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Revenue Committee  
February 20, 2013

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[LB81 LB281 LB328 LB457]

The Committee on Revenue met at 1:30 p.m. on Wednesday, February 20, 2013, in Room 1524 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on LB81, LB457, LB328, and LB281. Senators present: Galen Hadley, Chairperson; Paul Schumacher, Vice Chairperson; Tom Hansen; Burke Harr; Charlie Janssen; Beau McCoy; Pete Pirsch; and Kate Sullivan. Senators absent: None.

SENATOR HADLEY: Good afternoon. Welcome to the Revenue Committee. It's an amazing committee when I can call everybody by name that's sitting here with our committee. We must not have anything exciting today, huh? (Laughter) My name is Senator Galen Hadley from Kearney; to my left is Senator Schumacher from Columbus; to his left will be Senator Pirsch from Omaha; and to his left will be Senator Sullivan from Cedar Rapids. On my far right will be Senator Burke Harr from Omaha; Senator Janssen will be to his left; Senator McCoy from Omaha; and Senator Hansen from North Platte. Our committee counsel is Mary Jane Egr Edson to my right; Bill Lock is our research analyst; and Matt Rathje is our...to the far left, is our committee clerk. Our pages are Evan Schmeits and Nate Funk, they're here. Turn off cell phones or put on vibrate while in the hearing room. The sign-in sheets for testifiers are on the tables by both doors and need to be completed by everyone wishing to testify. If you are testifying on more than one bill, you need to submit a form for each bill. Please print and complete the form prior to coming up to testify. When you come up to testify, hand your testifier sheet to the committee clerk. There are also clipboards on the back of the room to sign if you do not wish to testify but would like to indicate your support or opposition to a bill. These sheets will be included in the official record. We will follow the agenda posted on the door. The introducer or representative will present the bill followed by proponents, opponents, and neutral. Only the introducer will have the option for closing remarks. As you begin your testimony, state your name and spell it for the record. If you have handouts, please bring ten copies for the committee and staff. If you only have the original, we will make copies. Give the handouts to the page who will circulate to the committee. With such an overwhelming response today, we will not use the light system today. But if you abuse it, we will have those on in just a quick second. Okay. With that, Senator Schumacher.

SENATOR SCHUMACHER: Thank you, Senator Hadley and members of the committee. My name is Paul Schumacher, P-a-u-l S-c-h-u-m-a-c-h-e-r. I represent District 22 in the Legislature. I'm here today to introduce LB81 to the committee. LB81 is one of those Sunday afternoon brain children that I came up with when I had nothing better to do. But anyway, it addresses a problem, at least brings that into this broad ranging discussion that we may be embarking on in this system and ideas of taxation. There are currently two ways in which business entities are taxed. One is taxed at a single level, and that's accomplished by an election made for a limited liability company or what they call a Subchapter S status company or a limited partnership or partnership.

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

---

And essentially the money comes in to the business, if it makes a dollar, it is then taxed as it were earned by the participants, the shareholders, or partners in the business. It's taxed a single time. There's also a system of taxation that's grown up around what I call regular corporations or ordinary corporations. They're technically called C corporations and a C corporation, when it makes a dollar, it's taxed as a C corporation, which is...there's various grades, but just for functional purposes you call it 34 percent at the federal level and then the state of Nebraska adds on an extra 7.81 percent tax, meaning that every dollar that is made by that C corporation ends up getting taxed right at 42 cents, leaving only 58 cents left to pass through or to use for its business purposes. And then Nebraska comes along and Nebraska does not give any special treatment to dividends. We tax those just as though they were earned income. The federal government does give a special treatment if it's a domestic corporation. It's 15 to 20 percent, is what the federal government taxes at. But if you add what the individual has to pay in tax, let's assume it's a domestic corporation of 15 to 20 percent, to Nebraska's personal income tax of 6.84 percent, when it's all said and done, somewhere between 55 and 65 cents on the dollar is eaten up in taxes. And that's really, really high. It's higher than what is generally thought appropriate. In fact, at the national level, and the national level has got to be part of this discussion at some particular point, our taxes comparatively to the rest of the world are so much higher that our corporations that earn global money are parking it offshore and they're not repatriating it. And money is parked offshore because they don't want to have to get hit with the double taxation. This attempts also to integrate into the thought process the fact that whether it's pension funds or whether it's just plain stock investments that have been made by our retirees, are bled down by this 55 to 65 percent ratio. Corporations themselves reluctant to pass...to pay a dividend because they know that most of their resources of that dollar they earned is going to end up going back to the government and not to the retiree. What this does is allow the corporation to deduct anything that pays out as dividends. And we think about it, dividend is kind of an interest on the shareholders original investment in stock. And there really should be no different treatment of capital that is acquired through selling stock and capital that is acquired by going to the bank and getting a loan. But when you go to the bank or they go to the capital markets and borrow money, or put it out in debentures or some type of debt instrument like that, and they pay interest on that loan, the corporation can deduct it. Corporation goes sells stock, corporation can't deduct it when it pays a dividend. And what this basically says is, let's put debt on the same level as equity for purposes of taxation. Let's eliminate the double taxation of it, let's permit it to be deductible at the corporate level. If a company pays out all of its profits of dividends, it effectively reduces or eliminates the corporate income tax to the extent that it doesn't pay out all of it as dividends and invests it in deductible expenses of some kind, it also effectively reduces or eliminates the corporate income tax. And we tax everybody equally the same way we would if it was a Subchapter S or a limited partnership. I think it has an internal corporate benefit also because today if you got an extra dollar and you pay it out as a dividend, you know that nearly two-thirds of it is going back to the government. If you, however, blow it on

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

---

excessive contribution...or compensation for executives, which you can deduct, then nothing of that dollar goes to the government because the corporation gets to deduct the entire compensation. So, this is an effort to raise this particular issue before the committee so it's put in our stack of things to consider as we develop tax policy. Is it wise to double tax corporate earnings? And should a regular corporation be treated in the same manner and according to the same rules as far as the double taxation as a Subchapter S or partnership corporation? And that concludes my introduction of LB81 and be happy to take any questions. [LB81]

SENATOR HADLEY: Questions for Senator Schumacher? Senator Sullivan. [LB81]

SENATOR SULLIVAN: Thank you, Senator Hadley. Has it always been this way? [LB81]

SENATOR SCHUMACHER: Yeah, it's been at least since I was in law school which is not always, but almost always. (Laughter) [LB81]

SENATOR SULLIVAN: Where do LLCs enter into this? [LB81]

SENATOR SCHUMACHER: It's my understanding that LLCs can also make an election that LLCs for the most part are all elect to be taxed as partnerships, but I think they can make an election to be taxed as a corporation for some reason. I might be wrong on that, but I'm pretty sure that's kind of how it works. [LB81]

SENATOR SULLIVAN: Okay. Thank you. [LB81]

SENATOR HADLEY: Senator Schumacher, I'm actually...I know it's hard to believe but I'm older than you, but I can remember back taking accounting classes many, many years ago and we talked about the double taxation. It's been around probably for a long, long time, right? And I suppose this is one of those things that if we had to do it all over again, we wouldn't do it this way, but now it becomes such a huge financial issue that the tax policy is overridden by the consequences of the dollars involved. Is that a fair statement? [LB81]

SENATOR SCHUMACHER: That's probably a fair statement. Now, the bill does have a variable in there for the percentage that would be allowed to be deductible. I cheated a little bit and put in xx, instead of a real number. I think the fiscal note, assuming it would be a hundred percent down the road is like \$118 million or something starting three years from now, it would be half that if the xx was 50 percent. But at the same time, it is a way of reducing the corporate taxes and it is a way of encouraging the payment of dividends to the folks who are now in our age category, Senator Hadley, who would like to have dividends if we're lucky enough to have stock. [LB81]

