Section 7: Fiscal Recommendations

Governor's Task Force on Tax Policy in Nevada

November 15, 2002

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Fiscal Recommendations

Introduction

Assembly Concurrent Resolution 1 ("ACR 1") mandates that in its deliberations the Task Force "[f]ocus on broader tax policy issues, such as optimal tax rates and structural budgetary deficits, and consider ways to reduce budgetary reliance on volatile or cyclical revenue streams."[1] In addressing these important issues, ACR 1 requires the Task Force develop one or more definitive proposals to 1) carry out the State's need to provide additional revenue for state programs; 2) to stabilize the tax base; and 3) to reduce the long-term structural deficit.[2]

We note that requirements one and three are very much interrelated. That is to say, by developing a proposal that provides sufficient revenues for state programs, we implicitly reduce the long-term structural deficit. This is treated more comprehensively in the previous sections of this report and is not revisited here.[3] Stabilizing the tax base lends itself less to quantification; however, ACR 1 provides additional guidance to the Task Force by laying forth the requirement that "[a]ny recommended legislation *must* include a plan to broaden the tax base so that it is *reflective of the diversity of the State's economy*"[4] (emphasis added). Again, this issue is treated more comprehensively in the previous sections of this report dealing with the stability of the State's existing fiscal structure[5] and the broadness of existing and proposed revenue alternatives;[6] these issues are not revisited here.

The goal of this section is simple and straightforward; it sets forth the Task Force's recommended proposal to address the State's fiscal challenges during the next several years. Our proposal has been developed and should be viewed through the lens of ACR 1. We offer this limitation because ACR 1 clearly embraces the merits of "a broad-based tax structure that is reflective of [the State's diverse economy];"[7] cautions against increased

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[1] Nevada Assembly Concurrent Resolution 1, Cl. 10. June 2001
[2] Nevada Assembly Concurrent Resolution 1, Cl. 15. June 2001
[3] Please see *Section 3: Defining the Problem* and *Section 4: General Fund Outlook*.
[4] Nevada Assembly Concurrent Resolution 1, Cl. 14. June 2001
[5] Please see *Section 3: Defining the Problem*.
[6] Please see *Section 6: Analysis of Revenue Alternatives.*
[7] Nevada Assembly Concurrent Resolution 1, Cl. 6 and Cl. 14. June 2001

Footnote continued on the following page.

reliance on "volatile or cyclical"[8] revenue streams; and mandates that any plan submitted by the Task Force "broaden" and "stabilize" the State's fiscal structure.[9] While we do not challenge the virtues of these boundaries, and in most cases embraced them, they were underlying considerations to our analyses and fundamental to merits assigned to alternative solutions.

This section outlines one potential plan to address Nevada's fiscal challenges. More than 30 alternative revenue sources were modeled by the technical working group, giving rise to nearly 100 alternative scenarios.[10] The proposal submitted reflects the alternative we believe best meets the long-run needs of the State[11] and spirit of ACR 1. That having been said, we are mindful of the truism that there is neither a perfect tax nor a perfect tax system.[12] In addition, Nevada's tax history is most clearly distinguished by its evolutionary nature and its concern for minimizing the individual tax burden. Regardless of the recommendations of this Task Force, or the ultimate action taken by the Nevada Legislature in 2003, Nevada's fiscal system will inevitably be required to adapt to the needs and the changing landscape of the local, national and international economy. This must be done with an eye to the future and not in spite of it.

We have stated several times throughout this report that this Task Force was not empanelled nor our recommendations developed with the intent of addressing the full spectrum of challenges confronting the State. There are those who would argue that State services are woefully underfunded, and there are those who would argue that the State provides too many services at too high a cost. The identification of "optimal" public service levels most assuredly rests in the eye of the beholder, and the resolution of this debate lies with those elected to represent the citizens of the State. It was neither the intent of ACR 1 nor the goal of this Task Force to undertake such an evaluation. Rather, the question presented to, and addressed by, the Task Force was the ability of the State to

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[8] Nevada Assembly Concurrent Resolution 1, Cl. 10. June 2001.

[9] Nevada Assembly Concurrent Resolution 1, Cl. 15 and Cl. 16. June 2001.

[10] Not all of the scenarios cited were considered in detail by the Task Force.

[11] Note that this is defined as maintaining existing State programs. *See* Nevada Assembly Concurrent Resolution 1, Cl. 4. June 2001; *see also Section 3: Defining the Problem*.

[12] Ebel, Robert D., ed., 1990. *A Fiscal Agenda For Nevada: Revenue Options for State and Local Governments In The 1990s*. Reno: University of Nevada Press; see also, Ebel, Robert D. and Michael E. Bell. 1978. *Financing of Urban Government: The Final Report of the District of Columbia Tax Revision Commission*. Washington, D.C.

maintain "current governmental services."[13] Our recommendations are limited by this directive.

The Task Force did not assume that any new revenues[14] were required to maintain current service levels. Section 4 of this report summarizes a comprehensive analysis of historical and projected general fund revenues and expenditures, resulting in a 10-year fiscal imbalance for the State.[15] That analysis concludes that the State will require an additional $4.6 billion (cumulative) if it intends to provide existing levels of public service through FY 2010-11, assuming that the costs of such services, adjusted for inflation, remain comparable to today's costs. It is this revenue requirement that dictated the extent of new revenues (e.g., taxes, levies, and other fiscal system changes) proposed herein.

We would caution the reader that adding the revenue production in the base year (arising from the various revenue sources), and comparing the total to the base year gap can be misleading. The problem with doing this is that it does not take into account the longer-term cash flow needs of the fiscal model. In other words, the model is constructed to allow for excess revenue in some years and deficient revenue in others. This presumes that excess revenues in one year will be carried forward to subsequent years when they may be needed to supplement revenues. To try to achieve a perfect match in all years projected would result in tax rates that varied from year to year. Suffice it to say that the solution has been constructed to fill the gap in an aggregate sense.

The estimates provided herein are based on the best available information accessible by the Task Force and our understanding of the State's economy and fiscal system. Generally, they represent a mid-range of possible outcomes. Three factors create considerable uncertainty around these estimates. First, a number of available datasets proved to be incomplete and, in many cases, there were significant inconsistencies among sources. Given this, limiting assumptions were often developed and applied. Second, Nevada's interdependent economy and fiscal system are highly complex and are affected by countless economic and technical factors. Our analyses and estimates are based on general trends, from which actual budgetary outcomes in any particular year will almost certainly differ. Finally, a number of application and administrative details remain

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[13] Nevada Assembly Concurrent Resolution 1, Cl. 4. June 2001.

[14] The term new revenues is used in the sense of those that do not currently exist in the State of Nevada.

[15] Please see *Section 4: General Fund Outlook*.

unanswered. How a revenue source is ultimately applied and administered will undoubtedly impact its revenue-generating capacity.

Our estimates and assumptions were shared with the State Budget Office, Legislative Counsel Bureau, Fiscal Analysis Division, the Gaming Control Board and the Department of Taxation to ensure their reasonableness and acquire a general uniformity of understanding. We recognize that more detailed information and additional analyses may be necessary to obtain forecasts more precise than the approximations provided. This is particularly true as it relates to the budgeting process, where additional short-run variables must be considered.[16]

Recommendation Summary

A table and chart summarizing the Task Force's recommendations is provided in Exhibits 7-1 and 7-2 on pages 7-6 and 7-7, respectively. In addition, a series of revenue increase overviews are provided in Appendix 7A. The plan provides an estimated $4.5 billion in additional State revenues through FY 2010-11, effectively offsetting the shortfall quantified in Section 4 of this report.[17] The revenue increases included are briefly noted below and discussed in greater detail in the sections that follow.

- **Passive revenue generators**: The passive revenue generator category is actually a series of recommendations that focus on potential efficiencies created by making changes to fiscal administration processes. Recommendations include items such as electronic funds transfer, e-filing, and allowing credit card payments.

- **Business license tax increase**: The Task Force recommends that the existing business license tax[18] rate be increased from $25 per full-time-equivalent ("FTE") employee per quarter to approximately $35 per FTE employee per quarter and that it be applied to all businesses and all employees. This recommendation reflects an adjustment in the tax rate commensurate with overall

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[16] Our estimates are intended to neither supplement nor supplant the biennial budgeting process. To do so would almost certainly provide misleading and inappropriate information, as we attempt to smooth out the cyclical variations that are critical to formulating the State's biennial fiscal plan.

[17] Please see *Section 4: General Fund Outlook*.

[18] NRS 364A; *see also* Nevada Taxpayers Association, *Nevada Tax Facts 2001* (detailing the history of the levy)

inflation growth since the tax was first implemented in FY 1991-92, and increases the uniformity of the levy.[19]

- **Corporate filing fees increase**: The Task Force recommends that all Secretary of State fees, including initial and annual filing fees, be increased by 50 percent.

- **Liquor tax increase**: The Task Force recommends that the State increase the taxes imposed on beer, wine, spirits, and hard alcohol by 89 percent.[20] Per gallon rates applied to liquor products have not been adjusted since July 1, 1983. The recommended modification is commensurate with the rate of inflation from the last adjustment through FY 2003-04.[21]

- **Cigarette tax increase**: The Task Force recommends that the State increase the tax imposed on the sale of cigarettes from $0.35 per pack to $0.70 per pack.[22] Cigarette taxes have not been increased since FY 1989-90, and the proposed increase would keep Nevada's levy 24 percent below the rate imposed in California.

- **Property tax increase**: The Task Force recommends that the State impose a property tax levy of $0.15 per $100 of assessed value. This levy is intended to be a flexible source of revenue that is split between capital projects and general fund operations.[23]

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[19] *See* United States Bureau of Labor Statistics, Consumer Price Index for All Western Urban Consumers. www.bls.gov.

[20] NRS 369; *see also* Nevada Taxpayers Association, *Nevada Tax Facts 2001* (detailing the history of the levy).

[21] *See* United States Bureau of Labor Statistics, Consumer Price Index for All Western Urban Consumers. www.bls.gov.

[22] NRS 370; *see also* Nevada Taxpayers Association, *Nevada Tax Facts 2001* (detailing the history of the levy).

[23] If the levy were to be used for capital projects, it would effectively be an offset to the State's general fund spending.

Exhibit 7-1: State Revenue Enhancement Recommendation Summary (in Millions) FY 2001-02 through FY 2010-11

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11
Projected General Fund Surplus/(Deficit) (1)	**$ (122)**	**$ (250)**	**$ (327)**	**$ (379)**	**$ (455)**	**$ (511)**	**$ (555)**	**$ (603)**	**$ (655)**	**$ (708)**
Carry Forward Revenue Balance (2)	-	-	-	-	131	210	259	285	293	277
Additional Sources of Revenue										
Passive Revenue Generators (3)	-	-	21	22	22	23	23	24	25	25
Business License Tax Increase (4)	-	-	51	54	51	52	53	54	55	56
Corporate Filing Fees Increase (5)	-	-	28	30	31	33	34	36	37	39
Liquor Tax Increase (6)	-	-	17	18	18	18	18	18	18	19
Cigarette Tax Increase (7)	-	-	62	63	64	64	65	65	66	66
Property Tax Increase (8)	-	-	81	33	42	53	60	76	89	93
Slot License Fee on Restricted Licensees Increase (9)	-	-	2	3	3	3	3	3	3	3
State Admissions and Amusements Transaction Tax (10)	-	-	74	76	79	83	86	89	93	97
State Activity Tax (11)	-	-	-	222	229	236	244	251	258	265
Net New Revenue	**-**	**-**	**336**	**519**	**540**	**564**	**586**	**616**	**644**	**663**
Revenue Offsets										
Taxation Information Technology Requirement	-	-	(20)	(10)	(5)	(5)	(5)	(5)	(5)	(5)
Total Revenue Offsets	-	-	(20)	(10)	(5)	(5)	(5)	(5)	(5)	(5)
General Fund Operating Surplus/(Deficit)	**$ (122)**	**$ (250)**	**$ (11)**	**$ 131**	**$ 80**	**$ 49**	**$ 26**	**$ 8**	**$ (16)**	**$ (50)**
Adjusted General Fund Surplus/(Deficit)	**$ (122)**	**$ (250)**	**$ (11)**	**$ 131**	**$ 210**	**$ 259**	**$ 285**	**$ 293**	**$ 277**	**$ 227**

Notes:

(1) See *Section 4: General Fund Outlook* , Exhibit 4-1.

(2) Revenues carried forward as a result of revenue enhancement. These revenues are not reflected in the existing general fund balance.

(3) Passive revenue generators are fiscal policy changes intended to increase collection and administration efficiency. Examples include electronic funds transfer, electronic reporting, and allowing payments via credit card.

(4) The proposed business tax enhancement reflects an inflation adjustment and a base expansion to include all for-profit business and employees, less those with special abatements awarded as economic development incentives. This adjustment is based on the rate of inflation between the time the tax was first imposed and FY 2003-04; *see* NRS 346A; *see also* Department of Labor Statistics.

(5) Enhancement reflects a 50 percent increase in all Secretary of State fees. This includes both the initial filing fees and the annual renewal levies. Please see NRS 78, 78A, 80, 81, 88A.900,86.151, 88.415, 88.516, 87.400, 87.560, 104, 600.360, and 600.370.

