



POLICY INSTITUTE

# Looking for Clarity:

An Overview of Nebraska Budget and Tax Policy

Updated December 2016





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## About OpenSky Policy Institute

Our mission is to improve opportunities for every Nebraskan by providing impartial and precise research, analysis, education and leadership.

# Acknowledgements



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When you come across the symbol  this means additional related material can be found in the appendix.

# Introduction



The good life in Nebraska is made possible by our natural resources, educated workforce, legal and business institutions, strong social fabric, and a responsive, efficient government. Nebraskans expect good public education, a clean environment, efficient transportation, safe communities, and humane social services. All are key elements of Nebraska’s competitive edge.

Good management of these resources is not a given; it is something we all have to create together. A critical component of this is the process by which public funds are raised and spent. It must be efficient, effective, fair, and responsive.

Poor public services, dilapidated highways, aging school buildings, and outdated communications technology do not stimulate job creation or build strong, thriving communities. All public spending needs to be scrutinized to ensure that taxpayers get the highest value for their dollar, yet we should not miss opportunities to make solid investments in our future.

To promote a vibrant debate on these vital issues, it is important to begin with a clear, precise explanation of how Nebraska generates resources and how those resources are spent. Any Nebraskan who wants to understand how the process works should find this primer a good starting point. It is intended as an overview of how the state creates a budget, how it allocates resources, and how those resources are generated.

Chapters 1 and 2 discuss how the budget is created and how state revenue is appropriated, or authorized for spending. Chapters 3 and 4 explain how revenue is generated and clarify what Nebraska taxes and does not tax. Chapter 5 evaluates our tax system and highlights its strengths and weaknesses.

We hope this primer illuminates how our system works and provides more explanation about the process.



**Appropriations** are annual laws directing and authorizing state spending.

**Revenues** are dollars flowing into the state budget through taxes, fees, or federal aid.

## Examples of How the State Budget Affects Us<sup>1</sup>

- Almost 10,000 miles of highway (enough road to reach nearly halfway around the earth) and over 3,500 bridges are maintained by the state;
- Nebraskans take more than 676,000 rides using state-supported rural transportation each year;
- Nearly 316,000 students are educated by 23,000 teachers in 1,000 public schools each year;
- Approximately 100,000 students attend the University of Nebraska, state colleges, and community colleges each year;
- Over 134,000 acres of surface water in lakes and reservoirs, 17,000 miles of rivers and streams, 177,000 irrigation wells, and 2,900 dams are monitored and inspected for water quality, dam safety, floodplain management, and public recreation purposes;
- The State Patrol drives approximately 10 million miles of Nebraska's roadways annually, improving public safety, enforcing traffic and drug laws, and investigating crimes;
- Nebraska's state parks and recreation areas receive about 12 million visits each year;
- More than 153,000 children receive health care through Medicaid and the Children's Health Insurance Program each month;
- More than 5,100 inmates are housed each month in the state correctional system; and,
- 168,000 professional licenses are overseen, including for more than 38,000 nurses, 9,200 pharmacists, 8,000 mental health professionals, 4,700 dentists, and 1,700 veterinarians.

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<sup>1</sup> For sources, please see Appendix A. 

# Chapter 1: The Budget Process

## What is the State Budget?

The state budget is the group of laws that direct how the state allocates and spends its resources. That includes spending decisions for every service the state provides.

The resources available to the state to be allocated and spent in the state budget are collected as state revenues, in the form of taxes, fees, or federal aid.

Like many other states, Nebraska creates a two-year budget instead of only one year at a time, though the Legislature can continue to make adjustments throughout each year as needed.

The two-year period is called the **biennium**.

The state's budget must be balanced, meaning that spending can only occur to the extent that money is available. Unlike the federal government, Nebraska cannot borrow money for general spending needs.<sup>2</sup>

Since the state must balance its budget, an increase in spending or decrease in revenues creates a budget "gap" or "shortfall." If this happens, the Legislature must fix the shortfall through some combination of spending cuts, tax increases, and use of reserves.

For Fiscal Year 2015-2016 (FY16), the Legislature appropriated almost \$9.6 billion<sup>3</sup> from three main sources: General Fund, Federal Funds, and Cash Funds. There also are Revolving Funds and Other Funds which are also appropriated.

The **General Fund** is the state's primary account. It consists largely of revenue from Nebraska's individual income tax, corporate income tax, and sales tax. The Legislature has significant discretion about how General Fund money is spent, and budget debates typically revolve around the use of this money. It is allocated for state priorities such as education, services for vulnerable citizens, and public safety.

**Cash Funds** are typically used when a tax or fee is imposed on a specific activity to pay for a specific service. For example, university tuition is deposited into an account that can only be used by the university. State motor fuels taxes, which are taxes levied on gasoline, diesel fuel, and compressed natural gas for highway use, are deposited into an account that is spent on transportation projects such as road construction.

*In Nebraska, the **Fiscal Year** ("FY") begins July 1 and ends June 30 the following year.*

*The **Biennium** is the period of two fiscal years covered by a single budget. For example, FY16 and FY17 represent the period from July 1, 2015 to June 30, 2017.*



**Federal Funds** come from the federal government and are devoted to a particular purpose. Our state Legislature appropriates and spends this money in accordance with federal rules. In Nebraska, federal funds go primarily to health care, K-12 education, higher education, and environmental quality. In some areas, such as Medicaid, the federal government matches a percentage of what our state spends on the service.

**Revolving Funds** and **Other Funds** make up the rest of the budget. Revolving Funds account for money paid by one government agency to another — for example, when an agency pays rent for office space in a state building. Other funds include small amounts of revenue used for construction and maintenance of state buildings, for example.

Nebraska also has a “rainy day fund” called the **Cash Reserve Fund**. If more tax revenue comes in than is projected by the Nebraska Economic Forecasting Advisory Board (or NEFAB, described below), the excess is automatically deposited into the Cash Reserve. The Legislature can also vote to transfer other money into or out of the “rainy day fund.” Lawmakers can use the money to cover obligations if the General Fund balance runs low or for other purposes, such as new construction projects.

Based on historical revenue trends, the Legislative Fiscal Office has calculated that a Cash Reserve balance of approximately 16 percent of net General Fund receipts is necessary to cover situations where revenues collected are short of what was forecasted.<sup>4</sup> The Government Finance Officers Association recommends that a minimum of two months, or 16.7 percent of General Fund revenues or expenditures be reserved to protect against revenue shortfalls or unanticipated expenditures.<sup>5</sup>

The Cash Reserve Fund reached 17.2 percent of annual General Fund receipts in 2009,<sup>6</sup> which was then an all-time high. This healthy reserve allowed the Legislature to reduce the severity of cuts that were made to balance the budget in the aftermath of the Great Recession and lower tax receipts between FY08 and FY11.<sup>7</sup> To address the budget shortfall during this period, \$986 million in one-time funds were used to balance the budget — \$654 million of which came from the federal government’s stimulus programs and \$259 million of which came from the Cash Reserve.<sup>8</sup>

The Cash Reserve Fund held approximately \$731 million at the end of FY16, which is 17 percent of that year’s net General Fund receipts.<sup>9</sup>

*The **Nebraska Economic Forecasting Advisory Board** was created to assist the Governor in developing estimates of revenue, and to assist the Legislature in setting income tax and sales tax rates. The board provides a forecast of General Fund receipts based on how it expects revenue-generating activities to perform. For example, the board looks at the state unemployment rate and economic activity to estimate individual income, corporate income, and sales taxes, and other miscellaneous revenues the state can expect. The board has nine members—five appointed by the Legislature and four by the Governor. Appointees must have expertise in tax policy, economics, or economic forecasting. The board meets in February and October of each year and in April of each odd-numbered (budget) year to develop its forecasts.*

## How is the budget developed?

The first session (odd-numbered years, also “long” session) of the biennium is typically considered the budget session. The **Governor** begins the budget process in the year before the long legislative session. Working with the **Department of Administrative Services (DAS) Budget Division**, he or she creates guidelines and instructions for the funding requests that Nebraska’s state government agencies must submit by September 15 of every even-numbered year. Agencies are required to indicate in their budget requests if their programs are evidence-based, meaning their outcomes can be measured using quantifiable benchmarks or research, and to what extent their programs meet those benchmarks.<sup>10</sup>

From September until January, the Governor develops a budget proposal, which must be balanced and is due to the Legislature by January 15 in odd-numbered years (or February 1 for a new Governor). The proposal then becomes the starting point for the budget debate.

In January and February, the Legislature’s **Appropriations Committee** meets with **Legislative Fiscal Office** staff to review agency budget requests and develop its own preliminary recommendation within 20 to 30 legislative days of the Governor’s budget submission in odd-numbered years.<sup>11</sup> The committee uses revenue forecasts by the **Nebraska Economic Forecasting Advisory Board** to determine how much revenue it has available to appropriate.

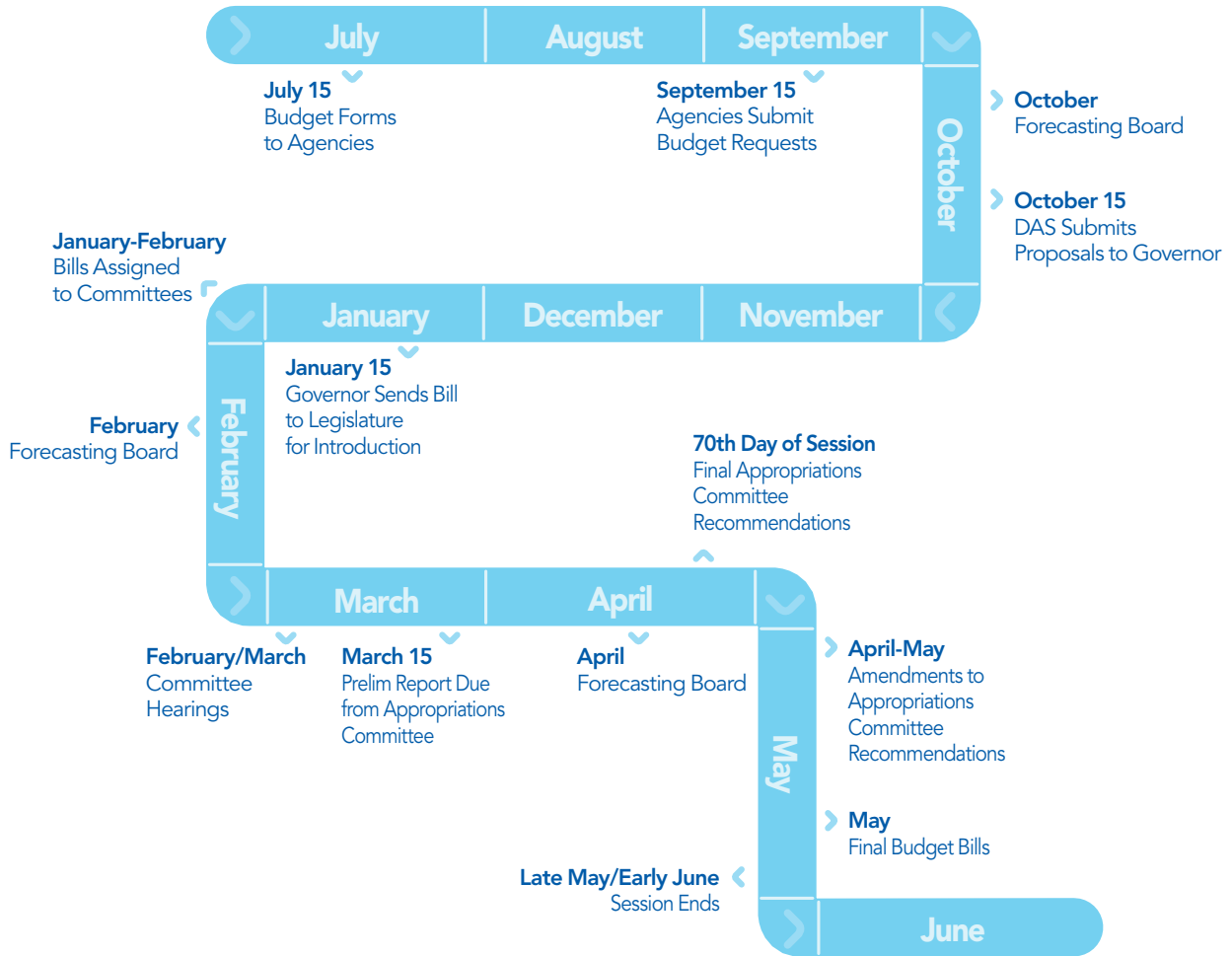
The Appropriations Committee is then required to hold public hearings on the budget. During this time, other committees are advancing bills for consideration by the full Legislature. Any bill that requires an appropriation will have an “A” bill (appropriations bill) that authorizes the spending necessary to implement the legislation. However, bills that require an appropriation may not be read on Final Reading (the last round of full legislative debate) until the budget bills are passed by the Legislature.<sup>12</sup>

Almost all budget bills are passed with a two-thirds vote (33 of 49 votes) of the Legislature.<sup>13</sup> They are then sent to the Governor. The Governor may sign the bills, not sign them (but allow them to take effect automatically), veto, or veto particular items in each bill. The Legislature may override all or part of any veto with 30 votes.

The budget passed during the odd-year long sessions begins on July 1 after the session ends, which is the beginning of the next fiscal year and the budget biennium. During even years, modifications to the budget continue according to a process similar to the one outlined above, but with narrower deadlines given the shorter session. Deficit appropriations, or adjustments made to appropriations after they are enacted in budget sessions, may be made during even-year sessions in response to agency needs. Also, the Legislature may need to make changes to the budget during even-year sessions due to a shortfall in tax revenues to ensure the budget is balanced.

It is important to note that while the Legislature’s **Revenue Committee** plays a vital role in influencing the amount of revenue collected by the state every year, the Revenue Committee does not play a primary role in developing the budget.

**Figure 1: Budget Timeline in Odd Numbered Years**



**What role do citizens play?**

Citizens play a critical role in developing the state budget. All legislative bills, including those that require appropriations, are given a public hearing where citizens can testify. Individuals can also be effective by contacting their state senators and sharing their opinion.

[Nebraskalegislature.gov](http://Nebraskalegislature.gov) offers many valuable tools to help you engage in the process, including how to find your state senator and his or her contact information, video streaming to watch committee hearings and legislative debate, and a free automated bill tracker service, just to name a few.

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- 2 The Nebraska Constitution limits state general obligation debt to \$100,000 with a few exceptions. Some entities, particularly the University, State Colleges, and Board of Education, have independent ability to issue bonds for construction purposes.
  - 3 This figure omits approximately \$876 million in revolving and other funds, which would be largely double-counted if included, because they are paid from one state agency to another, and includes deficit appropriations. Legislative Fiscal Office, State of Nebraska FY16 and FY17 Biennial Budget as Revised During the 2016 Legislative Session (May 2016), p. 57, downloaded from <http://www.nebraskalegislature.gov/pdf/reports/fiscal/2016budget.pdf>, on July 6, 2016.
  - 4 Nebraska Unicameral Legislature, State of Nebraska FY16 and FY17 Biennial Budget as Revised During the 2016 Legislative Session (May 2016), p. 15, downloaded from <http://www.nebraskalegislature.gov/pdf/reports/fiscal/2016budget.pdf>, on July 6, 2016.
  - 5 Government Finance Officers Association, Appropriate Level of Unrestricted Fund Balance in the General Fund, downloaded from <http://www.gfoa.org/appropriate-level-unrestricted-fund-balance-general-fund>, on July 6, 2016.
  - 6 The Cash Reserve Fund Balance as a percent of General Fund receipts reached a new all-time high of 17.5 percent at the end of FY14. Nebraska Unicameral Legislature, State of Nebraska FY16 and FY17 Biennial Budget as Revised During the 2016 Legislative Session (May 2016), p. 18, downloaded from <http://www.nebraskalegislature.gov/pdf/reports/fiscal/2016budget.pdf>, on July 6, 2016.
  - 7 This paragraph refers to the recession which occurred between December 2007 and June 2009. National Bureau of Economic Research, Business Cycle Dating Committee, downloaded from <http://www.nber.org/cycles.html>, on July 6, 2016.
  - 8 Nebraska Unicameral Legislature, State of Nebraska FY16 / FY17 Biennial Budget, p. 16, downloaded from <http://www.nebraskalegislature.gov/pdf/reports/fiscal/2016budget.pdf>, on July 12, 2016.
  - 9 Nebraska Unicameral Legislature, General Fund Financial Status, Tax Rate Review Committee July 2016, downloaded from <http://www.nebraskalegislature.gov/FloorDocs/Current/PDF/Budget/status.pdf>, on September 22, 2016.
  - 10 LB 1092 (2016), Neb. Rev. Stat. § 81-1113.
  - 11 Rules of the Nebraska Unicameral Legislature, Rule 8, Section 3, One Hundred Fourth Legislature Second Session 2016, downloaded from <http://nebraskalegislature.gov/FloorDocs/Current/PDF/Rules/RuleBook.pdf>, on Aug. 3, 2016.
  - 12 Rules of the Nebraska Unicameral Legislature, Rule 8, Section 5, One Hundred Fourth Legislature Second Session 2016, downloaded from <http://nebraskalegislature.gov/FloorDocs/Current/PDF/Rules/RuleBook.pdf>, on Aug. 3, 2016.
  - 13 This is because budget bills usually carry the "emergency clause," which requires 33 votes and allows the bills to take effect immediately the day after it becomes law. Nebraska Legislature, Frequently Asked Questions, Legislative Processes, accessed at <http://www.nebraskalegislature.gov/faq/faq.php>, on July 16, 2016.

