NEVADA

SIMPLIFYING NEVADA'S TAXES: A FRAMEWORK FOR THE FUTURE

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About the Tax Foundation

The Tax Foundation is the nation's leading independent tax policy research organization. Since 1937, our principled research, insightful analysis, and engaged experts have informed smarter tax policy at the federal, state, and local levels.

About the Las Vegas Metro Chamber of Commerce

The Las Vegas Metro Chamber of Commerce is the largest business organization in Nevada. Founded in the early days of Las Vegas, the Metro Chamber has a strong legacy of protecting and strengthening the Southern Nevada business community, helping its member businesses grow and thrive and providing a voice businesses in local, state and federal government.

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Table of Contents

Executive Summary
Summary of Tax Reform Options 5

Chapter 1: Nevada's Economy
Introduction 8
Income 8
Gross State Product 10
Major Industries 12
Employment 15
Interstate Migration 20

Chapter 2: Nevada Tax System Overview
Introduction 22
A Brief Overview of Nevada's Tax System 23

Chapter 3: Sales and Use Tax and Live Entertainment Tax
Introduction 26
Summary of Sales Tax and Live Entertainment Tax Reform Solutions (Reform Option B) 26
Sales and Use Tax 26
- **State-Levied Sales Tax Rate** 26
- **Local Option Sales Tax Rates** 27
- **Sales Tax Collections** 28
- **Sales Tax History** 29
- **Nevada's Sales Tax Base** 31
  - Taxation of Business Inputs 32
  - Taxation of Services 33
  - Nevada's Existing Sales Tax Exemptions 35
- **Sales Tax Distribution** 37

Live Entertainment Tax 39
- **Tax Rate and Base** 39
- **Problems with the Live Entertainment Tax** 39
- **Live Entertainment Tax Collections** 42

Solutions for Nevada's Sales Tax and Live Entertainment Tax 43
Summary of Sales and Live Entertainment Tax Reform Solutions 49

Chapter 4: Business Taxes
Introduction 52
Summary of Business Tax Reform Solutions (Reform Option C) 52
Modified Business Tax 52
- **General Modified Business Tax Structure** 52
- **Modified Business Tax History** 53
- **Taxing Financial Services More Heavily** 53
- **Modified Business Tax Base** 54
- **Modified Business Tax Collections and Distribution** 54

Solutions for Nevada's Modified Business Tax 55
Summary of Modified Business Tax Reform Solutions 56
Bank Branch Excise Tax 56

Business License Feeds 57

Nevada's General License Fee Structure and Collections 57

Other States' License Fees 57

Solutions for Nevada's Business License Fee 59

Summary of Business Tax Reform Solutions 60

Chapter 5: Property Taxes

Introduction 62

Summary of Property Tax Solutions (Reform Option D) 62

General Property Tax Calculation 62

Assessing the Value of Property 62

Property Tax Rate 63

Property Tax Cap 65

Summary of Property Tax Reform Solutions 70

Chapter 6: Net Proceeds of Minerals Tax

Introduction 72

Prepayment 72

Chapter 7: False Tax Reform

Gross Receipts and "Margin" Taxes 74

Corporate Income Taxes 75

Chapter 8: Other Important Considerations

Education Funding 78

Federal Land Ownership 79

Executive Summary

By a vote of 79 percent to 21 percent, Nevada voters on November 4, 2014 rejected a ballot initiative that would have established a 2 percent margin tax on business gross receipts. That debate was only the most recent example of an important state tax discussion that comes up in nearly every recent Nevada legislative session.

Why do taxes keep coming up? One reason is the volatility of the current system's tax collections. Another is the difficulty of understanding and complying with sales taxes and property taxes. Yet another is the simultaneous double taxation and complete exemption that exist in the Live Entertainment Tax. Revenue adequacy is also frequently cited.

This book is meant to continue this conversation by providing a framework for potential changes. In 2014, the Las Vegas Metro Chamber of Commerce commissioned the Tax Foundation to prepare a review of the Nevada tax system and recommend possible improvements. While they commissioned this report, neither the Las Vegas Metro Chamber of Commerce nor any of its sponsors directed this analysis or any of the recommendations.

We undertook this project as a national organization familiar with tax developments in many states, with the view that tax systems should adhere to sound economic principles, and in the spirit of providing useful information and observations for Nevada policymakers, journalists, and citizens as they evaluate their state's tax system.

Over the course of five months, we met with stakeholders from all walks of Nevada life, including small business owners, local government officials, trade associations, industry representatives, state officials, and ordinary taxpayers. We reviewed the history of the tax system, including previous tax reform studies, and available revenue and economic trends.

Broadly:

- **Nevada should consider fixing what is broken with the current tax system** instead of pursuing a brand new tax to layer on top of the narrowly based, complex existing taxes. A number of elements of the tax system exist only in Nevada, and those in particular should be scrutinized.
- Changes should address state revenue volatility, be fair, and reduce carve-outs that plague the system.
- The tax system should retain elements that ensure Nevada economic and tax competitiveness.

In the following pages, we provide background on Nevada's economy (Chapter 1) and on the overall tax system (Chapter 2). We then review each major tax, outline concerns, and propose reforms for consideration (Chapters 3, 4, and 5). Chapters 6, 7, and 8 conclude with discussions of several related issues relevant to policymakers but are outside the scope of our recommendations.

Summary of Tax Reform Options

Option A is a comprehensive tax reform proposal that includes the components of the other three tax reform options outlined hereafter (Options B, C, and D). It simplifies, broadens, and stabilizes the sales tax, Live Entertainment Tax, Modified Business Tax, Bank Branch Excise Tax, Business License Fee, and the property tax.

Option B stabilizes and modernizes Nevada's sales tax system and the Live Entertainment Tax, applying it evenly to all final retail transactions without special carve-outs. It would:

- Eliminate the current sales tax exemption for the service industry. As services grow to be an ever larger share of the economy, the sales tax becomes increasingly volatile and inadequate as it applies primarily to goods. We present three different scenarios of sales tax base expansion to services: small, medium, and large.
- Lower the 6.85 percent state sales tax rate, subject to revenue triggers.
- Exempt manufacturing machinery from the sales tax base. Nevada is one of just nine states that have this tax on capital investment, which double taxes final products.
- Exempt business inputs from the sales tax by issuing an identification number, registered with the Department of Taxation, to all businesses that pay the Modified Business Tax or the Business License Fee, which would exclude their business purchases from the sales tax base.
- Subsume the Live Entertainment Tax into the sales tax by repealing the current LET but applying the regular sales tax to all admissions charges and food, beverages, and merchandise sold at all venues that charge admission.

Option C further improves Nevada's already competitive business tax structure by applying the existing Modified Business Tax to all businesses and eliminating both special carve-outs and industry-specific rates. It would:

- Roll back the higher Modified Business Tax rate for financial institutions while adjusting the Modified Business Tax rate for general businesses.
- Repeal the $85,000 Modified Business Tax carve-out, applying the tax to all businesses.
- Repeal the Bank Branch Excise Tax, which raises little revenue and has no public policy rationale.
- Increase Business License Fees while instituting a graduated fee structure.

Option D proposes changes that add stability to Nevada's property tax system and bring it in line with best practices from other states. It would:

- Change the assessment method from replacement cost to market value and eliminate the depreciation factor.
- Adjust and reform tax caps, preserving predictability for homeowners and restrain local government spending growth while eliminating the unexpected downward "ratchet" that materialized in the most recent recession.
- Present an option for a circuit breaker for low-income homeowners as an alternative way to target more meaningful property tax relief for specific individuals.

We hope these options continue the tax conversation in Nevada by providing a framework upon which legislators and citizens can make further decisions. The menu of choices we present all ensure that the state builds a tax system for a diversified economy and positions itself as a destination for investment, entrepreneurs, and talented individuals in the years ahead.

Chapter 1

Nevada's Economy

Introduction

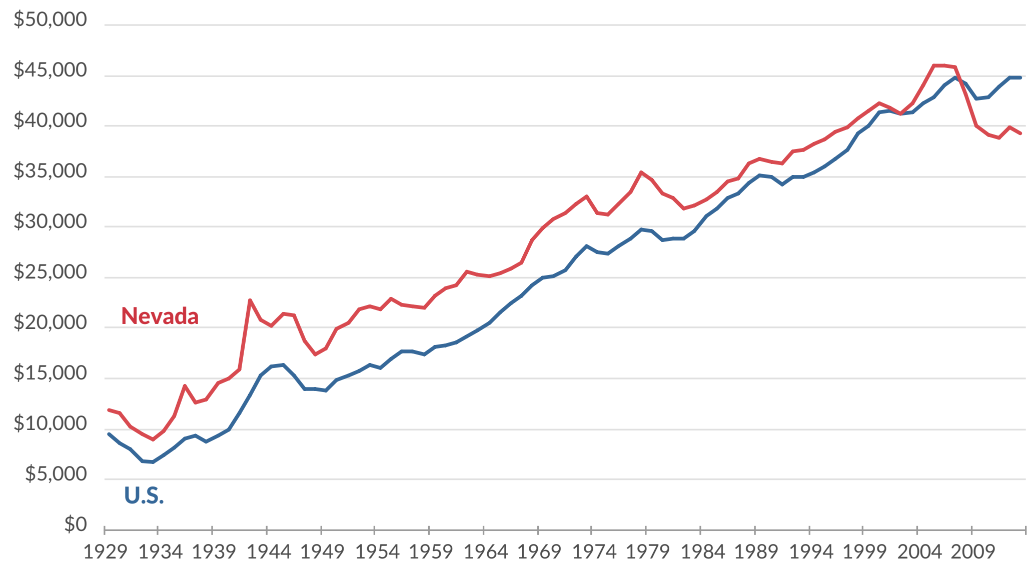
The following charts illustrate how Nevada's economy has fared over time—from its rapid growth and expansion in the 1990s to its sharp contraction in the most recent economic downturn (in terms of both output and employment). Currently, Nevada income and output sits below the country as a whole and many neighboring states despite outperforming both regional competitors and the national average in the years leading up to the recession. Nevada's unique industry mix is a major contributing factor to the state's economic performance over time, and its widely divergent local economies are key to understanding the state's diverse economy.

Income

In 1929, the average personal income of a Nevada resident was $11,889 (when adjusted for inflation)—well above U.S. average of $9,509.[1] Both national and Nevada income levels have risen since that time, but the U.S. average surpassed Nevada's in 2008 (see Figure 1). Nevada's personal income level has yet to recover post-recession. In 2013, it was just $39,235, while the U.S. level was $44,765.

Figure 1. Personal Income Per Capita

Nevada and U.S. (1929–2013, in 2013 Dollars)



Note: Dollar amounts are adjusted for inflation and expressed in 2012 dollars using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.
Source: Bureau of Economic Analysis, *Regional Economic Accounts (Annual State Personal Income).*

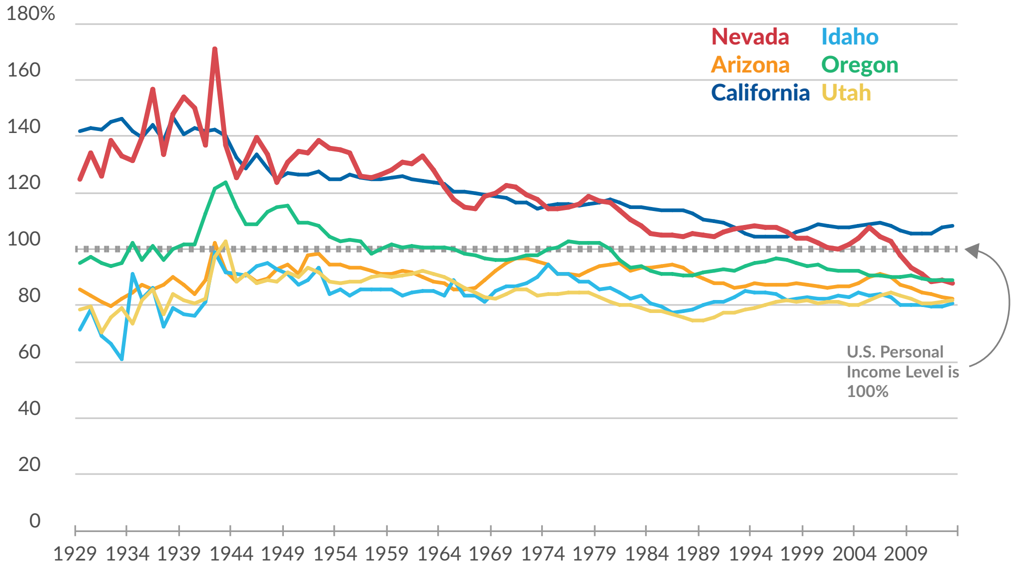
Nevada has slipped regionally, as well. Though Nevada's income levels exceeded most other regional states in the 1930s, 1940s, and 1950s, they have all started to converge on the U.S. average over time, and Nevada has dipped below average in recent years (see Figure 2).[2]

1 Bureau of Labor Statistics, *Regional Economic Accounts, Annual State Personal Income and Employment, Personal income, per capita personal income, disposable personal income, and population (Table SA1-3), United States and Nevada (1929-2013).*

2 Bureau of Labor Statistics, *Regional Economic Accounts, Annual State Personal Income and Employment, Personal income, per capita personal income, disposable personal income, and population (Table SA1-3), Arizona, California, Idaho, Nevada, Oregon, and Utah (1929-2013).*

Figure 2. Personal Income Per Capita As Percent of U.S. Level

Nevada and Neighboring States (1929–2013)

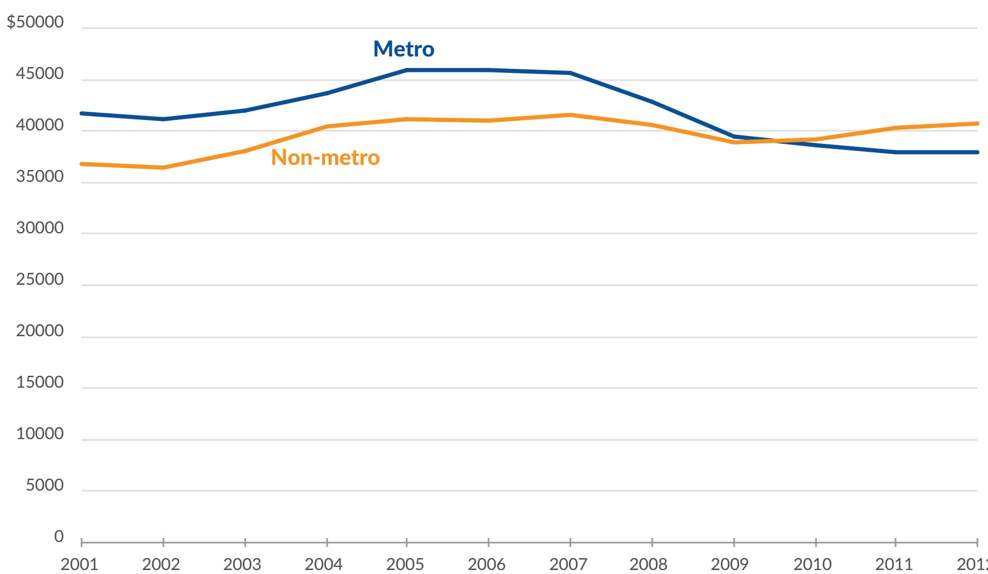


Source: Bureau of Economic Analysis, *Regional Economic Accounts (Annual State Personal Income).*

However, it's important to go beyond state-by-state comparisons and also look at intrastate incomes, since Nevada's metropolitan areas have significantly different economies and demographic characteristics than the more rural areas of the state. Prior to the recession, average personal income in metropolitan areas of Nevada was higher than the non-metro, more rural areas. However, this relationship flipped post-recession (see Figure 3).[3] This is likely due to the different industry compositions of metropolitan versus non-metro Nevada. Mining, an industry that fared better than others during the recession, is a major driver of non-metro area local economies.

Figure 3. Metro Area vs. Non-Metro Area Personal Income Per Capita

Nevada Statewide (2001–2012, in 2012 Dollars)



Note: Dollar amounts are adjusted for inflation and expressed in 2012 dollars using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.
Source: Bureau of Labor Statistics, *Regional Economic Accounts (Local Area Personal Income and Employment).*

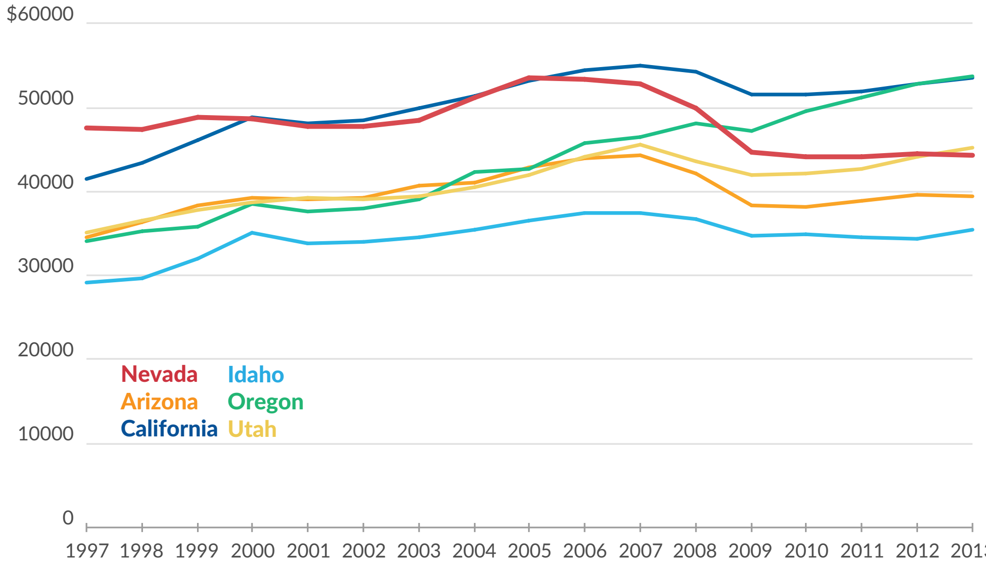
3 Bureau of Labor Statistics, *Regional Economic Accounts, Local Area Personal Income and Employment, Personal income, per capita personal income, and population (Table CA1-3), Nevada State Metro/Nonmetro portions (2001-2012).*

Gross State Product

Gross state product (GSP) is one way to measure a state's economic output. In 1997, Nevada's GSP was the highest among its neighbors at $47,601.[4] In 2009, after the previous year's economic downturn, Nevada output dipped below this level for the first time since the late 1990s. The state hit a high of $53,571 in 2005 but has yet to recover to the level of that prerecession peak and still remains lower than it was in 1997. Nevada currently ranks fourth among its neighbors (see Figure 4), only higher than Arizona and Idaho.

Figure 4. Gross State Product Per Capita

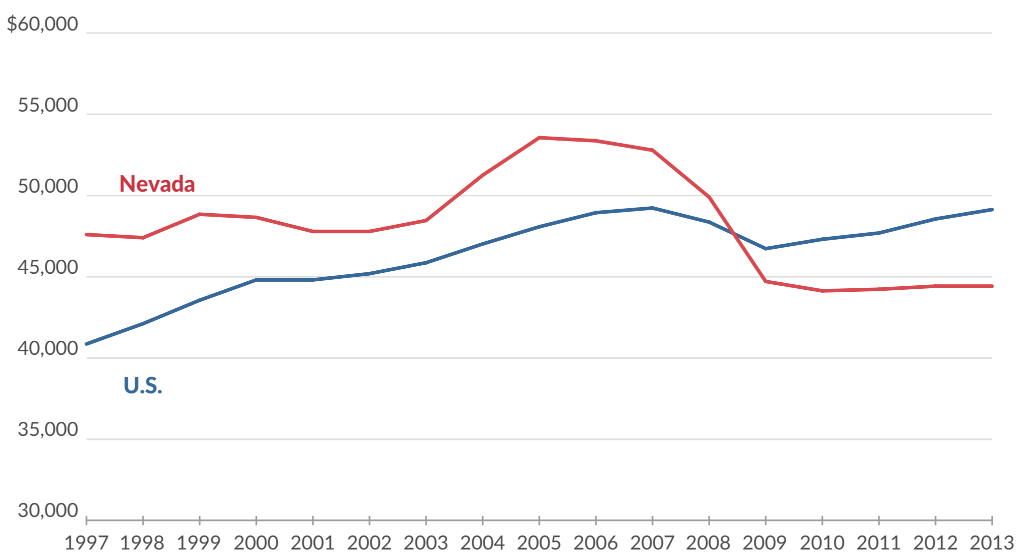
Nevada and Neighboring States (1997–2013, in Chained 2009 Dollars)



Note: Dollar amounts are adjusted for inflation and expressed in chained 2009 dollars, as calculated by the Bureau of Economic Analysis.
Source: Bureau of Economic Analysis, *Regional Economic Accounts (GDP by State).*

Figure 5. Gross State Product Per Capita

Nevada and U.S. (1997–2013, in Chained 2009 Dollars)



Note: Dollar amounts are adjusted for inflation and expressed in chained 2009 dollars, as calculated by the Bureau of Economic Analysis.
Source: Bureau of Economic Analysis, *Regional Economic Accounts (GDP by State).*

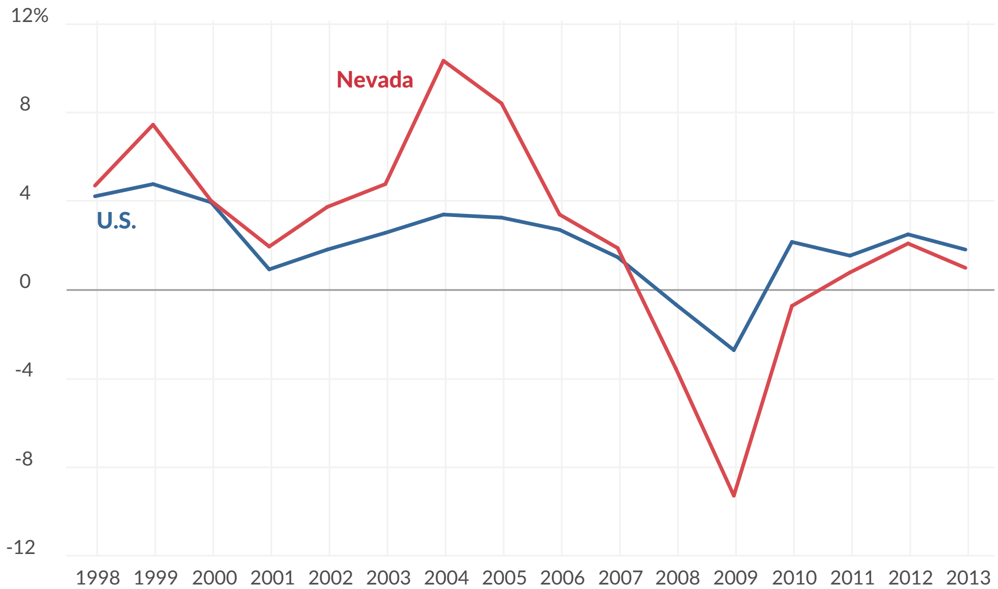
4 Bureau of Labor Statistics, *Regional Economic Accounts, Gross Domestic Product (GDP) by State, Real GDP in chained dollars, Arizona, California, Idaho, Oregon, and Utah (1997-2013).*

Nevada's economy also fared much worse than the rest of the country by this metric, dipping below U.S. output after the recession despite being well above national levels prior (as shown in Figure 5).[5]

Nevada's state economy is also more volatile than the U.S economy as whole. Nevada output has historically fluctuated more severely during economic cycles than the national economy, as demonstrated by its higher peaks and valleys in Figure 6.[6] A major contributing factor to this instability is Nevada's industry composition—sectors such as leisure and hospitality can fluctuate widely with the business cycle.

Figure 6. Annual Percentage Change in Real Gross State Product

Nevada and U.S. (1998–2013)



Source: Bureau of Economic Analysis, *Regional Economic Accounts (GDP by State).*

5 Bureau of Labor Statistics, *Regional Economic Accounts, Gross Domestic Product (GDP) by State, Real GDP in chained dollars, United States and Nevada (1997-2013).*

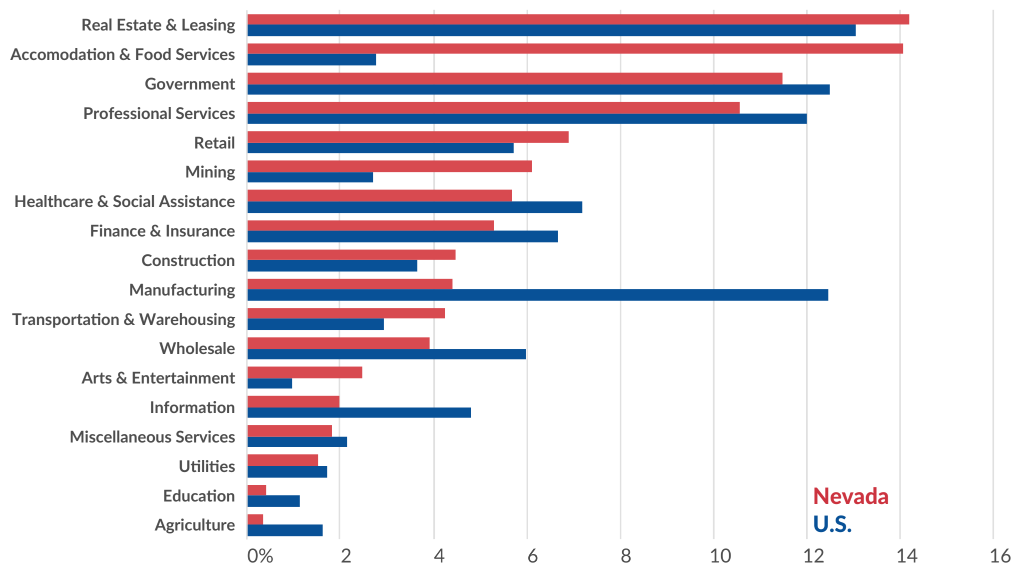
6 *Id.*

Major Industries

Nevada's industry mix differs greatly from the rest of the U.S. Though the state's largest sector (based on share of total output) is real estate (see Figure 7), this is also true of the rest of the country. The difference between Nevada and the U.S. as a whole arises, however, in the state's second largest industry: accommodation and food services (14.1 percent of total output). The U.S. hospitality sector is comparatively much smaller. Other large sectors include government (11.5 percent), professional and business services (10.6 percent), retail trade (6.9 percent), and mining (6.1 percent).[7]

Figure 7. Percent of Total Gross State Product by Industry

Nevada and U.S. (2013)



Source: Bureau of Economic Analysis, *Regional Economic Accounts (Annual State Personal Income).*

As noted, Nevada's tourism-related industry shares are markedly larger than the U.S. average—and this isn't just limited to hotels and lodging. For example, the arts, entertainment, and recreation sector (which includes gambling activities) is 2.5 percent of the Nevada economy but just under 1 percent of U.S. output as a whole.

