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Revenue Committee
March 02, 2011

[LB590 LB620 LB632]

The Committee on Revenue met at 1:30 p.m. on Wednesday, March 2, 2011, in Room 1524 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on LB620, LB632, and LB590. Senators present: Abbie Cornett, Chairperson; Dennis Utter, Vice Chairperson; Greg Adams; Deb Fischer; Galen Hadley; LeRoy Loudon; Dave Pankonin; and Pete Pirsch. Senators absent: None.

SENATOR CORNETT: Good afternoon. I'm Senator Abbie Cornett from Bellevue; to my left, Senator Dennis Utter, the Vice Chair of the committee, from Hastings will be joining us shortly; to his left will be Senator Deb Fischer from Valentine; and Senator Greg Adams from York; on my far right, Senator Pankonin from Louisville; to his left is Senator Pirsch from Omaha; Senator Loudon will be joining us from Ellsworth; Senator Galen Hadley from Kearney. Our research analysts today are Steve Moore to my right and Bill Lock to my left. Matt Rathje is the committee clerk. The pages are Marilyn Buresh and Amara Meyer. Before we begin the hearing today, I'd please ask everyone to turn your cell phone to either the off or vibrate position. Sign-in sheets for testifiers on the table by both back doors and need to be completed by everyone wishing to testify. If you're testifying on more than one bill, a sheet needs to be submitted for each form. Please print and complete the sheet prior to coming up to testify. When you come up to testify, hand it to the committee clerk. There are also clipboards by both back doors if you wish to indicate either your support or opposition to a bill but do not wish to testify, that will be admitted into the record. We will follow the agenda posted on the door today. Introducer or representative will present the bill followed by proponents, opponents, or neutral testimony. Only the introducer will have the opportunity for closing remarks. As you begin your testimony, please state and spell your name for the record. If you have handouts, please bring the committee ten copies and hand them to committee clerk and we will distribute those. If you need to have copies made, pages will do that for you. With that, we will begin today's hearings. Senator Larson, you are recognized to open on LB620.

SENATOR LARSON: (Exhibits 1 and 2) Senator Cornett and members of the Revenue Committee, my name is Senator Tyson Larson, T-y-s-o-n L-a-r-s-o-n, and I represent Nebraska's 40th Legislative District. I am here today to introduce LB620. The definition of a recession is two consecutive quarters of negative real economic growth, also known as gross domestic product. GDP is the sum of a nation's consumption, investments, government spending and net exports, that is, exports less than imports. GDP rises when people are consuming, investing, and producing. As we all, unfortunately, know, in a recession we are not consuming, investing or producing as much. It stands to reason that to get out of a recession we need to boost the GDP. Everyone wants to boost the GDP. It is the method by which we boost GDP that is the point of contention. We've heard arguments for healthcare and stimulus packages, but lost in the fray is one of the central topics of all presidential and all of our campaigns,

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taxes. Federally, as well as in Nebraska, we have a progressive tax policy. Progressive tax rates increase as a worker's taxable income increases. The harder we work, the more money we earn, the higher the taxes become. But the more money we earn, the greater...I'm sorry, but the more money we earn the greater the percentage taken from us. In effect, we are penalized for succeeding in our jobs. Proponents of progressive taxation believe this method is fair for two main reasons: Individuals and companies who earn more income should pay a higher proportion of their income in taxes and progressive taxation maximizes total revenue. Our progressive tax system, however, is neither fair nor optimal. To the contrary, our tax code operates on the large-scale redistributionist economics and encourages tax evasion. More than 20 countries and 7 states have realized the harmful inefficiencies of progressive taxes and have switched to a tax system that is not only fair across the board, but also economically viable, the flat tax. Some of those states include Colorado, Illinois, Indiana, Massachusetts, Pennsylvania, Rhode Island, and Utah. The rates in those states range from 3 percent to 5.3 percent. LB620 replaces the current system of progressive income taxes with a flat rate for individual and corporate income taxes. The tax rate is set at 3.5 percent beginning January 1, 2014. LB620 disallows itemized deductions and eliminates several tax credits, and instead provides that each individual can claim a personal exemption and a standard deduction. LB620 also adjusts the corporate income tax rate. Beginning in 2014, the tax rate will be 4.5 percent and each subsequent year will decline .1 percent until January 1, 2024, after which the rate will be set at 3.5 percent. A flat tax system applies a uniform tax rate to all earners. As a consequence, a flat tax simplifies the tax code and thus increases tax compliance and decreases the cost of collecting taxes. The flat tax offers a system where there will no longer be thousands of pages of statutory code and loopholes for tax-dodging individuals and companies. It offers a system where an entire tax code can be written in a few pages, thereby eliminating government bureaucracy and waste. Proponents of progressive taxes believe that such a system will increase the government's tax revenue because they are able to get more from the highest earners. The dirty little secret of taxation, however, is the actual tax rates in a progressive tax system do not matter, an observation first made by Kurt Hauser, now called Hauser's Law. And the handout that I gave everybody, I show what Hauser's Law is and the federal tax revenue and the marginal tax rates. And as you can see, even when...in terms of percentage of tax revenue in the...where our top tax bracket is, it's relatively the same. As you can see in the handout, no matter where the government sets our national tax brackets, tax revenue as a percentage of GDP has remained flat. The moral of the story is simple. The surest way to increase tax revenue is to increase GDP. While this handout shows federal income tax brackets, the concept can certainly be extrapolated to Nebraska's income tax system. If government income and, theoretically, spending is constant regardless of where we set tax brackets, why use a progressive tax system at all? A number of economic studies have shown that flat taxes incentivize work, lower the cost of doing business, and diminish tax evasion. The net effect is that production, income, and investment all increase, which in turn rises GDP. In addition to the acceptance of the efficiency of the flat tax by many economists,

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as mentioned above, there are also real world examples of the flat tax. Many of the Baltic States switched to the flat tax and achieved the highest growth rates in the European Union immediately afterwards. Russia, a G-8 country, notoriously known for its shady business dealings, instituted a 13 percent flat tax rate on the...in 2001, I believe, instituted a 13 percent flat tax and the country's income grew by 9 to 11 percent, windfall gains increased 4 to 5 percent, and tax evasion dropped 10 to 11 percent. Almost all of the states that have instituted a flat income tax have seen a GDP increase by more than 10 percent since 2005. The flat tax is efficient, fair, and embraces production and work. Are those not the principles on which America is built? Our current government, nevertheless, diminishes the idea of creating a flat tax. The government should not punish the brightest minds and the highest producers by looting their earnings because they will soon lose their willingness to produce. When our producers are no longer willing to support the government that continually takes them for granted, their innovation and their production, what will happen to us? The flat tax system is one step in the right direction in order to ensure a productive economic future for our state. Thank you, and I'll entertain questions to the best of my ability. [LB620]

SENATOR CORNETT: Thank you, Senator Larson. Questions from the committee? Senator Pirsch. [LB620]

SENATOR PIRSCH: Thank you, Senator Larson. And has this...anything close to this been implemented in any other states recently then? [LB620]

SENATOR LARSON: Yeah. As I mentioned, seven states currently have it. They are Colorado, Illinois, Indiana, Massachusetts, Pennsylvania, Rhode Island, and Utah. And their tax rates range from 3 percent to 5.3 percent and also 23 countries have it as I also mentioned. Many of those are in eastern Europe and as we can all guess, eastern Europe also is the fastest growing region in the EU in terms of economics and I don't think that's a coincidence. I see a direct correlation to their tax code and how it compares to western Europe. [LB620]

SENATOR PIRSCH: Thank you. [LB620]

SENATOR CORNETT: Further questions from the committee? Seeing none, Senator Larson. [LB620]

SENATOR LARSON: Thank you. [LB620]

SENATOR CORNETT: First proponent. Proponents, please come forward. Do you have your testifier sheet filled out? [LB620]

SETH GIERTZ: Yes, I do. [LB620]

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SENATOR CORNETT: Please hand it to the committee clerk. [LB620]

SETH GIERTZ: Thank you for the opportunity to testify on this bill. My name is Seth Giertz. I work in the economics department at the University of Nebraska, although I am not representing the university. If enacted into law, LB620 would substantially improve Nebraska's state individual and corporate income tax. The bill would, when phased in, broaden the state's tax base and replace both the individual and corporate tax rate schedules with a flat 3.5...flat rate of 3.5 percent. Compared to the state's current top marginal tax rates, this bill would nearly cut the individual rate in half and cut the corporate rate by more than 50 percent. This would represent a tremendous improvement for the state's business...state's business and economic climate and would send a positive signal across the country. I will speak to three economic issues related to the tax bill. Those are economic efficiency, tax revenues, and employment. First, with respect to efficiency, taxes are necessary to finance government. However, taxes create inefficiencies by distorting the signals that market prices send to individuals and business. Undistorted prices are central to ensuring the optimal allocations of societies resources. Taxes, by distorting prices, harm the economy, discouraging activities that are taxed, and encouraging activities that are not taxed. It is well known among economists that the harmful effects from taxes increased by the square of the marginal tax rate, thus a 7 percent tax rate is not twice as harmful to the economy as a 3.5 percent rate, but is actually four times worse. This is why economists often advocate a tax system with a broad base that is having a few exclusions and few deductions and low marginal tax rates. This is pretty much what LB620 would do. Second, with respect to tax revenue, aside from changes to the tax base, lowering rates should lower tax revenue compared to what would be raised at the higher rates. However, the drop in revenue is often less than expected because taxed activities grow with the lower rates since the penalty from earning and reporting income is reduced. An "extremem" version of this is termed the Laffer curve where cutting tax rates actually results in increased tax revenue. While the full Laffer effect is not realistic for Nebraska, behavioral responses to tax changes should substantially offset potential revenue losses. Again this bill does not just lower rates. It also expands the base, so by expanding the base we can have a tax system that raises the same revenue at substantially lower tax rates. At the federal level the Tax Reform Act of 1986 did this by cutting tax rates and broadening the base. Indeed, from 1986 to 1988 the top federal tax rate on income fell from 50 percent to 28 percent. Third, LB620 will encourage more rapid growth in employment within Nebraska. While people take into account more than taxes when deciding where to locate, taxes are important. Lower rates encourage more people and businesses to locate in Nebraska. A common approach to attracting business is to offer special incentives targeted to specific businesses. A much better way of attracting business is by creating a favorable economic climate that will appeal to many businesses. This approach is also consistent with LB620. So in sum, this bill has a lot to offer for the state of Nebraska. Coming out of the great recession, Nebraska is in better position than most states. The tax reform prescribed in LB620 would only improve the state's longer

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term economic prospects. Thank you. [LB620]

SENATOR CORNETT: Questions from the committee? Senator Pirsch. [LB620]

SENATOR PIRSCH: Thanks for coming here and lending your expertise. I guess you kind of raised the question which is, in terms of economic development policy, there's two approaches that basically you can pursue and we're pursuing one which is targeting specific job-creating industries, essentially creating tax credits or tax advantages and those. You're suggesting that if you went to a...just a flat, instead of having targeted economic development type of tax credits or whatnot, you think the overall effect would be a higher level of growth overall? [LB620]