## Chapter 2: State-Authorized Spending



As stated in Chapter 1, the state budget authorized and directed almost \$9.6 billion of General Funds, Federal Funds, and Cash Funds combined in FY16. Federal sources accounted for almost one of every three dollars spent by the state, and Cash Funds made up about one of every four dollars.<sup>14</sup>

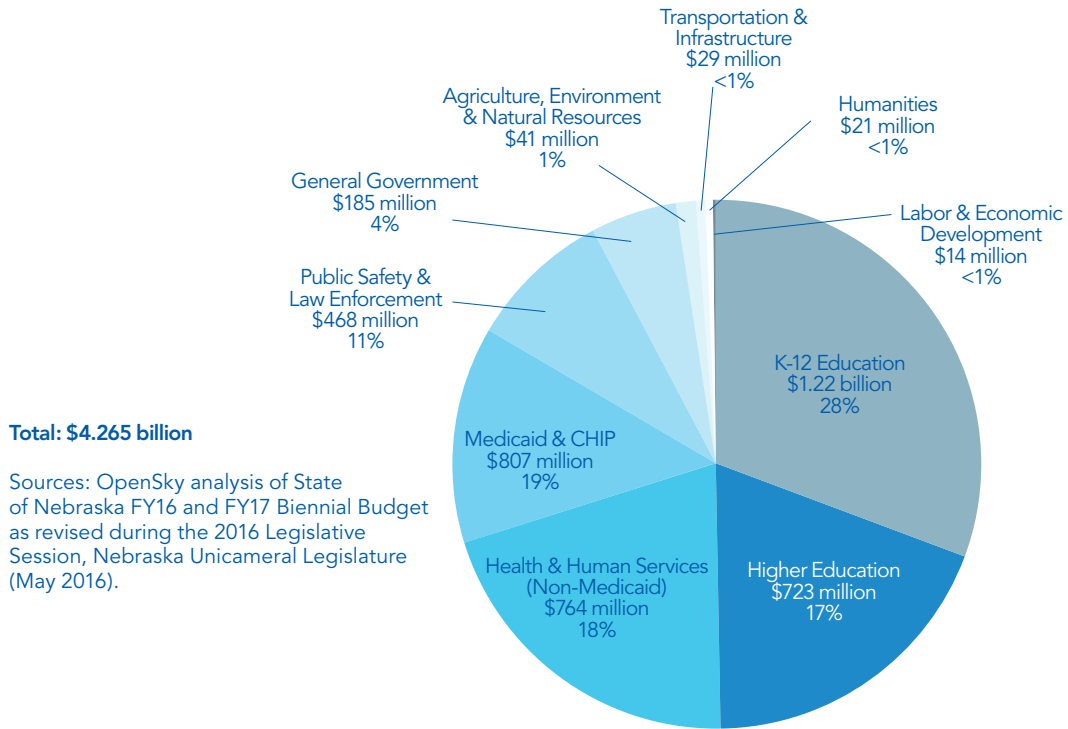
The General Fund is the largest piece of the budget — \$4.3 billion in FY16 — and because it is at the heart of state budget debates, it will be discussed here in the most detail. Almost half of all General Fund dollars were allocated for education, and more than one-third for health care and services for vulnerable Nebraskans (individuals with disabilities, abused and neglected children, for example) (Figure 2, p. 11), together making up the majority of the budget. It’s worth noting, however, that different services rely on different mixes of General, Cash, and Federal Funds. Medicaid and the Children’s Health Insurance Program (also known as CHIP),<sup>15</sup> for example, receive the majority of their funding from federal sources. In contrast, almost all transportation infrastructure appropriations come from Cash Funds, which receive the proceeds of the state’s motor fuels taxes, as well as a portion of the state’s sales tax which is diverted from the General Fund to transportation-related cash funds.<sup>16</sup>

Some state funding goes to local governments to support services provided at the local level, such as K-12 education.

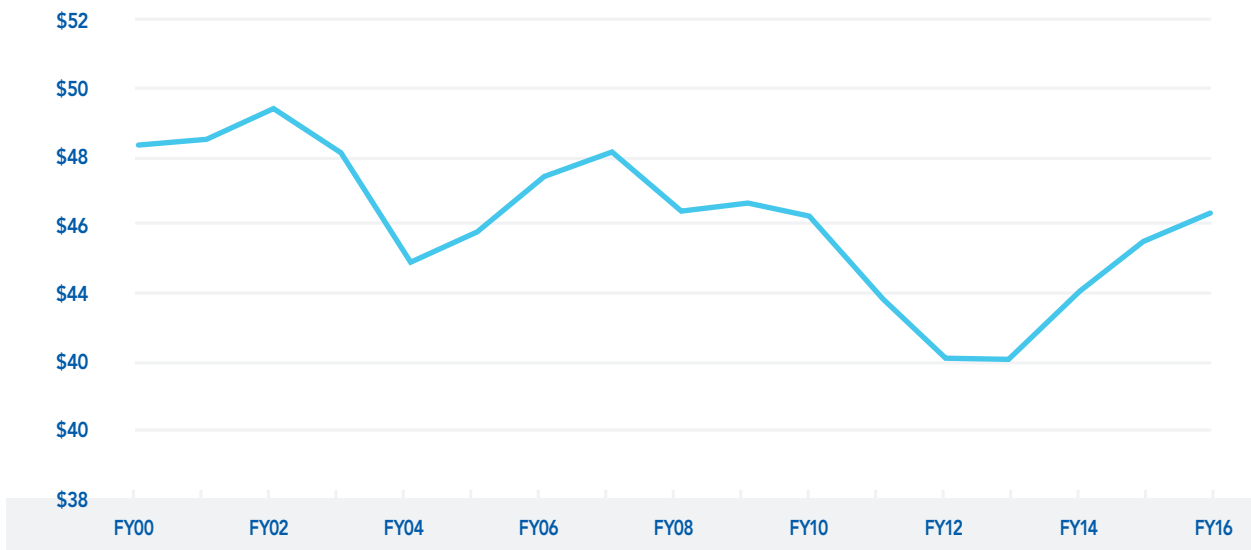
Appropriations are not the only way the state funds its priorities. Economic development, for example, is less than one percent of direct state appropriations but is a central goal behind various tax breaks and other subsidies. These “tax expenditures” are not counted as appropriations, but they are an important way in which the state spends money by significantly reducing revenue to the state. This is discussed further in Chapter 4.

State General Fund appropriations in Nebraska have fallen over the past decade as a share of the state economy (Gross Domestic Product). Effectively, in FY16, total General Fund appropriations were about \$634 million smaller than they were in FY00.<sup>17</sup> When we compare General Fund appropriations to a measure of economic growth (personal income), the overall impact can be seen, as well as in major areas like education and health care (Figure 3 and 4, see pg. 11 and 12) and transportation and infrastructure (Figure 5, see pg. 12).<sup>18</sup>

**Figure 2: Education, Health Care Top General Fund Appropriations** <sup>19</sup>  
 General Fund Appropriations (FY16) ▶◀



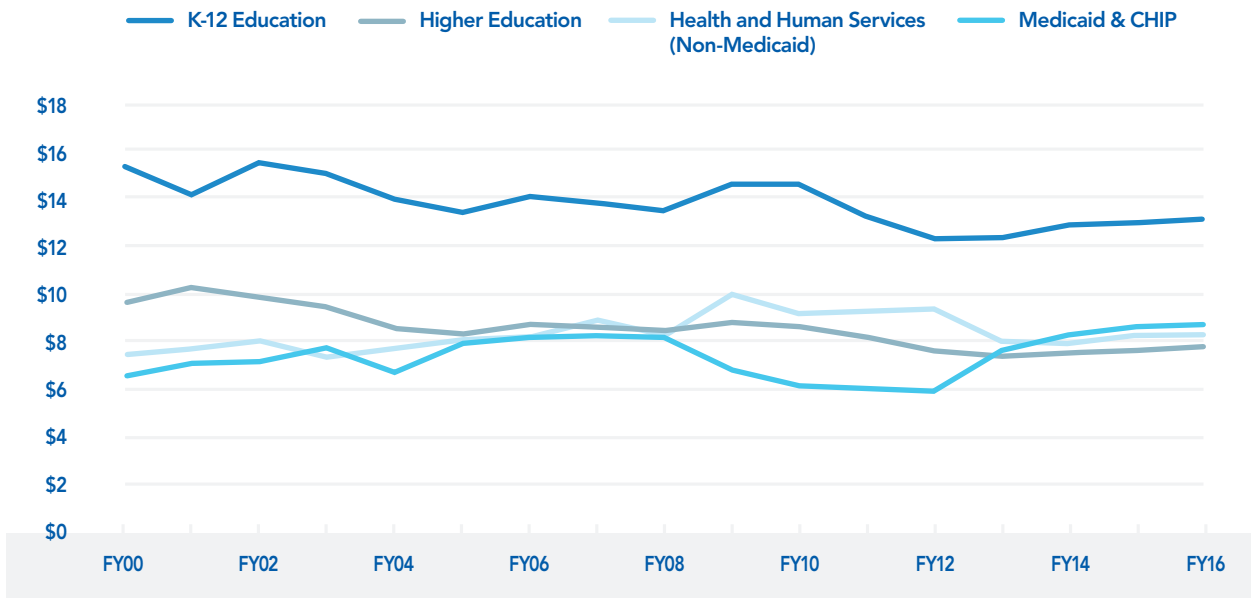
**Figure 3: General Fund Appropriations in Nebraska Have Fallen as a Share of the Economy**  
 General Fund Appropriations per \$1,000 of Nebraska Personal Income (FY00-FY16) ▶◀



Sources: Legislative Fiscal Office, US Bureau of Economic Analysis. Personal Income forecast from University of Nebraska-Lincoln Bureau of Business Research.

### Figure 4: Appropriations for Largest Budget Areas

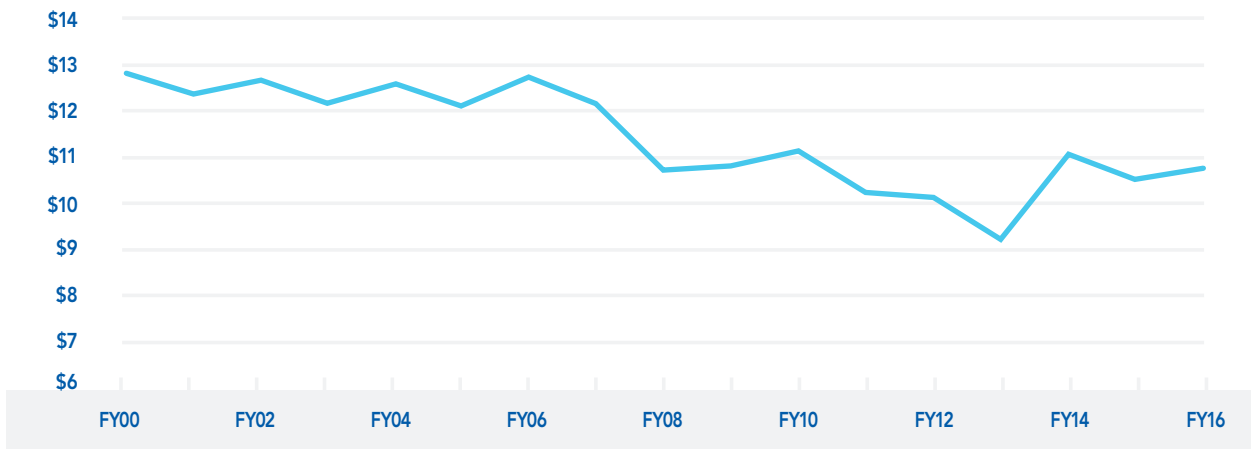
General Fund Appropriations per \$1,000 of Nebraska Personal Income (FY00-FY16)



Sources: Legislative Fiscal Office, US Bureau of Economic Analysis. Personal Income forecast from University of Nebraska-Lincoln Bureau of Business Research.

### Figure 5: Decline in Transportation and Infrastructure Appropriations

General, Cash, and Federal Fund Appropriations per \$1,000 of Nebraska Personal Income (FY00-FY16)



Sources: Legislative Fiscal Office, U.S. Bureau of Economic Analysis. Personal Income forecast from University of Nebraska-Lincoln Bureau of Business Research.

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- 14 The budget reports produced by the Appropriations Committee and the Legislative Fiscal Office contain actual state expenditures from prior fiscal years (actual spending) and authorized spending for the current fiscal year (and the next fiscal year during odd years). To make consistent comparisons across years, we use appropriations data in this primer.
  - 15 Also known in Nebraska as Kids Connection, and formerly called the State Children’s Health Insurance Program (SCHIP).
  - 16 The state receives funding from the Federal Highway Trust Fund, which is deposited in the Department of Roads Operations Cash Fund. Nebraska Department of Roads, Nebraska Transportation Financing, downloaded from <http://www.roads.nebraska.gov/media/2815/transportation-finance-flowchart.pdf>, on July 8, 2016.
  - 17 In FY00, state General Fund appropriations were 4.29 percent of Nebraska GDP. If the state devoted the same share of the economy to appropriations in FY16, appropriations that year would have been \$4.899 billion instead of \$4.265 billion, a difference of about \$634 million.
  - 18 Gross Domestic Product (GDP) has only been measured in its current form since 1997, so our graphs use a proxy measure, Personal Income (PI), which is available going further back in time. Personal Income generally represents 80% of GDP.
  - 19 The categories depicted in the graph are an aggregation of General Fund appropriations by agency based on the major function of the agency. The appropriation amounts include deficit appropriations made during the 2016 session.



# Chapter 3: State Revenue



How the state raises revenue has as much impact on Nebraska’s families and businesses as its spending decisions. The state collects a variety of taxes and fees from people and businesses and also receives money from the federal government to assist in providing certain services.

According to the U.S. Census Bureau, Nebraska generally ranks in the middle of states for various taxes (see Table 1 below) and in the bottom half of states for spending.