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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SENATOR HADLEY: Okay. Any other questions? [LB81]

SENATOR SCHUMACHER: I didn't mean to leave you out, Senator Hansen, of our age category. (Laughter) [LB81]

SENATOR HANSEN: Thank you. [LB81]

SENATOR HADLEY: Thank you, Senator Schumacher. Are there other proponents? Opponents? Neutral? Senator Schumacher, are you waiving closing? Waiving closing, okay. Next, Senator Krist, welcome to the Revenue Committee again. [LB81]

SENATOR KRIST: (Exhibits 1, 2, and 3) I didn't expect that to go that fast, so I'm a little unorganized here. We'll catch up. Good afternoon, Senator Hadley and members of the Revenue Committee. For the record, my name is Bob Krist, B-o-b K-r-i-s-t, and I represent the 10th Legislative District, northwest Omaha along with a north-central portion of Douglas County, which includes the city of Bennington. I appear before you today in introduction and support of LB457. It isn't very often that a pilot gets an opportunity to carry a bill for Barry Kennedy, and I feel privileged to do that today. What I'm introducing, the introduction here, basically is the net operating loss carryforward policy in Nebraska. I bring your attention, first of all, to the blue handout. And although we don't always do everything by rankings, over on the side you'll see that the state of Maine changed two very simple things and they went from 37 to 30 in terms of the attractability for corporate structure. What is a net operating loss carryforward policy? I will not insult this committee's intelligence by reading to you, but if you'll go down on the multipage stapled handout, the white one, you'll see that it gives, "An annual accounting system can create distortions if a corporation loses money in one taxable year and has profits in another. A business has a net operating loss, or NOL, when its tax-deductible expenses exceed taxable revenues during the fiscal year. The annual accounting method causes an unbalanced tax burden by not allowing businesses to benefit from the excess deductions generated in that NOL year." Senator Hadley, I think you could get up at the grease board and give us a class on this. I think you've instructed on... [LB457]

SENATOR HADLEY: Actually I carried this bill a couple years ago, so we're going to judge... [LB457]

SENATOR KRIST: So I don't have to explain it to the... [LB457]

SENATOR HADLEY: We're going to judge your opening versus mine. (Laugh) [LB457]

SENATOR KRIST: So we're going to cut to the chase and say, ask Hadley. How's that? No, I think this explanation, the three-page explanation, says all it needs to say and I won't insult you again by reading through it. I will tell you that the State NOL Carryback

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

---

and Carryforward Appendix I, which is also a handout to you, shows where we are in relationship to other states. And although I don't always think it's good to compete with other states, in this particular case it is a no-brainer. It's something that makes us more attractable to businesses and you'll see where we are right now in terms of rankings in our carryforward. I do think an introduction is important but I also think that the devil is in the details and the technical part of it is in that handout. And I know that there are others that will come after me who will speak to the issue, so I'd be happy to take any questions as long as they're simple or I can refer them to Senator Hadley. [LB457]

SENATOR HADLEY: Are there questions? Senator Sullivan. [LB457]

SENATOR SULLIVAN: Thank you, Senator Hadley. And Senator Krist, you referred to this blue paper and referred to Maine jumping up in their rankings due to two things, this net operating loss treatment, but also the alternative minimum tax. Which was more attributable to the increase in rankings? [LB457]

SENATOR KRIST: I believe the NOL was, but I know someone that's coming after me will speak to that ranking. [LB457]

SENATOR SULLIVAN: Okay. Great. [LB457]

SENATOR HADLEY: Further questions for Senator Krist? Seeing none, thank you. Are you going to stay for closing or...? [LB457]

SENATOR KRIST: I just introduced one in HHS and I'd like to close in there; it's a pretty technical issue. And so thank you very much for hearing me. [LB457]

SENATOR HADLEY: Okay. The first proponent. Mr. Cederberg, the last couple times you testified we went until 11 or 11:30 at night. I assume you're going to...do we need to use the light system tonight? [LB457]

JOHN CEDERBERG: (Exhibit 4) No, we don't. (Laugh) Good afternoon. I am John Cederberg, C-e-d-e-r-b-e-r-g, and I'm here this afternoon on behalf of myself. I come over today in support of LB457 and to urge that you advance it and also, since as my daughter was so kind as to publish for all to see in the Lincoln Journal Star on Sunday, I'm ancient enough to have been involved in this original activity. And anybody that would like some clarification as to how we got here, I certainly will welcome your questions. Historically, the last time that we addressed successfully or amended this section was in 1987, in LB772, which was part of the overhaul of Nebraska tax in response to the federal Tax Reform Act of 1986. You'll find in my written materials a history of the federal carryover periods, also some personal recollections from 1986. But a couple of things that I want to kind of emphasize orally, one is the atmosphere in which those bills were all passed. The federal Congress didn't act until October of 1986.

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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That gave us exactly three months, actually a short three months before the Legislature met in 1987. There was an urgent need to pass some response to that. It was a very difficult situation separate and apart from the corporate pressure to be competitive that became LB775. The difficulty was none of us had any idea how the 1986 Tax Reform Act was going to affect federal taxable income. And so one of the dominant themes of the Revenue Committee back in 1986 was, will we have adequate revenue under our revised bill? And this five-year carryover period, the short carryover period, was a component, was a product of that uncertainty. Senator Vard Johnson was the Chair at that time and was very focused on the fact that we should not end up needing to raise taxes in 1988. As it turns out, we all recall sort of how that worked out; but nevertheless, it was a difficult time and that is the source of this short period. A couple of things I'd like to raise that Senator Krist did not and one is the question of parity, and you'll see in my written materials some discussion of that. As I've told this committee last week, or said to you, that we have a very high percentage of our taxable business income that's taxed at the individual level, either through proprietorships, and particularly in the ag sector yet, or as S corporations or limited liability companies. There are some material differences in the loss treatment between the individual tax through pass-throughs and the corporate. The taxable corporation gets five years carried forward. The losses that might occur in an S corporation or an LLC that are passed through to individuals can either have a 2-year carryback or a 20-year carryforward. This bill would equalize the carryforward period between taxable corporations and S corporations. The other...another piece is that in pass-through taxation we have this concept of whether you're active or passive that does not apply to a C corporation. Passive shareholders of S corporations or passive members of LLCs, if they don't have other passive income, have basically an unlimited carryover period, and that's because of the way the federal government in the Internal Revenue Code treats excess passive losses. And then finally you have the situation that we all, you know, are kind of aware of that we don't talk about it much, that an S corporation shareholder or an LLC member, if they have other income, whether it's active or passive, can use losses, active or passive, as the case may be, out of their pass-through entity to offset that income. And so they have a wider opportunity to use losses than does a C corporation. So from that perspective, you know, we have closely held C corporations. This is not a provision that I would expect to be really very relevant to the large publicly traded companies. This is going to be relevant to those closely held businesses that for some reason, either the kind of shareholders, the number of shareholders, or whatever, are unable to make the S selection, and therefore are operating in C corporation forum; and this achieves parity and it's a good step forward toward...in that direction. Finally, I would comment on the fiscal note. It's \$8 million. From my 40-year experience in advising corporations, I kind of think it's right. You know, I expect some of you may react that it's low. But my experience is that there's only one situation in which a corporate net operating loss is used over a 20-year period, and that's in an acquisition where the buyer is limited and so they're using the acquired NOL over the extended period. Otherwise, my experience is, if a company doesn't use their NOLs in five to eight years, they will either go out of