SETH GIERTZ: Yes, I do. I think the kind of downside from the approach of having, not targeting specific businesses, is that you can't really kind of trace your policies to this business being located here or that one. And so you often don't see the kind of positive benefits being directly tied to the businesses that are here where you deal with the kind of targeted approach. But when you have the targeted approach, you're expending revenue or having special tax benefits to one or several businesses. And when you do that, in order to raise a certain amount of revenue, it means you have to have higher tax rates either on individuals or other businesses. And so you're discouraging those other businesses and other individuals from either productive activity or from coming to the state at the expense of encouraging specific business. And so usually, usually the business that does come or locate here that's very apparent and seen by everyone and kind of the downside or cost of that is often not seen because it's not as concentrated, but. [LB620]

SENATOR PIRSCH: Thank you. [LB620]

SENATOR CORNETT: Senator Hadley. [LB620]

SENATOR HADLEY: Senator Cornett, thank you. Is the assumption built into the flat tax that basically raising revenue is the only reason that we have taxes? [LB620]

SETH GIERTZ: It's...my perspective, that's not entirely the case, so a flat tax as described in this bill and some other bills has a deduction. So it has effectively a zero tax rate, so if we only wanted to raise revenue and that was our sole concern, there would be no purpose to have a deduction there. So in one respect you could view that as saying, well, we're not going to tax you at all up to a certain level, and then once you've met that level you have this lower rate. So I mean, I think the focus is definitely more on generating a revenue efficiently, but if that was the sole purpose, I don't think you would have that exclusion at the bottom to ensure the lower-income people aren't taxed at all. [LB620]

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SENATOR HADLEY: I guess I ask that from the standpoint from reading that basically the itemized deductions and such as that would go away and...from years ago in talking about taxes and such as that, I remember that at times we've had, you know, some of the reasons that itemized deductions are there are to basically try to direct behavior by, you know, we give a charitable deduction because we want people to help support charity. [LB620]

SETH GIERTZ: Right. [LB620]

SENATOR HADLEY: We give a deduction for maybe interest on your home loan because we want people to buy homes and such as that. And under the flat tax we do away with those kinds of incentives to try and move people's actions in certain ways? [LB620]

SETH GIERTZ: That is true and you're highlighting definitely a cost to this bill. So to taxpayers, a lot of the kind of benefits that certain taxpayers get from certain aspects of the tax code would go away and that's kind of the cost of having a broader base and the lower rates. Some of the things you mentioned...the deductions and exemptions and so forth are itemizations. They're not always really things that really benefit the low-income people as much as higher-income people. So about a third of federal taxpayers itemize. They're generally higher-income taxpayers and the benefits that you get from itemizing is directly related to a marginal tax rate. So the higher your marginal tax rate is, the greater savings you get from being able to deduct things. So there's clearly a cost from doing this. And as you mentioned, charitable contributions. If the benefits from the actual charitable activity go to help lower-income people or other people in society, then we're going to be lowering incentive. In that case there would truly be a cost and maybe some distributional issues. But I think in general, it's the modern higher-income people that benefit more from these deductions and itemizations. [LB620]

SENATOR HADLEY: And then just one last question. If we look across the spectrum from low income to high income, is there one strata that benefits more from a flat tax, vis-a-vis? You know, do higher-income people benefit more from a flat tax than say, moderate to low income? [LB620]

SETH GIERTZ: So in order to fully address that question, we would need...we could look at average tax rates and not marginal to see how much taxes you pay as a share of your overall income, not what you pay on the next dollar. And so in general now, higher-income people have higher marginal tax rates and so on their marginal earnings they pay a higher rate. But I think they also benefit more from some of these deductions that would be going away. So I think that's an important question that someone with access to the data could look at, but I don't know the answer off the top of my head. [LB620]

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SENATOR HADLEY: Okay. I guess I just worry that, you know, the lower income that we have a flat tax that right now they may not be paying any tax and if we go to a flat tax, even the lower income...and I'm not going to make an argument whether that's good or bad. [LB620]

SETH GIERTZ: Right. [LB620]

SENATOR HADLEY: But it could be an impact of having a flat tax. [LB620]

SETH GIERTZ: Right, right. So what the level of the deduction is set could impact that and there's a trade-off if we wanted to have a higher level of exemption or standard kind of deduction, then we would need to have a little bit higher rates to raise the same amount of revenue. But that's something that could be tweaked. Also in terms of progressivity and distributional issues, economists often believe that that activity is much better handled by the federal government than the state or local governments because people in investment is very mobile. If you tax it or subsidize it, you get much bigger responses at the local level and that changes equilibrium prices, including wages. And so the kind of longer term effects are often offset by this behavior to a much greater extent than they are at the federal level because it's a lot easier...lot more difficult to escape the federal tax. [LB620]

SENATOR CORNETT: Senator Utter. [LB620]

SENATOR UTTER: Thank you for your testimony. I'm looking at the fiscal note and I note that by 2015-16, the shortfall in revenues to the state approach a half a billion dollars. And I guess I'm just curious as to whether we have the rates set too low in this bill, or exactly where are we going take the half a billion dollars to make this whole thing balance? [LB620]

SETH GIERTZ: All right. I haven't seen the fiscal note but I know that estimating or projecting revenues is very complicated and there's lots of uncertainty. So if there is a shortfall, given this bill, I think that it would be very easy to have the main substance of the bill and to tweak the rates some. So if revenues come in better than anticipated by the bill, then we could maybe lower the rates a little bit. If they don't come in as well as we suspect, we could raise the rates some and have the same general approach in the bill. But that 3.5 percent might be something that we need to fiddle with. [LB620]

SENATOR UTTER: Thank you. [LB620]

SENATOR CORNETT: Senator Adams. [LB620]

SENATOR ADAMS: Thank you. I think you kind of touched on it, but I'm still wrestling with the question that Senator Hadley asked. So if an income tax...or excuse me, if a

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sales tax is regressive and an income tax is progressive, then a flat tax...where...have we disproportionately dinged somebody else? The middle? [LB620]

SETH GIERTZ: Okay. Well, a flat tax is a mildly progressive tax, so if there were no standard deduction it would be a proportional tax. Because there's a standard deduction, your tax liability, the share of your income, which is a definition of progressivity, increases, but it increases to a much smaller degree than it would be with a kindly steeply progressive tax. But...and the question of who is dinged, I think...I suspect it's going to be not real systematic. I suspect it's going to be these people that are losing their itemized deductions or at least losing it at the state level, so people who have large mortgages with interest, maybe people who are making substantial charitable contributions, and I guess, people who have...some other areas that have large deductions or exemptions, those are going to be the people that are hurt. Again if these people have very low incomes now, they're not going to really be benefiting from those deductions. You have to have a positive tax liability. And the higher the marginal tax rate, the more you're benefiting from those. But I suspect if you look at a particular income category, there's going to be some disparity in how people are treated under the current system because of these (inaudible). [LB620]

SENATOR ADAMS: In the states that you listed that have this, do you know, over time have they slowly started to creep right back into a progressive income tax system where they maybe start out ideally in a flat, and then over time legislatively, well, we ought to maybe do this and maybe do that and are their original plans now morphing into something else? [LB620]

SETH GIERTZ: Well, there...so this bill when...some states have a pretty flat tax rate but don't necessarily have a broad base and raise money in other ways. So kind of getting rid of these deductions of things I see as an advantage of this bill. However, there are people who will be hurt with that. In terms of a kind of morphing into something else, I don't know the specifics on some of these states and eastern European countries, but I know that kind of a lament with tax reform in general, my economist is that once you get a kind of good or preferable, at least to an economist's opinion, a tax system, it does tend to regress into something not as good. So the Tax Reform Act of 1986 was the biggest tax reform in many decades in the United States for the federal government and that was nowhere near a flat tax but it was a substantial flattening in of tax rates. So you go before 1980, we had top tax rates, 70 percent for very small sets of the income distribution. You go back farther, we had tax rates of 90 percent, and then '86 substantially widened the tax base kind of like this does, this bill does. And it lowered tax rates substantially so the rate on top income fell to 28 percent. However, it was still a very...it was still a progressive system with several different rate categories. After 1986, we've seen the tax base that was broadened a lot, narrowed. So it has been carved out in a lot of different ways. Special provisions have been added back in, and we have seen rates fluctuate some but are currently higher now, especially

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towards the top end than they were then. So I think that...what's happened in the U.S. is not a case where we've actually experienced the flat tax, but I think it's kind of consistent with the notion or problem that you propose there. [LB620]

SENATOR CORNETT: Senator Louden. [LB620]

SENATOR LOUDEN: Yes, thank you, Senator Cornett. Well, this would disconnect the state tax from the federal tax, right? [LB620]

SETH GIERTZ: That's my understanding, certainly with the things you can deduct and itemize. [LB620]

SENATOR LOUDEN: Yeah, because at the present time, why, you pay a percentage of your federal tax. [LB620]

SETH GIERTZ: Right. [LB620]

SENATOR LOUDEN: Now, what about...okay, I can understand how this will work with W2s or something like that. But what about in these businesses, farms, ranches, any kind of business, corporations, where do the capital gains fit in then? Would they...there not be such a thing as far as the state is concerned? It would have to be that 3.7 percent of any profit whether it's capital gains or whatever? [LB620]

SETH GIERTZ: Well, I'd have to ask the senator or refer to the bill, but capital gains aren't something that are deducted from the federal income tax. They're counted as income at the federal level when they're realized. [LB620]

SENATOR LOUDEN: Yeah, but only half of them or so is counted, not all of them is counted, that's what I mean. [LB620]

SETH GIERTZ: Well, they're subject to...well, they've changed rules over time, so it used to be that half of them were counted. Now they're subjected to a tax rate that's substantially lower than the other overall tax rate. [LB620]

SENATOR LOUDEN: But then...but Nebraska tax would have to decide whether or not they wanted it to be involved with capital gains or the full...? [LB620]

SETH GIERTZ: Yeah, that would be a decision Nebraska would need to make. If they wanted to have them... [LB620]

SENATOR LOUDEN: Okay, whether you sold stocks and made a capital gains, whether you would be liable for the tax on the entire amount, or whether you'd be just on the capital gains part of it or something like that, that would have to be a tax code then

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would have to be done by the state of Nebraska? [LB620]

SETH GIERTZ: If they want to have special provisions. So as it is now, capital gains are fully taxed but they're taxed at a preferential rate at the federal level except for capital gains from selling a home and some other things. But if Nebraska wanted to, they could just say capital gains or income and they're taxed at 3.5 percent. If they wanted to exempt them or include a portion of them or something, then that would be something more complicated that, yes, like you said, would be taking a loss. [LB620]

SENATOR LOUDEN: And then would they have to set up a whole tax code on what their deductions were and that sort of thing, because you've disconnected from the federal tax? And then would you have to set your own tax code up on what would be your deductions or interest paid on repairs or interest paid on the house or homes and that sort of thing? [LB620]

SETH GIERTZ: I mean that is one avenue you could go but you wouldn't have to. You could as...you could just have the capital gains counted as income and you could tax them at their end. As I said, I don't recall what this bill specifies in terms of capital gains, but that's one route you could go where you wouldn't have to go that way. In terms of decoupling, yeah, there's some complications there. If it's simply not allowing you to take your itemized deductions, that's a part that's all comprised on a particular form of your federal tax return, and so it would be very easy to back out your itemized deductions and back out certain exemptions depending on how far you wanted to decouple from the federal tax system or what areas could add some substantial complexity but certain areas would... [LB620]

