



POLICY INSTITUTE

Looking for Clarity:

An Overview of Nebraska Budget and Tax Policy – 2020



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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



OpenSky Policy Institute is supported by generous donors. This primer could not have been completed without their support.

We would also like to thank OpenSky Policy Institute’s Board of Directors and Technical Advisory Team for their contributions to this report.

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OpenSky Policy Institute, “Looking for Clarity: An Overview of Nebraska Budget and Tax Policy,” January 2020.

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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, strong 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 must 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.

Inadequate public services, dilapidated highways, aging school buildings, and outdated communications infrastructures do not stimulate job creation or build strong, thriving communities.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 public spending, it is important to begin with a clear, precise explanation of how Nebraska generates resources and how those resources are spent. This primer is a good starting point for any Nebraskan who wants to understand how the budget process works. 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 laws, passed annually, directing and authorizing state spending.

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

How the State Budget Affects Nebraskans¹

- 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 323,000 students are educated by 23,768 teachers in 1,004 public schools each year;
- Approximately 135,000 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, 3,016 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 13 million visits each year;
- More than 161,000 children receive health care through Medicaid and the Children's Health Insurance Program each month; and,
- More than 5,400 inmates are housed each month in the state correctional system.

¹ For sources, please see Appendix A. 

Chapter 1: The Budget Process

What is the State Budget?

The state budget is the set of laws that direct how the state allocates and spends its resources. These include 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, 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

An increase in spending or unexpected decline in revenues may create a budget "shortfall." Since the state must balance its budget, the Legislature must fix a shortfall through some combination of spending cuts, tax increases, cash fund transfers and use of cash reserves.

For Fiscal Year 2020-21 (FY21), the Legislature appropriated over \$10.8 billion³ from three main sources: The General Fund, Federal Funds, and Cash Funds. Smaller fund categories include Revolving Funds and Other Funds.

The **General Fund** is the state's primary account, consisting largely of revenues from Nebraska's individual income tax, corporate income tax, and sales tax. The Legislature has significant discretion over how General Fund money is spent, and budget debates in the Legislature typically revolve around the use of this money. General Fund money is allocated to programs addressing state priorities like education, services for vulnerable citizens, and public safety.

Cash Funds are used to hold taxes or fees imposed on specific activities to pay for specific services. For example, university tuition is deposited into a cash fund that can only be used by the university. State motor fuels taxes, which are taxes levied on gasoline, diesel fuel, and compressed natural gas, are deposited into a cash fund that is used for transportation projects like 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, FY20 and FY21 represent the period from July 1, 2019 to June 30, 2021.*

Federal Funds come from the federal government and are devoted to a particular purpose. The 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, including Medicaid, the federal government matches a percentage of state spending on the program.

Revolving Funds and **Other Funds** make up the rest of the budget. Revolving Funds are used for money transferred from one government agency to another — for example, when an agency pays rent to a different agency for office space in a state building. Other funds hold 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 (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 this fund for any reason, although it is primarily used to cover obligations in the case of a budget shortfall and to fund one-time 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.⁴ The Government Finance Officers Association recommends that a minimum of two months of General Fund revenues or expenditures be reserved to protect against revenue shortfalls or unanticipated expenditures.⁵

The Cash Reserve Fund reached 17.2 percent of annual General Fund receipts in 2009⁶ — an all-time high. This healthy reserve allowed the Legislature to reduce the severity of cuts made in the aftermath of the Great Recession even while the state was seeing lower tax receipts.⁷ To address the budget shortfall during this period, the Legislature used \$986 million in one-time funds 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.⁸

The Cash Reserve Fund held \$333.5 million at the end of FY19, or 6.8 percent of that year’s net

*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 of the biennium is usually known as the “long” session, or budget session, and occurs in odd-numbered years. The **Governor** begins the budget process in the year before the long legislative session. Working with the **Department of Administrative Services (DAS) Budget Division**, they create 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.¹⁰

Between September and January, the Governor develops a budget proposal, which must be balanced. The proposal is due to the Legislature by January 15 in odd-numbered years (or February 1 for a new Governor). This proposal becomes the starting point for the Legislature’s budget debate and is introduced by the Speaker of the Legislature on behalf of the governor. The budget proposal is introduced as a series of separate bills, including one for government appropriations, one for salaries of legislative members, and one for capital construction and property acquisition, among others. Seven mainline budget bills were introduced in the 2019 legislative session.

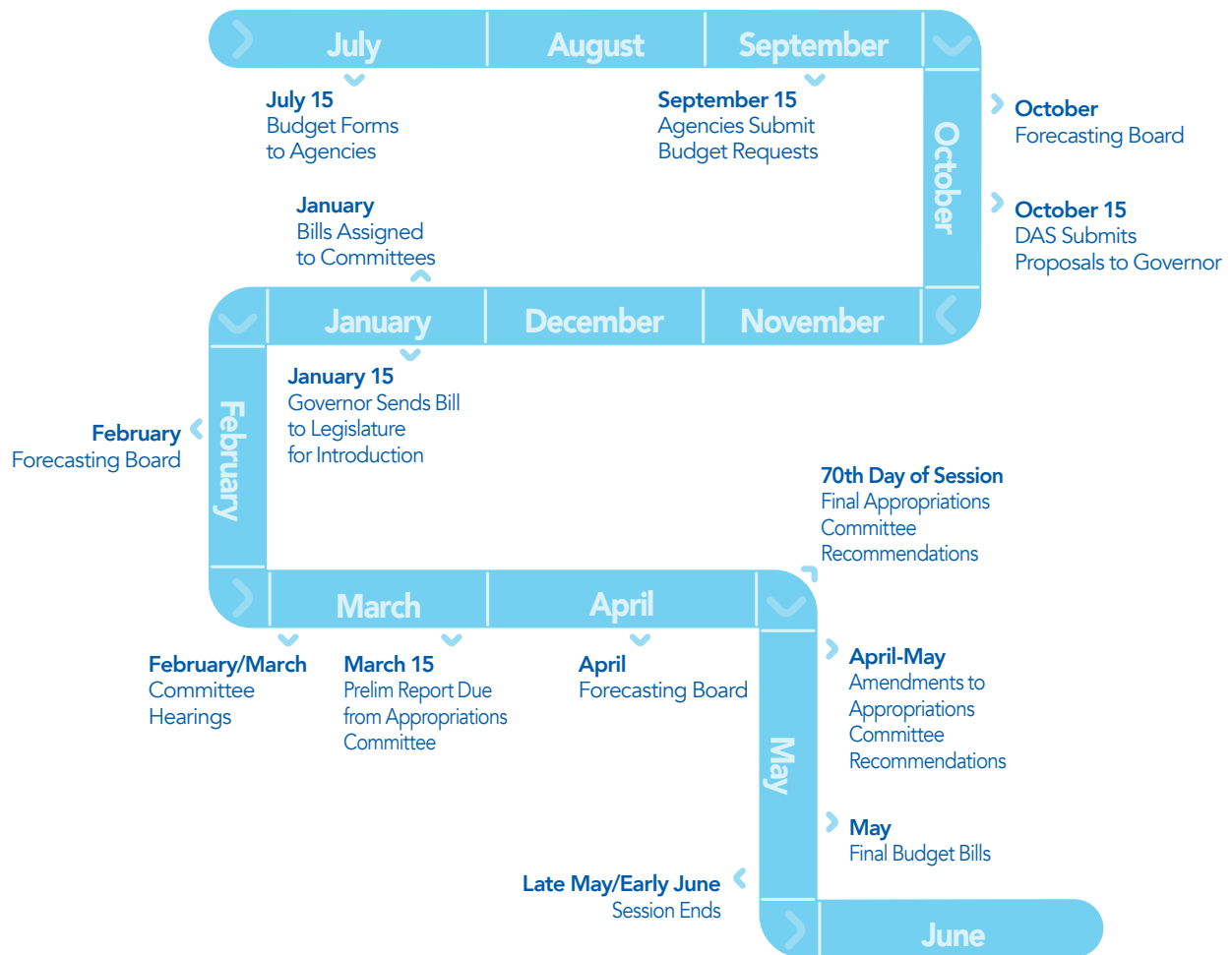
In January and February, the Legislature’s **Appropriations Committee** meets with **Legislative Fiscal Office** staff to review agency budget requests. They develop a preliminary recommendation within 20 to 30 legislative days of the Governor’s budget submission in odd-numbered years.¹¹ The committee uses revenue forecasts by the **Nebraska Economic Forecasting Advisory Board** to determine how much revenue it has available to appropriate. Next, the Appropriations Committee holds mandatory public hearings on the budget proposal.

During this time, other legislative committees are advancing bills for consideration by the full Legislature. 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. Any bill that requires an appropriation has an “A” bill (appropriations bill), authorizing any spending necessary to implement the proposed legislation. Bills that require an appropriations bill cannot be read on Final Reading (the last round of full legislative debate) until the budget bills are passed by the Legislature.¹²

Almost all budget bills are passed with a two-thirds vote (33 of 49 votes) of the Legislature.¹³ They are then sent to the Governor, who may sign the bills, decline to sign them (but allow them to take effect automatically), veto the whole bill, 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, budget modifications 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, can be made during even-year sessions in response to agency needs. The Legislature may also need to make changes to the budget during even-year sessions due to a shortfall in tax revenues to ensure the budget is balanced.

Figure 1: Budget Timeline



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 public hearings where members of the public can testify. Individuals can also contact their state senators to share their opinions.

Nebraskalegislature.gov offers many valuable tools to help people engage in the budget process, including how to find state senators' contact information, live streaming of committee hearings and legislative debates, and a free automated bill tracker service.

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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 the independent ability to issue bonds for construction purposes.
 - 3 This figure omits approximately \$992 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 include deficit appropriations. Nebraska Legislature, "State of Nebraska FY20 and FY21 Biennial Budget as Enacted in the 106th Legislature First Session," August 2019, p. 77, <https://nebraskalegislature.gov/pdf/reports/fiscal/2019budget.pdf>, accessed December 20, 2019.
 - 4 Nebraska Legislature, "State of Nebraska FY18 and FY19 Biennial Budget As Enacted in the 105th Legislature-First Session," August 2017, p. 4, <https://nebraskalegislature.gov/pdf/reports/fiscal/2017budget.pdf>, accessed December 20, 2019.
 - 5 Government Finance Officers Association, "Fund Balance Guidelines for the General Fund," <http://www.gfoa.org/fund-balance-guidelines-general-fund>, accessed December 20, 2019.
 - 6 The Cash Reserve Fund Balance as a percent of General Fund receipts reached an all-time high of 17.5 percent at the end of FY14. Nebraska Legislature, "State of Nebraska FY18 and FY19 Biennial Budget as Revised During the 2018 Legislative Session," May 2018, p. 17, <https://nebraskalegislature.gov/pdf/reports/fiscal/2018budget.pdf>, accessed December 20, 2019.
 - 7 The Great Recession refers to the recessionary period between December 2007 and June 2009. National Bureau of Economic Research, Business Cycle Dating Committee, "US Business Cycle Expansions and Contractions," <http://www.nber.org/cycles.html>, accessed December 20, 2019.
 - 8 Nebraska Legislature, "State of Nebraska FY18 and FY19 Biennial Budget As Enacted in the 105th Legislature-First Session," August 2017, p. 4, <https://nebraskalegislature.gov/pdf/reports/fiscal/2017budget.pdf>, accessed December 20, 2019.
 - 9 Nebraska Legislature, "General Fund Financial Status, Tax Rate Review Committee (November 2019)," <https://www.nebraskalegislature.gov/FloorDocs/Current/PDF/Budget/status.pdf>, accessed December 19, 2019.
 - 10 LB 1092 (2016), Neb. Rev. Stat. § 81-1113.
 - 11 Nebraska Legislature, "Rules of the Nebraska Unicameral Legislature," Rule 8, Section 3, <https://nebraskalegislature.gov/FloorDocs/Current/PDF/Rules/RuleBook.pdf>, accessed December 19, 2019.
 - 12 Nebraska Legislature, "Rules of the Nebraska Unicameral Legislature," Rule 8, Section 5, <https://nebraskalegislature.gov/FloorDocs/Current/PDF/Rules/RuleBook.pdf>, accessed December 19, 2019.
 - 13 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," <http://www.nebraskalegislature.gov/faq/faq.php>, accessed December 19, 2019.