(6) The proposed liquor tax enhancement reflects an 89 percent inflation adjustment. This adjustment is based on the rate of inflation between the time the tax was first imposed and FY 2003-04. It assumes that 100 percent of new funds would be directed to the state's general fund; *see* NRS 346A; *see also* Department of Labor Statistics.

(7) Cigarette tax increase reflects a $0.35 increase in the state cigarette, with 100 percent of the proceeds directed to the state's general fund; *see* NRS 370.

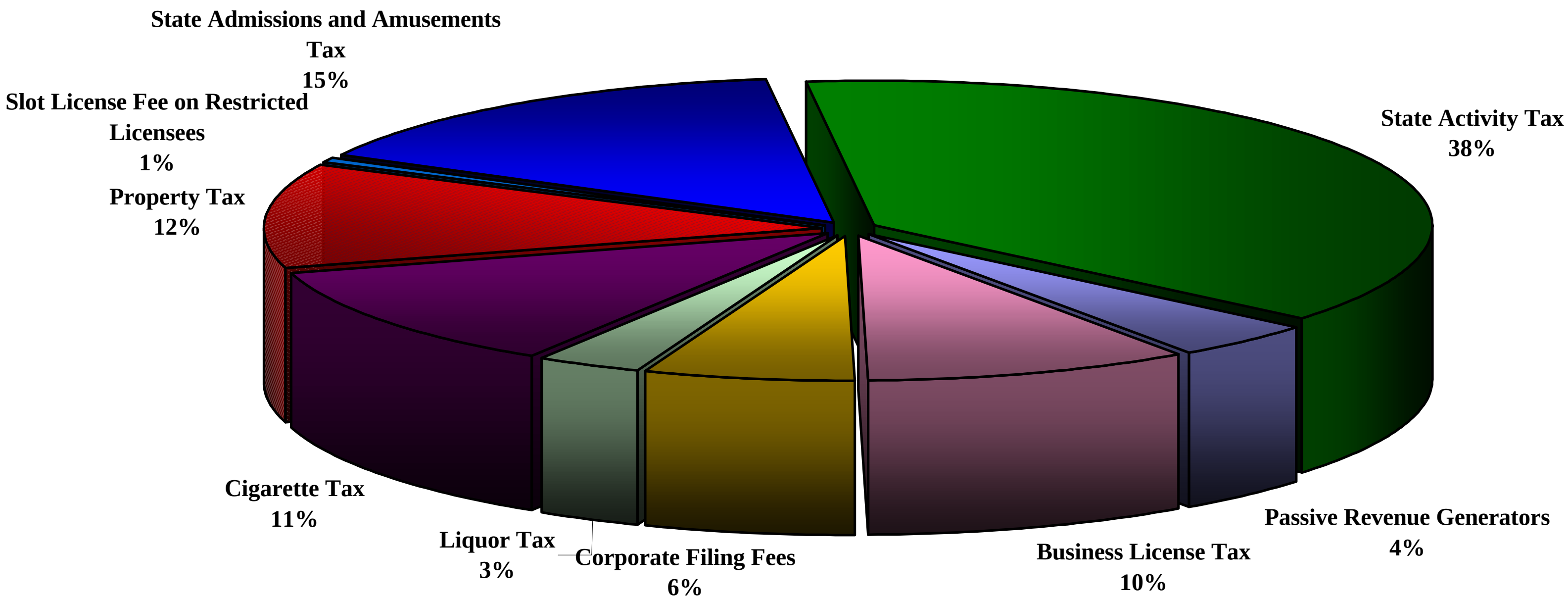
(8) Property tax increase reflects a $0.15 levy per $100 of assessed value. In FY 2003-04, $0.13 of the property tax is allocated to the general fund for operations and $0.02 is dedicated to capital projects; in FY 2004-05, $0.05 is allocated to the general fund for operations and $0.10 is dedicated to capital projects; from FY 2005-06 through FY 2009-10, the amount dedicated for operations increases by $0.01 per year until it reaches $0.10. the balance of the state levy is dedicated to capital projects; *see* NRS 361; *see also* Constitution Article 10.

(9) The proposed restricted slot tax enhancement reflects a 33 percent inflation adjustment. This adjustment is roughly based on the rate of inflation between the time the tax was first imposed and FY 2003-04. *see* NRS 463.373; *see also* Department of Labor Statistics.

(10) Increase reflects a 6.5 percent state levy imposed on "taxable" admissions and amusements expenditures, exempting those items for which the state's casino entertainment tax is currently imposed and participatory amusement; see NRS 463.401.

(11) Increase reflects a 0.25 percent levy on the gross receipts of all businesses in Nevada in excess of $350,000. It also includes a one-for-one credit for business license tax payments up to $100 per full-time equivalent employee per year.

Exhibit 7-2: Task Force Recommendation Summary
Revenue Enhancements and New Sources



- **Slot license fee on restricted licensees increase**: The Task Force recommends that the State increase its quarterly fees imposed on the operation of restricted slot machines by 32 percent.[24] This unit-based fee has not been adjusted since 1993; the recommended modification reflects the rate of inflation since the last adjustment.[25]

- **Admissions and amusement tax**: The Task Force recommends that the State impose a 6.5 percent levy on all non-participatory retail admissions and amusement transactions not currently covered by the casino entertainment tax or the State's boxing and wrestling fees.[26]

- **State activity tax**: The Task Force recommends that a gross receipts tax levy of 0.25 percent be imposed on all annual business receipts in excess of $350,000, less an annual $100 business license tax credit for each qualified Nevada employee.[27]

Revenue Increases & New Sources

Passive Revenue Generators

Passive revenue generators refer to a series of recommendations aimed at increasing efficiency within the State's existing fiscal infrastructure. Many of these recommendations do not lend themselves to quantification because they deal with items such as interest earned on monies held in transit (i.e., float revenues), the timing of collection allowances, or efficiencies created through reduced workloads. Based on testimony provided to the Task Force and additional conversations with State staff, we have estimated passive revenue to generate roughly $21 million annually. We note, however, that this estimate is largely symbolic.

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[24] NRS 463.373

[25] *See* United States Bureau of Labor Statistics, Consumer Price Index for All Western Urban Consumers. www.bls.gov.

[26] NRS 463.401

[27] A qualified Nevada employee is defined as an employee for whom the State's business license tax has been paid.

Passive revenue generator recommendations include:

- **Allow electronic funds transfers**: All general fund agencies which collect more than $1 million in annual revenue should encourage automatic account debits, credit card payments, and other means of paperless funds transfers. Doing so would significantly reduce the time that payments are in transit, increasing the State's ability to earn interest on those monies.

- **Implement a broad-based e-reporting system:** All tax payment forms should be able to be submitted electronically. There are multiple advantages to electronic reporting, including a reduction in the number of errors, a reduction in per account labor requirements, and 24-hour accessibility. We are cognizant of the fact that such a system will be costly; however, to the extent that the State can design a cost-efficient alternative, we believe that the long-run savings will outweigh the near-term cash outlay.

- **Permit the sales and use tax collection allowance only where the tax is remitted in a timely manner:** Currently, a person or business collecting retail sales and use tax is allowed to deduct a collection allowance of 1.25 percent whether they pay two weeks early or two years late. While penalties and interest are applied to late payments, allowing a delinquent taxpayer to deduct the collection allowance seems contrary to its intended purpose.

- **Require all businesses in the State of Nevada to register for use tax:** The State's retail sales and use tax is often misunderstood by individuals and business operators. This is particularly true when it comes to the State's "use" tax. If use tax registration were to be required in conjunction with each company's business license application, the Department of Taxation could initiate a campaign to increase awareness and compliance with State use tax provisions. One estimate suggested that if use tax were paid on all tangible goods purchased out-of-state and on the Internet, more than double the estimated $21 million for combined passive revenues would be generated each year.

- **Tier the State's sales and use tax collection allowance regime to encourage accelerated payment**: Currently the State allows a collection allowance of 1.25 percent for businesses subject to the retail sales and use tax. Remittance is required on the last day of the month following the month in which the sale took place; thus, a business may hold its collections for 30 to 60 days before submitting them to the State.

- **<u>Require registration for public works projects eligibility</u>:** We recommend that the State Legislature consider adding a provision to its public works statute[28] requiring contractors and subcontractors to be registered for all applicable licenses and with the Department of Taxation before being eligible to bid or being awarded a state or local project. Oftentimes, contractors and subcontractors are unaware that they are subject to retail sales and use taxes, even on public works projects.

- **<u>Establish a standard term limit for all tax exemptions</u>:** Nevada has a number of exemptions to both its sales and use and property taxes. Please see Exhibits 7B-1 and 7B-2, in the appendices following this overview. While many of these exemptions are fundamental to our tax system, a number are obsolete or may have outlived their intended purpose. We recommend that the State consider implementing a process whereby exemptions that are not written into the Constitution are reviewed every four to six years. Where no compelling public interest exists to maintain the exemption, it should be removed.

<u>Business License Tax Increase</u>

The State of Nevada imposes a business license tax ("BLT") of $25 per FTE employee per quarter, or $100 per FTE employee per year. In addition, a one-time $25 business license fee is assessed on new businesses registering with the Department of Taxation. In FY 2001-02, these levies generated $77 million, or roughly 4.9 percent of all State general fund tax collections.

The Task Force has three recommendations with regard to the BLT: 1) adjust the tax to reflect the rate of inflation growth since it was established in 1991; 2) make all businesses and employees subject to the levy; and 3) impose an annual business license renewal fee for all Nevada businesses for a two-year period. Each of these recommendations is discussed in greater detail below.

The Task Force recognizes that the BLT is unrelated to profitability and impacts different businesses differently. The tax does not distinguish between large and small firms, high and low margins, and is regarded as a somewhat regressive levy. Nevertheless, given the

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[28] Nevada Revised Statute 338

low tax rate, the Task Force found a modest increase in the tax acceptable. We also note that some segments of the business community recommended larger increases with little or no concern about the inequities of the BLT as it relates to different industries.

Adjust the Tax Rate So It Reflects the Rate of Inflation Growth

One of the fundamental weaknesses in Nevada's tax system is that many levies are "unit based" and tend to erode over time. This becomes particularly problematic when the State's expenditures reflect inflation, but its revenues do not. The BLT is illustrative of this phenomenon.

In 1991, the BLT was imposed when the average employee earned roughly $23,000 per year. At the existing per-employee tax rates, the levy equated to 0.43 percent of the average annual wage. By comparison, in 2002, the average employee will earn an estimated $35,000. The tax rate, which has remained unchanged, will represent only 0.28 percent of the average wage paid. By failing to keep pace with inflation, the BLT has effectively eroded with time. Please see Exhibit 7C-1.

Inflation growth between FY 1991-92 and FY 2003-04 is estimated at approximately 38 percent. To reflect this rate of inflation, we recommend that the BLT be increased from $25 per FTE employee per quarter to $35 per FTE employee, per quarter. In annual terms, this is an increase from $100 to $140 per FTE employee, per year. Please see Exhibit 7C-2.

The recommended increase will generate an estimated $286 million during the study period, or approximately $36 million annually. Please see Exhibit 7C-3. While the Task Force did consider the notion of indexing the BLT rate after FY 2003-04, such a recommendation is not reflected in this analysis. We do recommend, however, that the State Legislature periodically review the levy to insure that it continues to reflect the State's dynamic economy.[29]

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[29] Please see *Section 8: Supplementary Recommendations*.

Make All Businesses and All Employees Subject to the Business License Tax

Neither all businesses nor all employees are subject to the business license tax. Nevada Revised Statutes limits the number of businesses that are subject to the levy by providing, "[a] natural person who does not employ any employees during a calendar quarter *is exempt from the provisions* of this chapter for that calendar quarter"[30] (emphasis added). Additionally, State law also limits the number of employees who are subject to the tax by stating, "The total number of hours all employees have worked during the quarter must be calculated *excluding the hours worked by a sole proprietor or one natural person in any unincorporated business*, who shall be deemed the owner of the business rather than an employee"[31] (emphasis added). We recommend that these exemptions be removed, so the tax applies to all employees and all businesses operating within the State.

As it currently exists, BLT payments have historically accounted for between 82 and 85 percent of the State's average non-governmental employment base.[32] Please see Exhibit 7C-4. Of course, if all businesses were to have paid $100 per year for every employee (including owner employees), State BLT collections would have been significantly higher. At 100 percent of employment,[33] an estimated $20 million could have been added to the State's collection total in FY 2001-02.[34] This figure, however, includes part-time employees and tax payments by firms provided special abatements under Nevada law, and thus, overstate the State revenue potential.

A refinement of this estimate for projection purposes requires data that are generally unavailable.[35] An analysis of what limited information that could be obtained and

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[30] *See* NRS 364A.160 http://www.leg.state.nv.us/NRS/NRS-364A.html#NRS364ASec130

[31] See NRS 364A.150 (5) http://www.leg.state.nv.us/NRS/NRS-364A.html#NRS364ASec130

[32] As reported by the Nevada State Department of Employment, Training and Rehabilitation.

[33] We note that not all employment is reported to or by the Nevada State Department of Employment, Training and Rehabilitation. Nonetheless, these represent the best available estimates of statewide employment.

