

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

**Seventy-Eighth Session
February 24, 2015**

The Committee on Taxation was called to order by Chairman Derek Armstrong at 1:32 p.m. on Tuesday, February 24, 2015, 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/App/NELIS/REL/78th2015. In addition, copies of the audio or video of the meeting may be purchased, for personal use only, through the Legislative Counsel Bureau's Publications Office (email: publications@lcb.state.nv.us; telephone: 775-684-6835).

COMMITTEE MEMBERS PRESENT:

Assemblyman Derek Armstrong, Chairman
Assemblyman Randy Kirner, Vice Chairman
Assemblywoman Teresa Benitez-Thompson
Assemblywoman Irene Bustamante Adams
Assemblywoman Olivia Diaz
Assemblywoman Jill Dickman
Assemblyman John Hambrick
Assemblyman Pat Hickey
Assemblywoman Marilyn K. Kirkpatrick
Assemblywoman Dina Neal
Assemblyman Erven T. Nelson
Assemblyman Glenn E. Trowbridge

COMMITTEE MEMBERS ABSENT:

None

GUEST LEGISLATORS PRESENT:

None



STAFF MEMBERS PRESENT:

Russell Guindon, Principal Deputy Fiscal Analyst
Michael Nakamoto, Deputy Fiscal Analyst
Bryan Fernley, Committee Counsel
Gina Hall, Committee Secretary
Olivia Lloyd, Committee Assistant

OTHERS PRESENT:

Paul Moradkhan, Vice President, Government Affairs, Las Vegas Metro
Chamber of Commerce
Joseph Henschman, Vice President, Legal & State Projects,
Tax Foundation
Jared Walczak, Policy Analyst, Tax Foundation

Chairman Armstrong:

[Roll was called and housekeeping items discussed.] Today's presentation is from the Tax Foundation. I appreciate the Las Vegas Metro Chamber of Commerce putting this study together and Mr. Henschman and Mr. Walczak for giving this presentation today.

Before we begin, I will provide some of the structure for this meeting. I have asked Mr. Henschman and Mr. Walczak to go through their presentations, and we will hold the questions until the end. I will then structure the questions portion because there are different sections to this study. The first group of questions will be regarding sales tax and live entertainment tax. The second group will be about business taxes. The third group will be about property taxes. Then the fourth will be for general questions that were not covered previously.

Paul Moradkhan, Vice President, Government Affairs, Las Vegas Metro Chamber of Commerce:

The Las Vegas Metro Chamber of Commerce believes that these types of hearings are fundamentally important as we discuss how we can modernize Nevada's tax structure. Now is the time to have informed, open, transparent, and robust discussions about Nevada's tax structure and its future. As many of us are aware, the case for tax reform is strong this session. The Metro Chamber made a commitment to its members that it would be engaged in tax reform discussions at a statewide level. We recognize that a thoughtful, meaningful, and fact-based approach is important to modernizing Nevada's tax structure.

This is a priority for employers throughout the state because identifying long-term solutions will stabilize Nevada's taxes and help the employers of this state to better plan for the future. That is why the Metro Chamber is committed to help facilitate dialogue by providing resources and information about good tax policy to legislators and stakeholders throughout the state.

As a result of that commitment, the Metro Chamber commissioned the Tax Foundation last year to look at Nevada's tax structure. As you know, the Tax Foundation is one of our nation's leading permanent tax policy organizations.

As part of their efforts, the Tax Foundation met with Nevadans throughout the state, which included elected officials, employers, trade groups, and ordinary taxpayers, over the course of several months. At their meetings many Nevadans had thoughts and perspectives pertaining to Nevada's tax structure and reform.

In January, the Tax Foundation released their independent and objective analysis of Nevada's tax structure ([Exhibit C](#)), along with key findings and options that you will hear today ([Exhibit D](#)). It is important for this body to note that the Metro Chamber had no editorial control of the report or their findings. It was an independent analysis.

The report, based on the discussions across the state, found that Nevada's current tax structure is not stable, predictable, or transparent, but rather narrowly based. We have shared the report with a wide audience of individuals throughout the state since its release. While the Metro Chamber has not endorsed a specific tax option at this time, we are committed to be engaged in helping modernize Nevada's tax structure by providing resources such as this report to this body. The Metro Chamber has endorsed the four principles of sound tax policy, which are transparency, stability, neutrality, and simplicity. We believe that as we discuss tax policy, those principles should be used as reasonable measures in elevating different options. It is good tax policy to ensure that those four principles are present in any tax option we consider as a state.

It is my pleasure to introduce Joe Henschman, Vice President of Legal and State Projects at the Tax Foundation, and Jared Walczak, Policy Analyst with the Center for State Tax Policy at the Tax Foundation.

Joseph Henschman, Vice President, Legal & State Projects, Tax Foundation:

It is a great treat for us to be able to walk through the findings we have in our presentation ([Exhibit D](#)). I just want to give a little bit of background on the

book [*Nevada, Simplifying Nevada's Taxes: A Framework for the Future* ([Exhibit C](#))], and then I will turn it over to Mr. Walczak to walk you through the presentation ([Exhibit D](#)).

This is modeled after some work we did in a couple of other states, where we would come in as an outside observer and do our best to learn about a state's tax system and provide a national perspective to it. We do this in the hopes that what we offer can add to the conversation. It is certainly not meant as some outside, Washington, D.C., group coming in and telling you what you are supposed to do. That is absolutely not how we frame it. The book is laid out as a number of different options, not just one plan. If you were to look at our book on Nevada and compare it to the books we have done on North Carolina or Nebraska, for instance, you will find the conclusions are very different, as they should be, because states are very different. States have different strengths and weaknesses, and the tax system should reflect those. So I just wanted to give you that little preamble before I turn it over to Mr. Walczak to walk you through the presentation ([Exhibit D](#)), and after that we will be happy to take your questions.

Jared Walczak, Policy Analyst, Tax Foundation:

I appreciate this opportunity to walk through our presentation ([Exhibit D](#)). As Mr. Moradkhan and Mr. Henchman mentioned, this was the product of a series of meetings we had here in Nevada, meeting with a wide range of Nevadans, and is the product of our research. We appreciate the input of many of the members here and throughout the Legislature, and appreciate the time we had to meet with some of you individually.

The work that we have done is based on our principles of good tax policy. Taxes, to the greatest degree possible, should be neutral, simple, transparent, and stable. Unfortunately, looking at Nevada's tax system, that was not always the case.

There are some very good things about Nevada's tax system. You have low taxes that make the state very competitive. I think it is a place where businesses want to locate and people want to relocate to, but the taxes on the whole tend to be fairly narrow. They are not broadly based taxes.

Stability has clearly been a concern. We saw that during the recession. Every state was hit hard by the recession, but Nevada was hit harder than others. This was in part because of the industry mix, but the tax structure here, unfortunately, magnified the instability that already existed in the economy as a whole.

Nevada's tax structure is narrow, outdated, and complex. It will become increasingly unworkable as the economy diversifies. You want to build for a diverse economy. I think that is the goal of all the members here. Nevada, historically, has been seen as a state that is largely focused on gaming and mining, and all of you know that is no longer really your economy. Gaming and mining are still very significant portions, but Nevada is attracting a wide range of businesses. You have financial entities located here, and increasingly, tech firms. You have companies coming here, like Tesla, that are creating new opportunities and new jobs. Nevada's tax structure, unfortunately, is really not designed to grow with the economic growth the state is seeing, or to help it move forward so that the tax system and your revenue can grow with your economy and attract new businesses.

We looked at a lot of options. We looked at the existing tax system and ways to reform it. One conclusion we did draw is that while there is a lot of room to work on the existing tax structure, we believe Nevada should be wary of silver bullet taxes, proposals to reinvent the entire tax system. There is already a great deal of complexity in the system. Adding a new tax on top of the existing taxes without addressing some of the concerns that exist with the current tax system can exacerbate those problems. We believe there is a need to reform the existing tax structure.

