, liquor, property and admission/amusement taxes, along with the slot route fees, corporate filing fees and passive revenue generators each share a common, and important, characteristic; that they can be implemented rather quickly through statutory change by the Legislature, thus immediately producing revenue to meet State needs.

The same cannot be said of the business tax (other than an increase in the State’s business license tax), the broadening of the sales tax base, and the implementation of a State lottery. Each of these, to varying degrees, requires some amount of additional work to implement. In the case of a lottery, an amendment to the State’s Constitution will be required. In the case of a business tax upon receipts or revenues, administrative elements may require a number of months to address. The unique case of the expansion of the sales and use tax base will be discussed in further detail later in this summary.

For the reasons cited above, the Task Force elected to support the cigarette, liquor, property, and admission/amusement taxes, along with the passive revenue generators and increases to slot route fees in its initial set of recommendations. As illustrated in Exhibit 3, these sources come close to closing the gap in the first year of the next biennium, yet fall short by the second year. Thus there was a need to consider additional revenue sources to close the gap and to fulfill the balance of mandates contained in ACR 1.

To this end, the Task Force began its evaluation of other sources of potential revenue, including taxes upon businesses, an expansion of the base over which the sales and use tax is applied, a State lottery, and other potential sources. In the former case, several variations of business taxation were discussed and evaluated, including an increase to the existing business license tax, a net profits tax, a gross receipts tax, an adjusted gross receipts tax, a payroll tax, and a value-added (margin) tax.

After considerable analysis and deliberation, the Task Force favored the application of an adjusted gross receipts tax, or State Activity Tax (“SAT”), over the other business tax options. The recommended rate of taxation for the SAT is $\frac{1}{4}$ of 1 percent, or .0025. Included within the recommendation is a deduction for small business, allowing those small businesses with less than \$350,000 in gross receipts to avoid a tax liability (thus exempting roughly 60 percent of all Nevada businesses from the tax), and a credit for a portion of State business license taxes paid (for those businesses with more than \$350,000 in gross receipts). Credits and deductions, intended to address extraordinary circumstances affecting uniformity of application of this tax, have also been recommended. These include deductions or credits for bad debts, pass-through revenues, monies collected on behalf of a governmental entity, fund raising activities of non-profits, and several other circumstances. It is important to note that no industry will be exempt from the effect of the SAT as recommended. While the proposed SAT would apply to all non-gaming business activity (including the non-gaming business activity of nonrestricted gaming licensees) in a uniform manner, for gaming activity presently covered by a gross revenue tax under NRS 463, the Task Force recommends a corresponding $\frac{1}{4}$ of one-percent increase in the current rates, thereby insuring that all industries participate in the burden of the tax. At the rate of tax noted above, the tax would be among the lowest of its type levied in the country.

The Task Force additionally recommends that the State’s corporate filing fees be increased by 50 percent, that the business license tax be increased by an amount reflective of inflation since initial passage (34 percent), and that the business license tax apply to all types of businesses (including sole proprietorships).

These recommendations, in combination with those previously made, are projected to: a) provide sufficient funding to sustain existing programs; b) add stability and breadth to the State’s tax base; and c) reflect the State’s diverse economy. In other words, they mirror the elements and goals specifically called for in ACR 1. Further, the combined revenue producing potential better matches the longer-term profile of the projected funding gap.

It is important to note that the SAT option was thoroughly weighed against other business tax variations. While no tax is perfect in application, the SAT is believed to be superior to a net profits, margin, or value-added tax from the standpoint of stability, predictability and comparative ease of compliance and administration. Further, the inclusion of the small business deduction, as well as the other credits and deductions included in the recommendation, go far in addressing several of the concerns expressed to date regarding the SAT.

The disparate effect upon different categories of businesses was acknowledged, but the Task Force concluded that, on balance, the very low rate proposed for the SAT made it no less fair than the State business license tax which is based upon the number of employees of a particular business. Neither the proposed SAT nor the existing business license tax take into consideration business volume or margins, yet experience in both Nevada and other states demonstrates that low rates allow business to pay either or both taxes without major hardship. It is recommended that, if the Legislature enacts the $\frac{1}{4}$ of 1 percent SAT, it authorize the study of the impact of the tax upon the Nevada business community to make any necessary adjustments to prevent undue hardship or glaring inequities.

As noted earlier, the Task Force developed a State fiscal model to aid in its evaluation of different solutions to the projected funding gap. The model demonstrates the contribution of each revenue source and the cumulative effect of proposed revenue enhancement scenarios compared to projected annual expenditures.

