



POLICY INSTITUTE

Looking for Clarity:

An Overview of Nebraska Budget and Tax Policy

Updated March 2013



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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.

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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Poor public services, dilapidated highways, aging school buildings, and outdated communications technology do not stimulate job-creation or build strong communities. Every dollar of public spending needs to be scrutinized to ensure that taxpayers get the highest value for their dollar, yet we must not be afraid to adequately fund 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 income and how it is spent. Any Nebraskan who wants to understand more clearly 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 spends money, and how that money is generated.

Chapters 1 and 2 discuss how the budget is created and how the money is **appropriated**, or spent. 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 strengths and weaknesses.

We hope this primer will illuminate how our system works and provide more transparency to the process.

Appropriations are annual laws directing state spending.

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

Examples of How the State Budget Affects Us ¹

- Almost 10,000 miles of highway and over 3,500 bridges are maintained (enough road to reach nearly halfway around the earth);
- Nearly 300,000 students are educated by 22,000 teachers in over 1,000 public schools each year;
- More than 106,000 students attend the University of Nebraska, state colleges, and community colleges each year;
- Over 280,000 acres of surface water in lakes and reservoirs, 18,000 miles of rivers and streams, 108,000 irrigation wells, and 2,300 dams are monitored and inspected for water quality, dam safety, floodplain management, and public recreation purposes;
- The State Patrol drives more than 10 million miles of Nebraska's roadways annually, improving public safety, enforcing traffic and drug laws, and investigating crimes;
- More than 152,000 children receive health care through Medicaid and the Children's Health Insurance Program each month;
- More than 7,000 Nebraskans are cared for in Nebraska nursing facilities each month;
- Nebraskans take more than 750,000 rides using state-supported rural transportation each year;
- More than 4,600 inmates are housed each month in the state correctional system; and
- 175,000 professional licenses are overseen, including for more than 7,500 physicians, 35,000 nurses, 3,500 pharmacists, 7,000 mental health professionals, 1,500 dentists, and 1,000 veterinarians.

Footnotes

¹ Nebraska Department of Education, *Statistics and Facts about Nebraska Schools* 2010-2011 (September 2011), p. 1; Nebraska Department of Education, *Quick Facts about Nebraska Schools* (November 2011); Nebraska Coordinating Commission for Postsecondary Education, *A Factual Look at Higher Education in Nebraska 2011-2012* (August 2012); Nebraska Department of Environmental Quality Water Quality Division, *2012 Nebraska Water Monitoring Programs Report* (January 2013); Nebraska Department of Natural Resources, *Floodplain and Dam Safety Survey*; Nebraska Department of Natural Resources Public Information Office (note: not all wells and dams are inspected every year); Nebraska Department of Roads, *Some Facts and Figures* (December 2012); Nebraska Game and Parks Commission, *2011 Annual Report* (2012); Nebraska Department of Health and Human Services Division of Medicaid and Long-Term Care, *Nebraska Medicaid Annual Report* (December 2012); Nebraska Department of Roads, Rural Transit Project; Nebraska Department of Correctional Services, *Monthly Data Sheet* (January 2013); Nebraska Department of Health and Human Services Division of Public Health, Licensure Unit.

Chapter 1: The Budget Process

What is the State Budget?

The state budget is the group of laws that direct how the state collects and spends resources. That includes spending decisions for every service the state provides and revenue decisions affecting every Nebraskan.

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.²

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 2011-2012 (FY 11-12), the Legislature appropriated nearly \$8 billion³ from three main sources: the General Fund, Federal Funds, and Cash Funds. There also are Revolving Funds and Other Funds.

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 mostly around the use of this money. It is spent on state priorities such as education 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

*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, FY 13-14 and FY 14-15 represent the period from July 1, 2013 to June 30, 2015.*

that can only be used by the university. State gas taxes are deposited into an account that can only be spent on transportation projects such as road construction.

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.

Nebraska also has a “Rainy Day Fund” called the **Cash Reserve Fund**. If more tax money comes in than the Legislature expected and budgeted for, the excess is automatically deposited into the Cash Reserve. The Legislature can also vote to transfer other money into or out of it. Lawmakers can use the money to cover obligations if the General Fund runs low or for other purposes such as new construction projects. The fund reached 17 percent of annual General Fund revenues in 2009, allowing the Legislature to draw down reserves to reduce the severity of cuts made to balance the budget during the recession.⁴ The fund is projected to hold \$384 million at the end of FY 12-13, which is about 10 percent of annual General Fund revenues.⁵

How is the budget developed?

The **Governor** begins the budget process a year in advance. Working with the **Department of Administrative Services (DAS) Budget Division**, he or she creates guidelines and instructions for the funding requests that Nebraska’s government agencies must submit by September 15 of every even-numbered year. 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. The committee uses revenue forecasts by the **Nebraska Economic Forecasting Advisory Board** to determine how much it has to spend.

The Appropriations Committee is then required to hold public hearings on the budget. During this time, other committees are passing bills to the floor for consideration by the full Legislature. Any bill that requires an appropriation will have an “A” bill (appropriations

*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.*

bill) that provides for the spending necessary to implement the legislation.

Immediately following the public hearings, the Appropriations Committee and Legislative Fiscal Office staffs develop their budget bill to be considered by the full Legislature, which can accept the proposal or amend various parts of it.

Almost all appropriations bills are passed with a two-thirds vote (33 votes) of the Legislature.⁶ They are then sent to the Governor. The Governor may sign the bill, not sign it (but allow it to take effect automatically), veto it in total, or veto particular items. The Legislature may override all or part of any veto with 30 votes. It is important to note that while the Legislature's **Revenue Committee** plays an important role in influencing the amount of revenue collected by the state every year, the Revenue Committee has no role in developing the budget; any gaps between appropriations and revenue are usually addressed by the full Legislature. Created in 2009, the Legislature's **Planning Committee** is "charged with establishing and maintaining a future focus on the priorities of the State...by collecting and analyzing data, identifying priorities, setting long term goals and establishing benchmarks."⁷ While not specifically tasked to work on the state budget, the committee's work should provide useful information to be considered during budget development and debate.

What role do citizens play?

Citizens play a critical role in developing the state budget. All legislative bills, including appropriations, are given a public hearing, where citizens can testify. You can also be effective by contacting your state senator with your opinion. 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.

Figure 1: Budget Timeline in Odd Numbered Years



Footnotes

- 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 Legislative Fiscal Office, *State of Nebraska FY 2011-12 and FY 2012-13 Biennial Budget As Revised During the 2012 Legislative Session* (May 2012), p. 46. This figure omits approximately \$741 million in Revolving and Other Funds, which would be largely double-counted if included, because they are paid from one state agency to another.
- ⁴ Legislative Fiscal Office, *State of Nebraska FY 2011-12 and FY 2012-13 Biennial Budget As Revised During the 2012 Legislative Session* (May 2012), pp. 11, 21.
- ⁵ Legislative Fiscal Office, *General Fund Financial Status: Appropriations Committee Preliminary Budget* (February 2013).
- ⁶ This is because appropriations bills usually carry the "emergency clause," which requires 33 votes and allows the bills to take effect as soon as the next fiscal year starts.
- ⁷ Legislature's Planning Committee, *2011 Report* (January 2012), p. v.