We wanted to start by looking at Nevada's economy as it currently exists. This is something that the members of this Committee are well aware of, so I will not spend much time on it, but it does inform our analysis and certainly we spent a lot of time looking at Nevada's economy, so I will go through this very briefly.

What you see here (page 10, [Exhibit D](#)) is the annual percentage change in real gross state product. You can see that Nevada experienced significantly more volatility than the United States as a whole. That was good in the early 2000s, when Nevada was booming and doing much better than the nation as a whole, but you also had a trough that was significantly deeper than the nation experienced as a whole. Unfortunately the tax system looks even worse. When you look at revenue collections you see both the boom and the trough, but the tax collections went down even deeper than the change in gross state product, because you do have a tax structure that magnifies that volatility.

A lot of this is the change in the industry mix. It is the change in what economies look like as a whole. Nevada is not unique in this, but in some ways it is a leader in this. What you see here (page 11, [Exhibit D](#)) is a pie chart showing Nevada industries by whether they are service-or goods-producing industries. You can see that nearly 83 percent of all companies in Nevada are

providing services, not goods, and that accounts for over 70 percent of all economic output in the state being services, not goods. This is a trend we have elsewhere, but it is a trend that is much higher in Nevada. You see about a 2-to-1 split in most states. Nevada is above that and is continuing to expand in that area.

You have seen graphs like this before (pages 12 through 14, [Exhibit D](#)), but I wanted to run through them. Page 12 shows construction employment. This was one of the industries that was hit hardest by the recession. The reality is that Nevada is never going to see the peaks that it saw in the mid-2000s. There was a point where nearly 20 percent of your economy was construction-related expenditures. That will never happen again, and arguably that is not something you would want to happen again. I think that this Committee, and the body as a whole, is looking for a more diverse economy and the ability to grow beyond that. Nonetheless, it was a very significant hit for Nevada to see that sort of reduction.

You saw the recession have an impact on other industries as well, such as leisure and hospitality (page 13, [Exhibit D](#)). The gaming industry saw a dip that they are growing back from now.

Mining and logging (page 14, [Exhibit D](#)) experienced the recession, but then grew quite substantially coming out of it, and was a significant source of revenue growth for a while. We know that this past year the prepayment created issues when the estimates were off, because it is extremely difficult to determine what the spot price of gold or silver is going to be a year in advance.

Nevada's economy is more diverse than outsiders like me would necessarily realize. There is, of course, a significant element that is mining and gaming, but if you look at the map of the state broken down by county (page 15, [Exhibit D](#)) and look at the different sectors that are large in each county, you can see that there are parts of the state where you have a much stronger manufacturing component. There are some that were a combination of food services and gaming, and things like that are very strong, but there is a more diverse economy than I think many people outside of the state realize. There is an opportunity for this body, as you look at tax reform, to build a tax structure that helps bring new firms in. People do not know a lot about what Nevada has to offer. I think this is an opportunity to make Nevada a very enticing state for individuals and businesses looking to grow and expand.

We looked at three major tax areas: the sales tax, and we include the live entertainment tax (LET) within our analysis of the sales tax based on our recommendations there; business taxes; and property taxes. The structure we

use is to look at some of the challenges and issues with each and then offer a couple of options and recommendations the Committee may wish to consider.

Starting with sales tax, I want to talk briefly about why states choose a sales tax. Nearly all states do. Sales tax is one of the most common taxes in the nation, and it can be a pretty good tax. There are a number of reasons why sales taxes are generally chosen. First, if well-structured they can be fairly stable, and more stable than most taxes. They are one of the most transparent taxes; what you actually owe shows up on the receipt. If properly structured, it can reflect the overall economy. It is a way for everyone to chip in. Unfortunately Nevada sales tax is narrow, outdated, and complex, and it has led to increasingly higher rates over time. Page 20 ([Exhibit D](#)) shows the growth in the overall combined sales tax rate, because as everyone on this Committee knows, but perhaps others listening may not, Nevada sales tax is not one tax but a collection of multiple taxes. You have the basic state rate, local school support tax, basic city-county relief tax, and the supplemental city-county relief tax all combined in there, and there are combinations for both collections and remitting through the Consolidated Tax Distribution (CTX). When the sales tax was first introduced it was just a state rate of 2 percent. Now the statewide rate is 6.85 percent, and with local rates it averages 7.94 percent and is 8.1 percent in Clark County. In large part the reason for this is that the base on which the sales tax is collected has continued to decline over time. When it was imposed at the 2 percent rate you were taxing a much more significant percentage of your overall economy, and therefore it brought significantly more revenue than it would now if you were imposing that same rate. You can see that happen as the base continues to be eroded just by changes in consumer preferences, moving more and more toward services and untaxed goods. To have a rate that brings in the same amount of revenue it would have to continue to rise.

Nevada does have an average state and local sales tax rate of 7.94 percent as a weighted average. It is the thirteenth highest in the United States, but fairly competitive with regional neighbors. It is lower than California and Arizona, and a little higher than Utah. The challenge is not just the rate. It is what it is on and where the rate might be headed if there is not some course correction.

In 1988 the Urban Institute and Price Waterhouse were commissioned by the Legislature to take a look at the tax system. They produced a substantial book [*Fiscal Affairs of State and Local Governments in Nevada* (November 1988)], which we reviewed in the course of our research. It contains many great suggestions and good resources, but one thing that really stuck out to us was the quote (page 22, [Exhibit D](#)), "What Nevadans have now...is a sales tax...still has embedded in it many of the problems of 1956."

I am going to go further and talk about why sales taxes look like they do, because we agree that the sales tax in Nevada has not changed much since 1956. The rate has gotten higher. You have added more complexity, but many of the issues have not changed. Arguably it goes back further, into the 1930s. The first sales tax imposed in this nation was in Mississippi in 1930. When Mississippi imposed this, tax collections were a more difficult task. You wanted to go for the greatest simplicity possible, and you wanted to reflect your economy. For simplicity's sake Mississippi's economy in 1930 was a very good one. It was based on agriculture and small retail. It makes sense, under those circumstances to, in effect, just tax the sale of goods, and that is what Mississippi did. Perhaps it worked in Mississippi in 1930. Of course, during the Great Depression many other states copied Mississippi. You had a proliferation of sales taxes across the nation, and most states simply borrowed from the states before them, so they borrowed from Mississippi or from another state that was borrowing from Mississippi. Nearly all states that adopted sales taxes did so almost exclusively on goods. This is a challenge, because the share of purchases that are goods-based rather than services-based has continued to decline.

This is one measure of implicit sales tax breadth (page 23, [Exhibit D](#)). This was put together by Professor John Mikesell at Indiana University, who is one of the nation's leading experts on sales taxation. It is an attempt to measure and quantify—on the basis of personal income—the breadth of the sales tax base in Nevada beginning in 1970 and going to roughly the present day. You can see that in the early 1970s that breadth was quite significant. It reached about 80 percent. I believe it is now down to 47 percent and will continue to decline.

This is a national chart (page 24, [Exhibit D](#)) that shows the change between goods and services. You can see that there is a secular decline in the share of goods in the economy since the mid-1940s. In fact, if you looked at the entire series, starting when the first sales tax was introduced and up to the present, the only reason there is any growth in goods in the early years was simply because of World War II. A need for military equipment and matériel changed that balance, but other than during World War II, we have had a decline every year in the share of goods versus the share of services in the economy. There is no reason to believe that will change any time soon.

So why does this matter? First, because if you are taxing a smaller number of items, then your rate has to be higher to make up for it. Second, because rates can only be increased so far. You still have to remain regionally competitive. You still have to take into account the political considerations. At some point states really do have to look at service expansion, and a number of states are doing that. Every state, of course, has a different mix. Three states have very

significant taxation of services. Several other states are currently looking at options to expand significantly to services. Illinois is looking at that very closely right now, as is Maine. A number of other states are looking at substantial expansion to services.