Chapter 2: State-Authorized Spending

As stated in Chapter 1, the state budget authorized and directed almost \$10.8 billion of General Funds, Federal Funds, and Cash Funds combined in FY21. Federal sources accounted for almost one of every three dollars spent by the state, and Cash Funds made up about one of every five dollars.¹⁴

The General Fund is the largest piece of the budget — \$4.73 billion in FY21 — and is at the heart of state budget debates. Almost half of all General Fund dollars are allocated to education, and over one-third are allocated to health care and services for vulnerable Nebraskans, including individuals with disabilities, abused and neglected children, and others (Figure 2). Together, education and health care make up the majority of the budget. It's worth noting 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),¹⁵ 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 and a portion of the state's sales tax that is diverted from the General Fund to transportation-related cash funds.¹⁶

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 appropriations¹⁷ but is a central goal behind various tax breaks and other subsidies. These "tax expenditures" are not counted as appropriations, but because they significantly reduce state revenues, they are an important part of the state's budget. Tax expenditures are discussed further in Chapter 4.

State General Fund appropriations as a share of Nebraska personal income have fallen over the past decade, as shown in Figure 3. Effectively, in FY21, total General Fund appropriations were about \$434 million smaller than they were in FY00.¹⁸ We use personal income as a measure of inflation to compare with the growth of General Fund appropriations because it better reflects the growth in expenses that governments face. Some other measures of inflation, such as Consumer Price Index (CPI), are based on household purchases of a certain set of common items that are fundamentally different than most government expenses. Most education and healthcare-related expenses (which make up 81.7% of general fund appropriations, as shown in Figure 2) are not included in CPI.

Figure 2: Education, Health Care Top General Fund Appropriations¹⁹
 General Fund Appropriations (FY21) ▶◀

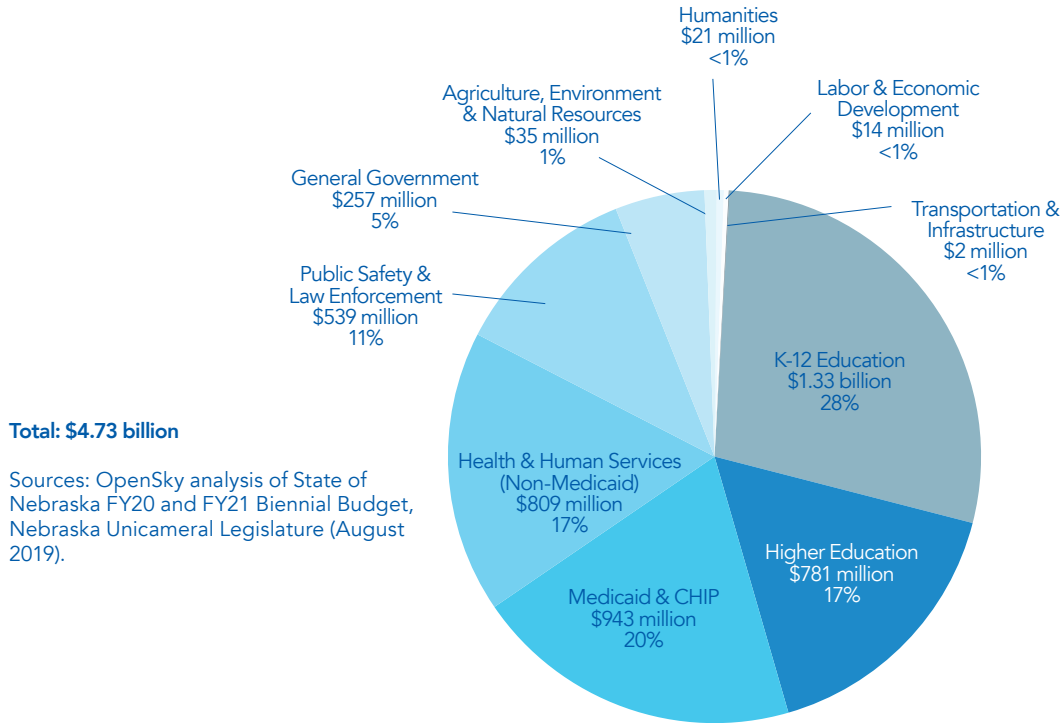
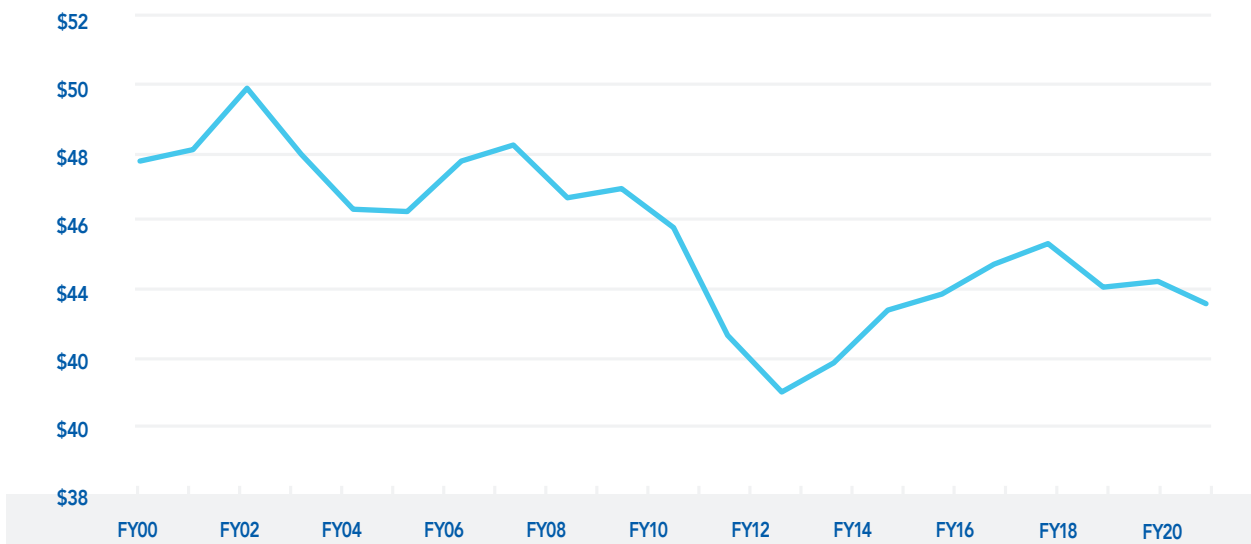


Figure 3: General Fund Appropriations in Nebraska Have Fallen as a Share of the Economy
 General Fund Appropriations per \$1,000 of Nebraska Personal Income (FY00-FY21) ▶◀

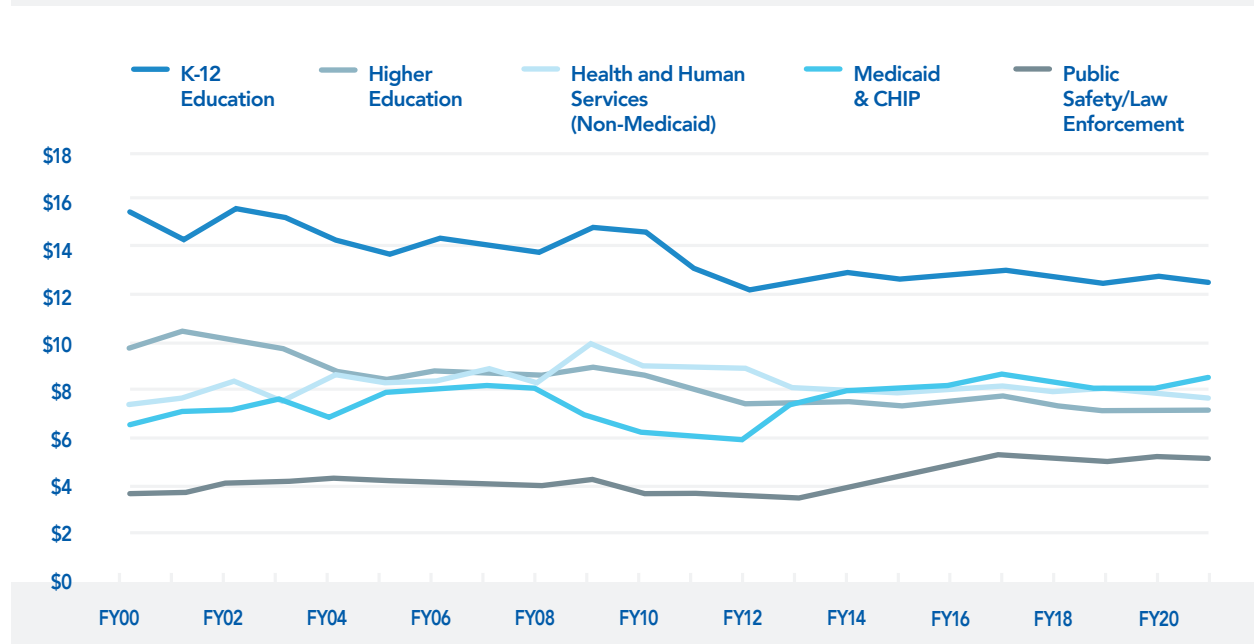


Sources: Legislative Fiscal Office, US Bureau of Economic Analysis; Personal income for FY19 - FY21 are estimated based on average change over prior years.

General Fund appropriations to major budget areas like education, health care, and transportation and infrastructure have also fallen as shares of Nebraska personal income over the last decade, as shown in Figures 4, 5, and 6.

Figure 4: Appropriations for Largest Budget Areas

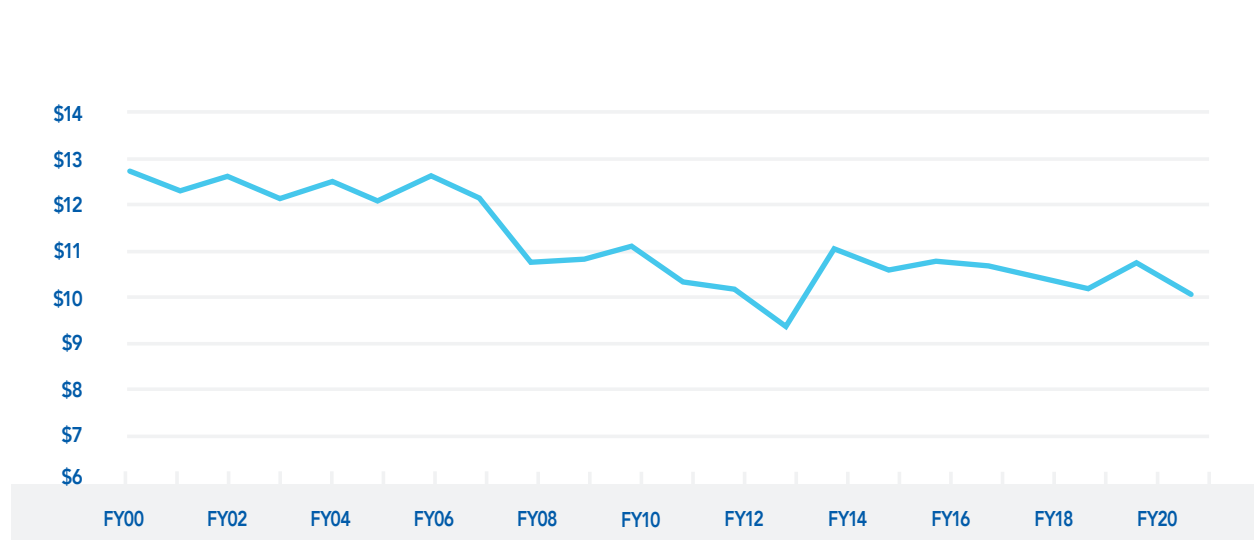
General Fund Appropriations per \$1,000 of Nebraska Personal Income (FY00-FY21)



Sources: Legislative Fiscal Office, US Bureau of Economic Analysis.

Figure 5: Decline in Transportation and Infrastructure Appropriations

General, Cash, and Federal Fund Appropriations per \$1,000 of Nebraska Personal Income (FY00-FY21)



Sources: Legislative Fiscal Office, U.S. Bureau of Economic Analysis. Personal Income for FY19 through FY21 is estimated based on change over prior year

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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. Nebraska Legislature, "State of Nebraska FY20 and FY21 Biennial Budget as Enacted in the 106th Legislature First Session," August 2019, p. 77, <https://nebraskalegislature.gov/pdf/reports/fiscal/2019budget.pdf>, accessed December 19, 2019.
 - 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 Transportation, "Nebraska Transportation Financing," <http://www.roads.nebraska.gov/media/2815/transportation-finance-flowchart.pdf>, accessed December 19, 2019.
 - 17 Labor and Economic Development make up 0.26% of general fund appropriations for FY21.
 - 18 In FY00, state General Fund appropriations were 4.77 percent of total Nebraska personal income. If the state devoted the same share of personal income to appropriations in FY21, appropriations for that fiscal year would be \$5.164 billion instead of 4.73 billion, a difference of about \$434 million.
 - 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 amounts do not include deficit appropriations.