Manufacturing, one of the largest sectors in the greater U.S. (12.5 percent of total output), represents a much smaller share of the Nevada economy, comprising a mere 4.4 percent of total output. Other comparatively smaller industries are information, wholesale trade, and finance and insurance.

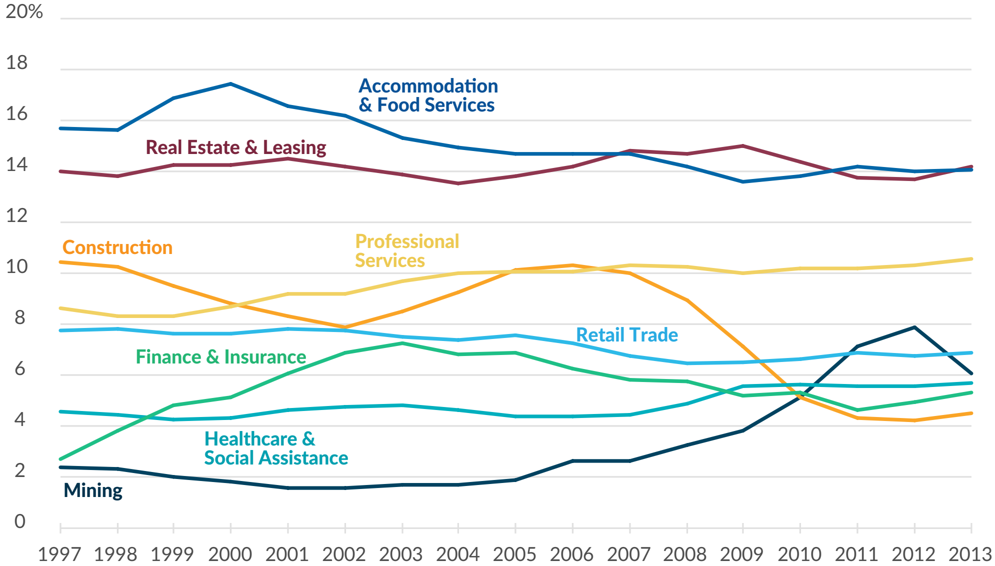
The hospitality industry has always been one of the largest sectors of the Nevada economy, though it has waned in recent years (see Figure 8). Construction's share has fluctuated over time, reaching a high of just over 10 percent in the mid-2000s but decreasing markedly in recent years to just over 4 percent of total output. Professional services continue to grow over time, and mining's recent spike has begun to abate.[8]

7 Bureau of Labor Statistics, *Regional Economic Accounts, Gross Domestic Product (GDP) by State, GDP in current dollars, United States and Nevada (2013).*

8 Bureau of Labor Statistics, *Regional Economic Accounts, Gross Domestic Product (GDP) by State, GDP in current dollars, United States and Nevada (1997-2013).*

Figure 8. Percent of Total Gross State Product by Industry

Nevada Statewide (Eight Largest Private Industries, 1997–2013)

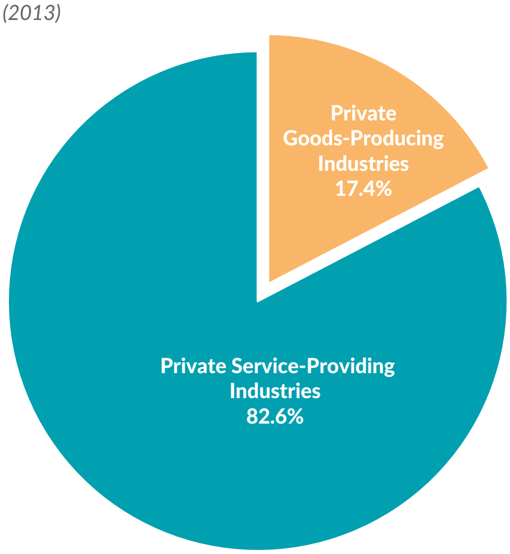


Source: Bureau of Economic Analysis, *Regional Economic Accounts (Gross Domestic Product by State).*

Like the rest of the country, a significant share of Nevada's economy is based on the provision of services. Service industries make up 82.6 percent of the state's private sector economy, while goods production is only 17.4 percent (see Figure 9).[9]

Figure 9. Percent of Total Private Gross State Product by Production Type

Nevada Statewide (2013)



Source: Bureau of Economic Analysis, *Regional Economic Accounts (Gross Domestic Product by State).*

It's important to point out that the sector makeup and concentration in rural Nevada is quite different from that in the southern, more metropolitan portion of the state. Figure 10 shows the largest

9 Bureau of Labor Statistics, *Regional Economic Accounts, Gross Domestic Product (GDP) by State, GDP in current dollars, Nevada (2013).*

sector in each county based on total employment at firms with at least one employee (non-employer businesses are not included).[10] These totals also include government jobs. For example, "Healthcare & Social Assistance" and "Education" often include public sector employment.

Figure 10. Largest Sector by County

Based on Percent of Total County Employment (2012)

Note: Data only includes firms with at least one paid employee.
Source: Census Bureau, *County Business Patterns*.

Clarke and Washoe Counties are the more metropolitan areas of Nevada. Both counties' largest sector is accommodation and food services, which is largely tourism related. This is also the largest sector in Douglas County, near Washoe. Northern, more rural counties (Humboldt, Elko, Pershing, Lander, Eureka, and White Pine) depend most heavily on the mining sector based on this metric, as does Esmeralda County. Employment in Churchill, Nye, and Lincoln counties is most concentrated in the retail sector. Mineral County employees are predominantly in education-related jobs, while Carson City is most concentrated in healthcare and social assistance employment. (Mineral County and Carson City both likely include many public sector jobs.) Manufacturing is the most prominent in Storey and Lyon Counties.

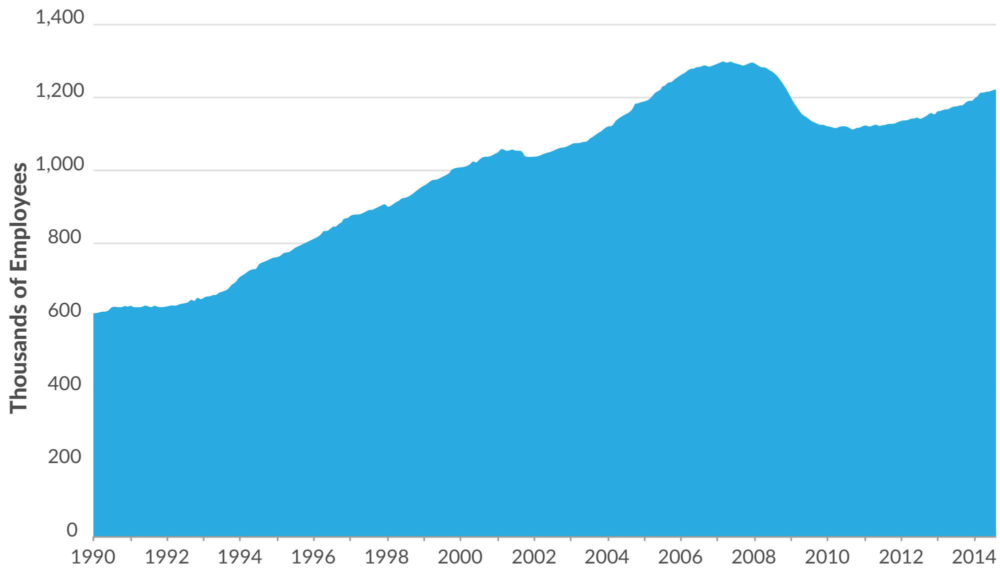
10 Census Bureau, *County Business Patterns (2012).*

Employment

Employment in Nevada since 1990 has generally seen an upward growth trend, though this was halted by the 2008 recession, during which the state was severely impacted. As of August 2014, Nevada still had not recovered to prerecession employment levels (see Figure 11).[11]

Figure 11. Total Nonfarm Employment

Nevada Statewide (Seasonally Adjusted, 1990–2013)



Source: Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*

During the most recent Nevada Economic Forum, the chief economist of the Research and Analysis Bureau of the Department of Employment, Training, and Rehabilitation pointed out that the state's recent rate of employment growth was comparatively higher than the rest of the country.[12] This job growth has helped Nevada begin to recover from the loss of approximately 175,000 jobs during the recession.[13]

The largest share of Nevada's workforce is concentrated in the Las Vegas metropolitan area—something that has been true for many years. In 2013, the average annual Las Vegas metro employment level was 891,483, while the workforce in the Carson City area was just 24,300.[14]

Most employment in Nevada comes from the leisure and hospitality industry, at 27.3 percent of total nonfarm employment (see Figure 12). This is followed by trade, transportation, and utilities (which contains retail and wholesale trades); professional and business services; government; and education and health services.[15]

11 Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*

12 State of Nevada Legislative Council Bureau, Meeting Notice, Agenda, and Minutes for Economic Forum Meeting (Oct. 17, 2014) at 8, https://leg.state.nv.us/interim/77th2013/Committee/NonLeg/EcForum/Other/17-October-2014/FINAL_Meeting_Packet_Website.pdf.

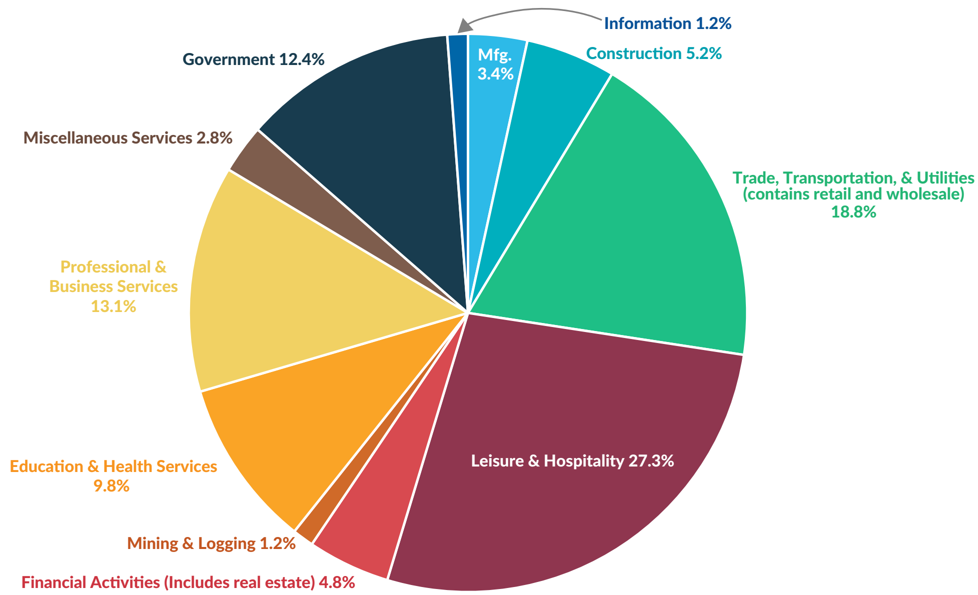
13 *Id.* at 9.

14 Bureau of Labor Statistics, *Local Area Unemployment Statistics.*

15 Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*

Figure 12. Percent of Total Nonfarm Employment by Industry

Nevada Statewide (Seasonally Adjusted, as of August 2014)

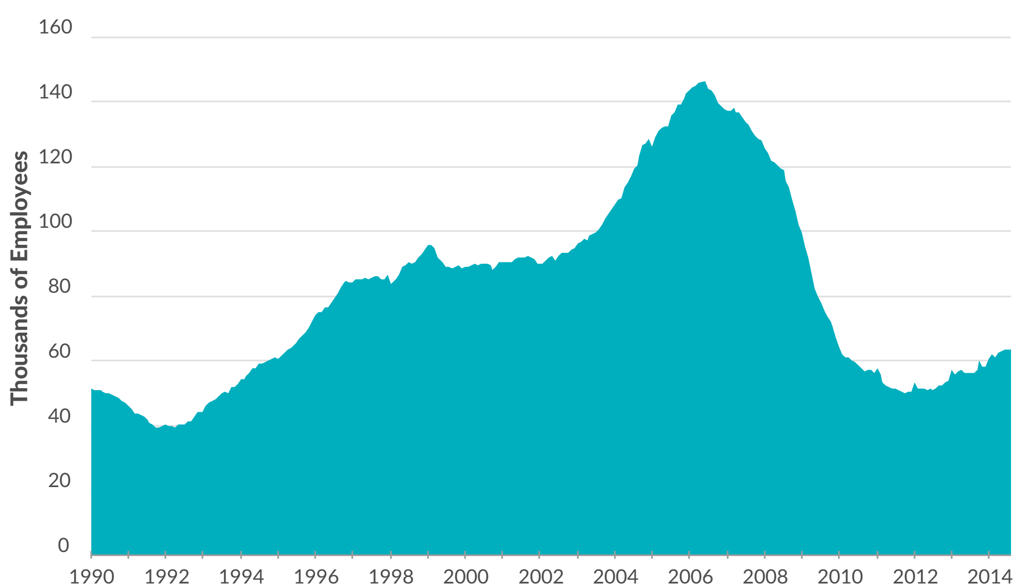


Note: "Mfg." stands for "Manufacturing." Nevada's information sector employment is not measured by BLS, so this value was extrapolated.
Source: Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*

Different sectors were impacted very differently during the recession. The sector which experienced the hardest impact was the construction industry (see Figure 13).[16] Even though construction comprises a small share of Nevada's total employment, this wasn't always the case. Employment in this industry tends to be more volatile than in others, a fact proven when construction employment began suffering a very steep decline in mid-2006, reaching a trough in late 2011 that was its lowest point since 1993. It has started to tick up again but is unlikely to ever reach prerecession highs or drive employment growth like it did in the past. The sector's high employment peak was largely driven by rapidly expanding commercial and residential real estate, which took a major hit during the recession.

Figure 13. Construction Employment

Nevada Statewide (Seasonally Adjusted, 1990–2013)

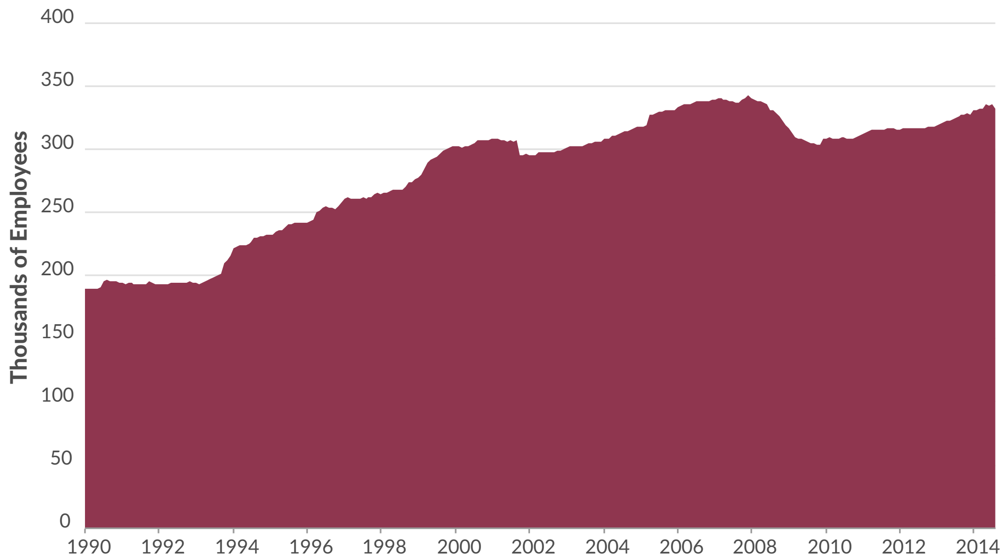


Source: Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*

16 Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*

Figure 14. Leisure & Hospitality Employment

Nevada Statewide (Seasonally Adjusted, 1990–2013)



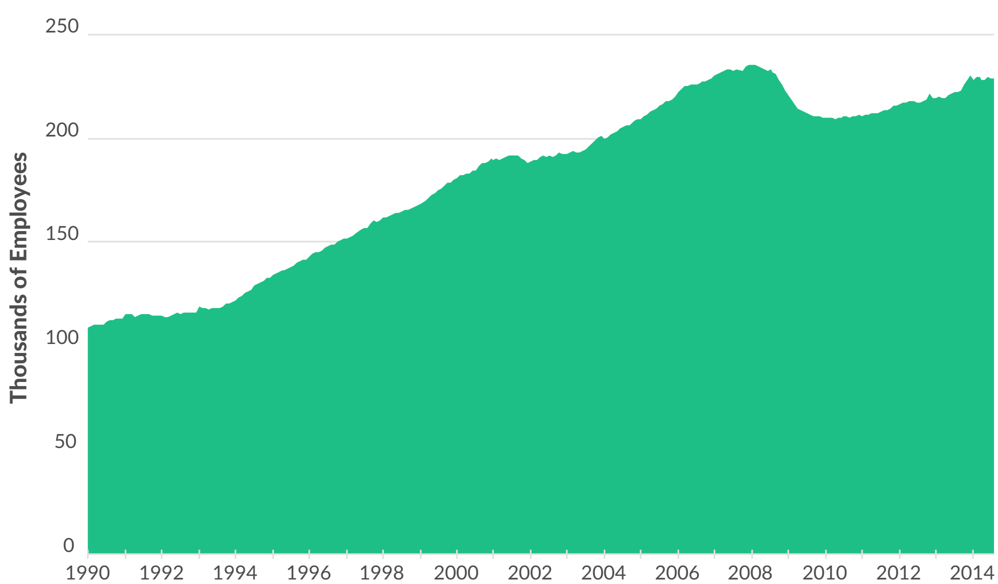
Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*

Leisure and hospitality industry employment took a mild hit post-recession. This sector's employment has generally trended upward over time and sat at over 300,000 employees in August of 2014—just over one-fourth of the entire Nevada workforce (see Figure 14).[17]

Trends in the trade, transportation, and utilities sector (which includes retail and wholesale) have been similar—a brief dip during the recession but a general upward trend over time (see Figure 15).[18]

Figure 15. Trade, Transportation, & Utilities Employment

Nevada Statewide (Seasonally Adjusted, 1990–2013)



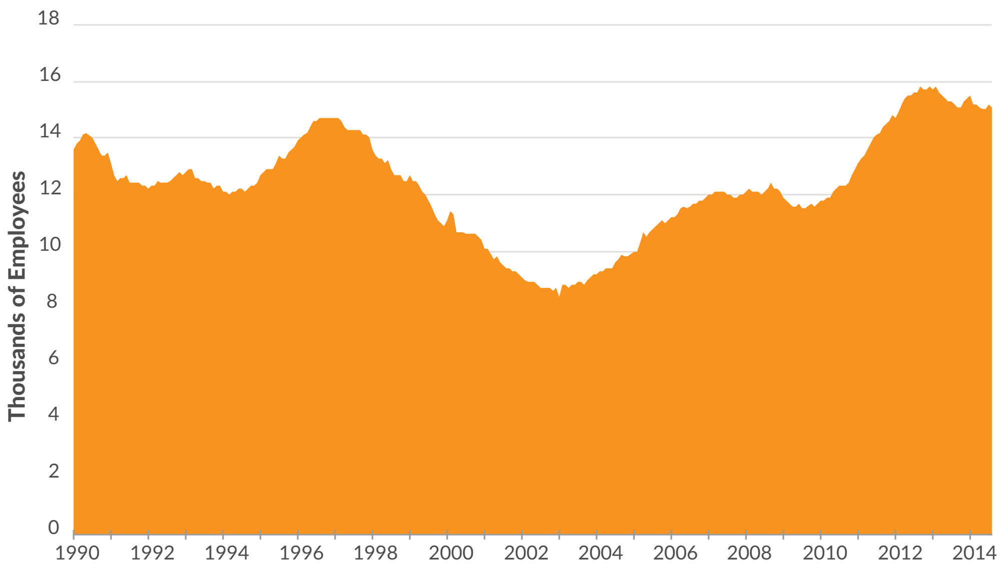
Source: Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*

17 Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*
18 Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*

Although Nevada's recent job growth has been broadly based overall (that is, job gains have not been limited to one sector), mining has remained flat due to declining gold prices.[19] Nevertheless, despite lower mining employment compared to other sectors, when considering the state as a whole, mining remains a vital sector for many local economies in Nevada. As Figure 16 shows, mining fared well during the recession, experiencing only a minor dip in total sector employment. The early 2000s were far worse for the industry.[20]

Figure 16. Mining & Logging Employment

Nevada Statewide (Seasonally Adjusted, 1990–2013)



Source: Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*

A very different picture exists in the education and healthcare sectors (see Figure 17), which have not seen any significant job losses in recent history. In fact, the recession was not felt at all in these sectors, primarily because many of these jobs are in the public sector.[21]

During the last recession, Nevada's unemployment rate was markedly higher than the greater U.S. rate (see Figure 18). Nevada's peak unemployment rate hit 13.9 percent in mid-2010, while the U.S. unemployment rate only hit a high of 10 percent in late 2009. Post-recession, the Nevada state rate still remains higher than the rest of the country at 7.3 percent, compared to the U.S. rate of 5.9 percent.[22]

19 Nevada Legislative Council Bureau, *Meeting Notice, Agenda, and Minutes for Economic Forum Meeting* (Oct. 17, 2014) at 9, https://leg.state.nv.us/interim/77th2013/Committee/NonLeg/EcForum/Other/17-October-2014/FINAL_Meeting_Packet_Website.pdf.

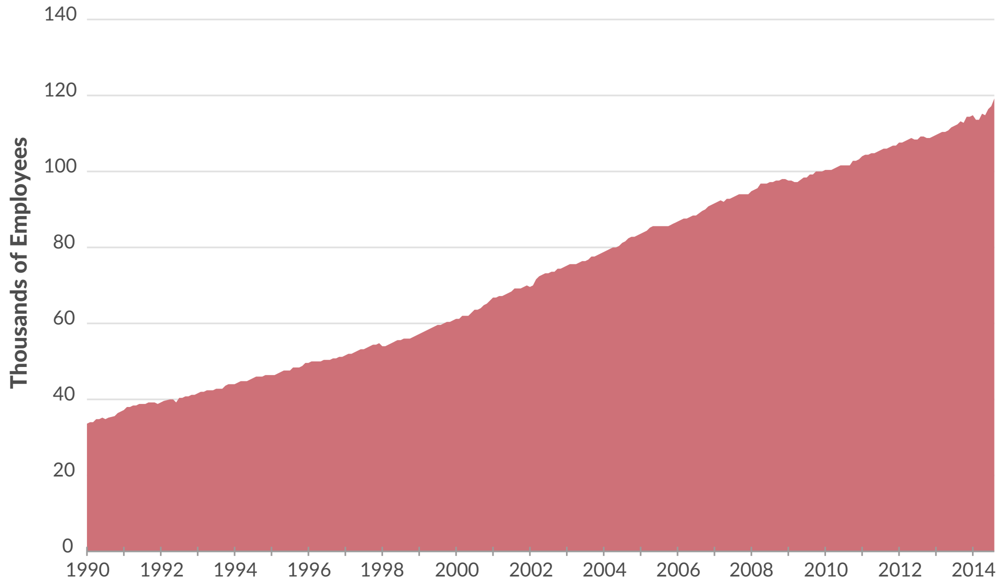
20 Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*

21 *See* U.S. Census Bureau, *North American Industry Classification System, Educational Services*, http://www.census.gov/cgi-bin/sssd/naics/naicsrch?chart_code=61&search=2012%20NAICS%20Search; U.S. Census Bureau, *North American Industry Classification System, Health Care and Social Assistance*, http://www.census.gov/cgi-bin/sssd/naics/naicsrch?chart_code=62&search=2012%20NAICS%20Search.

22 Bureau of Labor Statistics, *Local Area Unemployment Statistics and Labor Force Statistics from the Current Population Survey*.

Figure 17. Education & Health Services Employment

Nevada Statewide (Seasonally Adjusted, 1990–2013)

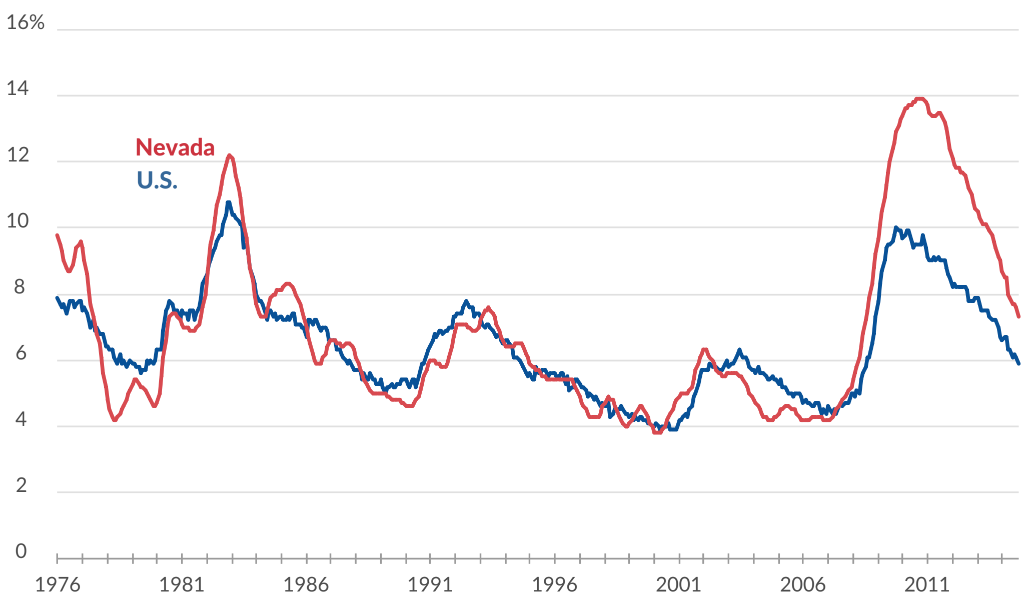


Source: Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*

Though Nevada's rate has decreased recently, state officials have expressed concern that "some of the decline in the unemployment rate was because fewer people were actively participating in the labor market, or were not actively looking for a job."[23] This can lead to a misleading decrease in the unemployment rate, because fewer people are counted as part of the labor force when in fact there has not been any meaningful decrease in people who are out of work.