SENATOR LOUDEN: As I remember when we had to start paying state income tax, the reason it was off of your federal return was for simplicity so that you didn't have to go through all of those codes and stuff. Whatever your federal tax was you paid the percentage of that and you went from there and that's what I'm wondering if we do...disconnect from the federal, then we will have to set up a whole set of codes. [LB620]

SETH GIERTZ: Well, you're right. There's additional complexity from decoupling with the federal tax system. However, the degree of additional complexity could vary. I mean, if it's just the matter of not allowing itemized deductions and a few other exemptions, then yes, you don't just take a percentage of your tax liability or of your federal income. You need to make an adjustment to that which would be subtracting a couple other line items that are on your tax form and it wouldn't require another kind of huge or kind of expansion of bureaucracy to do that. But I'm sure that if there were other areas you wanted to decouple in or there are other ways you could kind of complete a...have a tax system that's kind of structured completely differently from the federal tax system, you could certainly add a tremendous amount of complexity, but. [LB620]

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SENATOR LOUDEN: Okay. Thank you. [LB620]

SENATOR CORNETT: Maybe I wasn't paying attention closely enough, but when Senator Hadley asked you, in your opinion, who do you think this benefits the most? Did you say the middle class? [LB620]

SETH GIERTZ: I think that...well, first I have not taken the data and looked at it and run the numbers, and so forth. But I suspect that the big beneficiaries are going to be...I would think the middle class. I mean, I think the big beneficiaries are going to come from creating more jobs, having more economic activity, and that's different from looking directly at people's tax returns and seeing what happened to their actual tax liability. If you go that route, if you look at it by income, I wouldn't necessarily expect big changes across the distribution. But if you look at a particular income class, I would expect, I would expect a shifting there. People who have large mortgages and people who have large itemized deductions are going to pay more in taxes. People with the same income level that are renters or paid off their homes and so forth, are going to have lower tax bills. But again, to do a real thorough analysis would require...it would require data work that I haven't done or seen. [LB620]

SENATOR CORNETT: Well, it's just that there's somewhat of a disconnect between Senator Larson's opening that the progressive tax system hurts the brightest and best or highest income earners more so than middle class, at least in his opening. [LB620]

SETH GIERTZ: So there is a distinction that needs to be made between average tax rates and the marginal tax rates, so the average tax rate is what I think of when I think the actual burden the taxpayer pays, take a look at how much you paid in taxes as a share of your income. And if we look at the distribution of that, I don't know that that is going to substantially benefit high-income taxpayers. High-income taxpayers are going to have more income subject to tax but a lower rate. But if you're looking at people's incentives that are already here to engage in productive activity or to work more, I think that that improved incentive is going to be greatest at the highest income or the upper income because the marginal penalty for earning another dollar of income is going to fall by roughly 50 percent from close to 7 percent to close to 3.5 percent. So I think when I'm talking about that or when Senator Larson was referring to that, I would characterize that as looking at marginal tax rates and incentives. I think the biggest improvement incentives is clearly at the upper end. When you look at the burden of the tax, which I think is kind of hurt more by it, I'm thinking of the average and that is less clear to me than... [LB620]

SENATOR CORNETT: What about our lowest...our low-income earners? How does this benefit them? [LB620]

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SETH GIERTZ: Well, if they're not paying tax now, we have to look at the actual level, the standard deduction. I mean the lowest ones aren't going to be paying tax in either scenario. And if we wanted to change that group... [LB620]

SENATOR CORNETT: What about a moderate-income family with children that normally gets to itemize their children, or the standard deduction? [LB620]

SETH GIERTZ: Okay, well, they would have...if they lose... [LB620]

SENATOR CORNETT: And their interest on their home, the deduction for interest. [LB620]

SETH GIERTZ: Well, they would have to itemize then. And so if they're itemizing and they're in the 10 percent federal tax bracket, they get effectively 10 cents back from the federal government every dollar of mortgaged interest they have if they are itemized. [LB620]

SENATOR CORNETT: But I'm talking about from the state. [LB620]

SETH GIERTZ: Okay, but from the state, if they're in a low tax bracket, I mean, if they're going to get...if they're in a 3 percent tax bracket now, they're going to get 3 percent back for every dollar that they contribute to mortgage interest. If we flatten the rate, maybe the rate goes up...if the rate goes up a little bit, then they're going to get 3.5 percent back so they would benefit a little bit more from the mortgage interest deduction. But under that hypothetical scenario, they're going to pay a little bit more on their marginal dollar of income. Where the higher-income person, their marginal benefit from the state from deducting another dollar mortgage interest is going to fall from 6. or 8.4 percent to 3.5 so they're going to be hurt more by getting rid of the itemizations, but they're going to also benefit more at least in terms of having a substantially lower rate on their income and so those are things that we need to be (inaudible). Yeah, clearly the tax rate portion, that's falling a lot more for the top income person, and not looking at the changes to the base and things, yeah, that's clearly more of a benefit at the top. [LB620]

SENATOR CORNETT: And how would it affect some of our programs like the state EITC, in fact we're coupled with the federal government on the EITC and...? [LB620]

SETH GIERTZ: Right, so if you...so it would hurt some...it would likely hurt some of those things unless changes were made. So there are definitely costs to it, so their costs would... [LB620]

SENATOR CORNETT: Other than the ones that are reflected in the fiscal note, there are social costs? [LB620]

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SETH GIERTZ: Okay, well, I haven't read the fiscal note but there are distributions...the costs are distributed and there are definitely winners and losers. And so to the extent that benefits for low-income people are cut, for example, state EITC, then those groups, at least that part of the tax change, are going to be hurt by this bill. [LB620]

SENATOR CORNETT: So when you say there are winners and losers, who are the winners and who are the losers? [LB620]

SETH GIERTZ: Well, the losers are...well, we look on net, but the losers are people that have very...lots of itemized deductions, lots of things that aren't on the tax base or have lots of special tax preferences. Those are people that are going to lose because they have lots of income or things that aren't... [LB620]

SENATOR CORNETT: I'm sorry, just real quick. I thought you said that those were the winners, the upper or the middle income, upper middle income that could itemize. Earlier. [LB620]

SETH GIERTZ: Well, they're winning now. I mean, they're winning now. They're getting more benefits from the federal system, but if you make those itemizations taxable, you broaden the base. I mean, they're going to hurt from that...they're going to be hurt from that aspect of the tax change. [LB620]

SENATOR CORNETT: I'm sorry, I must have misunderstood you because I thought you said that the middle class would benefit from this. And they're usually...I mean they have quite a few of those deductions in there. [LB620]

SETH GIERTZ: Well, what tax rate are we referring to in the middle class, or...? [LB620]

SENATOR CORNETT: What were you referring to? [LB620]

SETH GIERTZ: Well, I was talking about the high-income people when you said who is going to be hurt by not having the itemized deductions. [LB620]

SENATOR CORNETT: Okay. Senator Hadley. [LB620]

SENATOR HADLEY: I just have one more quick...I guess more of a comment and everything. You know, I think this is an interesting concept and, you know, you mentioned eastern Europe, a lot of those had come out of...some of those had come out of a socialistic system where they were trying to implement a tax system. And it's a lot easier when you start almost from scratch to do it. And the other thing is, is that, you know, we have basically three taxes in our state, you know: property, sales, and income. And the complaints we hear, it's rare we ever hear a complaint about the income tax. It's just...I'm trying to think in the three years I've been here and

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campaigning, I don't believe I've heard a...but it's rarely a day goes by that somebody doesn't come in and tell us how bad our property tax system is. So if the economic community can help us develop a replacement or a fair property tax system, I would certainly be happy. Thank you. [LB620]

SENATOR UTTER: Further questions? If not, thank you very much for your testimony. [LB620]

SETH GIERTZ: Okay. Thank you. [LB620]

SENATOR UTTER: Other proponents? Is there anyone wishing to testify in favor of this bill? If not, opponents. Welcome. [LB620]

MARK INTERMILL: (Exhibit 3) Thank you. Thank you, Senator Utter and members of the committee. My name is Mark Intermill, M-a-r-k I-n-t-e-r-m-i-l-l, and I'm here today representing AARP. We do oppose LB620. There are a couple of principles that we have...several principles, two of which that we've looked at in relation to this bill. One is that we do support progressive taxation and this removes a significant degree of progressivity from Nebraska's taxing system. The other thing is that we believe that a taxation system should be adequate and provide an adequate and consistent source of revenue. And when I looked at the fiscal note, I had some questions about whether it would deliver that. It would take 10 percent of the General Revenue's Fund according to the fiscal note. And it minimizes the most progressive component of our tax structure. We have a fairly consistent taxation system that provides a consistent level of revenue in relationship to our personal income. Last year it was 1.1 percent of our personal income is what we collected in General Fund revenues. I think it's been as high as 1.34 but it seems to level out at about 1.21 percent. It's a very consistent method of collecting revenue for our state. I think this would probably disrupt that consistent method of collection of revenue. It would remove \$149 million in revenue in FY 2014 and \$458 million in 2015. And this is just not a good time to do that. I think, as I look at our Cash Reserve Fund at the end of the next biennium, it seems to me to be getting kind of thin. To take funds out of the revenue stream at this point just doesn't seem to be a good idea. And just to close, they wouldn't let me back in the AARP office if I didn't say that we do have a tax structure in Nebraska that is not retiree friendly. We have not sought any changes in that because we just didn't think this is a good time to do that. I also don't think it's a good time to pursue this particular proposal either. And with that, I'd be happy to try to answer questions. [LB620]

SENATOR UTTER: Questions for Mr. Intermill? If not, Mark, thanks for your testimony. [LB620]

MARK INTERMILL: Thank you. [LB620]

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SENATOR UTTER: Other opponents. Is there anyone who would like to testify in a neutral capacity? Seeing none, Senator Larson, you can proceed with your closing. [LB620]