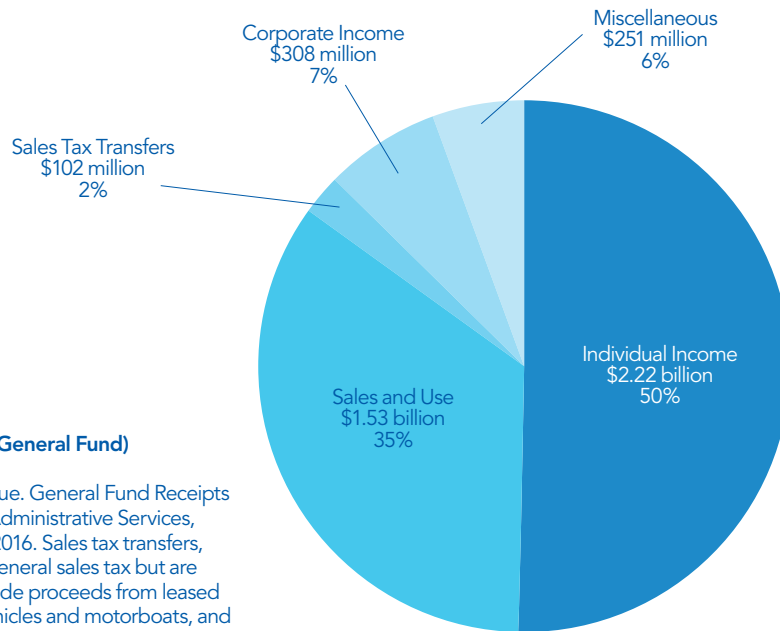
Of the \$9.6 billion received by the state in FY16, \$4.308 billion came from net sales, income, and miscellaneous taxes (see Figure 6, pg. 15) which were deposited in the General Fund. In addition, the state received and appropriated through the budget almost \$3 billion in grants, contracts, and matching funds from the federal government, and appropriated \$2.3 billion in cash funds, used to carry out specific programs.<sup>20</sup>

**Table 1: Nebraska’s National Tax & Spending Rankings (FY 14)<sup>21</sup>**

	PER CAPITA			PER \$1K NE PERSONAL INCOME			PER \$1K NE GDP		
	STATE + LOCAL	STATE	LOCAL	STATE + LOCAL	STATE	LOCAL	STATE + LOCAL	STATE	LOCAL
Individual Income Tax	16	13		22	18		27	23	
Corporate Income Tax	19	18		20	20		23	23	
Property Tax	12	35	10	12	35	9	13	35	11
Sales Tax	19	20	22	22	21	23	28	27	23
All Taxes	15	24	9	18	35	7	27	40	28
General Revenue (incl. charges)	18	33	11	27	28	16	38	45	28
Direct General Expenditure	24	31	13	33	39	23	45	43	32

Note: Nebraska is ranked out of 50 states for property tax, 46 for sales tax and corporate income tax, and 43 for individual income tax. Sources: U.S. Census Bureau, State and Local Government Finances and American Community Survey (population estimates); U.S. Department of Commerce, Bureau of Economic Analysis, Regional Economic Accounts.

**Figure 6: Most General Fund Revenue Comes from Individual Income and Sales Tax**  
 General Fund Tax Revenues (FY16)



**Total: \$4.410 billion (\$4.308 billion to General Fund)**

Source: Nebraska Department of Revenue. General Fund Receipts – June 2016; Nebraska Department of Administrative Services, Fund Summary by Fund Report – June 2016. Sales tax transfers, which are sales taxes paid through the general sales tax but are not deposited in the General Fund, include proceeds from leased motor vehicles and sales of all-terrain vehicles and motorboats, and transfers related to the Build Nebraska Act and the Convention Center/Sports Arena Facility Financing Assistance Acts.

## State Taxes

**Individual Income Taxes** – The individual income tax is the largest source of state revenue, totaling \$2.2 billion in FY16, all of which goes into the General Fund. This amounts to about \$1,171 per Nebraska resident.<sup>22</sup>

Most Nebraskans who pay federal income taxes are required to file Nebraska income tax returns, as are residents of other states who have income that comes from Nebraska sources. “Taxable income,” or what’s left after exemptions and deductions, is subject to four tax brackets plus an additional tax for high income earners.<sup>23</sup> Table 2 (pg.16) shows the marginal income tax rates facing Nebraska taxpayers for tax year 2015.

**Table 2: Nebraska Individual Income Tax Rates and Brackets (2016)<sup>24</sup>**

SINGLE AND MARRIED, FILING SEPARATELY	MARRIED, FILING JOINTLY	HEAD OF HOUSEHOLD	TAX RATE
\$0 to \$3,060	\$0 to \$6,120	\$0 to \$5,710	2.46%
\$3,061 to \$18,370	\$6,121 to \$36,730	\$5,711 to \$29,390	3.51%
\$18,371 to \$29,590	\$36,731 to \$59,180	\$29,391 to \$43,880	5.01%
\$29,591 and over	\$59,181 and over	\$43,881 and over	6.84%

Like many other states with income taxes, as well as the federal income tax, Nebraska's income taxes apply different tax rates to different amounts of income. For example, for a married couple in 2016 filing jointly, their first \$6,120 of income was taxed at 2.46 percent. The income they make above \$6,120 and below \$36,731 was taxed at 3.51 percent. The next section of income, between \$36,731 and \$59,180 was taxed at 5.01 percent. And any income that surpasses \$59,180 was taxed at 6.84 percent. Because different levels of income are subject to different tax rates in each bracket, and due to the claiming of exemptions and deductions, taxpayers face an effective tax rate different from the statutory rates specified above. According to the Nebraska Department of Revenue's 2012 Tax Burden Study,<sup>25</sup> the effective tax rate that taxpayers face changes with their adjusted gross income (AGI), divided into deciles<sup>26</sup> (see Table 3 below).

**Table 3: Effective Income Tax Rate by Decile (2012)**

DECILE	EFFECTIVE TAX RATE
First 7 Deciles (70% of Returns)	1.74%
8th Decile (Beginning AGI \$62,484)	3.16%
9th Decile (Beginning AGI \$82,534)	3.81%
10th Decile (Beginning AGI \$115,035)	5.04%
Top 500 Returns (Beginning AGI \$2,368,772)	4.62%

After the rates are applied, various credits or additional taxes may reduce or increase income tax liability. The rates, brackets, and other provisions are set in statute and subject to change by the Legislature, as was done in 2012, when a bill was enacted to reduce rates and expand the brackets.<sup>27</sup> Starting in 2015, the income tax brackets are adjusted for inflation each year.<sup>28</sup> Since the Nebraska income tax is tied to the federal income tax, changes to the federal tax also can affect the state income tax with no state legislative change.<sup>29</sup>

**Sales Taxes** – Nebraska collected almost \$1.9 billion in FY16 from the state’s sales and use tax,<sup>30</sup> about \$977 per Nebraskan.<sup>31</sup> Of that, \$1.5 billion, or 80 percent, went into the General Fund, making it the second largest source of General Fund revenue. The sales tax on motor vehicles generated 12 percent of total sales tax, which was deposited in a Cash Fund dedicated to road maintenance and construction.

Not all sales taxes levied and collected at the state level will make it to the General Fund, due to a number of policies that have diverted state sales tax revenue for other purposes. Sales tax receipts from the lease of motor vehicles for more than 31 days, as well as a quarter cent of the state sales tax rate, are diverted to and shared by the Department of Roads and local governments for road construction and maintenance. Sales taxes collected at eligible arenas and convention centers and nearby retailers are directed to cities to pay for arena construction.<sup>32</sup> Lastly, sales taxes collected on all-terrain vehicles and motorboats are directed to the Game and Parks Commission.<sup>33</sup> These sales tax receipts are reflected as “sales tax transfers” in Figure 6 (pg. 15).

All transactions subject to sales tax are taxed at the state rate (5.5 percent since 2002) unless the item, purchaser, or use is legally exempt. Groceries, manufacturing machinery and equipment when purchased by a manufacturer, and purchases made by government, schools, and religious organizations are among the exemptions. Cities, counties, and villages may impose an additional local sales tax if approved by a local vote. Table 4 (pg. 18) outlines examples of what is and what is not subject to sales tax.<sup>34</sup>

Some services also are subject to the tax, but unlike goods, they are not taxed unless specified by law. The Legislature’s decisions about which goods and services are taxed and not taxed are as important to the amount of revenue collected as the sales tax rate because the more that is exempt from sales tax, the higher the rate must be to raise the same amount of revenue. As a result, sales tax revenues may rise and fall not only because of changes in *how much* Nebraskans are buying but also *what* they are buying and *who* is buying it.

### ***The taxes the State of Nebraska collects include:***

- *Income taxes, which are a percentage of personal and business income;*
- *Sales and use taxes, which are a percentage of the price of certain purchased goods and services; and*
- *Excise taxes, which are paid on particular types of goods, like alcoholic beverages, tobacco, and gasoline.*

**Table 4: Nebraska’s Sales Tax Base - Examples<sup>35</sup>**

EXAMPLES OF WHAT IS SUBJECT TO TAX:	EXAMPLES OF WHAT IS EXEMPT FROM TAX:
Most goods, unless otherwise specified by law	Services, unless otherwise specified by law
Sales, leases, rentals, installations, and repairs of personal property	Sale of goods for resale
Admissions to movies, concerts, etc.	Component and ingredient parts
Intellectual and entertainment property	Transactions across state lines
Warranties, service agreements, etc.	Groceries
Accommodations of less than 30 days	Prescription drugs
Digital goods and prepaid calling	Livestock and feed
Utilities, such as water and electricity	Purchases by governments and some nonprofits

**Corporate Income Taxes** – In FY16, corporate income taxes generated \$308 million, which went into the General Fund, making up 7.1 percent of General Fund revenues.

Every corporation engaged in business in Nebraska, or having sources of income from Nebraska and subject to federal corporate income tax, must file a return. However, most Nebraska businesses are not organized as the sort of corporations that must pay the corporate income tax. They choose some other form, such as an S-Corporation or Partnership where profits are passed through to the owners and investors and taxed under the individual income tax. In tax year 2013, less than one-fifth (16 percent) of Nebraska businesses paid tax through the corporate income tax return.<sup>36</sup>

Similar to the individual income tax, Nebraska’s corporate income tax uses brackets and allows numerous deductions, exclusions, and credits to reduce the amount of tax owed. Corporations pay a tax rate of 5.58 percent on the first \$100,000 of net Nebraska taxable profits and 7.81 percent on profits above \$100,000. A corporation’s taxes also may be reduced by various subsidies the state developed with the aim of attracting businesses to the state or encouraging existing businesses to expand. These programs are discussed further in Chapter 4.

**Miscellaneous Taxes and Fees** –Excise taxes, such as those levied on alcohol, cigarettes, charitable gaming (keno, bingo, pickle cards), and insurance premiums raised \$251 million in FY16. This total also includes relatively small amounts of revenue raised through fees for business licenses and mechanical amusement device permits, sales of surplus state property, fines, statutory transfers, and interest earned on state investments.

**Motor Fuels Taxes<sup>37</sup>** - Excise taxes on motor fuels generated \$344 million in FY16.<sup>38</sup> The motor fuels tax rate is adjusted every six months as determined by the price of gas and a formula intended to keep up with the amount appropriated to the State Highway Trust Fund. However, since motor fuels tax revenue has declined over time (Figure 7, pg. 20), legislators passed a law

diverting a portion of the state sales tax from the General Fund to funding for roads that began in FY14.<sup>39</sup> In 2015, the Legislature approved an increase to the motor fuels tax<sup>40</sup> that will be phased in over four years at 1.5 cents per year starting in 2016. When fully implemented in 2019, the legislation will increase the motor fuels tax rate by 6.0 cents per gallon, with the proceeds allocated between the Nebraska Department of Roads and cities and counties for infrastructure. The total motor fuels tax rate is 25.8 cents per gallon as of the second half of 2016.<sup>41</sup>

## Local Taxes

Nebraskans also pay taxes to their local governments. The revenue is used to fund such services as police and fire protection, education, and road maintenance. Local taxes and services are not part of the state budget but are important to the overall tax and spending picture in the state.

**Property Taxes** – Property taxes apply to real estate (i.e. homes, commercial buildings, farmland, etc.) and some personal property used to generate income. Totalling approximately \$3.8 billion in 2015, property taxes are the largest source of local tax revenue.<sup>42</sup> In fact, more money is raised through local property taxes than through any state tax (Figure 7, pg. 20). The money is divided among a number of entities, including school districts, community colleges, counties, and cities<sup>43</sup> to help support the services provided by Nebraska’s 2,581 local governments.<sup>44</sup>

The state imposes limits on the property tax rate that can be applied, although voters may override limits for up to five years.<sup>45</sup> Certain types of property may be granted an exemption from property taxes, such as that which is owned by and used for a government, religious, educational, or charitable purpose, or is cemetery property.

Agricultural and horticultural land is taxed on 75 percent of its market value, and all other property is taxed on 100 percent.<sup>46</sup>

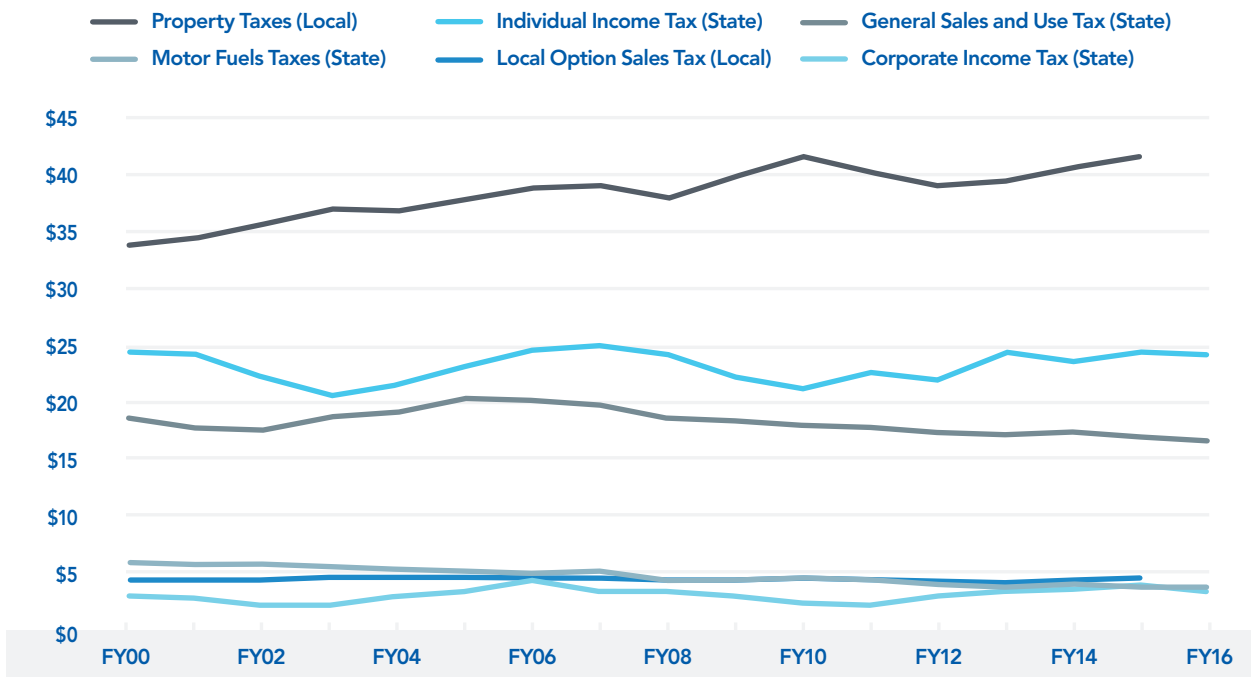
**Local Option Sales Taxes** – Cities, counties, and villages may impose a sales tax if approved by a local vote.<sup>47</sup> Of Nebraska’s 529 municipalities, 219 (and one county) levy a local option sales tax.<sup>48</sup> State law puts restrictions on these taxes. For example, the maximum rate is 2 percent, except for cities of the metropolitan class, which are limited to 1.5 percent,<sup>49</sup> and it can only be imposed on the same goods or services that are taxed at the state level. In 2015, municipalities (plus one county) received almost \$400 million in local option sales tax revenues.<sup>50</sup>

**Inheritance Taxes** – The inheritance tax, whose parameters are defined by the Legislature and the proceeds remitted to counties, is levied on the transfer of a descendant’s assets to beneficiaries of an estate, with the tax rate depending on the beneficiary’s relationship to the descendant. Surviving spouses pay no tax; close relatives and siblings pay one percent on the portion of inheritances over \$40,000; remote relatives pay 13 percent on the amount over \$15,000; and non-relatives pay 18 percent on the amount over \$10,000.<sup>51</sup> The inheritance tax raised about \$67 million for Nebraska’s counties in FY15.<sup>52</sup>

**Occupation taxes** are levied on a variety of business operations. For example, several Nebraska cities collect occupation taxes on hotels, restaurants, and/or bars to finance local construction projects like new or improved stadiums, arenas, streets, parks, and fairgrounds. Other types of occupation taxes can include taxes on phone service and rental cars.