Figure 18. Unemployment Rate

Nevada and U.S. (Seasonally Adjusted, 1976–2014)



Bureau of Labor Statistics, *Local Area Unemployment Statistics and Labor Force Statistics from the Current Population Survey.*

23 Nevada Legislative Council Bureau, *Meeting Notice, Agenda, and Minutes for Economic Forum Meeting* (Oct. 17, 2014) at 9, https://leg.state.nv.us/interim/77th2013/Committee/NonLeg/EcForum/Other/17-October-2014/FINAL_Meeting_Packet_Website.pdf.

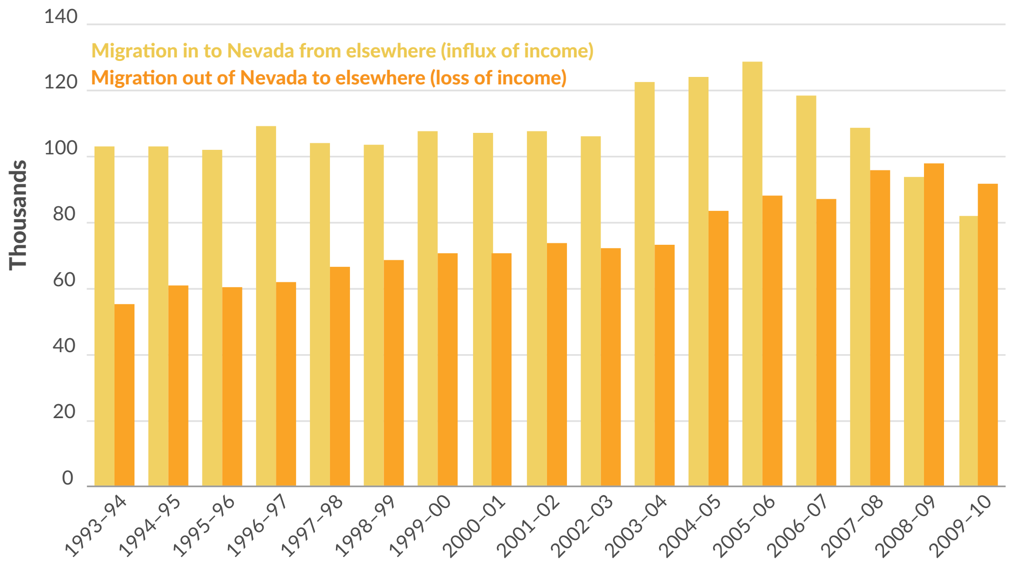
As of September 2014, Nevada's 7.3 percent rate was tied with California for the highest unemployment rate.[24] Nevada's rate is the fifth highest in the country.

Interstate Migration

Migration between states can be measured by tracking the movement of federal tax returns (and exemptions claimed on those tax returns) between states over time. Since the early 1990s, Nevada has gained 555,382 people on net.[25] Figure 19 shows the number of people moving into and out of Nevada each year. Until recently, migration into Nevada had consistently exceeded migration out of Nevada. In 2008 and 2009, however, the reverse has been true but only by a small amount.

Figure 19. Migration To and From Nevada

Based on Number of Federal Exemptions In and Out of Nevada (1994–2010)



Source: Internal Revenue Service, *Statistics of Income*.

Since 1993, Nevada has gained the most people from California, New York, Illinois, Hawaii, and Minnesota. Over the same time period, Nevada has lost the most people to Idaho, Arizona, Oregon, Tennessee, and Texas. The state economy is likely a key factor in these interstate migration trends.

24 Bureau of Labor Statistics, *Local Area Unemployment Statistics, Unemployment Rates for States* (Sept. 2014), http://www.bls.gov/web/laus/laumstrk.htm.

25 Tax Foundation, *State to State Migration Data*, http://interactive.taxfoundation.org/migration/.

Chapter 2
Nevada Tax System Overview

Introduction

Nevada is a low-tax state, and these low taxes make it competitive. However, the existing tax system magnifies economic volatility due to its dependence on tourism, its narrow bases, and its high rates. In general, Nevada's tax structure is narrow, complex, and inequitable, and it will become increasingly unworkable as the state diversifies and realigns its economy.

Nevada should move away from industry-specific taxes (such as the bank branch tax, new gaming taxes, or mining taxes, for example) and end the practice of enacting temporary tax hikes. History has shown that narrowly focused taxes do not produce adequate revenue over time, and that temporary rate increases often become permanent. Further, a newly invented "silver bullet" tax is neither needed nor advisable. Instead, the state can achieve a simplified, pro-growth tax system by fixing problems with its existing taxes.

It is important for lawmakers to realize that industry-dependent taxes are not sustainable in the long term and that the tax structure should reflect a diversified economy. Tax reform is needed to position the state for future growth, and the solution includes broadening the tax base and lowering rates without undermining key strengths of the existing system.

In general, the goals of tax reform in Nevada should be to

- Develop a tax system that reflects Nevada's evolving economy and positions it for growth;
- Broaden bases and lower rates;
- Address inequities, hyper-volatility, and overdependence on key industries;
- Retain the strengths and key selling points of Nevada's economy and tax system while addressing weaknesses; and
- Consider impacts not only to state revenue but also local revenue and to the wide variety of business types in Nevada.

To address these goals, this book will provide a menu of options for legislators that address separate parts of the tax system as well as a comprehensive option that addresses the system as a whole.

This chapter provides a very brief overview of the Nevada tax system, including how collections have behaved over time. Subsequent chapters will explain certain taxes in depth while providing reform options.

A Brief Overview of Nevada's Tax System

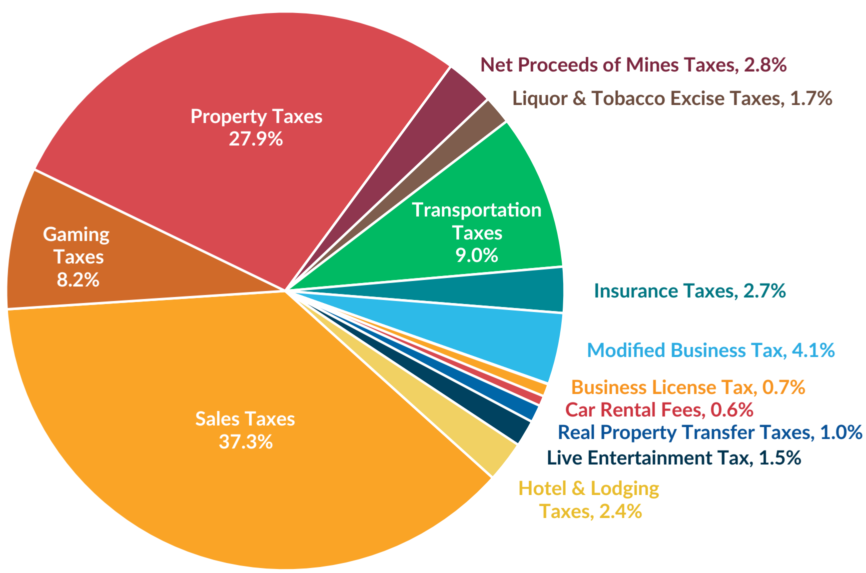
Nevada's tax system is one of the most unique in the country. Because of the historical strength of the state's tourism and gaming industry, Nevada has been able to depend heavily on gaming-related taxes and taxes that are easily exported to nonresidents (such as lodging taxes, sales and excise taxes on tourist purchases, and entertainment taxes). However, this model is not sustainable in the long run as international gaming locations become more developed and Nevada's tax rates become too high.

The largest tax collection source for Nevada's state and local governments is the sales tax, amounting to 37.3 percent of total combined state and local tax collections. Property taxes are the next largest source (27.9 percent of total), followed by transportation-related taxes (such as gasoline taxes and car taxes, which tend not to fund general operations, at 9.0 percent of total), gaming taxes (8.2 percent), and Nevada's version of a payroll tax (the Modified Business Tax, at 4.1 percent of total).

In addition to these five larger sources, a myriad of smaller taxes are levied on specific industries and activities. These include: taxes on mining, liquor and tobacco, insurance premiums, car rentals, transfers of real property, live entertainment, insurance premiums, hotels and lodging, bank branches, and financial institutions. Figure 20, below, shows the tax collection breakdown for the 2012 fiscal year.[26]

Figure 20. Nevada State & Local Tax Revenue Sources

Percent of Total Combined State & Local Tax Revenues (FY 2012)



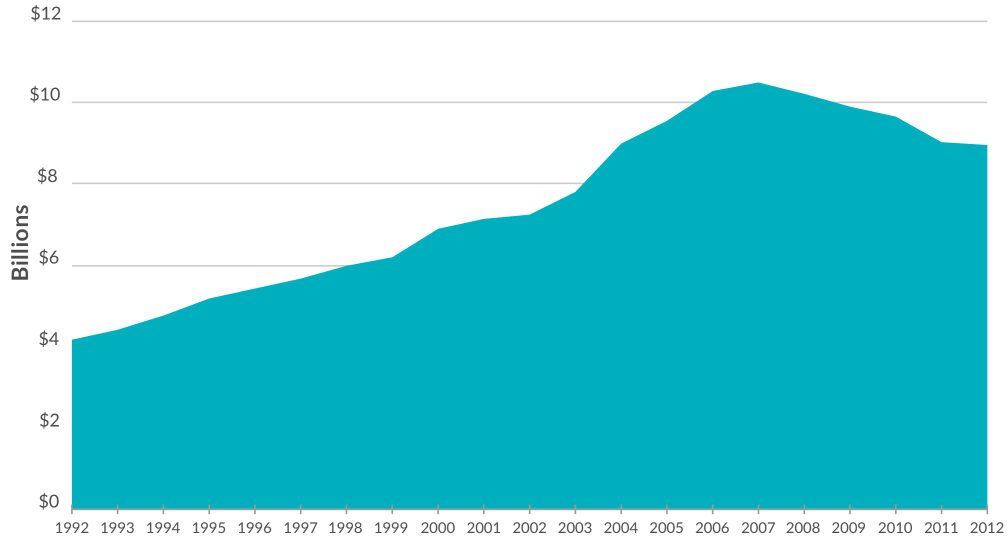
Note: Bank Branch Excise Fees not pictured, because revenues comprise such a small share of total.
Source: Nevada Legislative Council Bureau, *Revenue Reference Manual* (Jan. 2013 ed.).

Though Nevada state and local tax collections have grown, as shown in Figure 21, this increase must be viewed in the context of the state's expanding economy and net influx of people. Most important to consider is how tax collections behaved during and after the most recent recession. Collections have yet to recover to their pre-recession high.

26 The only taxes and fees included are those reflected in the *Revenue Reference Manual* published every other year by the Nevada Department of Taxation. "Transportation Taxes" include the gas excise tax, special fuel tax, jet fuel tax, and governmental services tax. "Gaming Taxes" include the gaming percentage fee, slot license fees, flat fee on games, advance license fees, annual slot taxes, and annual fee on games.

Figure 21. Total Tax Collections

Combined State & Local (FY 1992-FY 2012, in 2012 Dollars)



Note: Dollar amounts are adjusted for inflation and expressed in 2012 dollars using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.
Source: Nevada Legislative Council Bureau, *Revenue Reference Manuals* (Jan. 1993–Jan. 2013).

Chapter 3
Sales and Use Tax and Live Entertainment Tax

Introduction

This chapter will first explain the sales tax and the Live Entertainment Tax, then describe the issues with the current structure of these taxes. It will then conclude with tax reform options—one revenue neutral and one revenue positive.

Summary of Sales Tax and Live Entertainment Tax Reform Solutions (Reform Option B):

(1) Expand the sales tax base to services.
(2) Lower the 6.85 percent state-levied rate over time subject to revenue triggers.
(3) Exempt manufacturing machinery from the sales tax base.
(4) Provide an exemption from the sales tax for all business input goods and services by issuing an identification number, registered with the Department of Taxation, to all businesses that pay the Modified Business Tax or the Business License Fee which excludes them from the sales tax base.
(5) Repeal the Live Entertainment Tax (while simultaneously adding all admissions charges and food, beverages, and merchandise sold at all venues that charge admission to the sales tax base to the extent that it is not already taxable).

Sales and Use Tax[27]

Nevada's sales tax structure is narrow, outdated, and complicated. They are levied at the state and local level and fund state general operations, local governments, and education.

State-Levied Sales Tax Rate

Nevada's state-levied sales tax rate of 6.85 percent is composed of four separate component parts, all of which are levied by the state but distributed to different levels of government for a variety of purposes.[28] The 6.85 percent rate does not include any local option sales taxes, which will be discussed in the following subsection.

The state-level sales tax subcomponents are:

1. The **State Sales Tax** (2 percent), which goes to the State General Fund and is protected by the Nevada State Constitution.[29] Neither the rate nor the base can be changed without a vote of the people via referendum.
2. The **Local School Support Tax** (2.6 percent), which goes to the school districts in which it was collected (for in-state sales) and to the Distributive School Account (for out-of-state sales). A small share of collections goes to the State General Fund to cover collection and administration costs.[30]
3. The **Basic City-County Relief Tax** (0.5 percent), which is distributed to local governments (less a small amount to the State General Fund to cover costs) based on a

27 Though the statutory identification of the tax is the sales and use tax, we will refer to it simply as the sales tax.
28 Nevada Department of Taxation, *Annual Report Fiscal 2012–2013* (2014) at 12 [hereinafter *Annual Report*], http://tax.nv.gov/uploadedFiles/taxnvgov/Content/TaxLibrary/AnnualReport_FY13_final.pdf.
29 Nevada Legislative Council Bureau, Fiscal Analysis Division, *Revenue Reference Manual*, *Tax Revenue Summaries: Sales Taxes* (Jan. 2013) at 19, https://www.leg.state.nv.us/Division/Fiscal/FinalRRM2013.pdf.
30 *Id.* at 22. The Local School Support Tax rate was increased temporarily from 2.25 percent to 2.6 percent through June 30, 2015.

statutory formula.[31] This distribution formula is calculated under the Consolidated Tax, which will be discussed in the subsequent subsection.

4. The **Supplemental City-County Relief Tax** (1.75 percent), which is also distributed to local governments (less a small amount to the State General Fund) based on a formula.[32] Distribution of this tax also falls under the Consolidated Tax.

Since each of the four taxes are applied to an identical tax base (the sale of tangible personal property), together they operate as one combined-rate sales tax levied by the state.

Local Option Sales Tax Rates

Since 1981, county governments have been able to levy local option sales taxes for specific purposes on top of the 6.85 percent state-levied rate, if approved by the legislature. The legislature may or may not require voter approval. The first local option sales taxes approved by the legislature were for transportation and tourism.[33] The majority of the collections from such taxes stay within the county in which they were levied, though there are specific restrictions on how such revenues may be utilized.

After 1981, several special acts have allowed certain counties to levy additional sales taxes, such as the Local Government Tax Act in 1991, which allowed "certain counties that were negatively impacted by the change to the Supplemental County/City Relief Tax distribution formula" to offset revenues by levying a 0.25 percent sales tax to be used for general purposes.[34] Cities and other local government entities do not have the authority to levy Local Option Sales Taxes.

A small portion of local option sales tax collections goes to the State General Fund (1.75 percent of total collections), while the remainder is returned to the county.[35] Table 1 shows current Local Option Sales Taxes.

Table 1. Nevada's Local Option Sales Taxes

County	Uses of Local Option Sales Tax Collections	Total Percentage for All Local Option Taxes	Total Sales Tax Rate for County (State + Local)
Carson City	Public Roads, V&T Railroad Bonds	1.00%	7.85%
Churchill	Public Roads, Infrastructure	0.75%	7.60%
Clark	Regional Transportation, Southern Nevada Water Authority, Flood Control, Additional Police	1.25%	8.10%
Douglas	Construction of Facilities, Agriculture Protection	0.25%	7.10%
Elko	None	None	6.85%
Esmeralda	None	None	6.85%
Eureka	None	None	6.85%
Humboldt	None	None	6.85%
Lander	Water Treatment	0.25%	7.10%
Lincoln	School & Public Utilities	0.25%	7.10%
Lyon	Infrastructure	0.25%	7.10%
Mineral	None	None	6.85%
Nye	Public Roads	0.75%	7.60%
Pershing	Infrastructure	0.25%	7.10%
Storey	Tourism, School & Public Utilities	0.75%	7.60%
Washoe	Regional Transportation, Flood & Public Safety, All Railroad Grade Separation	0.875%	7.725%
White Pine	School Capital Improvement, Public Roads, Swimming Pool, Operating Costs under Severe Financial Emergency, Infrastructure & Public Safety	0.875%	7.725%

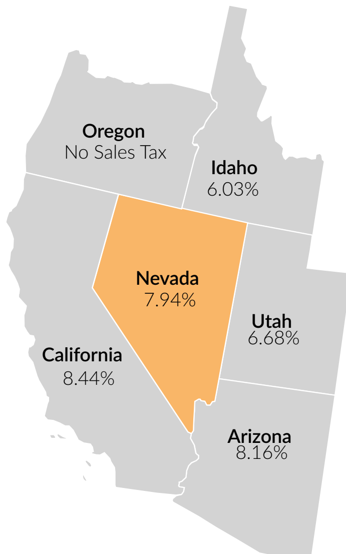
Source: Nevada Department of Taxation, *Annual Report Fiscal 2012–2013*; Tax Foundation, *State and Local Sales Tax Rates Midyear 2014*.

31 *Id.* at 20.
32 *Id.* at 21.
33 *See Annual Report*, *supra* note 2, at 26.
34 *See Annual Report*, *supra* note 2, at 27.
35 *See Annual Report*, *supra* note 2, at 26.

When the state-levied rate of 6.85 percent is combined with these local option taxes, the combined state-local rate ranges from a low of 6.85 percent in Elko, Esmeralda, Eureka, Humboldt, and Mineral counties to a high of 8.10 percent in Clark County. The average combined state-local rate in Nevada is 7.94 percent—thirteenth highest in the country and third highest among neighboring states.[36] Figure 22 shows average combined state-local sales tax rates for Nevada and its neighbors.

Figure 22. Combined State & Local Sales Tax Rates

Nevada and Neighboring States (as of September 2014)



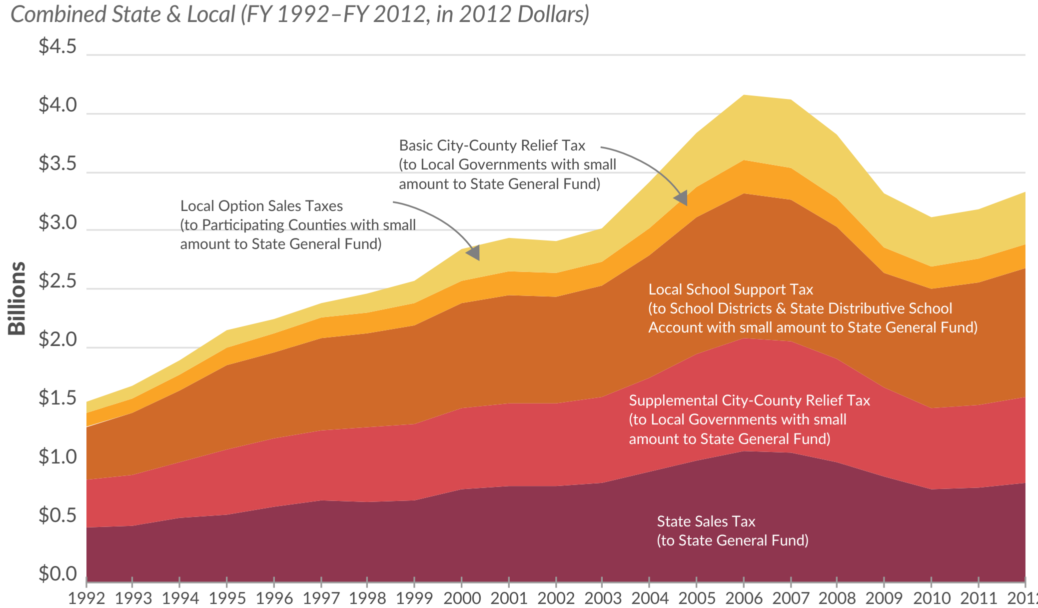
Source: Tax Foundation, *State and Local Tax Rates Midyear 2014*.

Sales Tax Collections

Altogether, state-levied sales taxes brought in $2.89 billion in the 2012 fiscal year, while local option taxes raised $436.7 million.[37] Figure 23 shows total Nevada state and local sales tax collections since 1992 (adjusted for inflation).

Figure 23. Total Sales Tax Collections

Combined State & Local (FY 1992–FY 2012, in 2012 Dollars)



Note: Dollar amounts are adjusted for inflation and expressed in 2012 dollars using the Consumer Price Index for All Urban Consumer (CPI-U) from the Bureau of Labor Statistics.
Source: Nevada Legislative Council Bureau, *Revenue Reference Manuals* (Jan. 1993–Jan. 2013)

36 Scott Drenkard, Liz Emanuel, & Jordan Yahiro, *State and Local Sales Tax Rates Midyear 2014*, Tax Foundation Fiscal Fact No. 438 (Sept. 16, 2014), http://taxfoundation.org/article/state-and-local-sales-tax-rates-midyear-2014.

37 Nevada Legislative Council Bureau, Fiscal Analysis Division, *Revenue Reference Manual, Tax Revenue Summaries: Sales Taxes* (Jan. 2013), https://www.leg.state.nv.us/Division/Fiscal/FinalRRM2013.pdf.

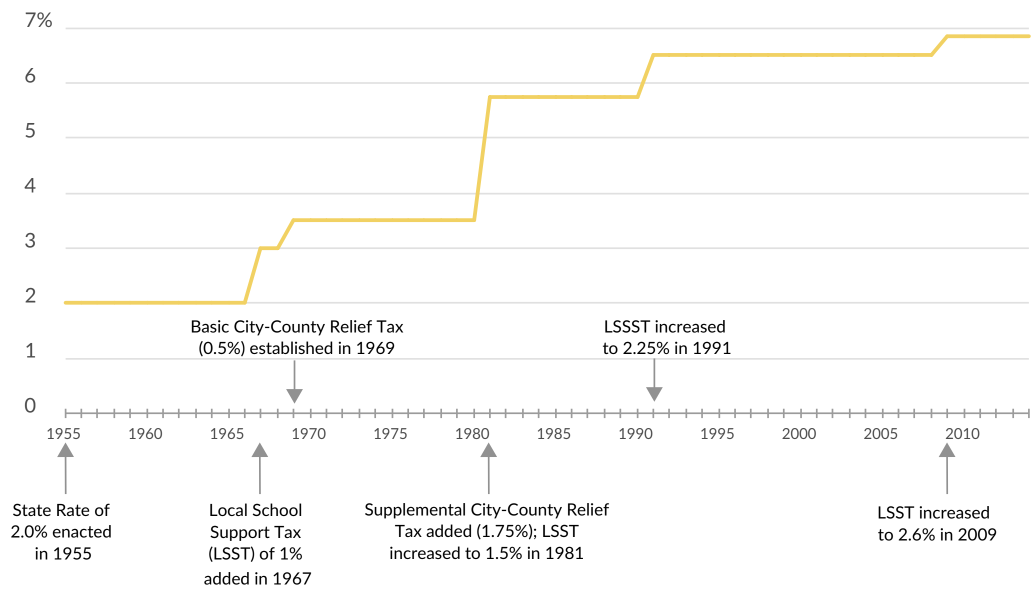
Collections dipped sharply during the most recent recession. As of 2011, total collections still had not recovered to the pre-recession peak.

Sales Tax History

The narrow, complicated, and fragmented structure of the sales tax is a historical relic and a direct result of the constitutional protection given to the 2 percent State Sales Tax. Over time, the combined state-levied rate has climbed from 2 percent in 1955 when the tax was originally enacted to 6.85 percent today. Figure 24 shows these rate increases over time.

Figure 24. Nevada Combined State & Local Sales Tax Rate

Includes Major Sales Tax Rate Policy Changes (1995–2014)



Note: Does not include Local Option Sales Taxes.
Source: Applied Analysis, *Local Governments and a Nevada Service Tax* (Feb. 2, 2012).

While most other states adopted sales taxes in the 1930s in the wake of the Great Depression, Nevada is one of the few that waited until much later.[38] Discussion of the idea began after the Second World War but did not gain real traction until 1954:

> By 1954, . . . the State was facing a financial crisis in public schools, compelling [the Governor] . . . to call for a special session of the legislature to deal with [the issue] . . . . Proponents (largely from small counties) argued for the tax based on the state's fiscal need, while the opponents (organized by urban labor) held out for a tax source that would not force low income taxpayers to bear a disproportional share of the net tax solution. The proponents prevailed. . . . As a result, school aid increased dramatically.[39]

A year after the tax was enacted, opponents pushed for repeal of the sales tax, but supporters of keeping the tax in place pushed to protect it "in the form of a Constitutional referendum" which was adopted by voters in 1956.[40] Unfortunately, this approach had consequences still felt to this day.

38 Liz Emanuel & Richard Borean, *When Did Your State Adopt Its Sales Tax?*, Tax Foundation Tax Policy Blog, July 11, 2014, http://taxfoundation.org/blog/when-did-your-state-adopt-its-sales-tax.
39 The Urban Institute & Price Waterhouse, *State Revenues and State and Local Debt*, in Fiscal Affairs of State and Local Governments in Nevada 14-2 (Nov. 1988).
40 *Id.* at 14-2 to 14-3.