We would caution the reader that adding the revenue production in the base year (arising from the various revenue sources), and comparing the total to the base year gap can be misleading. The problem with doing this is that it does not take into account the longer term cash flow needs of the fiscal model. In other words, the model is constructed to allow for excess revenue in some years and deficient revenue in others. This presumes that excess revenues in one year will be carried forward to subsequent years when they may be needed to supplement revenues. To try to achieve a perfect match in all years projected would result in tax rates that varied from year to year. Suffice it to say that the solution has been constructed to fill the gap in an aggregate sense. Please see Exhibit 4 for the projected impact of the Task Force’s recommended alternatives. Beyond the aforementioned recommendations, the Task Force also recommends that the sales and use tax base – one of the more narrow bases in the country – continue to be evaluated for opportunities to stabilize

the performance of the revenue stream over time. The current base is very narrowly applied to the litany of transactions that occur in the economy, and is, thus, too dependent on certain areas of trade. It is also subject to ongoing deterioration caused by increased Internet sales that remove otherwise taxable sales from the base. Significant revenue raising opportunities exist with a further expansion of the sales tax base, as do opportunities to reduce current rates and stabilize the revenue flow. The inclusion of the admission/amusement tax among our recommendations arises from our recognition that the existing sales tax base is subject to both volatility and erosion, and is a clear attempt to help stabilize the State's base.

The Task Force also considered the use of a lottery as a revenue raising mechanism. Given that the implementation of a lottery would require an amendment to the State Constitution, which could take up to six years to effect, a lottery was not viewed as a viable near-term revenue option. However, it was agreed that this matter should continue to be studied.

Clearly, the addition of any new sources of revenue (i.e., SAT, or other new form of business taxation), or the expansion of existing sources of revenue (i.e., amusement/entertainment transaction tax, extension of the BLT to all businesses, etc.), will have an impact upon the State's collection and enforcement infrastructure. The administration, collection and enforcement functions in any tax system need to insure that the tax is being collected in a fair, uniform, expedient and efficient manner – goals that are sometimes difficult to achieve, or are overlooked, when the governmental unit is also striving for frugality.

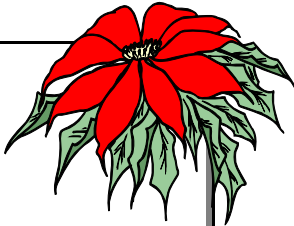
We would strongly recommend that the State, regardless of whether or not it chooses to implement new revenue sources, invest additional dollars in its collection and enforcement function. Most of this responsibility, both currently and prospectively, is vested within the State's Department of Taxation, and it is our observation that the function is not adequately funded to allow the department to meet all of the goals noted above despite the best efforts of the staff. In recognition of this, the Task Force has included an allowance for collection costs within its revenue model.

Finally, ACR 1 authorizes the use of up to five bill draft requests ("BDRs") for purposes of transmitting the recommendations of the Task Force to the Legislature. It is the intent of the Task Force to include all of its recommendations within a single BDR, as they are each linked with the others in an integrated manner, aimed at providing the State with a balanced solution. As is normally the case, the conceptual recommendations included in the Task Force report will undergo additional refinement during the BDR preparation process. Thus, detail that is not readily clear in the report will be developed during the BDR preparation process.

The report for which this narrative serves as an executive summary is an extremely detailed document, containing a wealth of data regarding the State of Nevada's fiscal characteristics. It is also very detailed in providing foundation for all assumptions used to project the State's fiscal condition and the revenue producing capacity of various sources of revenue that were considered. Further, it contains explanations of the processes used to formulate the recommendations contained therein. Readers are strongly encouraged to review the report in its entirety to fully appreciate both the level of effort expended and the worth of the analytical product.

The members of the Task Force would like to express their appreciation to the Governor and State Legislature for providing this opportunity to review the State's fiscal structure. It is a process that the Task Force, its technical support group, and numerous citizens and interest groups have taken very seriously.

According to information on the Legislative Counsel Bureau Website, "The complete report along with the Executive summary is also available on CD (in Adobe PDF format) for the cost of \$10.00 plus \$4.50 for S & H. The Executive Summary is also available in print form for \$3.00. Contact Legal Publications of the Legislative Counsel Bureau at 775/684-6835 or via email at publications@lcb.state.nv.us to purchase the CD or Executive Summary. Note: The complete printed report is approximately 1,200 pages and is not currently available." The LCB Website will provide ordering information when the Report is available. You can download the report to your computer, but beware you will need plenty of paper and extra ink cartridges.



Wishing you a
Beautiful Holiday Season
and a New Year of
Peace and Happiness

