**MINUTES OF THE MEETING
OF THE
ASSEMBLY COMMITTEE ON TAXATION**

**Seventy-Sixth Session
March 24, 2011**

The Assembly Committee on Taxation was called to order by Chair Marilyn K. Kirkpatrick at 9:06 a.m. on Thursday, March 24, 2011, in Room 4100 of the Legislative Building, 401 South Carson Street, Carson City, Nevada. Copies of the minutes, including the Agenda (Exhibit A), the Attendance Roster (Exhibit B), and other substantive exhibits, are available and on file in the Research Library of the Legislative Counsel Bureau and on the Nevada Legislature's website at www.leg.state.nv.us/76th2011/committees/. In addition, copies of the audio record may be purchased through the Legislative Counsel Bureau's Publications Office (email: publications@lcb.state.nv.us; telephone: 775-684-6835).

COMMITTEE MEMBERS PRESENT:

Assemblywoman Marilyn K. Kirkpatrick, Chair
Assemblyman Elliot T. Anderson
Assemblywoman Teresa Benitez-Thompson
Assemblywoman Irene Bustamante Adams
Assemblyman John Ellison
Assemblywoman Lucy Flores
Assemblyman Ed A. Goedhart
Assemblyman Pete Livermore
Assemblywoman Dina Neal
Assemblywoman Peggy Pierce
Assemblyman Lynn D. Stewart
Assemblywoman Melissa Woodbury

COMMITTEE MEMBERS ABSENT:

Assemblyman Harvey J. Munford, Vice Chair (excused)

GUEST LEGISLATORS PRESENT:

None

STAFF MEMBERS PRESENT:

Michael Nakamoto, Deputy Fiscal Analyst
Cyndie Carter, Committee Manager
Mary Garcia, Committee Secretary
Olivia Lloyd, Committee Assistant

OTHERS PRESENT:

Matthew Murray, Professor of Economics, University of Tennessee, Knoxville
Jeremy A. Aguero, Principal Analyst, Applied Analysis, Las Vegas, Nevada
Guy S. Hobbs, Managing Director, Hobbs, Ong and Associates, Incorporated, Las Vegas, Nevada

Chair Kirkpatrick:
This morning we have presentations, so at this time I would invite the presenters to come forward. We are going to invite Mr. Matthew Murray, Professor of Economics, University of Tennessee up first.

Matthew Murray, Professor of Economics, University of Tennessee, Knoxville:
Greetings from the Volunteer State of Tennessee. It is a pleasure and an opportunity to have the chance to speak to you this morning. I assume that my presentation (Exhibit C) has been loaded and is on the screen there in Carson City. Am I correct?

Chair Kirkpatrick:
Yes, that is correct.

Matthew Murray:
Very good. Thank you. Just as a matter of introduction, I do not think this economy needs much explanation at this point in time. We all fully understand and appreciate the scope and the depth of the great recession that began in December 2007 and formally ended in the summer of 2009. The aftermath of the great recession continues to linger. We have very depressed levels of economic activity across the country, especially in the State of Nevada. It will be a long period of economic adjustment and economic transformation as well as fiscal adjustment in the years ahead before the economy is mended and before the fiscal health of the state and the local governments are brought back together.

Next slide please (Exhibit C). This presentation is a team effort. The report that I will present today comes from a team of persons at Brookings Mountain West. That team includes Rob Lang, who is in residence at the University of Nevada, Las Vegas (UNLV); colleague Mark Muro, Brookings Institution in Washington, D.C.; a team of persons at Arizona State University at the Morrison Institute; and me. I have been serving as a consultant with this team of persons. I am an economist at the University of Tennessee. My expertise is state and local tax policy. I have studied all facets of state budgets from the tax and spending sides of the budget. I have extensive expertise in looking at state budgets in Tennessee, states across this country, and other countries. That is the expertise that is brought to bear on this fiscal matter.

This study has a very strong focus on California and the intermountain states. That is because at least three of those states—California, Arizona, and Nevada—are very cyclically sensitive, have experienced difficult economic times in the last several years, and have experienced difficult fiscal times as well. We have also included in our report an analysis of Colorado. But the real economic pain and the real fiscal pain has been concentrated in the other states.

This is not a study that encompasses all states around the country. In fact, calculating structural deficits and disentangling this notion of a structural deficit from a cyclical deficit is very difficult and requires expertise and knowledge of each state's economic and fiscal system. In this context, we rely heavily on the work of Tom Rex at Arizona State University. Tom is the one who actually put together the estimates of the cyclical deficits versus the structural deficits.

Next slide, please. As a point of departure, I would like to distinguish with you intuitively rather than try to take you through all the detailed methodological tools to disentangle the deficit into its cyclical and structural components. I will define for you a cyclical deficit, which is a decline in revenue relative to expenditures during an economic recession such as that which we have gone through over the course of the last couple of years. The difference between the cyclical shortfall in revenues and a structural deficit is that a structural deficit is a permanent shortfall in revenue relative to expenditures once you account for cyclicality and once you net out the influence of the cyclical deficit.

I want to impress upon you immediately that these are not esoteric or academic concepts. In fact, the kinds of deficits that you are dealing with in Nevada, and the same is true in California and Arizona, are a combination of a cyclical deficit brought about by a decline in economic activity and a decline in revenues along with increased service demands that arise during an economic downturn. But there are also very strong structural components to the deficits in Arizona, California, and Nevada as well.

So what? Well, the "so what" is really quite important. Because when you have a structural deficit, what that means is you go into an economic downturn such as the last couple of years. That downturn requires higher tax increases than otherwise would be required or greater cuts in spending than otherwise would be required to try to bring the budget back into fiscal health and back into balance.

The presence of a structural deficit means larger cutbacks in services that hurt residents, and larger cutbacks in services that can compromise or raise questions about the business climate. The business community does not know how those budgets will be brought back into balance and whether that will be done through tax increases, through spending cuts, or some combination of tax increases and spending cuts.

We end up in a crisis management mode when we are dealing with deficits of the magnitude that exist in states such as Nevada. Nevada has been able to avoid some of the rash, if not irrational, decisions that have been made in some of the other states. One can point to the state of California and the state of Arizona where those states chose to sell assets. The state of Arizona sold its Supreme Court Building and sold its Capitol building in order to generate revenues in the near-term. Of course the long-term consequence is a lease-back agreement that will cost the state a considerable sum of money for many years to come.

New York is an example of a state that has made some poor choices regarding its budgeting, and a good example of a poor choice is the way in which the state of New York met its pension fund obligation in 2010. In order to meet its pension fund obligation, it borrowed from the pension fund which simply deferred the consequences of dealing with that shortfall into the future.

Next slide please (Exhibit C). A structural deficit can arise from the interaction of any three major influences. To start, the first major influence is the state's fiscal structure. The fiscal structure includes the tax system. It includes the rates and the tax basis that apply to generate revenue in the state. The fiscal structure also includes state spending programs, state requirements in terms of K-12 education, health care, transportation, and obligations that are imbedded in state budgets.

Nevada's fiscal structure also reflects the rules and the parameters within which decision making is made. The State of Nevada has a supermajority requirement for tax increases. The state has a substantial amount of revenue that is earmarked for specific purposes that reduces its fiscal flexibility whether it be in good economic times or in bad economic times when trying to make fiscal adjustments.

Nevada has a sales tax system similar to virtually every state around the country that largely exempts services and does have significant commitments to support K-12 education through its constitution and legislation that has been enacted by this very Legislature.

Given that fiscal structure, with the passage of time demographic and economic trends ripple through to affect the spending side of the budget. A moment ago I mentioned the fact that states similar to Nevada rely very heavily on tangible goods in the context of the sales tax not taxing services very extensively. In economic transitions over a long period of time going back to the 1960s, there has been a declining share of consumption in the form of tangible goods and a rising share of consumption in the form of services. What that means is absent any other change in policy and absent any other change in the demographics of the state, that long-term trend can and will compromise revenue performance in Nevada. I can envision a situation where the state had a balanced budget and economic growth was trending along but the erosion of that sales tax base could manifest itself in the form of a structural imbalance, an imbalance that causes the state to raise taxes and/or cut expenditures to bring the budget back into alignment.