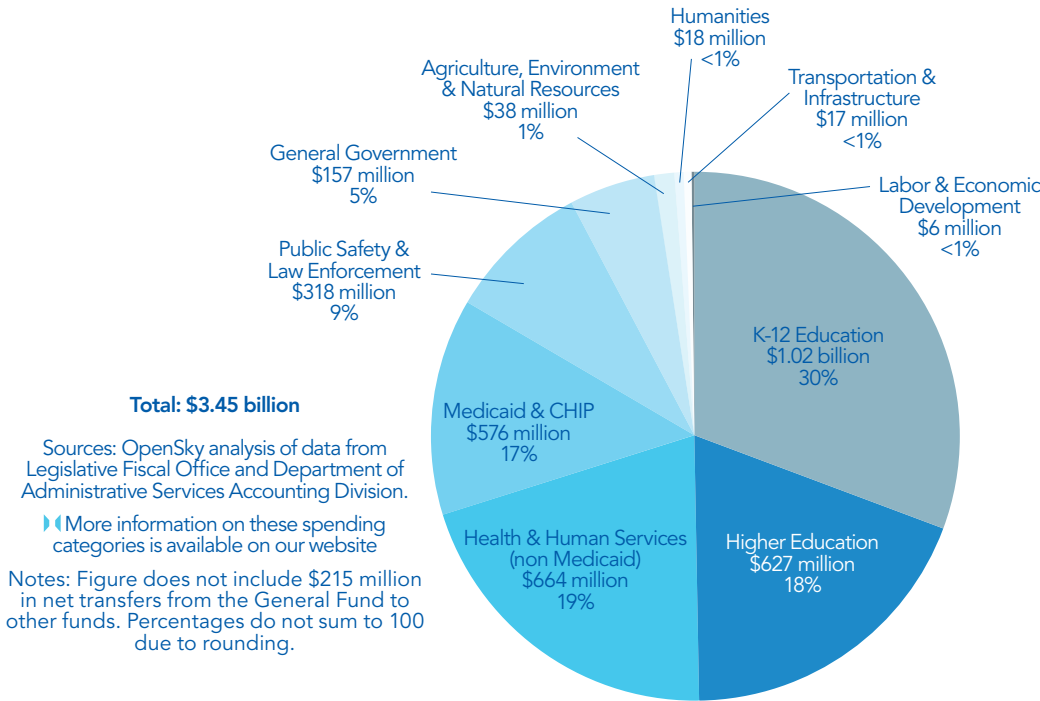
Chapter 2: State Spending

As stated in Chapter 1, Nebraska spent nearly \$8 billion of General Funds, Federal Funds, and Cash Funds combined in FY 11-12. Federal sources accounted for more than one of every three dollars spent by the state, and Cash Funds made up more than one of every five dollars. ▶▶

The General Fund is the largest piece of the budget — \$3.4 billion in FY 11-12 — 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 spent on education, and more than one-third on health and human services (Figure 2), together making up the vast majority of the budget. It's worth noting, however, that different services rely on different mixes of General, Cash, and Federal Funds. Medicaid and Children's Health (also known as CHIP ⁸), for example, receive more than 60 percent of their funding from federal sources.

In contrast, 95 percent of transportation spending comes from Cash Funds. Historically these Cash Funds have come mainly from gas and motor vehicle taxes, so that funding for roads has come from those who use them most. This will change beginning in FY 13-14 when a portion of the sales tax is re-directed from the General Fund to roads funding. This will increase total transportation spending, and since the additional funding is from a tax not related to the use of roads, it will also change how spending on roads has traditionally been funded.⁹

Figure 2: Education, Health Care Top Spending
General Fund Expenditures, FY 11-12

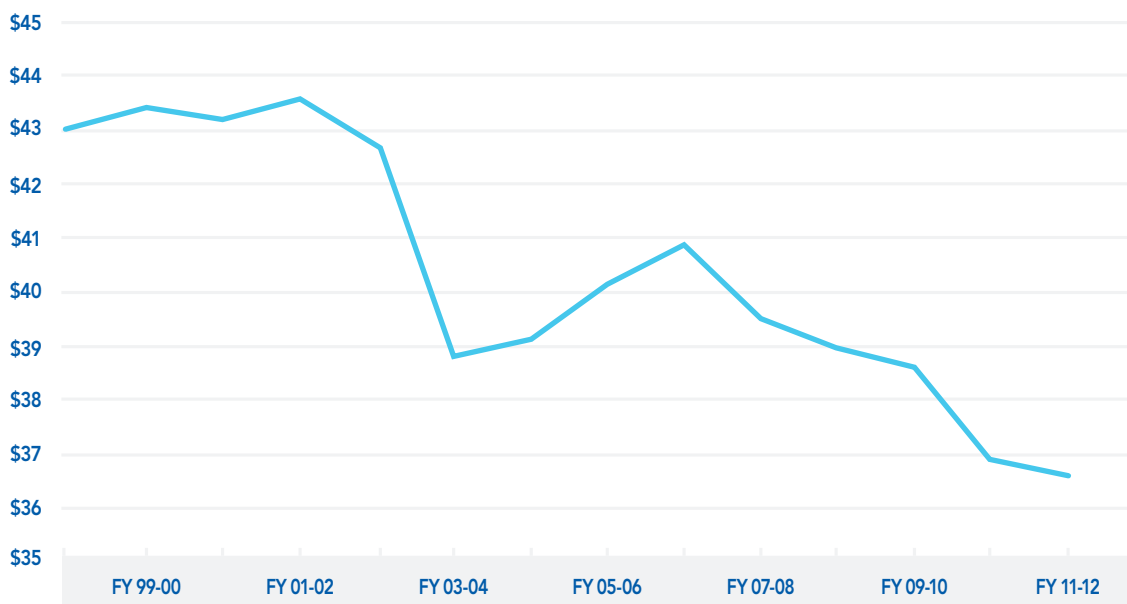


Some state spending goes to local governments to support services provided at the local level, such as K-12 education.

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 spending in Nebraska has fallen over the past decade as a share of the state economy (Figure 3).¹⁰ Effectively, the state budget is \$602 million smaller than it was in FY 98-99.¹¹ The impact can be seen in major areas like education and health care (Figure 4, see pg. 11) and transportation and infrastructure (Figure 5, see pg. 11). Although as stated previously, a portion of the sales tax will be used to increase funding for transportation and infrastructure beginning in FY 13-14.

Figure 3: State Spending in Nebraska Has Fallen
General Fund Spending per \$1,000 of Nebraska GDP, FY 98-99 to FY 11-12



Sources: OpenSky analysis of Department of Administrative Services Accounting Division, Legislative Fiscal Office, and US Bureau of Economic Analysis data.