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.

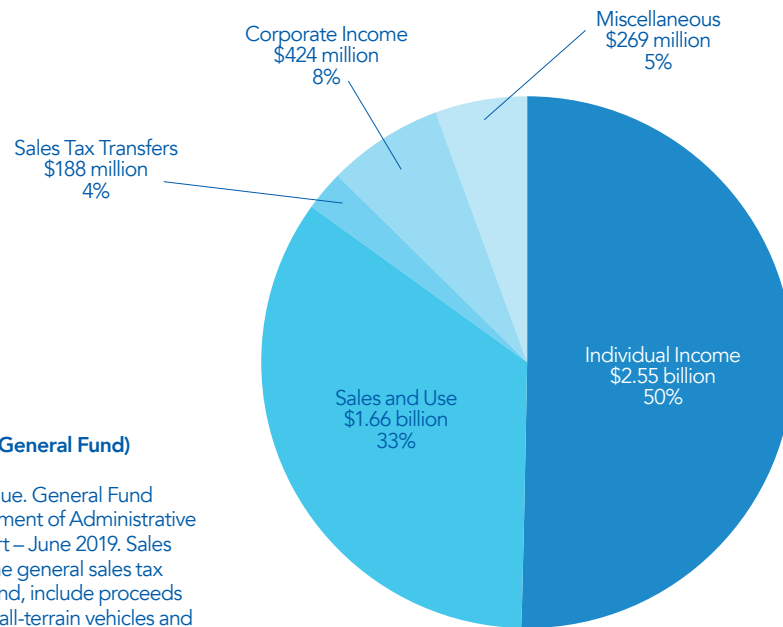
According to the U.S. Census Bureau, Nebraska generally ranks in the middle of states for taxes when measured against various economic growth statistics (see Table 1 below) and in the bottom half of states for spending.

Of the \$9.8 billion received by the state in FY19, \$4.896 billion came from net sales, income, and miscellaneous taxes (see Figure 6) 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 \$2.42 billion in cash funds, used to carry out specific programs.²⁰

Table 1: Nebraska’s National Tax & Spending Rankings²¹

| | 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 | 22 | 19 | | 25 | 22 | | 29 | 26 | |
| Corporate Income Tax | 17 | 16 | | 22 | 21 | | 28 | 28 | |
| Property Tax | 13 | | 11 | 11 | | 10 | 13 | | 10 |
| Sales Tax ²² | 21 | 22 | 23 | 25 | 24 | 23 | 27 | 29 | 24 |
| All Taxes | 16 | 29 | 11 | 17 | 36 | 5 | 29 | 40 | 10 |
| General Revenue (incl. charges) | 21 | 37 | 11 | 30 | 41 | 9 | 39 | 45 | 20 |
| Direct General Expenditure | 23 | 41 | 8 | 29 | 41 | 8 | 37 | 46 | 16 |

Figure 6: Most General Fund Revenue Comes from Individual Income and Sales Tax Net Tax Revenues (FY19)



Total: \$5.084 billion (\$4.896 billion to General Fund)

Source: Nebraska Department of Revenue. General Fund Receipts – June 2019; Nebraska Department of Administrative Services, Fund Summary by Fund Report – June 2019. Sales tax transfers, 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 \$2.545 billion in FY19. All individual income tax collections, which equal about \$1,320 per Nebraska resident, are deposited into the General Fund.²³

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 the amount of income left after subtracting exemptions and deductions, is subject to four tax brackets. Table 2 lists the marginal income tax rates in Nebraska for tax year 2019.

Table 2: 2019 Nebraska Individual Income Tax Rates and Brackets²⁴

| SINGLE AND MARRIED, FILING SEPARATELY | MARRIED, FILING JOINTLY | HEAD OF HOUSEHOLD | TAX RATE |
|--|-------------------------|----------------------|----------|
| \$0 to \$3,230 | \$0 to \$6,440 | \$0 to \$6,020 | 2.46% |
| \$3,230 to \$19,330 | \$6,440 to \$38,680 | \$6,020 to \$30,940 | 3.51% |
| \$19,330 to \$31,160 | \$38,680 to \$62,320 | \$30,940 to \$46,200 | 5.01% |
| \$31,160 and over | \$62,320 and over | \$46,200 and over | 6.84% |

Like most other state income taxes and the federal income tax, Nebraska’s income tax applies different tax rates to different amounts of income. A married couple with no children filing jointly could take the standard deduction of \$13,800 and each claim a \$137 personal exemption credit, as set for 2019. That would mean their first \$6,440 of adjusted gross income (AGI) over \$14,074 — the sum of the standard deduction and personal exemption credits — would be taxed at 2.46 percent. Their taxable income above \$6,440 and below \$38,680 would be taxed at 3.51 percent. Their taxable income between \$38,680 and \$62,320 would be taxed at 5.01 percent. Finally, any of their taxable income over \$62,320 would be taxed at 6.84 percent. A childless married couple with an AGI of \$76,000 would therefore not pay the top rate on any of their income because their taxable income (AGI minus the standard deduction and personal exemption credits) would be less than \$62,320. For that couple, once the standard deduction and personal exemption credits are factored in, only AGI above \$76,394 would be taxed at the top rate for 2019.

Because different levels of income are subject to different tax rates in each bracket, and many taxpayers claim exemptions and deductions, taxpayers pay *effective* tax rates that differ from the *statutory* rates specified above. According to the Nebraska Department of Revenue’s 2016 Tax Burden Study,²⁵ the effective tax rate that taxpayers face changes with their AGI, divided into deciles²⁶ (see Table 3 below).

Table 3: 2016 Effective Income Tax Rate by Decile

| DECILE | EFFECTIVE TAX RATE |
|---|--------------------|
| First 7 Deciles (70% of Returns) | 1.76% |
| 8th Decile (Beginning AGI \$62,484) | 3.17% |
| 9th Decile (Beginning AGI \$82,534) | 3.81% |
| 10th Decile (Beginning AGI \$115,035) | 4.81% |
| Top 500 Returns (Beginning AGI \$2,368,772) | 3.53% |

After the rates are applied, credits or additional taxes may apply that can reduce or increase income tax liability. Tax rates, brackets, and other provisions are set in statute and subject to change by the Legislature. For example, in 2012, a bill was enacted that reduced tax rates and expanded the tax brackets,²⁷ which have been adjusted for inflation annually since a 2015 law was passed.²⁸ As Nebraska's income tax is tied closely to the federal income tax, changes to the federal tax also can affect the state income tax with no state legislative change.²⁹ In 2018, the Nebraska Legislature passed LB 1090 as a response to federal changes that would have affected state income tax liability for Nebraskans. The law restored the personal exemption credit, increased the standard deduction and retained CPI as the measure to be used for indexing for inflation.

Sales Taxes – The state of Nebraska collected almost 1.9 billion in sales and use tax in FY19,³⁰ about \$998 per Nebraskan.³¹ Of that, about \$1.6 billion, or 84% percent, went into the General Fund, making it the second largest source of General Fund revenue.³² The sales tax on motor vehicles generated 12 percent of all sales tax.³³ Cities, counties, and villages may impose an additional local sales tax if approved by a local vote.

Not all sales taxes levied and collected at the state level are deposited in the General Fund because of several policies that divert state sales tax revenue to other funds for other purposes.

Sales tax collected on a quarter cent of the state's sales tax and all sales tax receipts from motor vehicles leased for over 31 days are diverted to the state Department of Roads and local governments for road construction and maintenance. Sales taxes collected at eligible arenas and convention centers and nearby retailers, also known as "turnback taxes," are directed to cities to pay for arena construction debt and other community projects.³⁴ Lastly, sales taxes collected on all-terrain vehicles and motorboats are directed to the Game and Parks Commission.³⁵ These sales tax receipts are listed as "sales tax transfers" in Figure 6.

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, equipment when purchased by a manufacturer, and purchases made by governments, schools, and religious organizations are among the exempted goods.

Table 4 below outlines examples of what is and what is not subject to sales tax.³⁶

Some services also are subject to sales tax, but unlike goods, they are not taxed unless specified by law. Decisions about what goods and services are taxed impact revenue collections just as much

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 - Examples³⁷

| 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 |

as the overall sales tax rate: the more goods and services are exempt from sales tax, the higher the sales tax rate must be to raise the same amount of revenue. As a result, sales tax revenues may rise and fall with changes in *how much* Nebraskans are buying but also in *what* they are buying and *who* is buying it.

Corporate Income Taxes – In FY19, corporate income taxes generated approximately \$424 million, which went into the General Fund, making up 8.65 percent of General Fund revenues.

Every corporation engaged in business in Nebraska, or that has a source of income from Nebraska and is subject to federal corporate income tax, must file a return. However, most Nebraska businesses are organized in such a way that they are not required to pay the corporate income tax. These businesses are organized as S-Corporations, LLCs, or Partnerships, whose profits are passed through to owners and investors and taxed under the individual income tax. In tax year 2015, just over 14 percent of Nebraska businesses paid tax through the corporate income tax return.³⁸

As with 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 may also be reduced by various state subsidy programs, developed to attract businesses to the state or encourage existing businesses to expand. These programs are discussed further in Chapter 4.

Miscellaneous Taxes and Fees – Excise taxes, including those levied on alcohol, cigarettes, charitable gaming (keno, bingo, pickle cards), and insurance premiums raised \$269 million in FY19.³⁹ 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 Taxes⁴⁰ – Excise taxes on motor fuels generated over \$393 million in FY19.⁴¹ 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, because motor fuels tax revenue has declined over time (Figure 7), legislators passed a law to

divert a portion of the state sales tax from the General Fund to funding for roads, beginning in FY14.⁴² In 2015, the Legislature approved a motor fuels tax increase⁴³ that was phased in over four years at 1.5 cents per year starting in 2016. The legislation has increased 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. The total motor fuels tax rate is 29.70 cents per gallon as of the second half of 2019.⁴⁴

Local Taxes

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

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 \$4.2 billion in 2018, property taxes are the largest source of local tax revenue⁴⁵ In fact, more money is raised through local property taxes than through any state tax (Figure 7). The money is divided among a number of entities, including school districts, community colleges, counties, and cities⁴⁶ to help support the services provided by Nebraska's 2,539 local governments.⁴⁷

The state imposes limits on the property tax rate that can be applied, although residents can vote to override limits for up to five years.⁴⁸ The state may grant exemptions from property taxes for certain types of property, including properties owned by and used for a government, religious, educational, or charitable purpose. Cemetery property may also be excluded.

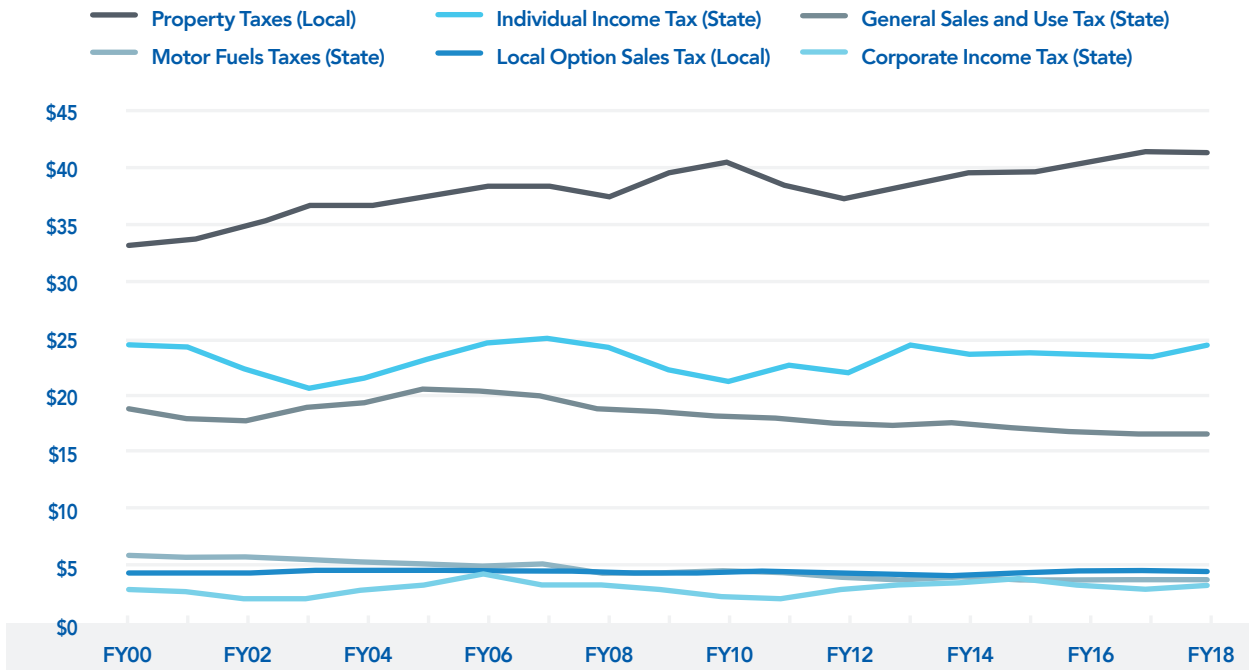
Agricultural and horticultural land is taxed at 75 percent of its market value. All other property is taxed at 100 percent.⁴⁹

Local Option Sales Taxes – Cities, counties, and villages may impose a sales tax if approved by a local vote.⁵⁰ Of Nebraska's 529 municipalities, 239 (and Dakota County) levy a local option sales tax.⁵¹ State law puts restrictions on these taxes. For example, the maximum local sales tax rate is 2 percent, except for cities of the metropolitan class, which are limited to 1.5 percent,⁵² and it can only be imposed on the same goods or services that are taxed at the state level. In 2018, municipalities received almost \$440 million in local option sales tax revenues.⁵³

Inheritance Taxes – The inheritance tax is levied on the transfer of a decedent's assets to beneficiaries of an estate, with the tax rate depending on the beneficiary's relationship to the decedent. 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 \$10,000.⁵⁴ The tax's parameters are defined by the Legislature and the proceeds — \$70.46 million in FY18⁵⁵ — are remitted to counties.