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

---

business and the NOLs will expire unused, because unused NOLs in a...when a C corporation sees this business, are not used by anyone; or they will go through bankruptcy, in which case the NOL would be absorbed as a reduction of their tax attribute by discharge of debt income; or they will be acquired. And so, you know, while I can't prove it one way or the other--I just don't have the resources to do that--I think the fiscal note is very sensible. It could even be a tad high depending upon the economy. But for these reasons I would urge the committee to either advance the bill separately or include it in whatever overall tax overhaul we do, and I'd be certainly welcome to any questions. [LB457]

SENATOR HADLEY: Just, we've been joined by Senator Sullivan and Senator Pirsch since we had the introductions. Senator Schumacher, did you have a question? [LB457]

SENATOR SCHUMACHER: I did. Thank you, Senator Hadley. Welcome again to the committee and appreciate your testimony. A couple questions. Apparently, Section 382 of the Internal Revenue Code limits the amount that can be used each year for up to 20...Would this particular bill do the same thing in Nebraska, or could they take all the deduction in one year? [LB457]

JOHN CEDERBERG: No, no. We would still follow 382 in Nebraska under this bill. [LB457]

SENATOR SCHUMACHER: So it would...and the second thing is, a company that used to have a terrible time of it and the only thing it has left is a big operating loss, can be acquired by another company, and for the sole purpose of paying value for its loss and deducting it. As I understand that, it's somehow how it works? [LB457]

JOHN CEDERBERG: Early in my career that's the way it worked. And before I came to Nebraska...well, before I came home to Nebraska, while I was in Washington, D.C., there were a couple of transactions very famous in the state where that occurred. As a practical matter, there are some very important impediments to doing that. One is the adoption of a new regulation, federal regulation, 1.368-1, which codifies, in effect, the services position on continuities. One of the tests, of course, is continuity of interest; but the second one is continuity of business enterprise. And while that regulation only applies specifically to tax-free reorganizations to obtain the NOL, the concept is also applied on examination to taxable acquisitions. And if there was no business to acquire, the service on examination will attack, and will attack successfully, the use of that NOL. The other leg to that issue is Section 382. Now let's suppose we had a company and its only asset was a \$200,000 net operating loss carried forward. If the acquirer were in the full rate bracket, that would be worth \$68,000. Okay? So they pay \$68,000 for that company. Section 382...because there would have been a change of control, Section 382 would say that you can only use the, quote, Section 382 limitation amount, which is a monthly published amount based on Treasury rates--a calculation of Treasury

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

---

rates--per year for the duration of its life. So if we paid \$68,000, the current 382 rate is about 2.5 percent. You see where I'm going? You know, that's how much we get to use per year. Well, even if you had the full 20 years, you don't come close to \$200,000 of NOL; and so those transactions just don't happen. I haven't seen those transactions in my business, oh, really, since I retired from Touche Ross back in '91. [LB457]

SENATOR SCHUMACHER: You know, the...you referred to the federal government in both of those cases. But would we allow the entire bite at that loss carryforward for Nebraska taxes? [LB457]

JOHN CEDERBERG: No. Our conformity or our piggybacking would graft 382 into our calculation of the NOL. [LB457]

SENATOR SCHUMACHER: So if it doesn't work with the feds, it doesn't work at our level. [LB457]

JOHN CEDERBERG: Yeah. [LB457]

SENATOR SCHUMACHER: Thank you. [LB457]

SENATOR HADLEY: Mr. Cederberg, I guess I have a question and it has more to do with what we're going to be doing in the next nine or ten months when we look at the entire tax system. I remember hearing, you know, kind of the big bath theory that when a corporation had a loss, they would try to pile any other potential losses into that year of loss with the idea of getting it all out of the way. I hope that--you can comment now--but I hope you comment when we have the study committee about...you know, we have a number of items that we're probably going to be looking at. And maybe we need to, you know, just bite the bullet on a number of these things and just do them in one fell swoop and try to get our tax code correct. Would you like to comment on that? [LB457]

JOHN CEDERBERG: Sure. You know, I think I said last week, probably to Senator Harr, but I said last week that, you know, it's been 25 years since we did it, the whole thing. We only did the Nebraska Advantage Act a few years ago, and it's time and...but it's time to do a comprehensive look and, hopefully, a comprehensive look in a little bit more orderly way than we were able to do in 1987. Because in 1987, the 1986 Tax Reform Act was a very fascinating exercise in political compromise in Washington. And I don't know how closely you followed it as a professor, Senator Hadley, but it came together very fast out of a really wide range of possibilities; and so none of us really had the opportunity to prepare for it and so we reacted under a great deal of pressure. Hopefully, this time around, we'll be a little more sensible and a little more orderly. You mentioned the big bath theory. And one of the things, though, that I would remind the committee is that when corporations do that, there are a lot of provisions and reserves that are provided: reserves for the cost of shutting down plants, reserves for the



Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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termination of employees, reserves for whatever, write-off of inventory. Very major parts of those financial reporting baths are not currently deductible. They end up being deducted over a number of years as they're, in fact, incurred. And so lest the committee, you know, be thinking about, you know, what exposures do we have here, we don't deduct...we are...you know, corporations do not get to deduct reserves and provisions for future expenses that don't have economic performance. So that's just kind of a side note while we're on the subject of big baths. But no, I think...you know, I would not be offended if all of these bills were rolled onto the table and we all studied them. You know, there's some very good ideas here, this one and some others. [LB457]

SENATOR HADLEY: Okay. Thank you. Any other questions? Thank you, Mr. Cederberg. We always appreciate your helping us. Thank you. The next proponent. [LB457]

RON SEDLACEK: Good afternoon, Chairman Hadley and members of the Revenue Committee. For the record, my name is Ron Sedlacek, R-o-n S-e-d-l-a-c-e-k. I'm here today on behalf of the Nebraska Chamber of Commerce and Industry in support of Senator Krist's LB457. As had been previously testified on Senator Pirsch's bill dealing with individual income tax, not too long ago, this particular measure, the alternative minimum tax proposal that's sponsored by Senator Schumacher as well as the proposal that is cosponsored by Senator Pirsch and Senator Burke Harr regarding the corporate income tax are, for the Chamber, elements of continued discussion and elements for the Revenue Committee to consider in regard to either tax reform, modernization, relief, whatever it might be called or referred to. However, it seems to us that, in particular, this bill and potentially the AMT repeal bill which was originally scheduled to be heard tomorrow, and the corporate income tax bill that will be heard later today, are elements that might be considered this year by the committee, which kind of takes those elements off the table at that point where...and open up more and looking at more individual and other taxation matters. These are reforms that have been introduced in years past. This particular bill has been fine-tuned. When a bill was introduced by our Chairman a couple of years ago, it dealt with both net operating loss carryforwards for...or net operating loss as well as capital loss carryforwards. And this bill...and it went for 10 years. This bill is for 20 years and it only applies to net operating losses. What it does is essentially conform Nebraska law with the provisions of federal...the Internal Revenue Code, federal law. We did not address, however, carrybacks. Federal law does allow for a two-year carryback in this situation, and we felt that that's...there's only a handful of states that do that. There are several that do it. But we felt that that was something perhaps that would be very hard to manage and predict and as far as revenue forecasting and so forth, and that what we would do is look at the carryover provision. Because really Nebraska is only one of five states with five years, of the states that have income taxation. All the other states have a longer period of time, and a majority of states--26, in fact--have a 20-year rule identical to the federal rule. And so what we're essentially asking is to conform with the federal. It's interesting that the federal rule

