

TAXTOPICS

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INCOME TAX INITIATIVE OPPOSED

Fred Gibson, Chairman of the Board of the Nevada Taxpayers Association, announced that a survey of the Association's Board of Directors resulted in overwhelming opposition to the initiative filed by the teachers' union for a 4% business income tax.

Gibson said, "The opposition to the initiative was based on two major points. First, the initiative earmarks this new revenue source for K-12 education. This is contrary to the accepted fiscal principle of not earmarking funds that are considered general revenues. The earmarking of revenue should only occur when there is a direct user-benefit relationship (i.e., gas tax used to build roads). Second, Section 53 of the initiative contains an extremely onerous provision which would be very detrimental to other state agencies and programs which rely on revenue support from the State's general fund. Contrary to the union's position that the new revenue source is what provides the 50% funding, the language of the initiative does not read that way. It requires 50% of the revenue projected to be received by the State to be used for education. This increase in revenue when added to the current expenditure level of 35% will most probably lead to the need for additional tax increases, as it is unlikely that other budgets and programs would be cut sufficiently to make up the shortfall in revenue to the State's general fund."

Association President, Carole Vilardo said "that in a preliminary review of the initiative, there appear to be a number of other problems and concerns which are identified on pages 2-5 in this issue of *TAX TOPICS*." One major concern she noted was that most persons asked to sign the petition will not take the time to read the 21 plus pages. That is unfortunate, particularly she added, since Section 17 of the initiative provides "**Any activity conducted for profit by a natural person shall be deemed to be a business that is subject to the provisions of the chapter**". (Emphasis added.) In essence, any Nevada resident who earns income from rent, royalties, trusts including family trusts, family limited partnerships, estates, and family farms and reports that income on schedule E or F of Federal form 1040, is now a business! And even though the individuals would not be required to pay the tax imposed by the initiative unless the Federal taxable income exceeds \$50,000, any individual captured by these provisions of the initiative will have to file a return and will potentially be subject to audit. Vilardo pointed out that this is the inherent danger of taxation by initiative - creating provisions that have intended or unintended negative consequences that cannot easily be corrected. Under Nevada statutes, if the initiative becomes law, the provisions cannot be changed for a period of three years.

THE TEACHER'S UNION INITIATIVE . . . MORE PROBLEMS THAN SOLUTIONS

Shortly before 5:00 p.m. on Friday, April 5, 2000 the teacher's union filed an initiative petition with the Secretary of State's office, that, if successful, would impose a 4% income tax on Nevada taxable income over \$50,000 received by a business or individual. The initiative which is titled "the Nevada Tax Fairness and Quality School Funding Accountability Act" contains 59 sections in its 21 and 1/3 pages. This initiative is a perfect example of why "taxation by initiative" has been opposed by the NTA Board of Directors. There are a number of problems associated with this initiative, and if it does become law we will have to live with those problems for three years before any corrections can be made by the legislature.

The following constitutes the Association's first pass at analyzing the concerns and problems that have been identified in the preliminary review of the various provisions of the initiative. The initiative appears to provoke more questions than answers. Those questions appear in italics and identify NTA's concerns and the potential problems associated with those sections.

FINDING AND DECLARATIONS & PURPOSES AND INTENT (SECTIONS 2 AND 3)

These provisions provide a laundry list of reasons why the tax is needed. Both sections also require "accountability"; accountability of students, parents and the individual school districts. However, no where in these sections or any other section is there a requirement for teacher accountability.

K Why, if this money is to be used to improve the level of education received by students wouldn't teachers also be held accountable for their role in improving student achievement?

Section 2.4 is quite telling in that it speaks to the additional funding being required to attract, retain and support the "very best teachers". This section provides "**The level and structure of compensation and benefits for teachers and other school employees is a matter of local concern that should be decided by each county school district through the process of collective bargaining.**" (Emphasis added.)

There is no dispute that good teachers are invaluable. They should be paid commensurately with their ability and performance, but that's not what this initiative provides.

K Why doesn't the language provide a guarantee of more money to those teachers who are responsible for improving student education?