Speaking of movement and growth of the population, if you have wealthy retirees moving to the State of Nevada to enjoy their retirement years, they typically do not bring with them children that need to be educated in the public schools. If you on the other hand have a population that is growing with significant numbers of school age children, given the budget situation and state commitment to funding K-12 education, you will see pressures arise on the spending side of the budget.

Start with the state fiscal system, the state tax system, the state expenditure structure, and the rules that define how the state makes its fiscal choices. Then these demographic and economic trends take place over time and they ripple through and affect the state's economy over time and into the future.

Gaming is one of those trends that has benefitted the State of Nevada during healthy economic times, but it has been a roller coaster: a boom and bust cycle. There are some concerns about whether gaming will ever regain its footing in the State of Nevada given the role of Internet gaming, given shifting demographics, and given shifting tastes for gaming and the type of gaming that takes place.

Some of the last few factors that can affect the presence and the magnitude of the structural deficit are political decision making and voter initiatives. These are choices that can be made during good times or during bad times. I think a classic example of the pressures that arise that contribute to the presence of a structural deficit and its magnitude are decisions made during good economic times when revenues are growing and it appears as if there is a fiscal surplus, or revenues in excess of expenditures.

The tendency during those good fiscal periods of time is to enact some combination of tax cuts or tax relief because of that fiscal surplus or expand expenditure requirements. The problem is that those kinds of commitments during periods of fiscal and economic health then come back to haunt you during a period of economic and fiscal decline and aggravate the fiscal deficit problem and aggravate the ability and limit the ability to remedy that problem.

Next slide, please (Exhibit C).

Chair Kirkpatrick:
Mr. Murray, may I ask a question? Does anyone else on the Committee have any questions?

When you spoke about the state's fiscal structure and you discussed tax expenditure reports, do other states have those tax expenditure reports? Nevada currently does not have tax expenditure reports. Are those beneficial and are there up front costs to produce those? Would you elaborate?

Matthew Murray:
Absolutely, a tax expenditure report is one of the very important recommendations that we make in this report. It is important to have a full accounting of those tax expenditures. Many states have tax expenditure reports. The state of Arizona has a tax expenditure report. The tax expenditure report lists foregone revenues from taxing economic activity. But the ideal tax expenditure report would be forward looking and would provide not only single estimates of tax expenditures but also long-term consequences associated with tax expenditures as well as an explanation as to why those tax expenditures exist in the first place.

As an example, the state of Illinois has a tax expenditure budget. Illinois does not tax many services under its state sales tax laws. Those tax expenditures for the sales tax and services are not even listed in that tax expenditure report in the state of Illinois. The uninformed citizen could open up that report and not understand the scope and the breadth of services that are exempt from the sales tax in the state of Illinois. Tax expenditure reporting is an essential component of good information sharing with the Legislature and with the public at-large.

Chair Kirkpatrick:
I have researched a couple of other states. Oregon has a tax expenditure report and Washington has a tax expenditure report. Do you know what the specific data elements should be in a tax expenditure report for a state and what elements we should look for? I guess my struggle with tax expenditure reports is I am unsure what elements to include. I considered developing a bill draft requiring a tax expenditure report, and I need to define which expenditures should be included and how to develop this process because Nevada is starting from ground zero. Is there a process Nevada should follow?

Matthew Murray:
Yes, and in Nevada that is a very important question because you have a constitutional prohibition against a personal income tax and a corporate income tax. Would you include that prohibition in your tax expenditure report? Perhaps, or perhaps not, but I think the citizens should at least be given some awareness of what the potential revenue might be from forgoing taxation of certain activities. But that is problematic when Nevada does not have an income tax, either a personal income tax or a corporate income tax.

The State of Nevada does not assess tax on many services under the sales tax laws. It does not assess tax on smaller scale services such as veterinarian services, but there are other services that are much more significant that are not taxed such as installation and repair services for example. The State of Nevada had chosen not to impose the sales tax on food. That results in substantial tax expenditure for the state. But by not having that tax expenditure report information available to a Legislature and the public at large, it means you are operating with nothing less than very limited information about the nature of the state budget and the potential forgone revenue.

Chair Kirkpatrick:
Thank you. Does anyone else have any questions? [There was no response.]

Matthew Murray:
This particular chart shows estimates by Tom Rex of Arizona State University about the magnitude and the decomposition of the deficit in terms of its cyclical components in light shading and the structural components shown in the darker shading. This magnitude is expressed as a percent of what are referred to as stable expenditures. These numbers will not necessarily correspond to the numbers that appear in a given state budget in California, Colorado, Arizona, or

Nevada because they have been estimated from the budget documents using a variety of assumptions.

There are serious problems in California, both a structural deficit and a cyclical deficit. The structural deficit in California is largely a reflection of the fact that the state increased spending and did not raise taxes commensurate with those increases in spending. That imbalance has been hidden during periods of economic and fiscal growth, and that deficit surfaced quite substantially during the period of economic and fiscal contraction.

Colorado is an interesting aberration in the numbers in this slide. Colorado has not only a small structural deficit but a small cyclical deficit. Part of the reason for the small deficit in the state of Colorado is the presence of the Taxpayer Bill of Rights (TABOR). The TABOR in Colorado has been effective in helping to avoid larger budget deficits but it also has contributed to a declining share of spending as a share of the state economy in the state of Colorado. The TABOR has substantially reduced spending for K-12 education, higher education spending, and other services. The TABOR has been effective in reigning in the deficits in Colorado but it has also come at a fairly high price in terms of reduced service delivery.

Arizona's structural deficit is largely a reflection of tax reductions that literally go back decades and the tax reductions were implemented primarily but not exclusively during periods of strong economic growth. The economy is performing well. The state has a fiscal surplus. Those revenues are being returned to citizens and taxpayers. The alternative would be to put at least some of those revenues into a rainy day fund. A larger rainy day fund could help deal with cyclical and structural shortfalls during an economic downturn.

In fact one of the recommendations that we made is to increase the size of the rainy day funds for all states around the country, particularly the four states in the study being California and the three intermountain west states, as well as local governments, because local governments generally do not maintain formal rainy day funds.

Chair Kirkpatrick:
We have another question. Mr. Stewart? And then we will hear from Mr. Anderson.

Assemblyman Stewart:
Thank you, Madame Chair. Professor, I am a little surprised that the structural deficit is only 1 percent in Nevada. Nevada is often criticized for its tax structure. Is it not true that the structural deficit can be strongly tied to the

cyclical deficit? Nevada has a high reliance on gaming tax and sales tax. Would not that reliance tie our structural deficit into the cyclical deficit?

Matthew Murray:
Yes, and I will develop that point here in another slide or two. But you are absolutely correct. One of the reasons why that structural deficit is so small is that you have enacted in the last couple of years a series of tax increases that have helped fill that particular gap. But one of the points I am going to be making here in just a moment is that I think the structural deficit in Nevada is going to rise. The structural deficit will potentially rise substantially for several years to come. I do not see the strong return to economic growth for the gaming sector or for the future rapid growth of the housing stock that helped propel sales tax revenues and property tax revenues forward. The experience of the earlier 2000s will not be repeated from the revenue side of the state budget. However, Nevada will continue to have rapid population growth because of climate and depressed property values. I think that you are looking at a much more serious structural deficit problem over the course of the next decade.

Assemblyman Anderson:
Thank you, Madame Chair. I have a quick question about California's structural deficit. Is a good part of that structural deficit the result of the voter initiatives as well? I have heard from a number of persons that voter initiatives on tax policy and spending policy have cost about one-third of the state's revenues in the budget and made those revenues nondiscretionary.

Matthew Murray:
Yes, that is correct. A whole series of different voter initiatives at the state level and the local level have constrained fiscal decision making at both levels of government in California. This includes an initiative in 1988 that earmarked almost $.50 of every $1 of new revenue generated from General Fund sources to K-12 education. I do not think any of you sitting in Carson City or anyone at the University of Tennessee would be opposed in principle to healthy and robust spending for K-12 education. But to tie your hands with nearly $.50 of every $1 raised in tax revenue supporting K-12 education creates a constraint on a state's ability to maneuver through difficult fiscal times such as we have been trying to maneuver through in the last few years.