The question is how can a state do a sales tax base the right way? If you brought into this room a group of public finance scholars, they would tell you that ideally you want the tax to be on goods and services purchased by final consumers. You do not want the tax on business inputs, because those tend to pyramid. This creates a circumstance where the same good or service can be taxed multiple times along the production process as different inputs are brought in, bringing an inequity within those rates that ultimately gets passed along to the consumer.

No state perfectly addresses tax pyramiding. I will give you an example on what tax pyramiding can look like, because I think it is valuable to talk a little about this. I come from Virginia, and in Virginia there has been a huge growth in the microbrewery industry. There are different ways that different companies in this industry handle their production process. Some of them have grown a little larger and they do most things in-house. They buy the barley and hops, they brew it themselves, bottle it themselves, label it themselves, do their own advertising, do their own books, and then they sell it. If you have a tax that applies to business inputs, they are not hurt that badly because they have done most things in-house, and there were not a lot of transactions along the way. If, however, they have a competitor that brews their own beer but pays someone else to bottle it, pays someone else to print the label, has a separate accountant, and has marketing done outside, then each of those components—each part of that production chain—is taxed individually, and of course that pyramids and you have a much higher effective tax rate on essentially the same product. When you are picking winners and losers, you are changing the way businesses make decisions. Now a business is not going to make decisions based on what is the most economically efficient way to produce their product, they are going to make decisions based on the tax structure and how a particular production chain would be penalized by that process. So we encourage you to attempt, to the greatest degree possible, to avoid tax pyramiding.

The table on page 29 ([Exhibit D](#)) is a graph of total sales tax collections over time. You can see the recession and how the different components are stratified.

I also want to talk a little about the LET, and then go to some recommendations on the sales tax. Most of you are well aware of the challenges of the LET.

I know it is something this Committee and the Assembly has taken up previously, trying to look at ways of correcting some of the problems with the LET. The tax is imposed on any facility with 200 or more seats where entertainment is provided and admission is charged. It is paid on admission, food, beverages, and merchandise. The rate varies based on maximum occupancy.

There are a lot of issues here. One is its very complicated and arbitrary definition. I am sure all of you have looked at this. You have seen the pages worth of lists of what sort of behaviors are and are not subject to tax. You know that things seemingly as arbitrary and capricious as whether you are on the bandstand as a performer or you grab the remote microphone or wireless microphone and are wandering around makes a difference on whether or not something is subject to tax. Decibel levels can make a difference. Tables that are too far away to hear the music effectively are not subject to tax. I doubt many consumers walking in know whether they are going to a table that is going to be taxed or a table that is not subject to tax. There are hundreds of other examples one could give. There is confusing compliance because of this. There is duplicative administration because it is jointly administered by two departments, and it is riddled with these exemptions. I know Assemblywoman Kirkpatrick and others have looked into ways of addressing this. It is something that we think does need to be tackled in some way.

The LET was a tax that replaced a prior casino entertainment tax. You can see on page 33 ([Exhibit D](#)) the growth of collections over time. What is significant is that it represents only 1.5 percent of state and local tax collection. Of course this is significant, and I do not want to underplay 1.5 percent of your tax collections, but it is a very complicated tax and that is a relatively small portion of your overall tax structure.

With that in mind, here are some possible solutions on sales tax and LET. One, we would recommend that this Committee and the Assembly look into the possibility of expanding the sales tax base to include certain final consumer services. In the book that you have ([Exhibit C](#)), and through the resources we have provided, we give some menus of options. These are examples. You may want to go a different way, but we show some of the basic categories and give you a small, medium, and large option on what expansion could look like. We break that down by components, so that if the Assembly had a different model in mind, this could be a baseline for that calculation, for understanding what the revenue options are with each of those. We recommend that as you do that and grow the base, you consider the opportunity to both lower the state-levied rate—bring down the rate—and to look at additional revenue collection within that, because I know revenue adequacy is certainly a concern

this Legislature has. We also talk about the possibility of exempting manufacturing machinery from the sales tax base.

Nevada is one of only nine states that applies a sales tax to manufacturing machinery. This has been a big deal recently. This was \$900 million of the \$1.5 billion tax abatement in the package given to Tesla, but that is the Tesla deal. The question is, where is the deal for every other taxpayer, because this is really a tax on capital. It is a tax on growing a business. If you are a manufacturer looking at moving to Nevada, this is an impediment that there is a sales tax on manufacturing machinery. None of your neighbors have this. Forty-one states do not have this. I think this is holding Nevada back. There is an opportunity, it is a fairly small component to the tax system, to look at reforming this within the sales tax system. Then we would recommend looking at repealing the LET and applying the sales tax to admission charges, essentially trying to bring the LET into the sales tax base. Right now you have a situation where some things are double-taxed and some things are not taxed at all. There are huge exemptions in the LET. NASCAR is not taxed. Burning Man and the Electric Daisy Carnival are not taxed. There is an opportunity to consolidate these taxes moving forward, to make collections much easier, and make this a more stable system, a more predictable transparent one.

In the book ([Exhibit C](#)) we give some revenue charts. You can see what the different expansion options would look like. The large expansion option is the "kitchen sink" package. We are not making recommendation as to do you go small or do you go large; we wanted to make sure the Committee was aware of the range. If you taxed all final consumer purchases, what would that look like? It is about \$2 billion in additional revenue per year, less some deductions to avoid taxing business inputs. If you want to go with smaller ones, we provided the options and also looked at how the Legislature might go about constructing those taxes. We recommend using triggers, so you ensure revenue adequacy. Essentially that means you have the sales tax expansion and when revenue reaches a threshold the Legislature sets, the first rate reduction would take place. If, in a subsequent year, you reached the next trigger point, a higher revenue collection, the rate would continue to decline to the target the Assembly sets. This would ensure that you have the revenue going forward, that there is not a question. Then they want to ask, what is the certainty on revenue collection? We have numbers you can take a look at, but you can establish this quite firmly by saying the rate reductions only happen when we reach those thresholds.

Regarding business taxes, Nevada's business tax structure has a lot of potential, but we think there are several opportunities for reform. When we did our interviews we were surprised at how positively people spoke of the

modified business tax (MBT). It is levied on all businesses and persons in the state that are required to pay the unemployment insurance (UI) tax. It has two separate rates, 1.17 percent for general businesses and a bifurcated 2 percent rate for financial institutions. It is collected quarterly. There is an \$85,000 exemption for general businesses, with other deductions for health benefits. What people liked about this tax is that it is simple and it is predictable. You can practically do it on the back of a napkin. If you know your payroll you know your MBT liability. There is a lot to be said for that in taxation, because you cannot say that about corporate income tax in other states. You cannot say that about most taxes, where there is a lot of complexity, a lot of moving parts. The MBT is very simple, very predictable, and I will show that it is also a very stable source of revenue in a state that does not have a lot of highly stable revenue sources.

We do think there is potential for a few tweaks to the MBT, because there are some issues. It is inequitable and non-neutral inasmuch as there are the two separate rates. Financial institutions are singled out currently. Ideally the tax could be more broadly based, it could be more equitably structured. It is narrow. The base is not as broad as it could be because there was, a few years back, an \$85,000 per quarter exemption put in, which accounts for almost 80 percent of businesses that are not paying the MBT currently. That exemption applies to all businesses, but any business that has less than \$85,000 in quarterly payroll is not paying the MBT at all. The tax structure has worsened over time. The general business rate has risen, while the base has gotten smaller.

What we are looking at on page 44 ([Exhibit D](#)) is MBT collections. I really want to draw your attention to the recession, because it is actually a little hard to see, at least compared with any other tax collection chart that you might have seen. You can see a dip, but it is not that substantial. That is remarkable stability during a very deep recession, when you experienced significant volatility on collections of every other tax. That really is an oasis of stability we think is important to Nevada's tax structure.