[34] See United States Bureau of Economic Analysis, Regional Accounts Data, SA30 State Economic Profile Summaries. http://www.bea.gov/bea/regional/spi/action.cfm. (estimating the total number of proprietors in Nevada at 203,000 and total employment at 1.3 million.); *see also* Nevada Department of Employment, Training and Rehabilitation. http://detr.state.nv.us/lmi/lmi_emp1.htm#PDF%20Format; *see also* Nevada Department of Taxation, Business License Tax Collections and Account Estimates. September 2002; *see also* Individual County Business License Departments, Business License Counts Estimates, Survey, 2002; *see also* United States Bureau of the Census, *Economic Census*, 1997 Estimate of Non-Employing Business in the State of Nevada.

[35] For example, the number of part-time employees in the State; a count of persons employed but not required to report to the State; a number of businesses receiving business licenses tax abatements and the timelines for

Footnote continued on the following page.

discussions with representatives of the Department of Taxation and Department of Employment, Training, and Rehabilitation, suggested that a reasonable estimate of the increase in collections associated with this recommendation was $10 to $14 million in FY 2001-02. This represents an increase of 13 to 18 percent, and is consistent with sole proprietor employment and similar considerations reported by the Bureau of Economic Analysis and others.[36] We have used the low end of this figure for projections purposes.

Establish an Annual Business License Renewal Fee for a Two-Year Period

As noted above, a component of the existing BLT is a one time $25 registration fee.[37] The controlling statute states, "a person shall not conduct a business in this State unless he has a business license issued by the [Department of Taxation]."[38] In FY 2001-02, this one-time fee accounted for less than 0.9 percent of the combined revenue total, or roughly $680,000.

The Task Force recommends that this levy become a business license renewal fee of $25 for a two-year period beginning FY 2003-04 and ending FY 2004-05. The intent of this recommendation is the creation of a "bridging mechanism" used to obtain the data required to develop and maintain a "statewide business database." The business database would be used to facilitate the efficient and effective implementation of the broader-based BLT (see above recommendation) as well as the State activity tax ("SAT"). The SAT is discussed in greater detail below; however, what is important here is the need to develop and maintain a reliable database that could be used to: 1) identify and track all businesses subject to the BLT and 2) to establish proper rates and exemption thresholds

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when those abatements are likely to expire; the number of unincorporated businesses within the State of Nevada; and the number of employees falling into non-governmental exempt categories. *See also* the following section which describes a mechanism by which this data might be collected and maintained as part of the complete recommendation.

[36] See United State Bureau of Economic Analysis, Regional Accounts Data, SA30 State Economic Profile Summaries. http://www.bea.gov/bea/regional/spi/action.cfm. (estimating the total number of proprietors in Nevada at 203,000 and total employment at 1.3 million.); *see also* Nevada Department of Employment, Training and Rehabilitation. http://detr.state.nv.us/lmi/lmi_emp1.htm#PDF%20Format; *see also* Nevada Department of Taxation, Business License Tax Collections and Account Estimates. September 2002; *see also* Individual County Business License Departments, Business License Counts Estimates, Survey, 2002; *see also* United State Bureau of the Census, *Economic Census*, 1997 Estimate of Non-Employing Business in the State of Nevada.

[37] *See* NRS 364A.130 Business license required; application for license; activities constituting conduct of business. Note also the discrepancy between NRS 364A.130 and NRS 364A.150; those who must register appear to be more than those who are subject to the tax.

[38] Id. at. 130 (1)

for the SAT. Data required include number and size of businesses, employment, output, industrial classification, etc.

The BLT is the medium by which these data can be obtained, and the additional levy is intended to provide a revenue offset to support this effort.[39] As it currently stands, the number of BLT accounts is 80,700. Thus, a $25 annual levy would likely generate approximately $2.0 million in FY 2003-04 from existing sources. There is evidence that the total number of businesses in Nevada is closer to 150,000; thus, year one revenues could be in excess of $3.7 million.

Projected Fiscal Impact of Recommendations

Adjusting the State's BLT for inflation and reducing the number of exempt businesses and employees would address a number of issues referenced in ACR 1. Most notable, perhaps, is the fact that these changes will broaden the State's tax base, increasing stability and making the overall fiscal structure more reflective of Nevada's diverse economy.[40]

In total, these recommendations are estimated to produce an additional $51 million in FY 2003-04, growing to $56 million by FY 2010-11. Note that the two-year "bridge" levy is reflected in FY 2003-04 and FY 2004-05 only. Please see Exhibit 7C-5. In inflation adjusted per capita terms, the tax will continue to erode through the balance of the study period; however, the adjustment will significantly reduce the declines that would have been realized without the recommended changes. Please see Exhibits 7C-6 through 7C-10.

<u>Corporate Filing / Secretary of State Fees Increase</u>

Corporate filing fees have been used in this analysis and throughout the Task Force's deliberations somewhat synonymously with Secretary of State fees. We recognize that the denotations of these two terms are distinct in practical application. While corporate filing fees make up the vast majority of Secretary of State collections, there are some

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[39] We do not believe that the $5 million that will be generated by this effort will be sufficient to offset the total cost of implementing an information technology system within the Department of Taxation.
[40] *See* Nevada Assembly Concurrent Resolution 1, Cl. 6, Cl. 10, Cl. 14 and Cl. 15. June 2001.

Secretary of State fees that are not corporate filings. The more encompassing Secretary of State fees are the focus of this recommendation.

The Secretary of State currently imposes more than 225 separate fees and charges. Information regarding the number of transactions attributable to each specific levy could not be provided by the Secretary of State's Office.[41] Thus, reported totals for commercial recordings, commercial filings, securities licenses, Uniform Commercial Code ("UCC") filings, notary fees and other miscellaneous charges were combined for analysis purposes. Please see Exhibit 7A-2b.

In FY 2001-02, these fees and charges accounted for approximately $50 million in State general fund revenues, a direct function of the 53,000 businesses registering for the first time in Nevada and the more than 190,000 entities operating under the laws of our State.[42] Please see Exhibit 7C-11. Nevada places second nationally in the number of registered entities per 1,000 residents, reporting approximately 91 per 1,000 in 2001.[43] Corporate formation and governance is recognized as an important part of the State's economic and legislative landscape.[44] Please see Exhibit 7C-12.

The Task Force recommends that Corporate Filing/Secretary of State fees be increased by a flat rate of 50 percent. Such an increase would generate approximately $28 million in new revenues for FY 2003-04 (the first year of implementation), growing to $39 million by the end of the study period. Please see Exhibit 7C-13. Corporate filing fees are similar to the BLT in that they do not adjust with inflation. As such, the levy is anticipated to decline in per capita inflation adjusted terms over the study period. Again, we recommend that the Legislature periodically review these fees to ensure they reflect trends in the State's economy.[45] Please see Exhibits 7C-14 through 7C-18.

The Task Force did consider the fact that the State's initial filing fees were increased by 100 percent in FY 2001-02. While some expressed concern that increases might have a

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[41] Interview with Mr. Scott Anderson, Deputy Secretary of State, June 2002. (noting that the Secretary of State's existing information technology system did not allow reporting at that level of detail).

[42] Note that entity estimates were through December 2001.

[43] Note that Delaware reports more then 400 entities per 1,000 residents placing first nationally; note also that Wyoming places third nationally with just over 66 entities per 1,000 residents.

[44] Information was also provided regarding the fact that many of these businesses deposit substantial sums of money in Nevada banks, travel to Nevada for corporate meetings and utilize the State's court system.

[45] Please see *Section 8: Supplementary Recommendations*

"chilling" effect on businesses currently organized or choosing to organize within Nevada, the general consensus was that Nevada fees remain relatively low in comparison to other jurisdictions, particularly when one considers the protections afforded businesses choosing to incorporate here. Given this belief, the Task Force expected little or no reduction in the number of businesses organizing within the State as a result of the provided increase.

Increasing the Corporate Filing/Secretary of State fees not only provides additional revenues for State programs, but also serves to augment and stabilize the tax base.[46] The number of businesses forming in Nevada has grown at a compound annual rate of 12.3 percent since 1994, well in excess of the rates of population and employment growth. While the formation of new business entities is somewhat cyclical in nature, increasing the accompanying annual fee will add a stabilizing element to the State's overall revenue mix.

Liquor Tax Increase

Nevada currently imposes four levies on alcohol products based on the percent of alcohol by volume. They are summarized in Exhibit 7-3 below. Existing per gallon rates have not been adjusted since FY 1983-84; and, similar to the levies discussed in the previous sections, their effective rates have eroded significantly in per capita terms over the past several years.

Exhibit 7-3:
Liquor Tax Increase Recommendation Summary

Type of Alcohol:	Recommendation:	Current Rate:	Increase Amount:
Malt Liquor (beer)	$0.17/gallon	$0.09/gallon	$0.08/gallon
Liquor up to 14% Alcohol (wine)	$0.76/gallon	$0.40/gallon	$0.36/gallon
Liquor with 14% to 22% Alcohol (spirits)	$1.42/gallon	$0.75/gallon	$0.67/gallon
Liquor with Greater then 22% Alcohol (hard alcohol)	$3.87/gallon	$2.05/gallon	$1.82/gallon

[46] *See* Nevada Assembly Concurrent Resolution 1, Cl. 6, Cl. 10, Cl. 14 and Cl. 15. June 2001.

The Task Force recommends that liquor taxes be adjusted to reflect the rate of inflation since the levies were last modified nearly 20 years ago. Please see Exhibits 7C-19 through 7C-22. This equates to an 89 percent increase, and is projected to generate approximately $17.3 million in additional revenue in FY 2003-04. Over the entire study period, the proposed liquor tax increases are estimated to generate approximately $144 million; however, like the other unit-based levies, it will continue to erode over time in per capita terms. Please see Exhibits 7C-23 through 7C-28.

One of the primary considerations in evaluating potential increases in the State's liquor tax was the ability of Nevada to remain competitive among neighboring jurisdictions. According to the most recent data available, Nevada ranks among the lowest states in the imposition of taxes on beer, wine, and hard alcohol.[47] Please see Exhibits 7C-29 through 7C-31.

Increasing the State's tax on beer from $0.09 per gallon to $0.17 per gallon would keep Nevada beneath the national median ($0.185), but would place it above Arizona ($0.16), Colorado ($0.08), Idaho ($0.15), and Montana ($0.14), in rate per gallon.[48] Increasing the State's tax on wine from $0.40 per gallon to $0.76 per gallon would place Nevada 20th among the 47 states that allow the sale of wine outside of state operated liquor stores. Nevada would impose a rate lower than Arizona ($0.84), Montana ($1.06), New Mexico ($1.70) and Washington ($0.87), but higher than California ($0.20), Colorado ($0.32), Idaho ($0.45), Oregon ($0.67) and Texas ($0.20).[49]

An analysis of spirits and hard liquor is more troublesome because these products are reported jointly in national surveys, and only 33 states allow spirits and hard alcohol to be sold outside of state-operated liquor stores. The United States' median levy is $3.30 per gallon, which is more than double the rate proposed for spirits and $0.57 less than the rate proposed for hard alc ohol.[50] It is noteworthy that rates recommended by the Task Force are adjusted to reflect levies in FY 2003-04, while the comparative data reported is for CY 2001. That having been said, no jurisdiction reported adjusting liquor taxes on an annual basis.

[47] Federation of Tax Administrators, 2002.
[48] Id.
[49] Id.
[50] Id.

After reviewing these levies, state rankings, and a number of other considerations, the Task Force agreed that an increase in Nevada's liquor taxes was an appropriate component of its revenue enhancement plan. While cognizant of the regressive nature of liquor taxes, the Task Force notes that this adjustment is meant to bring the levy back in line with the rates established 20 years ago.

Cigarette Tax Increase

The State of Nevada currently imposes a cigarette tax of $0.35 per pack of 20 cigarettes ("per pack"). The State receives $0.25 of this levy, with the balance directed to local governments.[51] In FY 2001-02, approximately 173 million packs of cigarettes were taxed generating $41.8 million for the State's general fund.

The Task Force recommends that cigarette taxes be increased to $0.70 per pack, or by $0.35. The State would retain $0.60 of the new levy, with the remaining $0.10 continuing to be deposited in the local government distribution fund. This revenue source would generate an additional $514 million for the State between FY 2003-04 and FY 2010-11, representing 11.4 percent of the total proposed revenue increase. Please see Exhibits 7C-32 through 7C-37.

A number of issues were considered in evaluating whether the cigarette tax should be included in the Task Force's recommendations. These include, but are not limited to, the question of regressivity; rising public health costs directly related to the consumption of cigarettes; trends in cigarette consumption; and the potential for tax increases to encourage foreign purchases as a form of tax avoidance.

We recognize that cigarette taxes are among the most regressive taxes imposed in the State; however, Nevada health division officials have reported that every pack of cigarettes generates $7.50 in smoking-related health care costs.[52] The Medicaid costs alone exceed the combined revenues from cigarette taxes by $35 million annually.[53] Moreover, testimony and reports from a number of groups, including those who cited alleged inequities in Nevada's overall tax structure, included significant increases in the

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[51] NRS 370; *see also* Nevada Taxpayers Association, *Nevada Tax Facts, 2001*.

[52] *See* Vogel, E., Smoking costs drain State, officials say, Las Vegas Review Journal, October 2002 (quoting health officials from the Nevada State Department of Health); *see also* Task Force for the Fund for a Healthy Nevada.

[53] Id.

State's cigarette tax levy.[54] In our opinion, the benefits of increasing the cigarette tax clearly outweigh its social costs.