K Why is the money to be provided through the collective bargaining process at the local level?

K Why are salary increases to be provided to all teachers regardless of their performance?

K With all the additional money proposed to be spent on improving education, why can't we have a money back guarantee if this initiative does not do what it proposes?

Sections 2.8 and 3.8 require school districts to issue reports, detailing how the money received from the tax was spent.

K Section 2.8 requires the report to be issued every four months while Section 3.8 requires the same report to be issued quarterly. Does this indicate a problem with the math skills of the authors?

DEFINES BUSINESS AND BUSINESS INCOME (SECTIONS 6 AND 17)

ARE YOU IN FOR A SURPRISE!

Section 6 defines a business as including all persons and entities and activities including residents of Nevada and other states, unless exempt by Nevada's Constitution or the Constitution, laws or treaties of the United States. Also, excluded are governmental entities and qualified pension plans.

Section 17 provides that, "**Any activity conducted for profit by a natural person shall be deemed to be a business** that is subject to the provisions of the chapter." (Emphasis added.) This includes an individual who files a Schedule E (Form 1040) Supplemental Income and Loss, with the Internal

Revenue Service **This form requires the reporting of any income earned from rents, royalties, partnerships, S corporations and trusts and estates. Also captured are the owners of family farms who use Schedule F (Form 1040) Profit and Loss From Farming.**

K Doesn't this provision capture more than just business income?

K Doesn't this capture the income of an employee of a business or a retired person or anyone else for that matter that receives income from renting a house, or income from royalties, or a family trust or a family limited partnership, or the family farm?

K Doesn't this start to look like personal income as well as business income is subject to this tax, in violation of Nevada's Constitution, Article 10, section 1.9?

DEFINITIONS OF FEDERAL TAXABLE INCOME, NEVADA TAXABLE INCOME AND ACTIVITIES OF A NATURAL PERSON CONSTITUTING INCOME (SECTIONS 8, 9, 17 AND 20)

You might believe that the requirement of levying the tax on income of \$50,000 and over would eliminate the filing provisions of this initiative. However, you would be wrong! Section 20 says, **"Whenever a natural person subject to taxation as a business under this chapter is required to file a federal income tax return under the provisions of the Internal Revenue Code, he shall also make a return to the department. A return must be filed with the department regardless of whether the Nevada taxable income of the business for the taxable year exceeds \$50,000."** (Emphasis added.)

The identification of "Taxable Income" might be relatively innocuous if it followed the existing Federal reporting requirements. In fact the whole process could have been simplified by applying the 4% tax to the Federal return on Nevada business income over \$50,000 and filing a copy of the Federal return with the Department of Taxation if the threshold for business taxable income was met. However, given the provisions of section 27, that wouldn't have benefitted the union's quest for more revenue.

K Why are filings even required if the threshold for taxable income is not met?

K Even with the funding provided to the Department of Taxation to carry out its "duties" under this initiative, will the Department have sufficient resources to provide the necessary space to handle all of these filings?

(The answer to this question is probably found in this analysis, on page 4, under the heading of "Actions by the Department or Taxpayer".)

ADJUSTMENTS, APPORTIONMENT & VARIATIONS TO COMPUTE NEVADA TAXABLE INCOME (SECTIONS 27, 28, 29 AND 30)

One of the principles of taxation is that a tax should be easily understood. This allows better compliance and generally reduces the cost of administration. These sections are not simple and the initiative would be better titled, "The Full-Employment Act for Accountants". Interesting to note that the author(s) of the initiative chose to make this tax unitary, which definitely complicates reporting . . . just ask any California based business.

K Other than squeezing the last penny out of an individual or business required to file the form why is Section 27 even included in this initiative?

K Was it the hope of elevating the income level to meet the \$50,000 taxable threshold?

Section 27.1(d) requires that the interest and dividends on the obligations or securities of any state or political subdivision of a state be added to the Federal taxable income to increase the reported Nevada taxable income.

K Don't both the Federal and Nevada constitutions prohibit the impairment of contracts?

