Chairman Hadley, Members of the Committee:

My name is Scott Drenkard, and I’m an economist at the Tax Foundation. I’m pleased to have the opportunity to speak today regarding L.B. 1097. While we take no position on legislation, I hope to give a review of our research on tax policy across the country and our survey of the economic literature on taxes and growth.

In October of 2013, in partnership with the Platte Institute, Joe Henchman and I authored a book titled Building on Success: A Guide to Fair, Simple, Pro-Growth Tax Reform for Nebraska. In it, we detail reform recommendations in line with the principles of sound tax policy: simplicity, neutrality, transparency, and stability. Many of the findings I will note here are discussed in more detail in that primer.

Reducing the Corporate Income Tax Boosts Growth and Competitiveness

The first proposal I’d like to address is the reduction of the corporate income tax rate over the next few years. Lowering the top corporate rate from 7.81 percent to 5.9 percent makes Nebraska competitive with more of its neighbors. Colorado, Missouri, and Kansas all currently have lower rates, and South Dakota and Wyoming do not levy corporate income taxes at all.

More importantly though, corporate income taxes are generally found to be among the most harmful taxes to economic growth. The economic literature that distinguishes between types of taxes provides very compelling evidence that corporate income taxes hurt economic growth most, followed by personal income taxes, then sales taxes, and finally property taxes.

Add to this the fact that corporate income taxes represented just 2 percent of Nebraska state and local collections in 2011, and in many ways corporate tax reduction is a high “bang for your buck” strategy to increase growth without costing the government a lot of revenue.

Finally, economists agree that corporate income taxes are not even borne by corporations themselves. While corporations cut the check to the department of revenue, the tax burden is
actually passed on in one of three ways: to consumers in the form of higher prices, to workers in the form of lower wages, and to shareholders in the form of lower dividends.

**Cutting and Simplifying the Income Tax Addresses Business Impediment in Nebraska’s Code**

Another element of this bill lowers the top individual income tax rate from 6.84 percent to 5.9 percent by 2018. The bill cuts taxes on the lowest bracket immediately and then phases in reductions to the upper brackets. These upper brackets are often what matters most to business activity. We often forget that some businesses file through the individual code rather than the corporate code. Nationwide, roughly half of all business income is filed through the individual income tax code, so these individual income tax cuts will work in concert with the corporate rate cut to promote job growth and a more attractive business locale.

In the economic literature, excessive taxes on income are found to discourage wealth creation. In a study of major articles on taxes and growth, a 2012 Tax Foundation report found personal income taxes are among the most destructive to growth, being outdone only by corporate income taxes.

For example, a 2011 OECD study by Arnold et al. found that reductions in the top marginal rate of individual income taxes raises productivity growth. Examining the period of 1969 to 1986, Mullen and Williams (1994) found that higher marginal tax rates reduce gross state product growth. This finding even adjusts for the overall tax burden of the state, lending credence to the principle of broad bases and low rates.

Reducing these rates will not only improve Nebraska’s standing against other states, it will improve the well-being of Nebraskans today.

**Adjusting Income Tax Brackets for Inflation**

Finally, the proposal to inflation-index Nebraska’s income tax brackets protects taxpayers against automatic tax increases that currently occur each year without a legislative vote. Without this vital measure, taxpayers will see more and more of their income subject to higher brackets of taxation as inflation increases wages on paper but not in purchasing power. This is one area where even the federal government has it right; the federal income tax has been adjusted for inflation every year for the last three decades.

**Further Steps**

While these changes are positive reforms, there are still a few options for making this plan better. In the individual income tax code, Nebraska would still have a provision called “income recapture,” which applies the rate of the top income tax bracket to previous taxable income after the taxpayer crosses the top bracket threshold.
This is a stealthy way of raising additional tax revenue that is highly rare. In fact, the only other states that have similar provisions are Connecticut and New York, which generally are not states with tax codes we seek to emulate.

Another option for further tax reform is to enact automatic rate cuts for future years that are based on the balance of the state’s surplus or rainy day fund. West Virginia has been phasing down its corporate income tax using this method for the last 3 years, and North Carolina employed this method during their hallmark tax reform in the 2013 session. Because the cuts are contingent on stable revenue growth, this allows policymakers to make the state more competitive without fear of harming revenue streams.

Thank you for your time; I look forward to your questions.