Per capita cigarette consumption is on the decline in Nevada, as it is nationally.[55] Thus, we anticipate that per capita revenues will decline over time. The rate of decline may also be accelerated by a trend emerging in some parts of the country where consumers are crossing state boarders, traveling to Native American smoke shops, or using the Internet to purchase cigarettes in an effort to avoid taxation. While the potential exists for this trend to also materialize in Nevada, the rate proposed is less than half those imposed in New Jersey, New York, Connecticut, and Washington, where the out-of-jurisdiction sales rates are reportedly 6 to 10 percent. Nevada will also remain significantly lower than California, whose rate is currently $0.87 per pack, who seems poised for substantial tax increases in the relatively near future. Please see Exhibits 7C-38 and 7C-39.

The Task Force believes that an increase in the State's cigarette tax is an important component to any revenue generating plan and clearly embraces the spirit of ACR 1. Increases in cigarette taxes will not only help generate the revenues required to maintain existing programs, they will help combat against the State's rising health care costs.[56]

Property Tax Increase

It is often reported that after the "tax shift" of 1981 the State retained very little stake in property tax revenues. This is inaccurate. At a minimum, the State has a $0.90 interest in the property tax levied on each and every property owner in the State. The $0.90 levy is made up of a $0.15 State debt service rate and the $0.25 and $0.50 State education rates that operate as direct offsets to the State's general fund obligations.[57] Given the statewide average property tax rate of $3.08 per $100 of assessed value in FY 2001-02, the State directly benefits from roughly 30 percent of all property tax collections.

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[54] See *Two Plus Two Plan*, Progressive Leadership Alliance, March 2002.

[55] Note that the number of packs of cigarettes consumed per capita decreased from 88 in FY 1993-94 to approximately 78 in FY 2001-02.

[56] *See* Nevada Assembly Concurrent Resolution 1, Cl. 6, Cl. 10, Cl. 14 and Cl. 15. June 2001; See also Cl. 3 (citing that the State is "falling behind" in education and long-term care needs.)

[57] Please see *Section 4: General Fund Overview, K-12 Education.*

The Task Force's position on property taxes is consistent with the proposal made by the Legislative Committee for Local Government Taxes and Finances[58] (the "Committee") in August 2002. The Committee recommended that the legislatively prescribed property tax cap, which currently stands at $3.64 per $100 of assessed value, be increased and bifurcated. In doing so, they recommended increasing the local government cap to $3.14 per $100 of assessed value and removing the $0.15 State debt rate and the combined $0.75 State education rates from the rate calculation. Thus, the new legislative prescribed maximum property tax levy would be $4.04,[59] creating $0.40 of "room" under the existing cap. This adjustment serves a number of important purposes, not the least of which is providing local governments, particularly those in rural areas, some much needed rate flexibility.

In developing this recommendation, the Task Force was mindful of Nevada's long history with property tax; the level of confusion associated with the levy and its implementation; and the viewpoint that property taxes hold a unique degree of disdain in the minds of Nevada's taxpayers. These considerations notwithstanding, the Task Force also took into account tax rates in comparable jurisdictions and the stability that comes with property taxes. Exhibit 7-3, above, summarizes Nevada's position among the 50 states in effective tax rates imposed. Exhibits 7C-40 and 7C-43 in the appendix provide additional detail.

Exhibit 7-3: Comparative Analysis of Effective Tax Rates
Nevada and the Nation
Urban and Rural, Residential and Commercial, 2000[60]

Market Value	Nevada's Effective Tax Rate (%)	Nevada's Ranking	National Average (%)
Urban Residential:			
$80,000	0.931	33	1.248
$200,000	0.798	35	1.136
Urban Commercial:			
$120,000	1.082	49	2.217
$1,000,000	1.082	49	2.256
$25,000,000	1.082	49	2.262
Rural Residential:			
$80,000	1.015	28	1.126
$200,000	0.870	29	1.004
Rural Commercial:			
$120,000	1.162	37	1.665
$1,000,000	1.218	38	1.702
$25,000,000	1.112	38	1.701

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58 Also referred to as the SB 557 Committee.

59 Note that the cited $4.04 maximum is largely figurative since only true state is the $5.00 Constitutional limitation.

60 Minnesota Taxpayers Association, *50-State Property Tax Comparison Study – 2001*.

The Task Force recommends that the State impose a $0.15 property tax levy to be split between general fund operations and capital projects. In FY 2003-04, $0.13 of the $0.15 levy would be allocated to the State's general fund operations to help "bridge" its immediate needs and allow alternative sources to be properly designed, developed, and implemented. The remaining $0.02 would be allocated to capital projects in FY 2003-04. As new revenue sources come on-line in FY 2004-05 (i.e., the state activity tax discussed below), we suggest that the State reduce the levy's allocation to the general fund from $0.13 to $0.05, directing the balance to the State's capital projects fund. From that point forward, the levy is intended to be flexible, allowing the State to direct monies where they are needed most. As modeled, the general operating levy increases by $0.01 per year from FY 2005-06 through FY 2009-10, until the allocations to general fund operations and capital projects are $0.10 and $0.05, respectively.

The Task Force could identify no source of taxation that is more stable in the long run than property taxes. While the potential for real property devaluation always exists, it is generally among the last revenues to erode in an economic downturn. Property taxes also reflect Nevada's diverse economy (consumer and supplier), and the State's average property tax rates are comparatively low in most cases.[61] Including property taxes as a component of the Task Force's revenue generating recommendations clearly forwards the objectives set forth by the State Legislature in ACR 1.

[61] Nevada's property tax rates on urban commercial property are among the lowest in the nation. The Task Force did consider the merits of splitting the tax roll between commercial and residential; however, the complexity, constitutional hurdles, and public acceptance of such a change made it a less desirable alternative.

Slot License Fee on Restricted Licensees Increase

Exhibit 7-4: Quarterly Slot License Fee on Restricted Licensees Rate Increase Recommendation

As Recommended		Status Quo	
One game	$81	One game	$61
Two games	$162	Two games	$122
Three games	$243	Three games	$183
Four games	$324	Four games	$244
Five games	$405	Five games	$305
Six games	$546	Six games	$411
Seven games	$687	Seven games	$517
Eight games	$828	Eight games	$623
Nine games	$969	Nine games	$729
Ten games	$1,110	Ten games	$835
Eleven games	$1,251	Eleven games	$941
Twelve games	$1,392	Twelve games	$1,047
Thirteen games	$1,533	Thirteen games	$1,153
Fourteen games	$1,674	Fourteen games	$1,259
Fifteen games	$1,815	Fifteen games	$1,365

The Nevada State Gaming Control Board currently licenses more than 2,800 restricted and non-restricted gaming operators, manufacturers, and distributors within the State of Nevada. Ninety percent of these licenses are issued to restricted and non-restricted licensees. Non-restricted licensees generally include the casinos and casino-hotels located throughout the State, while restricted licensees refer to operators permitted to own and operate a maximum of 15 slot machines at a single location. Common examples of restricted licensees include taverns, car washes, convenience marts and grocery stores where limited gaming is permitted.

A quarterly fee is imposed on all restricted licensees in the amount of $61 for each slot machine from 1 to 5 machines, and $305 plus $106 per machine for each unit in excess of 5 up to 15 for each calendar quarter. Please see Exhibit 7-4, above. In FY 2001-02, Nevada generated $6.7 million from this levy, accounting for 1.1 percent of all State gaming taxes.

The Task Force recommends increasing the State's tax on restricted licensees by 33 percent, or to $81 for each slot machine from 1 to 5 machines and $405 plus $141 per machine for each machine in excess of 6 up to 15 for each calendar quarter. This would generate approximately $22 million between FY 2003-04 and FY 2010-11, and represents approximately 0.5 percent of the Task Force's revenue increase proposal. These unit-based fees were last increased in FY 1983-84, and like many of the fees included in the Task Force's recommendations, have eroded over time in per capita terms.

This element of our revenue increase plan meets several of the objectives delineated in ACR 1. In addition to providing a supplementary source of revenue to support existing programs, it increases overall system stability. At first glance, this element may seem contrary to ACR 1's requirement that our proposal be "reflective of the diversity of the

State's economy" because it is oriented toward gaming activities which are a cornerstone of the State's existing tax system. However, closer scrutiny illustrates the disparate tax burdens, segmentations, and operations of Nevada's casino-hotels (non-restricted licensees) and restricted gaming operations. This line blurs somewhat when it comes to neighborhood casinos; however, the markets remain distinct from the core source of Nevada's gaming tax revenues – percentage fees. Even with the recommended increases, taxes imposed on the operation of restricted gaming establishments will remain well below those imposed on their non-restricted counterparts.

In addition, the Task Force acknowledges that it has rejected a proposal that restricted slot operators be required to pay the same percentage fees paid by non-restricted gaming operators. It was concluded that no industry should be required to pay an additional percentage fee as well as the proposed State activity tax.

Admissions and Amusement Tax

Discussion surrounding the admissions and amusement tax (the "AAT") and the State activity tax (the "SAT") differ from those provided in the previous sections of this report. This is because the AAT and SAT are new levies as opposed to adjustments in or modifications to existing sources of State revenue. As such, we have attempted to provide a more in-depth treatment of these taxes and their respective productivity estimates.

General Overview

The Task Force recommends that the State implement a 6.5 percent levy on all admissions and amusement expenditures, excepting participatory entertainment activities, those that are already taxed by the State (e.g., via the casino entertainment tax[62] and boxing and wrestling fees[63]), those associated with public or private schools,[64] and those conducted principally for charitable purposes.[65]

[62] NRS 463.401

[63] NRS 467

[64] If facilities that are a part of public schools, community colleges, universities, or other governmental entities are rented or otherwise made available to producers of for-profit events, the tax shall still apply.

[65] As proposed, 60 percent or more of the net proceeds would have to be dedicated to the charity in interest.

As recommended, this levy would be added to the retail price of the admission or amusement purchase and would be due at the time of sale. If the admission or amusement is provided free of charge as part of a promotional or marketing effort, the tax would be due on the face value of the admission charge or amusement cost. Additionally, if any required entry purchase is levied in lieu of an admission or amusement charge, for example, a two drink minimum, the purchase price of the required purchase or purchases is also subject to the transaction tax.

The objective of this element of the Task Force's recommendations is to generate additional revenues in support of existing State programs, to broaden the State's tax base, and to increase overall fiscal system stability. Admissions and amusements expenditures were singled out because of their discretionary nature and the fact that spending on admission and amusement tends to increase with wealth.[66]

The AAT is projected to generate approximately $678 million between FY 2003-04 and FY 2010-11. At an average of $85 million per year, this element represents roughly 15 percent of the Task Force's projected revenue increase total. Please see Exhibit 7C-44.

Base Estimates

The first question that must be asked in analyzing the productivity of the AAT is what the tax base will be. The Task Force debated this issue for some time, and finally decided to recommend that all admissions not currently subject to the casino entertainment tax and non-participatory amusements should be the base for the levy. The following tables illustrate categories of expenditures that are illustrative of the types of expenditures that would be subject to and exempt from the recommended levy.

[66] *See* United States Bureau of Labor Statistics, *Consumer Expenditure Survey*, 2001. *See also* Nevada Taxpayers Association, Admissions and Amusement Tax White Paper, August 2002. Note also these data omit the $4 million in spending generated by "non-employing industries." These data were not reported for the NAICS code reports which provided more detail on the type of spending likely to occur.

Spectator Entertainment (Taxable)

- Professional sporting events
- Professional motor sports events
- Professional rodeos and equestrian events
- Adult cabarets, gentlemen's clubs, etc.
- Concerts
- Theatrical stage productions
- Performances of orchestras, symphonies, dance companies, etc.
- Lectures and speaking performances
- Theme productions (i.e., ice shows, circus, other stage productions)
- Commercial art galleries
- Other fine arts exhibitions
- Beauty contests
- Tours and tour services
- Closed circuit or other transmission of an exclusive event
- Bars and nightclubs with live entertainment; and
- Motion picture theaters, including drive-ins
- Those events that fit any of the above categories that are otherwise exempt from the Casino Entertainment Tax

Other Entertainment-Related Areas (Taxable)

- DVD, video and game rentals

Participatory Entertainment (Exempt)

- Recreational rentals (i.e., bicycles, motorcycles, boats, saddle horses, skis, other recreational equipment)
- Pool and billiard halls
- Skating facilities (ice and roller)
- Golf courses
- Country, golf, tennis, gun and outdoor club memberships
- Ski areas
- Amusement, theme and water parks
- Bowling centers
- Instruction (including):
  - Arts and crafts (i.e., sewing, painting, photography, etc.)
  - Scuba, sailing, skydiving, ski, skating, etc.
  - Massage, yoga, etc.
  - Culinary arts

Unfortunately, there is no single database that could provide spending estimates for each of these categories. Rather, a series of databases were used to estimate general admissions and amusement spending. Depending on the dataset utilized, the total base of admissions and amusement expenditures is estimated to range from $838 million to $2.8 billion annually. The former estimate is based on business receipts of selected industries, while the latter results from a review and analysis of resident and visitor spending patterns. Both of these analyses are discussed in greater detail below.

We believe that the estimate derived from business receipts data ($838 million) underestimates the potential tax base. By contrast, the $2.8 billion estimate stemming from residential and non-residential spending patterns likely overestimates the tax base. The middle of these two outcomes is approximately $1.8 billion; this was assumed to be the mid-range of possible outcomes and is reflected in our baseline projections.