Footnotes

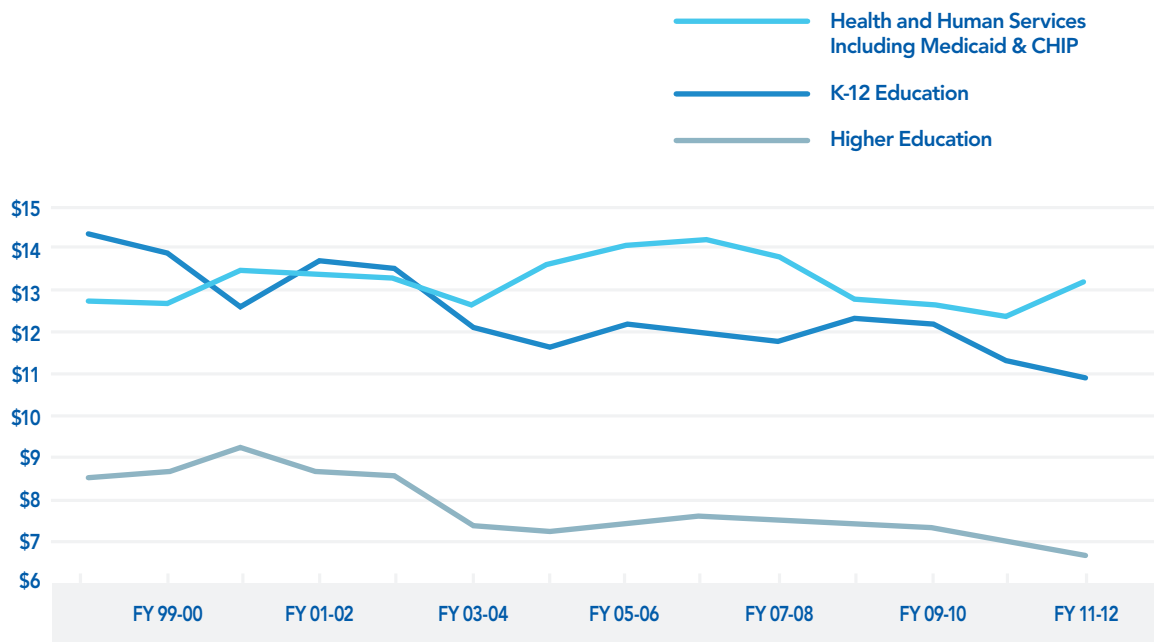
⁸ Also known in Nebraska as Kids Connection, and formerly called the State Children’s Health Insurance Program (SCHIP). Distinct from the Nebraska Comprehensive Health Insurance Pool (NECHIP).

⁹ Beginning in FY 13-14, .25 cents of the 5.5-cent state sales tax will be diverted from the general fund into roads funding. See Legislative Fiscal Office, *State of Nebraska FY 11-13 Biennial Budget* (August 2011), pp. 92-101, and Neb. Rev. Stat. §77-27,232 (Reissue 2011).

¹⁰ When evaluating historical trends in state revenue or spending, an often-used measure is share of the state economy, i.e. Gross Domestic Product (GDP).

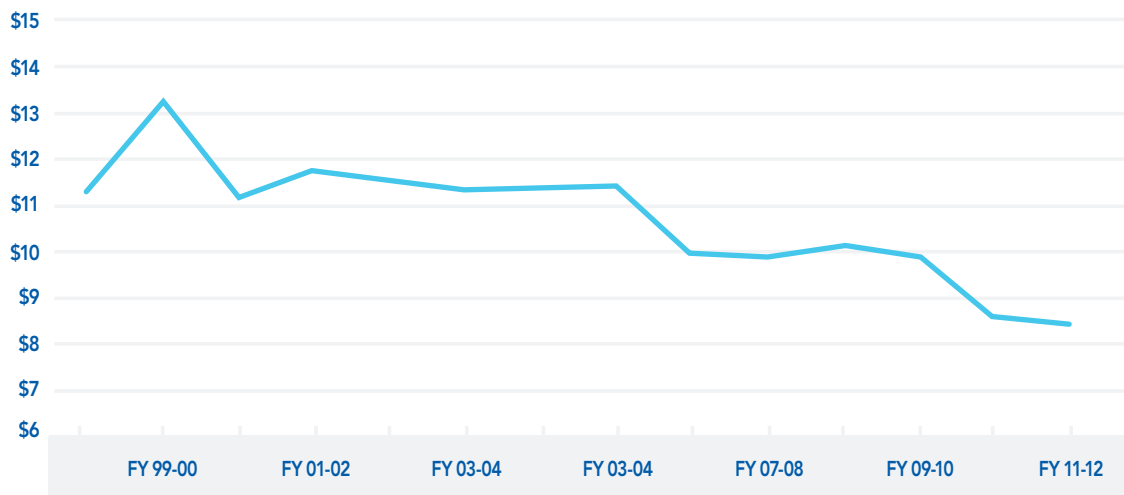
¹¹ In FY 98-99, the General Fund budget was 4.3% of Nebraska GDP. If the state devoted the same share of the economy to the state budget in FY 11-12, the budget that year would have been \$4.048 billion instead of \$3.446 billion, a difference of \$602 million.

Figure 4: Drop in Spending on Three Largest Budget Areas
General Fund Spending per \$1,000 of Nebraska GDP, FY 98-99 to FY 11-12



Sources: OpenSky analysis of Department of Administrative Services Accounting Division, Legislative Fiscal Office, and US Bureau of Economic Analysis data.

Figure 5: Decline in Transportation and Infrastructure Spending
General and Cash Fund Spending per \$1,000 of Nebraska GDP, FY 98-99 to FY 11-12



Sources: OpenSky analysis of Department of Administrative Services Accounting Division, Legislative Fiscal Office, and US Bureau of Economic Analysis data.

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 gets money from the federal government to assist in providing certain services.

In FY 11-12, the state received almost \$8 billion from people, businesses, and the federal government.¹² Of this, \$3.6 billion went to the General Fund (Figure 6). ▶◀

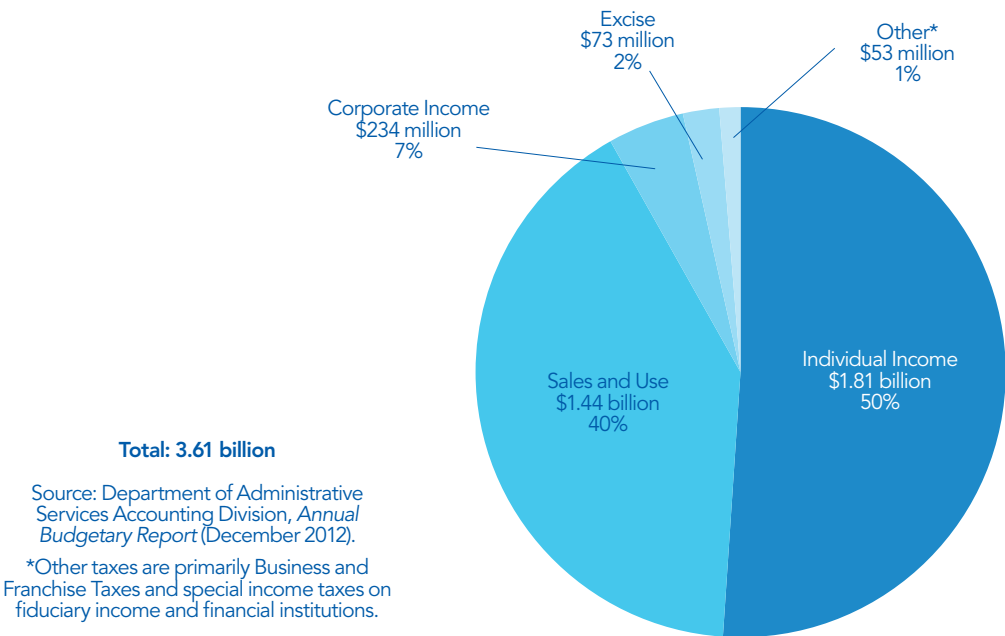
State Taxes

Individual Income Taxes – The individual income tax is the largest source of state revenue, totaling \$1.8 billion in FY 11-12, all of which goes into the General Fund. This amounts to about \$978 per Nebraska resident.¹³

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.¹⁴

“Taxable income,” or what’s left after exemptions and deductions, is subject to four tax brackets plus an additional tax for high income earners.¹⁵ For example, in 2012

Figure 6: Most Revenue Comes From Individual Income Tax and Sales Tax
General Fund Tax Revenues, FY 11-12



the first \$4,800 of a married couple's taxable income was taxed at 2.56 percent, the amount from \$4,800 to \$35,000 was taxed at 3.57 percent, the amount from \$35,000 to \$54,000 was taxed at 5.12 percent, and the amount more than \$54,000 was taxed at 6.84 percent. After the rates are applied, various credits or additional taxes may reduce or increase taxes owed. 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 over a two year period.¹⁶ 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.