There is the bank excise tax—the bank branch tax—which is again singling out a particular industry. It is non-neutral. It singles out brick-and-mortar banks in Nevada. It penalizes them compared with online banks, banks outside of Nevada, and it really raises next to no revenue. It is \$3.05 million per year. I do not have an estimate on what collection costs are, but it is a good guess collection costs are eating up a pretty significant portion of the \$3.05 million tax on this particular industry.

On page 46 ([Exhibit D](#)) is a pie chart of the different elements of state and local tax revenue. We do not put the bank branch excise fees on there because we cannot make this large enough to show a \$3 million revenue collection source.

Then there is the business license fee, \$200 per year paid annually. It is higher than most states, but has not been a significant impediment to Nevada as far as we can tell. This is in large part because Nevada does have a tax structure that is very attractive to businesses. Businesses like to locate in Nevada. You have overall low taxes. I think there is a lot of opportunity here. This license fee has not been a significant impediment to business growth here. Revenue is likely to maintain an upward trajectory because business filings continue to rise over time.

We looked at solutions to some of the issues facing business taxes. We would recommend repealing the separate MBT rate for financial institutions, and then potentially changing the general business rate, and there are some options here. I will talk about that in just a moment, because we also look at repealing the exemption. If you had repealed that \$85,000 quarterly exemption last year, that alone was worth \$84 million, which is fairly substantial for just that exemption.

That gives you some options. If you repealed the exemption to broaden the base and kept the current 1.17 percent rate, you would have an additional \$84 million per annum. If you wanted to be revenue neutral, a 1 percent rate gets you about revenue neutral. If you brought everyone up to the 2 percent rate, you would actually garner an additional \$408 million per year through the MBT. You could also do a graduated rate structure. There would be a number of options here. I know as this body has looked at opportunities for some revenue, this could be a substantial part of that. In fact, \$408 million goes well above what has been largely discussed as the current revenue needs. Again, that is in the annual figure, so some portion of that, either a loan or combined with other reform options, provides an opportunity to address some of those revenue adequacy concerns.

The bank branch excise tax, as I said, is only \$3 million, and we would recommend repealing that. We looked at a limited option with business license fees, creating a graduated fee structure, where it was \$300 if you had 20 or more employees, \$400 if you had 100 or more employees. That does not create a whole lot of revenue. We estimated \$14 million based on that. The challenge, if you change the business license fees too dramatically and turn it into more of a tax, is that at some juncture it could have an impact on businesses that choose to locate in Nevada and the number of incorporations. I know there are other proposals being floated. I know a member of this

Committee has looked at other options for that, and that can certainly be part of the discussion as well.

Joseph Henchman:

I almost had to relearn how property taxes work for the books we did for Nevada, just because it is so different from so many other states. In the course of the conversations we had with local governments, there was an adequacy issue, and even a stability and predictability issue.

I will start by talking about how property taxes work generally. If you were ever as unfortunate as I and had to take a public finance class and study this in depth, you know there are a lot of terms here (page 55, [Exhibit D](#)) that are par for the course for us but can confuse others, so I want to take a moment and walk through this chart.

In most states you start with market value. You buy a house, it is the price you paid, or if you have kept your house for a while and the value goes up, it is adjusted. Assessors come around and they adjust the value they are attributing to your house. You multiply that by an assessment percentage. In most states that is 100 percent, so you are taxing based on the market value. In Nevada you will see it is 35 percent, which by itself does not add a lot of complexity, but is another unique feature of Nevada's system. That will get you the taxable value. Multiply the taxable value by the property tax rate. In our example here (page 55, [Exhibit D](#)) we kept it simple, at just a 1 percent tax rate, and that gets you your liability of \$2,000. After that you subtract any abatements or credits that you might be eligible for, whether that be a homeowner credit, an old age credit, a veteran's credit, or whatever it happens to be, and that gets you what you owe. If you divide what you owe by your market value, that equals the effective tax rate for the jurisdiction.

There are ways Nevada departs from how property taxes typically work. First, Nevada does not assess based on market value, but rather on the replacement cost method.

There is also a depreciation allowance. Nevada is the only state in the country that has a depreciation allowance for property tax.

This is an example Applied Analysis put together (page 58, [Exhibit D](#)). It is in one of their publications, but we thought it was very apt because it illustrates this well. This shows two homes, one in Reno and one in Sparks, not too far away from each other. They both sold for \$200,000. These homes, you will notice, are very different though. One is a large home, on a large lot, and the other is a small home, on a small lot. Not only are they paying dramatically

different property taxes, it is the opposite of what you would think it should be. You would think if they are paying different property taxes the larger home would be paying more, even though they sold for the same price, but here it is the opposite due to the interplay of different factors.

There are other issues. There is the ability of nonresidential property owners to appeal different value methods to get the most beneficial. I know one of the newspapers found an example of a property on the Strip that is obviously worth millions of dollars, but is paying almost zero property tax because they are able to take advantage of this. This is something residential homeowners cannot take advantage of.

Some features of Nevada's property tax system include that the overall rate is constitutionally capped at \$5.00 per \$100 of value, and the statutory cap is \$3.64, so you are not anywhere close to the constitutional cap. There are multiple layers. It is always good to note, as in sales tax, that this is not just a tax that goes to one entity. A lot of different governmental jurisdictions depend on property tax, just as they depend on sales tax. So you have the portion going to the state, the portion going to schools, the portion going to counties, and so forth.

You have a property tax cap. This came in 2005, and as Carole Vilaro always reminds me, it was in the form of an abatement. It is not strictly a cap, as written in the *Nevada Constitution* and in statutes. It is not hard to understand why this came about. You were all here at the time of the quickly rising property values. In the run-up to the crash there was a desire to limit this growth in terms of how it appeared on people's property tax bills, so people were not thrown out of their homes because they could not afford their property tax after it went up 8 to 20 percent in one year.

There were unanticipated consequences associated with this though. As the cap is structured, residential property cannot increase more than 3 percent and nonresidential property cannot increase more than 8 percent. In the book ([Exhibit C](#)) we go into more detail on how those are not really 3 percent and 8 percent. There is some wiggle room there in terms of where they are in the state and what type of property it is. That is beyond what we really need to go into here, but generally there is a cap and it is in the form of a split roll.

One of the unanticipated consequences is that the tax cap has created a ratchet effect that I am sure people who are familiar with local government and finance are aware of. Property taxes were going up and up in the boom. Then the bust happened and property values came down. The cap, which had previously been rising with the assessments and was what was keeping them from growing too

fast, did not stay up here when property values plummeted. Instead the cap fell with the values. So now, as assessments recover, they are limited at the lower, ratcheted-down cap level.

Page 66 ([Exhibit D](#)) has a much neater representation of what I just described. The blue line, the lower line, is what you see currently. As property values begin to recover, eventually they are going to get back to where they were before the crash, but because they are now limited by the cap, property tax bills are going to take about 20 years to get back to where they were, even though property values will recover in just under 7 years. The green line is where property values are recovering. The blue line is where the tax revenues will recover. During that time, local governments are expected to continue providing the same level of services they were before the recession, only with dramatically fewer resources from the property tax.

Page 63 ([Exhibit D](#)) shows the collections over time. You can see the drop in revenue during the recession, which amounted to about \$1 billion annually just for the property tax.

I would say that this system is complicated and difficult to understand. We have talked to a number of Nevada taxpayers, and we have yet to find one that can articulate how their property tax is calculated. There are a lot of smart people in this room, and I am sure you all understand how property tax is calculated, but it is certainly a system that is counterintuitive in a lot of ways. It involves a lot of factors that do not exist in other places.

We lay out some solution options in the book ([Exhibit C](#)) that are essentially ways to get Nevada's tax system to resemble the property tax systems of other states that work very well. One is changing the assessment method from replacement cost, which is hard to understand on a conceptual basis, to market value. Then, when property changes hands, that is the assessed value, and if property stays in one individual's hands for a while you can assess it every three years, which is the standard, and then adjust the assessment accordingly.