Figure 7: Major State and Local Tax Revenues

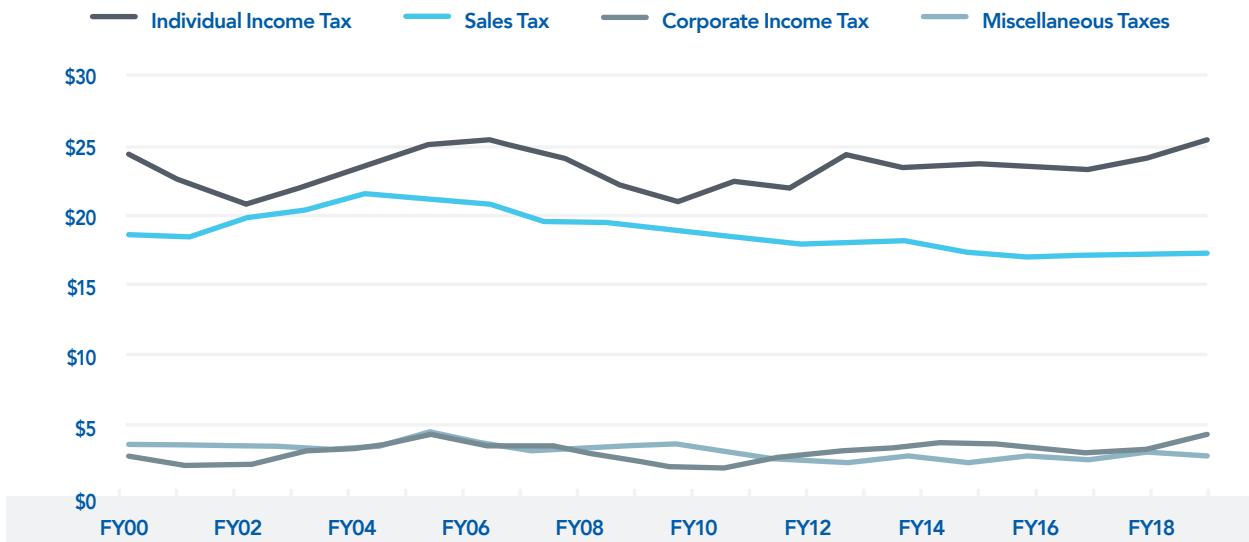
Tax revenue collected per \$1,000 of Nebraska Personal Income (FY00-FY18)⁶⁰



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-FY19)



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

Occupation taxes – These taxes are levied on a variety of business operations. For example, several Nebraska cities collect occupation taxes on hotels, restaurants, and bars to finance local construction projects like new or improved stadiums, arenas, streets, parks and fairgrounds. Other types of occupation taxes include taxes on phone service and rental cars. The rate is set by the city imposing it and can vary by the type of occupation or business activity within the city, which may result in multiple rates on different activities in the same city at the same time.⁵⁶

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, but a significant portion of the budgets of the University system and the Department of Education are also supported by federal funds.⁵⁷ Over time, federal funding as a share of the total appropriations has slightly increased from about 28.9 percent in FY00 to 30.36 percent in FY19.⁵⁸

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.⁵⁹ By this measure, Nebraska ranks 46th in the country in federal spending as a share of state GDP.

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- 20 Nebraska Legislature, "State of Nebraska FY20 and FY21 Biennial Budget as Enacted in the 106th Legislature First Session," August 2019, p. 77, <https://nebraskalegislature.gov/pdf/reports/fiscal/2019budget.pdf>, accessed December 19, 2019.
 - 21 All rankings are for FY17. U.S. Census Bureau, "Annual Survey of State and Local Government Finances," <https://www.census.gov/programs-surveys/gov-finances.html>, accessed December 20, 2019; and U.S. Bureau of Economic Analysis, "Personal Income, Population, Per Capita Personal Income," <https://apps.bea.gov/itable/iTable.cfm?ReqID=70&step=1#reqid=70&step=1&isuri=1>, accessed December 20, 2019. 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. All local taxes are out of 49 states.
 - 22 General sales taxes do not include selective sales taxes such as the motor fuel or alcoholic beverage tax.
 - 23 Sales Tax from Nebraska Legislature, "State of Nebraska FY20 and FY21 Biennial Budget As Enacted in the 106th Legislature First Session," August 2019, p. 77, <https://nebraskalegislature.gov/pdf/reports/fiscal/2019budget.pdf>, accessed December 19, 2019. Nebraska Population estimated to be 1,929,268 as of July 1, 2018. U.S. Census Bureau, "QuickFacts Nebraska," <https://www.census.gov/quickfacts/NE>, accessed December 20, 2019.
 - 24 Nebraska Department of Revenue, "2019 Nebraska Tax Calculation Schedule for Individual Income Tax," https://revenue.nebraska.gov/sites/revenue.nebraska.gov/files/doc/business/2019_Tax_Calculation_Schedule.pdf, accessed December 19, 2019..
 - 25 Nebraska Department of Revenue, "2016 Nebraska Tax Burden Study," November 1, 2019, p. 24, https://nebraskalegislature.gov/FloorDocs/106/PDF/Agencies/Revenue__Department_of/434_20191101-100007.pdf, accessed December 20, 2019.
 - 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 sales tax that is due but is not collected by the seller and must be paid directly by the buyer. For purposes of this primer, we use "sales tax" and "sales and use tax" interchangeably.
 - 31 Fiscal Year 2017-18 (FY18). Nebraska Department of Administrative Services, "State of Nebraska Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2018," <https://das.nebraska.gov/accounting/cafr/cafr2018.pdf>, accessed December 19, 2019; U.S. Census Bureau, "Annual Estimates of the Resident Population: April 1, 2010 to July 1, 2018," <https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=CF>, accessed December 19, 2019.
 - 32 Fiscal Year 2017-18 (FY18). Nebraska Department of Administrative Services, "State of Nebraska Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2018," <https://das.nebraska.gov/accounting/cafr/cafr2018.pdf>, accessed December 19, 2019.
 - 33 After 1% is retained by the County Treasurer and 1% is distributed to the Vehicle Title and Registration System Replacement and Maintenance Cash Fund, the remaining motor vehicle tax proceeds are allocated as follows: 22% to the county, 60% to the school district, and 18% to the city or village in which the motor vehicle has situs. Nebraska Department of Motor Vehicles, "Registration Fees and Taxes," <https://dmv.nebraska.gov/dvr/reg/registration-fees-and-taxes>, accessed December 19, 2019.
 - 34 Neb. Rev. Stat. § 13-3108.
 - 35 Neb. Rev. Stat. § 77-27,132.
 - 36 For more information about Nebraska's sales tax base, see Nebraska Department of Revenue, "Nebraska Sales and Use Tax FAQs," http://www.revenue.nebraska.gov/question/slstax_faq.html, accessed December 19, 2019.
 - 37 Neb. Rev. Stat. § 77-2701.16.
 - 38 The most recent available data are from 2016, when 9,593 C-Corporations (paying the corporate income tax) and 57,472 S-Corporations and Partnerships (paying the individual income tax) existed in Nebraska. Nebraska Department of Revenue, "2016 Nebraska Statistics of Income: Table A1," <https://revenue.nebraska.gov/research/statistics/statistics-business-income-tax-compiled-irs-data-state-nebraska>, accessed December 19, 2019.
 - 39 Nebraska Legislature, "State of Nebraska FY20 and FY21 Biennial Budget as Enacted in the 106th Legislature First Session," p. 25, August 2019, <https://nebraskalegislature.gov/pdf/reports/fiscal/2019budget.pdf>, accessed December 19, 2019.
 - 40 Motor fuels tax collections are not included in Figure 6, as those proceeds are deposited only in cash funds. 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.
 - 41 Nebraska Department of Revenue, "Monthly Reported Motor Fuels Taxable Gallons, Motor Fuels Taxes, and Comparison of Totals," <https://revenue.nebraska.gov/motor-fuels/monthly-reported-motor-fuels-taxable-gallons-motor-fuels-taxes-and-comparison-totals>, accessed December 19, 2019.

- 42 LB 84 (2011).
- 43 LB 610 (2015).
- 44 Non-motor fuel tax rates, such as those on aviation gasoline and jet fuel, are not determined by a formula but have instead been set at 5 cents and 3 cents per gallon, respectively, since 1985. Nebraska Department of Revenue, "Current Fuel Tax Rates for Gasoline, Gasohol, Diesel, Ethanol, and Compressed Fuels," <https://revenue.nebraska.gov/motor-fuels/fuel-tax-rates>, accessed December 19, 2019.
- 45 Nebraska Department of Revenue, "2017 Annual Report of the Property Assessment Division: Table 2," http://www.revenue.nebraska.gov/PAD/research/annual_reports/2018/annrpt2018_table_2.pdf, accessed December 19, 2019.
- 46 Neb. Rev. Stat. §77-3442.
- 47 U.S. Census Bureau, "2017 Census of Governments: Table 1," <https://www.census.gov/data/tables/2017/econ/gus/2017-governments.html>, December 19, 2019.
- 48 Neb. Rev. Stat. §77-3444.
- 49 Neb. Rev. Stat. §77-201.
- 50 Nebraska Department of Revenue, "Nebraska Sales and Use Tax," <https://revenue.nebraska.gov/businesses/sales-and-use-tax>, accessed December 19, 2019.
- 51 Nebraska Department of Revenue, "Local Sales and Use Tax Rates, Effective October 1, 2019," https://revenue.nebraska.gov/sites/revenue.nebraska.gov/files/doc/rates_10-1-2019.pdf, accessed December 19, 2019; Nebraska Department of Revenue, "Local Government Data: Certified Municipal Populations," http://www.revenue.nebraska.gov/research/local_gov_data.html, accessed December 19, 2019; Nebraska Department of Revenue, "Nebraska Sales and Use Tax FAQs," <https://revenue.nebraska.gov/about/frequently-asked-questions/nebraska-sales-and-use-tax-faqs>, accessed December 19, 2019.
- 52 Neb. Rev. Stat. § 77-27, 142. Cities of metropolitan class are defined by Nebraska statute as cities with 300,000 or more people as determined by the most recent federal census or the most recent revised certified count by the United States Census Bureau. Currently, Omaha is the only city of metropolitan class in Nebraska.
- 53 Nebraska Department of Revenue, "Local Government Data: Local Sales and Use Tax Remitted to Cities (historical)," http://www.revenue.nebraska.gov/research/local_gov_data.html, accessed December 19, 2019.
- 54 Neb. Rev. Stat. §§ 77-2005 and 77-2006.
- 55 Nebraska Association of County Officials, "2017-18 Survey of Nebraska County Clerks."
- 56 Nebraska Department of Revenue, "Occupation Taxes," <https://revenue.nebraska.gov/government/occupation-taxes>, accessed December 19, 2019.
- 57 Nebraska Legislature, "State of Nebraska FY20 and FY21 Biennial Budget As Enacted in the 106th Legislature First Session," p. 83, August 2019, <https://nebraskalegislature.gov/pdf/reports/fiscal/2019budget.pdf>, accessed December 20, 2019.
- 58 Historical appropriations data provided by Nebraska Legislature's Legislative Fiscal Office in July, 2016; Nebraska Legislature, "State of Nebraska FY20 and FY21 Biennial Budget As Enacted in the 106th Legislature First Session," p. 83, August 2019, <https://nebraskalegislature.gov/pdf/reports/fiscal/2019budget.pdf>, accessed December 20, 2019.
- 59 Pew Charitable Trusts, "Federal Spending in the States 2005-2014," March 3, 2016, <http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2016/03/federal-spending-in-the-states-2005-to-2014>, accessed December 19, 2019.
- 60 Property tax data are reported on a calendar-year basis.