### Figure 7: Major State and Local Tax Revenues

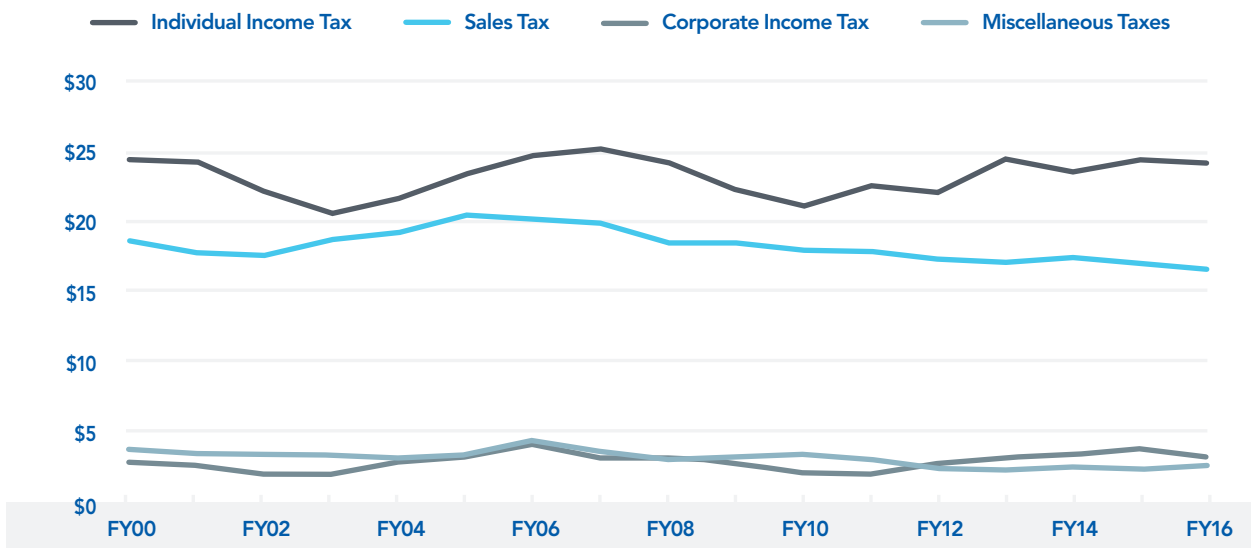
Tax revenue collected per \$1,000 of Nebraska Personal Income (FY00-FY16)<sup>53</sup>



Source: Data from Nebraska Department of Revenue, Property Assessment, Motor Fuels, and Research Divisions; Bureau of Economic Analysis. Property tax and local option sales tax is reported on a calendar-year basis.

### Figure 8: Major State Tax Revenues

General Fund Revenues per \$1,000 of Nebraska Personal Income (FY00-FY16)



Source: Nebraska Department of Revenue; Bureau of Economic Analysis.

## Federal Revenues

Historically, about one-third of Nebraska's total revenue comes from the federal government. Most federal aid goes to Medicaid, the Children's Health Insurance Program, and other health and human services areas, but a significant portion of the budgets of the University system and the Department of Education are also supported by federal funds.<sup>54</sup> Over time, federal funding as a share of total appropriations has slightly increased from about 28.8 percent in FY00 to 31.1 percent in FY16.<sup>55</sup>

According to the Pew Charitable Trusts, federal spending constitutes about 19 percent of state economic activity nationwide. Pew estimates that federal spending in Nebraska constitutes 14.9 percent of state GDP.<sup>56</sup> By this measure, Nebraska ranks 46th in the country in federal spending as a share of state GDP.

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- 20 Nebraska Unicameral Legislature, State of Nebraska FY16 and FY17 Biennial Budget as Revised During the 2016 Legislative Session (May 2016), p. 57, downloaded from <http://www.nebraskalegisature.gov/pdf/reports/fiscal/2016budget.pdf>, on July 6, 2016.
  - 21 All rankings are for FY14. U.S. Census Bureau, Census of Governments, 2014 State and Local Summary Table by Level of Government and State, downloaded from <https://www.census.gov/govs/local/>, on December 12, 2016; and U.S. Bureau of Economic Analysis, State Personal Income, downloaded from <http://bea.gov/regional/index.htm>, on December 12, 2016. Nebraska is ranked out of 50 states for property tax, 46 states for corporate income and sales taxes, and 43 states for individual income tax.
  - 22 Nebraska population was 1,896,190 at the beginning of FY16 (July 1, 2015). US Census Bureau, Annual Estimates of the Resident Population: April 1, 2010 to July 1, 2015, downloaded from <http://factfinder.census.gov>, on July 8, 2016.
  - 23 Nebraska has an additional graduated tax for earners whose federal adjusted gross income is between \$311,300 and \$903,100 (married, filing jointly), which was capped at \$1,698.21 for 2016. The additional tax imposes three marginal tax brackets on incomes in this range, which vary from 0.438 percent at the lower end to 0.183 percent at the top. Nebraska Department of Revenue, 2016 Nebraska Tax Calculation Schedule for Individual Income Tax, downloaded from [http://www.revenue.nebraska.gov/electron/2016\\_docs/2016\\_Tax\\_Calculation\\_Schedule.pdf](http://www.revenue.nebraska.gov/electron/2016_docs/2016_Tax_Calculation_Schedule.pdf), on Dec. 14, 2016.
  - 24 Nebraska Department of Revenue, 2016 Nebraska Tax Calculation Schedule for Individual Income Tax, downloaded from [http://www.revenue.nebraska.gov/electron/2016\\_docs/2016\\_Tax\\_Calculation\\_Schedule.pdf](http://www.revenue.nebraska.gov/electron/2016_docs/2016_Tax_Calculation_Schedule.pdf), on December 13, 2016.
  - 25 Nebraska Department of Revenue, 2012 Nebraska Tax Burden Study (November, 2015), p. 24 – 25, downloaded from [http://www.revenue.nebraska.gov/research/burden/2012\\_Tax\\_Burden\\_Study.pdf](http://www.revenue.nebraska.gov/research/burden/2012_Tax_Burden_Study.pdf), on July 19, 2016.
  - 26 Deciles are created by sorting all Nebraska Individual Income Tax returns by federal adjusted gross income and dividing them into ten groups with an equal number of returns.
  - 27 LB 970 (2012). The new rates and brackets took full effect in tax year 2014. Neb. Rev. Stat. §§ 77-2701,77-2715,77-2727, 77-2734, 77-2717.
  - 28 LB 987 (2014) – Neb. Rev. Stat. § 77-2715.03
  - 29 Neb. Rev. Stat. § 49-801.01
  - 30 The use tax is the name for sales tax that is due but is not collected by the seller and must then be paid directly by the buyer. For purposes of this primer, we use "sales tax" and "sales and use tax" interchangeably.
  - 31 This figure includes receipts from both the general sales tax in FY16 and motor vehicle sales taxes. Nebraska Department of Revenue, General Fund Net Receipts, June 2016, downloaded from [http://www.revenue.nebraska.gov/news\\_rel/jul\\_16/June\\_General\\_Fund\\_Receipts\\_7-14-2016.pdf](http://www.revenue.nebraska.gov/news_rel/jul_16/June_General_Fund_Receipts_7-14-2016.pdf), on July 15, 2016; and Nebraska Motor Vehicle Sales Tax Collections by County, accessed at [http://www.revenue.nebraska.gov/research/salestax\\_data.html](http://www.revenue.nebraska.gov/research/salestax_data.html), on July 15, 2016.
  - 32 Neb. Rev. Stat. § 13-3108.
  - 33 Neb. Rev. Stat. § 77-27,132.
  - 34 For more information about Nebraska's sales tax base, refer to the Nebraska Department of Revenue's Frequently Asked Questions about the Nebraska Sales and Use Tax at [http://www.revenue.nebraska.gov/question/slstax\\_faq.html](http://www.revenue.nebraska.gov/question/slstax_faq.html).
  - 35 Neb. Rev. Stat. § 77-2701.16



- 36 Most recent data are from 2013, when there were 10,568 “C-Corporations” (paying the corporate income tax) and 55,345 S-Corporations and Partnerships (paying the individual income tax). Nebraska Department of Revenue, Number of Nebraska Based Businesses According to Filing Requirements, Tax Year 2013, Table 1, downloaded from [http://www.revenue.nebraska.gov/research/statistics\\_of\\_income/stat\\_of\\_income\\_business.html](http://www.revenue.nebraska.gov/research/statistics_of_income/stat_of_income_business.html), on June 23, 2016.
- 37 Motor fuels tax collections are not included in Figure 6, as those proceeds are deposited only in cash funds. Another well-known cash fund-related tax is the Motor Vehicle Tax, which is dedicated to funding transportation-related projects, is also excluded from Figure 6, as proceeds from these taxes are not deposited in the state’s General Fund.
- 38 Nebraska Department of Revenue, Motor Fuels Division, Monthly Reported Motor Fuels Taxable Gallons, Motor Fuels Taxes, and Comparison of Totals, downloaded from [http://www.revenue.nebraska.gov/fuels/stats/monthly\\_comparison.html](http://www.revenue.nebraska.gov/fuels/stats/monthly_comparison.html), on September 8, 2016.
- 39 LB 84 (2011)
- 40 LB 610 (2015)
- 41 Non-motor fuel tax rates – those on aviation gasoline and jet fuel - are not determined by a formula; they have been set at 5 cents and 3 cents per gallon, respectively, since 1985. Nebraska Department of Revenue, Motor Fuels Division News Release, downloaded from [http://www.revenue.nebraska.gov/news\\_rel/jun\\_16/Motor\\_Fuels\\_Tax\\_Rate\\_6-21-2016.pdf](http://www.revenue.nebraska.gov/news_rel/jun_16/Motor_Fuels_Tax_Rate_6-21-2016.pdf), on July 15, 2016.
- 42 Nebraska Department of Revenue, 2015 Annual Report of the Property Assessment Division, Table 2: 2005 to 2015 History of Property Taxes Levied by Local Governments, downloaded from [http://www.revenue.nebraska.gov/PAD/research/annual\\_reports/2015/annrpt2015\\_table\\_2.pdf](http://www.revenue.nebraska.gov/PAD/research/annual_reports/2015/annrpt2015_table_2.pdf), on July 8, 2016.
- 43 Neb. Rev. Stat. §77-3442.
- 44 US Census Bureau, 2012 Census of Governments, p. 180-181, downloaded from <http://www2.census.gov/govs/cog/2012isd.pdf>, on April 19, 2016.
- 45 Neb. Rev. Stat. §77-3444
- 46 Neb. Rev. Stat. §77-201
- 47 Nebraska Department of Revenue, Local Option Sales and Use Tax Regulations, downloaded from <http://www.revenue.nebraska.gov/legal/reg/localopt.html>, on July 6, 2016.
- 48 Nebraska Department of Revenue, Current Sales and Use Tax Rates, downloaded from <http://www.revenue.nebraska.gov/question/sales.html> on July 12, 2016; and Nebraska Department of Revenue, Certified Municipal Populations, downloaded from [http://www.revenue.nebraska.gov/research/local\\_gov\\_data.html](http://www.revenue.nebraska.gov/research/local_gov_data.html), on July 26, 2016.
- 49 Neb. Rev. Stat. § 77-27,142.
- 50 Nebraska Department of Revenue, Local Sales and Use Tax Remitted to Cities (historical), downloaded from [http://www.revenue.nebraska.gov/research/local\\_gov\\_data.html](http://www.revenue.nebraska.gov/research/local_gov_data.html), on July 6, 2016.
- 51 Neb. Rev. Stat. §§ 77-2005 and 77-2006.
- 52 Nebraska Association of County Officials, 2014-15 Survey of Nebraska County Clerks.
- 53 Property tax data are reported on a calendar-year basis. Also, at this writing, local option sales tax data for FY16 were not available.
- 54 Nebraska Unicameral Legislature, State of Nebraska FY16 / FY17 Biennial Budget, p. 86, downloaded from <http://www.nebraskalegislature.gov/pdf/reports/fiscal/2015budget.pdf>, on July 6, 2016.
- 55 Historical appropriations data provided by Nebraska Legislature’s Legislative Fiscal Office in July, 2016.
- 56 Pew Charitable Trusts, Federal Spending in the States 2005-2014, downloaded from <http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2016/03/federal-spending-in-the-states-2005-to-2014>, on July 6, 2016.

## Chapter 4: Tax Expenditures

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In addition to the money spent by the Legislature through the appropriations process, Nebraska also supports many services and priorities through the tax code by giving out tax credits, deductions, and exemptions. These are known as “tax expenditures”<sup>57</sup> and have been the subject of many legislative bills and studies.<sup>58</sup>

Tax expenditures function just like spending in the sense that they represent money the state is using for some purpose, such as assisting certain taxpayers, subsidizing an activity, or incentivizing behavior.<sup>59</sup> The difference is that instead of tax revenue being collected by the taxing entity and then spent, the money is not collected in the first place. For example, Nebraska gives tax breaks to businesses in an effort to promote job creation and investment and offers tax credits to promote homeownership and support families with children. Because tax expenditures reduce the liability of taxpayers, the effect is the equivalent of households and businesses remitting taxes then receiving a refund from the state. The net effect to the state General Fund is the same as an appropriation supporting the purposes listed above.

However, the rules for tax expenditures and state budget appropriations are very different. For budget appropriations, the Legislature must authorize funding for each program every biennium, which means the spending can only continue after being reviewed at least every two years by the agency in charge, the legislative committees that oversee it, the full Legislature, and the Governor. A tax expenditure, however, generally only goes through that process once, and then is permanently written into the tax code with no requirement that it ever be reviewed by the Legislature again. For this reason, some tax expenditures can often outlive their usefulness or outgrow their expected costs, turning into significant—but unnoticed—drains on state revenue. As a result, while appropriations are under regular review, tax expenditures are essentially on auto-pilot once enacted. It should be noted that Nebraska has made positive steps in increasing the transparency of tax expenditures in recent years, and these efforts will be discussed in this chapter and the next.

*Nebraska Revised Statute § 77-381 defines a tax expenditure as a “revenue reduction that occurs in the tax base of the state or political subdivisions as a result of an exemption, deduction, exclusion, tax deferral, credit, or preferential rate introduced into the tax structure.”*

*The Department of Revenue produces a Tax Expenditure Report every October and a Tax Incentives Report covering major business tax breaks each July.*

Information available through the Department of Revenue and other sources can help policymakers and citizens learn about tax expenditures. Each year, the Department of Revenue releases the Tax Expenditure Report on October 15, and presents it to a joint hearing of the Appropriations and Revenue committees on or before December 1. Each even year, the full Tax Expenditure Report is published which reviews the credits, exemptions, deductions, and exclusions that exist for all tax programs. During odd years, the Department publishes an interim report that focuses on select sales tax exemptions on a rotating basis.<sup>60</sup>

**Sales and Use Tax Expenditures** – Many of Nebraska’s current sales tax exemptions were created when the sales tax was enacted in 1967, following the lead of other states with the aim of focusing the tax on the purchases of final consumers.<sup>61</sup> Since that time, several new sales tax exemptions have been enacted. Nebraska’s Tax Expenditure Report is required to include estimates for sales tax exemptions on business-to-business transactions and sales to final consumers.

The largest sales tax exemptions in the Tax Expenditure Report are exemptions for business inputs, most of which are exempt because they become products that are taxed when sold to consumers. Most states exempt business inputs from their sales tax bases to prevent pyramiding of the sales tax, which can result in economic distortion in markets, such as consumers paying a “tax on a tax,” the encouragement of firms to merge with their suppliers, a reduction in the transparency of the tax, and increased compliance costs.<sup>62</sup> Similarly, motor fuels are exempt from the sales tax but are taxed separately under the motor fuels tax. Purchases by governments and select nonprofits also are exempt, as are sales of groceries, newspapers, and school lunches.