Next slide please. This chart is a line chart showing the pattern of revenues and expenditures of the Nevada State General Fund. The funds are expressed as a share of personal income. That is the measure on the vertical axis. One could think about this as a measure of the size of the economy in Nevada. Personal income is about two-thirds of the gross domestic product (GDP) across most states in the United States. In some sense what you are looking at is the government's take out of the private sector of the economy. The pattern also reflects a state's ability to pay taxes out of personal income sources. That is a little bit of an anomaly for a state similar to Nevada because so much of the state's tax revenue is generated not from residents of Nevada but from transactions tax such as the sales tax, gaming levies, and lodging levies that are paid by visitors to Nevada.

I would like to draw your attention to the performance over the course of the 2000s. You can see that revenues grew very sharply on the heels of the recession in 2001. Once the economy started to recover, gaming activity started to be restored, and tourism activity started to pick up again, you can see increases. There were also tax increases in 2004 that contributed to the revenue increases. But you also see the fairly steady trend of increases in expenditures over that period of time. That expenditure growth is due in part to the fact that the State of Nevada had the strongest rate of population growth of any state in the country during the decade of the 2000s. When Nevada has a rapidly growing population, that same rapidly growing population is going to put public service pressures on state government and local governments as well.

Next chart please (Exhibit C). This gets a little bit closer to the question that was raised a moment ago about Nevada's structural deficit. The estimates from the Arizona State University team are provided on the cyclical deficit and structural deficit for the State of Nevada. The structural deficit component was declining while the overall deficit was rising as economic activity had literally plummeted in Nevada.

As you will note these underlying shifts in the economy that I alluded to earlier really threaten to nullify any progress that the state will have going forward in reducing its structural deficit. Nevada will continue to have very serious pressures in the short run perhaps from economic growth because it is building from a very low trough. But Nevada will experience longer-term serious pressures on its budget. And add to that the fact that a series of temporary tax increases that were enacted will expire effective July 1, 2011, and the state will lose those revenues and that accounts for about $1 billion in revenue that will be forgone.

Next slide please. If you consider the current situation in Nevada which you all know painfully well, Nevada was ranked by a publication called *State Policy Reports* as having the 50th ranking of "economic momentum" across the states as of December 2010. To my knowledge that index has not been updated with the current economic conditions in Nevada. Some indicators have improved slightly and some have not improved enough to likely move the state too far from that bottom ranking. Nationally, Nevada ranked 50th in personal income and employment growth, which is the highest unemployment rate in the nation. The state continued to have serious problems with its housing markets. I read the other day that Nevada had the second highest vacancy rate of any state in the country for residential housing. Adding to those pressures, Nevada ranks 17th in population growth between 2008 and 2009. While the state's revenue situation continues to be weak the economic environment continues to be weak. Nevada will continue to have relatively rapid population growth which will create ongoing pressures on the state budget and local budgets.

Assemblywoman Benitez-Thompson:
Thank you. Can you tell me for this 50th ranking in economic momentum, what comprises the criteria of economic momentum for this ranking?

Matthew Murray:
I do not have that in front of me but I would be happy to share that information with you later today. I would be happy to share it by email or any other mode of communication. I will get that data out to you.

Next slide please (Exhibit C). We start moving forward from today with a very weak economy, and if you look at the fiscal situation of the state, nearly two-thirds of Nevada's ongoing revenues come from various transactions taxes that I mentioned earlier such as sales, gaming, casino, and lodging taxes. Nevada has restrictions on its fiscal flexibility in the form of a supermajority requirement to raise taxes. The state has a sales tax rate that is imbedded in the *Constitution of the State of Nevada*. Nevada has a constitutional prohibition against corporate and personal income taxes. In the near-term that prohibition limits the state's fiscal flexibility.

Next slide, please. To draw out the importance of that tourism sector, this particular chart simply shows the share of gross domestic product that comes from leisure and hospitality services, the real estate sector, and the construction sector, all of which are very much tied to tourism and gaming. The state is much more disproportionately inclined towards those sectors of the economy. As a result the state has a very narrow economic portfolio. That narrow economic portfolio coupled with the current weak economy, and limited fiscal discretion, is that very collision course that I suggested earlier will create the likelihood of looming structural budget deficits over the course of the decade to come.

You can add to that deficit the fact that property values remain depressed and will likely continue to be depressed. The state will likely not see residential property values grow rapidly, will likely not see sales tax revenues grow rapidly, and will likely see downward pressures on property tax revenues. Those conditions are likely manifesting themselves already because of foreclosures and delinquencies. That problem will likely become more acute in the years to come when property is resold and put back on the assessment rolls at lower values. Lower values are a detriment to households that are in good standing with the mortgages that are now being paid. Declining values are also a problem for those individuals that have homes that are paid off. Nevada probably has, certainly in Las Vegas, excess commercial capacity. The state will not see substantial growth from that component of the economy that again would boost sales tax revenues through the construction process and through the escalation of property values and increased commercial property tax values.

The maturation of the gaming industry also does not bode well for Nevada. There are a series of near-term, long-term, and fiscal pressures that are not going to be easy for the State of Nevada to overcome.

Next slide please (Exhibit C). Our broad recommendations for California and the three intermountain west states that we have considered in our report come in two broad categories. The first recommendation is to broaden, balance, and diversify the tax base and the revenue system. The second recommendation is to impose and to institutionalize better budget processes and better information sharing with the public.

I would like to talk first about some of the elements associated with a more balanced approach to fiscal decision making. The first thing that I want to emphasize here is that Nevada's budget is Nevada's budget. It is not for me to sit here in Knoxville, Tennessee, and tell you how to tax and how to spend in Nevada. What I would argue though is that Nevada's budget does not exist in a vacuum. It does not exist in isolation. Nevada's budget exists to provide services to the State of Nevada and to its residents. Nevada's budget exists to provide services that are complimentary to private sector economic activity.

As such, we argue very strongly for a balanced approach in dealing with budget shortfalls, in particular an approach that does not rely solely on expenditure cuts and an approach that does not rely solely on tax increases, but an approach that is strategic. Budgets need to be guided by a strategic plan for what you want your government budget to do in concert with private sector market activity. That strategic plan is what should be guiding the decisions regarding budget balance.

There will be some persons who are not willing to accept any cut in services. There will be some who are not willing to accept any increase in taxes. Those two polar positions deny the important role that a state budget can play in providing services that meet the needs of individuals and families. The role of the budget is to provide infrastructure and services to promote economic development. The role of the budget is to provide education services that make the state's population and economy more productive and more competitive.

We argue strongly and passionately for a balanced approach to dealing with budget shortfalls.

We argue strongly to broaden the tax base. In particular, the State of Nevada should broaden its sales tax base to include a whole range of services that are currently not taxed. This will be unpopular among those who are primarily concerned with equity issues, but consideration should be given to putting sales tax on food even though the sales tax on food does have undesirable equity consequences. Those undesirable equity consequences might be addressed through other means such as a smart card that could have imbedded on it sales tax credits. Those credits would allow a low income household at the grocery store to use that smart card to erase the sales tax liability associated with the purchase of food. There is no reason to provide higher income individuals an exemption under the sales tax law for food purchases.

My estimate is we are talking about as much as half a billion dollars in revenue forgone because of the choice to not include food in the sales tax base.

It is conceivable that by broadening the sales tax base to include a whole host of currently untaxed activity the state could not only generate more revenue but could also lower the tax rate.

A caveat is that given Nevada's heavy reliance on tourism activity, it really does not matter in practice how broad the tax base in Nevada is going to be because the state will continue to be a cyclically sensitive state from a revenue perspective and will continue to rely heavily on the tourism sector. That is going to require a long-term strategy of transforming, reducing reliance on tourism, and reducing reliance on gaming, and not to forsake those sectors of economic activity that are very important to Nevada. Those sectors will continue to be very important to Nevada but the need to redirect the economy and grow other sectors of the economy is important.

It is important to give local governments not only the flexibility but the control and the ability to provide services at the local level. Most tax economists similar to me and public finance experts that look at government finance issues argue strongly for localizing to the extent possible the source of revenue generation to where service responsibility lies. Local voters and taxpayers know their local elected officials and have a greater opportunity for efficiency and accountability at the local level.

We argue strongly to enhance rainy day fund balances. The State of Nevada, similar to many states around the country, went through its rainy day fund balances very quickly when the recession unfolded. Then the state was left with nothing. Rainy day fund balances need to be much larger than they were when we entered this recession. Local governments need to be encouraged if not formally enabled to develop rainy day funds to help them deal with the vagaries of the business cycles and the uneven flow of tax revenues.