Another option that we talk about in the book ([Exhibit C](#)) is adjusting and reforming the caps. Aside from the downward ratchet effect, another issue with the property tax caps, which we heard about from a lot of people, is that it is potentially unconstitutional under the state's uniformity clause—having the 3 percent for some properties and the 8 percent for other properties, when the state requires that all property taxes be uniform under the *Nevada Constitution*. We suggest collapsing that back to one system, whether it be 3 percent or 8 percent, that works for everyone.

The third option is, if the concern is about low-income or elderly people getting thrown out of their homes because they cannot afford their property taxes because they are going up too much, then design a program to specifically solve that problem, rather than trying to encompass the entire state property-owning population into a system that it is not really designed for. That is known as a circuit breaker. Nevada actually had a circuit breaker before the caps were enacted in 2005. This is something other states do—a system where property taxes for this select population cannot be more than a certain percentage of their income—and whether that property tax is forgiven or is taken off as a tax lien when the property is next sold, there are a lot of different options for doing that.

There are other issues that we came across that do not fall into these three major categories of sales tax, business tax, and property tax, and they get some discussion at the end of the book ([Exhibit C](#)). I will go over some of them very briefly.

The prepayment of the net proceeds of minerals tax came about a couple years ago when a decision was made to have the mining industry essentially pay two years of taxes in one year. That helped the state in an immediate cash crunch at the time, but it has now thrown off the sync of each year's tax collections. When something happens like the price of gold dropping as has happened this year, rather than that being prospectively in and being able to plan for it, it happens after you have already committed to spend the revenue and you have to scramble to cover a shortfall. Solving this is both easy and hard. The solution is very easy. You have to go one year without relying on this tax revenue source, and then get the clock synced back up. Of course that is very hard, because that is revenue that you need for your budget.

Beware of false tax reform. Mr. Walczak addressed a bit of this at the beginning. There is a tendency, which we have seen in reviewing the history of Nevada taxes and talking with a lot of people who have been around for a long time, toward thinking "we do not need to fix what we have, we just need to find something out there that we can tax, we can get, or we can model, that would layer on top of it, and that will solve our immediate short term problems." This can solve short-term problems, but at the expense of the long term system of designing a tax system that can encourage economic growth, consistency, and stability, both for taxpayers and administrators.

Education funding of course is a major topic for this legislative session. We have briefly discussed that and how some other states do it, since I know it is of interest.

Federal land issues may not even be something that the Legislature can do anything about, but obviously the percentage of the state that is owned by the federal government is a restraint on your ability to prosper and succeed. Many states do not have a similar restraint.

That concludes our presentation. Before we open up for questions, I wanted to again thank you all for this opportunity today, and I especially want to thank two people who are not here right now. As I mentioned, Carole Vilaro was very open to us and walked us through what was done in 1988 and in past years. That really helped us get a good understanding of the broader framework of things. Assemblywoman Kirkpatrick was very thoughtful in taking us through a lot of the issues she has identified with the LET, and with the system in general. We would not have been able to understand the LET without that.

Chairman Armstrong:

I am sure that a lot of us have that same sentiment regarding Ms. Vilaro and Assemblywoman Kirkpatrick.

At this point we are going to open it up for questions, but in my attempt to try to move us forward we are going to organize the questions into four different groups. The first group will be for sales tax and LET, the second group for business taxes, the third for property taxes, and the fourth will be for general questions.

Assemblyman Hickey:

This question is for Mr. Walczak, since he covered that part. In looking at the LET, for example, you suggested a way of simplifying it would be to put it in the sales tax category. Have you looked at sales taxes in Nevada that are somewhat unique, because according to figure 20 on page 23 (of the book), 37.3 percent of taxes collected in Nevada currently are sales taxes. When you look at the North American Industry Classification System (NAICS) survey (page 3, [Exhibit E](#)), the highest category of taxes collected in Nevada are from food services and drinking places. Over \$10 billion a year in sales taxes are collected, which represents over 22 percent, so of that 37 percent, 22 percent actually comes from live entertainment or the hospitality gaming industry, so that is an exceptionally high portion. Our sales taxes do not necessarily fit your paradigm that everything is moving in the way of services, unless you call all of those things services. So I guess maybe the question is, are those services as well? Looking at sales taxes, that is a pretty big chunk. I know later on you are going to talk about possibly lowering sales tax, to make it revenue neutral if taxes on services go up, but given that it is such a large portion in Nevada, should we seriously consider lowering sales tax, when it brings so much in, especially from our hospitality sector?

Jared Walczak:

First, the bifurcation, when we look at goods and services, it does account for that. Nevada's service orientation is notwithstanding the fact that you do have a lot that is going into the sales tax through what is being provided in the entertainment and hospitality industry; you are seeing these percentages even with that. Certainly it is a very significant part of your overall sales tax collections, but it is addressed in the numbers we have. If you were going to repeal the LET outright, you are looking at \$152 million per year, so it is not anywhere near the size of the sales tax collections that are related to the entertainment industry. What we see with the LET is that some things are being double-taxed, and then there are a lot of elements that are not taxed at all, so there is an opportunity to simplify that. You are not foregoing all of the revenue with the LET, because a lot of it is not currently subject to tax.

Nevada is unique in the entertainment industry mix of goods and services that it has. When we provide the percentages and the revenue tables they are taking that into account. When we say, if you expanded it by a certain amount and brought down the rate, it is not neglecting the impact of gaming and hospitality within that.

Joseph Henschman:

To add to that, I think the majority of the activity you identified—the sales, food, drink, and entertainment tickets—we categorize as goods, not as services. It falls under the goods category of our analysis and just shows how large services are in Nevada. There is such a huge percentage—even with all the activity happening on the Strip that most outsiders identify as Nevada—that is falling under the goods category. I think that illustrates some of what we are talking about, which is how vital services are to Nevada's economy, notwithstanding the fact that you have a system that relies so heavily on gaming and the activities happening in and around casinos.

Assemblyman Hickey:

Would you comment on how regressive sales taxes are in Nevada? As you know we are one of the states that does exempt groceries and medical prescriptions, so I think that keeps us away from being as regressive as some other states with respect to a sales tax. Would you comment on how we rank in that area?

Joseph Henschman:

Regressivity itself is very difficult to measure, because there is no real established definition of it. It is one that you know when you see it. There are some organizations that try to look at it. Probably the most common method for evaluating regressivity is you take a taxpayer, or a set of taxpayers, and put

them in all 50 states. You identify how much of their income they spend on a particular tax. Aside from the federal income tax, all tax systems are regressive to some degree, in that a person with a very low income—below the poverty level, is going to pay a larger percentage of their income on that tax than would a person with a higher income. That said, the federal income tax is very progressive, to the point that it actually makes the overall government pie in the United States progressive as a whole. So, if the concern is what the overall regressivity is state to state, generally the federal income tax, just because it is a huge amount of revenue, overwhelms anything a state can do in terms of regressivity.

You did ask about state-to-state things, so I want to address that point. I think all but ten states exempt groceries from their sales tax, and Nevada is one that does exempt them, but even that is a mixed picture on how it affects regressivity. A low-income person can go into McDonald's and will pay a prepared food tax, whereas a wealthy person, going to Whole Foods to buy arugula, will be exempt from sales tax, and that is obviously not helping the regressivity picture.

I would say similar things with states that exempt clothing from the sales tax, as some states do, and other measures. Probably the approach that works better than trying to use the blunt instrument of sales tax exemptions to affect regressivity is to target it specifically for those individuals, either in the form of an earned income tax credit, which a number of states do, or even a grocery tax credit. Or address it on the spending side where most federal and state activity designed to address poverty happens, rather than using the tax code for something that it is really not intended for, which is kind of addressing a broader inequality in society. It is not the perfect instrument for that, and it leads to a lot of unintended consequences.