As discussed in Chapter 3, services are not taxed unless specifically defined as part of the sales tax base in statute, even though the objective of the sales tax is to tax final consumption. The Department of Revenue is required to include in its Tax Expenditures Report a list of services for nonbusiness use,<sup>63</sup> and it estimates that the failure to include these services in the sales tax base resulted in a total of \$423 million in foregone sales tax collections in 2015.<sup>64</sup> It should be noted that this estimate includes some business purchases of the services listed, as the department is unable to isolate business from consumer purchases of the listed services in its estimates.

Nebraska also did not collect an estimated \$118 million (2012) from untaxed Internet and catalog purchases from remote sellers.<sup>65</sup> While taxpayers are asked to voluntarily pay use tax for Internet and catalog purchases through their state income tax return or the state and local individual use tax return, federal law prevents Nebraska from requiring remote sellers to collect these taxes unless they have a physical presence in the state.<sup>66</sup> Some states have enacted “click-through nexus” laws in an attempt to enhance sales tax compliance, whereby local physical presence is established by affiliate sellers of large e-commerce retailers.

**Income Tax Expenditures** - Some income tax expenditures promote broad policy goals and affect most Nebraskans, such as the Personal Exemption Credit, which increases with family size based on the idea that income required for basic necessities should not be taxed. Other income tax expenditures benefit only specific groups of people, usually to encourage a particular behavior. For example, the Beginning Farmer Tax Credit is intended to help young farmers and ranchers get started, and the purpose of the Earned Income Tax Credit is to keep low-income working families in their jobs and out of poverty. Other credits and deductions are for child care expenses, charitable contributions, and college savings plans. The Special Capital Gains exclusion allows certain corporate employees to sell stocks or collect dividends and not pay tax on the earnings.

**Business Tax Breaks** – Nebraska has a long history of providing various tax subsidies to businesses that invest in the state by moving here, expanding, or creating new jobs.<sup>67</sup> Once the business has met the requirements for investment or employment, it earns credits that may be used to offset income or sales taxes, or to keep income taxes they withhold on behalf of their employees. Businesses also may be refunded directly for state and local sales taxes they paid on items related to a specific project and may receive local personal property tax exemptions, such as for computer systems. Property tax exemptions and refunds of local sales tax can cost local governments significant revenue.

The Department of Revenue publishes a Tax Incentives Annual Report each July 15 and presents its findings to a joint session of the Revenue and Appropriations committees on or before September 1 of each year. The report estimates the fiscal impact of the state's incentive programs, the number of jobs increased or decreased, and provides information on the projects approved for tax incentives.<sup>68</sup> Review of the effectiveness of Nebraska's tax incentives is performed by the Legislative Performance Audit Committee and is discussed in Chapter 5.

Nebraska has had many different business subsidy programs, beginning in 1987. In 2015, these programs awarded \$130 million in tax credits and sales tax refunds – primarily used to reduce state taxes, but also local sales taxes – and exempted \$998 million of property from property taxes.<sup>69</sup> The largest current program is the Nebraska Advantage Act, which in 2015 awarded almost \$85 million in tax credits, exempted the value of about \$929 million worth of property, and refunded almost \$33 million of state and local sales tax. In 2015, 59 agreements were approved under this program, bringing the total since 2007 to 310.

**Estimating Tax Expenditures** – *Many tax expenditure cost estimates are imprecise. Data are often not available, it is not possible to fully predict people's responses to tax changes, and there can be disagreement over what qualifies as a tax expenditure. Throughout this chapter, we use the best data available to provide a sense of the types and costs of tax expenditures in Nebraska.*

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- 57 Neb. Rev. Stat. §77-381
- 58 Including the following studies: Bill Lock, Memo Re: LR161, LR166, & LR 97 (Committee on Revenue: December 2009), downloaded from <http://nlc1.nlc.state.ne.us/epubs/L3770/B042-2009.pdf>, on April 20, 2016; Nebraska Tax Policy Commission, Final Report (known as the Burling Tax Commission Study) (November 2007), downloaded from <http://nlc1.nlc.state.ne.us/epubs/L3790/B068-2007.pdf>, on July 7, 2016; Maxwell School of Citizenship and Public Affairs at Syracuse University, Nebraska Comprehensive Tax Study (known as the Syracuse Tax Study) (1988); Report to the Legislature: LR155 – Nebraska’s Tax Modernization Committee (2013), downloaded from [http://www.nebraskalegislature.gov/pdf/reports/committee/select\\_special/taxmod/lr155\\_taxmod2013.pdf](http://www.nebraskalegislature.gov/pdf/reports/committee/select_special/taxmod/lr155_taxmod2013.pdf), on April 20, 2016; as well as multiple legislative bills and interim studies.
- 59 National Conference of State Legislatures, Tax Expenditure Budgets and Reports: Best Practices, downloaded from [http://www.ncsl.org/documents/task\\_forces/Tax\\_Expenditure\\_Report.pdf](http://www.ncsl.org/documents/task_forces/Tax_Expenditure_Report.pdf), on July 7, 2016.
- 60 Neb. Rev. Stat. § 77-385
- 61 Bill Lock, Memo Re: LR161, LR166, & LR 97 (Committee on Revenue: December 2009), p. 3, downloaded from <http://nlc1.nlc.state.ne.us/epubs/L3770/B042-2009.pdf>, on July 7, 2016.
- 62 William Fox and LeAnn Luna, How Broad Should State Sales Tax Bases Be? A Review of the Empirical Literature. *State Tax Notes*, September 4, 2006, v. 41, p. 639.
- 63 Neb. Rev. Stat. § 77-382.
- 64 Pursuant to Neb. Rev. Stat. § 77-3 (2)(l), services for nonbusiness use were included in the Tax Expenditure Report starting in 2014. See Nebraska Department of Revenue, 2016 Tax Expenditure Report, Section A at [http://www.revenue.nebraska.gov/research/tax\\_expenditure\\_rep/2016/Section\\_A.pdf](http://www.revenue.nebraska.gov/research/tax_expenditure_rep/2016/Section_A.pdf), downloaded October 25, 2016.
- 65 National Conference of State Legislatures, Collecting E-Commerce Taxes: An Interactive Map, downloaded from <http://www.ncsl.org/research/fiscal-policy/collecting-ecommerce-taxes-an-interactive-map.aspx>, on July 7, 2016, based on Donald Bruce, William Fox, and LeAnn Luna, *State and Local Government Sales Tax Revenue Losses from Electronic Commerce* (2009).
- 66 See *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).
- 67 Amounts in this section are from Nebraska Department of Revenue, Nebraska Tax Incentives 2015 Annual Report (July 2016), downloaded from [http://www.revenue.nebraska.gov/incentiv/annrep/15an\\_rep/15\\_annrp.html](http://www.revenue.nebraska.gov/incentiv/annrep/15an_rep/15_annrp.html), on July 18, 2016.
- 68 Neb. Rev. Stat. § 77-5731
- 69 Annual data are not available for the Invest Nebraska Act, the Nebraska Advantage Rural Development Act, or the Quality Jobs Act. The figures above reflect data from the Nebraska Advantage Act, the Nebraska Microenterprise Tax Credit Act, and the Employment and Investment Growth Act. The most recent data available at the time of writing are from 2015. Nebraska Department of Revenue, Nebraska Tax Incentives 2015 Annual Report (July 2016), downloaded from [http://www.revenue.nebraska.gov/incentiv/annrep/15an\\_rep/15\\_annrp.html](http://www.revenue.nebraska.gov/incentiv/annrep/15an_rep/15_annrp.html), on July 18, 2016.

# Chapter 5: Evaluating Nebraska's Tax System

There are many questions to ask when evaluating a tax system, and tax experts generally agree about what the central questions are:<sup>70</sup>

## **Does it collect enough revenue to pay for the public's priorities?**

A good test is whether a state collects enough money each year to match its spending needs. The failure to do this over time is called a structural deficit. That happens when revenues do not grow at the same rate as the cost of providing services. Legislative action on appropriations and taxes also can create a mismatch between revenue and appropriations.

Nebraska must balance its budget, as explained in Chapter 1. By law, in order for the budget to be balanced, a reserve consisting of at least three percent of net General Fund receipts to cover total appropriations and other state obligations must remain in the General Fund, which is not available for spending. This is referred to as the budgetary minimum reserve. The intent is to ensure that the General Fund has flexibility for cash flow purposes to meet its obligations.<sup>71</sup>

The Tax Rate Review Committee, which consists of the Speaker of the Legislature, the chairs of the Executive Board, Revenue and Appropriations committees, and the Tax Commissioner, meets in July and November of each year. They are charged with determining whether the current income and sales tax rates are able to generate sufficient revenue to pay for the state's obligations and appropriations. The criterion used to judge the adequacy of the tax rates is whether anticipated revenues are sufficient to cover the minimum reserve. If not, the committee may petition the Governor to call a special session of the Legislature to make changes to state tax rates.

Lawmakers can balance the budget on a biennial basis but, nonetheless, leave the state with a structural deficit, such as when tax cuts and other revenue-reducing measures are passed in one year but take effect in the future. The cost of providing education, health care, and other services becomes more expensive each year as the costs of goods, utilities, and labor increase. At the same time, the value of some revenue sources erode over time due to inflation and a changing economy. If revenues do not keep up with increasing costs, the state must repeatedly engage in some combination of raising taxes and cutting services.

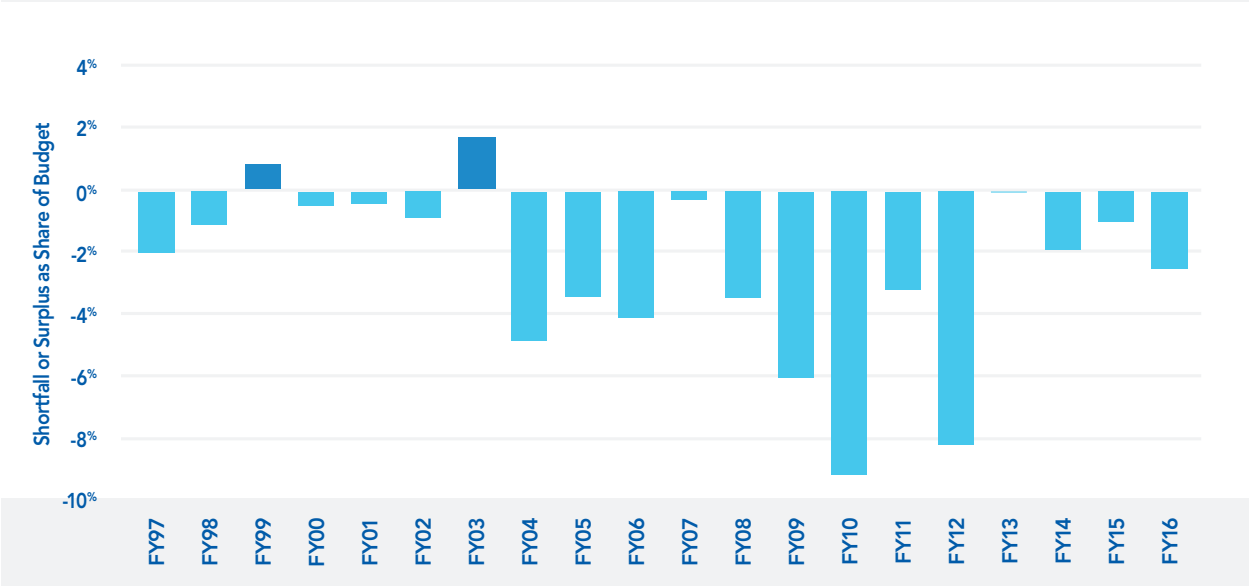
Every year, the Legislative Fiscal Office prepares a Biennial Budget Report that includes estimates of future shortfalls or surpluses.<sup>72</sup> This estimation is based on the state's obligations under current law and expected growth in the cost of providing services based on historical averages and other data.

A review of these reports shows that Nebraska has a recent history of structural deficits. In 18 of the last 20 years, even after balancing the biennium budget, the Legislature has ended its session projecting that revenues will fall short of projected appropriations in the following biennium (Figure 9, pg. 28).

Projected shortfalls do not always materialize, due to revised cost estimates and improved revenues, but in most of these years the Legislature has begun the session with a shortfall to address. In fact, out of the seven budget cycles from FY02 to FY16, the Legislature faced a budget gap in the following biennium requiring action in all but two. Those actions included tax increases in two of the seven biennia, Cash Reserve Fund transfers in all seven,<sup>73</sup> and spending cuts in all seven. Yet despite these recurring shortfalls, the Legislature also reduced state revenues by passing tax cuts in four of the seven biennia<sup>74</sup> and increased or added new tax expenditures in all seven. This has exerted downward pressure on funding for schools, health care, and other vital services as the economy has grown. In some cases, this has meant shifting funding obligations from the state to the local level.<sup>75</sup>

**Structural Deficit** - when a government's tax structure is not designed to collect enough revenue to pay for services as costs increase.

**Figure 9: Nebraska's Structural Deficit**  
Shortfall Projected for Following Biennium (FY97-FY16)

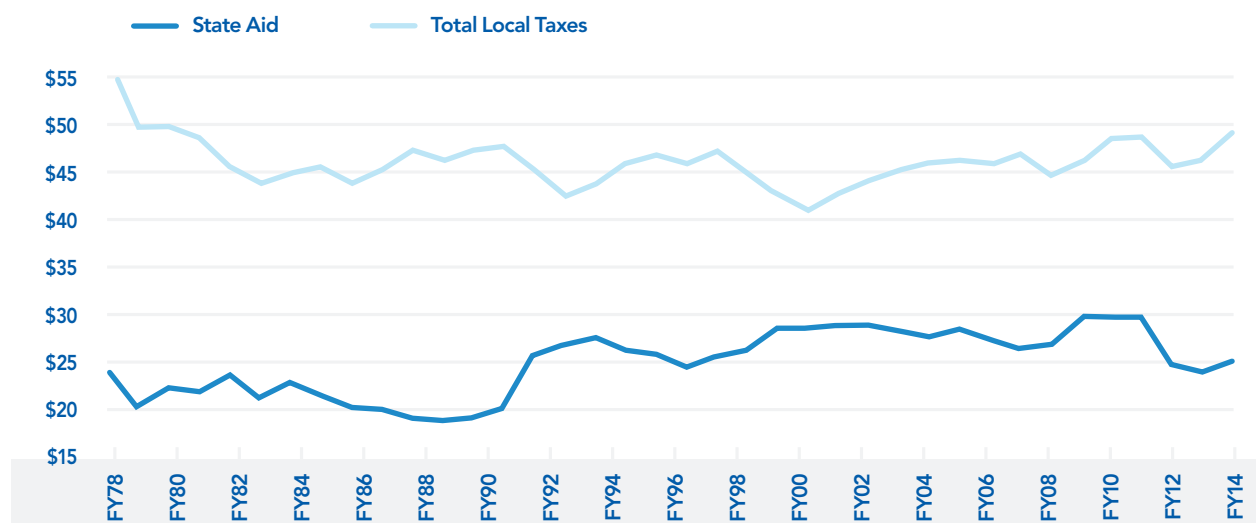


Source: Nebraska Unicameral Legislature, State of Nebraska Biennial Budget Reports, General Fund Financial Status.

Appropriations as a share of the economy for transportation and infrastructure also has declined (Chapter 2, Figure 5, pg. 12), as a large portion of revenue for those needs is tied to the amount of motor fuels sold. This means motor fuels tax revenues decrease as less fuel is consumed by the public due to higher fuel prices and/or the purchase of more fuel-efficient vehicles.<sup>76</sup> As previously noted, the Legislature passed a law to direct one-fourth of a cent of the sales tax from the General Fund for transportation and infrastructure in 2011, with the first transfers beginning in September 2013. Diverting revenue from the General Fund for infrastructure means even less will be available for the state’s other priorities. The Legislature also increased the motor fuels tax, beginning in 2016, to increase the state’s ability to meet infrastructure investment needs.