Sales Taxes – Nebraska collected more than \$1.6 billion in FY 11-12 from the state's sales and use tax¹⁷, about \$877 per Nebraskan. Of that, \$1.4 billion, or 89 percent, went into the General Fund, making it the second largest source of General Fund revenue. The remaining 11 percent was used for specific purposes. For example, the sales tax on motor vehicles went to a Cash Fund dedicated to road maintenance and construction.

Nebraska's sales tax is similar to that of most states. All sales of goods are taxed at the state rate (5.5 percent since 2002) unless the item or purchaser is legally exempt. Groceries, manufacturing machinery and equipment, and purchases 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.

Some services are also subject to the tax, but unlike goods, they are not taxed unless specified by law. For example, car rental is taxed, but hiring a limousine with a driver is not. 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.

The taxes 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 alcohol, tobacco, and gasoline.

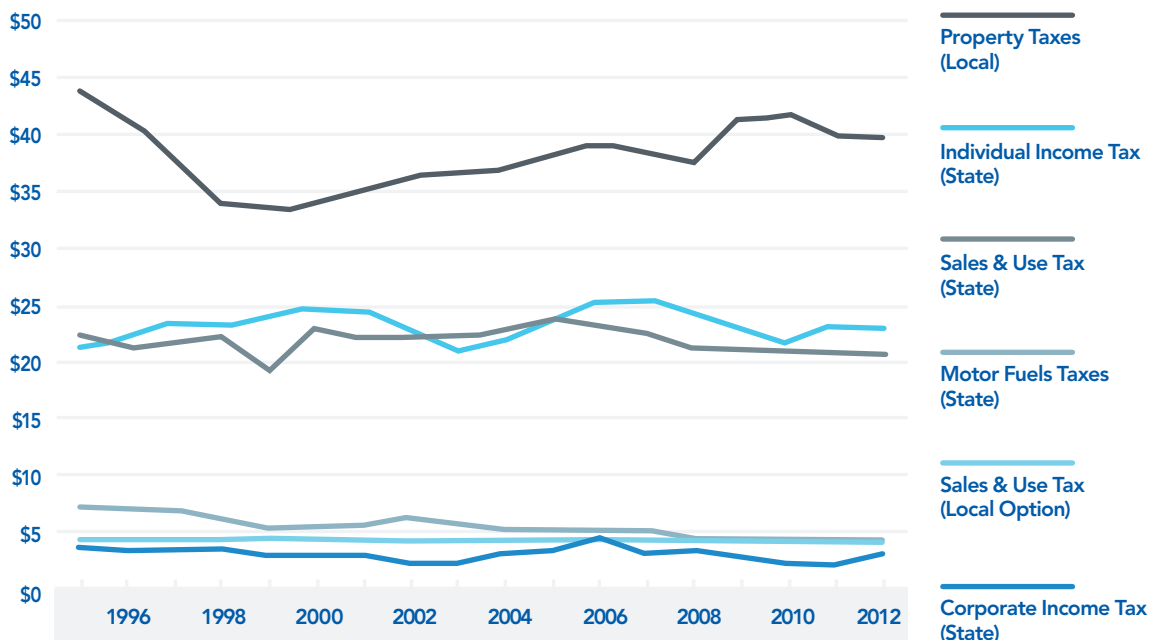
Corporate Income Taxes – In FY 11-12, corporate income taxes generated \$235 million, most of which went into the General Fund, making up 6.5 percent of General Fund revenues.

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 corporation that must pay the 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. Less than one-fourth of Nebraska businesses pay the corporate income tax.¹⁸

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 will be discussed further in Chapter 4.

Other Taxes and Fees – Excise taxes on gas and other fuels generated \$322 million for transportation-related Cash Funds in FY 11-12. The rate on all motor fuels, for example, changes every six months as determined by a formula intended to keep up with inflation and road maintenance needs. For January to July 2013, that rate was 24.6 cents per

Figure 7: Major State and Local Tax Revenues
Taxes per \$1,000 of Nebraska Personal Income, 1995-2012*



*State data are for fiscal years (2012 = FY 11-12); local data are for calendar years.
Sources: OpenSky analysis of Department of Administrative Services Accounting Division, Department of Revenue Property Assessment Division, Department of Revenue Research Division, and US Bureau of Economic Analysis data. See also footnote 25.

gallon.¹⁹ However, since gas tax revenue has declined over time (Figure 7, see pg. 14), Legislators passed a law diverting a portion of the state sales tax from the General Fund to funding for roads beginning in FY 13-14.²⁰

Other excise taxes, such as those on alcohol, tobacco, and charitable gaming (keno, bingo, pickle cards), raised another \$147 million, split about evenly between the General Fund and Cash Funds. Relatively small amounts of revenue also are raised through such miscellaneous sources as taxes on insurance companies and banks, and fees for fishing and hunting licenses.

Federal Revenues

Of Nebraska's total revenue, 35 percent, or \$2.7 billion, came from the federal government in FY 11-12.²¹ Most federal aid goes to Medicaid, Children's Health Insurance, and other health and human services areas. Over time, federal funding as a share of the total budget has increased, to 35 percent in FY 11-12 from 29 percent in FY 96-97.²² This trend is likely to reverse under current plans to reduce federal spending, which will mean less revenue for the state to fund existing commitments and priorities. ▶◀

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.

Local Option Taxes – Cities, counties, and villages may impose sales tax if approved by a local vote.²³ More than 95 percent of sales in Nebraska take place in localities that have local sales taxes.²⁴ State law puts restrictions on these taxes. For example, the maximum rate is 2 percent, and it can only be imposed on goods or services that are taxed at the state level.

Another type of local tax is the **occupation tax**, 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 phones and rental cars.

Property Taxes – Property taxes apply to real estate (i.e. homes, other buildings, farmland, etc.) and some personal property used to generate income. Totalling more than \$3.2 billion in FY 11-12, they are the largest source of local tax revenue. In fact, more money is raised through local property taxes than through any state tax (Figure 7).²⁵ The money is divided among a number of entities, including school districts,

community colleges, counties, and cities,²⁶ to help support the services provided by Nebraska's 2,659 local governments.²⁷

The state imposes limits on the rate that can be applied, although voters may override limits for up to five years.²⁸ 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 value, and all other property is taxed on 100 percent.²⁹ Efforts to reduce property taxes, begun in the 1990s, appear to have stalled, likely due in large part to state mandates and reduced state aid for local governments resulting in tax shifts to the local level, although further research is warranted.

Footnotes

¹² Nebraska received almost \$2.7 billion in Federal Funds in FY 11-12. According to the U.S. Census, Nebraska ranks 42nd in funds received from the federal government per person, US Census, *Federal Aid to States for Fiscal Year 2010* (September 2011), p. x.

¹³ Nebraska population was 1,848,880 in FY 11-12 (the average of July 1, 2011, and July 1, 2012). US Census Bureau, *Table 1: Annual Estimates of the Population for the United States, Regions, States, and Puerto Rico: April 1, 2010 to July 1, 2012*, downloaded from <http://www.census.gov/popest/data/state/totals/2012/index.html> on March 6, 2013.

¹⁴ Nebraska Department of Revenue, *2012 Nebraska Individual Income Tax Booklet*, p. 4, downloaded from http://www.revenue.ne.gov/tax/current/ind_inc_tax.html on March 6, 2013.