SENATOR LARSON: Thank you, Vice Chair Utter and members of the committee, and I'm just going to point out a few things that came up during the hearing through some of your questions and try to address some of your concerns. I don't know if I can address them all. I'd like to thank Professor Giertz for coming down and answering your questions. He did an excellent job. A little bit on the fiscal note. I think all of us have gotten fiscal notes we haven't liked before. And this is, I guess, my first, seeing that it's my first year down here to address a little bit. As Mr. Intermill put it, it does...the Fiscal Office does estimate \$129 million lost in the first fiscal year but three years after that it's already up to \$418 million. You know, I don't know if they're accounting for that much economic growth, but I think we have to continue to look at the flat tax as proven by Hauser's Law and the Laffer curve. Tax revenue is constant...regardless of the tax bracket and a percentage of GDP and as the Laffer curve does prove that the lower your taxable income tax rate becomes, the more taxes you bring in because of added economic growth. And I don't feel like the fiscal note takes that economic growth and added tax revenue and the broadening of the base into account. I don't think it takes into account the added jobs. I don't think it takes into account the added sales tax that will come into our communities because of the added jobs. I think there's just...I have a lot of problems with the fiscal note, and I think that we can all look through some of the numbers that are brought up. In terms of the lower income and who this helps most, I think it helps everybody. It does help the highest earners in the sense that we aren't penalizing them for their innovation and their bright minds. I think it helps the middle class because it does add jobs and it lowers the average taxable income at which they will be taxed at. And speaking directly to Senator Hadley and Senator Adams about the lower-income, right now I'll just...well, LB620 offers a standard deduction and...two deductions, a \$4,000 deduction and a \$3,000 deduction. The \$4,000...or it offers like a married filing...if you're single, it's a \$4,000; married, it's \$8,000; head of household, it's \$5,500. We have that currently in Nebraska. If you're single, it's \$4,750; if you're married, it's \$7,950; and if you're head of household, it's \$7,000. I offered a deduction similar to that, the \$4,000, \$8,000, and \$5,500, and then I also offer a personal exemption of \$3,000, which for the lower-income people that everybody gets \$7,000. And currently in Nebraska, its tax rate, you're taxed at 3.57 percent if you make more than \$2,400, and then you would get that...if you're single, you would get that \$4,750 deduction. So actually I think mine benefits the lower-income people more because we'd only be taxing them at 3.5 percent regardless, and they'd get the \$7,000 instead of just that \$4,750. So I think we're actually cutting some of the lower-income people out of our income tax system and helping those people as well. Technically, if you make in-between \$1 and \$2,400, you pay a 2.56 percent rate right now. But again, you would have the deductions, so they wouldn't pay anything either under our current system. So I think I'm helping all classes of people--the upper, middle and lower--in doing this. And

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I'll close real quick in just saying with one more example, again from eastern Europe, a small country of Estonia, which Nebraska actually has either a little larger or just about the same size GDP as Estonia. And when they came out of communism in the early '90s, it's a Baltic state, they set a flat tax of 24 percent. They have since lowered their tax rate four times. And I believe right now it's at 14 percent because they realize every time they lower their flat tax rate, added economic investment comes into their country. And they also are one of the fastest economic growing regions of Europe. They just went on to the Euro. They've had their currency pegged at the Euro for the last four or five years and they're doing very well, even in the economic downturn. And I'd stress we have to continue to look towards the future. I know it's...things like this are drastic measures, but if we don't look towards the future and towards economic...and ways to increase economic growth as we move forward, it will be future generations that are hurt. And I think it's now would be a good time to adopt a tax policy that encourages investment and encourages Nebraska to be a leader in the United States. And I'll entertain any questions if I can answer them. There might be some that I can't, but I'll do my best to find answers if I can't. [LB620]

SENATOR CORNETT: Senator Utter. [LB620]

SENATOR UTTER: Senator Larson, it's...even I, when I first came here, said...talked about the ghost of the fiscal note and some things like that. But let's assume for a moment that the fiscal note is correct, where do we go from there? [LB620]

SENATOR LARSON: You know if the fiscal note is correct, and I'm assuming...it's hard for me to assume that, but assuming that the fiscal note is correct, I think, you know, we could look at playing with the tax rates a little bit. Nebraska, I mean, as the State Chamber so kindly puts it, Nebraska is one of the heaviest tax states in the Union. It wasn't too long ago that Nebraska was...had the 44th worst business tax climate in the United States. We have since moved up to 29th by the latest standards. That isn't because we've lowered our taxes. It's because everybody else has raised theirs. Now I applaud... [LB620]

SENATOR CORNETT: Just real quick, we have made some serious changes though in the past few years. [LB620]

SENATOR LARSON: Well, lowered in terms of...I know that we've offered many incentives but we haven't lowered our income or...corporate income or individual income tax rates if I'm mistaken. Have we lowered those? [LB620]

SENATOR CORNETT: No. [LB620]

SENATOR LARSON: Okay. I'm sorry for the mistake on the other one, but we have done some things. I'm sorry, Senator Cornett. But in terms of income taxes, we haven't

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and a lot of other states have raised their income taxes. So I appreciate those of you that have been in the Legislature and make sure we haven't raised taxes, but we would have to look at the tax rate. Maybe 3.5 isn't the number, maybe 4.5 or 5.5 is. And I think that would help the fiscal note as well. I think there's obviously middle ground to be found, and I think 3.5 because it is on the lower end of scale of where the states are that do have a flat income tax. The lowest is 3 percent and I thought that would be a good number to start at because of the added economic investment that could come into our state in terms of comparing ourselves not only to the states surrounding us but the nation as a whole. Because if we want to continue to prosper and grow, especially in rural Nebraska, we have to be competitive to the entire nation to attract businesses out there. And that's kind of where I look at through this lens. [LB620]

SENATOR CORNETT: Further questions? Seeing none. [LB620]

SENATOR LARSON: Thank you. [LB620]

SENATOR CORNETT: Thank you. That will close the hearing on LB620. Senator Avery, you're recognized to open on LB632. [LB620]

SENATOR AVERY: (Exhibits 4, 5 and 6) Thank you, Madam Chair. My name is Bill Avery, B-i-l-l A-v-e-r-y. I represent District 28 here in Lincoln. I'm bringing to you LB632. And before I tell you what I'm doing, let me provide a little context. Federal legislation passed in December of last year greatly expanded and enhanced Section 179 in bonus depreciation in federal taxes. The total deduction was doubled to \$500,000. The total limit of equipment purchase was raised to \$2 million. These are huge increases designed to stimulate new business purchases. Over the past decade, Congress has repeatedly allowed faster depreciation of capital assets to stimulate business investment by providing what are called bonus depreciation allowances in the year the asset is purchased. In 2002, Congress let businesses claim a bonus depreciation allowance equal to 30 percent of the cost of the investment. The following year Congress raised the deduction to 50 percent. In 2008 in the stimulus package, they renewed the 50 percent deduction again. In the 2009 American Recovery and Reinvestment Act, they renewed the 50 percent deduction for investments made during 2009. The deal struck last December to extend the Bush tax cuts contains provisions to allow businesses to expense, that is to deduct from gross receipts all of their investments in 2011. Because Nebraska's tax code is linked to the federal tax code, changes in federal tax rules affect us. These changes in the Internal Revenue Code flow through to Nebraska by substantially reducing the taxable income of many businesses and corporate taxpayers in our state. And this includes hundreds of companies with headquarters in other states. This bill would prevent the unplanned for loss of revenue to our state treasury caused by tax changes at the federal level over which we have no control. The federal treasury can print money to get over the reduction in cash flow that would result from these new rules. We can't do that. So we're

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stuck with whatever the feds are doing. We're already facing a massive shortfall and this could add...this provision in the new tax code could add millions to that shortfall. And I have some tables here I'll pass out in a minute. This is similar to an unfunded mandate that has never been debated in our Legislature. It's never been approved by the Unicameral. What delinking does, in this instance, is merely requires businesses to calculate their state taxable income as if the federal depreciation change had never happened. So in a sense, it's a get back. I think this bill is an option that you might want to look at when you go about the difficult task of dealing with our budget problems. Let me tell you that in 2003, the Legislature did something similar to this in order to avoid a rather significant fiscal impact on the state because of changes made in the federal tax code. If the page would come, I would like for you to distribute two, two tables. What's being distributed is, number one, the Nebraska Economic Forecasting Advisory Board report. It's a table that shows that in the February forecast, the most recent, the Forecasting Board had to take into account what they estimated might be the consequences of this bonus depreciation in the federal law. And it reduced the forecast, would have been over \$107 million in additional receipts. It reduced that to \$44.5 million. That's one estimate. I have another table that is being distributed that comes from the Center on Budget and Policy Priorities dated March 1, 2011, and it shows 19...well, it doesn't list all 19, but the table is titled, "Nineteen States on Track to Lose \$5.3 Billion." Nebraska is the last one listed there. They estimate revenue losses of \$88 million to the state of Nebraska. So this is not insignificant. And I think that if the federal government is going to make changes that then cascade down to our state with rather severe negative consequences, we at least need to be aware of it and give ourselves the opportunity to do something about it if we choose. There is an amendment that is needed and the reason for that is actually...appears in the fiscal note. If you go to the fiscal note, you'll see the next to the last sentence it reads, for 2012 the bill will result in no General Fund impact on the 50 percent bonus depreciation portion because the bill appears to reference an incorrect Internal Revenue Code section. I have that...the appropriate section that needs to be referenced and I would ask you to consider that amendment. We don't know how much that would be worth but it would probably be, I'm guessing, \$30 million to \$35 million. With that, I would simply invite you to seriously consider this as we enter this difficult budget year. [LB632]

SENATOR CORNETT: Questions from the committee? Senator Hadley. [LB632]

SENATOR HADLEY: Senator Cornett. Thank you, Senator Avery, for bringing this. Senator Avery, from an economic stimulus concept, do you think that companies might, if they have investments to make, that they might pick states where they can get the tax break on the state return the same as the federal? [LB632]

SENATOR AVERY: I suppose one could make that argument but more and more states are actually opting out. [LB632]

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SENATOR HADLEY: Opting out, okay. [LB632]

SENATOR AVERY: That many...more and more states, I think it's up to 19 so far. [LB632]

SENATOR HADLEY: Okay. I was just curious as to whether companies would shop. [LB632]

SENATOR AVERY: Yeah. And it's also important to note that we, I think we tax businesses at about 6 percent. It's not a huge rate. I don't know if that would make the difference to many investors. [LB632]

SENATOR HADLEY: Okay. Thank you. [LB632]

SENATOR CORNETT: Further questions? Senator Utter. [LB632]

SENATOR UTTER: Senator Avery, you must have plans for these additional revenues you're going to raise. [LB632]

SENATOR AVERY: Going to spend them all in Hastings. (Laughter) [LB632]

SENATOR UTTER: That a boy. (Laughter) [LB632]

SENATOR AVERY: No, actually I don't have plans for this. I...you know, we have a lot of really tough choices to make. [LB632]

SENATOR UTTER: It seems to me like if something like this, in fact, became a reality, then the appropriate thing to do might be to embellish our rainy day reserve funds. [LB632]

SENATOR AVERY: I would not disagree with that. But we are, not to rehash an old sore subject, but we are dealing with some tough issues when we cut aid to cities and counties and NRDs and we have other things out there that might affect the ability of states or cities and counties to raise their own funds to cover the differences that are being created, partly by our doing. I think that it would certainly make...have made me feel a lot better if I had known when the Forecasting Board issued their report that there was a possibility that it could have been \$107 million, not just \$44 million. [LB632]

SENATOR CORNETT: Senator Louden. [LB632]

SENATOR LOUDEN: Thank you, Senator Cornett. Well, Senator Avery, this is some heavy lifting here for a cowboy like me. [LB632]

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SENATOR AVERY: You have an accountant right next to you. (Laughter) [LB632]

SENATOR LOUDEN: Well, I don't know if he knows his stuff either. I wouldn't pay, you know. (Laughter) As I look at this, what you're trying to do here is...do I understand this right, is some of the deductions that the federal tax allow that you're trying to move them in a different direction so that the state doesn't have to be party to that deduction? Is that... [LB632]

SENATOR AVERY: That's one way of putting it. Actually, the businesses will still be able to take the deduction on their federal returns. They can deduct this 100 percent from their gross receipts. [LB632]

SENATOR LOUDEN: Well, yeah, they can do the federal deal. [LB632]

SENATOR AVERY: Yeah, but because we're linked to the federal code, what happens there affects us. [LB632]

SENATOR LOUDEN: Well, I know that, yeah. [LB632]