Assemblywoman Neal:
Thank you, Madame Chair. I had a question about improving the quality of fiscal policymaking. You talked about the sales tax on food and I want you to clarify this for me. You basically are saying tax food and then subsidize the persons who cannot afford the tax. How can that be successful? To me I do not see how that can be successful. It is similar to a big Temporary Assistance for Needy Families (TANF) card for everybody who can not deal with the tax.

Matthew Murray:
That is exactly what I am saying. You have to make the decision as to whether the revenue forgone from the failure to collect tax on the food from visitors and high-income residents, and the resulting revenue loss, is worth the potential cost of the smart card and the potential stigma associated with the smart card. The fact is that an individual household may have to individually file for that smart card and that is simply one of the practical trade-offs that needs to be made.

In Tennessee what we are doing is we are stepping down with the passage of time the sales tax that is imposed on food. Our statewide sales tax rate is 7 percent. Our tax rate on food is now 5 percent. I am a university professor and I pay only 5 percent on the food. At some point I can imagine in the future I will pay no sales tax on food. That is not a very efficient use of a tax and that goes back to one of the first questions that was raised about a tax expenditure imbedded in a state budget. But that is a choice that persons in Nevada such as yourselves are going to have to wrestle with and make a decision on.

Assemblywoman Pierce:
Nevada has one of the most regressive tax systems in the country. I do not have to wrestle with taxing food at all. It is not a possibility. There are all kinds of other entities in the state who are not paying their fair share, and before I even think of tax on food that must change. Food is not a possibility.

Matthew Murray:
I am not suggesting that you do not provide low income relief. I think it is very important to deal with the regressivity of Nevada's sales tax. I am simply saying that Nevada is probably forgoing hundreds of millions of dollars in revenue that would be taken from higher income households right now who do not pay the sales tax on food. I am in favor of providing relief to low income households. But exempting food is an extensive means of providing that relief. I am suggesting the relief be targeted to the low-income population.

Assemblywoman Pierce:
I would be interested in you going back and defining more clearly what you consider a structural deficit and a cyclical deficit because that does not make sense to me.

Matthew Murray:
Let me try to give you an example. Imagine yourself during a period of fiscal health and your state has a balanced budget and your revenues are in alignment with expenditures. The economy continues to grow and you end up with a fiscal surplus because revenues are growing in a very healthy fashion. If you choose to cut taxes during that particular period of health and you choose to raise expenditures during that period of fiscal health, when the economy contracts, your revenues will contract simply because the economy is slowing. But that problem will be exacerbated by the choice to cut taxes or increase spending. That permanent change in taxes and expenditures that was enacted during a period of economic and fiscal health aggravates the cyclical deficit that surfaces during an economic downturn.

Assemblywoman Bustamante Adams:
Thank you, Madame Chair. I have a question about the smart card. Are you saying that Tennessee currently has a smart card, and if it does, are there any other states that use the same concept?

Matthew Murray:
We do not have a smart card in Tennessee. We provide that lower tax rate of 5 percent on food to everyone in the state of Tennessee. Whether you are rich, poor, a visitor to the state, or someone who goes to the Smoky Mountains and rents a cabin and buys food at a local grocery store, you benefit from that lower tax rate. What many states that have an income tax have chosen to do is they have chosen to provide refundable income tax credits under their personal income tax to provide that relief. The State of Nevada is not in a position to do that because the State of Nevada does not have a personal income tax.

I am simply suggesting the possibility of the use of a smart card. A smart card would create a stigma on the part of many of those who had to show that card at the grocery store. There could be some process that could require those low income individuals to register to receive that smart card and the sales tax credits could be imbedded in that card. I am using this as an example of some of the difficult trade-offs and policy choices that we have to make when we are trying to pursue a well-intentioned goal of providing equity relief for low income households in reducing the regressivity of the sales tax.

Assemblywoman Neal:
Thank you, Madame Chair. I have a question. I did not see an inclusion in your factors to increase personal income levels as a factor that could offset the limitation in our *Nevada Constitution*. Why is enhancing personal income not included as one of your factors?

Matthew Murray:
I think enhancing and growing personal income is critically important. When I talked about balancing and dealing with the budget shortfall, one of the things I mentioned was recognizing the important role that education plays both K-12 and higher education, in promoting economic well-being of persons and promoting the competitiveness of Nevada. The single most important thing that you can do in Nevada and any state to grow personal income is to maintain a good business climate but also invest in persons through education. The evidence is compelling that returns resulting from education and the human capital investment are substantial and significant. This is why we are advocating for the protection of education budgets. Protecting education budgets allows states to continue to invest in persons, and by investing in persons, you enhance their earning prospects and you enhance the growth of income over time.

Assemblyman Livermore:
Thank you, Madame Chair. I have not seen anything reflected in here about the economy and efforts to enhance businesses' opportunity to employ persons. Currently there is a sole-source payer of unemployment benefits and that decreases businesses' opportunity to employ additional persons. How would you propose relief for businesses in this process?

Matthew Murray:
That is very difficult because you have to maintain an unemployment insurance trust fund balance that is sufficient to fund the unemployment insurance claims that the unemployed persons draw down. Nevada has a poorly rated unemployment insurance trust fund from a national perspective not because it is poorly managed but because of the cyclicality and volatility of the state

economy. The state makes heavy use of that unemployment insurance trust because there are periods along with the low business cycle of very high rates of unemployment. That is not something that we looked at in this study. That is not a General Fund tax and the unemployment insurance claims being paid are not General Fund expenditures. I am not suggesting that is not important or irrelevant; it is just not something that was a primary focus of our analysis when we analyzed structural deficits.

Assemblyman Livermore:
I asked that question because I think it is an important element moving forward as the state returns to employment and encourages the growth of more taxpayers. If persons join the unemployment sector, they reduce the growth in goods and services. I believe that needs to be understood and considered.

Assemblyman Ellison:
Thank you, Madame Chair. One of the things you did not talk about at all in your study was downsizing government. It looks as though every state is going to have to tighten their belt based on your findings. Do you want to elaborate on that?

Matthew Murray:
You are absolutely correct. And virtually every state in the country will have to deal with a budget dilemma today and a budget dilemma that will be exacerbated with the withdrawal of the American Recovery and Reinvestment Act of 2009 (ARRA) funds. The general prescription to the states is that it is up to the states to decide, but the most general recommendation that we make in the near-term is to pursue dealing with budget shortfalls through balance. That balance is a balance of some degree of tax increases and expenditure cuts. But states must make those decisions with an eye on the long-term strategy and an effort to maintain or promote the competitiveness of the state's economy.

That takes me back to focusing on education. Severe cuts to education funding today harm individuals by reducing the quality of education and reducing accumulation of human capital. In doing so, what you have done long-term is you have weakened your position from an interstate and international perspective in terms of promoting economic development. Every state, or nearly every state around the country, is dealing with a budget shortfall right now. We would argue that every state needs to take a balanced approach to dealing with those budget shortfalls.

Chair Kirkpatrick:
Thank you. Let me just disclose, my stepdaughter and her family live in Franklin, Tennessee, so I am a little bit familiar with the Spring Hill area. In my opinion Nevada gets chastised a lot for not being business-friendly. Quite frankly, in Tennessee you charge a lot more tax to businesses than we could collect in five years. How did you find that balance in Tennessee?

The other thing that you are fortunate with in Tennessee is that you have a lot of persons with very wealthy wages who can contribute more to the day-to-day operations of the state by spending within the community regardless of the economy. At least in Franklin, you have a lot of the country western music stars. Sometimes persons will steal alcohol, tobacco, or music. Whether you are depressed or happy, you tend to always find money for alcohol, tobacco, or music so Tennessee is more fortunate. Tennessee is not necessarily as business-friendly as other states, but you are still drawing those companies to your state. How did you find the balance and still retain the higher tax?

Matthew Murray:
Let me just note for the entire group that Tennessee does not have a broad based personal income tax. The state does have a fairly narrow tax that falls on certain forms of dividend income and interest income. We do have a fairly standard corporate income tax when you compare it to other states. We rely heavily on the sales tax, particularly at the state level. Other excise taxes represent about two-thirds of our General Fund revenue. The gas tax and the excise taxes on tobacco and alcohol together represent about two-thirds of our revenue.