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

---

recognizes 20 years, which is more generous, in a sense, than...in treatment or in recognition of cyclical businesses, of startup businesses, and so forth; and we feel that it's really good tax policy. The question had...and I do want to address that before it escapes me, the question had been asked as to the Tax Foundation. And although we're not looking just at rankings but really good tax policy and what is favorable for Nebraska and what would grow Nebraska. But if you're looking at rankings I would suggest...and I'm not sure on this. Obviously I have not talked with the Tax Foundation. But the repeal of the alternative minimum tax is a repeal of an entire tax. At that time when it was originally introduced by Senator Cornett a couple years ago, it was put on the table in response to when there was an effort to repeal another tax, and that was because Nebraska was one of a handful of states that has an inheritance tax. Well, you could also repeal the alternative minimum tax, an entire tax, which is really kind of low-hanging fruit, and probably get just as big a bang out of the buck, as opposed to trying to figure out now how to reimburse counties and go through that whole political struggle in regard to that tax. It doesn't generate a lot. But we're not here on the alternative minimum tax; rather, the net operating loss rules. That is a subcategory that the Tax Foundation and others look at. It's one of three subcategories in regard to...rates is one and net operating loss is the other; and others are tax credits and deductions that are allowed. So I would suggest that it would have improved...in the example that Senator Krist used, Maine, it would improve the ranking maybe a little less than half. That's just my speculation only, but I'm trying to answer your question as best as I can in that regard. The bottom...really the bottom line for the Nebraska Chamber of Commerce is that what we're trying to do and we believe the policy that's being pursued in this legislative proposal is to improve our comparative tax climate and join the majority of states, allow small businesses and new ventures, and particularly high-tech business and manufacturers, additional time for investment and employment growth. Because these are industries that are prone to generate net operating losses in their earlier years of operation, and believe that they are currently disadvantaged, to some extent, by Nebraska's unique five-year rule. Lengthening that opportunity also addresses those highly cyclical businesses that may...you know, for example, in construction and so forth, where there can be...or that are prone to the effects of national recessions, and would recognize those types of businesses. But we believe, all in all, that it would aid in the promotion of entrepreneurship in Nebraska specifically. It would improve our competitive position, but we feel it's really a simple tax policy change and that it would promote our state as an economically viable climate to start and cultivate a business, and that we could point to our rules as being consistent with those of the federal. [LB457]

SENATOR HADLEY: Are there questions for Mr. Sedlacek? Senator Schumacher.  
[LB457]

SENATOR SCHUMACHER: Thank you, Senator Hadley. Thank you for your testimony today. There's no free lunch here. I mean, this money actually has been lost by this

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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business; it just hasn't had offsetting profits. Am I reading that right? [LB457]

RON SEDLACEK: Yeah. It's essentially it's...you know, you can use the common example where you have a business that has a loss...or a gain in year one of, let's say, of \$100,000; in year two, a loss of \$100,000. Taking a look at that, you know, logic and fair...essentially, any fairness would dictate that the net is zero. And it's only by happenstance, you know, we have to devise an income tax system. If you had a gross receipt tax it would be different. But when you have an income tax system that is based then on a year, on a year basis, it does not take into account those cycles. And so by the same token you could have a business that had...they could be paying...they would have \$50,000 in each year, and not, you know, pay the same amount of tax, you know. So there...I guess it's a matter of fairness. [LB457]

SENATOR SCHUMACHER: So basically if we were only to file taxes once every 20 years, this wouldn't be an issue because it would be in that 20-year block. [LB457]

RON SEDLACEK: Well, that's right. Or else the states and Congress could adopt...with income taxes. And they could adopt a refund capability. But that's never been utilized. It had been in discussion back in the 1970s as, you know, a negative tax...may be as close as you can get. Its comparison would be an earned income tax credit, but that's about all they could...as far as the individual is concerned, that's how I would look at it. [LB457]

SENATOR SCHUMACHER: Thank you. [LB457]

SENATOR HADLEY: Mr. Sedlacek, I've got two things. One is that since Mr. Cederberg alluded to my years as a professor, I used to teach the agricultural theory of income, and we had the reason for the year was the harvest tradition of the agrarian economy; that you planted in the spring, you tilled in the summer, you harvested in the fall, and you counted your money in the winter. And so consequently the recognition of revenue was based on a year. But it could have been five years or such as that. It was called the harvest tradition of income or however... [LB457]

RON SEDLACEK: Right. Or it could be a pay-as-you-go system, but... [LB457]

SENATOR HADLEY: Yeah, harvest concept. That was the first question or comment. But the second question: For the committee, would you distinguish between an operating loss and a capital loss? [LB457]

RON SEDLACEK: Oh, I wish Mr. Cederberg were here because he could do a much better job than I can. And I would...I'll defer. [LB457]

SENATOR HADLEY: Okay. Thank you. Any other questions? Thank you. [LB457]

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Transcriber's Office

Revenue Committee  
February 20, 2013

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RON SEDLACEK: Okay, thank you. [LB457]

SENATOR HADLEY: Any other proponents? [LB457]

BRUCE BOHRER: Good afternoon, Mr. Chairman. Bruce Bohrer, appearing on behalf of the Lincoln Chamber of Commerce. And I'll spell my last name, B-o-h-r-e-r. We have supported an expanded carryforward period for NOLs for I think at least five or six years, so we're back this year to support it as well. I know we supported it previously when the Chairman offered the bill, and this is a slightly varied version. I'll be brief. I'll just say I think most of the previous testifiers covered the points I want to make. The main thing is parity for us. And then also Mr. Sedlacek touched on it right at the end there; we really do think this is a policy change that's a fairly simple policy change that really does benefit our business climate, and especially for tech or startup-type companies. That clearly has a relationship with what we're trying to do in Lincoln with Nebraska Innovation Campus and our developments around the Haymarket. So that's our reasons, in a nutshell, for why we support this change. We do understand it's part of a larger conversation this year. And, you know, I didn't come prepared to really testify on LB81 but I think that's a very interesting concept, as well, and the other bills too. We'll be back supporting the corporate tax change and I think we had supported already the income tax reduction. But I know you've got a big job ahead of you, but we do think this idea should be included as a serious consideration in your discussions. I'll close and answer any questions you might have. [LB457]

SENATOR HADLEY: Questions for...? Part of the discussion on the tax reform thing is that we're going to put time-and-a-half in for the Legislature. So I just thought we will be well compensated for our time that we're going to put in. [LB457]

BRUCE BOHRER: Yeah, I'm sure. Okay. [LB457]

SENATOR HADLEY: Thank you. [LB457]

BRUCE BOHRER: Thank you. [LB457]

SENATOR HADLEY: The next proponent. [LB457]

BOB HALLSTROM: Chairman Hadley, members of the committee, my name is Robert J. Hallstrom, H-a-l-l-s-t-r-o-m, here on behalf of the Nebraska Bankers Association and the National Federation of Independent Business in support of LB457. Mr. Cederberg passed my knowledge on corporate income taxes early in his testimony, so I will simply say that we believe this bill will improve the tax climate in Nebraska and we believe the committee should move with all due haste in making this policy change which we think is positive and good for the state. I'd be happy to address any questions. [LB457]

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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SENATOR HADLEY: Questions for Mr. Hallstrom? I had a whole bunch of them but I'll pass. [LB457]

BOB HALLSTROM: Thank you. (Laughter) [LB457]