From the estimate of total taxable sales, spending on admissions and amusement currently subject to the casino entertainment tax,[67] subject to State boxing and wrestling fees, and expenditures on participatory amusements had to be removed. Based on conversations with representatives of the State Gaming Control Board and the gaming industry, the admissions and amusement component of the casino entertainment tax was estimated at roughly 80 percent of total collections.[68] Boxing and wrestling spending varies from year to year depending on the number and type of events drawn to the State. Based on information provided by the Nevada Athletic Commission and others, boxing and wrestling spending were estimated at between $30 and $40 million annually.

Finally, because of the manner in which admissions and amusement spending are tracked and reported there is no readily available means to estimate spending at this level of detail. Based on the limited data that was available, participatory amusements were estimated to represent approximately 20 percent of total taxable admissions and amusement spending. The remaining base-year taxable admissions and amusement spending was estimated at approximately $1.0 billion.

The analyses used to produce our taxable admissions and amusement spending estimates are briefly described in the sections that follow.

Taxable Business Receipts

In 1997, the last year for which business activity survey data is available, total receipts, sales, and shipments for Nevada businesses were $88 billion, or roughly $96,000 per

[67] NRS 463.401

[68] The gaming control board estimates that roughly 70 percent of spending was based on admissions and amusement; the gaming industry estimated that the figure was closer to 5 to 10 percent.

employee.[69] Admissions and amusement industry receipts accounted for just under four percent of the total at $3.8 billion. Receipts from taxable industries totaled $705 million, or 1.2 percent of total business activity.

Defining admissions and amusement industries is no trivial pursuit. While the majority of amusement and recreation spending is found in the *arts, entertainment, and recreation* category,[70] spending on other key items, such as movie theater tickets and sightseeing operations, are found outside the principal category and are recorded under the *information*[71] and *transportation*[72] classifications.

Additionally, not all of the receipts collected in the principal category would be properly subjected to an admission and amusement tax. The *arts, entertainment, and recreation* industry classification also includes revenues from businesses engaged in events promotion, certain non-profit activities, and non-hotel gaming establishments, all of which would be exempt from the reviewed levy.

A review of major spending categories was undertaken in an effort to identify reported industries whose business receipts would most properly be subject to an admissions and amusement tax. The identified industry categories and their reported productivity in 1997 are provided in Exhibit 7C-45 in the appendices that follow this summary.

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[69] Please see US Census Bureau, Economic Census, http://www.census.gov/epcd/www/econ97.html

[70] The Arts, Entertainment, and Recreation sector includes a wide range of establishments that operate facilities or provide services to meet varied cultural, entertainment, and recreational interests of their patrons. This sector comprises: (1) establishments that are involved in producing, promoting, or participating in live performances, events, or exhibits intended for public viewing; (2) establishments that preserve and exhibit objects and sites of historical, cultural, or educational interest; and (3) establishments that operate facilities or provide services that enable patrons to participate in recreational activities or pursue amusement, hobby, and leisure time interests. U.S. Census Bureau, http://www.census.gov/epcd/ec97/def/71.HTM.

[71] The Information sector comprises establishments engaged in the following processes: (a) producing and distributing information and cultural products, (b) providing the means to transmit or distribute these products as well as data or communications, and (c) processing data. The main components of this sector are the publishing industries, including software publishing, the motion picture and sound recording industries, the broadcasting and telecommunications industries, and the information services and data processing industries. US Census Bureau, http://www.census.gov/epcd/ec97/def/51.HTM.

[72] The Transportation and Warehousing sector includes industries providing transportation of passengers and cargo, warehousing and storage for goods, scenic and sightseeing transportation, and support activities related to modes of transportation. Establishments in these industries use transportation equipment or transportation related facilities as a productive asset. The type of equipment depends on the mode of transportation. The modes of transportation are air, rail, water, road, and pipeline. US Census Bureau, http://www.census.gov/epcd/ec97/def/48-49.HTM.

The next step in this analysis was to estimate revenue production for the base analysis year, 2001. Industry specific business receipts per employee multipliers were used to estimate revenue growth in taxable sectors. Because employment information could not be provided at a level of detail similar to that of business activity, the analysis assumes that employment distributions remain materially similar between 1997 and 2001. To be conservative, no inflation in revenue generation per employee was applied. Business receipts in 2001 were estimated to be $839 million.

These data have some important limitations. Primary among them is the fact that revenues spent are grouped by standard industry codes as opposed to how dollars are actually spent.[73] An example of the problems arising from this limitation can be illustrated by looking at a hypothetical theme park. Let us assume that a theme park residing within Nevada generates $5 million in revenue each year. A large share of its revenue would obviously come from the purchase of admissions passes or the active participation in arcade style games, both of which would be subject to an admissions and amusement transaction levy. Some of the revenue, however, would likely come from the sale of merchandise, food and/or beverages; these revenues would not be subject to an admissions tax. There is no way to distinguish between taxable and non-taxable revenues within the reported data.

The opposite situation is equally, if not more, troubling. When two activities (or more) are carried on at a single location under a single ownership, all activities are generally grouped together as a single "establishment." The entire establishment is then classified on the basis of its major activity and all data are included in that single classification.[74] Movie theater ticket sales within a casino-hotel, for example, would likely be classified as casino-hotel[75] revenue as opposed a movie production industry revenue.[76] Thus, many

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[73] This report presents data classified according to the 1997 North American Industry Classification System (NAICS).

[74] The Economic census documentation notes, however, that when distinct and separate economic activities (for which different industry classification codes were appropriate) were conducted at a single location under a single ownership, separate establishment reports for each of the different activities were obtained in the census. See http://www.census.gov/epcd/ec97/introgen.htm#purpose.

[75] NAICS 72112 (Casino Hotels): This industry comprises establishments primarily engaged in providing short-term lodging in hotel facilities with a casino on the premises. The casino on premises includes table-wagering games and may include other gambling activities, such as slot machines and sports betting. These establishments generally offer a range of services and amenities, such as food and beverage services, entertainment, valet parking, swimming pools, and conference and convention facilities.

revenues are not captured by this analysis, which likely leads to an underestimation of total taxable revenue.

Residential Consumer Spending Patterns

Nevada's consumer units (generally households) spend an estimated $566 annually on entertainment-related fees and admissions. With more than 800,000 households statewide,[77] total fee and admission spending by residents was roughly $470 million in 2001. Fees and admissions spending includes fees for participant sports; admissions to sporting events, movies, concerts, and plays; health, swimming, tennis and country club memberships; fees for other social, recreational, and fraternal organizations; recreational lessons or instruction; rental of movies: and recreation expenses on trips.[78] Again, it is important to note the list of inclusions is based on how the data is reported and does not necessarily mirror the recommended tax base.

Consumer spending estimates were derived from the U.S. Department of Labor, Bureau of Labor Statistics, *Consumer Expenditure Survey*, 2001.[79] These data were combined with employment earnings data provided by the Nevada Department of Employment, Training and Rehabilitation, and population figures supplied by the Nevada State Demographer's office. The "top-down" approach described below was used to ensure the revenue estimates remained conservative.

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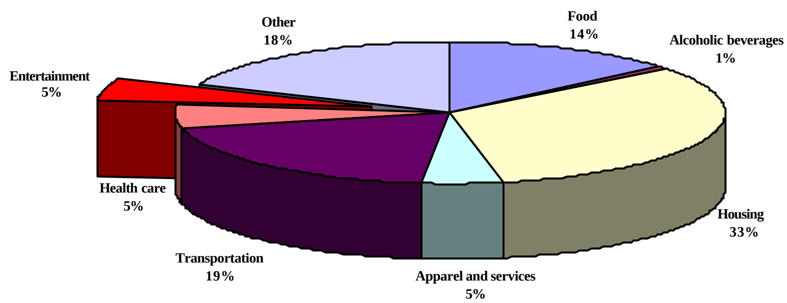
[76] NAICS 51213 (Motion Picture and Video Exhibition): This industry comprises establishments primarily engaged in operating motion picture theaters and/or exhibiting motion pictures or videos at film festivals, and so forth.

[77] Nevada State Demographer population estimates, 2001; U.S. Census Bureau persons per household estimates, 2001. Please see www.census.gov.

[78] Please see http://www.bls.gov/cex/csxgloss.htm#enter.

[79] Please see http://www.bls.gov/bls/proghome.htm.

Exhibit 7-5: Consumer Expenditures by Major Category



Source: US Department of Labor, *Consumer Expenditure Survey*, 2001.

On average, American consumer units (generally, households) spend $38,000 each year. Exhibit 7-5, above, illustrate how these expenditures are distributed across several spending categories, with entertainment account for just over five percent of the annual total. Exhibit 7C-46 in the appendix following this summary provides a detailed set of expenditures by consumer unit and by region. It is important to note that entertainment includes fees and admissions in addition to a number of other expenditures that would not be subject to the recommended levy. This is discussed further below.

Spending patterns differ by region.[80] Consumers in the Midwestern States, for example, tend to spend the least amounts on food, while consumers in the Western States tend to spend the highest amounts on housing. Aggregate income and spending levels also vary by region. Consumers in the Northeastern States have higher incomes relative to their overall spending levels; whereas consumers in the Midwestern States have lower incomes, but spend a higher share of their net earnings.[81]

While it was important to review overall spending trends as an element of this analysis, the more particular focus was on entertainment spending, specifically for fees and admissions in Nevada. Data specific to Nevada was not available through the reports issued by the United States Bureau of Labor Statistics; as such, national, regional, and

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[80] Id.
[81] Id.

comparable jurisdiction data were used as a basis of approximation and to ensure the reasonableness of the estimates generated.

The Western State's average expenditures were used as the basis for estimating Nevada's residential consumer spending.[82] The baseline average income was adjusted to more closely reflect the same in Nevada. The Nevada consumer unit income level was estimated at $44,042. This figure is approximately six percent lower than the reported Western State's average and reflects the ratio between Nevada's income and the national average as reported by the United States Bureau of Economic Analysis.[83] Expenditures were then recalculated based on their relative share of the adjusted income level. Exhibits 7C-47 and 7C-48 in the appendix following the text summary provide a detailed overview of consumer spending as reported for the Western United States and as estimated for the State of Nevada.

Again, the primary focus of this analysis was to estimate consumer spending on fees and admissions. Applying the analysis above, Nevada's households spend approximately $566 annually on entertainment-related fees and admission. Given estimates of population and household density factors provided by the Nevada State Demographer's Office, total spending on fees and admission was approximately $470 million in 2001.[84]

The primary limitation of this analysis is that it includes only spending by residential consumers.[85] Visitors to Nevada make up a formidable consumer group, and omitting them from this analysis would tend to materially underestimate the revenue productivity of an admissions and amusement tax. Estimates of the tax base created by these non-resident consumers are provided in the *Visitor Spending* section, below.

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[82] Western States included Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, and Wyoming. *See also* ftp://ftp.bls.gov/pub/special.requests/ce/standard/2000/region.txt.

[83] Please see http://www.bea.doc.gov/bea/regional/reis/

[84] Nevada's population in 2001 was estimated at 2.08 million. Nevada State Demographer's Office May 2002. Nevada's persons per household were estimated at 2.62. U.S. Census Bureau, Nevada Quick Facts, June 2002.

Income and Expenditure Regressivity

A discussion of consumer spending patterns would be incomplete without some treatment of regressivity. Generally, fiscal systems strive to achieve "vertical equity." Vertical equity is present where increases in income and/or spending are not coupled with decreases in a taxpayer's relative tax burden. Where poor residents carry greater burdens, the system or levy is said to be regressive. Where the opposite situation exists, the system or levy is said to be progressive.

Regressivity is generally measured by looking at changes in spending patterns between high-income and low-income consumer groups. Our analysis looked at Western States consumers with annual incomes between $10,000 and $20,000 and those with annual incomes above $70,000. These groups were selected because they each represented approximately 20 percent of the consumers surveyed by the US Department of Labor, *Consumer Expenditure Survey*.[86] Both income and expenditure regressivity measures were calculated and these analyses are summarized in Exhibits 7C-49 and 7C-50 in the appendices following this summary.

Because this analysis is specific to a transaction tax on admissions and amusement spending, expenditure regressivity is the most salient issue. Total spending for consumer units reporting annual incomes between $10,000 and $20,000 was $24,300 in 2000.[87] Total spending for consumer units with incomes above $70,000 was $82,707 during the same period.[88] Admissions and amusement spending for these two groups averaged $262 and $1,313 respectively.[89] This represented 1.1 percent of the lower income group's total annual expenditures and 1.6 percent of the higher income group's total expenditures.

Expenditure regressivity can be measured by looking at the changes in consumer spending patterns at each income level. The difference in average total spending was 240 percent, while the difference in admissions and amusement spending was 402 percent. That is to say that every 1.0 percent increase in total spending was accompanied by a 1.7

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[86] US Department of Labor, *Consumer Expenditure Survey*, 2000.

[87] We note that average expenditures for this category exceed average income by nearly $10,000 annually. This is largely the result of credit spending, spending of income reported from a prior period, and transfers of wealth via public assistance and other programs. US Department of Labor, April 2002.

[88] We note that average expenditures for this category were exceeded by total income by $35,000. The balances of these expenditures were likely placed in savings or other non-reported investment instruments. US Department of Labor, April 2002.

[89] US Department of Labor, *Consumer Expenditure Survey*, 2000.

percent increase in admissions and amusement spending. Thus, admissions and amusement spending appears to have a "progressive" pattern, where those consumers with the ability to spend more would bear a greater relative tax burden.