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**”⁶¹ and have been the subject of many legislative bills and studies.⁶²

Tax expenditures function like state spending in that both represent money the state uses for some purpose, like assisting certain taxpayers, subsidizing activities, or incentivizing desirable behaviors.⁶³ They differ, however, in that spending represents revenue collected by the state whereas expenditures represents potential revenue the state chose not to collect. For example, Nebraska gives tax breaks to businesses in efforts 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 on 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 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 is then written permanently into the tax code, with no requirement that it ever be reviewed by the Legislature again.

As a result, while appropriations are under regular review, tax expenditures are on autopilot once enacted. For this reason, some tax expenditures can outlive their usefulness or outgrow their expected costs, turning into significant — but unnoticed — drains on state revenue. However, Nebraska has made positive steps in increasing the transparency of tax expenditures in recent years. These efforts will be discussed in the next chapter.

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 on October 15, the Department of Revenue releases a tax expenditure report, and presents it to a joint hearing of the Appropriations and Revenue committees on or before December 1. Each even year, the Department publishes a full tax expenditure report that reviews credits, exemptions, deductions, and exclusions for all tax programs. During odd years, the Department publishes an interim report that focuses on select sales tax exemptions on a rotating basis.⁶⁴

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 by focusing the tax on purchases by final consumers.⁶⁵ 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 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 extra layers of taxation being created on each stage of production, called “pyramiding.” This can result in market distortions like 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.⁶⁶

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, consumer services are not taxed unless defined specifically 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’s Tax Expenditures Report is required to include a list of untaxed services for nonbusiness use.⁶⁷ It estimates that the failure to include these services in the sales tax base resulted in a total of \$469 million in foregone sales tax collections in 2018.⁶⁸ However, 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.

LB 284, passed in the 2019 Legislative session, requires remote sellers that have a gross revenue of more than \$100,000 from Nebraska sales or make at least 200 separate Nebraska sales in the previous or current calendar year to collect and remit sales tax to the state. This new source of revenue should temper the decline in sales tax collected by the state due to recent exemptions.

Income Tax Expenditures - Some income tax expenditures promote broad policy goals and affect most Nebraskans. For example, the Personal Exemption Credit increases with family size based on the principle that income required for necessities should not be taxed.

Other income tax expenditures benefit only specific groups of people, usually to encourage particular behaviors. For example, the Beginning Farmer Tax Credit is intended to help young farmers and ranchers establish themselves in the workforce. The Earned Income Tax Credit is intended to keep low-income working families out of poverty. Other income tax expenditures include credits and deductions for childcare expenses, charitable contributions, and college savings plans.

Additionally, the Special Capital Gains exclusion is a one-time tax break that allows certain corporate employees to sell stocks or collect dividends without paying taxes on the earnings. Nebraska also has an exclusion allowing 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 being taxed in another state.

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

The Department of Revenue publishes an annual Tax Incentives Report on July 15 and presents its findings to a joint session of the Revenue and Appropriations committees on or before September 1 of every year. The report estimates the fiscal impact of the state's incentive programs, including the number of jobs gained or lost, and provides information on the projects approved for tax incentives.⁶⁹ The Legislative Performance Audit Committee reviews the effectiveness of Nebraska's tax incentives, and is further discussed in Chapter 5.

Nebraska has had several business subsidy programs, the first of which was enacted in 1987. In calendar year 2018, the two largest programs, the Nebraska Advantage Act and the Employment and Investment Growth Act (LB 775), abated \$217M in state and local taxes. Local taxes include city sales tax and property tax abated by the programs.

Nebraska Advantage participants used \$79M in credits during calendar year (CY) 2018. Participants were also refunded \$77M in sales and use taxes at both state and local levels. LB 775 sunset in 2005 with the passage of Nebraska Advantage and is no longer accepting new applications; however, it still has active agreements that will be able to continue using benefits until 2025. In CY 2018, LB 775 participants used nearly \$25M in credits and over \$21M in sales and use tax refunds. Participants under both programs received an estimated \$14.1 million in property tax abatements, which reduce revenue at the local level, in 2018.⁷⁰

Earned tax credits can be carried forward for use in subsequent tax years because they are non-refundable, meaning a taxpayer can only use credits to the extent they have Nebraska income tax liability in any given year. LB 775 allows this carryover of credits for up to 8 years and Nebraska Advantage allows certain projects to carry credits forward for up to 15 years. Nebraska Advantage is set to sunset in 2020 and because of the way the program is structured, projects could receive benefits until 2040 or 2050.

Nebraska Advantage also includes a provision allowing participating companies to retain their employee's state income taxes. This "withholding component" applies to employment credits earned by participants and can be applied to new employees' withholding of income taxes. This

allows another avenue for participants to utilize the tax credits earned and was not available under LB 775.

If a company does not maintain the required investment and employment levels, the state can require it to repay any incentives received.

Both LB 775 and Nebraska Advantage have been shown by the Department of Revenue to cause significant revenue losses for the state. According to the Department's 2018 report, even after factoring in any revenue gains from increased economic activity induced by the incentives, LB 775 is projected to be a net revenue loss to the state of over \$2 billion at the end of its life in 2025 and Nebraska Advantage a net revenue loss of over \$1.5 billion at the end of the 2028.⁷¹

A 2019 performance audit of Nebraska Advantage conducted by the Performance Audit Committee of the Nebraska Legislature found that out of the 124 participating companies, only 13 were "new" to the state because they paid no wages in the state and no Nebraska income tax in the two years prior to participation.⁷² Furthermore, the report could not determine whether the incentive caused the project to locate in the state.⁷³ The audit also found that the full-time equivalent positions added averaged between \$7,440 to \$208,559 per year they existed and that most of the benefits earned under the Act were for investment added and not for full-time equivalents added.⁷⁴

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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- 61 Neb. Rev. Stat. §77-381.
- 62 Including the following studies: Bill Lock, "Memo Re: LR161, LR166, & LR 97 (Committee on Revenue: December 2009)"; Nebraska Tax Policy Commission, "Final Report (known as the Burling Tax Commission Study)," November 2007; Maxwell School of Citizenship and Public Affairs at Syracuse University, "Nebraska Comprehensive Tax Study (known as the Syracuse Tax Study)," 1988; Nebraska Legislature, "Report to the Legislature: LR155 – Nebraska's Tax Modernization Committee," 2013, http://www.nebraskalegislature.gov/pdf/reports/committee/select_special/taxmod/lr155_taxmod2013.pdf, accessed December 20, 2019; as well as multiple legislative bills and interim studies.
- 63 National Conference of State Legislatures, "Tax Expenditure Budgets and Reports: Best Practices," http://www.ncsl.org/documents/task_forces/Tax_Expenditure_Report.pdf, accessed December 20, 2019.
- 64 Neb. Rev. Stat. § 77-385
- 65 Bill Lock, "Memo Re: LR161, LR166, & LR 97 (Committee on Revenue: December 2009)," p. 3.
- 66 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.
- 67 Neb. Rev. Stat. § 77-382.
- 68 Pursuant to Neb. Rev. Stat. § 77-382(2)(l), services for nonbusiness use were included in the Tax Expenditure Report starting in 2014. See Nebraska Department of Revenue, "2018 Tax Expenditure Report," p. 16, October 12, 2018, https://revenue.nebraska.gov/sites/revenue.nebraska.gov/files/doc/research/tax-expenditure/2018_Tax_Expnd_Report.pdf, accessed December 19, 2019.
- 69 Neb. Rev. Stat. § 77-5731.
- 70 Amounts in this section are from Nebraska Department of Revenue, "Nebraska Tax Incentives: 2018 Annual Report to the Nebraska Legislature," July 15, 2019, https://revenue.nebraska.gov/sites/revenue.nebraska.gov/files/doc/incentives/annual_report/2018_Nebraska_Tax_Incentives.pdf, accessed December 19, 2019.
- 71 The 2018 annual report shows a net revenue loss for LB 775 for calendar year 2018. For Nebraska Advantage, however, the 2018 annual report shows no cumulative gain or loss for calendar year 2018 and instead shows a net revenue loss in 2019 and beyond. The cumulative gain or loss for the year of the report for Nebraska Advantage has not been included since 2012.
- 72 The 124 companies had their qualification audit by the Department of Revenue; more than 124 participate but have not been verified.
- 73 Nebraska Legislature, Performance Audit Committee, "Nebraska Advantage Act: Performance on Selected Metrics (April 2019), downloaded from https://nebraskalegislature.gov/pdf/reports/audit/advantageact_2019.pdf, on December 11, 2019.
- 74 Nebraska Legislature, Performance Audit Committee, "Nebraska Advantage Act: Performance on Selected Metrics," April 11, 2019, https://nebraskalegislature.gov/pdf/reports/audit/advantageact_2019.pdf, accessed December 19, 2019.

Chapter 5: Evaluating Nebraska's Tax System

There are many questions to ask when evaluating a tax system. Tax experts generally agree about the central questions to ask:⁷⁵

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 so over time is called a **structural deficit**. This occurs when revenues do not grow at the same rate as the cost of providing services. Legislative actions on appropriations and taxes can also create a mismatch between revenue and appropriations.

Nebraska must balance its budget, as explained in Chapter 1. By law, for the budget to be balanced, a reserve consisting of at least three percent of net General Fund receipts must remain unavailable for spending in the General Fund. This is referred to as the budgetary **minimum reserve**. The minimum reserve ensures that the General Fund has flexibility in its cash flow to meet any variation in its obligations.⁷⁶

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. The committee is charged with determining whether the current income and sales tax rates can generate enough revenue to pay for the state's obligations and appropriations. The adequacy of the tax rates is judged by whether anticipated revenues are enough 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 by making changes which only take effect after the current biennium, such as when tax cuts and other revenue-reducing measures are passed in one year and take effect in the future, or when tax changes are made based on projected revenues that have yet to materialize. 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 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.

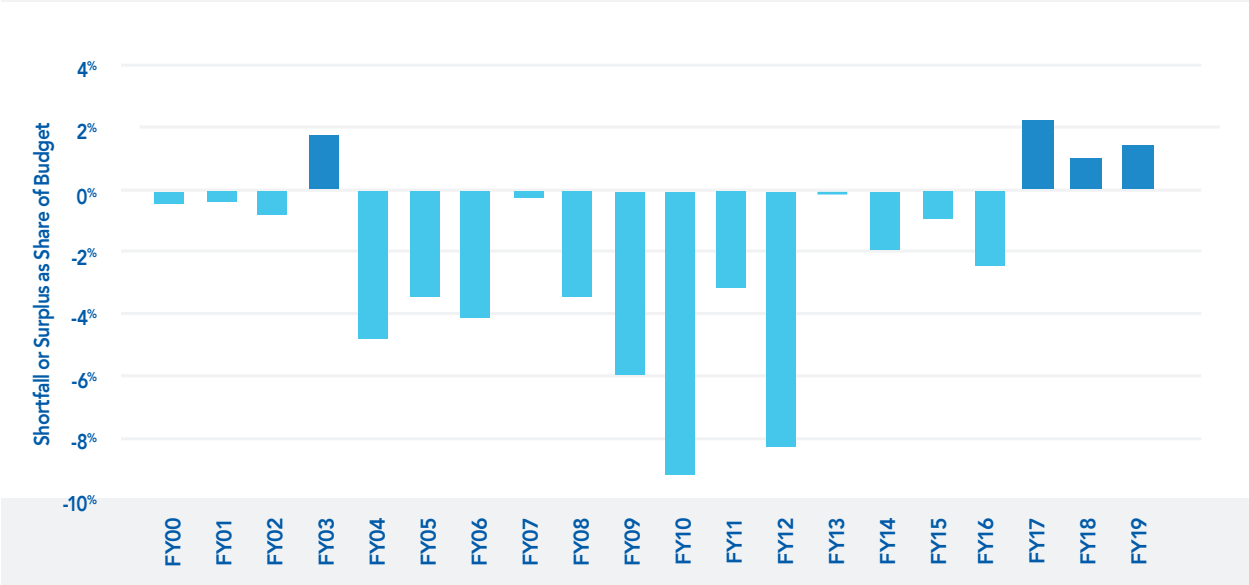
Every year, the Legislative Fiscal Office prepares a Biennial Budget Report that includes estimates of future shortfalls or surpluses.⁷⁷ These estimates are based on the state's obligations under current law and the expected growth in the cost of providing services based on historical averages and other data.