JOSEPH YOUNG: Chairman Hadley, members of the Revenue Committee, my name is Joseph Young, J-o-s-e-p-h Y-o-u-n-g, and I'm the director of public policy at the Greater Omaha Chamber, testifying in support of LB457 on behalf of the Chamber. Senator Schumacher and Senator Hadley kind of stole my thunder here. This bill really...the policy really is a function more of time than it is of profit. As Senator Hadley said, if you tax every 10 years or every 20 years, you'd be looking at net operating gains and taxing those. So conceptually the state doesn't really lose here. So we think this is great tax policy and we would urge the committee to send this to the floor. And I'll take any questions. [LB457]

SENATOR HADLEY: Any questions for Mr. Young? Seeing none, thank you, Mr. Young. [LB457]

JOSEPH YOUNG: Thank you very much. [LB457]

SENATOR HADLEY: Next proponent. [LB457]

BILL MUELLER: (Exhibit 5) Senator Hadley and members of the committee, my name is Bill Mueller, M-u-e-l-l-e-r. I appear here today in support of LB457 on behalf of Ash Grove Cement Company, Chief Industries, and Duncan Aviation. Senator Hadley, I want to thank you personally for introducing, in 2011, LB483, which was heard by this committee; and as you've already stated, was met with a \$38 million to \$40 million fiscal note from the Department of Revenue. Your staff Berri Balka and my law partner Kim Robak had meetings with the department to look at the fiscal note. And it was interesting, going back looking at my file. Back then we took the position that the actual fiscal note for that bill should have been \$7 million to \$8 million. The fiscal note that you have before you is \$8 million. What I will say about that is that as the fiscal note notes, this loss will not occur, if any, until 2020-2021, because already the current law gives a taxpayer a five-year loss carryforward. This bill would extend that another 15 years. So nothing will change for the next five years. I handed out a map--I'm a visual person--and when Senator Hadley was working on this bill two years ago, he asked us to put a map together. And I think that this map really does show that Nebraska is an outlier when it comes to this. We are the red state right in the middle, which is great; although in this case that shows that we have a loss carryforward period of five years. The vast majority of the country I believe is in green and that is a loss carryforward period of from 15 to 20 years. We support the bill. We're sorry that it wasn't passed two years ago, because with the bad economy in 2008 and '09 and '10 and '11, it would have been nice to have

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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that carryforward period. This bill, as I read it, applies to tax years beginning January 1, 2014. I'd be happy to answer any questions that the committee may have. We support the bill. [LB457]

SENATOR HADLEY: Questions for Mr. Mueller? Seeing none, thank you. [LB457]

BILL MUELLER: I should add, I asked Mr. Cederberg what the difference was between a net operating loss carryforward...or a net operating loss and a net capital loss. And I cannot even convey to you what he just told me from the front row (laughter), so I'm not going to attempt to. I don't know what the difference is. Apparently... [LB457]

SENATOR HADLEY: I think I have an idea. [LB457]

BILL MUELLER: Apparently, the difference is about \$30 million a year. (Laughter) [LB457]

SENATOR HADLEY: Yeah. Okay, that's...I think that's correct. [LB457]

BILL MUELLER: Thank you. [LB457]

SENATOR HADLEY: Thank you. Further proponents? Seeing none, opponents? Neutral? Senator Krist has waived closing, so that will close the hearing on LB457. Senator Pirsch, LB328. We've been joined by Senator Harr from Omaha. Just so you know, senators are introducing bills in other committee, so don't take a personal offense if they get up and leave or come late. [LB457]

SENATOR PIRSCH: And I will not. Chairman Hadley and members of the Revenue Committee, I am State Senator Pete Pirsch, for the record, P-i-r-s-c-h, and I am representing Legislative District 4 and the sponsor of LB328. I just kind of keeping up a little bit of the theme, LB328 quite a simple concept. It operates within the realm of corporate income tax, state income tax, and it simply brings about a parity between the now existing corporate income tax rates and those that are...those tax rates that would apply to income passed through entities such as S corporations and LLCs and the like. So it's a simple concept, but I think it is one that is in the state's best interest to achieve that parity. And I know there will be those testifying after me here today, so with that, I'll just open myself up to any questions. [LB328]

SENATOR HADLEY: Questions for Senator Pirsch? Senator Sullivan. [LB328]

SENATOR SULLIVAN: Thank you, Senator Hadley. I should have probably asked this question when you had the bill last week about lowering the income tax rates, but it falls in line with this as well. Any thoughts about how we either recoup some of the lost revenue or deal with that in terms of providing necessary services whether it's in

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Transcriber's Office

Revenue Committee  
February 20, 2013

---

education or infrastructure or help to needy individuals? [LB328]

SENATOR PIRSCH: Well, the passage of bills, as you well know, is a process not rather a one-time, and it has to meet in accord with the legitimate, you know, it's kind of like...I kind of liken it to putting a jigsaw puzzle together and it's...so it's not overnight or weekly process and there is going to be a lot of interaction that is required in terms of looking at these with the committee that you chair, for instance, the Education Committee and HHS. However, I am very optimistic that there is room. There's quite a new...not just this bill which deals with allowing individuals not to submit, I mean, the overall effect is quite right that if you achieve parity and I think we talked about historically, didn't seem to be a good reason why you would subjugate one type of business entity to a higher rate of taxation than all other business entities. But that's the way things came about as historically whether...without rhyme or reason that's the way things exist today. But I think there is opportunity to move back to a parity level and yet not upset the applecart and to make sure that our overall legitimate needs of citizens of the state of Nebraska in terms of education, Health and Human Services, those type of things are also met. And in the greater scheme of things as we're proposing a biennial budget of \$7 billion, you know, this is rather modest on the order of about \$20 million. So I think it can fit within any type of the jigsaw puzzle that we're trying to put together. And so, be open to, as that happens, obviously, comments and suggestions that members of this committee make in regards to putting that together. [LB328]

SENATOR SULLIVAN: Thank you. [LB328]

SENATOR PIRSCH: Yep. [LB328]

SENATOR HADLEY: Senator Pirsch, I have a quick question. From a tax policy standpoint, the federal government treats corporations differently than individuals in the tax rates. [LB328]

SENATOR PIRSCH: Yes. [LB328]

SENATOR HADLEY: What would be the tax policy reason that we would want to treat corporations the same as individuals? [LB328]

SENATOR PIRSCH: Well, I mean, I would suggest and, you know, I don't want to speak to federal tax policy, because by no means I'm an expert in that, but I do want to suggest that we ought not just to blindly follow the lead of the U.S. federal government in all things, otherwise, I mean, they've...a number of eccentricities and things have historically developed piecemeal there in a way that may or may not make sense. So I think we have to determine what makes sense for the state of Nebraska and with respect to these corporations, they're already being taxed...the C corps which not only have this higher tax structure which this bill was seeking to remedy, but they will...even

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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after, if this bill were passed, even with that, they would still be doubly penalized in the sense that C corporations alone in a way that LLCs and these other pass-through entities are taxed twice, first at the corporate level and then through, you know, down as they distribute those. And so, I guess I would say in just short order, we ought to develop tax policy that makes sense for the state of Nebraska and not hitch our cart to the federal government in any regard. [LB328]

SENATOR HADLEY: Thank you, Senator Pirsch. Questions? Thank you. First proponent. I bet we're going to find out the difference between operating loss and capital loss now, you want to bet? (Laughter) [LB328]