On the local level, the ability of cities, counties, and school districts to pay for local services can be affected by state budget policies, too. State aid cuts and local revenue limits can combine to squeeze local budgets, making it difficult to fund schools, police and fire departments, road and bridge repair, and other local services. As demonstrated in Figure 10 below, reductions in state aid to local governments are often offset by increases in local tax rates. State business subsidies also can interfere with local revenue streams when these packages include property tax exemptions and local sales tax refunds, creating budgeting uncertainty and reducing needed revenue.

**Figure 10: State Aid and Local Taxes Have Mirrored Each Other**  
Aid and Taxes per \$1,000 of Nebraska Personal Income (FY77-FY14)



Sources: US Census Bureau, State & Local Government Finances; US Bureau of Economic Analysis



- *A tax system is progressive if people with higher incomes pay a higher percentage of their income in taxes than those with lower incomes. Nebraska's income tax, in which higher rates kick in at higher incomes, is progressive.*
- *A tax system is proportional if everyone, regardless of their income and ability to pay, pays the same percentage of their income in taxes. Some states have "flat" income taxes that meet this description.*
- *A tax system is regressive if lower-income families pay more of their income in taxes than wealthier families. Sales taxes are typically regressive, in part because low-income families pay sales tax on nearly everything they buy, while high-income families spend less of their income on goods and services that are subject to sales tax.*

## **Is the tax system fair when it comes to who pays and how much?**

Fairness is often at the heart of any debate about a tax system, such as whether it should be progressive, regressive, or proportional (see box above). This is an important consideration for government and the public. As is typical in states across the country, lower- and middle-income families in Nebraska pay a greater share of their incomes in state and local taxes than do higher-income residents (Figure 11, pg. 31). The higher a household's income in Nebraska, the lower the share of that income it pays in state and local taxes. For example, overall, an average Nebraska family earns \$48,900 in income<sup>77</sup> and pays \$5,037 (10.3 percent) in total state and local taxes. Those who fall into the lowest 20% of taxpayers, (\$0-\$21,000 income), earn an average \$11,900 in income and pay \$1,297 in taxes (10.9 percent), while those in the top 1% of taxpayers (earning more than \$390,000) average \$1.3 million in income and \$83,948 in taxes (6.3 percent).<sup>78</sup>

This is primarily due to sales and property taxes, which are regressive taxes. For example, Nebraskans making less than \$21,000 per year pay more than 6 percent of their incomes in sales tax, while those making more than \$94,000 pay less than 3 percent of that income in sales tax and those making more than \$390,000 pay less than 1 percent.

Likewise, low- and middle-income families typically devote a larger share of their incomes to housing than higher-income families. Nebraska's tax law includes measures, such as the Homestead Exemption, to freeze or reduce property taxes for certain elderly and disabled Nebraskan homeowners. Still, the lowest-income families pay higher percentages of their yearly incomes in property taxes than those with higher incomes.<sup>79</sup>

This is partly because renters also pay property taxes – indirectly in the form of higher rent – but are not eligible for state relief programs like the Homestead Exemption.

In contrast to sales and property taxes, Nebraska's income tax is progressive. Nebraskans earning less than \$21,000 a year pay little to no income tax, while the average earner pays 2.5 percent of their income in income tax, and the highest-income individuals pay 4.7 percent of their income in

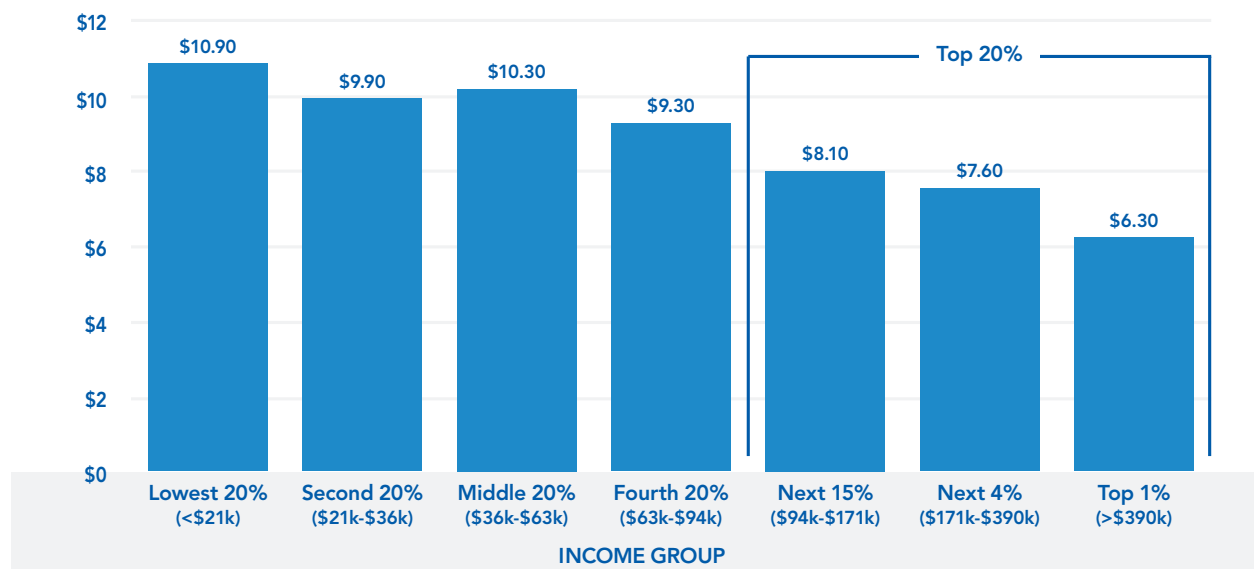
income tax.<sup>80</sup> This is due to the graduated income tax rate structure summarized in Chapter 3, as well as specific policies focused on low- and high-income earners.

Policies like the state Earned Income Tax Credit ensure that workers who earn too little to achieve economic stability only pay income tax on a small portion of their earnings. Combined with the additional tax for high-income earners mentioned in Chapter 3 and a tax rate that increases with income, higher-income families tend to pay income taxes on more of their earnings.

Like the individual income tax, the corporate income tax has a structure where tax rates rise with profits. Nebraska is one of 24 states<sup>81</sup> that even the playing field between small and large businesses, through a policy known as “combined reporting.”<sup>82</sup> This prevents large, multi-state corporations from shifting profits made in Nebraska to subsidiaries in other states where taxes might be lower or nonexistent. Combined reporting ensures that small in-state and large multi-state companies are on equal footing on taxes, with each contributing its share to maintaining the roads, schools, and other services that make their profits possible.

Tax expenditures can raise fairness issues. The policy goals behind many tax expenditures in Nebraska are widely accepted in several other states, such as not taxing business inputs like wood purchased by a furniture maker because it will be taxed when sold as a chair. However, other tax expenditures, such as taxing a night at the movies but not a day at the spa, may be more questionable from a tax policy perspective. Business subsidies also may raise questions. Businesses that are not in the targeted industries, are too small to qualify for subsidies, or already made the investments that are now being subsidized for other companies may argue that they are being treated unfairly because they effectively pay a higher tax rate than the subsidized businesses. Nebraska’s tax incentive programs are now regularly evaluated by the Legislative Performance Audit Committee.

**Figure 11: Nebraska’s Tax System is Regressive**  
State and Local Taxes per \$100 of Family Income by Income Group (2015)



State and local taxes, 2015 income levels, non-elderly taxpayers.  
\*Note: totals include effect of federal deductibility of state and local taxes.  
Source: Institute on Taxation and Economic Policy, “Who Pays?,” January 2015.

## Does the tax system provide a steady revenue stream as the economy rises and falls?

A tax system that is unable to weather changes in the economy results in less revenue in downturns when the public most needs services. It may lead to overly large surpluses in prosperous times, putting pressure on legislators to enact tax cuts to reduce the surpluses and unintentionally leaving the state short in the next recession.

No state's tax system is totally able to avoid the roller coaster ride of economic ups and downs. However, a good way to minimize severe revenue fluctuations is to maintain a variety of taxes that respond differently to economic cycles.<sup>83</sup> A tax system that includes a variety of taxes, draws from a broad cross-section of the population, and generates sufficient balances to support the state's obligations produces more stable revenue and allows states to plan ahead with more confidence. A strength of Nebraska's tax system is that it levies a broad range of taxes, rather than relying on just one or two major sources of revenue. However, there is room to improve.

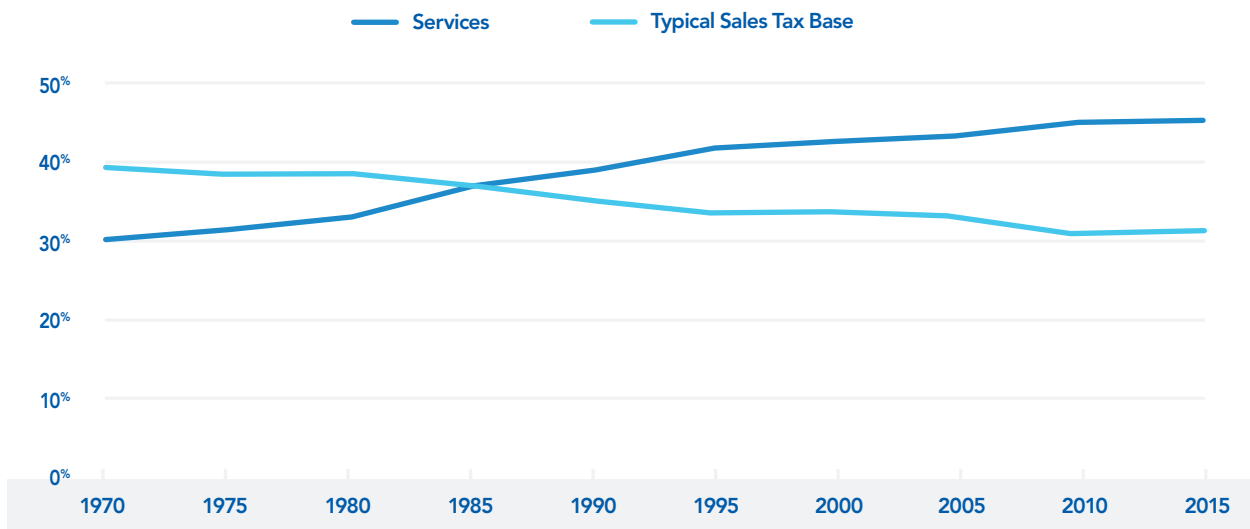
Each November, beginning in 2016 and every two years thereafter, the Legislative Fiscal Office (LFO) prepares a revenue volatility report. The report evaluates the General Fund tax base and the volatility of funds flowing to it, changes in federal legislation that affect the flow of funds to Nebraska, the Cash Reserve Fund status and projections and the adequacy of its balance, and General Fund revenue projections. LFO is also charged with making recommendations based upon its evaluation.<sup>84</sup>

Sales tax revenue is failing to keep up with growth in the economy, which in part, can be attributed to untaxed services and internet and catalog sales from remote sellers. Families across the United States today spend much more on services than on goods that are traditionally taxed (Figure 12, pg. 33). Yet, many services remain exempt from Nebraska state sales tax. In fact, according to a survey by the Federation of Tax Administrators, Nebraska taxes about half of the 146 services taxed in South Dakota, a state with a broad sales tax base.<sup>85</sup> Approximately 30 of the services exempted in Nebraska are taxed in at least two of our neighboring states; massage therapy and dry cleaning are two examples. And because services are only taxed if they have been individually added by law, the system is inconsistent. Barber shop and beauty parlor services are not taxed, but pet grooming services are taxed.<sup>86</sup> Carpet cleaning is taxed but swimming pool cleaning is not. Taxing more services would help the tax system to keep up with our changing economy.

Likewise, current federal law puts local retail stores at a competitive disadvantage with remote online and catalog sellers who cannot be required to collect sales taxes unless they have some physical presence, like a warehouse, in the state. Conversely, sellers that are physically located in Nebraska are legally required to collect sales tax. That means local stores --such as your local hardware store -- operate at a competitive disadvantage in Nebraska because they have to collect sales tax, but remote sellers do not. While changing current federal law requires an act of Congress, at least 17 states have passed their own laws to improve the collection of taxes for online purchases.<sup>87</sup> Changing state law could help Nebraska recoup some of the estimated \$118 million the state loses every year to untaxed online and catalog sales from remote sellers.<sup>88</sup>

In the meantime, Nebraska is a member of the Streamlined Sales and Use Tax Agreement (SSUTA). By adopting SSUTA rules, like mandating that cities define the same tax base as the state, Nebraska has eased compliance concerns for remote sellers and has been able to collect some revenue voluntarily by remote sellers.<sup>89</sup>

**Figure 12: Consumption of Services Increasing**  
 Goods and Services as a Share of Household Consumption (1970-2015)



Source: US Bureau of Economic Analysis, National Income and Product Accounts, Table 2.4.5U

## Can taxpayers easily obtain and understand information about the taxes they pay?

Information should be readily available about when residents pay taxes, to whom, how they are spent, and how the state’s tax and budget decisions are made. This can be achieved through high-quality state websites, timely and easily accessible budget reports, fiscal notes accompanying legislation to show the costs and benefits of proposed changes in law, and studies that show how taxes affect different income groups and sectors of the economy.<sup>90</sup> When tax policy is used to encourage behavior or advance a goal other than revenue collection – as when additional taxes are levied on tobacco to discourage smoking or tax breaks are given to promote certain investments – the state should be clear about what those goals are, how the policy is meant to promote them, and whether or not the policy goal is achieved.

The tax expenditures described in Chapter 4 make Nebraska’s revenue picture considerably less clear to the public and to policymakers. This spending is not subjected to the same level of legislative scrutiny that direct appropriations are each budget cycle. However, the Legislature has taken steps towards increasing the transparency of tax expenditures by requiring the presentation of the Tax Expenditure Report to a joint hearing of the Revenue and Appropriations committees each year and through the work of the Legislative Performance Audit Committee, discussed below.

Nebraska is one of 43 states to publish a regular Tax Expenditure Report, but it has some shortcomings. It contains no cost estimate for more than one-fourth of the sales and income tax expenditures it identifies,<sup>91</sup> and it is unclear which years the estimates represent. With incomplete reporting, it is impossible to know if Nebraskans are getting good returns on these investments. Without regular review, programs funded through tax expenditures can sometimes greatly exceed their original cost estimates, unexpectedly cutting into funding for other priorities.<sup>92</sup>

The Legislative Performance Audit Committee is now required to audit each business tax incentive program at least once every three years. The report evaluates the extent to which tax incentives strengthen and diversify the economy and the fiscal impact to the state and local governments. The findings are presented to a joint hearing of the Revenue and Appropriations committees. The Committee released its first report on the business tax incentive program, Nebraska Advantage, in November 2016. The report found an average cost per full-time employee of \$24,000 - \$320,000. Furthermore, the program was projected to cost the state between \$24 million to \$60 million annually, but in 2013, the program reduced state revenue by \$108 million, and is expected to exceed original projections in the future.<sup>93</sup> Sunset dates were placed on all tax incentive programs. Although the sunset dates can be extended by future legislatures, it forces review and discussion about the effectiveness of these programs.<sup>94</sup>

Nebraska has improved its business subsidy policy by implementing wage requirements to encourage higher-paying jobs and forcing businesses to repay if they fail to meet growth requirements. There also is more disclosure of how much is distributed in subsidies and to whom, but some important information is still not available to the public. For example, when the state's largest business tax credit program was created in 1987, the Legislature took other steps to entice businesses into the state and to retain existing businesses – making major changes to individual income tax rates<sup>95</sup> and changing the way multistate corporations calculate taxable income<sup>96</sup> – but the impact of these changes has not been tracked and reported.

**According to Neb. Rev. Stat. § 77-380:** “[T]he Legislature recognizes that the present budgeting system fails to accurately and totally reflect the revenue lost due to such tax expenditures and that as a result undetermined amounts of potential revenue are escaping public or legislative scrutiny. The loss of such potential revenue causes a narrowing of the tax base which in turn forces higher tax rates on the remaining tax base.”