A review of these reports shows that Nebraska has a recent pattern of structural deficits. In 16 of the last 20 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 materialize, due to revised cost estimates and improved revenue, but in most of these years the Legislature has begun the session with a shortfall to address. In fact, out of the eight budget cycles from FY04 to FY18, the Legislature faced a budget gap in the following biennium, requiring action in all but two cycles. The actions taken included tax increases in two of the seven biennia, Cash Reserve Fund transfers in all seven,⁷⁸ and spending cuts in all seven. Despite these recurring shortfalls, the Legislature also reduced state revenues by passing tax cuts in four of the seven biennia⁷⁹ 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.⁸⁰

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 (FY00-FY19)

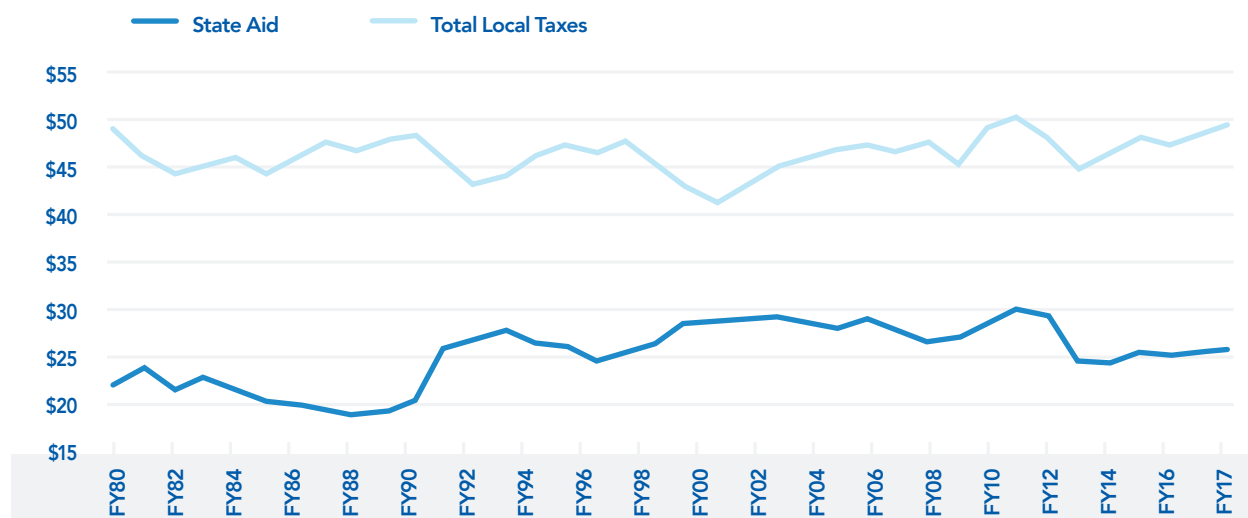


Source: Nebraska Unicameral Legislature, State of Nebraska Biennial Budget Reports, General Fund Financial Status.

Appropriations for transportation and infrastructure as a share of the economy also have declined (Chapter 2, Figure 5), as a large portion of revenue for those needs is tied to the amount of motor fuels sold. This means that, as the public consumes less fuel due to higher fuel prices or the purchase of more fuel-efficient vehicles, motor fuels tax revenues decline.⁸¹ As previously noted, the Legislature passed a law to direct a quarter 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 spending 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.

The ability of localities — cities, counties, and school districts — to pay for local services also are affected by state budget policies. 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 can also interfere with local revenue streams when they include property tax exemptions and local sales tax refunds, creating local budgeting uncertainty and reducing needed local revenue.

Figure 10: State Aid and Local Taxes Have Mirrored Each Other
Aid and Taxes per \$1,000 of Nebraska Personal Income (FY80-FY17)



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 at the heart of any debate about a tax system, including whether it should be **progressive**, **regressive**, or **proportional** (see box).

As in most states, 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). 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 \$50,500 in income⁸² and pays \$5,454 (10.8 percent) in total state and local taxes. Taxpayers in the lowest 20%, (\$0-\$24,400 income), earn an average income of \$13,800 and pay \$1,532 in taxes (11.1 percent), while taxpayers in the top 1% (earning more than \$462,600) have an average income of \$1.1 million and pay \$92,533 in taxes (8.7 percent).⁸³

Regressive taxes, such as sales and property taxes, are the primary cause of lower- and middle-income families paying a greater share of their incomes than higher-income residents. For example, Nebraskans making less than \$24,400 per year pay more than 6 percent of their incomes in sales tax, while those making more than \$103,500 and less than \$204,000 pay less than 3 percent of that income in sales tax and those making more than \$462,600 pay less than 1 percent.

Likewise, low- and middle-income families typically devote larger shares of income to housing than higher-income families. Nebraska's tax law includes measures like the Homestead Exemption that freeze or reduce property taxes for certain elderly and disabled Nebraskan homeowners. Still, the lowest-income families in Nebraska pay higher percentages of their yearly incomes in property taxes than those with higher incomes.⁸⁴ 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 \$24,400 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.⁸⁵ This is because of the graduated income tax rate structure summarized in Chapter 3, and specific policies focused on low- and high-income earners.

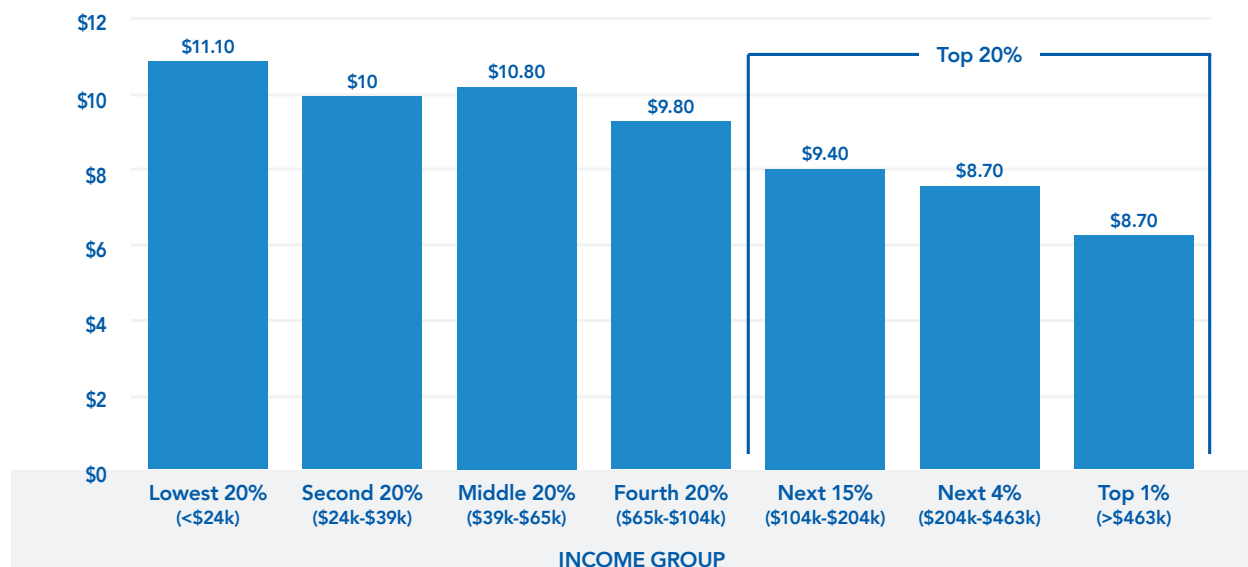
Policies like the state Earned Income Tax Credit ensure that workers who earn too little to achieve economic stability only pay income tax on a small portion of their earnings. Combined with the additional tax for high-income earners mentioned in Chapter 3 and an income tax rate that increases with income,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

Like the individual income tax, the corporate income tax is structured so that tax rates rise with profits. Nebraska is one of 25 states⁸⁶ that even the playing field between small and large businesses through a policy known as “combined reporting.”⁸⁷ 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 towards maintaining the roads, schools, and other services that make their profits possible.

Tax expenditures raise issues of fairness. Some tax expenditures used in Nebraska are widely accepted in several other states. These include those based on the principle of avoiding taxes on business inputs, like not taxing wood purchased by a furniture maker because it will be taxed when sold as a chair. Other sales tax expenditures, like exempting a day at the spa but taxing a night at the movies, may be more questionable from a tax policy perspective.

Business subsidies also may raise questions. In particular, businesses that are not in targeted industries, are too small to qualify for subsidies, or already made investments now being subsidized for other companies may argue they’re being treated unfairly because they effectively pay a higher tax rate than the subsidized businesses. Nebraska’s tax incentive programs are now evaluated regularly by the Legislative Performance Audit Committee (discussed below).

Figure 11: Nebraska’s Tax System is Regressive
State and Local Taxes per \$100 of Family Income by Income Group (2018)



State and local taxes, 2018 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?, 6th Edition,” October 2018.

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

A tax system unable to weather changes in the economy provides less revenue in downturns when demand on public services is greatest. Such a system also may lead to overly large surpluses in prosperous times, which can put pressure on legislators to enact tax cuts to reduce those surpluses, leaving the state short for the next recession unintentionally.

No state tax system is completely 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.⁸⁸ A tax system that includes a variety of taxes, draws from a broad cross-section of the population, and generates enough revenue to support the state's obligations produces more stable revenue streams 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.

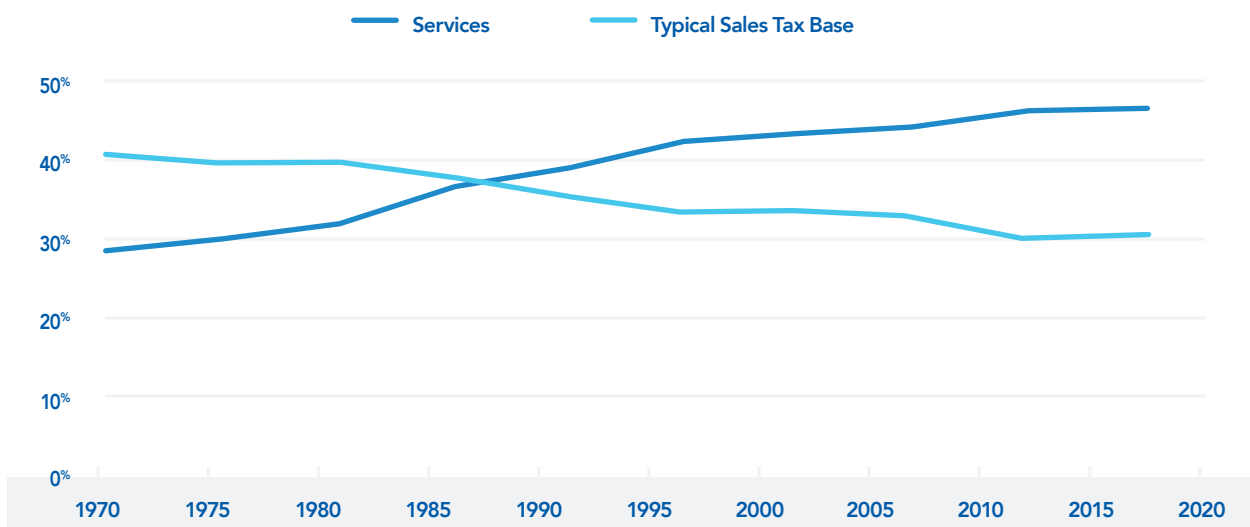
Each November, beginning in 2016 and every two years thereafter, the Legislative Fiscal Office (LFO) prepares a revenue volatility report. The report evaluates the General Fund tax base and the volatility of funds flowing to it, changes in federal legislation that affect the flow of funds to Nebraska, 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.⁸⁹

Sales tax revenue has failed to keep up with economic growth. This can be attributed in part to untaxed services and untaxed internet and catalog sales from remote sellers, although the latter was recently changed to require certain remote sellers in Nebraska to collect and remit sales tax to the state, as noted in the previous chapter. Families across the United States today spend much more on services than on goods that are traditionally taxed (Figure 12), yet, many services remain exempt from Nebraska state sales tax. According to a survey by the Federation of Tax Administrators, Nebraska taxes less than half the 176 services taxed in at least one other state. South Dakota and Iowa both tax more services than Nebraska.⁹⁰ Because services are only taxed if they have been individually enumerated in law, the system is inconsistent. Pet grooming services are taxed but barber shop and beauty parlor services are not.⁹¹ Carpet cleaning is taxed but swimming pool cleaning is not. Taxing more services would help the tax system keep up with a changing economy.