JOHN CEDERBERG: (Exhibit 6) Good afternoon, again. Why do I hear in my ears this Burlington Northern train whistle? (Laughter) Good afternoon, again. My name is John Cederberg, C-e-d-e-r-b-e-r-g. And actually I gave the clerk the wrong thing here. You're supposed to have that too. And in the interest of the committee's time, I'm not only appearing on behalf of myself but also the Nebraska Chamber of Commerce and Industry this time in support of LB328. I wanted to testify because it is so consistent with my previous discussion on the net operating loss that there is a major parity in this bill, and we certainly thank Senators Pirsch and Harr for bringing this concept to the committee. As I said a bit earlier this afternoon, when you have a state that is so heavily passed through in form, in proprietorships, LLCs taxed as partnerships, LLCs that have made elections to be taxed as S corporations, to have parity in the rate between C corporations, the closely held businesses that for whatever reason cannot make the S election and the S corporation, the individuals, just makes a great deal of sense. It's the right policy for the state of Nebraska and for that purpose I support it and the Chamber supports it. I would offer an observation regarding the relationship between corporate and individual taxes. Back in 1986, for the only time in my career, we had what we in the practice call an inversion where the federal corporate rate got to be larger than the individual rate. That was when the corporate rate was 34 percent under the 1986 Tax Reform Act and the maximum individual rate was 28 percent. Now, there was also a short period there where the capital gain rate was 28 percent on individuals. But, historically, the federal corporate rate has always been less than the individual rate. And at this point, it is...well, beginning this year, the federal corporate rate is 34 percent for businesses under ten million in taxable income, an extra percentage point for larger corporations. The maximum individual rate is 39.6, but with phaseouts of itemized deductions and personal exemptions, the maximum individual rate is over 40 percent. And so when you look at it, it's about a 12 to 15 percent premium on the individual rate over the corporate rate. Nebraska is exactly the opposite. Not only that, but the...historically, the...well, actually I shouldn't say historically, but in recent years, the federal government has allowed a special rate for dividends from C corporations. We have not. And the federal government has also allowed a special rate for gain on sale of corporate stock and we do not. So we are the reverse of the corporate...or of the corporate individual relationship at the federal level. Would urge the advancement of the



Transcript Prepared By the Clerk of the Legislature  
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Revenue Committee  
February 20, 2013

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bill, and be willing to take any questions. I guess I know what one will be. (Laugh)  
[LB328]

SENATOR HADLEY: Senator Harr. In fact, Senator Harr has joined us so I don't know whether I mentioned that. Senator Janssen is here, so. Senator Harr. [LB328]

SENATOR HARR: And I apologize, I did have another bill. I see that...well, I guess I need to preface the question with, how many C corps, if you know, have profits of less than \$100,000? [LB328]

JOHN CEDERBERG: I don't know. My hunch is that it's not a particularly small number because we are a small business state. And I know that there are a number of C corporations out there that, for example, are in ag that date from the '60s and '70s before the 1986 Tax Reform Act, and they were...they were incorporated for estate planning purposes and the shares are in trusts so they cannot make the S election. And, you know, my hunch is that those add up, but I don't know how many there would be. [LB328]

SENATOR HARR: Okay. And I hadn't thought of that, but you're probably right. [LB328]

JOHN CEDERBERG: I would guess that that is probably in the Department of Revenue's annual report, but I have not had occasion to look. [LB328]

SENATOR HARR: Okay. Because I see 31 states have a flat rate. What is your opinion about a flat rate or a corporate tax? [LB328]

JOHN CEDERBERG: You know, it's plus and minus. The question, you know, last week Senator Schumacher asked a lot of people about a modern tax and he reminded me of one of my professor's comments way back in ancient times, that taxation was the art of plucking the most feathers with the least squawking. And, you know, it...a flat tax will fit a state where you have a large number of corporations with relatively, on-average, common income. Okay. A flat tax does not seem to be very appropriate in a state where you might have a large number of corporations with relatively modest income, say up to a hundred, or two hundred and fifty, three hundred thousand. And then a few very large corporations that have a much larger taxable income. Frankly, our corporate tax is almost flat now. I mean, you only have the other rate, the lower rate for fifty thousand, or is it a hundred...no, we changed it to a hundred, didn't we? Yeah, but you know, that's not a lot of money in the modern world, inflated world. And so we're close to a flat tax now. [LB328]

SENATOR HARR: Okay. Thank you. [LB328]

JOHN CEDERBERG: You know, I don't have a policy opinion one way or the other, it's

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Transcriber's Office

Revenue Committee  
February 20, 2013

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what fits the state. [LB328]

SENATOR HARR: Okay. Thank you. [LB328]

SENATOR HADLEY: Mr. Cederberg, I notice that the handout you gave us has a column for a tax rate for financial institutions. And I've seen that, you know, when I've looked at other state's taxation and primarily, for example, South Dakota, and such as that. What reason do they single out financial institutions at times to have a separate taxation policy? [LB328]

JOHN CEDERBERG: This has a very long history and it relates to the uniqueness of financial institutions as investors in federal securities and investors in tax exempt municipal securities. You know, in many states...well, they used to have what we call capital taxes and that was an approach to, in effect, tax the investment in federal securities by taxing capital. And then that got in trouble with the federal courts. Nebraska used to include the financial institutions in our regular corporate tax until 1983 when the U.S. Supreme Court in Memphis Bank & Trust Company v. Garner ruled that it was unconstitutional to...for the state to follow the federal taxable income because it included federal interest. It was in 1985 then when we went to the deposit tax, which is a separate tax, that is not based on taxable income. It's based on deposits or book income. The...almost all states have had...Colorado is an important exception. Colorado subjects financial institutions to the same corporate income tax as other C corporations, but they tax all municipal interest, including their own in Colorado. And that's how they get by the federal constitutional problem. But, historically, virtually all states have a different tax on financial institutions because of the uniqueness of the asset base. [LB328]

SENATOR HADLEY: Okay. Thank you. Any other questions? Thank you, Mr. Cederberg. Appreciate it. Any further proponents? [LB328]

JOSEPH YOUNG: Good afternoon, again, Chairman Hadley and members of the Revenue Committee. For the record, my name is Joseph Young, that's Y-o-u-n-g. I'm director of Public Policy for the Greater Omaha Chamber of Commerce testifying in favor of LB328. And just quickly, I won't be long, but we think this is a good tax policy for a couple of reasons. First of all, we've long believed and lobbied for a more simple tax code. And to be sure, this reconciles the individual and corporate and think that simplicity is good in that sense. I'd also just bring up quickly in terms of the fiscal note and state spending to Senator Sullivan's point, from I think 2007-08 appropriations to 2012-13, state government grew at about \$326 million over those four or five years. This year's budget, over the next two year biennium, the budget is going to grow by, if it was passed today as it was introduced, \$366 million. So we think a modest rate reduction maybe is reasonable. And looking forward maybe in the next nine or ten months during the tax study, I think this committee and whatever that committee shakes

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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out and looks like, should look at what the appropriate level of growth is and what the so-called perfect amount of out-state spending would be as well. It's under the appropriate question. But we would...again, we're in full support of LB328 and answer any questions. [LB328]

SENATOR HADLEY: Questions for Mr. Young? Senator Schumacher. [LB328]

SENATOR SCHUMACHER: Thank you, Senator Hadley. Thank you, Mr. Young. And if I'm reading this right, current tax rates are 5.58 percent on the first \$100,000 and 7.81 percent of amount more than a hundred thousand. This actually, if you're making \$29,000 would increase taxes on those corporations making between \$29,000 and \$100,000 from 5.58 percent to 6.84 percent. [LB328]

JOSEPH YOUNG: That's right. And that's an issue. We wouldn't necessarily be in support of that and we'd certainly work with the committee on a tax increase on small business which we're not necessarily in favor of, but we do...we are in favor of the simplicity of the tax structure concept. [LB328]