¹⁵ Nebraska has an additional graduated tax for earners whose federal adjusted gross income is between \$173,650 and \$713,650 (married, filing jointly), which was capped at \$1,519.78 for 2012.

¹⁶ Legislative Bill 970, 2012. The new rates and brackets will take full effect in tax year 2014. Neb. Rev. Stat. §§77-2701,77-2715,77-2727, 77-2734, 77-2717 (Reissue 2012).

¹⁷ 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.

¹⁸ Most recent data are from 2005, when there were 13,347 "C-Corporations" (paying the corporate income tax) and 45,826 S-Corporations and Partnerships (paying the individual income tax). Nebraska Department of Revenue, *Corporation, S Corporation, Partnership, and Miscellaneous Tax Returns, Table 1*, downloaded from http://www.revenue.ne.gov/research/stat_2005/bus_2005_excel.html on March 6, 2013.

¹⁹ Nebraska Department of Revenue, *Nebraska Fuel Tax Rates*, accessed at <http://www.revenue.ne.gov/fuels/fuelrate.html> on March 6, 2013. 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.

²⁰ Neb. Rev. Stat. §77-27,232 (Reissue 2011).

²¹ Department of Administrative Services Accounting Division, *FY12 Comprehensive Annual Financial Report* (January 2013), p. 116.

²² Department of Administrative Services Accounting Division, *Comprehensive Annual Financial Reports* (2002 - 2012).

²³ Nebraska Department of Revenue, *Local Option Sales and Use Tax Regulations*, downloaded from <http://www.revenue.ne.gov/legal/regs/localopt.html> on March 6, 2013.

²⁴ Nebraska Department of Revenue, *Current Local Sales and Use Tax Rates*, accessed at <http://www.revenue.ne.gov/question/sales.html>; and *Table 1 – 2006 Net Taxable Sales and State Sales Tax*, accessed at http://www.revenue.ne.gov/ann_rept/06an_rep/Sales1.pdf, on March 6, 2013.

²⁵ Gross Domestic Product (GDP), which is used in Figures 3, 4, and 5, has only been measured in its current form since 1997, so Figure 7 uses a similar measure, Personal Income (PI), which is available going further back in time. Personal Income in Nebraska has grown more slowly than GDP over this time frame.

²⁶ Neb. Rev. Stat. §77-3442 (Reissue 2012).

²⁷ According to the US Census, in 2007, Nebraska had 93 counties, 530 municipalities, 454 townships, 288 school districts and 1294 special districts that cover services such as fire protection, housing, irrigation, and sewage treatment. US Census, *Exploring the Intricate Layers of State and Local Governments: Nebraska* (February 2011), downloaded from http://www2.census.gov/govs/pubs/state_snapshot/gov07-ne.pdf on March 8, 2013.

²⁸ Neb. Rev. Stat. §77-3444 (Reissue 2007).

²⁹ Neb. Rev. Stat. §77-201 (Reissue 2009).

Chapter 4: Tax Expenditures

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,”**³⁰ and have been the subject of many legislative bills and studies.³¹

Tax expenditures function just like spending in the sense that they represent money the state is using for some purpose. The difference is that instead of being collected 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. Instead of receiving a check from the state, the businesses and families receive tax reductions, but the effect is the same as if they received reimbursement from the state.

However, the rules for tax expenditures and regular spending are very different. For regular spending, the Legislature must appropriate funds 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 again. For this reason, tax expenditures can often outlive their usefulness or outgrow their expected costs, turning into significant—but unnoticed—drains on the state budget. As a result, while appropriations are under regular review, tax expenditures are essentially on auto-pilot once enacted.

Information available through the Department of Revenue and other sources can help policy makers and citizens learn about tax expenditures, but there are no mechanisms to require that tax expenditures be carefully evaluated and regularly reviewed to assess their effectiveness like other spending.

Sales and Use Tax Expenditures – The state’s 2012 Tax Expenditure Report estimates that sales tax exemptions reduced revenue by about \$4.1 billion. This is nearly double the amount estimated in 2010, due to increased estimates for many exemptions as well as new estimates for existing exemptions that had previously not been included in the report, such as the exemptions for sales of livestock and feed grain. The majority of sales tax exemptions are for business inputs, most of which are exempt because they become products that are taxed when sold to consumers. Similarly, motor fuels are exempt from the sales tax, but are taxed separately under gasoline and other taxes. Purchases by governments and select nonprofits also are exempt, as are sales of groceries, newspapers, and school lunches.

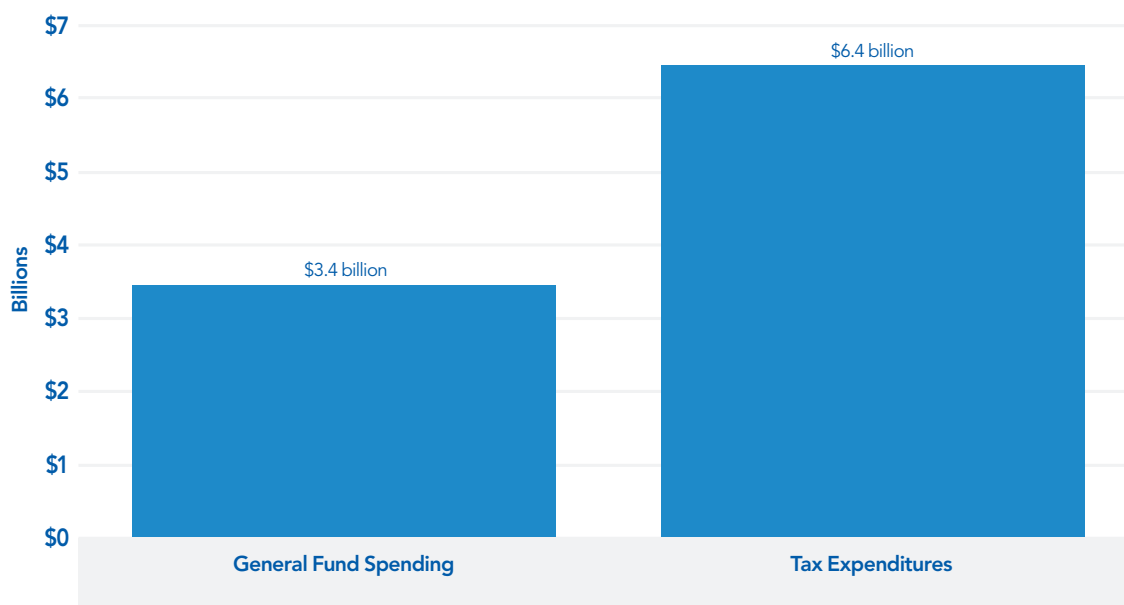
Though not included in the Tax Expenditure Report’s estimate, services not explicitly subject to the sales tax are exempt,³² a broad exemption that costs the state an estimated \$450 million to \$500 million every year.³³ Nebraska also loses an estimated \$98 million annually from untaxed Internet and catalog purchases.³⁴ While taxpayers are asked to voluntarily pay use tax for Internet and catalog purchases through state income tax returns, federal law prevents Nebraska from requiring sellers to collect these taxes unless they have a physical presence in the state.

Income Tax Expenditures – Income tax expenditures totaled \$1.6 billion in the 2012 Tax Expenditure Report, nearly equal to total income taxes collected that year.³⁵

Some of these 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.³⁶ Once the business has met the requirements for investment or

Figure 8: Tax Expenditures Exceed General Fund Spending
General Fund Expenditures and Estimated Tax Expenditures, FY 11-12



Sources: See footnote 38.