Visitor Spending

Nevada welcomes more than 48 million visitors each year.[90] On a full-time equivalency basis, these visitors account for roughly 18 percent of the State's population. They represent a substantial portion of the State's economy and its public revenues.

Data provided by the Las Vegas Convention and Visitors Authority ("LVCVA") and the Reno-Sparks Convention and Visitors Authority ("RSCVA") suggest that non-gaming visitor expenditures statewide total more than $27.8 billion each year.[91] Exhibit 7C-51, in the appendices following this summary, illustrates these expenditures by category.

The question raised by this analysis is: *which of these expenditures would be subject to an admissions and amusement tax*? Spending on shows, sightseeing, entertainment and special events account for 8.4 percent of all reported visitor spending, or $2.3 billion annually.[92] Of this total, 93 percent is attributable to expenditures in Southern Nevada.

While these data are important to the analysis, we must cite our concern that the information reported may tend to materially overstate visitor spending. For example, the LVCVA reported that, in 2001, visitors spent an average of $85.34 on hotel and motel lodging per visitor per night.[93] At the reported visitor volume for that year (35 million) and the average stay per visitor of (3.6 nights), total rooms spending would have been $10.1 billion.[94]

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[90] Nevada Commission on Tourism. Research Department. April 2002.

[91] Las Vegas Convention and Visitors Authority, *Visitor Profile Study*, 2001; Reno-Sparks Convention and Visitors Authority, *1999 Visitor Profile Study*, 1999.

[92] Expenditures not included in this analysis are those for food, drink, shopping, lodging, and recreation.

[93] GLS Research, *2001Las Vegas Visitor Profile Study*, 2001; *see also* http://www.vegasfreedom.com/gen_vizpro.asp.

[94] Conversations with representatives of the Las Vegas Convention and Visitors Authority suggest that this is due largely to the way in which data are reported and collected. Nonetheless, an application of the figures as generally represented would result in a material overstatement. We note that much of this error is outside the control of the Authority's research staff.

This estimate can then be measured against the rooms revenue figure reported by the Nevada State Gaming Control Board.[95] In 2001, total rooms revenue for all non-restricted gaming licensees with $1 million or more in gross gaming revenue was $3.5 billion. It is generally accepted that these gaming licensees account for the vast majority of the State's lodging revenue. Even if we assume that they represent only 75 percent of the State's room tax collections, an extrapolation of the LVCVA's estimates would still yield a base more than twice that which is likely to actually exist.

This analysis is not intended to be disparaging to the LVCVA in any way. Its research staff were helpful in this analysis and are more than qualified. Rather, the example above is intended to illustrate how these data's limitations may overestimate the base of visitor spending. There are no readily available ways of similarly validating the estimates of shows and sightseeing spending. It is important to note, however, that if similar trends are present, the base of sales supported by Nevada's visitor population may be materially overstated.

Comparable Jurisdiction Analyses

In the course of preparing the estimates provided in the preceding sections of this report, we also reviewed admissions and amusement taxes in other jurisdictions. This was not a comprehensive review, but was a supplemental information-gathering exercise. Thirty-seven states currently impose some type of levy on admissions and amusement.[96] Please see Exhibit 7C-52. The majority of these, however, include admissions and amusements as a component of their sales tax levy.

Representatives from selected jurisdictions were interviewed to better understand how similar levies function and whether their respective policy objectives were met. Additionally, the State of Ohio also prepared a summary of admissions taxation in 13 states. That analysis was also obtained and its findings integrated into the comparative summary.[97] Please see Exhibit 7C-53.

Some jurisdictions for which data was available included estimates of the revenue-producing capacities as well as tax bases. While each tax was unique, this information

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[95] State of Nevada Gaming Control Board, *Gaming Abstract*, 2001.

[96] Source: Zelman, S., et. al., All States Handbook, Research Institute of America, 2000 ed.

[97] Please see http://www.state.oh.us/tax/business_startup_btg.html

provided a valuable comparison to the broad theoretical levy analyzed herein. Most notable was the fact that jurisdictions imposing an admissions and amusement tax tended to generate only moderate revenues from the source.

One example is the State of Florida, which generates $346 million annually from $6.3 billion in admissions spending.[98] Florida's admissions spending is roughly $370 per capita. By comparison, the mid-scenario estimate for Nevada is $860 per person. At first blush it appears as though the local estimate may be overly aggressive, particularly considering both economies' reliance on tourism. A closer look, however, provides some additional perspective. Florida welcomes approximately 70 million visitors each year;[99] Nevada welcomes 48 million visitors.[100] In per capita terms, Florida reports 4.3 visitors per person. In Nevada, visitors per capita are 22.8. Obviously, the per capita benefits derived from visitor spending in Nevada are substantially greater than those in Florida.

While much of the state-to-state variation can be explained by similar differences in exemptions, rates, and demographics, the Legislature may want to look further into this issue before it concludes its review and analysis of this topic.

Admissions and Amusement Tax Rate and Revenue Projections

The Task Force recommends that the State impose an admissions and amusement tax rate of 6.5 percent. While this levy differs from the State sales and use tax, the rate recommended mirrors the statewide base sales tax rate.[101] This was done to create some level of parity in the relative taxes imposed on separate categories of purchases.

As outlined in the preceding sections, the AAT base is estimated to be $1.0 billion. This represents just over one percent of the State's gross receipts total. Spending on admissions and amusement has been growing at rates faster than the economy as a whole;

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[98] Florida Department of Revenue, 2001.

[99] Visit Florida, Research Department Interview, June 2002.

[100] Nevada Commission on Tourism.

[101] The base sales tax rate of 6.5 percent is made up of the 2 percent State sales tax, the 2.25 percent local school support tax, the 0.5 percent basic city-county relief tax, and the 1.75 percent supplemental city-county relief tax. The total levy in any county may differ from this base rate because the locality imposes an "optional" county levy.

this trend is anticipated to continue through the balance of the projection period.[102] By FY 2010-11, taxable admissions and amusement spending is estimated to reach $1.5 billion, equating to a compound annual growth rate of between four percent.[103] The recommended levy is projected to generate an average of $85 million per year during the study period, and is projected to remain relatively constant in per capita inflation-adjusted terms. Please see Exhibit 7C-54 through 7C-56.

State Activity Tax

General Overview

The final component of the Task Force's proposed revenue increase plan is a state activity tax (the "SAT"). As proposed, the SAT would be a 0.25 percent levy imposed upon the gross revenue of all businesses within the State. This will result in an additional 0.25 percent tax on gross gaming revenue. Gross revenue is defined as all sales, shipments, and receipts of businesses that may be legally taxed in the State of Nevada.

It is important to note that no industry will be exempt from effect of the SAT as recommended. While the proposed SAT would apply to all non-gaming business activity the same, for gaming activity presently covered by a gross revenue tax under NRS 463, the Task Force recommends a corresponding 0.25 percent increase in the current rates, thereby insuring that all industries participate in the burden of the tax.

The Task Force further recommends that the first $350,000 of gross revenue be exempt from the SAT. This "standard deduction" is intended to provide additional protection for small businesses and limit the regressivity of the levy. We also recommend that each business be allowed a one-for-one tax credit of up to $100 per year for each "qualified

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[102] See Moran, L. and McCully, C., Trends in Consumer Spending, 1959–2000; (noting a growth rate for recreation spending in excess of five percent per year); Veronis, Suhler, Stevenson, Media Merchant Bank, (stating filmed entertainment includes box-office, home video and television programming. These categories dominate the segment with 67.3 percent of total revenues, and posted 5.1% growth in 1999 to $40.8 billion. The CAGR for the 1994-1999 period was 6.1%. Veronis Suhler expects spending to grow to $53.9 billion by 2004, a 5.8% CAGR.); PriceWaterhouseCoopers, *PWC Forecasts Growth for Global Entertainment and Media*, 2002. (stating Buoyed by the growing importance of the Internet as a distribution medium, and overcoming the 2001 U.S. economic slowdown, the global entertainment and media industry will reach $1.2 trillion by 2005, growing at a 7.2 percent compound annual rate.); *see also* Nevada Gaming Control Board, 10-year history of Casino Entertainment Tax).

Nevada employee." A qualified Nevada employee is defined herein as an employee for whom the State BLT was paid.

A hypothetical calculation for a business with $1 million in revenue and 10 qualified Nevada employees is provided below.

Exhibit 7-6
Hypothetical Business Tax Calculation

Total Revenue	**$1,000,000**
Less: Standard Deduction (at $350,000)	($350,000)
Gross Taxable Revenue	$650,000
Gross Tax Liability (at 0.25%)	$1,625
Less: BLT Credit (at $100 per employee)	($1,000)
Net Tax Liability	**$625**

In addition to the standard deduction noted above ($350,000), the Task Force recommends that additional deductions be allowed for:

- Income represented by federal, state, and local motor vehicle fuel taxes;
- Government bond interest;
- Income which the State constitutionally cannot tax;
- Cash discounts taken by purchasers;
- Pass-through revenue;
- Bad debts;
- Receipt of counterfeit currency;
- Dividends of subsidiary firms;
- Health or life insurance claims paid by insurance companies;
- Income from governmental sources received by public or private hospitals;
- Operating income of public electric, gas, sewer or water utilities; and
- Fundraising activities and dues of non-profit organizations.

Finally, the Task Force recommends that an additional credit be allowed for certain capital investments in Nevada. As proposed, the credit would be allowed for "approved firms,"[104] and would be administered by the Nevada Commission on Economic Development.

This element of the Task Force's proposal is intended to provide a broad and stable revenue source that will help the State meet its long-run funding needs and counterbalance existing and future structural challenges. While the tax will ultimately be borne by both businesses and consumers, it is directed specifically toward entities doing business in Nevada. There is no tax we could identify that more completely reflects the State's diverse economy; and thus, we believe the SAT epitomizes both the letter and spirit of ACR 1.

The SAT does not come without its challenges. There are those who will argue that a tax on gross revenue is not equitable because it does not take into account a businesses' profitability; it will discourage investment and maintenance of assets; it will disparately impact high-volume, low-margin industries; it may lead to increased prices for some because of "pyramiding."[105] These same concerns apply to the BLT, and were issues considered by the Task Force and weighed in developing our final recommendations.

We again state that there is neither a perfect tax nor a perfect tax system. The threat of additional taxes will inevitably spawn opposition, and there is no more obvious sign that a proposed levy will produce no revenue than the fact that no one lobbies against it. It is important to separate fact from fiction, and issues of substance from political rhetoric while considering this issue.

Conversely, we do not purport to have considered every issue impacting or being impacted by the imposition of the SAT or any other new tax or fee recommended in this report. The Task Force has provided the State as much detail as was reasonably possible. This was done with the intent of providing a tool and a schematic, building the structure (and living in it) is the job of the State's elected representatives, and will surely entail a degree of due diligence well beyond what has been provided.

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[104] The Task Force did not formally define what would constitute and approved firm; however, discussion around this topic included consideration of high-tech industries, research and development investments, and in industries paying higher than average wages.

[105] Pyramiding is a process by which a tax compounds on itself. However, it has been noted that pricing strategies of many national retailers tends to minimize this impact of this trend.

In total, the SAT is projected to generate $1.7 billion during the study period, or roughly $245 million annually. We note that our proposal assumes that the SAT will come on-line in FY 2004-05. This was done to balance the revenue-generating needs of the State; to allow the Legislature and staff to work through the countless administrative details that will be critical to effective and efficient implementation; and to collect the data necessary to set the appropriate rates and exemption levels. These issues are discussed in greater detail in the sections that follow. Please see Exhibit 7C-57.

The Need for More Complete Information

The base estimates that are the foundation for our revenue projections rely on data provided by a number of third-party sources. These data were often inconsistent and were uniformly incomplete. We highly recommend that the State undertake a data collection effort prior to implementing the SAT. Doing so would allow legislators, tax officials, and budget analysts to better estimate the number of businesses operating in Nevada, their gross revenues, and their number of employees. Having reliable data in these areas is critical to establishing an appropriate tax rate as well as appropriate exemption levels. This will go a long way to avoiding many of the political pitfalls that have plagued legislators and tax increases throughout history.

In the *Business License Tax Increase* subsection, we recommend that a "statewide business database" be created and maintained by the Nevada Department of Taxation (the "Department"). We have estimated the cost for this effort (as well as an overall up-grade to the Department's information technology system in our recommendation).[106]

Base Estimates

The base upon which the SAT would be levied is total sales, shipments, receipts, revenue, or business done by establishments within Nevada.[107] Data used in this analysis include information reported in the United States Census Bureau's Economic Census (the "Economic Census"); information reported by Dun & Bradstreet ("D&B"); as well gross state product information reported by the United States Bureau of Economic Analysis.

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[106] Please see Exhibit 7-1.

[107] *See* General Definition of Sales Activity, U.S. Census Bureau, 2002. http://www.census.gov/epcd/ec97brdg/def/ECVALUE.HTM.

Each of these analyses is discussed in the sections that follow.

United States Census Bureau: Economic Census

Every five years, the U.S. Census Bureau conducts a survey of businesses and industries across the United States. It is commonly referred to as the "Economic Census." Information collected includes the number of establishments, total receipts, and employment by industry. The latest data available from this very comprehensive dataset is for 1997.