One of the things that Tennessee has that Nevada does not have is we simply have a more diversified economy. Our economy is manufacturing oriented and in that sense it relies disproportionately on one sector of the economy. Unlike 1970, when about 33 percent of our jobs were in manufacturing, right now only about 15 percent of our jobs are in manufacturing. Statewide we have a more diversified economy.

You mentioned the middle Tennessee area where we have a very vibrant arts, music, and athletics culture. We have professional football and professional hockey. We simply have a more diversified economy. I would add to that the fact that we do not go through the same degree of volatility. If you were to look at Tennessee's performance in terms of revenues and economic growth, we simply perform in a more stable fashion.

We were hit hard by the economic downturn. Our former Governor Bredesen is a Democrat and wanted to protect K-12 education. Governor Bill Haslam is a

Republican and wanted to protect K-12 education also. He is very committed to trying to focus on what makes the state more productive and competitive long-term. Tennessee lags national standards in measures of educational attainment and its investment in education.

The last factor I will present is Tennessee had a fairly substantial rainy day fund. We did not have the same boom and we did not have the same bust. We still have money in our rainy day fund totaling about $400 million. A whole host of factors have contributed to generating a more stable economic climate in Tennessee that has been reflected in a more stable fiscal situation for the state.

Assemblywoman Pierce:
I appreciate that the recommendations that you are making are quite general. I think that it is important to understand that in a fundamental way, Nevada is not even close to the middle. We have by very large margin the smallest state government. We have spent the last 30 years downsizing. Persons in this building often talk about states having priorities. When you look at the priorities that the other states have, note that Nevada threw two-thirds of those priorities away 20 years ago. There are many things that other states do that Nevada does not do. It is important to remember that Nevada went down a road in the last 30 years that no other state went down. There is no comparison between Nevada and other states. Even the state that is closest to us is different. If Nevada hired 10,000 government workers tomorrow, we would still have the smallest state government in the country. It is easy to say just make some cuts, but Nevada has been making cuts for 30 years.

Matthew Murray:
I think there is a very important lesson in that. The lesson is that Nevada has an economy that is built on one economic sector. What you have done over the course of the last couple of decades is invest in a single stock. Those of you who own stocks do not own a single stock. You own a portfolio of stocks. That has not been the situation in the State of Nevada.

I would like to turn to the last page to really draw out a point that I have been talking to in a variety of different ways. That point is to think about the strategic direction for the State of Nevada. Your budget, your policy, and your planning needs to be focused on a strategic plan. If you want to continue to focus on simply having low taxes, tourism, and gaming, then I promise you and I guarantee you that Nevada will go through an economic cycle similar to this again in the next 5 to 10 years, in the next 10 to 15 years, and in the next 20 to 25 years. The state will be constrained by that very narrow economic portfolio. You need to think strategically about the opportunity to broaden your tax base, to broaden your services not simply to make government bigger but strategically to grow the government to help as a complement, not as an impediment, but as a complement to the private sector to promote economic growth.

Low taxes are a good thing. It is good to have low taxes. In Tennessee, similar to in Nevada, you get what you pay for. It is similar to your cable television, or your car. We all want to have a low car payment and a low cable television bill, but you get what you pay for. When you have a low cable television bill, you do not get very many channels. If that is what the State of Nevada wants, then stick to the path that you are on right now. But you rely heavily on one sector. You rely heavily on taxes that are paid not by residents of the state but by visitors to the state. It is very difficult for me to tell the State of Nevada what to do. But when I look at Nevada, it is an outlier and has a very narrow tax portfolio and a narrow economic portfolio. I do not see strong economic growth on the horizon for Nevada given those particular characteristics.

Assemblyman Goedhart:
We hear a lot from different persons and some say we have the smallest government, which a lot of persons agree with. Where do we rank nationally in terms of the amount Nevada spends for government services per capita? I was told Nevada ranked somewhere between 23rd and 25th putting us solidly in the middle of the pack in terms of how much we spend per capita for governmental services.

Matthew Murray:
I am sorry but I do not have that number in front of me or in my file but I can find that number very quickly. I would argue that a per capita measure is not the best measure to use because it does not reflect your ability to pay taxes. I would argue strongly for looking at tax burdens as a share of your economy and as a share of personal income in your state. Personal income as I noted in one of those introductory slides, really does reflect the size of your economy and also reflects your ability to pay taxes. I would argue that would be a better measure. Regardless of how you look at the size of government in Nevada, it is a small government.

Assemblyman Goedhart:
I think according to your slide, the share of dollars per thousand dollars of personal income as evidenced by the contraction in the private sector was about $25 in 2001 and escalated to about $35 or $36 and is currently around $32 or $33 per thousand. It seems as though the states that are actually doing the best are those states that have diversified beyond just leisure and service industries but have some sort of either a manufacturing base or they have a

resource-driven component as part of their economy, such as oil, natural gas, or something of that nature.

Matthew Murray:
That is absolutely correct. There are some states in the upper mid-west in the Dakotas where food prices have been climbing. Those states have been doing quite well. Generally the point you make is absolutely correct. The states that are doing well have diversified economic portfolios and tend to have diversified fiscal portfolios or revenue portfolios also.

Assemblyman Goedhart:
It seems as though the sector that is doing better just in being diversified is the resource sector, whether it is commodities, energy, or things of that nature.

Matthew Murray:
That is absolutely true. Part of that is a temporary phenomenon. But there is also a long-term element to that as well, particularly when it comes to energy related commodities. Those will be in ever-rising demand and prices will continue to move forward. States that have those particular resources will do relatively well from a revenue perspective, at least in that component of their budget.

Chair Kirkpatrick:
Are there any other questions? Thank you, Mr. Murray. We appreciate you giving us some enlightenment. I think you are going to make a presentation to the Senate Committee on Revenue this afternoon. If you come up with any specific pieces for this tax expenditure report based on a couple of good state examples, I would be interested in having that information. Thank you for coming to the Assembly Committee on Taxation.

The next presentation is from Jeremy Aguero and Guy Hobbs.

Jeremy Aguero, Principal Analyst, Applied Analysis, Las Vegas, Nevada:
We were asked to prepare a study back in 2008 and 2009 on other tax studies that have been done for the State of Nevada. That is the report (Exhibit D) that is before you. I will take a little bit of time to walk through the report and hit on a few of the highlights. I think what you will find is there are any number of common themes both in association and reflection of the analysis that you just heard relative to our deficits and our problems that we deal with as an economy and perhaps some others. I will try and do play-by-play analysis and walk through the presentation briefly.

The first of the tax studies is from 1960 on my time line. It is referred to as the *Zubrow Report*. These tax studies go back a long time. Nevada has been asking these questions for a number of decades. The *Zubrow Report* was prepared in October 1960. It was a relatively comprehensive report overall. There was a 25-person special citizens committee on taxation and fiscal affairs that assisted with the report. The recommendations were limited to existing sources and did not include an analysis of new sources of revenue. To put 1960 into perspective, Nevada's combined statewide population in 1960 was 280,000. Today, Nevada has a population of 2.6 million. In 1960, statewide employment was about 100,800 and state government employment was only 3,200 persons in the entire State of Nevada.

Nevada's total state spending was $60 million with $25 million in the General Fund. Sales and use tax and gaming taxes accounted for 75 percent of the General Fund revenues. The state had a tax surplus, which makes the outcome of this report a little bit different. Education accounted for 68 percent of General Fund spending. Nevada was still using the cash basis of accounting, as opposed to the accrual basis of accounting. We had not made that change yet. The Great Depression and World War II economic cycles remained considerations. Dwight Eisenhower was the President of the United States. Cassius Clay, who would later become Muhammad Ali, won his first professional fight. This was a long time ago.

Although if we look at the report's recommendations, they were very similar to others you may hear. There was this idea of exempting personal household effects from the tax base and reducing the state levy to compensate local jurisdictions. There was the idea to exempt food, other than restaurant meals, from the tax base in order to improve overall equity in the tax structure. There was the idea to increase the cigarette tax from 2 cents to 5 cents and reallocate the proceeds between state and local government. There was the idea to significantly increase the alcohol beverage tax, doubling the rate. There was the idea to modify and redistribute the county table tax and that involved how money was being distributed between state and local government. There was the idea to increase the state gross gaming tax scale from 3 percent-5.5 percent to 3 percent-7 percent.