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 property tax exemptions, such as for corporate jets. Property tax exemptions and refunds of local sales tax can cost local governments significant revenue.

Nebraska has had many different business subsidy programs, beginning in 1987. In 2011³⁷, these programs awarded \$193 million in tax credits and sales tax refunds – primarily used to reduce state taxes, but also local sales taxes – and exempted \$970 million worth of property from property taxes. The largest current program is the Nebraska Advantage Act, which in 2011 awarded nearly \$60 million in tax credits, exempted more than \$790 million worth of property, and refunded \$5.5 million of sales tax. In 2011, 15 agreements were approved under this program, bringing the total since 2007 to 143.

Available data suggest that the state foregoes approximately \$6.4 billion on all tax expenditures each year, more than it spends through all General Fund appropriations (Figure 8).³⁸ ▶◀

Estimating Tax Expenditures – Tax expenditure cost estimates are always 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. In Figure 8 and throughout this chapter, we use the best data and lowest estimates available to provide a sense of the types and costs of tax expenditures in Nebraska.

Footnotes

³⁰ Neb.Rev.Stat. §77-381.

³¹ 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 March 7, 2013; 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 March 7, 2013; Maxwell School of Syracuse, *Nebraska Comprehensive Tax Study* (known as the Syracuse Tax Study) (1988); as well as multiple legislative bills and interim studies.

³² For a list of taxable services see Michael Mazerov, *Expanding Sales Taxation of Services: Options and Issues* (Center on Budget and Policy Priorities: July 2009).

³³ Lock, *Memo Re: LR161, LR166, & LR 97*. Estimates have varied. The 2002 Tax Expenditure Report estimated \$791 million, but this included many services, such as medical services, that are not considered feasibly taxable. Another estimate that looked only at a list of 30 services commonly taxed in Nebraska’s border states estimated that expanding the sales tax to those services would generate \$60 million per year. Estimates focusing on all feasibly taxable services have come in between \$450 million and \$500 million.

³⁴ National Conference of State Legislatures, *Collecting E-Commerce Taxes: An Interactive Map*, downloaded from <http://www.ncsl.org/issues-research/budget/collecting-e-commerce-taxes-an-interactive-map.aspx> on March 7, 2013. Based on state and local sales tax collections in 2012, the state’s share is approximately 83 percent, or \$98 million of the \$118 million total estimated by NCSL. See Nebraska Department of Administrative Services Accounting Division, *FY12 Annual Budgetary Report*, (December 2012), and Nebraska Department of Revenue Research Division, *Local Sales and Use Tax Remitted to Cities (historical)*, downloaded from http://www.revenue.ne.gov/research/county_official_data.html on March 7, 2013.

³⁵ Amounts in this section are from Nebraska Department of Revenue, *2012 Tax Expenditure Report* (October 2012), downloaded from http://www.revenue.ne.gov/research/tax_exp_reports.html on March 7, 2013.

³⁶ Amounts in this section are from Nebraska Department of Revenue, *Nebraska Tax Incentives 2011 Annual Report* (July 2012), downloaded from http://www.revenue.ne.gov/incentiv/annrep/annl_rep.html on March 7, 2013.

³⁷ Annual data are not available for the Invest Nebraska Act or the Quality Jobs Act. The most recent data available at the time of writing are from 2011. Nebraska Department of Revenue, *Nebraska Tax Incentives 2011 Annual Report* (July 2012).

³⁸ Figure 8 Sources: Appropriations: Legislative Fiscal Office. Business Incentives: Nebraska Department of Revenue, *Nebraska Tax Incentives 2011 Annual Report* (July 2012); Untaxed Internet and catalog sales: National Conference of State Legislatures, *Collecting E-Commerce Taxes: An Interactive Map*, downloaded from <http://www.ncsl.org/issues-research/budget/collecting-e-commerce-taxes-an-interactive-map.aspx> on March 7, 2013, and Donald Bruce, William F. Fox, and LeAnn Luna, *State and Local Government Sales Tax Revenue Losses from Electronic Commerce* (University of Tennessee: April 2009); Untaxed Services: 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 March 7, 2013; all others: Nebraska Department of Revenue, *2012 Tax Expenditure Report* (October 2012); 2012 data were used where possible.

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:³⁹

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.

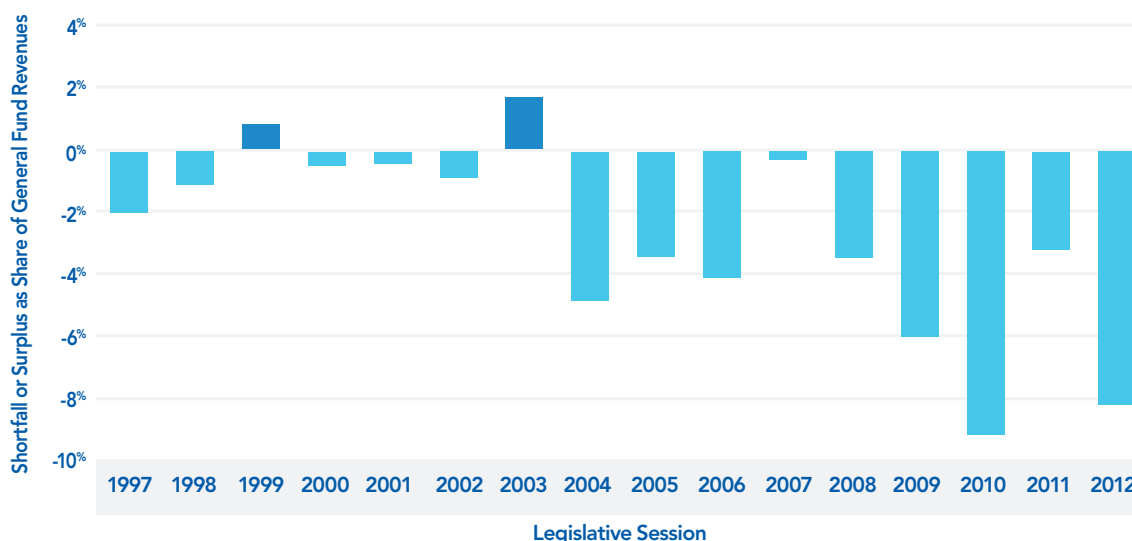
Nebraska must balance its budget, as explained in Chapter 1. Lawmakers can achieve this on an annual basis, but nonetheless leave the state with a structural deficit, such as when tax cuts and other revenue reducing measures are passed in one year but take effect in the future. The cost of providing education, health care, and other services gets more expensive each year as the costs of goods, utilities, and labor increase. At the same time, the value of some tax sources erodes 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. In a state without a structural deficit, the tax system will collect sufficient revenue each year to cover increased costs without raising tax rates.

Every year, the Legislative Fiscal Office prepares a Biennial Budget Report that includes estimates of future shortfalls or surpluses.⁴⁰ 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 14 of 16 years, even after balancing the short-term budget, the Legislature has ended its session projecting that revenues will fall short of needs in the following biennium (Figure 9). Projected shortfalls do not always come true, thanks 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 six budget cycles from FY 01-02 to FY 12-13, the Legislature faced a budget gap requiring action in every one. Those actions included tax increases in two of the six biennia,

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

Figure 9: Shortfalls Common in Recent Years
Shortfalls Projected in 14 of Last 16 Years



Sources: Legislative Fiscal Office, *Biennial Budget Reports* (1991-2012).