SENATOR AVERY: And I'm trying to hold the state of Nebraska harmless here. [LB632]

SENATOR LOUDEN: Yeah. Okay. And that isn't bad what...if you're on the paying side of it (inaudible). What I'm wondering is, we have these people that...and we've got a gentleman here on my right that's sold tons of machinery to these folks that made a lot of money in the grain business and they're buying that machinery because they get this quick deduction. And, in fact, they're taking delivery, you know, in 2010 and all kinds of stuff like that so they can get this larger deduction. Now what will they do then, will they have to go ahead and pay that income tax...? [LB632]

SENATOR AVERY: What this does is they would still get the deduction on their federal return but by delinking, it merely requires the businesses to calculate the state...their state taxable income as if the federal depreciation never happened. [LB632]

SENATOR LOUDEN: Wasn't there, yes. In other words, they would have a significant increase in state income tax. [LB632]

SENATOR AVERY: It's about...but it's only about 6 percent. [LB632]

SENATOR LOUDEN: Well, depends on how big the first number is. Six percent, you know, I mean, yeah, 6 percent of \$100 isn't that much but when you put a bunch of zeros back there like these implements cost, why, then it's significant. [LB632]

SENATOR AVERY: Well, here's another way to look at it, Senator. If Nebraska thought

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this was a good idea, then we ought to have had that debate in our Legislature. [LB632]

SENATOR LOUDEN: Okay. Now my next question then is, if they don't...how does that affect their income taxes because you pay your income taxes on a portion of your...in other words, your state income taxes, is whatever they pay for income taxes for a state deductible off your federal income tax? [LB632]

SENATOR AVERY: Uh-huh. [LB632]

SENATOR LOUDEN: Okay. Then the more federal income...the more state tax you pay then it comes off your federal income tax, and if you're connected to your federal income tax you would actually be losing money on that side of it, is that correct? [LB632]

SENATOR AVERY: I'm not sure. I'm not an accountant. [LB632]

SENATOR LOUDEN: Or do you follow what I'm...? [LB632]

SENATOR AVERY: But I think I follow what you're saying. [LB632]

SENATOR LOUDEN: Because, I mean, this is like sales tax or anything else. They talk about a tax, but on the other hand it's a deductible tax so you don't have to pay. It affects your income on that so. [LB632]

SENATOR AVERY: But now what's really significant here is that what they did in December at the federal level was unprecedented in Nebraska tax...I mean, in federal tax code. We've never ever had a bonus depreciation of 100 percent. [LB632]

SENATOR LOUDEN: Well, they're trying to stimulate the economy. [LB632]

SENATOR AVERY: Well, they're trying to pry loose some of the cash that's being held. [LB632]

SENATOR LOUDEN: We've had different deals over the years. You've had investment credit and stuff like that. If you bought stuff you got to deduct it. I mean that's...we haven't seen that for 20 years now but at one time we had that so. [LB632]

SENATOR AVERY: But I do think that we in this Legislature ought to have control over our own financial fate to the extent... [LB632]

SENATOR LOUDEN: And you think we should have a flat tax like this...we just discussed? [LB632]

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SENATOR AVERY: No, I don't think so. [LB632]

SENATOR LOUDEN: Okay. Thank you. (Laughter) [LB632]

SENATOR CORNETT: Senator Hadley. [LB632]

SENATOR HADLEY: Just one quick point. You know, I really like this because that honorable profession of the CPA, the more we can complicate things and making sure that the federal and state are completely different, the more people have to come and use their CPAs, so I really like something like this. [LB632]

SENATOR AVERY: You're all for this. (Laughter) [LB632]

SENATOR UTTER: I thought it would be less use of a CPA. [LB632]

SENATOR HADLEY: No, more because they're going to have to...more complicated. (Laughter) [LB632]

SENATOR AVERY: I'm sure you'll want to talk with your committee staff about this and they certainly...I've worked with them in developing this piece of legislation, so they're fully aware of it, what's going on. [LB632]

SENATOR CORNETT: Further questions? Seeing none, thank you. [LB632]

SENATOR AVERY: Okay. I may not be able to stay. I would like to hear some of the discussion, but I have another bill coming up. [LB632]

SENATOR CORNETT: First proponent? [LB632]

SENATOR AVERY: I feel like Ron Raikes (laugh). [LB632]

SENATOR CORNETT: That's not a good feeling. First opponent? Neutral? [LB632]

WILLIAM PETERS: Senator Cornett, members of the committee, my name is Bill Peters, P-e-t-e-r-s, address, Suite 320, 411 South 13th. I'm representing myself in this appearance. I do regret that. I wish somebody was paying me to. However, there's a point that I'd like to bring. This is a policy decision. I want you to be aware that if you make the policy decision to adopt this bill, there's a real possibility that you'll be passing a tax provision that taxes income that never existed. That happened before when we deferred a bonus depreciation, disallowed it in the year and then you could, I think, some of it is still going on as we keep multiple sets of books for each state. You could take your depreciation as a percentage down the road. What happens, and I think it's a real unfairness, if the business or individual...and I notice they will be primarily

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individuals from the fiscal note, for some reason sells that property on which they took the bonus depreciation. They have to recapture for federal tax purposes and that's where we start our tax rate at. And there would be no adjustment and that's where they would be taxing income that never existed. You elevate that recaptured amount into taxable income which you never saw the benefit from Nebraska. So I would suggest that if this approach is adopted as a policy decision, that we should allow a deduction from taxable income equal to any depreciation recaptured for federal purposes, which depreciation hasn't been allowed under the Nebraska Revenue Act. And I think it's also well to remember that this doesn't just apply to Nebraska companies and Nebraska individuals. It applies to anyone who has nexus in Nebraska to be taxed. So a corporation anywhere or an individual that has business activities in Nebraska is subject to this particular calculation. Though I will agree with Senator Hadley, being in the tax practice, it really makes a lot of good opportunities. The more we delink, the more work we get to do. And with that, I would be willing to answer or evade questions. [LB632]

SENATOR CORNETT: Actually I've got a couple. And it follows up on what Senator Loudon was talking about. How badly would we be hurting some of our taxpayers with this when they have to pay the full rate then without any of the federal...without looking at the federal depreciation? [LB632]

WILLIAM PETERS: That's a hard one for me to answer. It would depend on where they stand with their federal tax. We would...I think it would. It would be an impact, but how much I really couldn't say. It would be...or I guess with our state taxes, either state tax rate times the 100 percent depreciation if they're on the new bonus, or the 179 depreciation which is also covered would have the same impact. The other thing is, there are limits spelled out which I don't really understand in that new federal code as far as once you get over two million, then you drop a dollar for dollar or something, which tells me that that (inaudible) would start bothering the...or impacts more on the low and middle size operations. [LB632]

SENATOR CORNETT: Questions from the committee? Seeing none, thank you. [LB632]

WILLIAM PETERS: Thank you. [LB632]

SENATOR CORNETT: Is there anyone else in a neutral capacity? I believe Senator Avery has left, so that will close the hearing on LB632. Senator Gloor, you are recognized to open on LB590. [LB590]

SENATOR GLOOR: Good afternoon, Chairwoman Cornett, Senators of the Revenue Committee. This is the first of two bills relating to tobacco products that you'll be hearing from me in the next couple of days. Appears I'm to be the Marlboro Man this week, at least for this committee. I'm Mike Gloor with the 35th District, that's G-l-o-o-r. I'm here

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today to introduce LB590, legislation that changes provisions related to cigarette taxation. And I would say when I was first approached to carry this bill I was interested, and as the weeks and weeks have gone by I've gotten more and more interested and now realize this bill is far, far more significant than I thought it was. I will also tell you that it is far, far more complicated than I thought it was. I have done due diligence in trying to wade through it, but my apologies for the fact that there is no way to boil this down to a Reader's Digest version. And so my presentation on this and the AG's to follow is pretty dry stuff, but I would tell you that I also think it is extremely important stuff, especially as relates to potential ramifications if this legislation does not move forward. In 1998, the attorneys general of 46 states, including Nebraska, signed the Master Settlement Agreement, which I'll refer to from now on as the MSA, with the four largest tobacco companies in the United States to settle state suits to recover billions of dollars in costs associated with treating smoking-related illnesses. We call this the tobacco money settlement. A number of tobacco companies subsequently joined the MSA; however, numerous companies, called nonparticipating manufacturers, are not bound by the provisions of the MSA. Since 1998, the Attorney General's Office of this state and the Department of Revenue of this state have actively and successfully enforced the provisions of the MSA to reduce tobacco use and protect consumers. Under the MSA, the participating tobacco manufacturers are required to make an annual payment to the states to cover costs incurred by the state in addressing public health issues associated with tobacco use. Another provision of the MSA, though, requires the state to adopt a qualifying statute. A qualifying statute requires the state to collect escrow from all nonparticipating manufacturers of that MSA to cover the public health costs incurred by the state from their product. This same provision of the MSA requires the states to diligently enforce the statute or be subject to an adjustment of the MSA payments. It's an important, important point. In 2002, the states and participating manufacturers identified concerns with loopholes in the original qualifying statute. As a result, the Legislature in 2003 adopted LB572, commonly referred to as complementary legislation that prohibited the sale of any brand of cigarette or roll-your-own tobacco in the state of Nebraska unless the manufacturer was listed on Nebraska's directory of compliant manufacturers and brand families. In 2004 we, the Legislature, adopted LB944, the allocable share amendment, which closed a loophole that allowed nonparticipating members to concentrate its sales exclusively in states where allocable shares were low, thereby entitling them to a release of escrow funds. The participating manufacturers have disputed all states' diligent enforcement of their qualifying statutes and in July 2010 commenced a nationwide arbitration to resolve the 2003 nonparticipating members' adjustment. For 2003 to 2010 the amount of the adjustment for all states totals approximately \$7 billion with Nebraska's share of the adjustment totalling approximately \$46 million. As a result of concerns raised in the arbitration and in an effort to avoid being subject to any future nonparticipating member adjustment, the provisions of this bill, LB590, will assist the state by closing loopholes and enhancing enforcement under the MSA. The revised adjustments will cover both stamped and unstamped nonparticipating member sales. LB590 establishes uniform licensing,