> [T]here was a catch of historical accident that the proponents of the sales tax appeared to have not foreseen: a provision of the Constitution that provides that once a referendum is so approved no modifications can be made in it without the express voter approval at another general election. As a result, not only did the two percent tax rate become 'Constitutional' but so did all the regulatory and administrative language.[41]

In order to get around this constitutional provision and raise the tax rate, several "creative legislators . . . devised a plan to circumvent the two percent limitation through enactment of three additions to the basic two percent rate (1967, 1969, and 1981), with the provisions that these were local—not state—revenue."[42]

Luckily, a constitutional amendment was approved in 1983 to allow regulation and administration related to the tax to be completed by the legislature rather than having to present each change for a vote of the people. For voters, however, the primary purpose of this amendment was an exemption for food for home consumption that still exists today.[43] It's unlikely that the average voter was aware of the regulatory and administrative implications of the amendment.

These previous actions created a system that is difficult to reform to better reflect the state of the current economy. Thus, "what Nevadans have now . . . is a sales tax . . . that still has embedded in it many of the problems of 1956."[44] A critique voiced in 1988 still stands today:

> As important as overall sales tax revenues are to the State, it is not the fully flexible tool of Legislative fiscal policy that a sound public administration requires. . . . Nevadans would be well to . . . consider removing all of the sales tax laws from the Constitution . . . .[45]

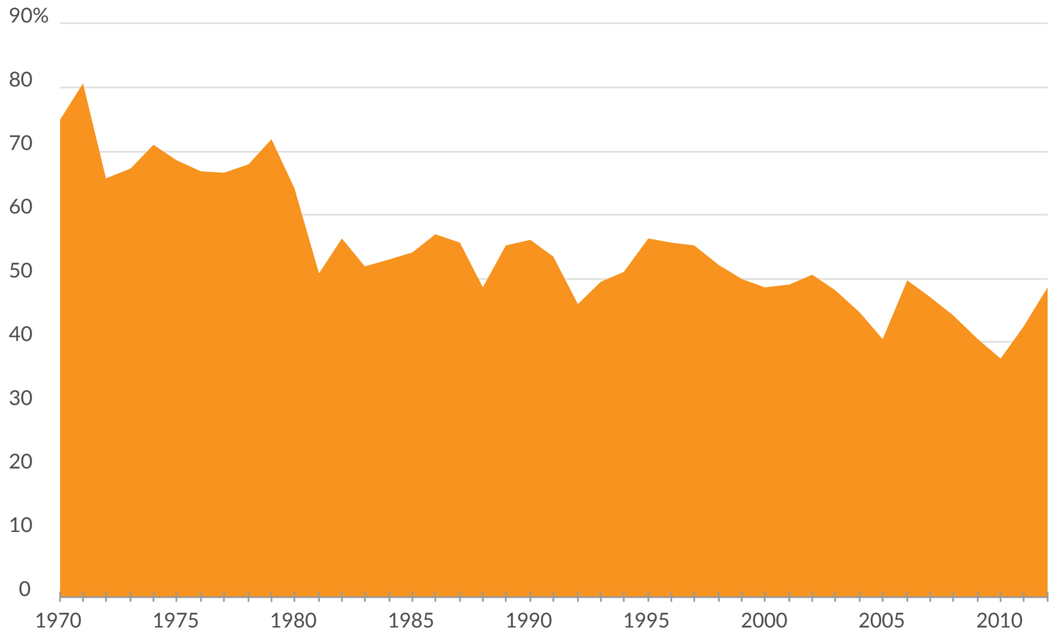
41 *Id.*
42 *Id.* at 14-3.
43 *Id.*
44 *Id.* at 14-3 to 14-4.
45 *Id.* at 14-4.

Nevada's Sales Tax Base

The most pressing problem with Nevada's sales tax is its narrow base. Data indicates that since 1970, Nevada's sales tax breadth—a measure of the broadness of the tax base—has gone from 73 percent to just 49 percent in 2012 (see Figure 25).

Figure 25. Nevada Sales Tax Breadth

Measured by Implicit Sales Tax Base Divided by Personal Income

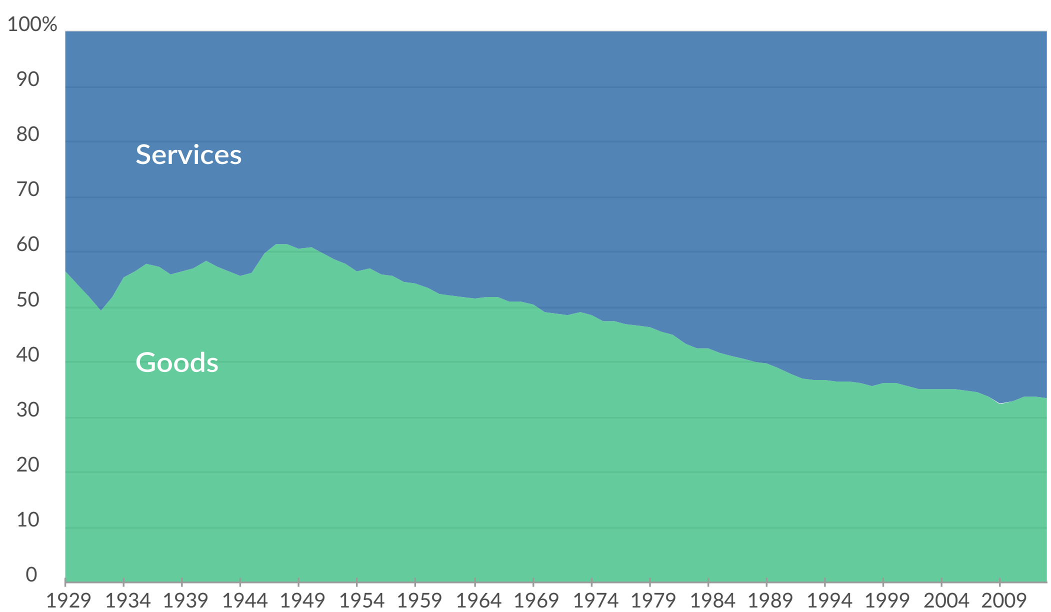


Source: Professor John Mikesell, Indiana University.

A major contributing factor to this—in Nevada and other states—is that American consumption habits have shifted over time. We no longer spend the majority of our consumption on goods and have instead shifted toward services. Figure 26 shows national goods and services consumption shares over time.

Figure 26. Percent of Total Personal Consumption Expenditures

Goods vs. Services, U.S. (1929–2013)



Source: Bureau of Economic Analysis, *National Income and Product Accounts (Personal Income and Outlays).*

Because Nevada's sales tax base is primarily the purchase of tangible personal property (that is, goods) and services are largely exempted from the tax, it is no surprise that the base has become smaller over time. This problem is exacerbated in a state like Nevada, where the majority of the economy is made up of services (as seen in Chapter 1, Figure 9).

As the tax base shrinks, lawmakers tend to look to rate increases for additional revenue. A better option is to broaden the tax base, which can permit rate reductions even in revenue positive scenarios.

Taxation of Business Inputs

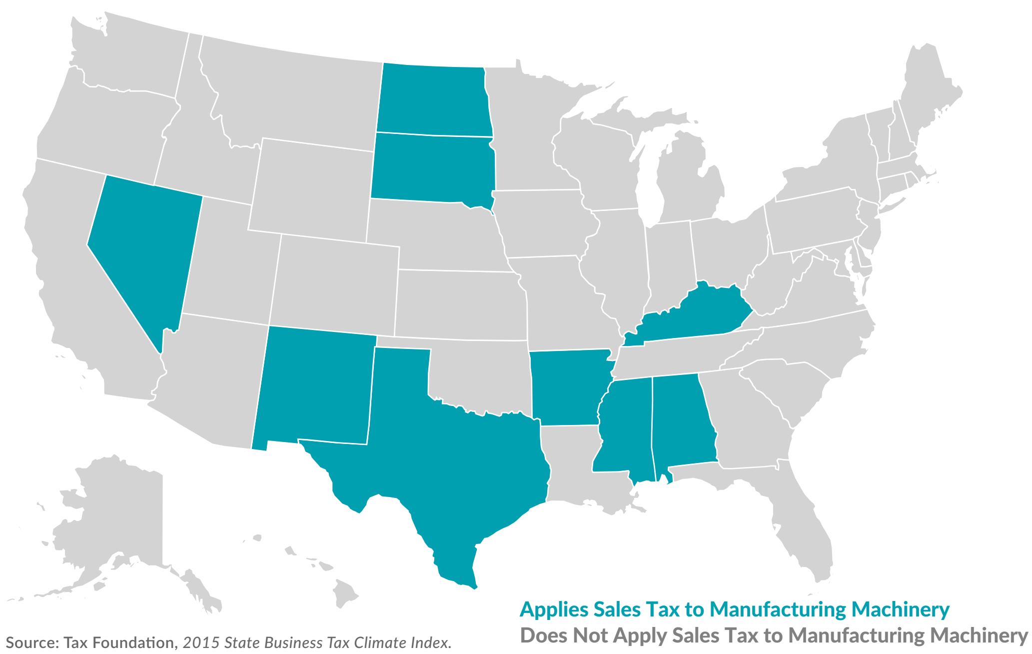
One vital consideration should be made when broadening a sales tax base. A perfectly structured sales tax would be imposed upon all final consumer services and exempt all purchases made by businesses that will be used as an input in their production process. This is not because businesses deserve special treatment under the tax code, but because applying sales tax to business inputs results in "tax pyramiding," where taxes pile up on top of one another and become embedded in a good's price as it moves through the production process. The result is higher and inequitable effective tax rates for different industries and products—this is both non-neutral and non-transparent.

Most states do a poor job of exempting business inputs from sales taxation. It is estimated that 21.9 percent of total business taxes paid in Nevada were sales taxes in 2014, above the national average of 18.6 percent.[46] In a perfectly structured tax code, that share would be zero.

Nevada fails the business input test in several key product areas, the most important of which is the taxation of manufacturing machinery, which is taxable under Nevada's sales tax when it should be exempted.[47] Several key stakeholders that were interviewed said that businesses considering locating in Nevada decided against it because of the lack of a manufacturing machinery exemption. In fact, all states but nine (and the District of Columbia) provide this exemption, as shown in Figure 27. This change would need to be approved by voters.

Figure 27. Sales Taxation of Machines Used in Manufacturing

Nevada Statewide (2013)



Source: Tax Foundation, *2015 State Business Tax Climate Index*.

46 Anderson Economics Group, Alex Rosaen, & Jason Horwitz, *2014 State Business Tax Burden Rankings* (July 29, 2014), http://www.andersoneconomicgroup.com/Portals/0/upload/aAEG%20Tax%20Burden%20Study%204th%20Edition%20-%202013.pdf.

47 Scott Drenkard & Joseph Henchman, 2015 State Business Tax Climate Index (Oct. 28, 2014), http://taxfoundation.org/sites/taxfoundation.org/files/docs/TaxFoundation_2015_SBTCI.pdf.

Similarly, Nevada taxes the following business input goods that should be exempted from the sales tax:[48]

- Computer hardware purchased by a business for use in production,
- Purchase by hotels of complimentary amenities provided in guest rooms, and
- Supplies and equipment purchased by hotels.

Because these involve the sale of tangible personal property, they fall under the general umbrella of what is taxable in Nevada.[49] Either specific exemptions should be written for these transactions, or a broad sales tax exemption for business inputs should be enacted. A broad exemption would require voter approval, since it would not be considered an administrative change.

Taxation of Services

The Federation of Tax Administrators (FTA) periodically publishes a survey of services taxable under each state's sales tax, with the most recent data compiled in 2010. The data includes both business-to-business services (inputs, which should be exempted under a well-structured sales tax) and final consumer services.[50] The survey delineates 183 specific services, 60 of which are business inputs, 53 of which are final consumer services, and 70 that could be either, depending on the identity of the final purchaser.

As of 2010, Nevada taxes 22 of the 183 services enumerated in the FTA survey under the general sales tax and 6 of the services under other excise taxes (the Live Entertainment Tax or lodging and rooms taxes). Of the 22 that fall under the sales tax, at least 6 of those should be exempted, because they are business inputs.

Table 2, Table 3, and Table 4 summarize these FTA survey services. In a very broad, ideal sales tax base, all of the services outlined in Table 2 would be subjected to the sales tax. The services in Table 3 would remain exempted. However, since broadness of the sales tax is not the only consideration, certain services may be exempted for other reasons (such as regressivity). These include medical services and out-of-hospital nursing services.

48 Commerce Clearing House, *CCH Smart Charts, State Tax Smart Charts, Taxability of Specific Transactions: Computers: Computer Hardware and Hotels: Hotel Purchases: Supplies and Equipment.*
49 Nev. Rev. Stat. § 372.105.
50 Federation of Tax Administrators, *Actual Survey Data in Sales Taxation of Services* (Mar. 2010), http://www.taxadmin.org/fta/pub/services/services.html.

Table 2. Consumer Services Not Taxable Under Nevada's Sales Tax

Pet grooming	Personal instruction (*e.g.*, golf, tennis, and dancing)
Intrastate transportation of persons	Swimming pool cleaning and maintenance
Local (intra-city) buses	Personal tax return preparation
Household goods storage	Residential utilities
Fur storage	Tuxedo rental
Dating services	Water softening and conditioning
Debt counseling	Downloaded music, movies, and digital video
Dental services	Pari-mutuel racing
Diaper services	Amusement parks
Funeral services	Billiard parlors
Fishing and hunting guides	Bowling alleys
Gift and package wrapping	Circuses and fairs
Tailors and shoe repair	Coin operated video games
Health clubs	School and college sporting events
Tanning	Private club memberships
Laundry and dry cleaning	Cultural events admission
Medical services	Pinball and mechanical amusements
Massage	Professional sporting events
900 numbers	Home video and DVD rentals
Out-of-hospital nursing services	

Source: Federation of Tax Administrators.

Table 3. Business Input Services Exempted from Nevada's Sales Tax

Soil preparation, custom bailing, and other agricultural services	Process server fees
Mental, non-metal, and coal mining services	Public relations
Seismograph and geophysical services	Secretarial and court reporting services
Oil field services	Security services
Typesetting service and platemaking for print trade	Sign construction an installation
Gross income of construction contractors	Telemarketing on contract
Intra- or interstate courier services (air and land)	Telephone answering
Cold storage	Temporary help agencies
Marine towing	Test laboratories (excluding medical)
Packing and crating	Information services
Industrial utilities (telephone, cellular service, electricity, water, natural gas, and other fuel; sewer and refuse)	Data processing
Sale of advertising time or space (billboards, radio and television, newspapers, magazines)	Mainframe computer access and processing
Advertising agency fees (excluding ad placement, which is above)	Online data processing
Armored car services	Rental of films by theatres
Bail bond fees	Engineering services
Check and debt collection	Land surveying
Commercial art and graphic design	Medical test laboratories
Commercial linen supply	Bulldozers
Credit information and credit bureaus	Rental of hand tools by licensed contractors
Employment agencies	Custom fabrication labor
Maintenance and janitorial services	Labor for commercial fishing vessel repair
Consulting	Labor for railroad rolling stock repair
Marketing	Welding labor

Source: Federation of Tax Administrators.

Table 4. Services Exempted from Nevada's Sales Tax That Could Be Either Business Inputs or Consumer Services Depending on Final Purchaser

Veterinary services	Tire repair
Horse boarding and training	Window cleaning
Landscaping	Software (all types)
Carpentry, painting, and plumbing	Internet services providers
Construction service	Miscellaneous electronic downloaded goods
Water well drilling	Automotive washing and waxing
Taxis	Automotive road and towing service
Automotive storage	Parking lots and garages
Food storage	Cable and satellite TV
Fur storage	Accounting and bookkeeping services
Mini-storage	Architecture services
Marina service (docking, storage, cleaning, and repair)	Attorneys and legal services
Banking and other financial services (loan brokerage and financial reporting)	Automobile, limousine, and aircraft rental and lease
Insurance	Chartered flights
Investment counseling	Hotel, motel, and lodging services
Property sales and real estate agents	General repair labor
Real estate management fees (rental agents)	Repair on specific transactions (aircraft, inter- or intrastate vessels, motor vehicles, radio/TV or other electronic equipment, tangible personal property, remodeling, warranty repairs)
Real estate title abstract services	Service contracts
Carpet and upholstery cleaning	Installation charges
Interior design and decorating	Custom processing
Extermination	Custom meat slaughtering, cutting, and wrapping
Private investigation	General repair services

Source: Federation of Tax Administrators.

Shipping charges, restocking charges, banquet room rentals, travel agent services, and pest control are not outlined by FTA but are not taxable services in Nevada. These could also be business inputs or consumer services depending on the final purchaser.

Taxing these services requires a bit of creativity in administration to ensure that when purchased by consumers these service transactions are taxed, but when purchased by businesses they are not. One feasible option is to identify business taxpayers by using two existing taxes: the Modified Business Tax and the annual Business License Fee. When paying either of these taxes, a firm would be granted a business identification number registered with the Nevada Department of Taxation. The firm would then present this number upon purchase of any goods or services used in the production process and be exempted from paying sales tax on those purchases.

Nevada's Existing Sales Tax Exemptions

In November of 2014, the Nevada Department of Taxation released an exhaustive list of every tax expenditure that exists within the state—the first of its kind in Nevada. A tax expenditure is something that would have been taxed but was specifically exempted or abated, or a subtraction, credit, deduction, exclusion, or preferential tax rate was implemented to reduce or completely eliminate an entity or individual's tax liability. Included in the report were 41 sales tax expenditures responsible for at least $895.3 million in the 2013 fiscal year.[51] This value is a lower bound estimate, however, because the report was unable to provide monetary value estimates for 25 of the 41 sales tax expenditures.

51 Nevada Department of Taxation, *2013–2014 Tax Expenditure Report* at 8, http://tax.nv.gov/uploadedFiles/taxnvgov/Content/TaxLibrary/Tax_Expenditure_Report_2013-2014.pdf.

Not all of these expenditures are created equal. Three of the 41 sales tax expenditures were for economic development purposes: abatements for "business in certain areas of economic development,"[52] "eligible machinery or equipment used by certain new or expanded businesses,"[53] and "developers in a tourism improvement district."[54] An abatement is a direct reduction in the amount of tax owed. But these abatements should not be restricted to businesses in certain geographic areas or conducting specific activities. They should be available to all firms on an equal basis and should be converted to a tax exemption—that is, all business input purchases should be exempted from the sales tax entirely. But again, doing so would require voter approval.

Five of the sales tax expenditures are exemptions for transactions that can be classified as business inputs (aircraft and aircraft components,[55] containers,[56] farm machinery and equipment,[57] sales to a common carrier,[58] and net proceeds of mines[59]). These should not be framed as industry-specific tax benefits but instead as exemptions that prevent the sales taxation of business inputs and thus good tax policy.

Three of the 41 expenditures are exemptions that could be classified as business inputs or consumer purchases, depending on the identity of the final purchaser.[60] These should be added to the sales tax base in concert with a broad exemption for business inputs to ensure that when these are purchased by final consumers, they are taxed, but when they are purchased to be used as the part of a production process they are not taxed. Again, these require voter approval since they would change a constitutionally-protected tax base.

Eight expenditures are administrative provisions: a collection allowance that helps a firm cover the cost of collecting sales taxes,[61] an exemption for occasional sales (such as garage sales, where the cost of collecting sales tax would outweigh the tax revenue collected),[62] two exemptions for sales of property that will be shipped out of state (because sales taxes are levied based on point-of-destination, not point-of-origin),[63] an exemption to ensure that use tax is not paid on property in which sales tax was already paid,[64] a deduction for bad debts,[65] and two exemptions that prohibit retroactive sales tax from being levied on sales before the sales tax was enacted.[66] These should also remain in law.

Four expenditures exempt transactions involving government entities from the sales tax. These are common exemptions and prevent government entities from paying sales tax.[67]

The remaining eighteen expenditures carve away at the sales tax base, forcing the rate to be higher in order to raise the same revenue on a smaller base of transactions. Table 5 lists these expenditures.

52 *Id.* at 196.
53 *Id.* at 197.
54 *Id.* at 233.
55 *Id.* at 199.
56 *Id.* at 202.
57 *Id.* at 206.
58 *Id.* at 224.
59 *Id.* at 219.
60 Exemptions for domestic fuels, fuel used to propel a motor vehicle, and animals and plants intended for human consumption. *Id.* at 198, 204, 208.
61 *Id.* at 201.
62 *Id.* at 214.
63 *Id.* at 220-23.
64 *Id.* at 236.
65 *Id.* at 203.
66 *Id.* at 217-18.
67 These four exemptions are for "Loans or donations to United States, State, political subdivision or religious organization," "Sale of certain medical devices to governmental entities," "Sale to United States, state or political subdivision," and "Transfer of property and motor vehicles to the State of Nevada and its unincorporated agencies and instrumentalities." *Id.* at 210, 222, 225, 235.

Table 5. Existing Sales Tax Expenditures

Exemption for food for human consumption	Exemption for property sold to members of the Nevada National Guard on active duty and their families
Exemption for utilities (gas, electricity, and water)	Exemption for manufactured homes and mobile homes (repeal should occur in concert with adding sales tax to the purchase of site-built homes)
Exemption for personal property sold by or to nonprofit organizations created for religious, charitable, or education purposes	Exemption for meals and food products sold to students or teachers by school, organizations of students, or PTAs
Exemption for prosthetic devices, orthotic appliances, certain supports and casts, appliances, supplies relating to ostomy, and products for medicine and hemodialysis	Exemption for newspapers
Exemption for textbooks sold within the Nevada System of Higher Education (this provision was voter approved)	Partial abatement for renewable energy facilities
Subtraction for trade in allowances on the purchase of a motor vehicle (this provision was voter approved)	Exemption for broadcasting activities

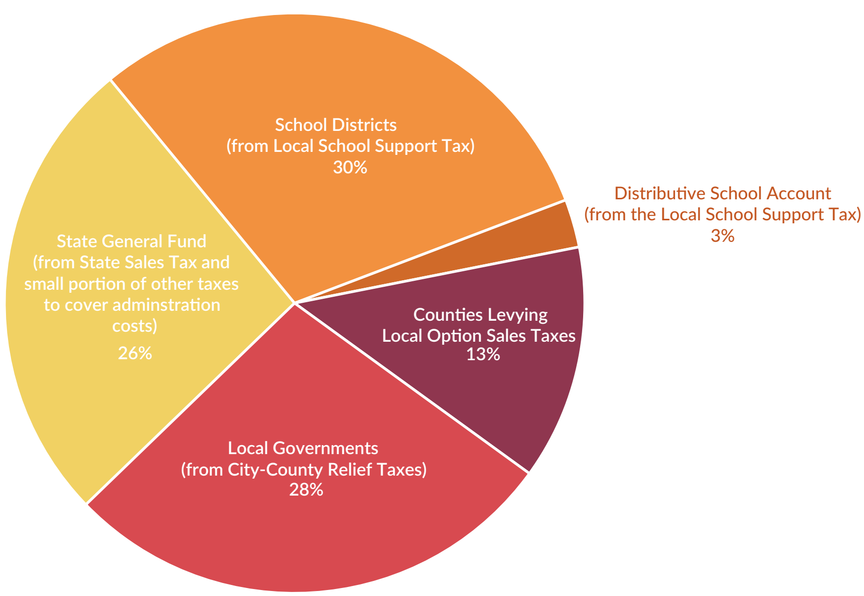
Source: Nevada Department of Taxation, *2013-2014 Tax Expenditure Report*.

Sales Tax Distribution

The majority of total state- and local-levied sales taxes collected in Nevada is distributed back to the local level (counties, cities, school districts, and special districts). In fact, 74 percent of total sales tax collections are distributed locally (in the form of state aid or collected directly by the local government), while 26 percent goes to the State General Fund. Figure 28 shows the distribution for total sales tax collections in the 2012 fiscal year.

Figure 28. Combined State & Local Sales Tax Distribution

Percent of Total Combined State & Local Sales Tax Collections, by Distribution (FY 2012)



Source: Nevada Legislative Council Bureau, *Revenue Reference Manual* (Jan. 2013 ed.).

Collections going to local governments are distributed among local entities in a variety of ways, including a statutory formula known as the Consolidated Tax, local option sales taxes, and the Local School Support Tax.

The Consolidated Tax

Of all the sales taxes collected in Nevada, 28 percent go directly to local governments' general funds and are distributed via the Consolidated Tax system. Also known as the C-Tax, the Consolidated Tax is a means of distributing the taxes collected under the Basic and Supplemental City-County Relief Taxes (in addition to four other taxes) among Nevada's local governments. In total, the C-Tax has six components that are distributed among local governments each month, which are outlined below. Note that for the taxes listed in (3), (4), and (5), only a small portion of the total taxes collected are distributed via the C-Tax.

1. the Basic City-County Relief Tax (a 0.5 percent subcomponent of the total state sales tax rate, as noted above);
2. the Supplemental City-County Relief Tax (another subcomponent of the total state sales tax rate, at 1.75 percent);
3. Real Property Transfer Taxes;
4. Cigarette and Other Tobacco Product Excise Taxes;
5. Liquor Excise Taxes; and
6. the Government Services Tax (a type of property tax levied on motor vehicles).

Revenues from these six components are deposited into what is known as the Local Government Tax Distribution Account, a fund created in 1997.[68] The statutory formula governing the distribution of Consolidated Tax revenues is a complicated, two-step distribution formula whereby C-Tax revenues are first distributed among Nevada's seventeen counties and then, in a second-tier distribution formula, are allocated within those counties to cities, towns, and special districts. The lion's share of Consolidated Tax revenue is made up of sales taxes (87 percent of total).[69]

Local Option Sales Taxes: Serving Several Purposes

As discussed previously in this section, Local Option Sales Taxes go to the counties in which they were levied to fund specific purposes. Option taxes comprise 13 percent of all sales taxes collected in Nevada.

School Districts via the Local School Support Tax

Education is by far the largest beneficiary from Nevada sales taxes. Recall that the state-levied sales tax of 6.85 percent includes a 2.6 percent Local School Support Tax (LSST). Collections from in-state businesses are distributed directly to the school districts in which they were collected. Collections from out-of-state businesses are placed in the Distributive School Account (which ultimately goes back to school districts). In total, these amount to 33 percent of all sales tax collections in the state.

68 Nevada Legislative Council Bureau, *Appendix C: History and Overview of the Local Government Tax Distribution Account*, in Allocation of Money Distributed From the Local Government Tax Distribution Account (Jan. 2013) at 59.