70 National Conference of State Legislatures, Principles of a High-Quality State Revenue System (June 2007), accessed at <http://www.ncsl.org/issues-research/budget/principles-of-a-high-quality-state-revenue-system.aspx>, on April 21, 2016

71 Neb. Rev. Stat. § 77-2715.01

72 Nebraska Legislative Fiscal Office, Biennial Budget Reports (1997 – 2016), accessed at <http://www.nebraskalegislature.gov/reports/fiscal.php> on Aug. 3, 2016.

73 In FY14, the Legislature transferred \$53 million to Cash Reserve Fund, which was the amount of increased revenue predicted at the April 2013 Nebraska Economic Forecasting Advisory Board meeting. However, on net for the budget biennium, the legislative transfers were a net loss for the Cash Reserve Fund due to \$78 million in transfers out in the preceding fiscal year. See LB 199 (2013) and Nebraska Unicameral Legislature, State of Nebraska FY14 and FY15 Biennial Budget, p. 14, downloaded from <http://www.nebraskalegislature.gov/pdf/reports/fiscal/2014budget.pdf>, on July 7, 2016.

74 Nebraska Department of Revenue, Nebraska Tax Rate Chronologies – Table 1, Income Tax and Sales Tax Rates, downloaded from <http://www.revenue.nebraska.gov/research/chronology/4-607table1.pdf>, on July 11, 2016.

75 For example, in 2011 the Legislature decreased state aid to schools partly by temporarily increasing the Local Effort Rate factor in the school funding formula (LB 235 of 2011); Neb. Rev. Stat. §79-1015.01

76 Nebraska Legislature, Transportation and Telecommunications Committee, LR 152 (2009), downloaded from [http://www.nebraskalegislature.gov/pdf/reports/committee/transport/2009\\_lr152.pdf](http://www.nebraskalegislature.gov/pdf/reports/committee/transport/2009_lr152.pdf), on April 21, 2016.

77 \$48,900 is the average income of a family in the middle 20 percent income group. Institute on Taxation and Economic Policy, Who Pays? A Distributional Analysis of the Tax Systems in All 50 States, 5th ed. (January 2015), p. 84, downloaded from <http://www.itep.org/whopays/states/nebraska.php>, on July 7, 2016.

- 78 Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, 5th ed. (January 2015), p. 84, downloaded from <http://www.itep.org/whopays/states/nebraska.php>, on July 7, 2016.
- 79 Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, 5th ed. (January 2015), p. 83, downloaded from <http://www.itep.org/whopays/states/nebraska.php>, on July 7, 2016.
- 80 Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, 5th ed. (January 2015), p. 83, downloaded from <http://www.itep.org/whopays/states/nebraska.php>, on July 7, 2016.
- 81 Connecticut General Assembly, *Adoption of Combined Reporting in Selected States, 2015*, downloaded from <https://www.cga.ct.gov/2015/rpt/2015-R-0163.htm>, on July 6, 2016.
- 82 Michael Mazerov, *A Majority of States Have Now Adopted a Key Corporate Tax Reform – “Combined Reporting,”* (Center on Budget and Policy Priorities, April 2009), downloaded from <http://www.cbpp.org/research/a-majority-of-states-have-now-adopted-a-key-corporate-tax-reform-combined-reporting>, on July 7, 2016.
- 83 See National Conference of State Legislatures, *Principles of a High-Quality State Revenue System* (June 2007), downloaded from <http://www.ncsl.org/research/fiscal-policy/principles-of-a-high-quality-state-revenue-system.aspx>, on July 7, 2016.
- 84 Neb. Rev. Stat. § 50-419.02.
- 85 According to a Federation of Tax Administrators survey, Nebraska taxes 77 services, and South Dakota taxes 146. Federation of Tax Administrators, *Sales Taxation of Services*, downloaded from <http://www.taxadmin.org/number-of-services-taxed-by-category-and-state---july-2007>, on July 7, 2016.
- 86 Unless performed by a veterinarian on livestock for surgical purposes. See Neb. Rev. Stat. §77-2701.16.
- 87 Roxanne Bland, *Evolutionary Nexus*, *State Tax Notes*, April 4, 2016, v. 80, p. 59.
- 88 National Conference of State Legislatures, *Collecting E-Commerce Taxes: An Interactive Map*, downloaded from <http://www.ncsl.org/research/fiscal-policy/collecting-ecommerce-taxes-an-interactive-map.aspx>, on July 7, 2016. See also footnote 66.
- 89 Neb. Rev. Stat. § 77-2712.05.
- 90 The Department of Revenue produces a report on these issues every two years. The department is able to use a computerized model of Nebraska’s economy to estimate how a given tax change will ripple through the economy and who it will ultimately affect. Nebraska Department of Revenue, *2012 Nebraska Tax Burden Study* (November 2015), downloaded from [http://www.revenue.nebraska.gov/research/burden/2012\\_Tax\\_Burden\\_Study.pdf](http://www.revenue.nebraska.gov/research/burden/2012_Tax_Burden_Study.pdf), on July 7, 2016.
- 91 Out of 157 sales and income tax expenditures identified in the report, 41 are recorded as “Estimate: Not available.” Nebraska Department of Revenue, *2016 Tax Expenditure Report* (October 2016).
- 92 Michael Leachman, Dylan Grundman, and Nicholas Johnson, *Promoting State Budget Accountability Through Tax Expenditure Reporting*, (Center on Budget and Policy Priorities: May 2011), downloaded from <http://www.cbpp.org/research/state-budget-and-tax/promoting-state-budget-accountability-through-tax-expenditure>, on July 7, 2016.
- 93 Legislative Performance Audit Committee, *Nebraska Advantage Act Performance on Selected Measures*, downloaded from [http://nebraskalegislature.gov/pdf/reports/audit/naa\\_2016.pdf](http://nebraskalegislature.gov/pdf/reports/audit/naa_2016.pdf) on December 14, 2016.
- 94 See LB 538 (2015).
- 95 See LB 773 (1987). See also Nebraska Tax Policy Commission, *Final Report* (November 2007), p. 6-1 to 6-13.
- 96 Neb. Rev. Stat. §77-4105; Neb. Rev. Stat. §77-2734.05

# Conclusion



The state budget should be a strategic plan for Nebraska, establishing our priorities now and for the future. Our investments today in education, roads and transportation networks, healthy communities, and the Nebraska workforce, for example, will have far-reaching consequences for decades to come.

Likewise, ensuring that the state has the revenue to make critical investments and support the needs of Nebraska’s changing population and economy is just as critical to the future of Nebraska.

As a state, we have made strides in budget and tax policy since the first draft of this report was published in 2012. Since then, the Legislature’s Tax Modernization Committee conducted a comprehensive study of our state’s tax code, finding that Nebraska’s tax system “is comparable in design to most states and does not require significant changes” but that our reliance on property taxes is greater than the national average and most of our border states.

The Legislature has gone on to implement a number of changes in tax and budget policy in response to the Tax Modernization Committee’s recommendations, as well as other measures that have increased budget and revenue transparency and strengthened the state’s fiscal position. In 2014, the Legislature indexed the income tax brackets for inflation, ensuring that low- and middle-income Nebraskans will not be subject to higher income tax rates as a result of “bracket creep.” The Legislature has also implemented a number of reporting measures on tax expenditures and business tax incentive programs that increase the transparency of these policies and programs.

Challenges remain, however, and they are exacerbated by the ongoing effects of tax reductions lawmakers have passed since 2005. These changes in the tax code -- which reduced state revenue by more than \$750 million in FY17 alone -- along with changes in the economy have prevented our state revenue system from keeping pace with the existing and growing needs of our state’s residents. This has threatened funding for schools and other vital state services, as well as shifted many funding responsibilities to our local governments – which are becoming even more reliant on property taxes to maintain key aspects of the “The Good Life.” Facing these challenges will be of vital importance for our state and its economy in the years to come.

Nebraska is neither a high-tax nor a low-tax state. We also are not a high-spending state (Table 1, pg. 14). But we do have outstanding schools and other vital services that have been key to sustaining economic growth and labor force participation that is the envy of many states. As we lack major oil and natural resources, tourism and gaming that help other states generate revenue, it will always be important that we levy reasonable and appropriate taxes to meet our state’s needs and make investments in what grows our state and builds our communities.

Doing this requires a strategy that must be built on the following considerations: What are our goals as a state? What do we need to do to meet those goals? What will it cost? How should we update our tax system to support a strong economy and provide sufficient funding to allow us to invest in these goals?

We must answer these questions together, and together we can create opportunities for every Nebraskan, now, and in the decades to come.

# Appendix A : Sources for “Examples of How the State Budget Affects Us”



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LR 528 Study, *The Alarming Condition of Nebraska’s Rural Bridges*, December 2014, downloaded from [http://nebraskalegislature.gov/pdf/reports/committee/transport/2014\\_lr528.pdf](http://nebraskalegislature.gov/pdf/reports/committee/transport/2014_lr528.pdf), on May 31, 2016.

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State of Nebraska Consolidated Annual Financial Report, *Operating Indicators by Function*, p. 152, downloaded from <http://das.nebraska.gov/accounting/cafr/cafr2015.pdf>, on May 31, 2016.

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Nebraska Department of Health and Human Services Division of Medicaid and Long-Term Care, *Nebraska Medicaid Reform Annual Report* (December 2015), fig. 1, p. 3; downloaded from [http://www.nebraskalegislature.gov/FloorDocs/104/PDF/Agencies/Health\\_and\\_Human\\_Services\\_\\_Department\\_of/107\\_20151210-131933.pdf](http://www.nebraskalegislature.gov/FloorDocs/104/PDF/Agencies/Health_and_Human_Services__Department_of/107_20151210-131933.pdf), on May 31, 2016.

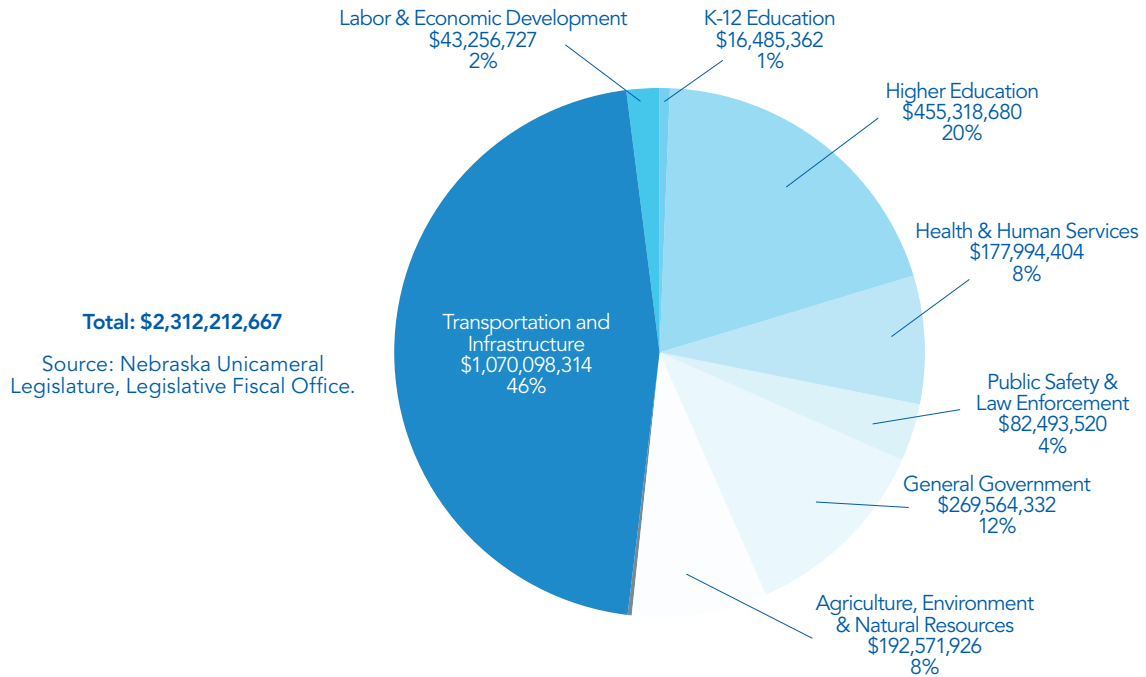
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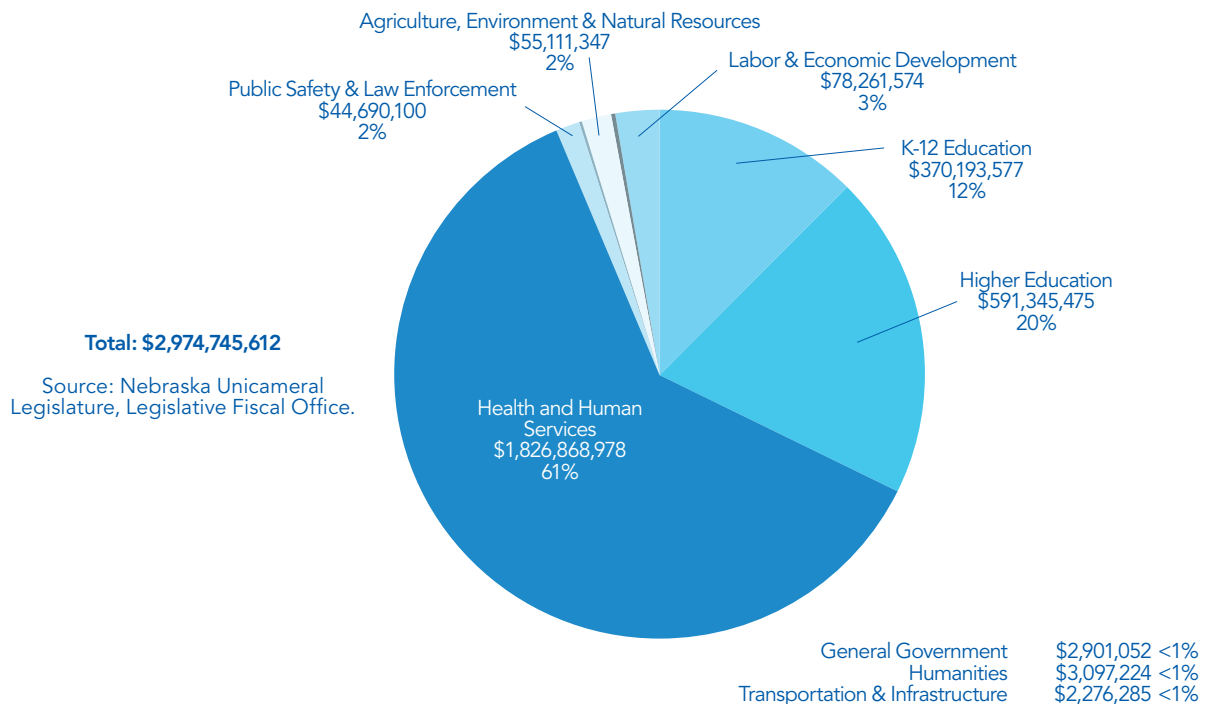


# Appendix B: Supplemental Material to Chapter 2

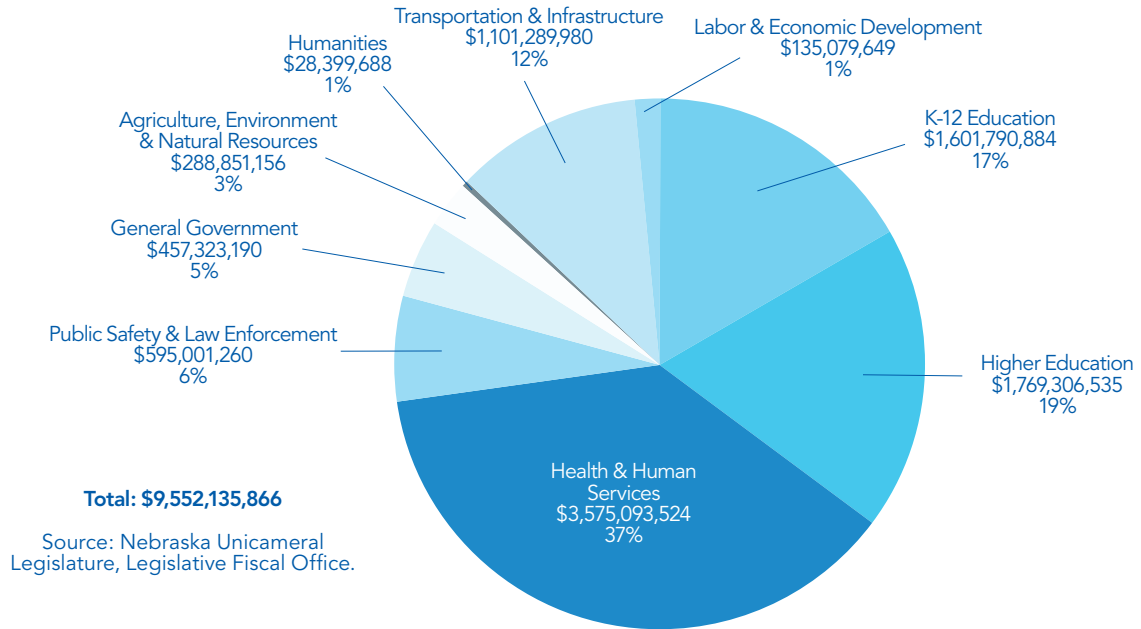
**Figure B1: Cash Fund Appropriations by Category (FY16)**