K Doesn't this provision fly in the face of an existing statutory provision, NRS 350.710, which provides that the income from bonds and other securities issued under the provisions of the Local Government Securities Law "must forever be and remain free and exempt from taxation by this state or any subdivision thereof."?

K Doesn't this breach the contracts of holders of state and municipal bonds which were purchased with the understanding that they were tax free?

K Doesn't this discourage the purchase of State and municipal bonds and other securities by Nevada residents or businesses, (particularly curious since Nevada's school districts tend to be the largest issuers of bonds)?

Section 29 provides for the apportionment of income to Nevada by multiplying the amount of the businesses' total income by a fraction, the numerator of which is the average of the three factors below. These are the "unitary" provisions and potentially captures more than the income earned in Nevada by businesses who do business in more than one state.

- 1) The value of all real and personal property owned or rented in Nevada, divided by the total value of all real and personal property owned or rented by the business everywhere.
- 2) The amount of payroll in Nevada divided by the total payroll of the business everywhere; and
- 3) The total sales in Nevada divided by the total sales of the business everywhere.

The total of these factors is then divided by three (3) and the result multiplied by the total net income of the business to determine that portion of the business's net income that is taxable to Nevada.

NOTE - A business that only owns or rents property in Nevada, but conducts no current business here could potentially owe tax if it had income elsewhere, subject to its ability to appeal under Section 30.

K Is the use of the unitary method of determining income a revenue "grab"?

K Why does the property factor include property rented by the business?

K Doesn't this double count revenue from the same source (i.e., the person who rents the property has to include the value as does the person that owns the property)?

It's interesting that businesses that have been attracted to Nevada from California have frequently cited California tax laws as one of the reasons for their move, and now this initiative proposes a provision that is as onerous as California's.

Section 30 allows a business to appeal for the use of different apportionment factors if the extent of business activity in the state is not fairly represented. **It also allows the Department of Taxation to challenge the apportionment factors and change them.**

K Hasn't this provision along with others that detail the administrative and compliance procedures just ordained the creation of a bureaucracy in Nevada to rival the Internal Revenue Service? (See following - "Actions by Taxpayer or Department")

ACTIONS BY TAXPAYER OR DEPARTMENT (SECTIONS 11, 12, 40 AND 43)

Section 11 requires the examination of records by the Department and says, "To verify the accuracy of any return filed or, if no return is filed, to determine the amount of tax required to be paid, **the department** or any person authorized in writing by it **may examine the books, papers, records and equipment of any person or business that may be liable for the tax imposed by this chapter.**" (Emphasis added.)

K As stated in the prior narrative, doesn't this section further support the creation of a bureaucracy to rival that of the IRS?

Section 12 authorizes the executive director of the Department to obtain even confidential information from another governmental agency or officer to carry out the provisions of this chapter.

K Doesn't this open the door to sharing information with the Internal Revenue Service (otherwise known as "quid pro quo", that if I can get information from you, I have to give information to you in return)?

RESTRICTS LOCATIONS FOR LEGAL ACTIONS (SECTIONS 40 & 43)

These sections provide that legal actions are restricted to courts in Carson City or Clark County.

K Why, when SB 362 of the 1999 session changed the "legal action" provisions in the taxation statutes to ALL COURTS in the State, does this initiative restrict legal actions just to the courts in Carson City and Clark County?

DISTRIBUTION OF THE MONEY (SECTIONS 14 AND 53)

These sections can only be characterized as taxpayers be damned . . . get ready for a tax increase!

Not only included are provisions that say, “No money in the quality schools trust account in the state distributive school account may be used to supplant any state or local general fund monny [sic] any purpose.” (Obviously accountability wasn’t required for spelling or English grammar in the writing of this initiative.)

- but also -

“For each year of the biennium, the basic support guarantees must be established in such amounts so that collectively, after deducting local money available for public schools, they represent not less than 50 percent of the projected revenue of the state for that year.” For the current biennium, K-12 education receives 35% of the State’s general fund appropriation.

NOTE: Local money is the property tax of 25 cents per one \$100 assessed valuation and the 2 ¼% portion of the sales tax known as the local school support tax.