Cash Reserve Fund transfers in five of six, and spending cuts in all six. Yet despite these recurring shortfalls, the Legislature also reduced state revenues by passing tax cuts in three of the six biennia and increasing or adding new tax expenditures in all six. This has continually subjected schools, health care, and other vital services to reductions in state spending (as seen in Chapter 2, Figures 3-4). In some cases this has meant shifting funding obligations from the state to the local level.⁴¹ ▶◀

Spending for transportation and infrastructure also has declined (Chapter 2, Figure 5), as a large portion of revenue for those needs is tied to the amount of gas sold. This means gas tax revenues decrease as less fuel is consumed by the public due to higher fuel prices and more fuel-efficient vehicles.⁴² Also, the gas tax formula is structured so that the rate can go down even as revenue needs increase.⁴³ As previously noted, the Legislature addressed this issue by passing a law to divert one-fourth of a cent of the sales tax from the General Fund for transportation and infrastructure. While more funding is clearly needed to reverse the decline in spending for roads, diverting the money from the General Fund means even less will be available for the state's other priorities, the funding of which has been declining as well.

On the local level, the ability of cities, counties, and school districts to pay their bills 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 and police forces. State business subsidies also can interfere with local revenue streams when

- 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.

these packages include property tax exemptions and local sales tax refunds, creating budgeting uncertainty and reducing needed revenue.

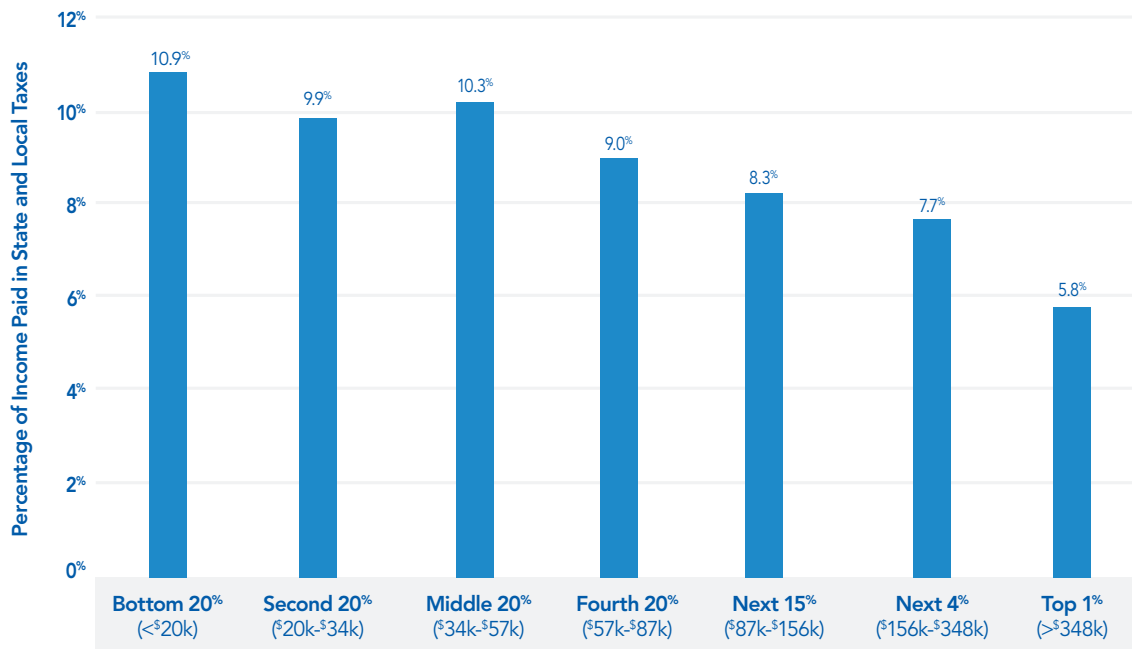
Is the tax system fair when it comes to who pays and how much?

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). So 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 income in state and local taxes than do better-off residents (Figure 10). 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, the average Nebraskan makes \$45,600 in income and pays \$4,697 (10.3 percent) in total state and local taxes. Those making less than \$20,000 average \$11,100 in income and \$1,210 in taxes (10.9 percent), while those making more than \$348,000 average \$1.1 million in income and \$63,962 in taxes (5.8 percent).⁴⁴

This is primarily due to sales and property taxes, which are regressive taxes. For example, Nebraskans making less than \$20,000 per year pay more than 6 percent of their income in sales tax, while those making more than \$87,000 pay less than 3 percent and those making more than \$350,000 pay less than 1 percent.

Likewise, low- and middle-income families must devote a larger share of their incomes

Figure 10: Nebraska's Tax System is Regressive



Source: Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, 4th ed. (January 2013)

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.⁴⁵ 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 \$20,000 a year pay little to no income tax, while the average earner pays 2.5 percent, and the highest-income individuals pay 4.3 percent. 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 stay out of poverty pay income tax on a fairly small portion of their earnings. Nebraska also is one of a small number of states with an Alternative Minimum Tax, which is an additional tax meant to ensure that higher-income individuals cannot use so many deductions and credits that they end up paying no income tax at all. 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 23 states that even the playing field between small and large businesses, through a policy known as “combined reporting.”⁴⁶ 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. While a large percentage of the estimated \$6.4 billion in annual tax expenditures in Nebraska are widely accepted exemptions, such as not taxing wood purchased by a furniture maker because it will be taxed when sold as a chair, other tax expenditures, such as taxing a night at the movies but not a day at the spa, may be more questionable to the average taxpayer. 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. Better data about how effective these subsidies are in creating jobs and increasing investment in the state could help address these concerns.

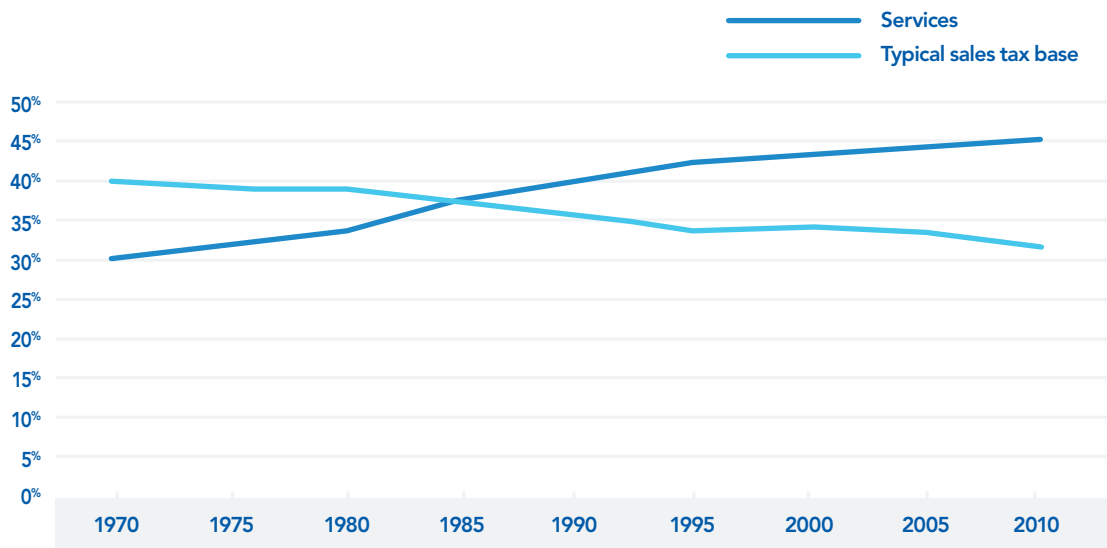
Does the tax system provide a steady revenue stream as the economy rises and falls?