Assemblyman Kirner:

My question has to do with pyramiding. I was trying to appreciate what you had to say, given the way I think it is today. I come out of a company that manufactures slot machines. In a slot machine you have electronics, you have the box, you have plastics, and so forth. We sourced that out all over the country, and some locally. We paid sales tax on everything, so in effect would you say what we were doing was pyramiding?

Jared Walczak:

Yes.

Assemblyman Kirner:

I was trying to follow your solution and how it would work. Maybe you could explain it again for me? How would pyramiding, or a lack of pyramiding, work in a situation where you are sourcing components from around the world?

Jared Walczak:

There is, as you noted, pyramiding taking place within the existing tax structures to a significant degree. In an ideal tax structure, we would argue that should not be the case, and to the degree that Nevada can move away from it, that would be an excellent thing to do. We recognize that it is very difficult to address some of those issues within the existing base, simply because of the rate changes that would be necessary to do that, but at the very least what we are suggesting is that if the state would move forward with an expansion to services, where you could see significantly more of this, there would be some way to address this.

There are a couple of different ways you can do this. The goal is to make sure that those business inputs are not taxed individually, and that the tax is on the final transaction. So when you sell that slot machine there would be a sales tax on it, but when you buy all the component parts there is not an individual sales tax on each one, because this changes the structure of how business would operate. It encourages vertical integration. If a larger business says we can manufacture more of this in-house, even if it is not efficient to do so on a general economic measure, it might become artificially economically efficient to bring it in-house, simply because they are not paying the sales tax at every stage in the process. A business that can vertically integrate is tax-advantaged versus one that is unable to do so for whatever reason. You are creating economic deadweight loss there because there are now transactions taking place in a different manner, not for any economic reason, but simply to address tax liability questions.

There are a couple of ways this can be addressed. Many states provide some sort of tracking system for sales tax and other taxes, with a number or a card for nonprofits, so that a nonprofit is not paying sales tax. For a business that is paying unemployment insurance taxes, or paying the MBT, you could set parameters to make purchase of either select goods or any goods or services, so those business inputs are exempt from the sales tax. You could effectively use a tracking system for that. The other way that this could be approached is to identify, based on NAICS codes, purchases that are exclusively business-to-business transactions. Some services are only going to be used by businesses as part of the business process, some of them can go either way depending on who the purchaser is, and some are exclusively consumer goods. It is possible, at least if you are doing service expansion, to not exempt

categories that are exclusively business input, so as not to further aggravate the existing pyramiding in the system.

Assemblyman Kirner:

I am still having trouble visualizing how that might be accomplished when you are sourcing from literally around the world, other states, and so forth. Other states will charge you the sales tax. It is very difficult to say to Indiana, we do not want to pay your sales tax because we are going to put this in our machine.

Jared Walczak:

Yes sir, certainly, speaking to what Nevada can do, but understanding that if you were to purchase out of state, there are those sales tax components, and of course you also have a use tax requirement, so it still benefits you. If you are purchasing out of state you are required to remit a use tax, so if it is exempt here in Nevada—if there was an expansion of the services and a particular classification of service is exempt because it is clearly a business input—you at least would not owe the use tax here. Nevada cannot impose on another state that does not have that more enlightened policy and may choose to tax you.

Assemblyman Kirner:

With services, such as painting a house, you have to buy the raw materials used—the paint—you are going to pay the tax on the paint. Then if there is a service tax, you are going to charge your customer that service tax for painting the house. This pyramiding concept is interesting. Is there an example of where it works really well?

Jared Walczak:

I am not entirely sure that I am following the question. We argue that you want to avoid pyramiding to the greatest degree possible. Sometimes it is not possible to eliminate all pyramiding, and it may not be politically, or in terms of the budget, possible to eliminate everything that happens under the existing system. We are not arguing that pyramiding ever works well, if that was your question. We would argue that if you are looking at expanding the base, you want to avoid creating more opportunity for pyramiding within that expansion by exempting those categories. I apologize if I have misunderstood the question.

Assemblyman Kirner:

I appreciate the fact that avoiding pyramiding is a recommendation you have. I am just wondering what state is that working well in?

Joseph Henschman:

No state does it perfectly, and I will be up front in admitting that. I would isolate Indiana and Utah as states that do it better than others.

As Mr. Walczak mentioned, there are two ways to skin this cat. One is to design the system so that only final purchases are taxed and inputs are not. There would be some hazy areas, such as the farmer who buys the ATV to check on his cattle, and then his son uses it to drive into town. Is that a business input or is that a personal purchase? You are always going to have iffy categories like that. The other approach is through how you define every good and service in the tax code and what is taxable and what is not. The ones that are predominantly or exclusively business inputs would be excluded from taxation.

For instance, I know the Assembly has aircraft parts under consideration. That is a business input. Nobody is really buying aircraft parts for personal use at their home. That is exclusively a business input, so it can be put in that category, through the tax code, from the beginning. Indiana and Utah pretty much take the latter route, especially Utah, where they are going through the code and identifying things that are exempted for that reason. Indiana actually has a rather vibrant blanket exemption for business inputs, so if you are a business owner and you say, "I am paying sales tax when I sell this, it is a component, I should not pay sales tax on the pieces as I am buying them," Indiana Department of Revenue (DOR) will let you do that, and they have some rules associated with doing that and making payment.

Assemblyman Trowbridge:

One of your first comments was that one of the basic principles of tax policy is simplicity. I would certainly agree with that.

I also need to confess a personal bias against any taxes, because they always have a way of growing. We might drop one and raise another, or drop one to justify creating another, but eventually they both go up. That might be the case when we have the sales and services taxes that we are talking about, because part of the sales tax is that they are going to be revenue neutral. If it is revenue-neutral, why bother to do it. I question revenue-neutral because there are going to be administrative costs associated with the collection of sales taxes. Are we seriously talking about hiring a bunch of sales tax collectors that are going to follow anybody with a pickup truck, with a lawnmower, or a ladder, or a brush in the back? Are we going to follow tip workers or cash workers to make sure they pay their services taxes? I see a horrendous bureaucracy and a tremendous opportunity for just out-and-out fraud. We are making criminals out of people who are now going to be paying their taxes via

sales tax when they consume. Everybody pays the consumption tax, which is sales tax, so that gets us to the point that we are not talking about chasing around people with pickup trucks or tip workers. Now we are talking about exemptions and abatements. How are those going to be manipulated while we still maintain our principle of simplicity?

Joseph Henschman:

I completely sympathize with that question, and I share a lot of the concerns that you raise. My response includes two categories: stability and fairness. The sales tax base is declining over time. You saw that in the charts; this is just because we are moving away from a goods-based economy to a services-based economy. It is one that Nevada has embraced more than a lot of other states have. Services are a huge part of Nevada's economy, and they are going to continue to grow as a percentage of that economy. What happens to the adequacy of the sales tax as that happens, if it remains just a tax on goods? Either you fix the sales tax so it grows with the economy, or you are going to have to rely on other tax revenue sources. Most economists will say that if you have a choice between a tax on consumption and a tax on production, you should try to rely on the tax on consumption. That has less of a negative effect on economic growth and job creation. I guess that is a fair question. If you want the sales tax to remain a vital part of the revenue picture, as Assemblyman Hickey pointed out, if you want it to continue producing revenue and you do not want to have to rely on other taxes to make up that gap, what do you do to make sure the sales tax remains vibrant. This is one of the things to look at.

The other point would be fairness. I am a lawyer by training, and in most states the services I provide to consumers such as writing wills or drafting contracts are not subject to sales tax. I think it is a little strange that what I do is not subject to tax. I do not have to collect tax on it and I am not taxed on it, whereas the guy who owns a convenience store or owns the food cart or is selling stuff from a table on the street has to collect sales tax on everything they sell. I think that is a fair equity issue that a lot of people raise. There is no easy road map to implement this, and you are absolutely right to be cautious about it and understand that it is something that would need to be done over a period of time, and maybe even only as other states also do it. We talk about that in the book ([Exhibit C](#)), but we wanted to make sure that you are aware, and the Legislature is aware, that the vibrancy of the sales tax and its ability to provide revenue year in and year out is in danger, because it is not growing with the state's economy. I think this is something that a lot of legislators have put their finger on—that overall you have a tax code that is not growing with the economy and has been creating problems.