69 Nevada Department of Taxation, *Consolidated Tax Distribution* (Aug. 2014) at 5, http://tax.nv.gov/uploadedFiles/taxnvgov/Content/TaxLibrary/Consolidated_Tax_15.pdf.pdf.

Live Entertainment Tax

The Live Entertainment Tax (LET) is a state-level tax jointly administered by the Gaming Control Board and the Department of Taxation. Taxes collected at gaming establishments are administered by the Gaming Control Board, while taxes collected at non-gaming establishments are administered by the Department of Taxation.

Prior to the LET, which was enacted in the 2003 legislative session, Nevada had a similar tax that was known as the Casino Entertainment Tax (the CET), originally enacted in 1965.[70] The switch to the Live Entertainment Tax essentially broadened the base of the Casino Entertainment Tax.[71]

Tax Rate and Base

The LET is imposed on any facility with 200 or more seats where live entertainment is provided and admission is charged.[72] It is paid at the time of transaction on "all amounts paid for admission, food, refreshments, and merchandise"[73] while the establishment is "in casino entertainment status."[74] A different rate is paid based on maximum occupancy, as Table 6 shows.[75]

Table 6. Live Entertainment Tax Rate Structure

Rate	Maximum Occupancy
Exempt	Less than 200 and if the establishment has less than 51 slots, 6 table games, or any combination within the limits
10%	200 to 7,499
5%	7,500 or more

All receipts from the LET go to the State General Fund. In the 2012 fiscal year, the tax brought in $136.9 million—91.5 percent of which came from gaming establishments.[76]

Problems with the Live Entertainment Tax

The Live Entertainment Tax is structurally flawed. First, it is not neutral, encouraging consumers to change behavior. For example, a patron of an establishment in which live entertainment will be provided at 8:00 pm could purchase and enjoy food and drinks prior to the showtime to avoid the tax, rather than buying food and beverages in the entertainment venue.

Second, compliance is needlessly complex. If live entertainment is taking place in one part of an establishment and not in another part, patrons in the portion with entertainment would be required to pay the tax but those in the part without entertainment would not (even if the establishment is small).

70 Nevada Taxpayers Association, *Nevada Tax Facts* (2001) at 30.
71 Legislative Council Bureau, *Fiscal Analysis Division, Revenue Reference Manual* (Jan. 2013) at 51, https://www.leg.state.nv.us/Division/Fiscal/FinalRRM2013.pdf.
72 *See Annual Report*, *supra* note 2, at 38.
73 Legislative Council Bureau, Fiscal Analysis Division, *Revenue Reference Manual, Tax Revenue Summaries: Other Taxes and Fees* (Jan. 2013) at 73, https://www.leg.state.nv.us/Division/Fiscal/FinalRRM2013.pdf.
74 The Urban Institute & Price Waterhouse, *State Revenues and State and Local Debt*, in Fiscal Affairs of State and Local Governments in Nevada 12-26 (Nov. 1988).
75 Legislative Council Bureau, Fiscal Analysis Division, *Revenue Reference Manual, Tax Revenue Summaries: Other Taxes and Fees* (Jan. 2013) at 73, https://www.leg.state.nv.us/Division/Fiscal/FinalRRM2013.pdf.
76 *Id.*

Third, the tax is jointly adminstered by two departments at the state level, making adminstration costs duplicative and higher than they need to be.

Fourth, the definition of "live entertainment" used by the state is complicated and arbitrary. The following activities are "not considered as live entertainment":[77]

- "Instrumental or vocal music, which may or may not be supplemented with commentary by the musicians, in a restaurant, lounge or similar area if such music does not routinely rise to the volume that interferes with casual conversation and if such music would not generally cause patrons to watch as well as listen";
- "Occasional performances by employees whose primary job function is that of preparing, selling or serving food, refreshments or beverages to patrons, if such performances are not advertised as entertainment to the public";
- "Performances by performers of any type if the performance occurs in a licensed gaming
- establishment other than a licensed gaming establishment that is licensed for fewer than 51 slot machines, fewer than 6 games, or any combination of slot machines and games within those respective limits, as long as the performers stroll continuously throughout the facility";
- "Performances in areas other than in nightclubs, lounges, restaurants or showrooms, if the
- performances occur in a licensed gaming establishment other than a licensed gaming
- establishment that is licensed for fewer than 51 slot machines, fewer than 6 games, or any
- combination of slot machines and games within those respective limits, which enhance the
- theme of the establishment or attract patrons to the areas of the performances, as long as any seating provided in the immediate area of the performers is limited to seating at slot machines or gaming tables";
- "Television, radio, closed circuit or Internet broadcasts of live entertainment";
- "Entertainment provided by a patron or patrons, including, without limitation, singing by patrons or dancing by or between patrons";
- "Animal behaviors induced by animal trainers or caretakers primarily for the purpose of education and scientific research"; and
- "Occasional activities, including, without limitation, dancing, that do not constitute a performance, are not advertised as entertainment to the public, primarily serve to provide ambience to the facility; and are conducted by an employee whose primary job function is not that of an entertainer."

Finally, the LET is riddled with exemptions, resulting in a very narrow base. The following activites and events are exempted from the tax:[78]

- "Live entertainment that is provided by or entirely for the benefit of a nonprofit religious, charitable, fraternal or other organization that qualifies as a tax-exempt organization";
- Certain boxing constests or exhibitions;
- Establishments with occupancy lower than 200 people;
- "Merchandise sold outside the facility in which the live entertainment is provided, unless the purchase of the merchandise entitles the purchaser to admission to the entertainment";
- Live entertainment at a trade show;
- "Music performed by musicians who move constantly through the audience if no other form of live entertainment is afforded to the patrons";
- "Live entertainment that is provided at a licensed gaming establishment at private meetings

77 Legislative Council Bureau, Fiscal Analysis Division, *Revenue Reference Manual* (Jan. 2013) at 187, https://www.leg.state.nv.us/Division/Fiscal/FinalRRM2013.pdf.

78 *Id.* at 188-189.

or dinners attended by members of a particular organization or by a casual assemblage if the purpose of the event is not primarily for entertainment";

- "Live entertainment that is provided in the common area of a shopping mall, unless the
- entertainment is provided in a facility located within the mall";
- "Live entertainment that is incidental to an amusement ride, a motion simulator or a similar digital, electronic, mechanical or electromechanical attraction";
- "Live entertainment that is provided to the public in an outdoor area, without any requirements for the payment of an admission charge or the purchase of any food, refreshments or merchandise";
- "An outdoor concert, unless the concert is provided on the premises of a licensed gaming establishment";
- NASCAR's Nextel Cup Series, or its successor racing series, and all associated races;
- Minor league baseball games; and
- "Live entertainment provided in a restaurant which is incidental to any other activities conducted in the restaurant or which only serves as ambience so long as there is no charge to the patrons for that entertainment."

Notably, two large events that occur in Nevada each year, the Electric Daisy Carnival and Burning Man, are also exempted from the Live Entertainment Tax.

The LET exemptions are difficult to track, making periodic legislative review equally difficult. The Department of Taxation was unable to provide monetary estimates for any of the 30 LET expenditures outlined in the November 2014 Tax Expenditure Report.[79]

The same problems riddled the earlier Casino Entertainment Tax, and criticisms published in a 1998 Nevada tax study conducted by the Urban Institute still stand: Nevada should "reevaluate the advisability of imposing the casino [or similarly, the live] entertainment tax."[80]

The LET only generated 1.5 percent of total state and local tax collections in Nevada in the 2012 fiscal year (see Figure 20 at the beginning of Chapter 2). As such, its compliance and administrative issues, as well as the lack of neutrality and simplicity in the LET structure, should be regarded as prohibitively troublesome for such a comparatively small amount of tax revenue.

During the 2013 legislative session, legislation was introduced by Assembly Speaker Marilyn Kirkpatrick that would have replaced the LET with a "Nevada Entertainment and Amusement Tax," which essentially would have broadened the base of the LET to include other types of entertainment and would have changed the rate to 8 percent.[81] While this was an admirable attempt to fix a very broken tax, an even better option would be to repeal the LET entirely and include all admission charges under the sales tax base. All food, beverage, and merchandise sold at events that charge admission should instead be subject only to the sales tax. As the system is currently structured, all food, beverages, and merchandise sold at these events is double taxed—once under the state LET and also under sales taxes. A better alternative is only levying state and local sales taxes on these transactions.

79 Nevada Department of Taxation, *2013-2014 Tax Expenditure Report*, http://tax.nv.gov/uploadedFiles/taxnvgov/Content/TaxLibrary/Tax_Expenditure_Report_2013-2014.pdf.

80 The Urban Institute & Price Waterhouse, *State Revenues and State and Local Debt*, *in* Fiscal Affairs of State and Local Governments in Nevada 12-39 (Nov. 1988).

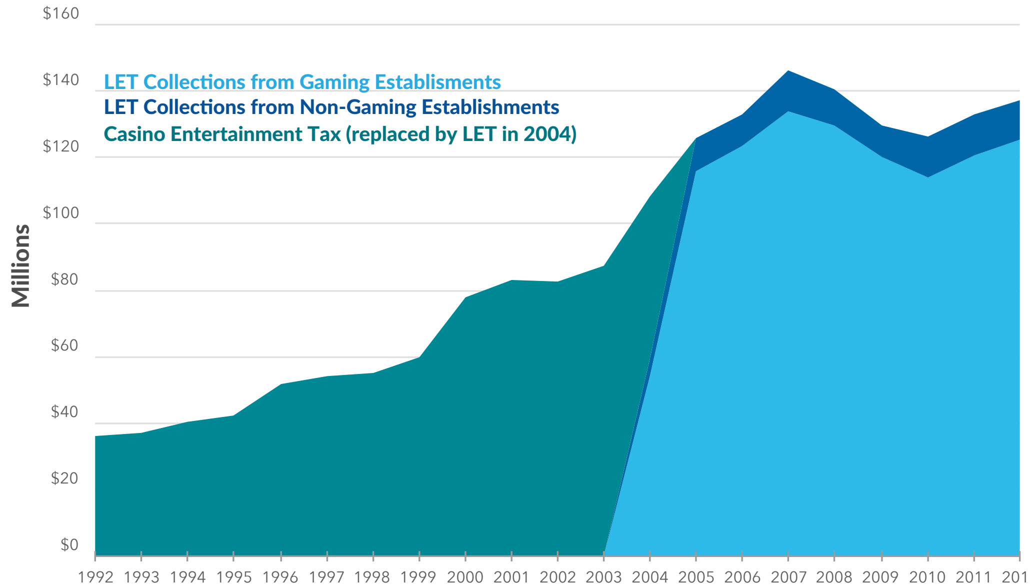
81 A.B. 498, 76th Gen. Assem., Reg. Sess. (Nev. 2013).

Live Entertainment Tax Collections

Prior to the enactment of the LET, Casino Entertainment Tax collections grew over the twelve year period before its repeal—from $36 million in 1992 to nearly $88 million in 2003. The Live Entertainment Tax raised $128 million during the first fiscal year in which it was in full effect. It has since grown even more, but collections have been volatile, especially during the most recent recession, as Figure 29 shows.

Figure 29. Total Live Entertainment Tax Collections

Combined State & Local (FY 1992–FY 2012, in 2012 Dollars)



Note: Dollar amounts are adjusted for inflation and expressed in 2012 dollars using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.
Source: Nevada Legislative Council Bureau, *Revenue Reference Manuals* (Jan. 1993–Jan. 2013).

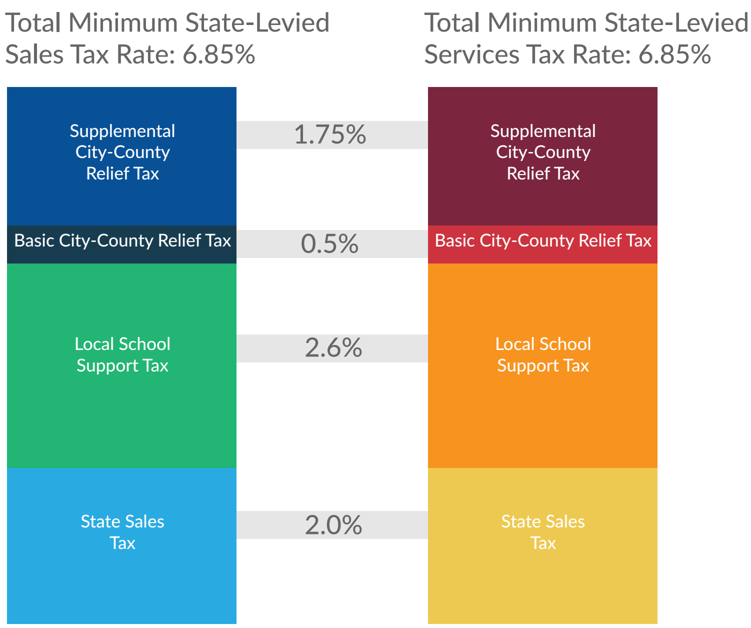
Solutions for Nevada's Sales Tax and Live Entertainment Tax

(1) Expand the sales tax base to services.

Since the 2 percent state sales tax is constitutionally protected, and the four additional sales tax components (Basic City-County Relief Tax, Supplemental City-County Relief Tax, Local School Support Tax, and Local Option Sales Taxes) are built upon this and use the same base, an expansion of the sales tax base requires a bit of creativity. There are two ways this expansion can be done.

First, a separate, parallel services tax could be created, in which the structure mirrors that of the sales tax (including the base and the five separate rates). Recall the state-levied sales tax breakdown (shown on the left side of Figure 30). Expanding the sales tax to services would create an identical services tax structure alongside the existing sales tax (shown on the right side of Figure 30).

Figure 30. Possible Sales Tax Base Expansion Structure



The base of the newly created State Services Tax, the Local School Services Tax, the Basic City-County Services Tax, and the Supplemental City-County Services Tax (and any Local Option Services Taxes, if applicable) would be identical in order to ease administrative and collection burdens. This would function operationally in the same way as expanding each of the individual sales tax components to include services in their bases. There would effectively be two taxes with identical bases: one that covers the sale of goods (the existing tax structure) and one that covers the sale of services. Essentially, there would be two tax bases for the Department of Taxation to consider but eight statutorily defined taxes. Since the State Sales Tax of 2 percent is not altered, this proposal appears to be constitutional.

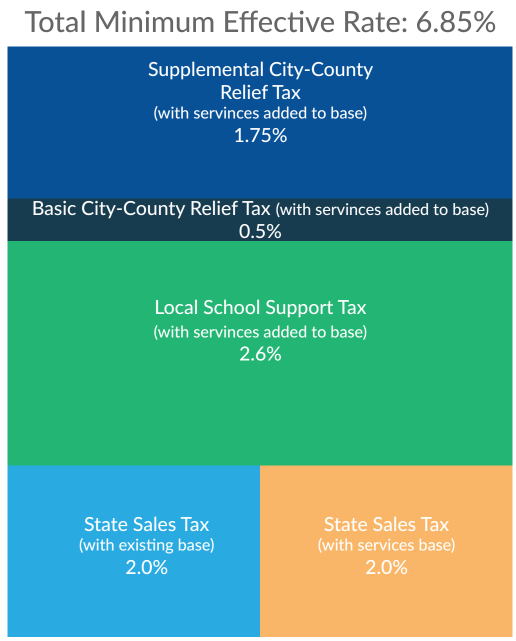
Further, the services tax structure would follow the same distribution as the sales tax: collections from the 2 percent State Services Tax would go to the State General Fund (SGF), collections from the 2.6 percent Local Services Tax would go to school districts (less a small portion to the SGF to cover costs), and collections from the City-County Services Taxes (0.5 percent and 1.75 percent, respectively) would be distributed via the Consolidated Tax (less a small portion to the state to cover costs). Collections from any Local Option Services Taxes would still go back to the counties in which they were levied.

The second way to expand the base would be to enact a 2 percent State Services Tax that would sit alongside the 2 percent State Sales Tax (effectively broadening the tax base to cover services without violating the constitutional protection of the State Sales Tax of 2 percent) in addition to simultaneously adding services to the bases of the Local School Support Tax, the Basic City-County Relief Tax, and the Supplemental City-County Relief Tax (and any Local Option Sales Taxes). The structure is shown in Figure 31.

Under this structure, there would be three tax bases for the Department of Taxation to consider but only five statutorily defined taxes. Again, since the State Sales Tax of 2 percent is not altered, constitutional conditions are satisfied.

Similar to the first option for base expansion, the distribution of collections from the Local School Support Tax, the Basic City-County Relief Tax, the Supplemental City-County Relief Tax, and any Local Option Sales Taxes would remain the same.

Figure 31. Another Possible Sales Tax Base Expansion Structure



The services to be considered for addition to the base via one of the two above options are outlined in Table 2 and Table 4 of this chapter. Table 7 outlines three options for base broadening, where the “small” option adds a few additional consumer services to the sales tax base, and the “large” option is the broadest, adding all final consumer services and ignoring all other concerns (such as regressivity). These options do not attempt to qualify the political considerations that are bound to accompany any discussion of base broadening. Portions of the existing sales tax base are also presented for reference.

Table 7. Sales Tax Base Expansion Options

(Please note that not all transactions listed below are included in all base-broadening options. See the "small," "medium," and "large" columns for specific inclusions in each expanded base.)

		Expanded Base Options (also includes current sales tax base items)		
Area of Expenditure	Current Base	Small	Medium	Large
Motor Vehicles and Parts	✔	✔	✔	✔
Furniture and Appliances	✔	✔	✔	✔
Electronics and Sports Items	✔	✔	✔	✔
Jewelry	✔	✔	✔	✔
Eyeglasses, Contact Lenses, and Therapeutic Items	✔	✔	✔	✔
Books and Other Media	✔	✔	✔	✔
Prepared Food & Beverage Purchases	✔	✔	✔	✔
Clothing and Footwear	✔	✔	✔	✔
Nonprescription Drugs	✔	✔	✔	✔
Prescription Drugs				✔
Recreational Items (Games, Toys, Pet Products, Plants)	✔	✔	✔	✔
Household Supplies	✔	✔	✔	✔
Personal Care Products	✔	✔	✔	✔
Tobacco	Subject to tobacco excise tax			
Periodicals		✔	✔	✔
Rental Housing				✔
Household Utilities & Communications Services				✔
Health Care Outpatient Services				✔
For-Profit Hospitals and Nursing Home Services				✔
Non-Profit Hospitals and Nursing Home Services				✔
Automobile Repair Services	✔	✔	✔	✔
Motor Vehicle Rental & Leasing	✔	✔	✔	✔
Membership Clubs		✔	✔	✔
Amusements		✔	✔	✔
Museum Admissions		✔	✔	✔
Photo Processing and Video Rental Services	✔	✔	✔	✔
Veterinary Services		✔	✔	✔
Accommodations	Subject to lodging tax			
Financial Service Charges, Fees, and Commissions			✔	✔
Investment Services			✔	✔
Trust, Fiduciary, & Custody Services			✔	✔
Day Care & Nursery Schools				✔
Higher Education Tuition & Expenses				✔
Elementary & Secondary Education Tuition & Expenses				✔
Legal Services			✔	✔
Accounting Services			✔	✔
Labor Organization Dues			✔	✔
Professional Association Dues			✔	✔
Funeral & Burial Services			✔	✔
Personal Care Services		✔	✔	✔
Dry Cleaning, Clothing Repair, & Shoe Repair Services		✔	✔	✔
Child Care Services				✔
Household Services (Moving, Repairs, Cleaning)		✔	✔	✔
Insurance	Subject to insurance taxes			
Gaming	Subject to gaming taxes			
Public Transportation				✔

Table 7. Sales Tax Base Expansion Options, *continued*

	Expanded Base Options (also includes current sales tax base items)		
State-Level Revenue Impact in Initial Year:	Small	Medium	Large
Adding additional transactions to sales tax base (excludes revenues from Local Option Sales Taxes and assumes existing state-levied rate of 6.85 percent with no Local School Support Tax rate increase sunset)	+$151.7 million	+$287.5 million	+$1.97 billion
Assuming state-levied rate drops to 6.5 percent due to the scheduled Local School Support Tax rate increase sunset	+$144.9 million	+$272.8 million	+$1.87 billion

(2) Lower 6.85 percent state-levied rate over time subject to revenue triggers.

Most sales tax rate reductions outlined below would only occur if predetermined revenue targets (often referred to as revenue triggers, because meeting a revenue target statutorily triggers an automatic rate reduction) are met. This satisfies concerns that rate cuts will result in revenue shortfalls.

A possible rate reduction could be structured as follows (in sequential order), paired with a sales tax base expansion to services:

(a) First, **cancel the scheduled sunset of the increased Local School Support Tax rate** (set to expire July 1, 2015, which would reduce the rate from 2.6 percent to 2.25 percent) effective immediately. Thus, rather than the total state-levied rate dropping to 6.5 percent on July 1, 2015, it would remain at 6.85 percent.

(b) Second, **reduce the total state-levied rate of 6.85 percent to 6.25 percent** over a number of years by lowering the rate of three of the four component parts. Recall that the total state-levied rate of 6.85 percent includes four subcomponents: the State Sales Tax of 2 percent (which is constitutionally protected), the Local School Support Tax (LSST) of 2.6 percent, the Basic City-County Relief Tax (BCCRT) of 0.5 percent, and the Supplemental City-County Relief Tax (SCCRT) of 1.75 percent. To lower the overall rate of 6.85 percent to 6.25 percent, the LSST, BCCRT, SCCRT would be reduced in equal proportion, as outlined below:

- Lower LSST from 2.6 percent to 2.278 percent
- Lower BCCRT from 0.5 percent to 0.438 percent
- Lower SCCRT from 1.75 percent to 1.534 percent

These changes would occur over a five-year period, beginning in FY 2018, subject to revenue triggers each year (and would thus be fully phased in during FY 2022). Each revenue trigger could be structured such that the year's sales tax rate reduction would only occur if state-levied sales tax collections had risen at least $100 million in the preceding fiscal year (or whatever dollar figure is preferred by lawmakers). Revenue triggers should be adjusted for inflation using the Consumer Price Index for All Urban Consumers (known as the "CPI-U") as published by the Bureau of Labor Statistics.

(c) Third, **reduce the total state-levied rate from 6.25 percent to 5.75 percent** by lowering the State Sales Tax rate of 2 percent. This change would be structured as follows. Contingent upon (b) above, reduce State Sales Tax from 2 percent to 1.5 percent via referendum in 2023, with provisions for further contingent relief in FY 2025 (outlined in (d) below).

(d) Fourth, **reduce the total state-levied rate from 5.75 percent to 5 percent** by again lowering the State Sales Tax rate from 1.5 percent to 0.75 percent. This change would be structured as follows. Contingent upon passage of (c) above and, subject to revenue triggers, the State Sales Tax would be automatically reduced from 1.5 percent to 0.75 percent via contingent authorization language in the 2023 referendum (described in (c) above).

If further rate reductions are desired, they could be paired with a larger broadening of the sales tax base (consistent with our moderate or large base expansion proposals, which are outlined in Table 7). These revenue triggers could be set to be revenue neutral or revenue positive.

State-Level Revenue Impact in Initial Year (without rate reductions):

With existing sales tax base:	+$185.8 million
With small sales tax base expansion:	+$193.6 million
With medium sales tax base expansion:	+$208.3 million
With large sales tax base expansion:	+$309.0 million

Note: The only portion of (2) that would occur in initial year is the cancellation of the LSST rate increase sunset (that is, keeping the total state-levied rate at 6.85 percent rather than letting it drop to 6.5 percent).

(3) Exempt manufacturing machinery from the sales tax base.

Machinery used in manufacturing is only taxable in nine other states and the District of Columbia. Since 2008, six states have repealed the tax,[82] because taxes on manufacturing machinery constitute a tax on business inputs, which tends to pyramid. Sales taxes should be assessed on final purchases, not business inputs; otherwise, the consumer ultimately pays several layers of taxes on the same product. By exempting manufacturing machinery in conjunction with a general broadening of the sales tax base, Nevada can eliminate an economically destructive feature in the sales tax. This would require voter approval.

State-Level Revenue Impact in Initial Year:[83]

At existing 6.85 percent state-levied sales tax rate:	-$32.8 million
At 6.5 percent state-levied sales tax rate (allowing LSST to sunset on July 1, 2015):	-$31.1 million

82 *See* Scott Drenkard & Joseph Henchman, *2015 State Business Tax Climate Index* (Oct. 28, 2014), http://taxfoundation.org/sites/taxfoundation.org/files/docs/TaxFoundation_2015_SBTCI.pdf; Joseph Henchman, *Economic Growth Requires Bold Steps: Mississippi Should Consider Tax Reform Recommendations*, Tax Foundation Tax Policy Blog, July 18, 2008, http://taxfoundation.org/article/economic-growth-requires-bold-steps-mississippi-should-consider-tax-reform-recommendations; Joseph Henchman, *The Right Prescription for Mississippi*, Tax Foundation Fiscal Fact No. 139 (Aug. 19, 2008), http://taxfoundation.org/article/right-prescription-mississippi.

83 Machinery manufacturing taxable sales were $479,204,480 in FY 2014. *See* Nevada Department of Taxation, *Combined Sales & Use Statistical Report* (Aug. 25, 2014) at 54, http://tax.nv.gov/uploadedFiles/taxnvgov/Content/TaxLibrary/SUT_Stat_Jun_14(1).pdf.

(4) Provide an exemption from the sales tax for all business input goods and services.

Just as purchases by nonprofit organizations can be exempted from the sales tax by producing an authorized identification number, businesses should receive a number, registered with the Department of Taxation, which exempts them from the sales tax base, provided that they are paying either the Modified Business Tax or the Business License Fee. The purpose of such an exemption is not to grant special treatment to the business community but to avoid double and triple taxation that gets baked into the price of the final product. However, though ideally all inputs should be exempted, this would require voter approval and would be very costly.

However whereas some goods and services are clearly intended for final purchasers and others are clearly business-to-business transactions, whether some goods and services are consumer goods or business inputs is dependent upon the identity of the purchaser. Software, for instance, is a consumer good when purchased by an end user, but a business input when a company purchases a corporate license. The simplest and most reliable way to address this conundrum is to exempt such purchases when made by bona fide businesses, as established by their payment of business taxes.