K What do we cut from the existing general fund budget to allow this additional revenue to go to education?

K Do policy makers, cut the prison budgets, or human services budgets, or the University of Nevada system’s budget, or do they not provide for state employee salary increases (you get the picture)?; or

K Do we ask the general public for an increase in their property tax rate or an increase in the sales tax rate to cover the shortfall that will occur because of this provision?; or

K Do we increase the state’s business license tax, or gross gaming tax, or mining tax, or insurance premium tax, or do we create a tax for another business segment such as manufacturing or financial institutions?

APPROPRIATIONS TO THE DEPARTMENT OF TAXATION (SECTIONS 17.4, 56 AND 57)

Depending on whether the initiative (if it qualifies) is passed by the legislature or by the voters, there is an outright appropriation of \$2.2 million made for the Department to fund employees, computer programming costs and operating costs, and a collection allowance of .05% of the total revenue

received as reimbursement for the costs of administration.

Since the first phase of the Business Process Re-Engineering (BPR) study determined that the current computer program used by the Department (ACES) for sales tax and the business tax couldn’t be easily expanded, the \$2.2 million identified won’t even cover the computer costs let alone the increased number of employees.

K Have these provisions created the “Son of Genesis”?

K Will we wind up with a stand alone system that defeats the purpose of the BPR?

K Why is the collection allowance .05%, when local governments pay .75% for the Department to collect the sales tax?

CONFLICT WITH THE INITIATIVE TO INCREASE THE GROSS GAMING TAX (Section 54)

While concern for a double whammy on the gaming industry is shown by the union with the inclusion of this provision, and can be appreciated, the use of additional revenue proposed to be generated in the “other measure” is earmarked for completely different purposes.

K Is it fair or even constitutional to disenfranchise those voters who sign the “other measure”, and, if it qualifies, expect to at the very least to be able to vote on it?

INCREASES THE BUSINESS LICENSE TAX (NRS 364.A) (SECTIONS 49, 50 AND 51)

These sections provide for nominal increases in the BLT (i.e.. from \$25.00 to \$25.50 per employee, per quarter).

K Why are these provisions even included when the increase in revenue does not appear to figure in any of the earmarking?

K Why, since these provisions expire by limitation on June 30, 2003 and would be in place for either 18 months or six months depending on whether (if the initiative qualifies) the enactment is by the legislature or the voters, would anyone want to incur the expenses of changing reporting forms, adopting corrected regulations, etc.?

OTHER THINGS YOU SHOULD KNOW ABOUT THE INITIATIVE

THE DEVIL IS IN THE SOUND BITES

A wallet-sized, fold-over card which is being distributed by teachers to students to bring home to their parents, is replete with sound bites, but sadly lacking in accurate information. The front of the card says:

“THE NEVADA TAX FAIRNESS
&
QUALITY SCHOOL FUNDING
ACCOUNTABILITY ACT”

This initiative is not about Tax Fairness. It is about taxing the other fellow.

*“Don’t tax you,
don’t tax me,
tax the fellow behind the tree!”*

Author Unknown

It is not about Accountability. If it was, there would also be accountability provisions for the role teachers have in contributing to improving a students performance. The back of the card says:

“IT’S SIMPLE.
IT’S FAIR.
AND, IT’S TIME!”

It is not Simple, Fair or Time! Just read this issue of Tax Topics.

The inside of the card has a series of bullet points to justify this initiative. Future issues of *TAX TOPICS* will address each of the points.

ABOUT THE COALITION TO DEFEAT THE BUSINESS INCOME TAX

The Coalition to defeat the Business Income Tax needs your support. It is a statewide coalition, that is comprised of Chambers of Commerce, Development Authorities, Trade Associations and concerned business.

The Coalition is not Anti-education!

In fact most of the members of the coalition have been involved with raising funds to support school bond issues, have been involved with “adopt-a-school” programs, in addition to providing employees to support student mentor and shadow programs. A number of business have also provided school buses, land for buildings, computers and other supplies and equipment.

For additional information on the Coalition call (702) 735-2460