Assemblywoman Neal:

You made a statement to Assemblyman Kirner about pyramiding, and when he asked the question the first thing that came to my mind was that if you are going to tax the final transaction what the required rate would be, because it would have to be proportional, or would it be a flat rate to each business that fell within a particular industry? We have, as you noted in your report, very limited industry. How would you deal with the final transaction and what would that rate be, because clearly it would have to be flat?

Jared Walczak:

We are looking at this as the sales tax, which is a flat rate tax. It is currently 6.85 percent on all transactions that it covers, and that would remain the same. The rate could be brought down if you expanded to include services. How much it could decline would depend on how significant the expansion was and the degree to which, if any, the Assembly wished to capture a portion of that revenue to address budgetary issues. To provide an example, if you taxed all services at the final level, you would bring in about \$2 billion. I think the abatement is about \$600 million if you take out all of the input, so you are looking at about \$1.4 billion additional that you would bring in if you taxed all final transactions, added all the services, without lowering the rate.

We wanted to provide you with what it is on either side. So if you added everything to the base except business inputs, at the current rate of 6.85 percent that is approximately \$1.4 billion. That would give you the opportunity to lower the rate and perhaps capture some revenue. If you wanted to be revenue neutral on that, you could bring it down below 5 percent, I think significantly below. If you wanted to capture portions of it, you would have a differential rate.

Assemblywoman Neal:

With a couple of statements in the book, I was really trying to get an idea of your philosophy and where you are coming from. You stated that in order to do tax reform you must study the way a tax behaves in and out of a recession, so I started reading through the book, trying to see how you examined that principle. On page 26 (of the book), when you talk about reform option B, I was trying to figure out why you would want to exempt an industry, or all businesses, because I am assuming the manufacturing machinery is under LET.

Jared Walczak:

It is not under LET, but it is part of the sales tax.

Assemblywoman Neal:

It is in that section. So some of the manufacturing machinery is gaming technology, right? When I looked it up, that is what came up.

Jared Walczak:

Yes.

Assemblywoman Neal:

I started thinking about that as a growing and improving area, and you want to exempt businesses. You made the statement "provide an exemption from the sales tax for all business input goods and services." What do you do with an industry that is built on the goods that it produces and the services it produces for consumers? Is that an effective policy for gaming? Does it open a door where there is nothing that you are capturing with that individual industry or that group of industries? Generally you build a tax revenue, or the government looks at the tax revenue, based on the market economy. If that is a particular area that is growing and doing well, why would I want hands off on it?

Joseph Henschman:

The theory behind the sales tax is that you are taxing what individual consumers are buying in the marketplace, whether it be goods or services. If there is a product that has no individual consumers buying it, then the way to tax it is not under the sales tax, but under some other form of tax. You tackle that revenue some other way, whether it be the gaming gross receipts tax, the MBT, property taxes on those businesses, et cetera. If there is a business in Nevada that is producing goods they are not selling to consumers, and if the idea behind the sales tax is that we are taxing what consumers are buying, then, no, it would not be taxed under the sales tax. Maybe that is not the outcome that you want. Maybe you do want to make sure that businesses that are selling to consumers still have to pay sales tax, but the danger you get into there is for those businesses that are selling to consumers, if they have to pay both taxes, they are getting double-taxed, and that puts them at a competitive disadvantage to other businesses.

Assemblywoman Neal:

But there are business-to-business transactions that fall within the sales tax?

Joseph Henschman:

There are a lot of them.

Assemblywoman Neal:

On page 27 (of the book) you make the statement that, "Since each of the four taxes are applied to an identical tax base (the sale of tangible personal

property), together they operate as one combined-rate sales tax levied by the state." So I was trying to filter this, and you are the only person who can answer this statement. Do you see that as a flaw, and if it is a flaw within the system, then what is the other tangible stable product that those four sales tax components should be applied to if it is not the tangible personal property?

Joseph Henschman:

I also have trouble understanding it. On page 43 (of the book) we have a picture version, which I find much easier to follow. It shows the four taxes, graphically represented, that make up the overall sales tax.

Jared Walczak:

When we speak of the four, this is a complexity that is based entirely on constitutional and statutory restraints here in Nevada, from when the 2 percent sales tax was originally imposed. It was several years afterwards that it was affirmed by a vote of the people, and therefore it has a constitutional protection to it, so it could not be easily amended or changed. In subsequent years, when there was an effort to increase the rate of taxation, the legislature was unable to simply take that 2 percent rate and make it 3 percent or 4 percent—and ultimately 6.85 percent—but instead had to create a second parallel tax structure, taxing the exact same goods. So you have a 2 percent tax and then you have a local school support tax, a basic city-county relief tax, and a supplemental city-county relief tax. They are all taxing the same items, and it adds up to 6.85 percent. For simplicity's sake, for the consumer, the consumer just sees on the receipt 6.85 percent, or if you have a local additional tax, you see maybe 8.1 percent. They just see one line for sales tax, but it actually does include those four, sometimes five if you have a local tax. Different components are all a part of that rate. That creates complexity on the back end. It does not create a lot of complexity for the consumer. It is an artifact of some of the restraints that the Nevada Legislature has operated under.

In terms of the basket of what is taxed, your tangible personal property is your goods. We are not saying eliminate the tangible personal property—your goods basket. We are saying that you should also consider expanding beyond tangible personal property, to include certain categories of services.

Joseph Henschman:

It is an excellent question, and we actually had this in the slide show, but we took it out because it is so confusing to most people. If you are a consumer, or even a retailer, there is just the 6.85 percent state tax, plus local taxes. You do not know that the 6.85 percent is actually four different taxes that add up to 6.85 percent. Their genesis being, as Mr. Walczak pointed out, the fact that

the *Nevada Constitution* says you can only have a 2 percent sales tax, so you have had to create these other taxes to add to it.

Chairman Armstrong:

That leads me to an observation. If we actually did change the LET and put it under the sales tax umbrella, our state portion would drop down to 2 percent, instead of the 5 or 10 percent.

We have about 20 minutes left for questions so I am going to open it up for all questions.

Assemblywoman Kirkpatrick:

I apologize that I missed your presentation; I had to be somewhere else.

I want to make sure that the message is clear, because we are unique when we talk about services taxed. Our local governments are funded based on our sales tax. It is a big component of it. So when you did the estimates for the \$1.6 billion, all the way out, how much of that is actually the state portion, because I am concerned? I love to help local governments, but we have jobs to do at the state level as well, and that would be everything. I want to understand how that was calculated across?

Joseph Henschman:

The calculation is based on the 6.85 percent expanding and all of it going to the state. That is obviously flexible. You can divide the state and local portion. It also depends on how much you bring the rate down, as you broaden the base. The particular calculation you are referencing assumes the 6.85 is expanded to the state. It said nothing about the local add-on taxes on top of that. So, for instance, in Las Vegas the sales tax adds up to over 8 percent. That does not assume expansion of that local sales tax there, or any local sales taxes in Nevada.

Assemblywoman Kirkpatrick:

That helps clarify that.

The other piece would then be the process of putting it in place. We are not quite set up to do that, nor are the retailers, and there has to be a bridge. So in other states that have gone in this direction, how long did that take?

Joseph Henschman:

In terms of expansion to services, no state has done that comprehensively, so that would be trailblazing. A number of states have expanded to a smaller basket of services and the Federation of Tax Administrators has a list of about

180 different services and how many states tax each one. We can certainly provide that information to you. For those states it is often a date set in the future, when they will be subject to tax, with the goal being to establish all the regulations and collection administration prior to that date, in a way that everyone feels comfortable. If a state were to go the route of broad expansion to services, I would say to do a lot of that preparatory work in advance, and in fact the first step would be something the Governor has mentioned in his proposals, which is to at least ask businesses what you are spending on different services, because that will give you a baseline in understanding what is out there. Be slow and steady on this. When Texas adopted a tax expansion it was a three-year process, where the first year was data collection, the second year was preparing the regulations and administration, and the third year was enactment.