State-Level Revenue Impact in Initial Year:

At existing 6.85 percent state-levied sales tax rate:	-$957.8 million
At 6.5 percent state-levied sales tax rate (allowing LSST to sunset on July 1, 2015):	-$908.6 million

(5) Repeal the Live Entertainment Tax.

Complex, costly to administer, and open to substantial evasion, the Live Entertainment Tax has all the hallmarks of bad tax policy. Given its byzantine structure and myriad exemptions, it keeps taxes artificially low on some forms of entertainment, resulting in high taxes on the resulting narrow base.

By repealing the Live Entertainment Tax and including admissions in the sales tax base, the state could collect revenue from many events currently exempted and would collect a modestly higher rate on venues with high maximum occupancy, which currently enjoy a preferential tax rate of 5 percent. Unusually, the current tax falls more heavily on modestly sized venues than large ones, a regressive feature that would be eliminated with inclusion in the sales tax base. All food, beverages, and merchandise sold at events that charge admission should also only be subject to the sales tax.

State-Level Revenue Impact in Initial Year:

Repeal of Live Entertainment Tax	-$151.9 million

Note: This does not include the interaction with adding certain transactions to the sales tax base.

Summary of Sales and Live Entertainment Tax Reform Solutions

Tax reform options for the Sales Tax and Live Entertainment Tax are summarized in Table 8.

Table 8. Summary of Sales Tax and Live Entertainment Tax Reform Solutions

	Recommendation	Initial Year State-Level Revenue Impact
(1)	**Expand the sales tax base to final consumer services**	
	Small base expansion	+$151.7 million
	Medium base expansion	+$287.5 million
	Large base expansion	+$1,972 million
(2)	**Repeal Local School Support tax temporary rate increase sunset** (this is the only portion of (2) that would be effective in initial year)	
	Assuming current sales tax base	+$185.8 million
	Current sales tax base plus small base expansion	+$193.6 million
	Current sales tax base plus medium base expansion	+$208.3 million
	Current sales tax base plus large base expansion	+$309.0 million
(3)	**Exempt manufacturing machinery from the sales tax base**	-$32.8 million
(4)	**Provide an exemption from the sales tax for all business input goods and services**	-$957.6 million
(5)	**Repeal Live Entertainment Tax**	-$151.9 million

Chapter 4

Business Taxes

Introduction

Nevada has a competitive business tax climate due to its lack of a corporate income tax, a gross receipts tax, or a margin tax. By avoiding these distortionary taxes, Nevada also avoids the heavy tax burdens on productive activity that can limit growth. Instead, Nevada levies a unique broad-based business tax—the payroll tax, formally known as the Modified Business Tax (MBT). This tax has the advantage of simplicity and ease of compliance. Nevertheless, the tax's current structure is not neutral, leaving several opportunities for improvement. Large exemptions create a narrow base, and a higher rate on financial institutions is non-neutral and inequitable.

Several other of Nevada's business taxes deserve attention, including one that singles out one industry—the Bank Branch Excise Tax, levied on banks with more than one branch in the state. Such a tax on one industry is also inequitable and non-neutral while raising a miniscule amount of revenue. Nevada's Business License Fee structure also presents reform opportunities.

Summary of Business Tax Reform Solutions (Reform Option C):

(1) Repeal the separate Modified Business Tax rate for financial institutions while adjusting the Modified Business Tax rate for general businesses.
(2) Repeal the $85,000 Modified Business Tax exemption for general businesses.
(3) Repeal the Bank Branch Excise Tax.
(4) Increase Business License Fees while creating graduated fee structure.

Modified Business Tax

General Modified Business Tax Structure

First implemented in 2003,[84] Nevada's Modified Business Tax (MBT) is a payroll tax levied on all businesses and persons in the state that are required to pay the unemployment insurance tax. The MBT, which is collected quarterly, has a standard rate of 1.17 percent on the sum of all taxable wages above $85,000 per quarter after deducting the cost of employee health insurance, with a higher rate of 2 percent for financial institutions.

The state offers a partial MBT abatement to qualifying new businesses during their first four years of operation, but the incentive is small, amounting to a mere $415,058 in the 2014 fiscal year.[85]

The MBT is unique; no other state imposes a similar tax. It is generally praised for its stability as well as its simplicity, because liability is easily calculated based on information already readily available to payers. Due to its ease of calculation, firms can easily predict what future tax liabilities will be—not the case for corporate income taxes, gross receipts taxes, or margin taxes.

Though its chief weakness is that, as a payroll tax, it falls more heavily on labor-intensive businesses than capital-intensive businesses, this is not enough to outweigh the benefits of the tax's overall structure. It could, however, be improved; potential reforms are simple and have the potential to bring in additional revenue.

84 Nevada Taxpayers Association, *Nevada Tax Facts* (2013–2014 ed.) at 4-5 [hereinafter *Tax Facts*].
85 Nevada Department of Taxation, *2013-2014 Tax Expenditure Report* at 80, http://tax.nv.gov/uploadedFiles/taxnvgov/Content/TaxLibrary/Tax_Expenditure_Report_2013-2014.pdf.

Modified Business Tax History

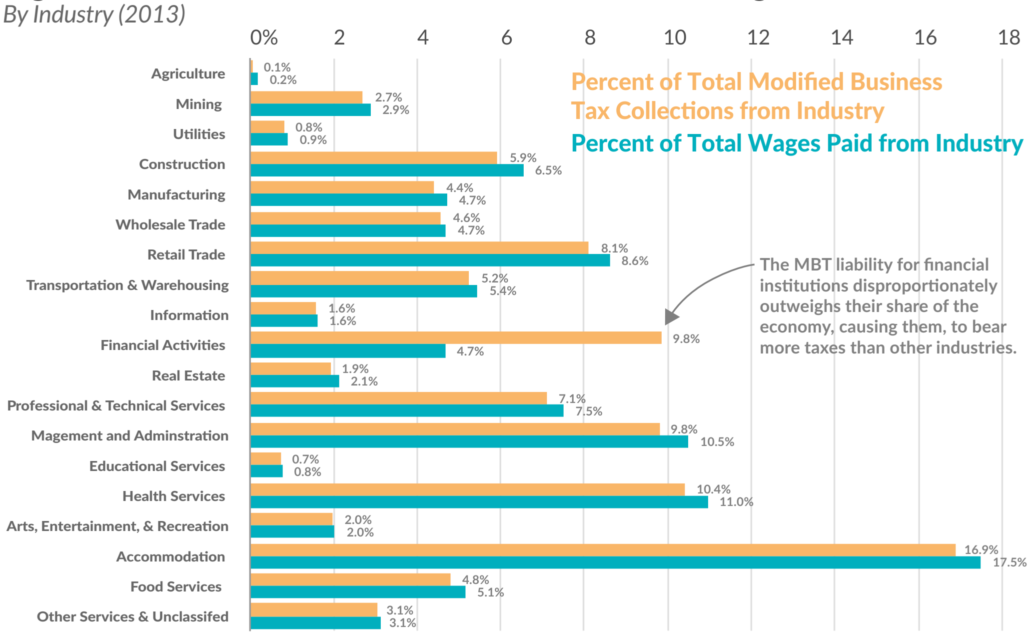
While the rate on financial institutions has been at 2 percent from the beginning, the general business rate has been changed several times in the tax's short ten-year existence. The rate began at 0.70 percent but now sits at 1.17 percent. The MBT's existing general business rate of 1.17 percent was the product of a temporary increase set to sunset on June 30, 2015, at which time it is scheduled to revert to 0.63 percent. A sunset was originally scheduled for 2011 but has been twice delayed.[86]

Taxing the Financial Sector More Heavily

Unique among businesses subject to the tax, financial institutions pay a rate of 2 percent on gross wages less employer health insurance contributions. The MBT on financial institutions differs from the MBT on general business in two ways: the rate is higher and there is no exemption level for the financial institution MBT.[87]

Figure 32 shows each sector's estimated share of modified business tax collections in addition to each sector's share of total state wages. The MBT generally does a reasonably good job of mirroring the structure of the Nevada economy, with smaller sectors (based on total wages) paying a smaller share of the tax. The exception, however, is the finance industry, where the share of total MBT payments is more than twice the financial sector's share of the economy. The disproportionate share borne by the finance industry is inequitable and non-neutral and should be corrected. There is no economic rationale for singling out one industry with a higher rate.

Figure 32. Modified Business Tax Share vs. Total Wage Share
By Industry (2013)



Source: Applied Analysis, *The Fiscal and Economic Impacts of Nevada Ballot Question #3* (Feb. 2014); Bureau of Economic Analysis, *Regional Economic Accounts (State Annual Personal Income), Wages and Salaries by NAICS Industry*, (2013).
Note: The Applied Analysis Margin Tax Study includes estimates of Modified Business Tax liability by sector.

86 *See Tax Facts*, *supra* note 1, at 4.
87 *Id.* at 5.

Modified Business Tax Base

The MBT base has become smaller and smaller over time, forcing lawmakers to turn to rate increases to make up for lost revenue. When originally enacted, the general business rate was 0.70 percent with no exemption other than a deduction for employer-provided health insurance. In 2005, that rate dropped to 0.63 percent. In 2007, the MBT on general business adopted a graduated structure, with a tax of 0.5 percent on quarterly gross wages up to $62,500 and 1.17 percent above that. In 2011 the tax was again modified to eliminate the graduated structure, resulting in one rate of 1.17 percent and a quarterly exemption level of $62,500 in wages. In 2013, the exemption threshold was increased to $85,000.[88]

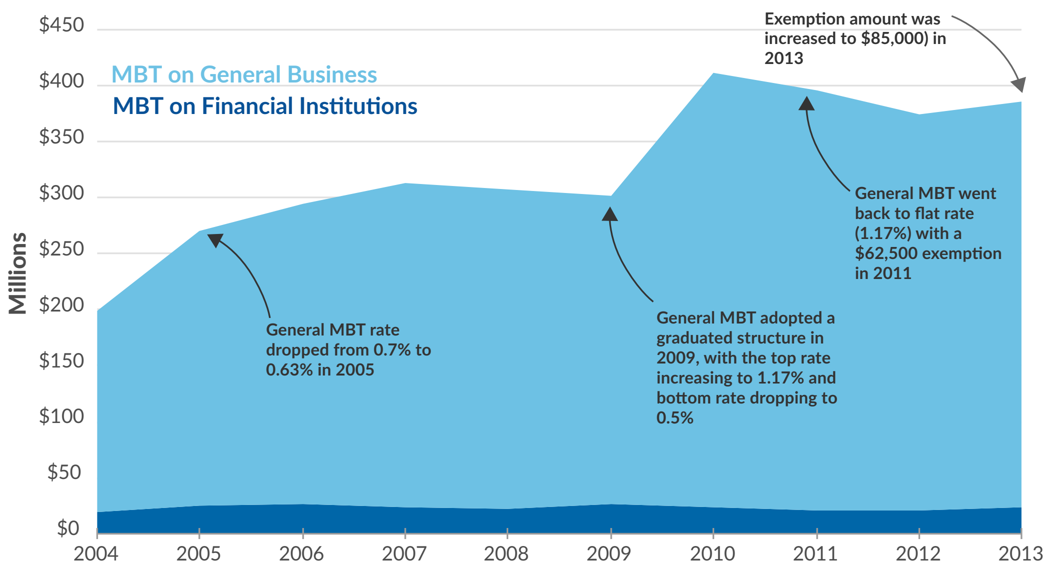
This $85,000 exemption carves out a large number of firms from the tax base, forcing other firms to make up the difference. The MBT has the potential to be a simple, neutral, fair, and broad-based business tax, but this large exemption is counterproductive to that goal.

Modified Business Tax Collections and Distribution

The Modified Business Tax raised $369.7 million in the 2012 fiscal year, with 94.4 percent of that coming from general businesses, compared to only 5.6 percent from financial institutions. Proceeds from the MBT are deposited into the State General Fund (SGF).[89] The MBT on general businesses and financial institutions combined made up only 4.1 percent of total state and local tax revenues in Nevada in the 2012 fiscal year and is projected to comprise 12.2 percent of the State General Fund in the current biennium.[90] Figure 33 shows MBT collections since the tax's inception in 2003.

Figure 33. Modified Business Tax Collections

General Business vs. Financial Institutions (FY 2004–2013, in 2013 Dollars)



Note: Dollar amounts are adjusted for inflation and expressed in 2012 dollars using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.
Source: Nevada Legislative Council Bureau, *Revenue Reference Manuals* (Jan. 1993–Jan. 2013).

88 *See Tax Facts*, *supra* note 1, at 12.
89 Nevada Legislative Council Bureau, *Revenue Reference Manual* (Jan. 2013 ed.).
90 *Id.*

Solutions for Nevada's Modified Business Tax

The Modified Business Tax has the potential to be a good, well-structured, neutral tax—but not in its current state. It has the benefit of being easy to calculate and predict; several business leaders we met with during research for this publication noted that they appreciated that they could "calculate it on the back of a napkin" and that it was relatively simple to accurately estimate what their tax liability would be now and each year in the future. However, there are several features of the tax that should be reformed.

(1) Repeal separate Modified Business Tax rate for financial institutions while adjusting the Modified Business Tax rate for general businesses.

The Modified Business Tax should treat all firms equally regardless of their industry. Singling out financial institutions and forcing them to pay a higher tax rate is non-neutral and inequitable—something that lawmakers should strive to avoid when designing a tax system.

Several options exist when choosing an MBT rate:

(a) Tax all types of firms at the existing financial institution rate of 2 percent.
(b) Tax all types of firms at the existing general business rate of 1.17 percent.
(c) Tax all types of firms at a rate of 1 percent.
(d) Create a graduated rate structure where different wage levels are taxed at different rates. For example, rates could be structured as follows: tax wages up to $100,000 at a rate of 0.5 percent, tax wages above $100,000 and up to $500,000 at a rate of 1.0 percent, and tax wages above $500,000 at 1.5 percent.

(2) Repeal $85,000 Modified Business Tax exemption for general business.

The exemption level of $85,000 exempts many firms, carving away at the base and causing the rate on all other firms to be higher to make up the loss. Instead, the MBT could be a broad-based business payroll tax that all firms pay. This would allow the rate to be reduced, making the tax less distortionary overall. Or, if revenue enhancement is desirable, this base expansion could bring in additional tax collections when coupled with the higher rate.

Summary of Modified Business Tax Reform Solutions

Table 9 outlines several reform option combinations in addition to estimating initial year revenue impact.

Table 9. Summary of Modified Business Tax Solutions Options and Revenue Impact

		Initial Year Revenue Impact
MBT Option (a)		
Eliminate $85,000 exemption for non-financial institutions		+$89.4 million
Eliminate separate rate for financial institutions		+$319.2 million
Tax all firm types at a rate of 2 percent		
	TOTAL	+$408.6 million
MBT Option (b)		
Eliminate $85,000 exemption for non-financial institutions		+$89.4 million
Eliminate separate rate for financial institutions		-$5.7 million
Tax all firm types at a rate of 1.17 percent		
	TOTAL	+$83.7 million
MBT Option (c) (Revenue Neutral)		
Eliminate $85,000 exemption for non-financial institutions		+$89.4 million
Eliminate separate rate for financial institutions		-$72.3 million
Tax all firm types at a rate of 1 percent		
	TOTAL	+$5.7 million
MBT Option (d)		
Eliminate $85,000 exemption for non-financial institutions		+$89.4 million
Eliminate separate rate for financial institutions		Unknown, but revenue positive
Create graduated rate structure		
	TOTAL	Unknown, but revenue positive

Note: Baseline is existing rate structure (separate rates for general business and financial institutions) with all existing exemptions. Revenue impact estimates assume fiscal 2014 values for gross wages and deductions.

Bank Branch Excise Tax

The bank branch excise tax is a quarterly excise tax levied on banks with more than one branch at a rate of $1,750 per branch. Banks with a single branch are exempt, and those with more than one branch have an exemption for one per county.[91] The tax was originally implemented in 2004 and raised a paltry $3.05 million in fiscal year 2012.

Already resented by banks as punitive, the tax offers little revenue potential to the state and violates the principle of neutrality, targeting one industry with a quarterly excise above and beyond the already-heightened MBT paid by banks due to their status as financial institutions. By assessing a fee on branches, moreover, this excise tax penalizes brick-and-mortar banks located within the state's borders relative to online and out-of-state banking institutions. It is a tax with scant benefit or justification.

State-Level Revenue Impact in Initial Year:

Repeal of the Bank Branch Excise Tax	**-$3.05 million**

91 Nevada Department of Taxation, *Annual Report Fiscal 2012–2013* (2014) at 39, http://tax.nv.gov/uploadedFiles/taxnvgov/Content/TaxLibrary/AnnualReport_FY13_final.pdf.

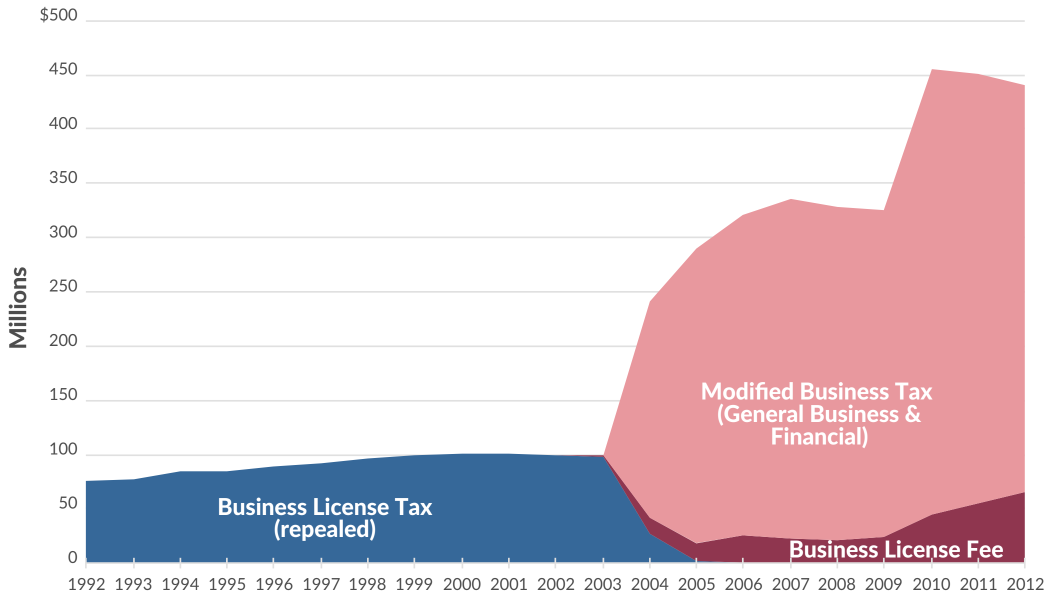
Business License Fees

Nevada's General License Fee Structure and Collections

At $200 per year, business license fees in Nevada are already relatively high, though they are rendered considerably less onerous by the absence of a corporate income tax or gross receipts tax. Gradually replacing a Business License Tax that peaked at an inflation-adjusted $100.8 million in revenues in 2000, Business License Fee revenue has grown steadily since 2009, to $64.8 million in fiscal year 2012. Revenues should maintain an upward trajectory, as over 303,000 businesses filed in Nevada in the past year, and the number continues to rise.[92] Figure 34 shows business license collections over time.

Figure 34. Business License Collections

Business License Tax vs. License Fee (FY 1992–2012, in 2012 Dollars)



Note: Dollar amounts are adjusted for inflation and expressed in 2012 dollars using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.
Source: Nevada Legislative Council Bureau, *Revenue Reference Manuals* (Jan. 1993–Jan. 2013).

Other States' License Fees

All but three states require businesses to pay some form of annual business license fee, or a similar fee associated with the filing of annual reports, but Nevada is one of only five states—along with Indiana, Kansas, Kentucky, and New Jersey—that levies the annual fee on sole proprietors. Nevada's fee is high compared to most states, though unlike some of its peers, Nevada does not assess occupation- or industry-specific business fees (separate of professional licensure application fees, *e.g.*, licensure as a professional engineer).

The burden of a comparatively high business license fee in Nevada is offset by the relatively modest level of business taxation in the state generally. In other states, general business license fees, where they exist, typically range from $15 to $50, though annual report filing fees range from $20 to $120.

Nevada law requires that all persons and entities doing business in the state obtain a license annually, though there are automatic exemptions for nonprofits and corporations sole (which hold title to

92 Nevada Secretary of State, *Quarterly Economic & Business Activity Report* (Q2 2014).

property for religious organizations), as well as for landlords with four or fewer dwelling units, licensed insurance companies, individuals operating home businesses with net earnings of two-thirds of the average annual wage or less, and film production companies.

In addition to the $200 business license fee, the state also imposes an annual list filing fee for stock corporations (a franchise tax in all but name), ranging from $125 per year for small stock corporations to $11,100 for corporations with more than $20.5 million in authorized stock. A corporation with $1 million in authorized stock pays $375 per year.[93]

By way of comparison, California stock corporations only pay a $25 fee associated with the filing of their biennial "statement of information," with no other annual filing or general business license requirements (though the state does have above average professional licensure fees), while limited liability corporations pay a $20 biennial fee.[94]

Among other neighboring states, Arizona imposes a $45 annual report fee on corporations, with no fee for LLCs. Local governments, however, are permitted to impose annual license fees; the city of Scottsdale, for instance, imposes an annual fee of $50–200 (depending on the number of employees) in addition to transaction privilege and use tax license of $50 a year.[95] Oregon and Utah impose modest annual fees, and Idaho does not impose any annual fees.

Table 10. Nevada Business License and Annual List Fees by Corporation Size

(in authorized stock issue)

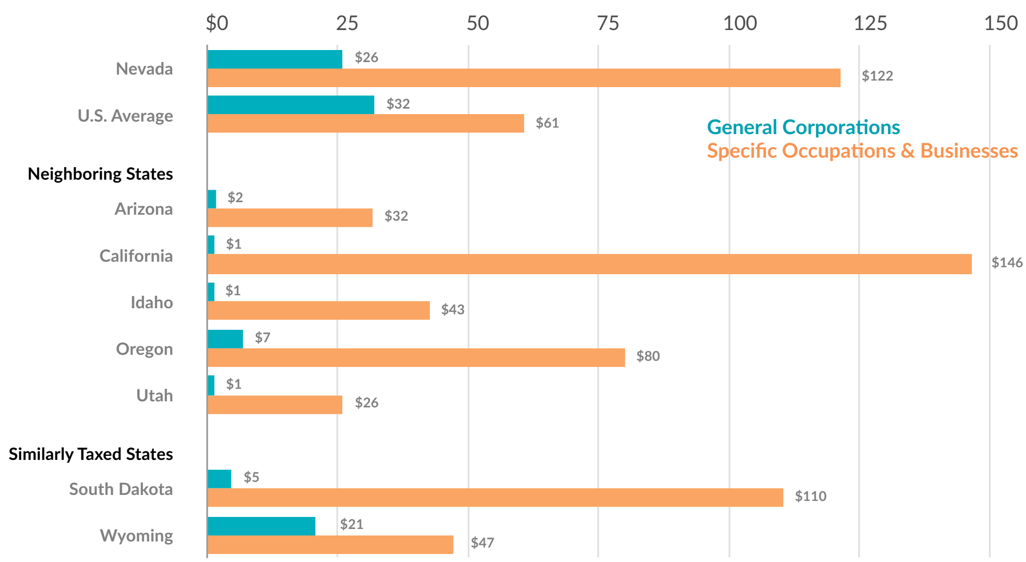
Authorized Issue	Annual Fees (a)
Pass-through (b)	$200
$75,000	$325
$500,000	$475
$1 Million	$575
$10 Million	$5,525
$25 Million	$11,300

(a) Business license fee plus annual list filing fee.
(b) Pass-throughs do not pay an annual list fee, only the annual business license fee.

Table 10 illustrates Nevada's combined business license and annual filing fee requirements for businesses of various sizes (in stock authorizations).

Figure 35. License Tax Collections Per Capita

Combined State & Local, Selected States (2011)



Note: Includes two Census license tax categories: "Corporations in General" and "Occupation and Business Not Elsewhere Classified."
Source: Census Bureau, *State and Local Government Finance.*

93 Nevada Secretary of State, *Annual List Fee Schedule, For Profit Corporations*, http://nvsos.gov/Modules/ShowDocument.aspx?documentid=1042.

94 California Secretary of State, Business Programs Division, *Statements of Information*, http://www.sos.ca.gov/business/be/statements.htm.

95 City of Scottsdale, Arizona, *Transaction Privilege (Sales) & Use Tax License*, http://www.scottsdaleaz.gov/Page3829.aspx.

Figure 35 shows license tax collections per person, as estimated by the Census Bureau, for Nevada, neighboring states, and other similarly taxed states (those without a corporate income tax or a gross receipts tax). Also included is the U.S. average.

Collections per person for general corporations tend to be smaller than those for specific occupations and businesses. Nevada license collections (both categories) are higher than the two other states without traditional business taxes (South Dakota and Wyoming, both of which do not have corporate income taxes or gross receipts taxes). Nevada's collections also tend to be more than neighboring states', with the exception of California. When license tax collections are examined from a national perspective, Delaware's general corporation and specific occupation license collections are by far the highest at $704 and $361 per capita, respectively (not pictured in Figure 35).

Despite comparing unfavorably to the business license and annual reporting fees of surrounding states, Nevada remains an attractive destination for businesses due to other, more favorable elements of its tax structure. It is worth noting that Delaware still remains a highly popular destination for incorporation despite hefty franchise taxes.[96]

In addition to Delaware, Wyoming, and North Dakota are also desirable incorporation states. Raising Nevada's license fees remains one option for revenue generation, but legislators must bear comparisons with competing states in mind.

Solutions for Nevada's Business License Fee

If necessary, Nevada could raise additional revenues by graduating the Business License Fee. An additional $100 per year on businesses with 20–99 employees (for a total annual fee of $300) and an additional $200 a year for those with 100 or more employees (for a total annual fee of $400) could generate an additional $14 million per year.[97] However, Nevada already has the potential for a broad-based business tax in the MBT, which would be a superior vehicle for revenue generation.

