

Data show that in Nebraska, when state aid for schools and local government increases, local taxes like property taxes go down as a share of the economy, and vice versa. LB 614 presents Nebraska lawmakers with a way to reduce property taxes and protect our investment in K-12 education by increasing state aid to schools. In this way, the measure falls in line with the 2013 Tax Modernization Committee's top recommendation for lowering property taxes in Nebraska, increasing state support for K-12 education. LB 614's revenue and funding changes are discussed below.

### **Income tax changes**

Previous tax changes, including several income tax reductions, have reduced Nebraska's tax base and increased our reliance on property taxes to fund K-12 education and other services. LB 614 would reverse this trend by making income tax changes including eliminating all itemized income tax deductions except for medical expenses. The state increased its standard deduction in response to 2018's federal tax changes but Nebraskans can still reduce their taxes dramatically by itemizing those remaining deductions.

The bill also eliminates the s-corp and LLC non-Nebraska income exclusion, which allows Nebraskans to avoid paying income tax on earnings from s corporations and limited liability companies that are generated from goods or services sold outside Nebraska, even when the income isn't taxed in another state.<sup>1</sup> Furthermore, LB 614 discontinues the special capital gains and extraordinary dividends election, which is a one-time tax exclusion that allows Nebraskans to sell stock in their employers' companies without paying state income taxes on the capital gains.<sup>2</sup>

### **Personal property tax exemption eliminated**

LB 614 would end the personal property exemption, which allows taxpayers to exempt the first \$10,000 of tangible personal property value for each tax district in which a personal property return is filed. Tangible personal property is personal property possessing a physical existence, excluding money, and includes trade fixtures, such as machinery and equipment, used directly in commercial, manufacturing, or processing activities conducted on real property.<sup>3</sup>

### **Consumption tax changes**

Under LB 614, Nebraska would tax candy, soda and bottled water. The measure also would increase Nebraska's cigarette tax by \$1.50 per pack. Presently our cigarette tax

<sup>1</sup> Nebraska Legislature, "Nebraska Revised Statute §77-2716 (4)," accessed at <https://www.nebraskalegislature.gov/laws/statutes.php?statute=77-2716> on Dec. 26, 2018.

<sup>2</sup> Nebraska Legislature, Nebraska Revised Statute §77-2715.09, accessed at <https://www.nebraskalegislature.gov/laws/statutes.php?statute=77-2715.09> on Dec. 26, 2018).

<sup>3</sup> State of Nebraska, "Information Guide: Personal Property Exemption, June 2018," accessed at [http://www.revenue.nebraska.gov/PAD/infoguide/per\\_prop\\_info\\_guide.pdf](http://www.revenue.nebraska.gov/PAD/infoguide/per_prop_info_guide.pdf) on November 7, 2018.

ranks 40<sup>th</sup>. It would rank 13<sup>th</sup> under LB 614.<sup>4</sup> Furthermore, LB 614 would increase Nebraska's tax on spirits by five cents per drink. The state's spirit tax presently ranks 38<sup>th</sup> and under LB 614, it would rank 16<sup>th</sup>.

### **K-12 finance changes include more allocated income tax, special education funding**

LB 614 would provide supplemental state aid to all school districts based on a percentage of the statewide average general fund operating expenditures per formula student. Beginning in school fiscal year 2019-20, supplemental state aid will be paid to each school district for property tax relief. The bill also would increase the rate at which Nebraska reimburses school districts to educate special education students from 51 percent to 80 percent. Furthermore, it would increase the allocated income tax from 2.23 percent to 20 percent. Allocated income tax (AIT) is state income tax revenue that is sent back to the district in which it was paid in the form of K-12 aid. When the state's school funding formula was implemented in the early 1990s, it called for the AIT to be 20 percent, but changes made to the formula since have resulted in the AIT currently being slightly more than two percent.

### **EITC increase, renters credit help low and middle-income earners**

LB 614 would increase the Nebraska Earned Income Tax Credit (EITC) – which helps many low- and middle-income earners with children – from 10 percent to 15 percent of a recipient's federal EITC. This change would lead to an average \$118 increase in the refundable tax credit for those who receive it.<sup>5</sup> Increasing the EITC would help offset the regressive effects of other tax changes in LB 614, such as taxing soda, candy and bottled water and increasing taxes on cigarettes and spirits.

### **Revenue and expenditure report helps ensure property tax transparency**

Rather than imposing additional spending or revenue limits on schools that would create unintended consequences, LB 614 requires school districts and ESUs to publish a summary of revenue sources and expenditure reductions or increases. The summary, which must be published at least three days prior to a district budget hearing, also would detail current and future cost savings if the proposed budget were adopted. Failure to publish the summary would result in withholding of state aid until the notice is published.

<sup>4</sup> Tax Policy Center, "State Cigarette Tax Rates: 2001-2018, August 10, 2018," accessed at <https://www.taxpolicycenter.org/statistics/state-cigarette-tax-rates> on Dec. 7, 2018.

<sup>5</sup> U.S. Internal Revenue Service, "Statistics for Tax Returns with EITC," accessed at <https://www.irs.gov/eitc-central/statistics-for-tax-returns-with-eitc/statistics-for-tax-returns-with-eitc> on May 7, 2018. To provide this estimate, the average federal credit for NE in 2017 (\$2,360) was multiplied by 10 percent to obtain the average state EITC estimate.

## Conclusion

Over the past several years, state support for public education and other local governments has declined as a share of the economy and property taxes have risen. The tax changes put forth in LB 614 can help reverse that trend and allow Nebraska to make significant progress in resolving our longstanding struggle with high reliance on property taxes while at the same time protecting our vital investment in K-12 education.