A tax system that is unable to weather changes in the economy results in less revenue in downturns when the public most needs services, and may lead to overly large surpluses in prosperous times, putting pressure on legislators to enact tax cuts to reduce the surpluses, 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.⁴⁷ Tax systems that include a variety of taxes, draw from a broad cross-section of the population, and generate sufficient balances for emergencies produce more stable revenue and allow states to plan ahead. A strength of Nebraska’s tax system is that it levies a broad number of taxes, rather than relying on just one or two major sources of revenue. However, there is room to improve.

The sales tax, for instance, fails to produce as much revenue as it could as the state loses about \$550-\$600 million per year in untaxed services and Internet and catalog sales alone. Families across the United States today spend much more on services than on goods that are traditionally taxed (Figure 11). Yet most services remain exempt from Nebraska state sales tax. In fact, Nebraska taxes less than half of the 168 services taxed in at least one

Figure 1 1: Consumption of Services Increasing
Goods and Services as Share of Household Consumption



Sources: OpenSky analysis of data from Center on Budget and Policy Priorities, and US Bureau of Economic Analysis, *National Income and Product Accounts, Table 2.4.5U*

state. Approximately 30 of the services exempted in Nebraska are taxed in at least two of our neighboring states; massages 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.⁴⁸ Carpet cleaning is taxed, but swimming pool cleaning is not. Taxing more services would allow the tax system to keep up with our changing economy.⁴⁹ ▶◀

Likewise, current law puts local stores at a competitive disadvantage with out-of-state online and catalog sellers who can't 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, like Amazon.com, do not. While changing current federal law requires an act of Congress, at least ten states have passed their own laws to improve the collection of taxes for online purchases. Changing state law could help Nebraska recoup some of the estimated \$98 million the state loses every year to untaxed online and catalog sales.⁵⁰

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.⁵¹ 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 and how the policy is meant to promote them.

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 legislative scrutiny and regular public hearings that direct appropriations are each budget cycle. As the Nebraska Department of Revenue has written:

“[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.”⁵²

Nebraska is one of 43 states to publish a regular Tax Expenditure Report, but it has several shortcomings. It contains no cost estimate for almost one-fourth of the sales and income tax expenditures it identifies,⁵³ it is unclear which years the estimates represent, and it makes no recommendations despite the fact that they are required by law.⁵⁴

With incomplete reporting, it is impossible to know if Nebraskans are getting good returns on these investments. With no regular review, programs funded through tax expenditures can sometimes greatly exceed their original cost estimates, unexpectedly cutting into funding for other priorities.⁵⁵

Nebraska has improved its business subsidy policy by implementing wage requirements to ensure high-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 rates⁵⁶ and changing the way multistate corporations calculate taxable income⁵⁷ – but the impact of these changes has not been tracked and reported.

The nonpartisan Pew Center on the States⁵⁸ recommends that Nebraska evaluate its subsidies during policy and budget deliberations to ensure lawmakers consider the results. The state also should improve how it measures the economic impact of subsidies, Pew says.⁵⁹

Footnotes

- ³⁹ 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 March 8, 2013; National Conference of State Legislatures, *State Tax Reform Efforts: Measuring State Tax Actions Against Tax Principles* (Presentations from Fiscal Leaders Seminar: December 2009), downloaded from <http://www.ncsl.org/issues-research/budget/state-tax-reform-efforts-measuring-state-tax-acti.aspx> on March 8, 2013.
- ⁴⁰ Nebraska Legislative Fiscal Office, *Biennial Budget Reports* (1997 – 2012), available at <http://nebraskalegislature.gov/reports/fiscal.php>.
- ⁴¹ 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 (Reissue 2011).
- ⁴² Nebraska Legislature, Transportation and Telecommunications Committee, *LR 152* (2009), downloaded from http://www.nebraskalegislature.gov/pdf/reports/committee/transport/2009_LR152.pdf on March 8, 2013.
- ⁴³ *Id.* The report concluded that increased revenues for Nebraska’s Highway System are required, yet the gas tax declined a half cent per gallon from the first half of 2012 to the second half.
- ⁴⁴ Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, 4th ed. (January 2013), p. 79.
- ⁴⁵ *Id.* p. 6.
- ⁴⁶ Michael Mazerov, *A Majority of States Have Now Adopted a Key Corporate Tax Reform – “Combined Reporting”* (Center on Budget and Policy Priorities: April 2009).
- ⁴⁷ See especially National Conference of State Legislatures, *Principles of a High-Quality State Revenue System* (June 2007).
- ⁴⁸ Unless performed by a veterinarian, Neb. Rev. Stat. §77-2701.16 (Reissue 2012).
- ⁴⁹ Lock, *Memo Re: LR161, LR166, & LR 97*. The memo includes a list of approximately 30 services that are subject to sales tax in South Dakota and either Kansas or Iowa but exempt in Nebraska, worth a total of about \$60 million in lost revenue. See also Mazerov, *Expanding Sales Taxation of Services: Options and Issues*.
- ⁵⁰ National Conference of State Legislatures, *Collecting E-Commerce Taxes: An Interactive Map*. See also footnote 34.
- ⁵¹ The Department of Revenue produces a report on these issues every four years. See Nebraska Department of Revenue, *2007 Nebraska Tax Burden Study* (December 2010), downloaded from http://www.revenue.state.ne.us/research/2007_Tax_Burden_Study.pdf on March 8, 2013. The Department is able to use a computerized model to estimate how a given tax change will ripple through the economy and who it will ultimately affect. However, the limited scope and rare publication of the report limit its usefulness.
- ⁵² Nebraska Department of Revenue, *2012 Tax Expenditure Report* (October 2012), p. iii.
- ⁵³ Out of 115 sales and income tax expenditures identified in the report, 27 are recorded as “Estimate: Not available.” Nebraska Department of Revenue, *2012 Tax Expenditure Report* (October 2012).
- ⁵⁴ Neb. Rev. Stat. §77-382. “The report shall make recommendations relating to the elimination, in whole or in part, of particular tax expenditures or to the limiting of the duration of particular tax expenditures to a fixed number of years.”
- ⁵⁵ Michael Leachman, Dylan Grundman, and Nicholas Johnson, *Promoting State Budget Accountability Through Tax Expenditure Reporting*, (Center on Budget and Policy Priorities: May 2011).
- ⁵⁶ LB 773 of 1987. See also Nebraska Tax Policy Commission, *Final Report* (November 2007), pp. 6-1 to 6-13.
- ⁵⁷ Neb. Rev. Stat. §77-4105, and Neb. Rev. Stat. §77-2734.05.
- ⁵⁸ The Pew Center on the States “provides nonpartisan reporting and research, advocacy, and technical assistance to help states deliver better results and achieve long-term fiscal health by investing in programs that provide the strongest returns”, pewstates.org.
- ⁵⁹ Pew Center on the States, *Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth* (April 2012).

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, 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 support the needs of Nebraska's growing population and changing economy is just as critical to the future of the state.

Nebraska hasn't had comprehensive tax reform since 1967, when the sales and income taxes were established. Yet, today's economy and spending habits are dramatically different. For example, services now make up a greater share of household consumption than goods, untaxed online sales are growing rapidly, and new industries are born daily.

Our outdated tax system is taking a toll on our ability to invest in Nebraska's future. In each of the last nine years the Legislature has ended the year with a shortfall projected in the next budget cycle. As a result, our investments in our schools, roads, and communities have declined, and even greater challenges for us lie ahead.

Every year we find ourselves scrambling to respond to a tax and budget structure that's out of balance, rather than following a strategic plan that allows us to look forward and work toward our common goals. If we want our children to have a strong future, it's time for a strategy that puts us back in control.

Such a strategy 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 promote prosperity, 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.

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.

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