Nebraska's sales tax base has faced recent challenges due to the state's previous inability to collect millions in sales tax revenue from online purchases. The U.S. Supreme Court ruling in *South Dakota v. Wayfair*, however, has cleared the way for states to collect sales tax on purchases from remote sellers.⁹² In Nebraska, this collection has been in effect since Jan. 1, 2019, and was legally mandated with the passage of LB 284 during the 2019 session.⁹³ This policy change should help to limit the erosion of Nebraska's sales tax base, even without the removal of sales tax exemptions.

The Legislative Fiscal Office estimates that sales tax from remote sellers will contribute \$9 million in FY19, \$26 million in FY20 and \$30 million in FY21, with these predictions already included in the economic forecast.⁹⁴ According to the fiscal note of LB284, collecting sales tax from large remote sellers will increase state revenue by roughly \$10 million per year.⁹⁵

Figure 12: Consumption of Services Increasing
 Goods and Services as a Share of Household Consumption (1970-2018)



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 about when residents pay taxes, to whom, how they are spent and how the state’s tax and budget decisions are made should always be readily available. 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 can all be used to disseminate accurate information.⁹⁶

When tax policy is used to encourage behavior or advance goals other than revenue collection – like 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 a given tax 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 as direct appropriations are in each budget cycle. However, the Legislature has taken steps towards increasing the transparency of tax expenditures by requiring the Tax Expenditure Report be presented 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 estimates for around one-fifth of the sales and income tax expenditures it identifies.⁷⁷ It is impossible to know if Nebraskans are getting good returns on these investments due to incomplete reporting and without regular review, programs funded through tax expenditures can sometimes greatly exceed their original cost estimates, cutting into funding for other priorities.⁷⁸

State law now requires the Legislative Performance Audit Committee to audit each business tax incentive program at least once every five years.⁷⁹ The committee's reports evaluate the extent to which tax incentives strengthen and diversify the economy and their fiscal impact on state and local governments. The findings are presented to a joint hearing of the Revenue and Appropriations committees. All state tax incentive programs have sunset dates on which the programs stop accepting applications. Although the lives of the programs can be extended, sunset dates force future legislatures to review and discuss the effectiveness of these programs.¹⁰⁰

Transparency has been an issue, as some important information about the distribution of subsidies is not disclosed to the public. For example, when it created the state's largest business tax credit program 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 rates¹⁰¹ and changing how multistate corporations calculate taxable income¹⁰² – but the impact of these changes has not been tracked and reported.

There is also a lack of transparency as to the companies participating in the program. The only company-specific information reported publicly is the investment and employment from the business's application and two-year aggregate totals of the benefits used. No company-specific metrics are reported, including yearly totals and types of benefits earned and used and the actual investment and employment increases of the individual incentivized companies.

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.”

75 National Conference of State Legislatures, “Principles of a High-Quality State Revenue System,” updated June 2007, <http://www.ncsl.org/issues-research/budget/principles-of-a-high-quality-state-revenue-system.aspx>, accessed December 19, 2019.

76 Neb. Rev. Stat. § 77-2715.01

77 Nebraska Legislative Fiscal Office, “Budget Reports,” accessed at <http://www.nebraskalegislature.gov/reports/fiscal.php>, accessed December 19, 2019.

- 78 In FY14, the Legislature transferred \$53 million to the Cash Reserve Fund, which was the amount of additional General Fund revenue predicted at the April 2013 Nebraska Economic Forecasting Advisory Board meeting. However, because \$78 million was transferred out in the preceding fiscal year, legislative transfers were a loss for the Cash Reserve Fund on net for the budget biennium. See LB 199 (2013); Nebraska Legislature, "State of Nebraska FY14 and FY15 Biennial Budget As Revised in the 2014 Legislative Session," p. 14, <http://www.nebraskalegislature.gov/pdf/reports/fiscal/2014budget.pdf>, accessed December 19, 2019.
- 79 Nebraska Department of Revenue, "Nebraska Tax Rate Chronologies – Table 1, Income Tax and Sales Tax Rates," <http://www.revenue.nebraska.gov/research/chronology/4-607table1.pdf>, accessed December 19, 2019.
- 80 For example, in 2011 the Legislature reduced 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.
- 81 Nebraska Legislature, "LR 152," 2009, http://www.nebraskalegislature.gov/pdf/reports/committee/transport/2009_lr152.pdf, accessed December 20, 2019..
- 82 \$50,500 is the average income of a family in the middle 20 percent income group. Institute on Taxation and Economic Policy, "Nebraska: Who Pays? 6th ed.," October 17, 2018, <http://www.itep.org/whopays/states/nebraska.php>, accessed December 19, 2019.
- 83 Id.
- 84 Institute on Taxation and Economic Policy, "Nebraska: Who Pays? 6th ed.," October 17, 2018, <http://www.itep.org/whopays/states/nebraska.php>, accessed December 19, 2019.
- 85 Institute on Taxation and Economic Policy, "Nebraska: Who Pays? 6th ed.," October 17, 2018, <http://www.itep.org/whopays/states/nebraska.php>, accessed December 19, 2019.
- 86 Institute on Taxation and Economic Policy, "Combined Reporting of State Corporate Income Taxes: A Primer," February 24, 2017, <https://itep.org/combined-reporting-of-state-corporate-income-taxes-a-primer-1/>, accessed December 19, 2019.
- 87 Combined reporting treats a parent company and most subsidiaries as one corporation for state income tax purposes. Michael Mazerov, "A Majority of States Have Now Adopted a Key Corporate Tax Reform – 'Combined Reporting,'" Center on Budget and Policy Priorities, revised April 3, 2009, <http://www.cbpp.org/research/a-majority-of-states-have-now-adopted-a-key-corporate-tax-reform-combined-reporting>, accessed December 19, 2019.
- 88 See National Conference of State Legislatures, "Principles of a High-Quality State Revenue System," updated June 2007, <http://www.ncsl.org/research/fiscal-policy/principles-of-a-high-quality-state-revenue-system.aspx>, accessed December 19, 2019.
- 89 Neb. Rev. Stat. § 50-419.02.
- 90 According to a Federation of Tax Administrators survey, Nebraska taxes 81 services, Iowa taxes 89 and South Dakota taxes 152. Federation of Tax Administrators, "Sales Taxation of Services," <https://www.taxadmin.org/sales-taxation-of-services>, accessed December 19, 2019.
- 91 Unless performed by a veterinarian on livestock for surgical purposes. See Neb. Rev. Stat. §77-2701.16.
- 92 *South Dakota v. Wayfair, Inc.*, 585 U. S. __ (2018).
- 93 Nebraska Department of Revenue, "Statement from the Nebraska Department of Revenue Regarding the *South Dakota v. Wayfair* United States Supreme Court Decision," July 27, 2018, <https://revenue.nebraska.gov/sites/revenue.nebraska.gov/files/doc/news-release/ndr/wayfair.pdf>, accessed December 19, 2019.
- 94 Legislative Fiscal Office, "Tax Rate Review Committee Report," p. 10, November 15, 2018.
- 95 See LB 284 (2019).
- 96 The Department of Revenue produces a report on these issues every two years. The department can 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, "2016 Tax Burden Study," November 1, 2019, https://nebraskalegislature.gov/FloorDocs/106/PDF/Agencies/Revenue__Department_of/434_20191101-100007.pdf, accessed December 19, 2019.
- 97 Out of 167 sales and income tax expenditures identified in the report, 36 are recorded as "Estimate: Not available." Nebraska Department of Revenue, "2018 Tax Expenditure Report," October 12, 2018, https://revenue.nebraska.gov/sites/revenue.nebraska.gov/files/doc/research/tax-expenditure/2018_Tax_Expend_Report.pdf, accessed December 19, 2019.
- 98 Michael Leachman, Dylan Grundman, and Nicholas Johnson, "Promoting State Budget Accountability Through Tax Expenditure Reporting," Center on Budget and Policy Priorities, updated May 24, 2011, <http://www.cbpp.org/research/state-budget-and-tax/promoting-state-budget-accountability-through-tax-expenditure>, accessed December 19, 2019.
- 99 Neb. Rev. Stat. § 50-1209 (2).
- 100 See LB 538 (2015).
- 101 See LB 773 (1987). See also Nebraska Tax Policy Commission, Final Report (November 2007), p. 6-1 to 6-13.
- 102 Neb. Rev. Stat. §77-4105 and §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, Nebraska has 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 implemented several 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 2006. These changes in the tax code — are projected to reduce state revenue by more than \$913 million in FY20 alone¹⁰³ — 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, while shifting additional funding responsibilities to 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 are also not a high-spending state (Table 1). 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 the state’s goals? How can the state meet these goals? What will it cost? How can the tax system best support a strong economy and sufficiently invest in these goals?

Nebraskans must answer these questions together. 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”



Nebraska Department of Roads, Some Facts and Figures (June 2016), accessed August 14, 2018.

Nebraska Department of Transportation, “Bridge Condition Report,” March 22, 2019, <https://dot.nebraska.gov/media/2909/bridge-condition-report-summary.pdf>, accessed December 19, 2019.

Nebraska Department of Education, “Statistics and Facts about Nebraska Schools 2017-2018,” p. 3-5, tables 3 and 5, https://cdn.education.ne.gov/wp-content/uploads/2018/11/Statsfacts_20172018-for-pdf.pdf, accessed December 19, 2019.

Nebraska’s Coordinating Commission for Postsecondary Education, “2019 Higher Education Progress Report,” March 14, 2019, p. S2, https://ccpe.nebraska.gov/sites/ccpe.nebraska.gov/files/PR_2019.pdf, accessed December 19, 2019.

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Nebraska Department of Natural Resources, “Dam Inventory,” (note: not all wells and dams are inspected every year), <http://www.nebraskamap.gov/datasets/dams>, accessed December 26, 2019.

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Appendix B: Supplemental Material to Chapter 2

Figure B1: Cash Fund Appropriations by Category (FY21)

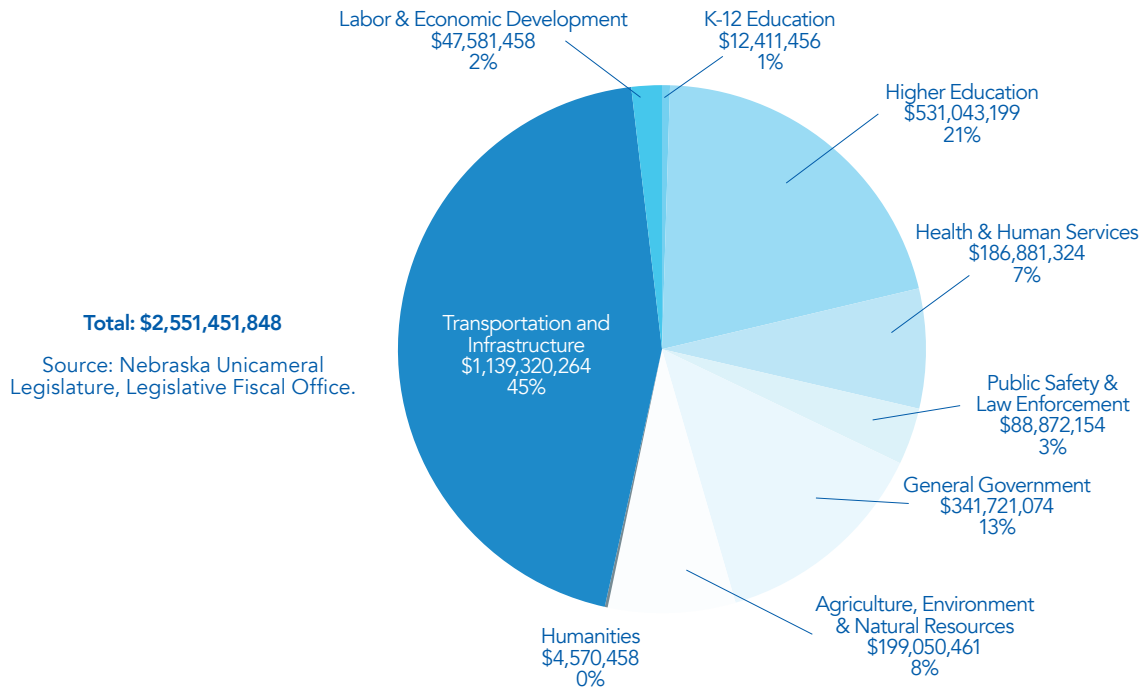


Figure B2: Federal Fund Appropriations by Category (FY21)