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stamping, and reporting provisions for tobacco product manufacturers, stamping agents, and wholesalers of cigarettes and roll-your-own tobacco. It also clarifies and enhances enforcement pertaining to those distributing tobacco in this state. Specifically, LB590 requires that all escrow payments made pursuant to Section 69-2703 be made quarterly or be subject to removal from the state directory. Under current law, only a portion of the nonparticipating manufacturers pay on a quarterly basis and the remainder pay on an annual basis. LB590 further authorizes removal of a tobacco product manufacturer and its brand families from the state directory if it is removed from the directory of any other state. In addition, LB590 requires a nonparticipating manufacturer to post a bond for the benefit of the state to cover its escrow obligations should it fail to make timely payments. LB590 also implements a universal reporting system which requires cigarette manufacturers, importers, and wholesalers to submit reports within 15 days following the end of each month, containing in that report the total number of cigarettes sold in or into the state during that month. LB590 further requires reporting sales from this state into another state. These reporting requirements are consistent with the recently passed federal Prevent All Cigarette Trafficking Act of 2009, commonly known as the PACT Act. LB590 also authorizes the negotiation and execution of a compact between the state and any federally recognized Indian tribe within the state concerning collection of cigarette taxes and escrow on sales to tribal members on tribal lands and recognizes the use of a tribal stamp to establish collection of taxes by the tribe on their tribal lands. The Attorney General's Office has worked with the Department of Revenue and participating tobacco manufacturers in development of LB590. As you can imagine with a bill of this technical complexity, we have identified a handful of areas that need tweaking. The Attorney General's Office is currently working with a variety of stakeholders, including tribal representatives, to prepare a comprehensive amendment which we will present to the committee for its consideration. We were actually working on this up until about noon today, at least in meetings I was involved in, and I'm thinking some of those meetings continued beyond noon. This is a complicated issue, a complicated bill. If this bill does not pass, there can be some fairly stern and sobering ramifications for the state, for if the court finds the state has not been diligent in enforcing this law, we could lose future payments and potentially have to pay back millions of dollars now sitting in the Health Care Cash Fund. In other words, there are clawback provisions. I'll close. I'll defer more specific questions to David Cookson, chief deputy attorney general. And if you have any specific questions you'd like to ask of me, I'll certainly take a shot at trying to answer them. Thank you for your listening to this important but complex matter. And by the way, I will also waive closing. I have need to get back to my Health and Human Services Committee hearings. [LB590]

SENATOR CORNETT: Senator Louden. [LB590]

SENATOR LOUDEN: Yes, thank you, Senator Cornett. Well, Senator Gloor, as I look through this, how come the Indian tribes are mentioned in here? What do we have to do with them? I thought they more or less were on their own reservation, sovereign nation;

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they did as they could please on there. How come we're putting this into law what we can do with the Indian tribes? [LB590]

SENATOR GLOOR: Well, that's part of the complexity of this issue since it involves the Master Settle...master...the MSA initially, years ago, which was federal. Has to do with issues related to Supreme Court rulings and has to do with some of the negotiation and cooperation that, thank goodness, exists between the tribes and the Attorney General's Office and the Department of Revenue in areas that also include collection of gas tax as an example. But I'll let Mr. Cookson go into more detail on that. [LB590]

SENATOR LOUDEN: Okay. Thank you. [LB590]

SENATOR CORNETT: Further questions from the committee? Seeing none, thank you. [LB590]

SENATOR GLOOR: Thank you very much. [LB590]

DAVID COOKSON: Madam Chairman, members of the committee, I'm David Cookson, D-a-v-i-d C-o-o-k-s-o-n, chief deputy attorney general. I'll try to hit some of the high points, but I suspect most of what I'll discuss will come through questions to the committee. The MSA does a number of things, but primarily in exchange for the significant amounts of money that the state receives on an annual basis, we have obligations to the companies as part of the agreement to make sure that companies that may be contributing to the healthcare costs who don't join the settlement are required to deposit into escrow an amount that reflects what they would be paying if they made MSA payments as part of the agreement. Those escrow payments sit in an account in which the state could then make a claim for healthcare costs should we ever get to that point. If we don't do that, and this is part of our qualifying statute, then we are subject to an adjustment to our MPM or to our MSA payment. In each year from 2003 to 2010, as Senator Gloor indicated, that adjustment now totals roughly \$7 billion in dispute and the part that may be somewhat sobering is of that \$7 billion in dispute the state's have already received or had released by the companies about 60 percent or roughly \$3.7 billion, so that money is already in the state coffers. The dispute still exists. They didn't waive their right to get it back. That's the clawback that he referred to. So what does it mean to diligently enforce a qualifying statute? And this goes to Senator Louden's question. It means for every nonparticipating manufacturer, we are obligated to make sure that escrow is deposited in an account, and this was part of the original qualifying statute passed by the Legislature in '99, to make sure that each cigarette or stick, as it's commonly referred to, has a corresponding escrow amount deposited in a qualifying escrow account and that money sits there. When it comes to the number of loopholes that have existed over the years, the Legislature twice has fixed them, as Senator Gloor indicated. A new area that has been created, relatively two areas, were the Internet and tribal sales. The Internet provided a mechanism wherein--you've dealt with this on other

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Internet tax issues--where cigarettes were being sold over the Internet without state excise tax and escrow being paid on MPM sticks. Congress addressed that with the PACT Act and it addressed it through reporting requirements, banning the delivery by the U.S. Postal Service, and by requiring Internet sellers to pay the specific state excise and escrow requirements or they could...not...or the sales would be illegal contraband and subject to seizure and criminal penalties through ATF and the Department of Justice. Where it gets tricky is the relationship between the states and the tribes as sovereign entities. Tribes have the authority, the states do not have the authority to tax tribal activities involving tribal entities and tribal members. The state has no authority in which to do that. However, tribes also have the ability through their entities to sell to nontribal members. The Supreme Court has repeatedly said, and as part of our obligation under the MSA, we can tax tribal sales to nontribal members. The problem is many of those sales occur on the reservation, and it is difficult for the states and for the tribes often to reach agreement how to do that. We have developed a very productive working relationship with the Winnebago Tribe of Nebraska and several years ago, I believe eight years ago, negotiated a tax compact with them in which we devised a formula for sharing of the appropriate gas taxes between the tribe and the state, and it has worked exceptionally well. The tribe has been, as a sovereign, a productive partner, and we would like to resolve our issues with regards to accounting for MSA obligations by entering into a compact with the tribe. We had introduced provisions in the bill to account for what would happen if we couldn't enter into an agreement. In discussing that with the tribe, we believe it's more productive for us to bring to the committee an amendment that removes Section 15 of the bill, which is what happens if we don't have a compact, and put that aside because we're confident, based on our discussions, that we can...it will be difficult but we'll find a way to work out an agreement that allows us to fulfill our obligations and allows them to conduct their business in the manner they deem appropriate. They also raise some other concerns with language, which we thought were appropriate. We had a very productive discussion today, and we will be incorporating those agreements into what we put together as an amendment. But to get to your question, we do have authority to tax and the Supreme Court has said we actually have authority to require the tribe that collects a tax on non-Natives. But it's bad policy to try to do that at the retail outlet by requiring identification. We agree with the tribe that that is not the way to do this. The way we've done it with the gas tax is the way to do it. And so we've asked for enabling authority to negotiate a compact. We've been working with the Tax Commissioner and his staff in how we will put that together, and we hope to begin negotiations with the tribe as soon as we possibly can and that will allow us to meet our obligations to the tribe as our sovereign partners and meet our obligations under the MSA and secure our payments in perpetuity. The other thing this does is every...MPMs were not really a creature that existed before the Master Settlement Agreement, because you couldn't simply go out and start a cigarette company because you couldn't compete with the major tobacco companies. But once the major tobacco companies started paying the state billions of dollars every year, their price point jumped up and it became a price competitive advantage for MPMs to

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purchase tobacco manufacturing equipment, manufacture cigarettes, and then evade state taxes and state escrow requirements. And I'm not talking about the tribes. I'm talking about foreign companies, fly-by-night companies. So what the other provisions of LB590 do allow us to make sure we have uniform licensing, stamping, reporting, so we know how many cigarettes come in the state, how many are sold in the state and we're responsible for, and how many go out of the state to other states through multistate wholesalers. And I would add we've met with the wholesalers' association. They've raised some concerns they have. They like the bill but they have concerns that some of their legitimate folks might inadvertently get caught up, so we're going to modify some language in working with them as well. So LB590 is primarily designed to enhance our enforcement ability to allow us to have the same productive relationship with the tribe by negotiating a compact that is mutually beneficial to both of us, and then allows us to secure our MSA payment and hopefully get out of this rather expensive arbitration that we're currently in with the participating manufacturers. We've had four hearings and the states collectively have spent \$400,000 just on the hearings. The tobacco companies are paying half; they've spent \$400,000. So it's extremely expensive. There's a significant amount of money at risk, and we would like to address those concerns and make this go away through LB590. And I would be happy to answer any questions. [LB590]

SENATOR CORNETT: Two questions to start with: When you talk about the clawback provision, how much money are we talking about that we could lose if this bill is not passed this year? And secondly, is there a priority on this bill? [LB590]

DAVID COOKSON: Yeah, I believe that the Speaker has indicated that he would consider this for a Speaker priority. [LB590]

SENATOR CORNETT: Okay, because earlier he indicated no fiscal notes for a Speaker priority. [LB590]

DAVID COOKSON: We're working with the Department of Revenue. The fiscal note is based off the green copy of the bill. The committee amendment that we will bring to you that we worked through with Revenue will relate to an adjustment, and there are funds available in the Health Care Cash Fund, as we understand it from talking to DAS Budget, that can be used for this process because that's what it's intended to do. [LB590]

SENATOR CORNETT: I was going to say, how are you going to pay for, I think it's, three or four full-time employees? [LB590]

DAVID COOKSON: That will be revised based on the amendment. We're working with...because the amendment hasn't been introduced, they had to do their fiscal analysis based on the... [LB590]

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SENATOR CORNETT: But they will, even with the amendment,... [LB590]

DAVID COOKSON: There will be some... [LB590]

SENATOR CORNETT: ...Department of Revenue is still going to need employees to administer this, correct? [LB590]

DAVID COOKSON: Yes, and... [LB590]

SENATOR CORNETT: And that money is coming from the...? [LB590]

DAVID COOKSON: We're going to look to the Health Care Cash Fund, which is where the tobacco money goes. We already use a portion of that to pay our share of the arbitration and to pay for the costs associated with the tobacco litigation, so there's some working...some flexibility within the fund that we could use. [LB590]

SENATOR CORNETT: So do you have a backup plan on the priority status? [LB590]

DAVID COOKSON: Not at the moment, no. If we don't, then we'll have to see what the Speaker wants to do. [LB590]

SENATOR CORNETT: Senator Pankonin. [LB590]

SENATOR PANKONIN: Thank you, Senator Cornett. Mr. Cookson, thanks for being here. And thanks to you and Senator Gloor, I think I've got a handle on the situation. And you know when I hear billions I perk up quite a bit, because having been on the HHS Committee the last four years, knowing what that fund does and how big it is, when you start talking about \$50 million a year that we get off that fund for various things, I think that's very true or somewhere in that neighborhood. You know the principal is a big number, so that's the first thing. This is big numbers, huge consequences. How assured are you that if we do pass something that passes this year that we do get out of the issues with the major manufacturers? [LB590]

DAVID COOKSON: Well, it will be dependent on how many other states join us, and we've been in settlement negotiations with the tobacco companies for the last 18 months. Regrettably, because my boss is the chairman, one of the cochairs of the NAAG Tobacco Committee, I've been one of the lead negotiators for the state. We have a deal, a potential settlement with the tobacco companies that would give us the significant portion of the amount in dispute if we get a sufficient number of states to join, and we're in the process of getting those states on board. We're about halfway to where we need to get. [LB590]

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SENATOR PANKONIN: My follow-up question is you mentioned that this...with amendments, with changes that are ongoing through your discussions with the tribes, that this would still be enabling legislation to enable your office to complete these negotiations. Is that what I heard correctly? [LB590]

DAVID COOKSON: Actually, it enables the Governor. The Governor is the executive branch authority who negotiates. We would provide legal advice to his designated representative. Typically, that would be the Tax Commissioner and his staff. [LB590]