SENATOR SCHUMACHER: So you consider four brackets simpler than two? [LB328]

JOSEPH YOUNG: No, but for the small business determining...or whether we can get the rates correct, certainly it would be easier to follow one tax structure for both individual and corporate rather than...as Mr. Cederberg said, we essentially have a flat tax now. And that's pretty simple, but we also see simplicity in the reconciling the individual and corporate income taxes. [LB328]

SENATOR SCHUMACHER: Thank you. [LB328]

SENATOR HADLEY: Just a rhetorical question. It would be interesting to know if we did go to a flat tax at either the 5.58 or the 7.81 what the economic impact of that, and we certainly don't have to get into that today but since we are fairly close to that, maybe that's something as a committee down the line we could be, you know, looking at. So, thank you, Mr. Young. [LB328]

JOSEPH YOUNG: Thank you. [LB328]

SENATOR HADLEY: Any other proponents? [LB328]

BOB HALLSTROM: Chairman Hadley, members of the committee, my name is Robert J. Hallstrom, H-a-l-l-s-t-r-o-m. I appear before you today as registered lobbyist for the Nebraska Bankers Association and the National Federation of Independent Business in favor of LB328. About the only thing that I would add in terms of the simplicity, we oftentimes go back and forth with issues as to whether or not we should raise or lower

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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individual income taxes or corporate income taxes, and I would rather imagine from a policy perspective that if everybody's ship is rising with the parity of rates the same, that we could perhaps eliminate those types of discussions if we had a need to either raise or lower taxes. It would hit the individual and corporate communities on an equal basis going forward once we provided parity with the rates. With that, I'd be happy to address any questions. [LB328]

SENATOR HADLEY: Questions of Mr. Hallstrom? Senator Schumacher. [LB328]

SENATOR SCHUMACHER: Thank you, Senator Hadley. Thank you, Mr. Hallstrom. If a bank were to own an LLC and the LLC made a dollar, passed it...would it be able to pass it through the bank just like if it were Subchapter S corporation or would that have to be taxed at the LLC level? [LB328]

BOB HALLSTROM: I would probably defer to Mr. Cederberg. My hunch would be it would be taxed at the LLC level, but... [LB328]

SENATOR SCHUMACHER: But if it were...if it were...if it could pass through... [LB328]

BOB HALLSTROM: It wouldn't be taxed at the LLC level, but it would be passed through, yeah, yeah. [LB328]

SENATOR SCHUMACHER: If it's passed through, then the tax on that income from what we've just learned, would be taxed according to the special bank calculation rather than the ordinary corporate taxation calculation. [LB328]

BOB HALLSTROM: Well, it would be subject to taxation based on the formula that's used for the bank deposit tax. [LB328]

SENATOR SCHUMACHER: Do you know, is that generally higher or lower than...would that dollar be, once passed through, have a bigger bite taken out of it if it were taxed under the bank calculation than if it were taxed under the corporate calculation? [LB328]

BOB HALLSTROM: I don't know that I could tell you without looking at a specific situation because the bank deposit tax formula, there's a cap based on deposits, and then there's also a tie-in to the formula that's based in part on the highest corporate income tax bracket. [LB328]

SENATOR SCHUMACHER: Thank you. [LB328]

SENATOR HADLEY: Questions for Mr. Hallstrom? Thank you. [LB328]

BOB HALLSTROM: Thank you. [LB328]

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

---

SENATOR HADLEY: Next proponent. [LB328]

BRUCE BOHRER: Good afternoon, again, Mr. Chairman, members of the Revenue Committee. Bruce Bohrer appearing on behalf of the Lincoln Chamber of Commerce. My last name is spelled B-o-h-r-e-r, here in support of LB328. I think the previous testifiers have covered it mostly for us. It is a parity issue. I would like to address that I guess the reason whether it's really simpler right now with four brackets, and maybe Senator Harr's question about a flat tax, I think probably LB328, the concepts are drafted the way they are with the parity with the individual income tax as they stand right now, at least that's the way we look at it. We would like to see us go to a flatter tax or fewer brackets in both the income and the corporate tax. So as it is right here, I think it's trying to mirror what we've got in our income tax. I think that may be something for you guys to discuss as part of your tax review over the next few months. But it is parity, and I guess either comparability or competitiveness, whichever word you want to use, we are fairly high in the region for our top corporate rate. So with that, I would answer any questions you might have. [LB328]

SENATOR HADLEY: Questions for Mr. Bohrer? Senator Schumacher. [LB328]

SENATOR SCHUMACHER: Thank you, Senator Hadley. And thank you for your testimony today. [LB328]

BRUCE BOHRER: You're welcome. [LB328]

SENATOR SCHUMACHER: The flatter tax, though, that would mean the guy at the bottom comes up, the guy who is way at the top he comes down. Is that necessarily a fairer tax? [LB328]

BRUCE BOHRER: Well, not for the guy at the bottom. (Laughter) You know, as you're looking at all the things, though, I mean, it's interesting just to hear some of the history from Mr. Cederberg earlier about why we compressed our time frame. It wasn't really on policy, it was on whether or not we were afraid that we were going to have enough money or not on another issue; and I think that's the way you're probably going to have to look at these issues too, just kind of from a clean slate. [LB328]

SENATOR SCHUMACHER: Thank you. [LB328]

SENATOR HADLEY: Just a follow-up on Senator Schumacher, what he just posed is a concern that this entire Revenue Committee is going to have to look at as we look at the entire tax code because if we feel that it's important to neutrality, you know that we neither increase taxes in the aggregate...or lower taxes in the aggregate, there can be times... [LB328]

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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BRUCE BOHRER: On the micro level, yeah. [LB328]

SENATOR HADLEY: ...where some individual person's tax may go up and some person's tax may go down, but in the aggregate it's going to be neutral, but it will not be neutral for any one individual person. [LB328]

BRUCE BOHRER: Absolutely. I heard you make the point yesterday and I do think, you know, if we do it right, and I think the committee will do it right over the next few months, we have to have a rationale and explain rationale for why we're doing our policy the way we're doing it. [LB328]

SENATOR HADLEY: We appreciate that. Thank you, Mr. Bohrer. [LB328]

BRUCE BOHRER: Thank you. [LB328]

SENATOR HADLEY: Other questions? Any other proponents? Opponents? Neutral? Senator Pirsch would you like to close and open? [LB328]

SENATOR PIRSCH: And I'll be brief in closing on this bill and I think...I appreciate the testimony here. And so the question is, is there any...has anybody been able to voice a policy reason to explain this discrepancy or the disparity, while it's not parity, and I don't think there is one that's been here and so, yes, historically, it is now because it's always been that way but it was apparently done without much thought. So there is good reasons why we...if we could, wouldn't want to have disparity, unnecessary disparity and should...rather have parity. We talked about how...I think the testifier, Mr. Cederberg talked about there are, in his opinion, we're not talking about, you know, kind of large companies, that there's a sizable amount of C corporations who are formed out there in Nebraska, who are not large companies, who are working with very modest amounts of income. So we're not talking about, you know...we're talking about average Nebraskans here who are very much affected by this disparity. And secondly, you know, the need for simplicity and what that can do for you and a number of different contacts as you...especially if you're reformulating and revising taxes, overall tax codes, having them at a...on a parity that's just one less complexity you have to deal with. With respect to Senator Schumacher's kind of comment with regard to there may be unintended consequences that whereby in some instances those individuals might be paying individual income tax at a rate that's lower than the corporate income tax. If that does develop, that's purely unintended and we can easily modify that to make sure that that doesn't happen. The concept overarching all of this is parity. And so with that, I will just close and open myself up to questions or... [LB328]