State-Level Revenue Impact in Initial Year:

Graduating the Business License Fee	+$14 million

96 Delaware Division of Corporations, *How to Calculate Franchise Taxes*, http://corp.delaware.gov/frtaxcalc.shtml.
97 Estimates made using the U.S. Census Bureau's *Statistics of U.S. Business.*

Summary of Business Tax Reform Solutions

Tax reform options for the Modified Business Tax, the Bank Brank Excise Tax, and Business License Fees are:

(1) Repeal the separate Modified Business Tax rate for financial institutions while adjusting Modified Business Tax rate for general businesses.

(2) Repeal the $85,000 Modified Business Tax exemption for general businesses

Initial year revenue impact estimates for Options (1) and (2) are outlined in Table 11 (identical to Table 9 but reproduced here for reference).

Table 11. Summary of Modified Business Tax Reform Solutions and Revenue Impact

		Initial Year Revenue Impact
MBT Option (a)		
Eliminate $85,000 exemption for non-financial institutions		+$89.4 million
Eliminate separate rate for financial institutions		+$319.2 million
Tax all firm types at a rate of 2 percent		
	TOTAL	+$408.6 million
MBT Option (b)		
Eliminate $85,000 exemption for non-financial institutions		+$89.4 million
Eliminate separate rate for financial institutions		-$5.7 million
Tax all firm types at a rate of 1.17 percent		
	TOTAL	+$83.7 million
MBT Option (c) (revenue neutral)		
Eliminate $85,000 exemption for non-financial institutions		+$89.4 million
Eliminate separate rate for financial institutions		-$72.3 million
Tax all firm types at a rate of 1 percent		
	TOTAL	+$5.7 million
MBT Option (d)		
Eliminate $85,000 exemption for non-financial institutions		+$89.4 million
Eliminate separate rate for financial institutions		Unknown, but revenue positive
Created graduated rate structure		
	TOTAL	Unknown, but revenue positive

(3) Repeal the Bank Branch Excise Tax
Initial Year Revenue Impact -$3.05 million

(4) Increase Business License Fees while creating graduated fee structure
Initial Year Revenue Impact +$14 million

Chapter 5

Property Taxes

Introduction

Nevada relies on property taxation to fund local governments, including school districts, and for the state's bond debt redemption.[98] However, Nevada's property tax system values property differently from all others in the United States. Unique features include a depreciation factor and a "ratchet" effect in the property tax cap that has presented challenges for local governments. Although the concerns that prompted these features remain valid, the resulting system is cumbersome, convoluted, and unstable, especially in the wake of a recession.

Summary of Property Tax Solutions (Reform Option D):

(1) Change the assessment method from replacement cost to market value, in addition to eliminating the depreciation factor.
(2) Adjust and reform tax caps.
(3) Enact a "circuit breaker" for elderly and low-income homeowners.

General Property Tax Calculation

When calculating property taxes, officials first assess the value of a property. In some states, including Nevada, only a percentage of this **assessed value** is then taxable. Multiplying the assessed value by this percentage (in Nevada, 35 percent) equals taxable value. This value is then multiplied by the **tax rate** (which is usually expressed as a certain number of dollars and cents per $100 of assessed value) to equal property tax liability owed by the property owner. State and local governments often grant property tax abatements, credits, or administer other programs that will reduce a property owner's gross tax liability. Subtracting out any of these programs gives the net property tax liability on the property. Expressing the final net property tax liability as a portion of the property's market value gives the property's **effective tax rate**. Table 12 demonstrates this formula.

Table 12. General Property Tax Calculation Formula
(with hypothetical example)

Market Value			$200,000
x	Assessment Percentage	x	100%
=	Taxable Value	=	$200,000
x	Property Tax Rate	x	0.01
=	Gross Property Tax Liability	=	$2,000
-	Any Abatements or Credits	-	$500
=	Net Property Tax Liability	=	$1,500
Effective Tax Rate			
	(Net Liability / Market Value)	=	0.75%

Assessing the Value of Property

Unlike most states that begin with cash market value—the value the property would sell for at this present time—Nevada since 1981 has taxed land based on cash market value but improvements based on replacement cost minus depreciation set by state law. **Replacement cost** is how much the property costs to replace if it were lost or destroyed, which may not equal market value. Nevada is the only state in the country to apply a **depreciation factor** in its property taxes, reducing assessed value by

98 Nevada Taxpayers Association, *Understanding Nevada's Property Tax System* (2013-2014 ed.) at 4, http://www.nevadataxpayers.org/pdf/property-tax-2013.pdf. The State Board of Finance has the authority to redeem state securities issued or secured by the state. Broadly speaking, state bonds fall into two categories: general obligation bonds, which are tax-supported (guaranteed by the state's taxing authority), and revenue bonds, which are commonly used to finance capital projects and are paid from a designated revenue stream generated by the supported project.

1.5 percent of the improvement's replacement cost for each year of the property's lifetime for fifty years. (The depreciation factor was 2 percent until 1985, and there have been occasional calls for its further reduction or elimination.)

If this "cost summation" approach produces a taxable value higher than the full cash value, appraisers are instructed to subtract obsolescence present relative to similarly situated property (the sales comparison approach) or apply a valuation based on the net present value of future earnings and benefits from the property (the income capitalization approach). The acceptance of these three approaches enables nonresidential property owners to appeal on the basis of the approach that is most beneficial.

The depreciation allowance and the replacement cost assessment method can lead to inequitable tax bills between similarly situated properties. A property tax analysis by Ekay Economic Consultants outlines an instructive example involving two homes that each sold for $200,000 in 2011:

> The first home, located in Reno, was constructed in 1963, making it 48 years old in 2011. The home has 2,028 square feet of improvements on a 25,352 square foot lot. The home was sold in 2011 for $200,000, but has a total taxable value of $110,048. The Sparks home was constructed in 2002, making it nine years old in 2011. The home has 1,662 square feet of improvements on an 8,123 square foot lot. The home was also sold in 2011 for $200,000, but its taxable value is $149,758. Already we can see that while the homes have a similar market value, the age of the older home has resulted in a lower taxable value for this home, despite the larger size of its land and improvements.[99]

Property Tax Rate

Article 10 of the Nevada State Constitution limits the maximum tax rate on real and personal property to $5.00 per $100 of assessed value.[100] State law sets the rate at $3.64 per $100 of taxable value, a change made in 1979 in the aftermath of California's Proposition 13.[101] As of 2014, this rate includes:

- $0.17 per $100 state-level rate, composed of a 15 cent state debt rate included in the statutory cap and 2 cents outside the cap;
- $0.75 per $100 for school districts;
- rates imposed by general or special improvement districts;
- legislatively approved overrides of the baseline statutory rates, e.g., authorization for counties to levy a property tax of 1.5 cents per $100 to fund the cost of providing medical treatment to indigent persons injured in automobile accidents; and
- additional tax levies approved by voter overrides on a general or special election ballot.[102] Special elections for the purpose of increasing taxes may only be held in a declared fiscal emergency.

The $3.64 cap does not include a $0.02 state rate that exists outside the cap (part of a voter-approved state-level rate), effectively bringing the maximum property tax rate to $3.66 per $100 in assessed

99 Ekay Consultants, *State of Nevada Property Tax System Recommendations for System Improvements Including Removal of Depreciation and Changes to Property Valuation* (Mar. 2011) at 6, http://www.ekayconsultants.com/Prop%20Tax%20Paper.pdf.

100 Nevada Taxpayers Association, Tax & Budget 101 (Aug. 26, 2014).

101 Nevada Legislature Research Division, *Nevada Tax Relief: 1978–1983*, Background Paper 83-7 at 4, https://www.leg.state.nv.us/Division/Research/Publications/Bkground/BP83-07.pdf.

102 Nevada Department of Taxation, *Nevada Property Tax: Elements and Application* (Jan. 18, 2013) at 22-24, http://tax.nv.gov/LocalGovt/PolicyPub/Active_Publications/Elements_and_Applications/2013_Nevada_Property_Tax_-_Elements_and_Application/.

value. At present, two counties (Mineral County and White Pine County) and the cities of Caliente, Carson City, and Reno assess the maximum $3.66 per $100 rate. The lowest rate is in Eureka County, at $1.77 per $100 of assessed value. Table 13 lists the tax rates in Nevada's counties as well as in a few select cities for fiscal year 2012, which do not include other property tax components, which can include special districts, school taxes, the indigent fund rate, the state rate, and others.[103]

Table 13. Property Tax Rates for Nevada Counties and Select Cities

County/City	Rate (FY 2012)
Carson City	3.6600
Churchill County	2.8029
Clark County	2.7264
Henderson	2.8969
Las Vegas	3.2782
Douglas County	2.8699
Elko County	2.5623
Esmeralda County	3.0195
Eureka County	1.7743
Humboldt County	2.2016
Lander County	3.3552
Lincoln County	2.9985
Lyon County	2.9326
Mineral County	3.6600
Nye County	2.8518
Pershing County	3.0968
Storey County	3.4607
Washoe County	2.7002
Reno	3.6600
Sparks	3.6163
White Pine County	3.6600

Note: Rates given in dollars per $100 of value.
Source: Nevada Department of Taxation.

The school tax rate is established at a minimum of 75 cents per $100 but can be increased by referendum. It ranges from the baseline 75 cents in Esmeralda County and Eureka County to a high of $1.50 in Elko County.[104] Special district tax rates, meanwhile, range from zero to $0.82 in the city of Yerington in Lyon County.[105]

The result of this rate structure is that total property tax rates end up containing many different parts, making them difficult to understand. Table 14 illustrates this complexity by showing the property tax rate breakdown for Yerington, a city in Lyon County.

Table 14. Anatomy of a Tax Rate (City of Yerington)

Combined Tax Rate	0.4044
County Tax Rate	0.8644
Combined Special District Tax Rate	0.8202
School Tax Rate	1.3367
State Tax Rate	0.1700
Total Property Tax Rate	**3.5957**

Note: Rates given in dollars per $100 of value.
Source: Nevada Department of Taxation.

103 *Id.* at 26.
104 The Elko County rate includes 75 cents for pay-as-you-go school construction. Had this construction been funded by debt instead, the 75 cents would have been classified as school debt, leaving the general school rate at 75 cents.
105 *Id.* at 27-29.

Property Tax Cap

In 2005, Nevada enacted a cap on the amount that property tax liability can increase each year. At the time, real estate prices (and, consequently, assessments) were rising fast, and the caps were meant to provide relief to homeowners facing soaring tax bills.

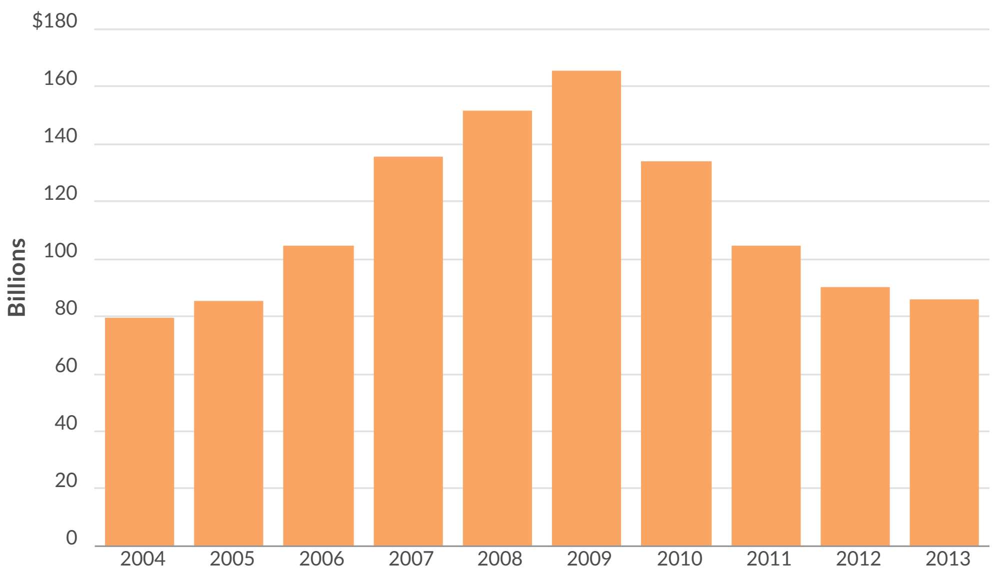
The cap is structured as a partial abatement, whereby the property tax bill on owner-occupied residential property cannot increase more than 3 percent annually unless the increase is due to improvements. If the property owner's liability, when calculated, exceeds the partial abatement, then the current year's tax bill cannot exceed the prior year's tax bill by an amount greater than the abatement. Other property is capped at the average percentage change in the assessed value of property in a county over a ten-year period, or twice the increase in CPI for the previous year, whichever is greater, so long as this does not exceed 8 percent.[106] New construction in its first year is excluded from the cap.[107]

If a property decreases in value more than 15 percent in one year, and the following year increases by more than 15 percent, the property owner must repay the tax not levied in the prior year due to the cap, payable over three years in a mechanism known as "recapture."[108]

However, multiyear valuation changes are not subject to recapture, as illustrated by recent experience. Between 2008 and 2012, Nevada assessed property values tumbled 43 percent, as shown in Figure 37.

Figure 37. Total Assessed Property Values

Nevada Statewide (FY 2004–FY 2013, in 2013 Dollars)



Note: Dollar amounts are adjusted for inflation and expressed in 2013 dollars using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.
Source: Nevada Department of Taxation, *2012–13 Statistical Analysis of the Roll.*

As assessed values fell, the property tax cap reset at these lower levels, creating a "ratchet" effect. Now, as assessed values begin to return to prior values, taxable values substantially lag, because they can only grow up to 3 percent per year (or up to 8 percent in the case of non-residential property).

106 Ekay Consultants, *State of Nevada Property Tax System Recommendations for System Improvements Including Removal of Depreciation and Changes to Property Valuation* (Mar. 2011) at 2, http://www.ekayconsultants.com/Prop%20Tax%20Paper.pdf.
107 Nevada Taxpayers Association, *Tax Facts* (2013–2014 ed.) at 89.
108 Nevada Taxpayers Association, *Understanding Nevada's Property Tax System* (2013–2014 ed.) at 13-14, http://www.nevadataxpayers.org/pdf/property-tax-2013.pdf.

The abatement of property tax liability increases above the 3 and 8 percent annual cap is by far the largest property tax expenditure on the books, behind only the exemption for property owned by local, state, and federal governmental entities.[109] In fiscal year 2014, a total of $123.4 million in property taxes was abated—$91.3 million under the non-residential cap and $32.1 million under the residential cap.[110]

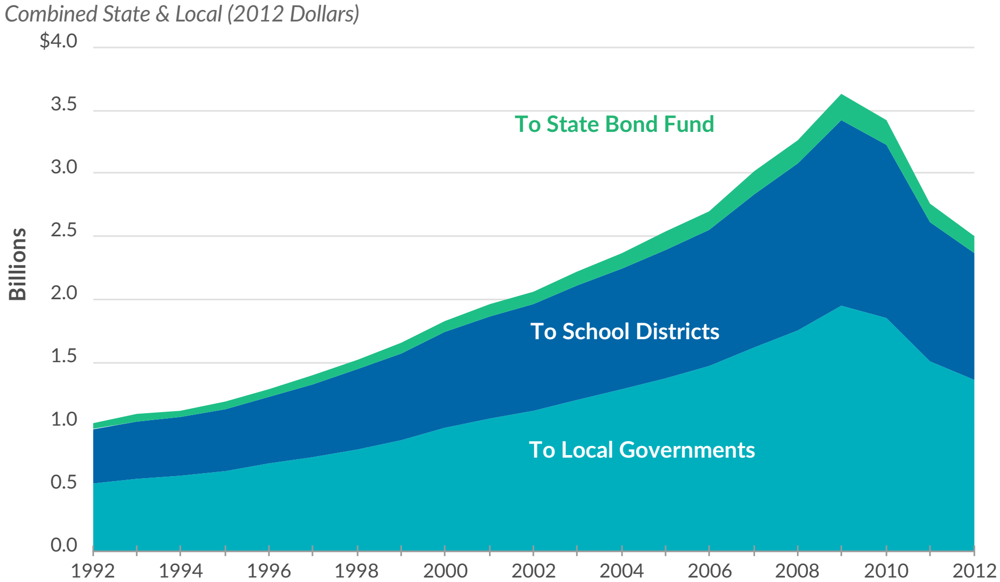
Further complicating the system and limiting property tax growth is a state cap on the growth in the amount of total property tax collections that can be brought in by a locality each year. This growth is capped at 6 percent, though this excludes new construction added to the tax roll.[111]

Property Tax Collections

Property tax collections have increased over time even after adjusting for inflation, from just over $1 billion in 1992 to $2.5 billion in 2012. This increase was the product of a rapidly expanding base as real property both expanded and increased in value. Figure 38 shows property tax collections in Nevada for the last two decades.

Figure 38. Property Tax Collections, FY1992–FY2012

Combined State & Local (2012 Dollars)



Note: Dollar amounts are adjusted for inflation and expressed in 2012 dollars using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.
Source: Nevada Legislative Council Bureau, *Revenue Reference Manuals* (Jan. 1993–Jan. 2013).

Figure 38 uses a slightly different data source involving a longer time series to show the effect of various property tax policies enacted over the years. Property tax collections decrease sharply right after 1979 and 1981. At the far right end of the figure, the sizeable "downward ratchet" post-recession can be seen.

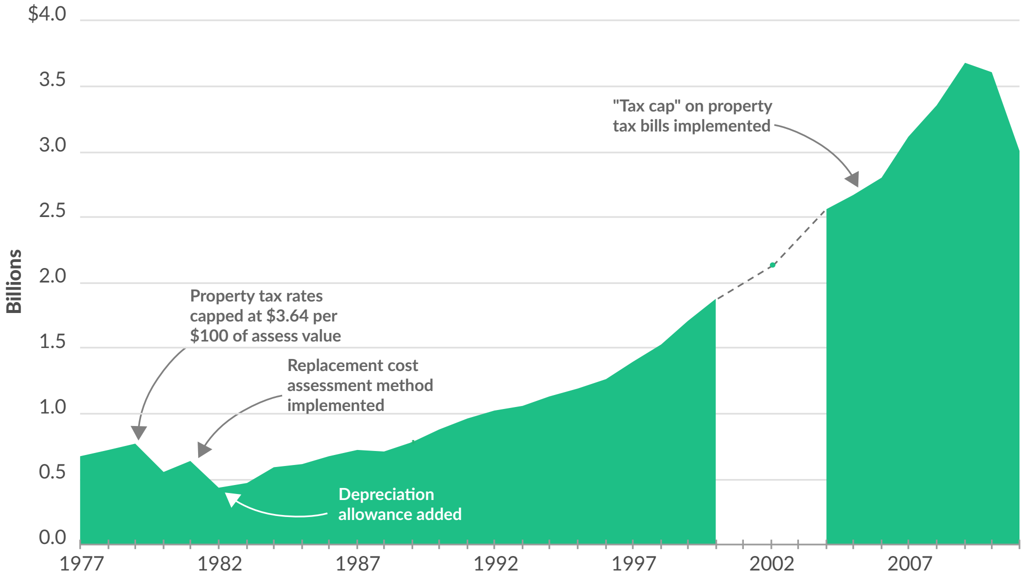
109 *Nevada Department of Taxation, 2013-2014 Tax Expenditure Report*. at 94, 117, 131, 161-162, 169, http://tax.nv.gov/uploadedFiles/taxnvgov/Content/TaxLibrary/Tax_Expenditure_Report_2013-2014.pdf. In all, there are $654.6 million worth of itemized tax expenditures within the property tax system, with roughly $500 million of these "expenditures" are actually the exemption of governmental property and most of the rest the tax cap abatement. Note, however, that the total figure is larger, as the Department of Taxation is unable to calculate the value of some exemptions. Other exemptions include charities ($8.3 million tax expenditure in fiscal year 2014), property of churches ($16.8 million), property owned by daycares and charitable and religious residences (no figures available), low-income housing, non-profit private and charter schools, specific foundations, lodges and benevolent associations, hospitals, property owned by veterans who incur service-related disabilities, and a $1,000 exemption for surviving spouses. Partial abatements are also available for LEED-certified buildings and renewable energy facilities.

110 *Id.* at 144–146.

111 Nevada Taxpayers Association, Tax & Budget 101 (Aug. 26, 2014).

Figure 39. Property Tax Collections, 1977–2011

Combined State & Local (2011 Dollars)



Note: Dollar amounts are adjusted for inflation and expressed in 2011 dollars using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics. Local data of 2001 and 2003 is not available from this source so those points were excluded here.
Source: Census Bureau, *State and Local Government Finance*.

Property Tax Administration

The Council on State Taxation (COST) releases a report detailing the property tax administration practices of the fifty states, in addition to giving each state's system a letter grade based on their practices. According to COST,

> [I]t is essential for state legislators and tax administrators to ensure the tax is administered fairly and without perceptions of bias or undue administrative burdens. Taxpayers are much more willing to fairly and fully comply with a property tax system perceived as unbiased, equitable and efficient.[112]

States are evaluated based on the following criteria (taken directly from COST's report): whether or not they have a uniform tax base and rates, efficient filing procedures, centralized review and uniform appeal procedures, and tax payment requirements on contested valuations.[113]

Based on these criteria, Nevada receives a grade of C-, which is among the worst of the fifty states. Contributing to this poor score is Nevada's practice of waiting five years between most property reassessments (state law requires at least every five years; only 13 of 17 counties reappraise annually), a lack of unequal interest rates for repaying past due taxes, a heavy burden of proof on the taxpayer under the appeal process, a lack of ability to escrow or partially pay disputed tax bills, and a lack of equal cap value between residential and commercial properties, among others.[114]

112 Council on State Taxation, *The Best and Worst in Property Tax Administration* (May 2011) at 1, http://www.cost.org/workarea/downloadasset.aspx?id=78745.
113 *Id.* at 2.
114 *Id.*

Solutions for Nevada's Property Tax

Nevada's property tax system relies on assessment mechanisms that were designed to not capture market value, counterintuitively depreciating structures and imposing caps that create a downward ratchet in periods of economic decline. The system is needlessly complicated, difficult to understand, and makes it nearly impossible for taxpayers to predict the taxable value of their property and their future tax bills.

(1) Change the assessment method from replacement cost to market value, in addition to eliminating the depreciation factor.

Fair market value is a straightforward, reliable basis for assessment and would dramatically reduce the system's complexity, cut down on appeals, and reduce the inequity of the current system. A shift to market value, in concert with the elimination of the depreciation factor, would bring Nevada in line with other states.

Of course, any transition to market value should take place upon the sale or transfer of real property, avoiding sudden tax changes for homeowners who rely on the current assessment method. Such a change would require amending Article 10, Section 1 of the state constitution.

The repeal of the depreciation factor could be phased in or eliminated outright. However, even if improvements to real property should cease to depreciate, they should not be restored to their undepreciated assessed value for reliance reasons.

Revenue Impact in Initial Year:

Eliminate the depreciation factor	Unknown, but revenue positive

The data necessary to calculate the potential revenue enhancement through a change in assessment method are not publicly available, and we must defer to any subsequent analysis by the Legislative Council Bureau on this matter. The shift would, however, be revenue positive over time.

A study conducted by Applied Analysis suggests that an outright elimination of further depreciation (without clawing back prior depreciation) would increase property tax collections by approximately 0.84 percent, which would have amounted to $21.6 million in the 2014 fiscal year. An average homeowner would pay less than $30 a year in higher taxes over the first ten years due to the elimination of depreciation. Current benefits from using depreciation are likely outweighed by the complicated nature of calculating it, while its repeal will substantially improve the efficiency and equity of the state's property tax system.[115]

115 Tax Foundation calculations based on estimates from Applied Analysis, *Ad Valorem Property Taxes in Nevada* at 40, http://www.leg.state.nv.us/Session/77th2013/Exhibits/Assembly/TAX/ATAX346C.pdf and collections data from the Nevada Department of Taxation, *Nevada Property Tax: Elements and Application* (Jan. 18, 2013) at 25, http://tax.nv.gov/LocalGovt/PolicyPub/Active_Publications/Elements_and_Applications/2013_Nevada_Property_Tax_-_Elements_and_Application/.

(2) Adjust and reform tax caps.

The tax liability caps, adopted when property values were soaring in the early-to-mid 2000s, rightly protect Nevada homeowners from being priced out of their own homes but were not designed to take into account substantial losses of value which would reset the caps to much lower values. Many with whom we spoke lamented the fact that even if property values rebound to where they were pre-recession, it will take as long as twenty years for local tax collections to catch up.

Consider a hypothetical $150,000 home that lost 40 percent of its value in the housing market collapse but has since increased back to its original value over five years of recovery (see Table 15). Even though the property has the same assessed value in years one and seven, the property tax burden remains a third lower than it was at the outset and in this example would take a further thirteen years to revert to its pre-recession tax liability.

Table 15. Property Tax Calculations for Typical $150,000 Home

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 7
Initial Taxable Value	$150,000	$90,000	$100,000	$115,000	$130,000	$150,000
Assessment Rate	35%	35%	35%	35%	35%	35%
Assessed Value	$52,500	$31,500	$35,000	$40,250	$45,500	$52,500
Tax Rate (per $100)	$2.8969	$2.8969	$2.8969	$2.8969	$2.8969	$2.8969
Pre-Abatement Liability	$1,521	$913	$1,014	$1,166	$1,318	$1,521
Abatement Over 3 Percent	$0	$0	$74	$198	$321	$494
Adjusted Liability	$1,521	$913	$940	$968	$997	$1,027
Effective Tax Rate	1.01%	1.01%	0.94%	0.84%	0.77%	0.68%

It will take many years—even decades—for the taxed value of property to catch up with assessed value under the state's existing property tax system, and the system remains highly vulnerable to the effects of any future recession. Nevada could:

(a) Allow taxes on assessed value to "catch up" to pre-recession levels more rapidly than is currently possible under the partial property tax abatement,
(b) Revise the cap to a higher rate, or
(c) Eliminate the "downward ratchet" to avoid a recurrence of the current situation.

While property values are recovering their pre-recession assessed values, the taxable value continues to lag substantially due to abatements through the 3 and 8 percent caps. The abatements on value recovered post-recession should be phased out by permitting property tax bills to grow outside the cap at a rate of up to 10 percent for five years, after which the caps could be reset to up to 5 percent annually on all property, residential and otherwise (a middle ground from the potentially unconstitutional split cap of 3 percent for some property and 8 percent for others).