We would add, as Mr. Walczak mentioned earlier, that as the revenue comes in, you lower the rate, as opposed to committing yourself to what might be a revenue gap if the revenue does not materialize. All of this is flexible, and there are examples of how not to do it and how to do it out there.

Assemblyman Nelson:

I appreciate your comments about putting the LET under the sales tax. If we cannot get that done, if there is not the political will to do that, what about the other proposals of removing a lot of the exemptions? You discussed NASCAR, Burning Man, outdoor concerts, things like that. If we removed those exemptions, how much would that increase revenues?

Joseph Henschman:

I cannot give you an exact revenue estimate on that, because it would depend on exactly what parameters you are talking about. That might be a conversation we could have offline. What we see overall with the sales tax and LET is you have some people paying nothing, and you listed a couple of them. You have some people paying one or the other, and you have some people paying both. Aside from the complexity of administering that, complying with it, not knowing whether you are one or the other depending on some arbitrary factors, it is also a little unfair in my opinion. The best you can do is move to a system where people know when they owe and everybody is paying once rather than some people getting double-taxed and some people paying nothing; that is ideal. To the extent a proposal moves in that direction, I would say it is a good one.

Assemblywoman Bustamante Adams:

My question has to do with the MBT, and then the business license fees. In the MBT you made a statement that you interviewed businesses and they were generally pleased with the simplicity of the MBT and its calculation. In your interviews, did it include people who were not paying the MBT, those that were under the \$85,000 threshold, and how did they feel about it?

Jared Walczak:

We did have conversations with people not currently paying the MBT, and I know that the Chamber has had conversations with members that pay and do not pay. They have not made recommendations yet, but I think there have been discussions going on with people on both sides. I am confident that no business enjoys paying taxes. No one enjoys paying taxes. I think there was a fair degree of acceptance that it would be equitable and that it would be something that businesses could step up to the table with, especially potentially compared to taxes like the margin tax that was rejected. There was a lot of discussion we heard from individuals saying they had grave concerns about the margin tax last year, but they were willing to come to the table in some way, and for many of them I think the MBT was such an option. It is very simple to calculate. It is very predictable. It is stable. It has a lot, I think, that is appealing to businesses, and I think a lot of that could be appealing to this body as well.

Assemblywoman Bustamante Adams:

In your business license fee, I know that you stated Nevada is slightly higher. Is there any comparison on how other states deal with entities that have multiple locations within their state, like several Starbucks or several Domino's Pizza? How do they deal with various locations when it comes to business licenses? Do they pay a flat fee for each one? How does that work in other states, especially western states?

Joseph Henschman:

That is an excellent question, and one I actually do not know the answer to. I might have to dig around and report back on it.

We have an overall state by state comparison on page 58 (of the book). There is a chart there, but it does not address that particular question, which I will have to research.

Assemblyman Hickey:

I too wanted to ask about the MBT. Your prescription is to broaden our base. Obviously we have narrowed it with the exemptions we have given to the MBT, so broadening it seems to make it more equitable. You have talked about the

positives. What are the negatives to the MBT as you see it expanding, not just that those that are not paying it now are enjoying the exemptions and are going to resent paying it. What are some things that are not good about it, from a tax policy standpoint?

Joseph Henschman:

You took the main negative that I was going to list, which was obviously some people are not paying it now, and if you were to broaden it, at least theoretically, people who currently pay no taxes may not be very happy if they have to start paying taxes; however, we did not encounter a lot of that, as Mr. Walczak mentioned.

It does not take a lot to find problems with business taxes, but there are not a lot with the MBT. It is stable. It is much more stable than any other business taxes we have seen at the state level in the United States. It is fairly simple, and anybody who has talked to any corporate tax officer knows there are not a lot of state business taxes that are simple and easy to comply with. From the administrative perspective, I believe it is fairly easy to administer. Typical things we usually point out about state-level business taxes are not problems with the MBT, so I would struggle to find a serious problem with it.

Assemblyman Hickey:

Are there any other states where businesses do not pay any business taxes? In Nevada's case, we do not have any personal income tax, nor do we have corporate income tax, which is probably prohibited. So the argument that we ought to get rid of the MBT, or any business taxes, is not realistic in your view. I do not think in the modern era states can support themselves merely through sales taxes, even if they are extended to services. Is that true in your opinion?

Joseph Henschman:

I do not know whether it would be realistic or not. Certainly businesses in all 50 states pay taxes to some degree. The vast majority of states have a specific tax of some form on businesses. Of course, businesses pay property taxes, pay sales taxes on inputs as we discussed at length earlier, and pay a number of other taxes. If the question was, can you name a state where businesses pay no taxes? There is none.

Assemblywoman Benitez-Thompson:

My question is on page 56 (of the book), where you outline your figures for the proposed MBT tax reform solutions. You have the suggestion to tax all firms at a rate of 2 percent. Just for clarification, when you say tax all firms, do you mean that when I look back to the figure on page 53, with the industry sectors, all licensed businesses within that sector?

Jared Walczak:

Yes. What we are specifically referring to is the \$85,000 exemption that currently exists. Essentially the first \$340,000 of annual payroll is not subject to the MBT. A significant number of Nevada businesses have payroll annually under that threshold, and therefore are not paying the MBT. We are not talking about changing what constitutes a business, or anything of that nature. We are simply saying that our recommendation is that all businesses, regardless of the amount of payroll they have, be subject to the tax. Ideally this would be at a uniform level, not having that bifurcation of a 1.17 percent rate on most businesses and 2 percent on some.

Assemblywoman Benitez-Thompson:

Thank you for that clarification, because I was reading it differently.

My last is just a comment. I like that you mentioned an order of operations in which the state might progress in terms of addressing reforms, that the first step is not starting with exemptions, and then moving to broadening the base. It would be broadening the base first. You mentioned specifically data collection as one of those steps. I feel the state has been very diligent in data collection. We have numbers all over the place about taxes, who pays what, at what rate, and whole generations preceding this tax study of other tax studies, that beget more tax studies. I would say we are at the point of actually doing something more than just a study. I hope we are there.

Joseph Henschman:

One of the comments about this study in the press was that it does not offer anything new. I disagree with that, but I also find it comforting in a way, in that we are building on the work that has previously been done and a lot of these recommendations have been made in the past.

The comments on phasing it in are especially true for sales tax, but I would note that for MBT you already have everything in place for that, so if you wanted to make adjustments to the MBT, there is not necessarily anything holding you back administratively from doing it.

Chairman Armstrong:

Thank you Mr. Walczak and Mr. Henschman for your presentation. Mr. Moradkhan, do you have any final comments?

Paul Moradkhan:

Just to again thank you and the Committee for allowing the Tax Foundation to give their presentation and to share their findings with this body.

Chairman Armstrong:

With that we will close this presentation and we will open it up for public comment. Seeing none, we will close public comment. We are adjourned [at 3:10 p.m.].

RESPECTFULLY SUBMITTED:

Gina Hall
Committee Secretary

APPROVED BY:

Assemblyman Derek Armstrong, Chairman

DATE: _____

EXHIBITS

Committee Name: Committee on Taxation

Date: February 24, 2015

Time of Meeting: 1:32 p.m.

Bill	Exhibit	Witness / Agency	Description
	A		Agenda
	B		Attendance Roster
	C	Joseph Henschman, Tax Foundation	Simplifying Nevada's Taxes: A Framework for the Future, (book)
	D	Jared Walczak, Tax Foundation	PowerPoint Presentation
	E	Assemblyman Pat Hickey	Statewide Taxable Sales by NAICS