In 1966, Nevada received the *Lybrand Report*, which was the second of the tax studies that I will review today. It was titled "The Study of General Fund Revenues of the State of Nevada" and was released by Lybrand, Ross Bros. & Montgomery, Certified Public Accountants. It was created by Senate Concurrent Resolution No. 8 of the 12th Special Session (1966) and gave special priority to gaming taxes and financial controls. The state was facing a projected shortfall and expected not to be able to fund existing programs.

In 1966, the state had grown dramatically to a population of 419,000. The total state revenues were about $178 million. The General Fund revenues were about $52 million. The projected revenue shortfall was 14 percent of the budget in 1968 [$9 million] and increased to $45 million or 35 percent of the budget shortfall in 1976. An initiative petition was being circulated that would raise the gaming tax by 200 percent so there was some degree of an incentive to take a look at our revenue structure. Regulatory oversight of the gaming industry was a concern and the report noted particularly skimming. This is a time when there was a greater degree of organized crime in our tourism industry and there was a belief that not all money was generating taxes as it should.

Sales taxes and gaming taxes made up the vast majority of State General Fund revenue (Exhibit D). As part of a nationwide protest against the Vietnam War, demonstrations were staged all over the United States. The first African American senator was elected to the United States Senate. *Star Trek* and *The Newlywed Game* premiered.

The *Lybrand Report* recommendations were similar to the prior report and proposed an increase of 100 percent to rates of fees, licenses, fines, and charges. The recommendations included implementing the state death tax to allow for the state "pick up" portion of the estate tax. This was a period in time when the federal government was going to allow the states to pick up their portion of the estate tax. We wanted to generate that revenue. Resurfacing again was a recommendation to increase the liquor tax by 50 percent and increase the cigarette tax by 2 cents per pack.

The report's recommendations also included:

- Increase the gaming percentage fees by 50 percent over the next 8 years and 25 percent immediately.
- Institute a corporate income tax of 5 percent escalating to 12.5 percent over an 8-year period.
- Institute a personal income tax of 1.25 percent escalating to 3 percent over an 8-year period.

Fast forwarding we have sort of a break with regard to tax studies and the next one was the Price Waterhouse Urban Institute Report in 1988. The report was titled *Fiscal Affairs of State and Local Governments in Nevada* (November 1988). The editor of the report was Robert Ebel. The legislatively commissioned study was specifically seeking policy recommendations guiding the state through the next decade. The analysis focused on maintaining services at current levels after the tax shift. You will remember in the early

1980s Nevada had something referred to as the "tax shift" in which moneys were redistributed between the state and local governments.

In 1988, Nevada's state population was 1.05 million (Exhibit D). More than half a million people were employed. State revenues were $1.4 billion-$1.5 billion. The General Fund revenues were $613.5 million. The statewide visitor volume was 19 million. The rate of inflation was 4.1 percent. Ronald Reagan was President of the United States. A Pan Am Boeing 747 exploded over Lockerbie, Scotland from a terrorist bomb. The Netherlands became the second country to get connected to the Internet. *Rain Man* was the top grossing film. The Los Angeles Dodgers won the World Series.

Many recommendations came out of that study and included the removal of constitutional constraints. This idea comes up quite a lot. It is a bit of a nuance item. We write much of our tax law into the *Constitution of the State of Nevada,* which makes it remarkably inflexible. If you write tax law into the *Constitution*, it takes you at least four years to change it. There were cautions in the study against writing the tax law into the *Constitution*.

The recommendations in the report *Fiscal Affairs of State and Local Governments in Nevada* included:

- Remove constitutional constraints, revenue earmarking, and tight restrictions on local government that limit the state's ability to adapt to changing market conditions.
- The state should avoid earmarking except in limited cases.
- Nevada should be careful to maintain its business tax advantage however the business tax could be raised without jeopardizing the state's competitive position.
- Property tax relief measures should not be targeted to the elderly; rather it should be targeted to low-income taxpayers.
- Property should all be assessed at 100 percent of market value.
- Tax system transparency should be increased. There was some concern that those paying the taxes were not always clear.
- Significant reforms to the intergovernmental revenue system should be addressed.

There were concerns that the state was heavily dependent on gaming tax but local governments were heavily dependent on property tax and sales tax and that could create some issues.

- Replace per gaming machine taxes and per unit taxes with taxes based on gross receipts.

Why? Because if you have a gaming tax that only taxes on a per unit basis, it is going to be static over time. When gross receipts grow because inflation happens, they move along together.

- The state should not implement a state lottery.
- Broaden on a revenue neutral basis, the general sales tax base to fully include hotels and lodging, food for home consumption, drugs, household fuels and other utilities, services to persons, and newspapers. To attain revenue neutrality, significantly reduce the state's sales tax rate and to address the regressivity issue the state should enact a "variable vanishing sales tax credit."
- Raise the cigarette tax to 30 cents per pack and then index the tax to the annual rate of change in the consumer price index.
- Tax all alcohol products on an ad valorem basis using the same rate for all products no matter what the alcoholic content.

Our alcohol taxes in Nevada are unit-based so they do not reflect changes in prices.

- Consider the use of mileage fees for classes of drivers.

The concerns were about our gas taxes being unit-based and not keeping up with how persons drive or who puts the most demand on our roads.

- Local government should be required to invoke the full local gasoline tax option prior to receipt of additional state aid.

This was about whether local governments were using the actual tax capacity they had.

- Mines should continue to be principally taxed on net proceeds, and due to the instability of the revenue source, recurring operations should only be funded by a floor price of gold.

What they were recommending was to determine what the floor price of gold was and take any additional money that might be generated. If gold goes up to $1,400 per ounce, then those moneys should be put into a special account to be used for special purposes using the interest much as other states use with their natural resources.

- The net proceeds should be supplemented with a severance tax based upon gross yield.

They recommended a second tax on our mining industry.

- Personal income tax would be overkill to address the anticipated revenue shortfall and should only be considered as an option if there is legislative determination that government services need to be increased.
- The constitutional prohibition against an income tax should be removed.
- If additional revenues are needed, a general business tax would be an appropriate revenue source. However caution should be given to preserving Nevada's competitive advantage as a low business tax state. They offered an alternative: a 3 percent business income tax with a 0.12 percent franchise tax on invested capital imposed on all businesses.
- The state should eliminate the sales tax on equipment purchases for local telecommunications companies and long distance carriers.

Those were growing dramatically during the late 1980s and well into the 1990s and they were trying to incentivize that as an economic development initiative.

- Sales tax should be applied to phone bills.

One of the most common expansions of the sales taxes nationwide is to expand to cell phones. This is something I think they were trying to think about in terms of telecommunications and understanding that it was growing.

- Financial institutions should be taxed in a manner similar to other businesses and should be included in the tax base of any general business tax.

This was a caution against singling out financial institutions.

- State should maintain the estate tax pick up.

The next tax study was the Assembly Bill No. 801 of the 65th Session (1989) study that was titled *Study of Taxation in Nevada* (December 1990) and created a Legislative Commission Subcommittee. The Subcommittee was directed to consider the equity distribution and adequacy of all taxes and the feasibility of future revenue sources (Exhibit D).

In 1990 Nevada had grown to a population of 1.24 million persons. Nevada's employment was 0.63 million. The total state revenues were now $1.7 billion and our General Fund revenue was $802 million. Nelson Mandela had just been released from a South African prison. East Germany and West Germany had just been reunified. A McDonald's opened in Moscow, Russia.

The Subcommittee's recommendations were many and most had to do with the distributions of existing revenue sources and some type of shoring up of the revenue sources of the state. The formula for intergovernmental transfers should be changed. The Subcommittee wanted the property tax which currently had an assessment rate of 35 percent to have some "brackets" around it. There were some discussions of different counties having different tax brackets around rates. Elko County and Eureka County should be consolidated. The Subcommittee recommendations were similar but very specific recommendations overall in terms of statutory limitations. The Subcommittee did not want any additional limitations on property tax, but essentially wanted to let the tax system work more efficiently.