SENATOR PANKONIN: Okay. And that's what we do. [LB590]

DAVID COOKSON: Right. [LB590]

SENATOR PANKONIN: Right. [LB590]

DAVID COOKSON: But we can't negotiate the compact without legislative authority. [LB590]

SENATOR PANKONIN: Authority to do it. Thank you. [LB590]

SENATOR CORNETT: Senator Hadley. [LB590]

SENATOR HADLEY: Yes, Senator Cornett. Mr. Cookson, thank you. You mentioned the wholesalers. Are there going to be additional costs and reporting concerns as far as the wholesalers are concerned? [LB590]

DAVID COOKSON: No, and that's the beauty of this from a practical standpoint. The PACT Act, which was passed in 2009, in June 2010 required all cigarette manufacturers and distributors, including the tribes, to report all cigarettes that are sold monthly that are sold into a state and to provide certain information with regards to those cigarettes. So the reporting that we've put in this simply matches the requirements that they already have to do under the federal act. What we want to get to is one form. You submit your PACT Act report. That suffices for the state reports. We can correlate all of that data. We can know what we're responsible for and control our destiny which allows us to know going forward that we're in compliance, and at the same time does not create an additional burden on the wholesalers or the manufacturers. We really, because the negotiations were going on while the PACT Act was being debated in Congress and then passed, what we did with the companies was to build the reporting component around what the feds were going to already require so that we wouldn't impose an additional burden. Now states are free to do that but I don't think that's good policy, at least from my perspective. I think allowing the companies to comply with the federal law and the state reporting requirements with one form is a much better way to go. [LB590]

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SENATOR HADLEY: Thank you. [LB590]

DAVID COOKSON: And, Senator Cornett, I would add that the total on the clawback, if we were to lose diligent enforcement for every year from '03 to 2010, it could be roughly \$300 million, somewhere in the neighborhood of \$280 million to \$300 million, depending on the interest. Now we don't think we're going to lose. We think we did...Revenue and the AG's Office did what we were supposed to do, but it's litigation, it's arbitration. Arbitrators like to sometimes split the baby and so we are potentially at risk. [LB590]

SENATOR CORNETT: Further questions? Seeing none, thank you. [LB590]

DAVID COOKSON: Thank you. [LB590]

SENATOR UTTER: Next proponent. [LB590]

DAVID HOLMQUIST: Senators, thank you. I'll be very brief in my comments. My name is David Holmquist, D-a-v-i-d H-o-l-m-q-u-i-s-t. I am a registered lobbyist. I represent the American Cancer Society in Nebraska. I'm here in support of LB590. As you may know, the American Cancer Society has focused much of its efforts over the past 20 years on tax issues as they relate to smoking. We find ourselves, on a bill like this, in the unique position of being in agreement with the major tobacco manufacturers. One of the reasons that legislation like this is important is it creates a level playing field between the manufacturers who are participating manufacturers and who made the agreement with the Master Settlement, the other Master Settlement Agreement states, and between those manufacturers who either didn't exist or existed in a small...smaller place at that point in time, in 1998, when the MSA was negotiated. This bill simply levels that playing field, we feel. As the Attorney General's Office and the senator have both indicated, there is a potential very negative financial impact to the state unless the state moves forward and continues their process of due diligence, and this is really all about due diligence and all about maintaining a level playing field, and I certainly support their efforts to pass this legislation so that they can enter into a compact with the tribal nations. Oklahoma has the largest number of tribes in the United States and they for many, many years have had compacts of this nature that have been helpful in their progress toward working together on issues like gasoline tax and cigarette tax. With that, I would try to answer any questions. There's 67 pages of legal jargon here and I am not nor will ever be an attorney, so... [LB590]

SENATOR UTTER: Thank you, Mr. Holmquist. Questions for Mr. Holmquist? Seeing none, thank you very much. [LB590]

DAVID HOLMQUIST: Thank you, Senator Utter. [LB590]

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SENATOR UTTER: Next proponent. Are there any further proponents? Welcome.
[LB590]

KATHY SIEFKEN: Hello, Senator Utter and members of the committee. My name is Kathy Siefken, S-i-e-f-k-e-n. I'm the executive director of the Nebraska Grocery Industry Association here in support of LB590. My wholesaler members, and they are the people that put the stamps on the cigarettes, reviewed this and they wanted me to come and let you know that this is a good bill. It levels the playing field and it's something that we need. And I'm sure I can't answer any questions that Mr. Cookson and Senator Gloor haven't already shared with you, but I'd be willing to try. [LB590]

SENATOR UTTER: Are you really sure about that? Senator Adams wants to ask you a question. [LB590]

SENATOR ADAMS: I probably should have asked earlier but my mind is behind the times here. When you say, from your industry standpoint, it levels the playing field, tell me again how your industry sees this leveling the playing field. [LB590]

KATHY SIEFKEN: What happens is the cheaper tobacco comes in at a lower price and it sells at a lower price and, frankly, the idea is that the Master Settlement Agreement was put into place for a reason and all tobacco companies should be treated fairly and equally. It shouldn't make... [LB590]

SENATOR ADAMS: So this catches up with those. [LB590]

KATHY SIEFKEN: It catches up, uh-huh, and... [LB590]

SENATOR ADAMS: Okay. Okay. [LB590]

KATHY SIEFKEN: And frankly, this probably...this isn't the first time, as Mr. Cookson mentioned, this isn't the first time that everyone has been back trying to close all the loopholes, because it seems that the minute you close one loophole there's another one that tends to pop up. [LB590]

SENATOR ADAMS: Okay. Thank you. [LB590]

SENATOR UTTER: Other questions for Kathy? Senator Fischer. [LB590]

SENATOR FISCHER: I should probably ask...ask this before, too, but Senator Adams and I are visiting here and getting more confused I think by it. These other companies that are involved now that we're trying to level the playing field for and for the tribes, is this required by federal law that we do this or are we just trying to level the playing field?
[LB590]

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KATHY SIEFKEN: I'm not the one to answer that question I don't believe. [LB590]

SENATOR FISCHER: Okay. If somebody comes up and would like to do that later, that would be good then. Thank you. [LB590]

KATHY SIEFKEN: Thanks. [LB590]

SENATOR UTTER: Thank you, Kathy. Next proponent. Opponents? Anyone here opposing the bill? Welcome to the Revenue Committee. [LB590]

LANCE MORGAN: My name is Lance Morgan. I'm the CEO of the Winnebago Tribe of Nebraska and a member of the Winnebago Tribe, and I am an opponent of the green copy. And a few hours ago I was really an opponent and we've been working on it the last several hours to deal with some of the objections. I think we sent a letter detailing some of the specific objections to each member of the committee last week, so I won't necessarily go into that. But I would like to offer some perspective and answer your question, if I could. No, this is not a requirement from the federal government. In fact, any time we hear the word "level the playing field," it makes us cringe because we think that usually is something bad for us. But I think it's more of a competitive issue and, as in most things in America, it's about money, I suspect. I wanted to give you just a little bit of background and compare this to what we did in the gas situation, which has worked out remarkably well. There is federal law that says the state can collect taxes from essentially Nebraska's white people but they can't collect it from Indians, and the problem is when those laws were...or when those cases were done, tribes didn't have any businesses. The businesses were largely owned by non-Indians or nontribal members, and the tribe would try to pass a tax and the court would say, well, you can't tax that non-Indian tribal member business. What's happened in the meantime is we now control every business of substance on our reservation. We decided we would kind of do things for ourselves. And the state comes in and says, now wait a minute, we'll give you a refund if you fill out this form for the Indians and you've got to send us money for your white customers. And we're like, you know, we're not doing that anymore. This is...it's an anachronism. You know, it's something from the past. We will not do race-based pricing. We will not do anything of that sort on our own land, on our own buildings and in our own businesses where we run and control them. It is an affront to us. And although that is...the Supreme Court said that, the Supreme Court said something else too. They said they can't make the tribes do it. We have what is known as sovereign immunity, just like the state of Nebraska has. We cannot be sued unless we agree to. So the fact that we took control of our economic destiny and control over our own businesses allowed us to implement our own taxation system. Now I hear big numbers being talked about but our tobacco tax is \$250,000, that's what we raise, and that combined with the gas tax is projected to be a whopping \$500,000, which is nothing to Nebraska but everything to us. It's money that we use for a community development

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fund, for cultural preservation, and for down payment assistance in our community. And so it's something that we want to fight for and it seems somewhat a waste of resources that our competitors want to attack us, you know, as the loophole for us doing this thing. Now that being said, let me explain how this happened. We had a simple problem with gasoline a few years ago, ten years ago I think we settled it, and we were making ethanol on our reservation. And the law is, if you create your own product, you don't have to pay state tax. Tribal interest outweighs state. But we agreed to share 75 to 25 percent of our tax on the reservation with the state. Now we owned every gas station so we didn't...and we didn't have to do it, but we did it under one...under a couple different circumstances. One, we wanted it to be a tribal tax that was race neutral and then that we would share that tax with the state, give them 25 percent. We also wanted to write the check. You never want to be the guy waiting for the check, as Philip Morris is proving to you guys, I think, with the MSA. They're withholding the check. And so those two circumstances were resolved and we moved forward. Now the tobacco, we have never been able to do it. About 12 years ago I got a call from the state of Nebraska and they said, we settled with the tobacco companies; we sued them, we settled, we have something called the MSA now and you have to kind of raise your prices. And I said I saw that, I saw you're getting like \$1 billion, how much do we get, right? And they said, well, nothing. So I said, I'm not the world's greatest lawyer but you had a private settlement, you sued somebody, you settled, you can't put my name on it outside of your jurisdiction and expect us to comply with it. And they said, well, we really want you to. And we said, well, we don't want to. And that's what led to sort of a price advantage on our reservation and that created this sort of constant pressure to do things. This is actually like the third or fourth attempt to kind of close some loophole. The problem is the tribes cannot be made to do anything, right? We have to agree. The problem with agreeing to a tax compact with cigarettes is that with gas there's one tax, an excise tax. Now with the MSA it was a price increase in the wholesale price, all right? And so...and then...so that's not a tax that they want to share. And if you don't pay it, there's something called escrow. So there are three sources of payment, none of which the state put...the state only wanted to put one source of payment. And when the state also, in order to sort of close the loophole or level the playing field, they also created something called a list law and they said if you're not on the list, you can't put the Nebraska state stamp on that tobacco. And surprisingly, none of the brands that we sold were on the list. And so we had no incentive whatsoever. The state would only share one of the three sources of revenue and they would make the products that we sold and made on our own reservations illegal. So that's the problem we face. Now that kind of detente has continued on for some time. Somebody mentioned the federal law was passed called the PACT Act. That was designed to stop sort of an Internet cigarette business. In that the tribes were upset with that law and they protected the sovereign immunity of the tribes and they also said that it would protect tribal common law, and so that law went forward without a ton of tribal objection, although I was personally objecting to it because I didn't quite trust, you know, the large tobacco companies. And so when this law was introduced after a year of negotiations to enable us to enter into a