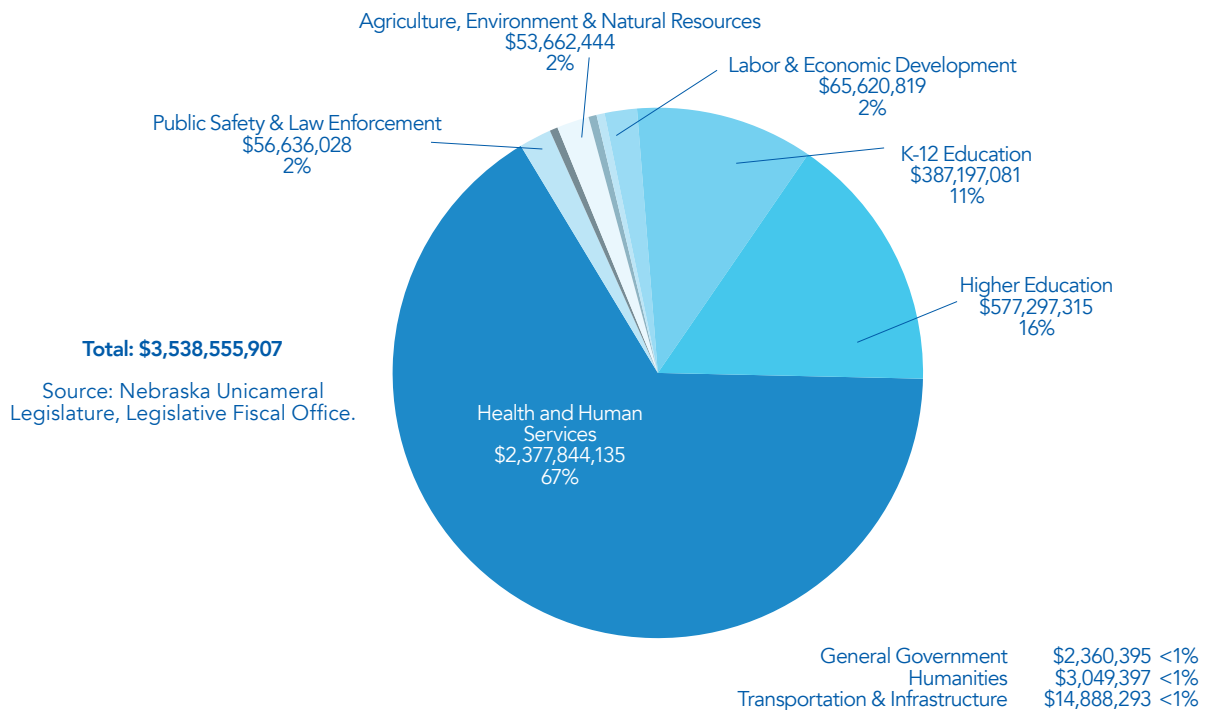


Figure B3: Total Appropriations for General, Cash, and Federal Funds by Category (FY21)

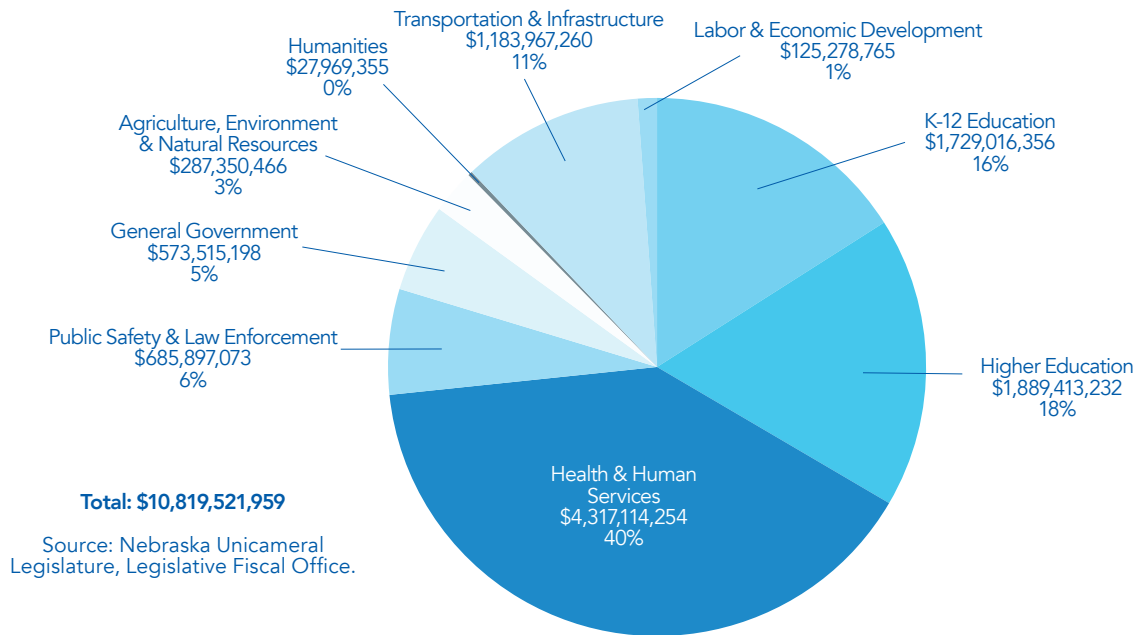
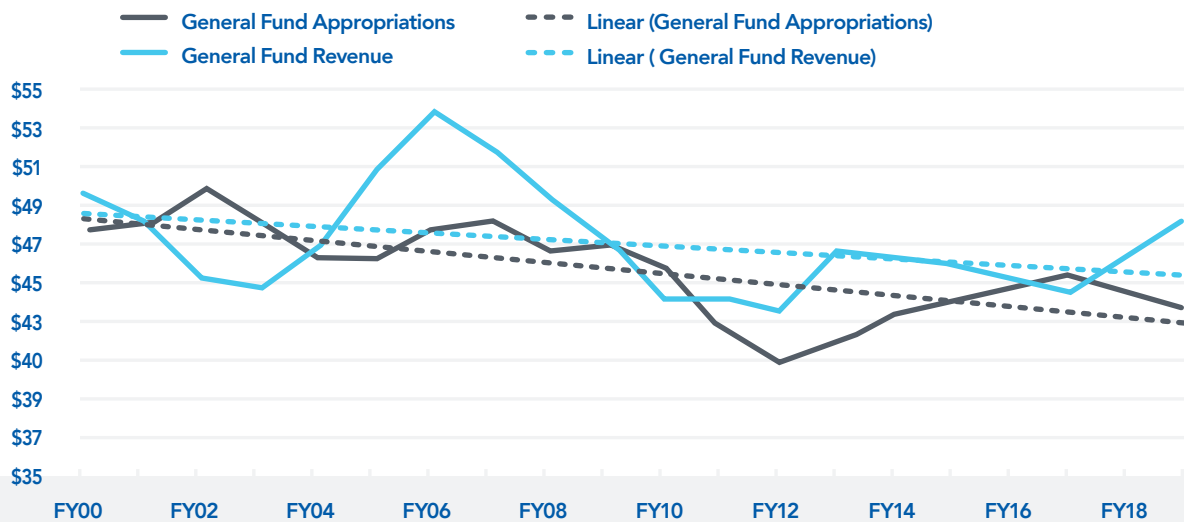
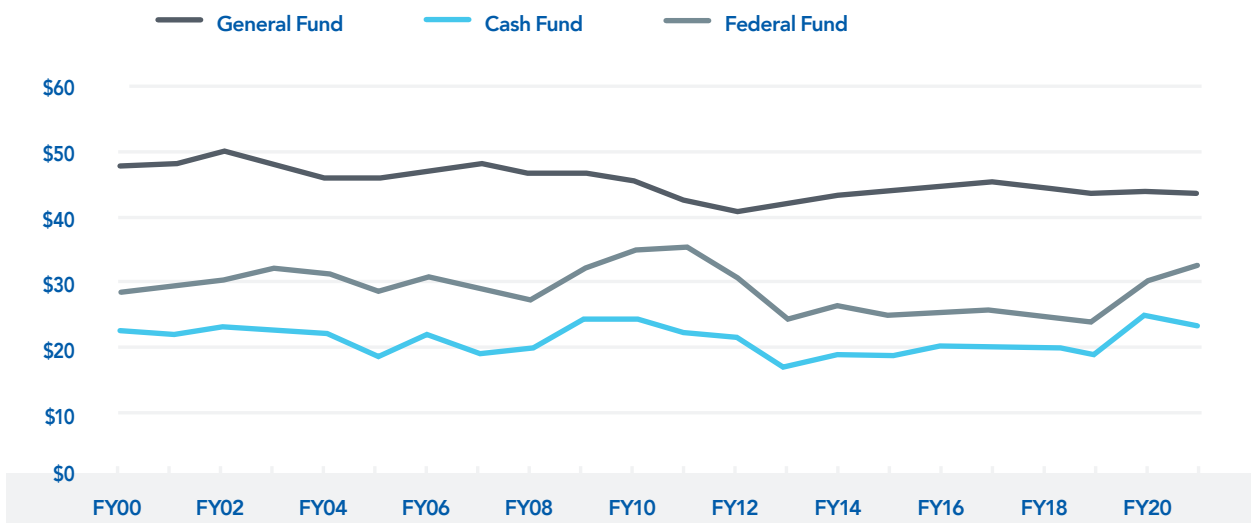


Figure B4: General Fund Appropriations and Revenues per \$1,000 of Nebraska Personal Income (FY00-FY19)
Appropriations and Revenue per \$1,000 NE Personal Income



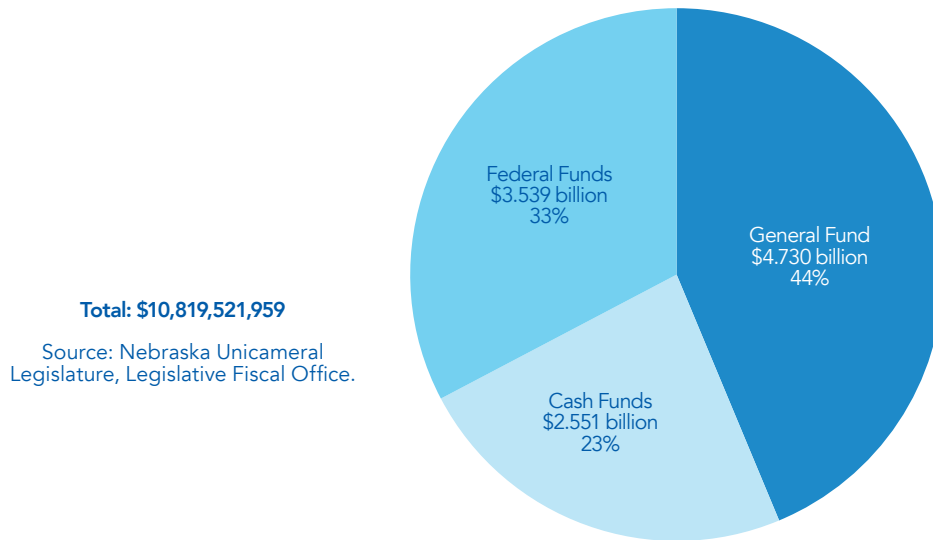
Source: Nebraska Unicameral Legislature, Legislative Fiscal Office; Bureau of Economic Analysis.

Figure B5: General, Cash, and Federal Fund Appropriations per \$1,000 of Nebraska Personal Income (FY00-FY21)



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

Figure B6: Appropriations by Fund Source (FY21)



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 Aeronautics (later merged into transportation), Roads (later merged into transportation), Transportation, Capital Construction, Motor Vehicles, The Public Service Commission, The Railway Council, The Electrical Board, Energy office and The Power Review Board. 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 (later merged into Transportation)
 - Roads (Later merged into Transportation)
 - Transportation
 - Capital Construction
 - Motor Vehicles
 - Public Service Commission
 - Railway Council
 - Electrical Board
- **Health and Human Services (Non-Medicaid):** 93 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.

o **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 42 percent 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
- 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
- Real Property Appraisers

• **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

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

President-elect

Kathy Campbell resides in Lincoln where she represented District 25 in the Nebraska Legislature from 2009 to 2017.

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Jerry Bexten resides in Omaha where he has been the Director of Education Initiatives for the Sherwood Foundation since October 2006.

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.

Rosemary Ohles resides in Lincoln and serves as a seminar facilitator for the Council of Independent College's Program on Presidential Vocation and Institutional Mission. She also has been active in several national and area service organizations.

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Annette Smith resides in Omaha where she works in development for Black Dog Management. She also sits on the board of directors for several non-profit organizations and is an active community volunteer.

Technical Advisors

Jerry Deichert is Director Emeritus 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 retired in 2017 after holding leadership positions in state government in several capacities over a period of more than four decades beginning with the administration of Governor Norbert Tiemann. Most recently he served as Vice Chancellor for Business Affairs and Special Assistant for Strategic Initiatives at the University of Nebraska Medical Center.

Staff

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

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