In 2002 there was a group called the Governor's Task Force on Tax Policy created by Assembly Concurrent Resolution No. 1 of the 17th Special Session (2001). It was created in the wake of the events of September 11, 2001. The chairman of that group was Guy Hobbs. Members included persons from the community and representatives from gaming, information technology, and the chambers of commerce. They met for one year and their analysis was required to consider measures that could have the tax system more closely reflect the actual economy. In 2002 Nevada was coming out of the effects of September 11, 2001. The state was showing a decline in per capita inflation adjusted revenues. The state's employment base had lost about 25,000 jobs and Nevada lost about 1 million visitors. Inflation was relatively low but there was certainly concern about the stability of the revenue sources over the long-term. During that same time the Olympics were being held in Salt Lake City and *American Idol* debuted.

The recommendations from the group were relatively specific and included:

- Increase the efficiency of state revenues by allowing for electronic funds transfers, e-filing of returns, credit card payments and other similar "passive" measures.

This would make it easier for persons to pay their taxes.

- Implement a state activity tax of 0.25 percent on all business receipts in excess of $350,000 per year.

This was one of the cornerstones of the group and was commonly known as the gross receipts tax. What is common about that particular tax is that it was only to apply to business receipts in excess of $350,000 per year, which would have exempted a majority of businesses in Nevada. The idea was to come up with something per the mandate of A.C.R. No. 1 of the 17th Special Session

(2001) and the requirements of the Governor's Task Force on Tax Policy to reflect the state's economy.

- Increase the business license tax to reflect inflation or from $25 per employee per quarter to $35 per employee per quarter and expand the tax to capture all employees.

Note that in 2002 many of the taxes including the business license fee, the cigarette tax, and liquor taxes had not been changed for a long period of time.

- Increase of 50 percent in corporate filing fees.
- Increase all liquor tax components to reflect inflation since last adjusted or by 89 percent.
- Double the cigarette tax from 35 cents per pack to 70 cents per pack.
- Implement a property tax "flex rate" of 15 cents per $100 of assessed valuation that could be adjusted up or down based on actual tax collections.

The Governor's Task Force on Tax Policy recognized that there was no perfect tax system. There was no way that it could fashion a solution to the state's tax revenues that would allow it to deal with the ebbs and flows that were going to occur. It recommended a 15 cent flex rate that would be added to the state's revenue sources. When revenues were coming in lower than expectations, this flex rate would kick in and when revenues were higher the rate would have to be reduced. This was setting a threshold and allowing the tax system to actually attempt to adjust.

- Increase the slot license fee on restricted slots by 32 percent.
- Implement a broad based admissions tax of 6.5 percent on amusements.

This would make admissions to amusements subject to the same minimum rate applied to all retail sales and use tax at the time.

- Consider expanding the sales and use tax base to include more services or eliminating exemptions and lowering the rate.
- Consider development of a lottery as part of a longer-term strategy.
- Consider the importance of expenditure accountability.
- Consider strategies to increase Nevada's allocation of federal funds.

There were many recommendations around using information technology to make government more efficient. It recommended dealing with unfunded mandates. Tax policies should consider economic development.

I will now start on the second part of the presentation. I am going to discuss a couple of very high level issues and then I will leave the balance of summarizing this to Guy Hobbs in terms of what the tax studies said. But on slide 30 (Exhibit D) is the puzzle, which is all of the things we would consider in terms of good tax policy. We want it to be tax neutral. We want it to be predictable. We want it to be transparent. We want it to be stable. We want it to be uniform. We want good taxes that do the things that we want them to do. The little red piece in the middle I would argue is the most important variable in everything that has to do with taxation, and that is political viability. The question is whether or not the Legislature and the Executive Branch can come to an agreement and find a way to implement something that makes sense for the state.

These ideals in terms of what is good tax policy are not new. In the *Zubrow Report* in 1960 it referenced Adam Smith and *The Wealth of Nations* written in 1776. I have just put a couple of passages in the slides for you.

Adam Smith on revenue system equity said, "The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state . . . ."

Adam Smith on transparency said, "The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and into every other person . . . ."

Adam Smith on ease of compliance said, "Every tax ought to be levied at the time, or in the manner in which it is most likely to be convenient for the contributor to pay it . . . ."

Adam Smith on cost of administration said, "Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what brings into the public treasury of the state . . . ."

In the slides that follow, I have tried to extract from the volumes of reports that I have reviewed elements on equity, transparency, sufficiency, and predictability. What you will see is in some cases they say many of the same things but in some cases they say things that are different.

I would just like to skip to the bottom line at the end which deals with this issue of political viability. There is no perfect tax system. Taxes are invariably unpopular, but a sound fiscal policy rarely wins a popularity contest. No one is going to like taxes. The cycle of analysis, spending, and taxing is relatively clear. As opposed to me walking through what each one of these reports have said, I will turn it over to Guy to make comments about the similarities of these reports.

Assemblywoman Pierce:
I wanted to mention something that I learned recently. On slide 17 you talked about the state should maintain the estate tax pick up, and I did appreciate that you used the actual title of that tax instead of the more politically charged term "death tax" as you did earlier in the report. In the 1990s, Nevada's portion of the estate tax was about $30 million on average for a biennium and all of that went to education. When President Bush's tax cuts were passed in 2002, the state's pick-up tax started to get phased out. But in 2005 Nevada's ability to pick up any portion of that estate tax went away. Even though the estate tax has now been reinstated at a higher level, the law did not change to allow Nevada any share of the tax. That is $30 million that Nevada used to get for education that we do not get now.

Assemblyman Goedhart:
Thank you, Madame Chair. I appreciate the fact that you explained some of the different ideas that have been brought in by different studies. But one of the areas that I always had a hard time rationalizing was this gross receipts tax. You could have a business with an extremely low profit margin, or possibly even a temporary negative profit margin, and the dollars of sales really do not have any correlation to the ability to pay. What is your opinion on that?

Jeremy Aguero:
Sure. You are right. That is a problem. And there are other problems with the gross receipts tax. You have got pyramiding issues. No tax is perfect. We accept that. Some industries have relatively high volume and low margins such as sales of petroleum and gasoline. The reality is where there is that level of competition, where there are those homogeneous goods, where I do not have any choice as to where to buy, the tax is going to get passed on to the consumer. Yes, it is something of an issue. But we are not exactly averse to taxing companies irrespective of the profits that they earn. The gaming tax is imposed irrespective of how much persons earn. The net proceeds of minerals tax could be somewhat argued in that same way. We have all types of unit taxes such as gasoline taxes that are imposed irrespective of the cost of gasoline. You are right; that is something that is a problem. We would want to guard against that and monitor it. But in reality I do not know that it would have the type of negative economic fiscal impact that some feared particularly at 0.25 percent in terms of the tax rate that was being imposed.

Chair Kirkpatrick:
I have all the prior books and my biggest frustration in the last couple of years is we ask all these persons to get together and we ask for all these tax studies, and then we never ever take any of their recommendations. It is just such a waste of time and money from everybody. I am curious to know how many recommendations the State of Nevada has actually implemented over time if any. I doubt we have implemented any recommendations that we have received since 1988 and 1990. I was here in Nevada when we did the big tax shift. I was graduating from high school. The economy was bad. It was almost the same economic problem as now because persons were losing their homes, there were foreclosures, and there were strikes on The Las Vegas Strip. But Nevada had a smaller population. The construction industry had stopped.

We keep doing all these studies but I do not know that we are ever really solving the problem for the long-term. I have constituents today that are saying the state should have kept that $300 million that we gave back. And I say that is not what you were saying when there was that $300 million. You wanted the money then and said that is your money so give it back. I think that persons are starting to understand that the state cannot keep reacting and must be proactive. If I am off-base let me know, but the state is always reacting instead of being proactive.

Jeremy Aguero:
I think that is a great transition to the comments that Guy Hobbs is going to make. He has certainly been involved in everything from the tax shift in the early 1980s to chairing the Governor's Task Force on Tax Policy and probably has more knowledge of that than I do.

Guy S. Hobbs, Managing Partner, Hobbs, Ong and Associates, Incorporated, Las Vegas, Nevada:
At this point we have the benefit of all of those tax studies, all of the good intentions, and all the hard work that came before this moment. I was lucky enough to have been involved in the most recent study in 2002-2003. We spent a considerable amount of time looking at the entire fiscal system of the state, modeling it, and putting forth alternative recommendations. I heard the discussion earlier about having a tax expenditure report. Nevada has a tax expenditure report from 2002-2003. The matrix that is included in that report essentially puts a value to and scores on various levels of every conceivable revenue source that we could possibly think of at that time. I believe the world has not changed that much in eight years. You already have the benefit of that work product.