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compact, I was thrilled until I read it. Now I just told you that there's a provision in the PACT Act protecting sovereign immunity, but under the law that came forward, it said if you claim sovereign immunity you get put on a naughty list and nobody can sell you any tobacco. And so it was if we exercised our legal rights, it would become sort of an economic sanction for us, and of course we were less than thrilled. And I think that our position has been articulated to the state, and I think in the amendment that's coming forward, some of the more objectionable provisions are going to be removed and we're going to add some flexibility into the negotiation. I think the main thing that I would like...so that's...so I'm hoping that that will come forward in a much better manner from our standpoint. I think one of the main things you need to understand is that this is not some happy, we're-all-in-it-together sort of thing. I mean you guys, the state of Nebraska, and 46 other states made a deal with Marlboro, the same people who raised their hand and lied to Congress, you know? And I was saying earlier, if you make a deal with the devil, it gets...you know, it works out great at first but it gets a little nervous at the end, and they're proving their colors and they want you to squish the tribal business. That's part of what they're pressuring states to do. Now the tribes have never been part of the MSA. We've never gotten a penny. We were outside the jurisdiction; we weren't part of the lawsuit. But for some reason, they're now holding this sword over your head and saying if you don't crush the Indian tribes, well, we're going to withhold this money, and that was never the deal. And so you're dealing with some larger, slightly more sinister issues I think and it's all driven by this somehow need for competitive control. And in this instance, we're talking \$250,000 in tax revenue, half the tax base of the entire tribe. You have to understand that all of our land is owned by the federal government. It's not subject to property tax. The only people we can tax according to federal law is ourselves, and we're poor. So I don't know...I know Nebraska is antitax but we're really antitax, and so this is our only tax revenue. In 1992, when I first started working with a tribe as an intern, our entire discretionary budget for 4,000 members was \$180,000. We had several employees. Right now the Winnebago Tribe has 2,000 employees. We've taken hundreds of people off the welfare rolls in Nebraska and we're probably one of the largest employers in northeast Nebraska. Ho-Chunk, Inc. itself, the company I run, has 1,400 employees and we started with \$400,000 in revenue and this last year we ended with \$193 million, and we work in five other countries. When Senator Johanns was Governor, he came to our tribe and he said, what can I do to help? I said, you can hurt us more than you can help us. Just leave us alone. We've figured out how to take care of ourselves. We don't want anyone's sympathy. We just want to be able...the opportunity to do these kinds of things. But people know tribes got a bad deal. What they don't realize is that we're still fighting for some basic rights, things that you take for granted. And, you know, big tobacco can come down here with their lobbyists--I'm sure they're behind me somewhere, I don't know who they are, I was kind of trying to figure it out--and they can whisper in people's ear and tell us, level the playing field. But what they're really doing is trying to crush somebody and, you know, we intend to fight for what little rights we have to promote ourselves and do these kinds of things, and these laws make us nervous. We're hoping, like with the gas issue, which

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we have settled and worked perfectly for eight or nine years, that we can come up with an agreement with tobacco. It's going to be harder because there's a lot of regulatory complexities to it. It's not a straight tax-sharing sort of deal. It's trying to impose what we can sell, how we sell it, who we can sell it to. And so we're optimistic that we can solve those issues but, from our standpoint, we want an agreement that recognizes our jurisdiction, no longer makes racial determinations at the cash register, and keeps...really we would like it also if Philip Morris would stay out of our business, you know? That's kind of my general remarks. I don't know if anybody has any questions for what we're doing. [LB590]

SENATOR CORNETT: Senator Louden. [LB590]

SENATOR LOUDEN: Yeah, thank you, Senator Cornett. Well, yes, and that was when, Lance, when I looked at this deal and I always...from where I come from up there, I always have some qualms when I start looking at some legislation and you start talking about Indian tribes. Would you prefer you were written clear out of this bill that they're doing here, you know? Because there's some new language that describes who a person is and they had all kinds of corporations and companies and all that, and then they go on to say, "including any Indian tribe or instrumentality thereof or any member of an Indian tribe." Now that's new language that's written into this LB590. As you've been negotiating with them, is some of that language out of there or is that still in there? [LB590]

LANCE MORGAN: Yeah, that was just sort of, on a personal level, objectionable to us to be...to have to be identified specifically as a person. That was solved about a hundred years ago with Standing Bear, I believe, Chief Standing Bear. He became a person under the law. And so we're already people so we probably don't need that, and I think the state agreed to remove that just because it was mildly offensive to just us in general. [LB590]

SENATOR LOUDEN: Well, that was one of the... [LB590]

LANCE MORGAN: But as far as the other provisions, we do want an agreement. We asked for the enabling legislation. We asked, so this came... [LB590]

SENATOR LOUDEN: Well, can you get an agreement... [LB590]

LANCE MORGAN: ...but the negative language, I'm sorry to interrupt, came as a huge surprise to us, you know, the stuff about... [LB590]

SENATOR LOUDEN: Okay. Can you get an agreement with the Attorney General or whoever with you being written entirely out of here? Do you have to be mentioned in this thing anyplace in order to get an agreement other than where it says the Tax

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Commissioner may, I think someplace in here, can enter into an agreement with an Indian tribe or something like that? But is that all that's necessary in that bill? [LB590]

LANCE MORGAN: Well, that would do it probably. I think Nebraska is walking a tightrope. The people from Nebraska and especially the Attorney General's Office, the tax stuff has been a little more controversial, the office there, but the Attorney General's Office has been...has treated us with respect and understands our position, but they're dancing to somebody else's tune, to some extent, and they...you know, they have to show that they're diligently enforcing the MSA. And Philip Morris has now taken the position that it applies on the reservation, even though they didn't use to, and so they're trying to show, for purposes of this litigation and arbitration, that they're trying to do something and this compact hopefully will solve that problem. I'm not sure it will make them happy until we're totally leveled, you know, till the playing field is completely leveled and we're gone. But I think that Nebraska is trying to tap-dance that. But within that you run into some real controversies internally inside your own government. We thought we had a deal with Nebraska in December. I signed a document called the final draft, and then I got another review that had many objectionable provisions. The primary one was they said we can sell Indian cigarettes but only to Indians. So we're allowed to manufacture a product but we can only sell it to a certain race of people. Now I don't even know how to respond to that without, you know, some sort of laugh or something. But I mean these are the kind of things that emerge when you get into these kind of fights at the bottom, and so there's a lot of details that need to be worked out. And we asked, and the states had agreed largely, to take out some of the more restrictive provisions in the...that you have that allow for us to be creative to deal with the reality of the situation, and the reality is no government can tell another government what to do. And this game of a sort that's played where the state tries to, the state can't directly tell us what to do so what they do is they try to tell everybody else who deals with us what to do, and then we find another way around it because we, you know, we're hard to kill and we don't like to go out of business because somebody else voted on it. [LB590]

SENATOR LOUDEN: Now on this then, this has been a work in progress since last summer or sometime like that? [LB590]

LANCE MORGAN: Well, the negotiations, we have been trying to negotiate. There was a meeting a few years ago where somebody...where the state of Nebraska sent some representatives to my office and I said, are you here because Philip Morris sent you, kind of in a smart-alecky sort of way, right? And they said, yes. (Laugh) Now so...and they wanted to see all of our records and we had been in a litigation in Kansas where Nebraska gave all our records, because Nebraska is pretty good about that. And so we objected immediately. If Nebraska...if someone were to come...your state government were to come representing your competitor to look at your financial information and who you sell to, you probably would be somewhat upset too. That's what triggered this latest crisis. And in a meeting, we kind of had the discussion where it was kind of like you

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people need to do this, and so I think we kind of ceremoniously sent our license back to Nebraska and we've been fighting about it ever since. Unfortunately, I forgot, while I was...that we do have businesses off the reservation who need that license (laugh), but I was mad at the time. And so we were trying to negotiate an agreement to get it back. And that's when...that's what's taken over a year just to have a discussion to get a normalized license. At one point, somebody said they had to go check with big tobacco, and so we really have this sort of strange dynamic that's evolving here and I think that, rather than continue the fight, the answer is some sort of general enabling legislation that allows us to craft something that is fairly complex to solve this problem for the long term. That way the tribe could have some visibility and then we can reinvest our capital and continue to build up without this sort of constant threat and concern, you know, that's facing... [LB590]

SENATOR LOUDEN: Well, then as it mentions in Section 20, it gives the Governor authority to negotiate or something I think and then before that the Tax Commissioner. Actually that's as far as working with...Nebraska working with the tribe, that's all that's necessary, isn't it, giving somebody permission to negotiate? [LB590]

LANCE MORGAN: Well, hopefully, yes. There was a provision that said they could negotiate as long as it didn't conflict with...then a string of statutes (laugh), right? And so that's really not much of a negotiation if Nebraska law is based on federal law that we no longer...that no longer really applies. And so I think Nebraska has agreed to show some more flexibility and to allow a more general sort of approach. And as long as that is the case, I think we can solve this problem in fairly short order and come up with an agreement that maybe some of the other states will follow. I'm involved with other tribes all across the country and this is an issue everywhere. The states have woken up to the fact that they're being...the tribes have woken up to the fact that they're being manipulated, that their tax agreements only represent one-third of the money that is tied to cigarettes anymore and that they're being controlled through a regulation that tells them what they can and cannot sell that all happens outside of their process. And so this is an emerging issue, it has been for the last couple of years, and I think our gas agreement was one of the first of its kind that recognized tribal law and didn't have a racial element to it. And I think that if we...that it's going to be harder but we have the potential to craft the same sort of law here. I'm a little bit worried about, you know, some of the people being sticklers about some aspects of the law, from a federal Indian law from the '70s or the '60s, that no longer really apply in the real world, you know, so... [LB590]

SENATOR LOUDEN: Okay. Thank you. [LB590]

SENATOR CORNETT: Further questions? Seeing none, thank you very much. [LB590]

LANCE MORGAN: I appreciate your time and indulgence. [LB590]

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SENATOR CORNETT: Is there anyone else in opposition? Neutral? [LB590]

MICK MINES: Madam Chair, members of the committee, my name is Mick Mines, M-i-c-k M-i-n-e-s. I'm a registered lobbyist today representing the Nebraska Association of Tobacco and Candy Distributors. First of all, I'd like to thank Kathy Siefken for coming up before you and testifying in a positive position. We do, in fact, support the work that Dave Cookson and the Attorney General's Office are doing in this instance. I'm testifying neutral because we do have several concerns, and Mr. Cookson outlined one of those. There are two provisions in this contract, particularly Section 9, that changes the reporting requirements required of the tax stamp, the stamping agents, of which my members are stamping agents; reduces that from quarterly to monthly. And Mr. Cookson did identify that they are working on language that would include that reporting along with other monthly reportings, and we appreciate that. Secondly, Section 10, we are concerned that our members, again the stamping agents, would be required to not only set up the escrow accounts, which the state does now, or are responsible for the escrow accounts and for the collection of those. That responsibility would shift over to our members, the stamping...the taxing agents, and we don't feel that that's appropriate and we are working with Mr. Cookson and the Attorney General's Office to make sure that that is changed. Otherwise, we appreciate his time and his efforts, and I appreciate your time. Thank you very much. [LB590]

SENATOR CORNETT: Questions from the committee? Seeing none, thank you. [LB590]

MICK MINES: Thanks. [LB590]

SENATOR CORNETT: Is there anyone else in a neutral capacity? Seeing none, I believe Senator Gloor waived closing. That will end the hearings for today. [LB590]