An important element of these data is that they consider both "employing" and "non-employing" establishments. An employing establishment is generally defined as a single physical location at which business is conducted and/or services are provided. It is not necessarily identical with a company or enterprise, which may consist of one or more establishments. Economic census figures represent a summary of reports for individual establishments rather than companies. The count of establishments represents those in business at any time during 1997.[108]

General economic activity includes the total sales, shipments, receipts, revenue, or business done by establishments within the scope of the analysis; thus, it is somewhat synonymous with the term "gross receipts" that has been used by the Task Force.[109] For non-employing businesses, it includes gross receipts, sales, commissions, and income from trades and businesses, as reported on annual business income tax returns.[110]

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[108] *See* www.census.gov/epcd/. For cases where a census report was received, separate information was obtained for each location where business was conducted. When administrative records of other Federal agencies were used instead of a census report, no information was available on the number of locations operated. Each economic census establishment was tabulated according to the physical location at which the business was conducted. When two activities or more are carried on at a single location under a single ownership, all activities generally were grouped together as a single establishment. The entire establishment is classified on the basis of its major activity and all data for it were included in that classification. However, when distinct and separate economic activities (for which different industry classification codes were appropriate) were conducted at a single location under a single ownership, separate establishment reports for each of the different activities were obtained in the census.

[109] *See* General Definition of Sales Activity, U.S. Census Bureau, 2002. http://www.census.gov/epcd/ec97brdg/def/ECVALUE.HTM.

[110] Id. at http://www.census.gov/epcd/nonemployer/rcptsdef.htm#NON. Note also the composition of nonemployer receipts may differ from that of the related data item that is published for employer establishments. For example, for wholesale agents and brokers without payroll, the receipts item contains commissions received or earnings. In contrast, for wholesale agents and brokers with payroll, the sales item published in the economic census represents the value of the goods involved in the transactions.

Business income consists of all payments for services rendered by nonemployer businesses, such as payments received as independent agents and contractors.

Exhibit 7C-58 provides economic activity estimates reported by the Economic Census, specific to the State of Nevada. In 1997, total economic activity was reportedly $90 billion. Of this total, 95 percent was attributable to employing establishments. Applying the Nevada Department of Employment, Training, and Rehabilitation's 2001 employing worksite estimate of 51,100 to the average revenue generated per business results in an estimated total activity figure of $120 billion for FY 2000-01. Please see Exhibit 7-7, below. We note that in order to be conservative, no inflation factor was applied in this analysis.

Exhibit 7-7: Base Year Economic Activity Estimate Based on Number of Employing Establishments, 1997 and 2001

	1997	2001
Employing Establishments	38,200	51,100
Total Economic Activity (in $1,000s)	85,141,462	113,893,422
Total Economic Activity Per Establishment (in $1,000s)	2,229	2,229
Share of Total Activity Accounted for By Employing Establishments	95.2%	95.2%
Total Economic Activity (in $1,000s)	**89,471,902**	**119,686,235**

A second alternative for reviewing these data is to consider total economic activity as a function of gross state product. In 1997, Nevada's gross state product was $59.2 billion. By 2001, that figure rose to an estimated $78 billion, or by 32 percent. Applying the economic activity-to-state product ratio existing in 1997 to the total state product in 2001, produces an estimated total economic activity factor of $118 billion. Please see the table on the following page.

A third alternative for estimating Nevada's aggregate economic activity is to use employment growth and industry sales activity to create sales-per-employee multipliers. In 1997, sales per employee were estimated at $130,700 and total industry employment was estimated at 775,000. Combining these factors generated an estimated $101 billion in total economic activity.[111] Applying the industry specific employee multipliers to the

[111] We note that this figure is roughly $12 billion higher than that reported in the earlier analyses. This is due to a factoring analysis that was conducted to estimate unreported economic activity based on average industry estimates.

2001 employment estimates, and using annual growth rates of 1.3 percent annually generates a base-year economic activity factor of $125 billion.[112] (see table below).

Exhibit 7-8: Base Year Economic Activity Estimate Based on Gross State Product Growth, 1997 and 2001

	1997	2001
Gross State Product (in $1,000s)	$59,248,000	$78,444,352
Total Economic Activity (in $1,000s)	**$89,471,902**	**$118,450,972**
Economic Activity Ratio to State Product	1.51	1.51

Exhibit 7-9: Base Year Economic Activity Estimate Based on Employment Activity Multipliers, 1997 and 2001

	1997			2001		
Employment Sector	**Employ ment**	**Sales (in 000's)**	**Sales Per Emp.**	**Employ ment**	**Sales (in 000's)**	**Sales Per Emp.**
Mining	14,663	$3,373,191	$230,048	10,501	$2,415,731	$230,048
Construction	81,953	$11,957,767	$145,910	87,697	$13,474,286	$153,647
Manufacturing	40,604	$6,782,255	$167,034	46,032	$8,096,592	$175,891
Transportation and public utilities	44,877	$7,145,534	$159,225	57,328	$9,612,015	$167,667
Wholesale trade	34,892	$15,242,041	$436,835	40,115	$18,452,764	$459,997
Retail trade	145,533	$20,179,170	$138,657	182,301	$26,617,585	$146,009
Finance, insurance, and real estate	40,338	$9,628,206	$238,688	48,599	$12,215,131	$251,344
Services	371,753	$26,932,705	$72,448	448,003	$34,177,834	$76,289
Total	**774,613**	**$101,240,868**	**$130,699**	**920,576**	**$125,061,938**	**$135,852**

Dun & Bradstreet Database

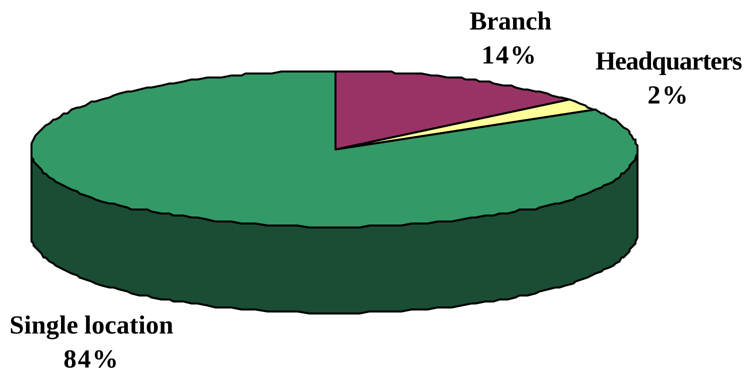
D&B is a national provider of business information. The Task Force procured the D&B database for Nevada to compare it with the estimates generated from other sources. Of the 85,000 records, in the database, 63,000 reported estimated sales activity. Combined, reporting businesses accounted for more than $97 billion in total economic activity.

The D&B database also provides information on the type of business location, segmenting all businesses into three categories: single location, branch office, or headquarters. Exhibit 7-10 below depicts the reported location-type distribution for

[112] See *Section 1: Economic Overview and Baseline Estimates*.

Nevada businesses. This distribution is important because of the manner in which revenues are reported within the database. Revenues for headquarters include all revenues for that business, in some cases nationwide. Branch offices, on the other hand, do not report revenues, as their income is rolled up to their headquarters.

Exhibit 7-10
D&B Database Estimate of Business by Location Type, 2001



A taxable percentage factor was applied to all headquarters businesses. This percentage was based on the number of employees located in Nevada versus the total number of employees the business reported. The average was 24 percent. Branch office revenues were then estimated using industry-specific revenue-per-employee multipliers.

The D&B database includes information on public and private sector establishments. All public sector, religious, and charitable organizations were flagged so as not to be counted in the estimated taxable total. Approximately nine percent of all business establishments were identified as exempt.

The resulting economic activity estimates are provided in Exhibit 7-11, below. For the 81,409 taxable establishments in the State of Nevada, total sales activity is estimated to be $103 billion. If we adjust the number of establishments to reflect the aggregate establishment count estimates provided in the following section (100,000), total sales activity would be a reported $127 billion.

Exhibit 7-11
D&B Database Estimate of Aggregate Economic Activity

Total Economic Activity	$	103,050,000,783
Total Number of Taxable Establishments		81,409
Economic Activity Per Establishment	$	1,265,830
Estimated Actual Number of Establishments		100,000
Benchmarked Economic Activity Estimate	**$**	**126,583,000,000**

Summary of Base Estimates and Projections

All of the approaches used to estimate aggregate business activity in the State of Nevada produced relatively similar results. For modeling purposes, the Task Force utilized the estimates derived from the Economic Census and employment growth. These data provided a number of advantages because they were the most detailed and historical information was available. Please see Exhibit 7C-59.

Growth in the taxable base was modeled as a function of employment growth and an inflation factor. To be conservative, the per employee revenue multipliers were inflated by a rate of 1.3 percent, or roughly half projected rate of inflation. Under these assumptions, the tax base is anticipated to grow from $136 billion in FY 2003-04 to $160 billion by FY 2010-11. If a 0.25 percent levy were to be placed on this base it would generate nearly $340 million in FY 2003-04, growing to $408 million by the close of the study period. Please see Exhibit 7C-60.

Estimated Impact of the Standard Deduction

As noted in the *General Overview*, the Task Force recommends a number of SAT deductions for items such as charitable donations, governmental revenues, and bad debts. The most significant by far, however, is the standard deduction of $350,000 that is recommended for all businesses. It was the desire of the Task Force to exempt no fewer than 50 percent of all businesses in the State, and we believe this threshold meets or exceeds this goal.

The following sections attempt to review the data used to quantify the impact of this deduction. Data on the aggregate number of Nevada businesses were collected and reviewed from a number of sources, including the Nevada Department of Employment, Training and Rehabilitation, the United States Census Bureau, the Secretary of State's Office, Dun & Bradstreet, the Department of Taxation and the State's respective local business licensing offices. The number of businesses identified from each of these sources varied considerably.

Local Business Licensing Departments

Our efforts began by surveying the business license departments within Nevada's largest local governments. Somewhat surprisingly, however, only a handful of these agencies could accurately report the number of businesses currently licensed within their borders. Nonetheless, the table below summarizes the limited information that was available.

Exhibit 7-12: Business Licenses Issued and Active for Selected Jurisdictions, 2002[113]

City/County	# Issued	Notes
Clark County	40,000	Approximation
City of Las Vegas	35,000	Approximation
City of North Las Vegas	4,000	Very rough estimate. Minimum of 3,000.
Henderson	11,724	Exact as of 9/23/2002.
Boulder City	1,500	Approximation
Carson City	6,443	Exact as of 9/23/2002.
Reno	20,000	Reported as "over 20,000"
Lake Tahoe	1,000	Approximation
Sparks	6,138	Includes the City of Sparks and outlying areas.
Total	**125,805**	**n/a**

Nevada Department of Employment Training and Rehabilitation ("DETR")

DETR is probably the most authoritative source for business and industry estimates in the State. It has a team of skilled economists who collect, analyze, and monitor employment, firm, and wage data on a continuing basis. Information most pertinent to the number of businesses in Nevada is reported in DETR's analysis of Nevada firms and worksites. The total number of firms reported as of the second quarter of 2002 was 46,800, and the number of worksites reported was 51,100 in its September 2001 release. Additional information is provided in Exhibits 7C-61 and 7C-62 in the appendix following this text summary.

[113] Based on data provided from interviews with representatives from each jurisdiction, September 2002.

The distinction between what is a worksite and what is a firm is an important one and is not always clear.[114] Much of the information that DETR collects is tied to unemployment insurance reporting requirements. Where an employer has more than 10 employees working at multiple sites, they are required to report information to the State for each site. Thus, an individual owning 10 grocery stores would report 10 worksites where only one firm might exist.

It is also important to note that not all businesses are required to report to the State because not all businesses fall under the purview of unemployment insurance laws. Non-reporting businesses include those with one employee, not-for-profit businesses, government employers and sole proprietors. Thus, it is likely that Nevada's total number of firms and worksites is underestimated by these data.

Nevada Secretary of State

Nevada's Secretary of State was able to provide relatively detailed data regarding the total number of corporations, limited-liability companies, limited partnerships, and

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[114] Definitions provided by Nevada Department of Employment, Training and Rehabilitation Bureau of Labor Statistics Unit Supervisor (stating The Bureau of Labor Statistics ("BLS") defines a multiple work site establishment as an employer who has more than one physical location (or establishment) under the same "unemployment insurance account number" within the State, and who has a total employment of 10 or more in all of the secondary locations combined. The primary establishment is defined as the location or establishment with the largest employment. BLS regulations require the Covered Employment and Wage program (ES-202) to collect and disaggregate employment by work site for such an employer. Once the criterion of 10 employees is met, each work site should be reported separately, regardless of the size of the work site.

Nevada collects Multiple Work site data each quarter from all Nevada employers meeting these requirements. The number of private establishments typically provided by the covered employment and wage program represents a count of work sites, not individual firms. Thus, if one unemployment insurance account number represented 10 locations, the ES-202 would count that as 10 work sites in its detailed establishment data. If the number of firms only is required, a different count would be needed than the standard quarterly ES-202 output. This count also excludes government locations by ownership code.

The 'Total Private' count of work sites represents employers covered by unemployment insurance laws in Nevada. An employer becomes subject to the law when he first pays wages of $225 or more to workers in employment covered by the law. After an employer becomes subject to the law, even though wages paid in a quarter are less than $225, he must continue to file quarterly reports until his account is closed.