Most of that study today holds up very well because our fiscal system did not materially change over the course of the last decade. Likewise the predictions included in that report have come to pass because there is an imbalance between per capita revenues and per capita expenditures. For those of you who have not had a chance to read that 1,000-page report, I would strongly suggest you read the executive summary as an alternative to the entire report. But much of the study still holds true today, and certainly the analytics that underlie it should be a tremendous resource to you during your deliberations.

I have looked at all these reports and recognize that the economy of the State of Nevada and the United States has changed dramatically over the 50 years since the *Zubrow Report.* The economy shifted from a goods-based economy to more of a service-based economy. I think we can expect that type of shifting to continue to occur in the years to come. I recognize that the most fundamental pieces of our tax structure of gaming tax and property tax were put into place much longer than 50 years ago. Nevada's economy has evolved. Our tax structure has not. The fact that the two are not working in concert should be no surprise to anyone.

What are the things that we know are consistent in all of these tax studies? What are those things that we probably do not have to study again? We know we have devised a fiscal system in the state that is largely based on property tax, sales tax, and gaming tax. At the local government level and at the state level, those revenue sources in different combinations fund two-thirds of everything we do in the state.

Let us look at each one of those elements. The sales tax base in this state is only applied to the retail sale of tangible personal property thereby eliminating everything that is not tangible personal property from taxation such as all of the services. Plus the state has a series of exemptions that exempt a high amount of what would otherwise be tangible personal property from taxation. At the end of the day the sales tax base is covering only a very small percentage of the overall economic activity that occurs.

This is not me saying you should tax various items but is just the recognition that we are not taxing that much of our economy. But we continue to increase the rate to chase a small and declining tax base. The base will continue to decline because of things such as Internet sales until such time as those types of items are worked out. The shifting from a goods-oriented economy to a service-oriented economy is occurring now. We should not be surprised by anything that happens in that area any longer. And further inattention to that base will lead to further erosion. There is no question in my mind about the erosion.

Gaming tax has been declining on an inflation adjusted per capita basis for several years. That should be no surprise to us. Gaming has really become more of an entertainment-type industry. The pie chart looks quite a bit different today than it did 20 years ago as to how a visitor spends his money. Twenty years ago a large piece of that spending would have been gaming. Today a much smaller piece of that spending is now gaming. We know that portion of our economy has also been evolving away from gaming into things such as retail, food and beverage, shows, and lodging as profit centers, which are all taxed differently and in many cases the money goes to different functions. We should not be surprised by that.

Let us discuss property tax. Probably the newest problem to raise its ugly head in the state is the decline of property tax that has traditionally been one of the most reliable revenue sources in the state. The decline in assessed valuations and the imposition of the 3 percent and 8 percent caps on property taxes serve to limit the amount of recovery and the speed by which we could recover over time. Property taxes are declining and that funds a large part of education and local government spending and presents a problem.

The bottom line is the tax structure in the State of Nevada does not emulate our economy. Our economy continues to evolve and our tax structure does not evolve. The fact that the two are moving apart from each other should be no surprise to us.

It could be argued that our tax structure gets very low marks in certain areas, such as equity, reliability, predictability, sufficiency. There are some things that could be done to improve things such as equity, sufficiency, volatility, and lack of predictability that we probably should have been doing for some time.

Past predictions said that declines in per capita revenue and increases in per capita expenditures throughout the state would lead to an imbalance. That has proven true. We are at that point where the two have diverged and you are trying to fill the gap that remains in between those two.

Finally there still exists a very enviable tax structure in the State of Nevada from the standpoint of attracting businesses and maintaining that implied contract we seem to have with the persons that move into our state. That contract says here is the quality of life and here is how we expect you to pay for it. We still have tax capacity and it is worth protecting those things that are assets for us, but it is also worth recognizing those things that present themselves as opportunities.

In a very brief fashion those are the things that all those studies tell us. When we are encountering difficult circumstances such as we are right now, one of the great temptations is to study it. Given the investments that have been made in the past in the form of money and human capital, we have a lot of the answers needed to move forward.

Assemblywoman Bustamante Adams:
Mr. Hobbs, could you state the dates again for when the study was conducted of the revenue sources that existed in 2002-2003?

Guy Hobbs:
The Governor's Task Force Report was prepared in advance of the 72nd Session (2003) and was issued in late 2002. The Legislative Counsel Bureau has a copy of that report and we can certainly provide that to you.

Chair Kirkpatrick:
I want to know how many of the recommendations have we ever implemented.

Jeremy Aguero:
I can provide that to you. The other sheet that I gave the Committee (Exhibit E) is the history and shows everything that we have done in terms of implementing or changing our tax system. The long and the short answer is that these tax studies have been destined to be uniformly ignored. With regard to what we have done about implementing recommendations, it has been limited. The recommendations we implemented included things such as increasing the cigarette tax and liquor tax. But few broad based-significant reforms have been implemented.

Chair Kirkpatrick:
I have been on both sides of the abatements, exemptions, incentives, and they are all very distinct and different. In other states persons are paying all of these other fees and taxes and that is really not bothersome to them. Nevada's message has been wrong for about 10 years. We have met with businesses and they want more and more incentives. I understand that you have to have more incentives to attract businesses, but at the same time that is not what they look for. I do not know how we balance the two together because you have to have the incentives. The film industry is an example. They tell us about all the great incentives offered by all these other states but we do not even collect those types of taxes. How do we tell the public what we collect and what we do not collect. The regular citizen does not know what is collected unless it affected him personally.

Jeremy Aguero:
You and I have had that conversation before. It is a tough problem. The conclusion that you drew is that the best economic development incentive we can provide is the tax structure that we are providing today. We are not giving businesses more money back because we are not taking as much money away from businesses in the first place. Different experts disagree about how important incentives are.

I would recommend rethinking the structure of the incentives that we have and trying to dedicate those toward specific purposes such as employee training and trying to attract businesses. But in reality Nevada is not giving away that much in incentives every year. When the last tax study was done, incentives totaled something less than $10 million as real economic development incentives. The broader question addresses abatements, incentives, exemptions, the narrowing of the sales tax base and redevelopment activities. There are many moving parts of the tax structure. Some recommendations are very helpful and some could probably be restructured to be more effective. It will require some effort on our part to restructure the tax system. But a broader effort will be required to help the community and businesses understand that the real incentive that is being provided is the "pro business" environment.

Chair Kirkpatrick:
As I was looking at the recommendations and trying to structure them a little bit differently, I started comparing them. Comparing the recommendations is not as easy as comparing apples to apples. One person may be giving me a bunch of bananas for one slice of my apple and someone may want that deal. By restructuring the economic development incentives and streamlining the processes, our state's economy will improve in the future. Our focus should be deciding what our core economic structure should be.

Are there any further questions about this matter or other business for the Committee? Hearing none, I will adjourn this meeting until Tuesday at 8 a.m., when the Committee will start hearing about 15 tax bills and one more tax presentation. I want the members to understand the complete tax structure before we start hearing our colleague's bills. There being no further business of the Committee, I will adjourn this meeting [at 10:53 a.m.].

RESPECTFULLY SUBMITTED:

Mary Garcia
Recording Secretary

RESPECTFULLY SUBMITTED:

Janice Wright
Transcribing Secretary

APPROVED BY:

Assemblywoman Marilyn K. Kirkpatrick, Chair

DATE: ____________________________

EXHIBITS			
Committee Name: Committee on Taxation			
Date: March 24, 2011		**Time of Meeting: 9:06 a.m.**	
Bill	**Exhibit**	**Witness / Agency**	**Description**
	A		Agenda
	B		Sign-In Sheet
	C	Matthew Murray, Professor of Economics, University of Tennessee, Knoxville	Structurally Unbalanced, Cyclical and Structural Deficits in Nevada, California and the Intermountain West
	D	Jeremy Aguero, Principal Analyst, Applied Analysis	Studies on Nevada's Tax Structure
	E	Jeremy Aguero, Principal Analyst, Applied Analysis	An Incomplete History of Nevada's Tax System