Eliminating the downward ratchet prevents the caps from declining with falling property values. If a property's assessed value falls, the associated tax burden declines as it does now, but the capped value would not. As property later appreciates in value, it can rise with market prices up to the pre-recession cap, afterward appreciating no faster than the cap allows.

The revenue estimates for this option are not possible at this time, though the result would be revenue positive for local governments over time.

Revenue Impact in Initial Year:

Adjust and reform tax caps	Unknown, but revenue positive

(3) Enact a "circuit breaker" for low-income homeowners.

Property tax "circuit breakers" provide targeted relief for low-income households adversely affected by increases in the taxable value of their property. They are generally based on percentages of income, in which a ceiling is placed on the property tax bill for taxpayers at or below a certain income level. They are often structured as abatements or rebates.

Nevada formerly had a circuit breaker for elderly, low-income homeowners in the form of a direct rebate check.[116] This circuit breaker had a maximum benefit of $500 and was available to homeowners aged 62 or older with a maximum income of $27,863, subject to income and home value restrictions. At present, the state offers a deferral of property taxes for up to three years at a 6 percent interest rate to households with household income below the federal poverty level, subject to home value and other restrictions.[117]

While, on the whole, accruing additional value (and equity) is good for property owners, that value may not be realized until the property is sold. In the interim, the property owner shoulders the burden of additional taxes, which can be particularly onerous for those on a low or fixed income. If reforms to the assessment method, the depreciation factor, and caps are enacted, a circuit breaker can ensure that additional burdens do not accrue to those least able to pay.

The state could bring back its circuit breaker but this time extend it to all Nevada households under the federal poverty line or a specified maximum income, not just those aged 62 or older. Such a policy would provide important protections for Nevadans on a fixed income.

Revenue Impact in Initial Year:

Enact "circuit breaker"	Unknown, but revenue negative

Summary of Property Tax Reform Solutions

Table 16. Summary of Property Tax Reform Solutions

	Recommendation	Revenue Impact in Initial Year
(1)	Change property assessment method from replacement cost to market value, in addition to eliminating the depreciation factor	Unknown, but revenue positive
(2)	Adjust and reform tax caps	Unknown, but revenue positive
(3)	Enact a "circuit breaker" for low-income homeowners	Unknown, but revenue negative

116 Lincoln Institute of Land Policy, *Property Tax Circuit Breakers: Fair and Cost-Effective Relief for Taxpayers* (2009) at 49, http://www.lincolninst.edu/pubs/dl/1569_838_Property Tax Circuit Breakers Final.pdf.

117 Lincoln Institute of Land Policy, *Significant Features of the Property Tax*, http://www.lincolninst.edu/subcenters/significant-features-property-tax/Report_State_Summaries.aspx.

Chapter 6

Net Proceeds of Minerals Tax

Introduction

Nevada's net proceeds of minerals (NPOM) tax dates to 1989, with a constitutional amendment setting a maximum 5 percent rate on net proceeds of minerals separate from the local property tax rate.[118] Local governments receive the share associated with their local property tax, with the remainder up to the 5 percent maximum deposited into the State General Fund.[119] The tax is assessed at 5 percent for mining interests with net proceeds of $4 million or more and at a graduated rate for smaller operations, as shown in Table 16, with the lowest rate at the greater of 2 percent or the local property tax rate.[120]

Table 17. Net Proceeds of Minerals Tax Rates

Net Proceeds as Percent of Gross Proceeds	Tax Rate on Net Proceeds
< 10%	2.0%
10 - 18%	2.5%
18 - 26%	3.0%
26 - 34%	3.5%
34 - 42%	4.0%
42 - 50%	4.5%
> 50%	5.0%

Source: Nevada Taxpayers Association, Understanding Nevada's Net Proceeds of Minerals Tax (2007-2008 ed.).

As an ad valorem tax on minerals when they are sold or removed from the state, the NPOM Tax includes deductions for the costs of extraction, transportation, processing, marketing, equipment maintenance and repair, depreciation of machinery and equipment, royalties, mine development, and other inputs, covering the costs of labor, supplies, and materials. It does not, however, include any carryforward or carryback provisions.[121]

Prepayment

In 2009, facing a revenue shortfall, a special session of the legislature shifted to prepayment of NPOM taxes—a transition that brought a one-time windfall in 2010. Prepayment now produces no net benefit for the state and in fact has recently caused significant revenue volatility and budget uncertainty. Similarly, mining companies must now estimate their revenues for the coming year and prepay their taxes, a calculation that can prove difficult due to uncertain prices for gold and other minerals.[122]

Volatility is illustrated by estimates of 2014 proceeds compared to 2013, with mineral prices dropping, gross yield declining 25.9 percent, net proceeds plummeting 54.2 percent, and mineral tax revenue falling 54.5 percent.[123] Prepayments for 2014 totaled $159.4 million, compared to $239.8 million the previous year. However, because prices continued to decline, the state will still owe mining companies a substantial refund.

Prepayment of the NPOM tax essentially began as a no-interest loan to state government. It is, unfortunately, difficult to unwind; having received two years' worth of revenues in 2010, reverting to payment in arrears would require Nevada to go a year without a substantial revenue stream. Despite the difficulty, reforming this provision is in the long-term best interests of the state.

118 Nevada Taxpayers Association, Understanding Nevada's Net Proceeds of Minerals Tax (2007-2008 ed.) at 2.
119 *Id.* at 5.
120 *Id.*
121 *Id.* at 4.
122 John Dobra, *An Economic Overview of Nevada's Minerals Industry, 2010-11* (Natural Resource Industry Institute at the University of Nevada Reno) at 21.
123 *Id.*

Chapter 7

False Tax Reform

Gross Receipts and "Margin" Taxes

One tax type that is sometimes intriguing to policymakers is the gross receipts tax, otherwise known as a "turnover tax." Instead of being levied on profit, gross receipts taxes are business taxes levied on total revenue, regardless of profitability. At first glance, gross receipts taxes seem to meet the "low rate, broad base" criteria of tax reform, but while the rate is low, the base is actually broader than the size of the economy, taxing every transaction and resulting in double and triple taxation along the production chain.

For example, if you were to buy a loaf of bread that had been produced under a gross receipts tax regime, the farmer would have paid a gross receipts tax on the sale price of the wheat, the miller would have paid a gross receipts tax on the sale price of the flour, the baker would have paid a gross receipts tax on the sale price of the loaf of bread, with those taxes just getting passed on to the consumer.

This "tax pyramiding" effect is a chief criticism of tax policy experts, who widely note that gross receipts taxes create a hidden tax cost on consumers,[124] disproportionately burden industries with long production chains,[125] and can even incentivize vertical integration of industries just to avoid taxes.[126]

While the academic literature is not kind to gross receipts taxes, historical experience has been worse. Almost everywhere that a gross receipts tax is enacted, it is later repealed out of unpopularity and economic destructiveness. John Due notes in a 1988 survey of tax policy in developing countries that

[A] turnover tax was introduced in Germany, France, Italy, the Netherlands, and other European countries (and for a time in Canada) after World War I. It was also widely adopted by the Latin American countries. […] The defects of the turnover tax have been made extremely clear by long experience and of course have been responsible for the abandonment of the tax by most countries.[127]

This movement away from gross receipts taxes extends to the United States, where recent years have seen states that previously levied gross receipts taxes repealing or replacing them. The most notable of these examples was the 2011 repeal of the notorious Michigan Business Tax. Other recent examples include the repeal of the Indiana gross receipts tax in 2002, the repeal of the New Jersey gross receipts tax in 2006 (it was just four years old),[128] and the repeal of the very short-lived Kentucky gross receipts tax, which was enacted in 2005 and immediately repealed in 2006.[129]

Today, gross receipts taxes exist at the state level in just three states: Delaware, Washington, and Ohio. Virginia additionally levies a local gross receipts tax called the BPOL (Business Professional Occupation License Tax), and Texas levies a modified gross receipts tax called the "margin" tax, which is a complicated calculation of gross receipts with a variety of optional deductions (see Figure 40).

124 Justin M. Ross, *A Primer on State and Local Tax Policy: Trade-Offs Among Tax Instruments* (Feb. 25, 2014), http://mercatus.org/publication/primer-state-and-local-tax-policy-trade-offs-among-tax-instruments.

125 James Mirrlees & Peter Diamond, *Optimal Taxation and Public Production I: Production Efficiency*, 61 American Economic Review 8-27 (1971).

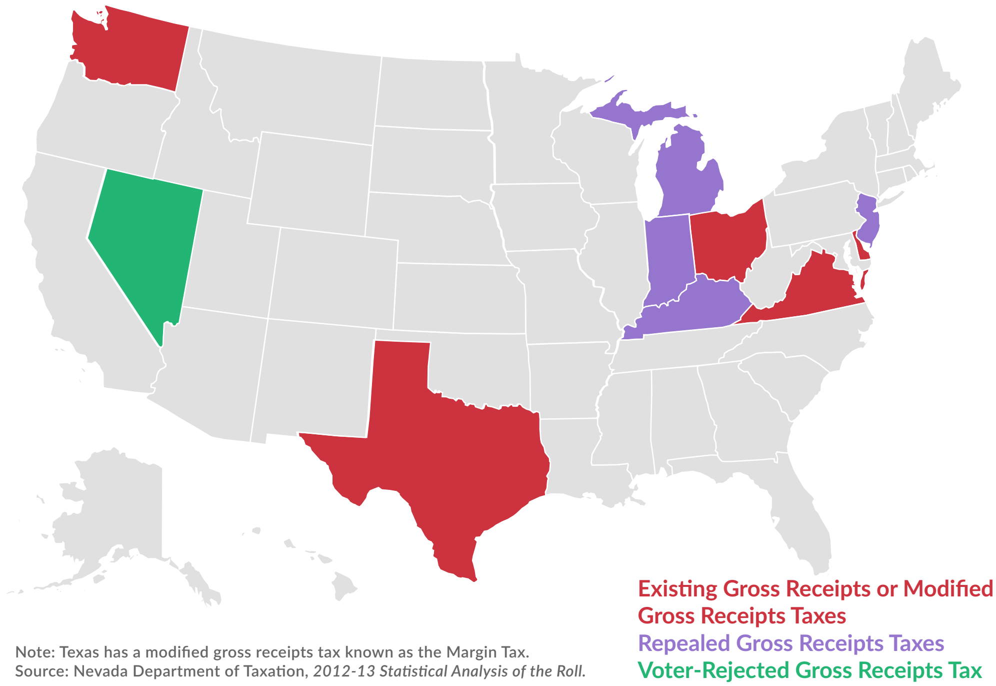
126 John L. Mikesell, *Gross Receipts Taxes in State Government Finances: A Review of Their History and Performance,* Tax Foundation & Council on State Taxation Background Paper No. 53 (Jan. 31, 2007), http://www.taxfoundation.org/legacy/show/2180.html.

127 John F. Due, *Indirect Taxation in Developing Countries, Revised Edition* (Johns Hopkins Press 1988) at 92-93.

128 Andrew Chamberlain & Patrick Fleenor, *Tax Pyramiding: The Economic Consequences of Gross Receipts Taxes*, Tax Foundation Special Report No. 147 (Dec. 4, 2006), http://taxfoundation.org/article/tax-pyramiding-economic-consequences-gross-receipts-taxes.

129 Scott Drenkard & Joseph Henchman, *2015 State Business Tax Climate Index* (Oct. 28, 2014), http://taxfoundation.org/article/2015-state-business-tax-climate-index.

Figure 40. Gross Receipts Taxes



Note: Texas has a modified gross receipts tax known as the Margin Tax.
Source: Nevada Department of Taxation, *2012-13 Statistical Analysis of the Roll.*

Even in states that still employ gross receipts taxes, the levies are a constant source of legislative headache and hassle. During its last session, at least 89 bills were filed in the Texas Legislature that aimed at changing the Texas Margin Tax, with eight of those aimed at repealing it.[130] In Virginia, all three 2013 gubernatorial candidates campaigned on a platform of reducing or eliminating the state's BPOL.[131] In Washington, the state has enacted different rates on each industry in an attempt to mitigate tax pyramiding problems, and now levies rates on some 35 different industry classifications.[132]

Noted tax economist John Mikesell summed up the case against gross receipts taxes quite well, saying, "There is no sensible case for gross receipts taxation. . . . [Gross receipts taxes] do not belong in any program of tax reform."[133]

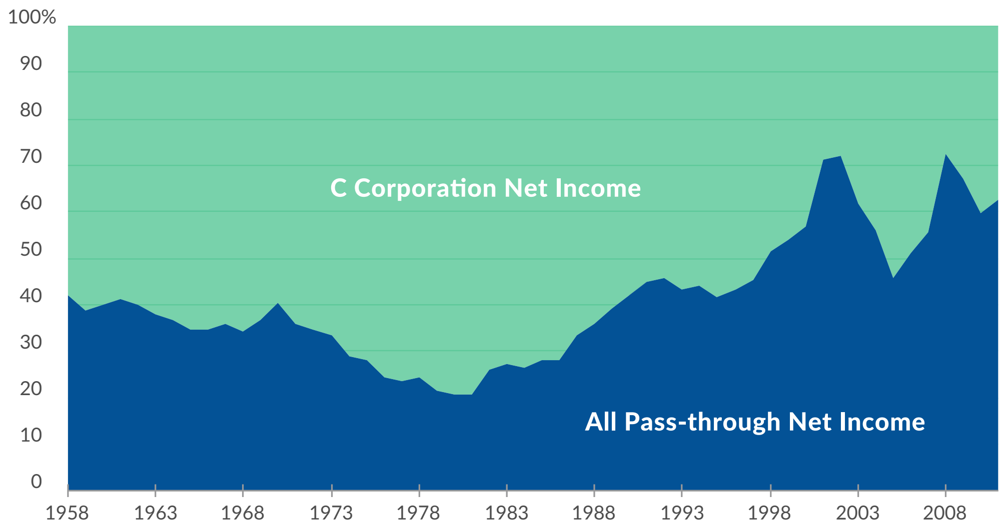
Corporate Income Taxes

The most notable feature of Nevada's tax code is that the state goes without taxing individual or corporate income. This competitive advantage is a primary driver behind the state's positive scores in numerous business friendliness rankings,[134] is a benefit for incorporating in the state, and helps the state lean on other more stable revenue streams. Going without a corporate income tax in particular helps Nevada avoid the many tax code deficiencies with which other states constantly struggle.

130 *83rd Legislative Session Bills: Tracking Franchise Tax Bills*, Texas Tribune, http://www.texastribune.org/session/83R/bills/trackers/franchise-tax-bills/.
131 Scott Drenkard, *Gubernatorial Candidates Eye Cumbersome Tax Code*, Tax Foundation Fiscal Fact No. 376 (July 15, 2013), http://taxfoundation.org/article/virginia-gubernatorial-candidates-eye-cumbersome-tax-code.
132 Washington Department of Revenue, *Business & Occupation Tax Classifications*, http://dor.wa.gov/Content/FindTaxesAndRates/BAndOTax/BandOrates.aspx.
133 *See* Mikesell, *supra* note 9.
134 Nevada ranks 8th in the Chief Executive ranking, achieves a B+ for small-business friendliness from Thumbtack.com, and ranks 3rd in the Tax Foundation's 2015 State Business Tax Climate Index. *See* JP Donlon, *2014 Best & Worst States for Business*, Chief Executive, Aug. 7, 2014, http://chiefexecutive.net/2014-best-worst-states-for-business; Jon Lieber, *United States Small Business Friendliness* (2014), http://www.thumbtack.com/survey#/2014/1/states; Scott Drenkard & Joseph Henchman, *2015 State Business Tax Climate Index* (Oct. 28, 2014), http://taxfoundation.org/article/2015-state-business-tax-climate-index.

For example, research shows that corporate income tax revenue is in decline across the country as more businesses choose to structure as S corps and LLCs (see Figure 41), single sales factor apportionment schemes grow more common (discussed below), and states give away more of the tax base in special credits and deductions for favorable activity. But though revenue is declining, the complexity of state corporate income taxes remains (or has increased), resulting in a situation where, by the account of one source, "the compliance and administrative costs of the state corporate income tax are the highest per dollar raised of any other source of revenue."[135]

Figure 41. Percent of Total Net Income Pass-throughs vs. C Corporations, 1958–2011



Source: Internal Revenue Service.

One of the worst features of state corporate income taxes is that profits from companies that operate in multiple states must be divided—or "apportioned"—in some way to determine the taxable base for each state. However, apportionment formulas are not uniform across the states, with each state following its own complicated set of calculations.

In some states, the percentage of corporate income apportioned to the state is derived from an equal weighting of property, sales, and payroll that the corporation has in the state. Other states have formulas that lean more heavily on the percentage of sales a company makes in a state, by double weighting the sales factor in their apportionment formula, triple weighting the sales factor, or by only basing apportionment on how much of a business's sales are in each state. Still other states offer multiple, different apportionment schemes based on what industry a business is in.[136]

Businesses go to great lengths to plan their activities around these apportionment methods, employing accountants and lawyers to comply with these provisions. Nevada is one of few states that offers corporate entities the ability to escape some of this complexity, and this selling point is not lost on prospective businesses.

135 David Brunori & Joseph J. Cordes, *The State Corporate Income Tax: Recent Trends for a Troubled Tax*, American Institute of Tax Policy (Aug. 15, 2005), http://www.americantaxpolicyinstitute.org/pdf/StateCorpTax%208-15-05%20_2_.pdf.

136 Institute on Taxation and Economic Policy, *Corporate Income Tax Apportionment and the "Single Sales Factor"* (Aug. 2012), http://itepnet.org/pdf/pb11ssf.pdf.

Chapter 8
Other Important Considerations

Education Funding

Education funding in Nevada is highly centralized. It is primarily built around state-provided Distributive School Account (DSA) funding and state-administered local taxes under what is known as the Nevada Plan. The plan provides a formula-driven guaranteed funding level for each of the state's seventeen school districts that is intended to reflect educational needs, not local variations in tax collections.[137]

Under the Nevada Plan, each school district's basic support guarantee is determined by a formula that takes into account the district's demographic characteristics and weighted apportionment enrollment. Actual state financial aid, however, equals the difference between this guaranteed amount and local available funds derived from mandatory taxes.[138]

The state share, disbursed from the DSA, draws from the State General Fund, a share of the annual slot tax, federal mineral land lease receipts, investment income from the Permanent School Fund, and certain education-specific sales tax revenues that cannot be attributed to a particular county. The deducted local share consists of a 2.6 percent Local School Support Tax (sales tax) and one-third of the proceeds of a 75 cent ad valorem tax dedicated to education expenditures (part of the property tax).[139]

These local taxes are collected by the state, and since local collections are used to offset the amount of state funds disbursed to local school districts, localities do not enjoy a benefit tied directly to how much is raised in-county by the LSST and the dedicated portion of the property tax. In effect, both of these revenue sources are state-directed, with no ability for surpluses or higher collections to accrue to an individual school district.[140]

School districts do derive a modest share of their total funding from local sources that exist outside the Nevada Plan, including the remaining two-thirds of the 75 cent ad valorem tax cited above, the share of the basic government services tax distributed to school districts, and other miscellaneous local revenues. Additionally, school districts can receive "categorical" state funding for programs like class size reduction, career and technical education, and early childhood education, in addition to unrestricted and categorical federal funding.[141]

Once school districts receive their guaranteed state funding, each of the seventeen school districts allocates resources to schools within the district primarily by formula, with school finances largely managed at the district level. Staffing ratios, compensation schedules, and funding for everything from maintenance and utilities to textbooks and transportation are set at the district level.

Though education funding recommendations are outside the scope of this book and our expertise, it is important to keep them in mind as tax reform is debated.

137 Nevada Legislative Counsel Bureau, Fiscal Analysis Division, *The Nevada Plan for School Finance* (2013) at 2-3, http://leg.state.nv.us/Division/Fiscal/NevadaPlan/Nevada_Plan_2013.pdf.

138 Nevada Legislative Counsel Bureau, *Nevada Plan for School Finance and Education Revenues and Expenditures* (2013) at 77, http://www.leg.state.nv.us/Division/Research/Publications/EdDataBook/2013/Ch06.pdf.

139 Nevada Legislative Counsel Bureau, Fiscal Analysis Division, *The Nevada Plan for School Finance (2013)* at 4-6, http://leg.state.nv.us/Division/Fiscal/NevadaPlan/Nevada_Plan_2013.pdf.

140 *Id*.

141 Nevada Legislative Counsel Bureau, Fiscal Analysis Division, *The Nevada Plan for School Finance (2013)* at 2, http://leg.state.nv.us/Division/Fiscal/NevadaPlan/Nevada_Plan_2013.pdf.

Federal Land Ownership

Federal ownership of over four-fifths of all land in Nevada has been a point of contention since the state was first admitted to the Union. It also adds an important wrinkle to local tax considerations.

With 83.1 percent of all Nevada acreage under federal management, the state has far and away the greatest concentration of federal land in the country. Federal lands comprise more than half of all land area in only four other states, and the next closest, Alaska, has nearly a quarter less land under federal control.[142]

As a condition of statehood, Nevada "forever disclaim[ed] all right and title to unappropriated public land within its boundaries" and within two decades waived another 1.9 million acres, exchanging its 3.9 million acre school grant for its selection of 2 million acres of federally-held land to meet an immediate revenue need. Today, a variety of federal agencies—predominantly the Bureau of Land Management, but also the U.S. Forest Service, the National Park Service, the Fish and Wildlife Service, and the Department of Defense, among others—hold title to 83 percent of Nevada's lands and over 97 percent of the land in five counties: Esmeralda, Lincoln, Mineral, Nye, and White Pine.[143]

The Bureau of Land Management controls the lion's share of federal lands, at nearly 82 percent, followed by the U.S. Forest Service at roughly 10 percent. Together, the two agencies—which permit regulated yields, including grazing, timber harvesting, and resource extraction—account for 91.8 percent of federal land, while the more substantially protected lands of the National Park Service and Fish and Wildlife Service, along with Department of Defense lands and installations, account for the bulk of the residue.[144] See Table 18 for this breakdown.

In all cases, even where surface or subsurface lands are leased for purposes ranging from grazing (1.2 million head of cattle were authorized in FY 2012)[145] to timber harvesting or resource extraction, localities are precluded from collecting any property taxes on public lands, putting counties with a particularly high concentration of federal lands at a distinct disadvantage.

Table 18. Federal Land in Nevada

Agency	Acreage (in millions)	Percent of Total
U.S. Forest Service	5.8	9.9%
National Park Service	0.7	1.3%
Fish and Wildlife Service	2.3	4.0%
Bureau of Land Management	47.8	81.9%
Department of Defense	0.3	0.5%
Other	1.5	2.6%
TOTAL	58.4	100%

Similarly, federal ownership skews usage patterns in available lands, promoting high-density development and making it difficult for localities to establish the industrial bases that often generate the greatest revenue. While all Nevada counties must struggle with federal land ownership, some are more adversely impacted than others. Whereas 90 percent of Storey County's acreage is classified as either local government or private property, the same can be said of a mere 1 percent of land in Esmeralda and Lincoln. In the

142 U.S. Department of the Interior, Bureau of Land Management, *Public Land Statistics 2012* (June 2013) at Table 1-3, http://www.blm.gov/public_land_statistics/pls12/pls2012.pdf.
143 Nev. Rev. Stat. § 321.596.
144 Ross Gorte, Carol Vincent, Laura Hanson, & Marc Rosenblum, *Federal Land Ownership: Overview and Data* (Feb. 8, 2012) at 13, http://fas.org/sgp/crs/misc/R42346.pdf.
145 U.S. Department of the Interior, Bureau of Land Management, *Public Land Statistics 2012* (June 2013) at Table 3-8c, http://www.blm.gov/public_land_statistics/pls12/pls2012.pdf.

metropolitan counties of Clark and Washoe, only 8 percent and 27 percent of land, respectively, is in private or local governmental hands.[146]

So long as the federal government continues to administer large swaths of Nevada, wide variations in tax collections potential will persist across the state's localities. Consequently, Nevada officials and its congressional delegation should discuss with federal officials options to reduce the scope of federal land ownership in the state.

146 Thomas Harris, William Riggs, & John Zimmerman, *Public Lands in the State of Nevada: An Overview*, Fact Sheet-01-32 (2001) at 3, http://www.unce.unr.edu/publications/files/cd/2001/fs0132.pdf.

Principles of Good Tax Policy

Creating sound tax policy is more than a question of how much revenue is being raised and whether that amount is too much or not enough. Public finance experts and economists generally agree that not all taxes are created equal, and certain types of taxes are more damaging to the economy than others.[118] Below are four tax reform principles that should be kept in mind when evaluating tax policies.

Simplicity

Time spent complying with taxes is a burden on individuals, and administrative costs are a loss to society. Complicated taxation also undermines voluntary compliance by creating incentives to shelter and disguise income. With the complexity of the federal income tax, state tax codes should strive not to add to that complexity. Taxes may be the price of a civilized society, as Justice Holmes once wrote,[119] but they ought to be as civil as possible.

Transparency

Tax rates and bases should be easily understandable by taxpayers. Tax changes should be made with careful consideration and input, allowing taxpayers to understand how much and how they will pay their taxes. Adam Smith, one of the first public finance experts, wrote, "The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person."[120]

Neutrality

The fewer economic decisions that are made for tax reasons, the better. Taxes are meant to raise revenue for necessary government services, not pick winners and losers in the economy. As much as is possible, the tax code should tax similar activities at the same rate, and tax liabilities should not be borne more by one similarly-situated group than another. Economists often refer to the best tax system as one with "a broad base and low rates" because this type of system minimizes economic distortions.

Stability

Frequent changes to tax codes make long term economic planning difficult and unpredictable. Temporary tax laws should be avoided.

118 These principles were originally outlined in Adam Smith's *An Inquiry into the Nature and Causes of the Wealth of Nations* .
119 *See Compania General de Tobacos de Filipinas v. Collector*, 275 U.S. 87, 100 (Holmes, J., dissenting) ("Taxes are what we pay for civilized society…").
120 Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Random House 1937) (1776) at 778.

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