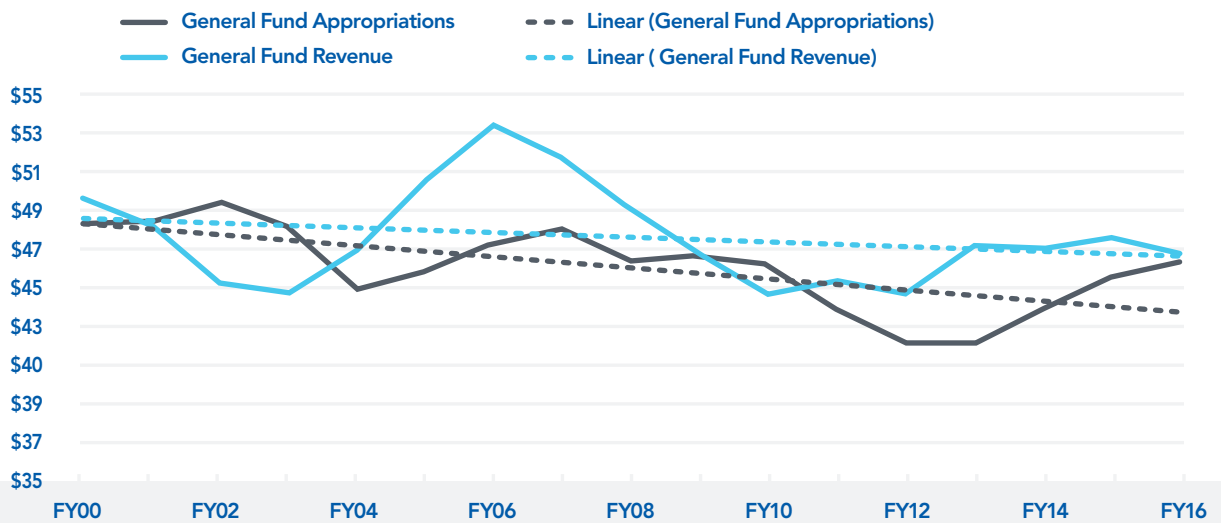
**Figure B2: Federal Fund Appropriations by Category (FY16)**



**Figure B3: Total Appropriations for General, Cash, and Federal Funds by Category (FY16)**

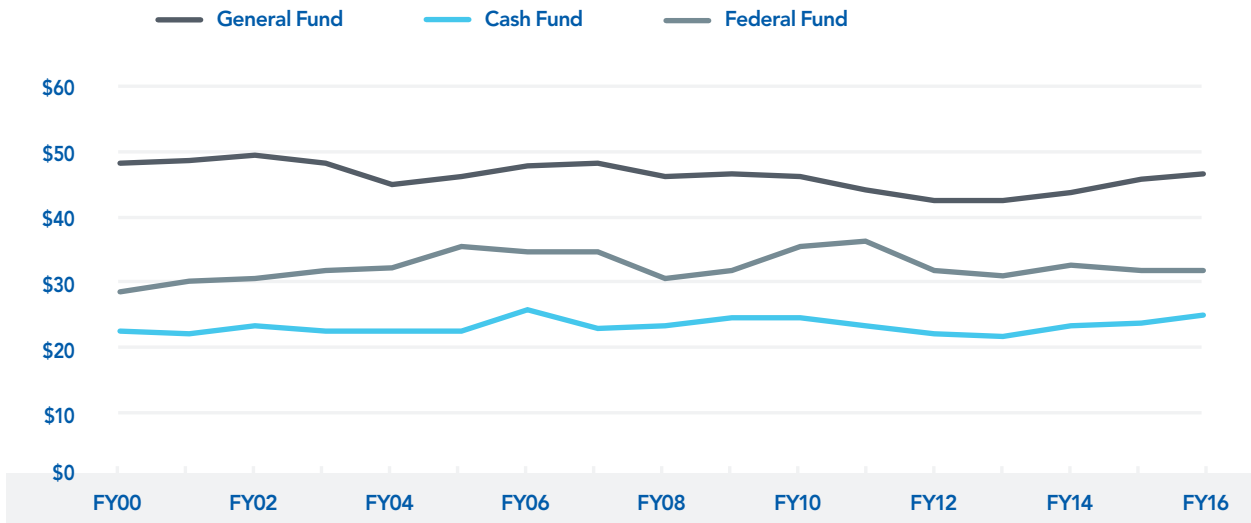


**Figure B4: General Fund Appropriations and Revenues per \$1,000 of Nebraska Personal Income (FY00-FY16)**  
Appropriations and Revenue per \$1,000 NE Personal Income



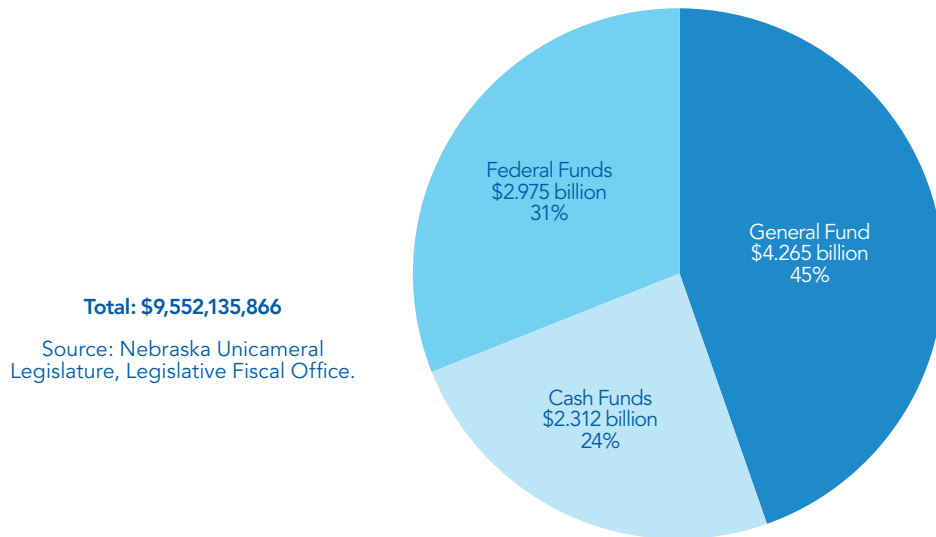
Source: Nebraska Unicameral Legislature, Legislative Fiscal Office; Bureau of Economic Analysis.

**Figure B5: General, Cash, and Federal Fund Appropriations per \$1,000 of Nebraska Personal Income (FY00-FY16)**



Source: Nebraska Unicameral Legislature, Legislative Fiscal Office; Bureau of Economic Analysis.

**Figure B6: Appropriations by Fund Source (FY16)**



## Definitions of categories used in appropriations graphs:

- **K-12 Education:** The only agency included in this category is the Department of Education. Most of the spending is devoted to public school aid, which is distributed to local school districts through a formula called TEEOSA (the Tax Equity and Educational Opportunities Support Act).
  - **Agencies included:**
    - Department of Education
- **Higher Education:** This category consists of the University of Nebraska, Nebraska State Colleges, Community Colleges, and the Coordinating Commission for Postsecondary Education. Cash Funds in this category include tuition and fees paid by students, but not proceeds of business-like enterprises such as dormitories and food sales.
  - **Agencies included:**
    - Community Colleges
    - Postsecondary Coordinating Commission
    - State Colleges
    - University of Nebraska
- **Transportation and Infrastructure:** This category consists of Capital Construction, Public Service Commission, Railway Council, and the departments of Aeronautics, Motor Vehicles, and Roads. Most of this category is funded through motor fuels taxes and motor vehicle sales taxes, which are deposited into the Highway Trust Fund and then transferred into Cash Funds as needed.
  - **Agencies included:**
    - Aeronautics
    - Capital Construction
    - Motor Vehicles
    - Public Service Commission
    - Railway Council
    - Roads
- **Health and Human Services (Non-Medicaid):** 99 percent of this category is the Department of Health and Human Services. Also included are a few small related agencies, such as Veteran's Affairs and the Commission for the Deaf and Hard of Hearing (full list below). Cash Funds in this category include tobacco prevention programs funded by tobacco settlement money, services for compulsive gamblers funded by taxes on lotteries and charitable gaming, and oversight of health care licensing standards funded by license fees, among others. Medicaid and CHIP appropriations are shown as an independent category in Figure 2 but are not isolated from federal and cash fund appropriations in Appendix B.
  - **Agencies included:**
    - Blind/Visually Impaired
    - Department on Aging
    - Foster Care Review
    - Hearing Impaired
    - HHS System (excluding Medicaid and Children's Health Insurance)
    - Indian Commission
    - Latino American
    - Status of Women
    - Veterans Affairs
- **Medicaid and CHIP:** This category consists of only Medicaid and the Children's Health Insurance Program. The federal government provides matching funds for every dollar Nebraska spends on these programs.
  - **Agencies included:**
    - Medicaid (part of Health and Human Services agency)
    - Children's Health Insurance (part of Health and Human Services agency)
- **Public Safety and Law Enforcement:** About half of this category is the Department of Corrections. The Supreme

Court, State Patrol, and Attorney General make up most of the rest. Many small regulatory and licensing agencies are also included here, such as the Liquor Commission, Department of Banking and Finance, and Board of Barber Examiners (full list below). An example of Cash Funds in this category is court fees used to fund probation services and substance abuse rehabilitation programs.

o **Agencies included:**

- Abstracters Board
- Attorney General
- Banking
- Barber Examiners
- Board of Geologists
- Correctional Services
- Crime Commission
- Crime Reparations Board
- Electrical Board
- Engineers and Architects
- Equal Opportunity
- Fire Marshal
- Industrial Relations
- Insurance
- Land Surveyors
- Landscape Architects
- Liquor Control
- Military Department
- Motor Vehicle Dealers
- Pardons and Parole
- Public Accountancy
- Public Advocacy
- Racing Commission
- Real Estate Appraisers
- Real Estate Commission
- State Patrol
- Supreme Court
- Workers Comp

- **General Government:** This category is mostly the Department of Revenue, whose largest expenditure is payments to certain elderly and disabled homeowners through the Homestead Exemption program. Also included are the Retirement Board, Legislative Council,

Department of Administrative Services, and the offices of the Auditor, Governor, Lt. Governor, Treasurer, Secretary of State, etc. (full list below). Most of the Cash Funds spending in this category is made up of the Property Tax Credit Act, which is funded by transfers from the General Fund to the Property Tax Credit Cash Fund. Another example is the Home Energy Improvement Program, an energy conservation effort funded by a portion of sales taxes paid to public power districts.

o **Agencies included:**

- Accountability and Disclosure Commission
- Administrative Services
- Athletic Commissioner
- Constitutional Revision Commission
- Governor/PRO/Energy
- Investment Council
- Legislative Council
- Lt. Governor
- Power Review Board
- Property Assessment and Taxation
- Retirement Board
- Revenue
- Secretary of State
- UCC Filing Council
- State Auditor
- State Building Commission
- State Treasurer
- Tax Equalization Review Commission
- Rounding Adjustments

• **Agriculture, Environment, & Natural Resources:**

This category consists primarily of the departments of Natural Resources, Game and Parks, Environmental Quality, and Agriculture. Also included are several smaller agencies such as the Dairy Board and Ethanol Board (full list below). Nearly half of this category is funded through Cash Funds, notably through hunting and fishing licenses and entrance fees to state parks and recreation areas.

o **Agencies included:**

- Agricultural Activities
- Agriculture
- Beef Board
- Brand Committee
- Corn Board
- Dairy Board
- Dry Bean Board
- Educational Lands & Funds
- Energy Office
- Environmental Quality
- Ethanol Board
- Game & Parks Commission
- Grain Sorghum Board
- Land/Water Conservation Fund (G&P)
- Natural Resources
- Oil & Gas Commission
- Soybean Board
- State Fair Board
- Wheat Board

• **Labor and Economic Development:**

This category consists of the Department of Labor, Department of Economic Development, and the Rural Development Commission. An example of Cash Funds spending in this category is the Nebraska Tourism Commission, which is funded through a one percent lodging tax.

o **Agencies included:**

- Economic Development
- Economic Opportunity Commission
- Labor
- Rural Development Commission
- Tourism Commission

• **Humanities:** This category consists of Educational Telecommunications (NET television and radio), Historical Society, Library Commission, and Arts Council.

o **Agencies included:**

- Arts Council
- Bicentennial Commission
- Hall of Fame/Ft Robinson
- Historical Landmarks
- Historical Society

- Library Commission
- Educational Telecommunications Commission

**Note:** The listings of agencies above include agencies and commissions that have either been dissolved or merged with other agencies, but are included to show their historical appropriations.



# OpenSky Policy Institute: Clear Thinking for a Stronger Nebraska



OpenSky’s mission is to improve opportunities for every Nebraskan by providing impartial and precise research, analysis, education, and leadership.

## Board of Directors

### *Board President*

**Kristin Williams** resides in Omaha and joined The Sherwood Foundation in September 2006.

### *President-elect*

**David Spinar** resides in Lincoln where he has been a financial adviser for RBC Wealth Management since 2009.

### *Board Secretary*

**Douglas German** resides in Eustis where he owns and manages farm properties.

### *Board Treasurer*

**Tulani Grundy Meadows** resides in Omaha where she is a Political Science and Human Relations Skills faculty member at Metropolitan Community College.

### *Past President*

**Richard (Dick) Campbell** resides in Lincoln and is owner of Campbell’s Nurseries and Garden Centers.

**Mary Bills-Strand** resides in Lincoln and has more than three decades of experience in real estate sales and management, including having served as Executive Vice-President for Woods Bros. Realty.

**Dr. Joel Johnson** resides in Kearney and is an active community volunteer. From 2002-2008, Dr. Johnson served as a Senator in the Nebraska Legislature, and held the position of Chairman of the Health and Human Services Committee during his tenure.

**Chuck Karpf** resides in Omaha where he is semi-retired and works part time as a housing coordinator for the Metropolitan Area Planning Agency.

**Dr. John Harms** resides in Scottsbluff. After a 30-year career as president of Western Nebraska Community College, Dr. Harms retired in 2006 ahead of an eight-year term in the Nebraska Legislature.

**Annette Smith** resides in Omaha where she is an active fundraiser and community volunteer and works with Alley, Poynter, Macchietto Architecture.

**Ross Wilcox** resides in Lincoln and is Vice-Chairman of Union Bank & Trust Co.



## Technical Advisors

**Jerry Deichert** is Senior Research Associate and the Director of the Center for Public Affairs Research at the University of Nebraska Omaha, and is currently a member of the Nebraska Economic Forecasting Advisory Board and Manager of the Nebraska State Data Center.

**Carol Ebdon** is Regents/Foundation Professor in the School of Public Administration at the University of Nebraska Omaha, where her research and teaching emphasis is in the area of local government budgeting and financial management.

**Don Leuenberger** is Special Assistant for Strategic Initiatives at the University of Nebraska Medical Center, and has held leadership positions in state government in several capacities during the last 45 years, beginning with the administration of Governor Norbert Tiemann.

## Staff

**Renee Fry** is the founding Executive Director of OpenSky Policy Institute.

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