Sometimes firms are unable to provide DETR with detailed work site data or refuse to cooperate. In this case, the firm would only be counted as one work site, since no breakouts by location are provided. Codes are assigned to these firms to identify that we know they have more than one location but are not willing/able to comply with BLS regulations.)

business trusts organized under Nevada state law. This total was roughly 194,000 and is summarized in the table on the following page.

Exhibit 7-13
Number of Business Entities in the State of Nevada, 1998 - 2001[115]

Business Type	1998	1999	2000	2001
Corporations	111,014	121,025	132,557	143,127
Limited-Liability Companies	15,608	22,427	30,180	34,997
Limited Partnerships	11,808	13,833	15,680	16,013
Limited Liability Partnerships and Business Trusts	86	114	243	312
Total	**138,516**	**157,399**	**178,660**	**194,449**
Growth Rate	16.5%	13.6%	13.5%	8.8%

No information was available, however, on the number of these entities which actually have Nevada as a principal place of business or who otherwise market their product or services within the State. Additionally, sole proprietorships and partnerships and companies that are not formed as limited liability entities have no filing requirements and are unaccounted for in the Secretary of State's dataset.

U.S. Census Bureau: Economic Census

Similar to the data collected and analyzed by DETR, Economic Census estimates also rely on federal reporting requirements. The Economic Census, however, goes further than the State in that it attempts to identify and quantify activity in non-employer businesses, or establishments that have no paid employees, annual business receipts of $1,000 or more ($1 or more in construction industries), and are subject to federal income taxes. As noted above, generally, an establishment is a single physical location at which business is conducted or services or industrial operations are performed. However, for non-employers, each distinct business income tax return filed by a non-employer business as an establishment is counted. Non-employer businesses may operate from a home address or a separate physical location.[116]

In total, Nevada's aggregate number of business establishments identified in 1997 was 131,000, with 71 percent, or 93,000, of those businesses being non-employing in nature.

[115] State of Nevada Secretary of State's Office, September 2002. www.sos.state.nv.us.

[116] Id. Most geography codes are derived from the business owner's mailing address, which may not be the same as the physical location of the business.

These non-employing businesses, however, represented less than five percent of the reported sales activity of the State (approximately $90 billion).[117]

The establishments reported in the Economic Census are somewhat analogous to the worksite data collected and reported by DETR. To estimate the number of establishments in Nevada during 2001, we used the ratio generated by the Economic Census data and applied that to the worksite figure provided by DETR. This results in a total establishment estimate of more than 175,000, and a compound annual growth rate of eight percent per year. We felt this estimate was somewhat aggressive, given the 3.0 percent growth rate DETR reported in total firms and the 6.5 percent growth rate the U.S. Census Bureau reported in non-employing establishments between 1997 and 2001. At a 5.0 percent rate of growth, the number of establishments would be roughly 160,000. While too brief to support any definitive conclusions, these data tend to suggest an increasing marginal propensity of employees to seek out independent contractor-type opportunities.

Dun & Bradstreet Database

The fifth data source used in our analysis of Nevada's business entities was that available from D&B. Essentially, D&B attempts to maintain a database of all businesses existing and active in the State of Nevada. While the information is often used for public and private analysis purposes, the data is survey-based and is limited in its accuracy and utility. To mitigate these issues, the database was refined to eliminate outliers and duplicate records as well as differentiate between businesses reporting from and operating in Nevada. This was done to generate a relatively "clean" sample set.

In total, the D&B database reported 85,900 business establishments statewide, of which 81,500 are non-government, not charitable in nature.[118] These data also reflected the same general trend as the Economic Census and DETR data, as nearly 65 percent of all reporting businesses had one or two employees. Please see Exhibit 7C-63 in the appendices following this text summary.

The D&B data admittedly does not capture all of the non-employing business reflected in the Economic Census data. That having been said, it likely captures the majority of the

[117] Aggregate sales activity is discussed in greater detail in the sections that follow.
[118] Note that government, religious, and charitable establishments were removed.

State's active businesses and provides a series of meaningful insights into Nevada's business distribution by size of firm.

Nevada Department of Taxation

The final source of entity data considered in our analysis was that reported by the Nevada Department of Taxation (the "Department"). The Department tracks the number of business license tax and sales and use tax accounts, which are business specific. They totaled 80,800 and 64,100, respectively, in FY 2001-02.[119]

Representatives from the Department cautioned that these data will tend to under represent the total number of businesses in the State because not all businesses are required to pay business license tax, nor are they necessarily required to register for a sales and use tax account.

Summary of Standard Deduction Estimates and Projections

Finding a balance between Nevada's number of businesses and worksites was challenging in and of itself; however, the question of the standard deduction becomes even more difficult when one considers how a businesses reports to the State for tax purposes. To illustrate this point, assume a hypothetical business owner exists in Nevada and owns three grocery stores, one in Las Vegas, one in Reno, and one in Elko. That business owner may remit one tax payment or three, depending on how the business is organized (and whether there is a benefit to do one or the other). As such, the number of business licenses issued may tend to over estimate the number of firms in the Nevada, while the worksite and tax account data may underestimate the businesses due to limited reporting requirements and exemptions.

The Task Force has opted to use an approximate base-year midpoint of 100,000 entities for modeling purposes. This figure is higher than the worksite and account data, but lower than totals reported by local business license departments and estimates of establishment produced by the Economic Census. Thus, we believe it to be a reasonable approximation. Business growth was modeled as a function of employment growth through the balance of the study period.

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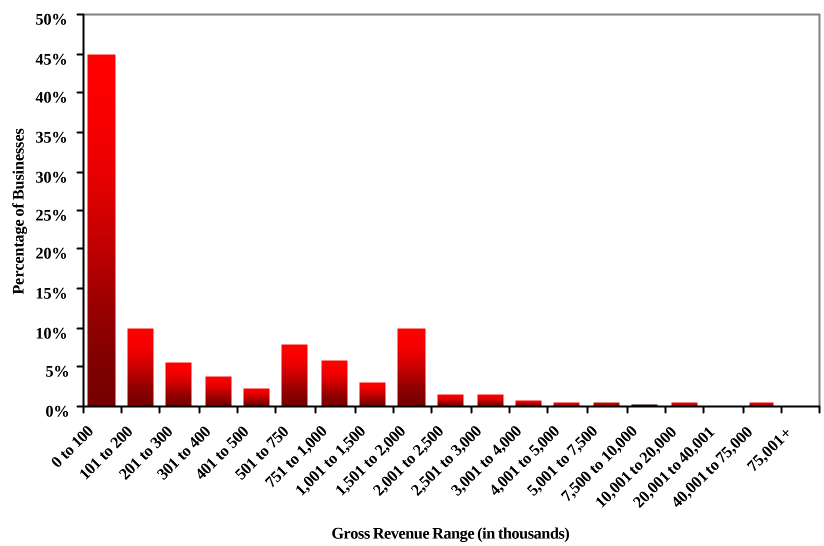
[119] Data provided by the Nevada Department of Taxation, October 2002.

If Nevada were to apply the $350,000 exemption to the estimated number of entities in FY 2004-05 (107,400), a maximum deduction of $38 billion could potentially exist. This would have a tax implication of $94 million in that year. Not all businesses, and in fact most businesses, do not generate $350,000 per year in gross revenue. Data from the D&B database were used to estimate Nevada's business distribution by revenue threshold.[120] Exhibit 7-14, below, illustrates the modeled trend.

Exhibit 7-14: Estimated Distribution of Businesses by Gross Revenue Range



The actual impact of the exemption is anticipated to be roughly half the potential maximum referenced above. In FY 2004-05, the estimated decline in taxable revenue associated with the standard deduction is approximately $24 billion, or $59 million in potential tax collections. By the close of the study period the exemption total is anticipated to reach $27 billion, or 17 percent of the State's potential base. Exhibit 7C-64 illustrates the projected impact of the deduction throughout the study period.

[120] We note that while there are a number of limitations to these data, they appeared to be consistent with related data sets reported by the Department of Employment, Training, and Rehabilitation; The U.S. Census Bureau; and the Internal Revenue Service.

Estimated Impact of the Qualified Nevada Employee Credit

As an additional element of the SAT, the Task Force recommends that each business be allowed a one-for-one tax credit of up to $100 per year for each "qualified Nevada employee." A qualified Nevada employee is defined as an employee for whom the BLT has been paid. To estimate the impact of this credit, the number of employees by gross revenue range must be estimated. There are two sources of these data: 1) the Nevada Department of Employment, Training and Rehabilitation; and 2) Dun & Bradstreet.

The Nevada Department of Employment, Training, and Rehabilitation

The Nevada Department of Employment, Training and Rehabilitation ("DETR") reports data on the number of worksites by size of business as well as the number of employees by size of business. The size of the business is measured based on the number of employees because DETR does not report business activity data in terms of business revenue. These data were used to verify the reasonableness of the trends reported in the Dun & Bradstreet database, which does include revenue-specific information.

Exhibit 7C-65 and 7C-66 in the appendices following this text summary illustrate the data provided by DETR.[121] They show that the majority of worksites and firms have relatively few employees, and that a limited number of larger firms tend to employ a majority of the State's workforce. These data are consistent with the information reported by Dun & Bradstreet (see below) and similar information reported for comparable jurisdictions.

Dun & Bradstreet Database

As noted in previous sections, the D&B database provides information on businesses, incomes, and employment. The sample set extracted from the refined dataset appeared consistent with other related information, in this case the data reported by DETR; and as such, it was used for modeling purposes. The reported distribution of employees by gross income range is summarized in the chart below.

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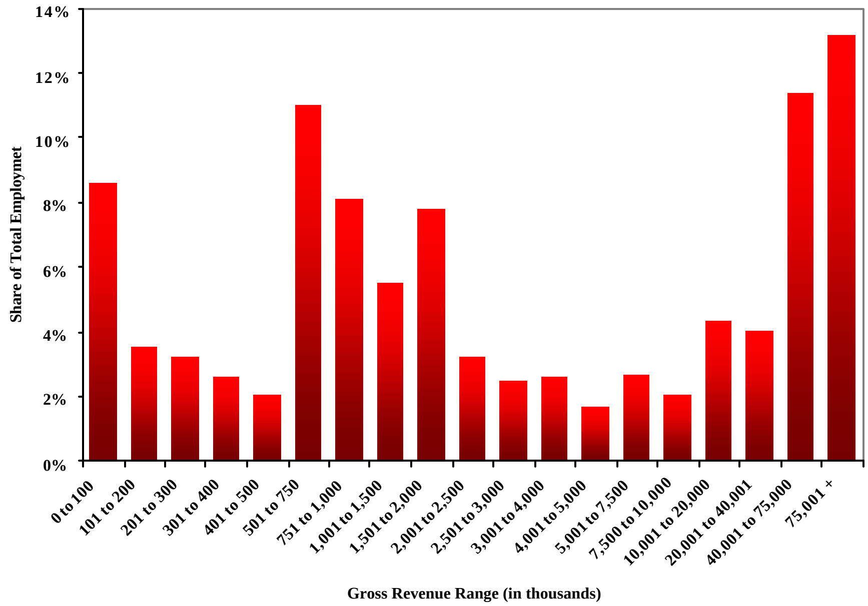
[121] See also Exhibits 7C-60 and 7C-61.

Exhibit 7-15
Estimated Distribution of Employment by Gross Revenue Range



Summary of Nevada Qualified Employee Credit and Projections

To estimate the impact of the SAT qualified employee credit, each income range's SAT and BLT payment was approximated. To be conservative, we assumed that all businesses subject to the SAT received a $100 BLT credit for every reported employee. Where the calculated SAT liability was greater than the calculated BLT liability, the SAT value was assigned. Likewise, where the group's BLT liability was greater than the SAT, no credits and no payments were assigned.

Simply put, the exemption reduces the taxable revenue level by approximately 20 percent each year. This equates to $27 billion in FY 2004-05, or $204 billion over the study period. The tax collection impacts average roughly $69 million annually. These impacts are illustrated in Exhibit 7C-67.

When combined, the standard deduction and Nevada qualified employee credits reduce taxable revenues by roughly 37 percent. Please see Exhibit 7C-68. Thus, SAT revenues are projected to generate roughly $245 million annually or $1.7 billion during the projection period. Please see Exhibit 7C-69.

Administration and the Department of Taxation

The low-end of the range estimates was used to be conservative, but also because the Task Force is concerned with potential administrative challenges accompanying these recommendations. The Department of Taxation is account driven. That is to say that its staffing requirements directly reflect the State's number of taxpayers and the number of payments that must be processed each year.[122] Moreover, the well-documented technological challenges facing the Department only serve to exacerbate its ability to effectively and efficiently deal with growth and change.

We recognize that the implementation of these recommendations will significantly increase the number of accounts serviced and payments received by the Department of Taxation. Moreover, the number of "problem accounts" resulting from business failures, relocations, and willful non-compliance will likely be greater among the added groups.[123] That having been said, we make this recommendation under the assumption that the other suggestions noted throughout this report are also implemented, not the least of which is the suggestion that the State provide for electronic reporting, payment, and account tracking within the Department of Taxation.[124] Doing this would likely ease the administrative burden associated with this recommendation and increase cost effectiveness. The creation of such a system is essential to the overall implementation of the Task Force's recommendations.

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[122] Interview with Nevada Department of Taxation staff, August, 2002.

[123] Id. Noting that the single persons firms have a higher incidence of business failures and relocations than do businesses as a whole.

[124] Please see *Passive Revenue Generators*.