SENATOR HADLEY: Senator Pirsch, I have one question. Do you think that most C corporations in Nebraska are corporations that do business in numerous states? Maybe

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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you can't answer that. [LB328]

SENATOR PIRSCH: I'd hate to give a percentage number, but I guess some do and I mean, obviously, some do and some...I think the testimony of Mr. Cederberg here today is what may surprise you, a surprising number of C corporations may not. They may be only operating in Nebraska. [LB328]

SENATOR HADLEY: Okay. Because we do if they are larger and doing business in numerous states, we get in the sourcing problem of income, you know, that they're paying, if they have nexus in many states, which is, you know, something later we can look at when we're doing that but it just dawned on me that I just wondered about that. [LB328]

SENATOR PIRSCH: Sure. And I'd be happy to work with the committee in helping to crunch any numbers you may have about our categories, so. [LB328]

SENATOR HADLEY: Thank you, Senator Pirsch. Do you want to open on LB281? [LB328]

SENATOR PIRSCH: Yes, I would, and I'll be formal about this again. State Senator Pete Pirsch, P-i-r-s-c-h, representing the 4th Legislative District, the sponsor of LB281, and so the topic in this bill is the Angel Investment Tax Credit program. So a little bit of history to understand and I'm sure, you know, Senator Hadley and Schumacher, I believe was on the committee back in 2011, and so the impetus of the passage of this bill was the Legislature and paid for Battelle study. We wanted to gauge Nebraska's competitive growth in an objective manner. What are our strengths, where our weaknesses, what should we do? There's a million things we can do and every week we're pitched with a million different ideas of what we could be doing, but what should we be doing was, and so we...I had a very well-respected company and paid a great sum of money to harness their expertise in guiding us in the most productive manner. So on October 2010 they did, in fact, issue a report customized for Nebraska identifying building on our strengths and looking at our uniqueness and the study revealed that there was what they called a glaring shortage of technology-based development programs in Nebraska oriented to assisting high growth potential businesses. So the Battelle study recommended immediate enactment of the Angel Investment Tax Credit and as the report put it, entrepreneurs and early stage technology companies interviewed indicated that it is very difficult to access early stage capital in Nebraska. While Nebraska has wealthy individuals that could become Angel investors, most are not experienced in technology areas such as the biosciences or renewable energy and are, therefore, less likely to invest in industries with which they are not familiar. One mechanism that states use to decrease the risk of investing in technology ventures is to provide tax credits to individual Angel investors. They pointed out at least 21 states at that time did so. And the key there is, you know, technology and...first of all, these are

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Transcriber's Office

Revenue Committee  
February 20, 2013

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homegrown companies which is a lot easier to...and more productive for the state to engage in rather than attracting some sort of company that may be in Tokyo or New York or California. And secondly, these are technology very high-oriented, high-paying jobs that all demographers say in...you know, those...that's exactly what any state economy needs in 10-20 years from now if you're not going to be relegated to low-paying menial jobs. So we have a fundamental core need for that is what Battelle studied. The Governor identified that as a top priority in his State of the State and did, in fact, indicate that...propose a \$5 million Angel Investment Tax Credit to foster high tech startups and indicated it was, in his opinion, key to increasing the number of higher paying jobs in the state. The Revenue Committee...the then Revenue Committee Chair sponsored it pointing out that we were 44th rank in the states, the 50 states, in this manner, and there was an exhaustive hearing by this Revenue Committee, if you'll remember, and we did give it due diligence and consideration and sent it through the floor and it passed, I think, without opposition. A very high number of senators voting in favor of it. The key elements just to reflect...to refresh your memory, individual investors, minimum investment of \$25,000 per year; investment funds, minimum investment of \$50,000 per year; minimum of three investors. The Department of Economic Development certifies qualified small businesses, Nebraska-based with more than 51 percent of employees in the state shall have 25 or fewer employees at the time of investment to ensure that these are in fact startups. And the cap, the credits, and...had a focus on high tech businesses and one thing that I think, which is the subject of this bill that we didn't do correctly, was problematic, and I don't know that we realized it back then, is what one...let me say, one thing we did right was we very appropriately put a sunset date on the bill of 2017 to encourage review and measurement of the performance of the bill, so. And I think we should do that with all that we passed here. So really it was conceived of as a pilot project. The problem, to get back to that, that I think this bill seeks to create, is the original proposal for adequate funding was figured to be \$5 million to get a fair type of measurement. Due to tough times, you know, back then it was scaled back to \$3 million and the problem is that this reduced amount is...then reflects as the Department of Economic Development attempts to administer this, they're fully appropriated by approximately midyear in its first year of operation, 2012. They're already in the second month of 2013, half appropriated. So if...I feel, and the underlying reason for this bill is, if we're going to give this...we've already decided to give this a shot, it's been identified as a top priority in a core area that we're sadly lacking compared to even neighboring states, but if we're going to give this a full and fair understanding of the cost and benefits of the program during its five year run before it's sunsetted, then I don't think we can do things halfway. I think we need...it's one of those things that you either do correctly or you don't do it. Kind of like the invasion of Normandy, right? If you're going to do it, you do it. If you're not going to do it, don't do it. But we decided it was a core need, that it was a doable amount...I mean, within the realm of a doable amount. So I just...this bill would reinstate the original proposal for \$5 million in funding so it would be an additional \$2 million in yearly funding until such time as we get to its sunset date, then we'll have a five year history of cost benefit and we'll



Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

---

be able to more accurately gauge how it worked for the state. So, again, this bill would encourage native homegrown companies, encourages...also importantly the development of something that doesn't exist but it was...is imperative for the state. The development for the first time of a core group of investors in the state focusing on Nebraska technology startups, and this will have...the development of this core group would have important and helpful ramifications in other ways for the state. Right now, Nebraska investors if they are, you know, have enough money to invest are looking elsewhere. So with that, I will close and open myself up to questions. [LB281]

SENATOR HADLEY: Questions for Senator Pirsch? Senator Hansen. [LB281]

SENATOR HANSEN: Thank you, Mr. Chairman. Senator Pirsch, thanks for bringing this, and I do appreciate the sunset on here. I think that programs like this that are funded need to be reviewed, especially at the time of sunset. Was that the original sunset date, 2017? [LB281]

SENATOR PIRSCH: 2017 has not changed, and so I don't need to change. I still think that we have enough years in there that if we fund it appropriately, that we'll be able to gauge it accurately as having worked or not worked. But that is the expectation that this can work and must work. [LB281]

SENATOR HANSEN: And I assume that it's going from the \$3 million now adding another \$2 million to the total of \$5 million per year? [LB281]

SENATOR PIRSCH: That's right. [LB281]

SENATOR HANSEN: And why does the fiscal note only show \$2 million per year because there is an already amount there...an amount there already that should be \$3 million plus the additional \$2 million, should add up to five, if my math works right. [LB281]

SENATOR PIRSCH: Yeah, and I don't run that...the fiscal note office, but I guess what they're probably saying is any bill they measure the unique effect of that particular bill rather than whether it's joining a pot of money that might have been allocated 40 years ago and the overall effect. [LB281]

SENATOR HANSEN: So just everybody understands it, Angel Investment Tax Credit does equal \$5 million a year and not \$2 million like it shows in the fiscal note. [LB281]

SENATOR PIRSCH: The overall effect, yeah, these \$2 million, an additional fund which would join the \$3 million to reach the original proposed \$5 million per year. [LB281]

SENATOR HANSEN: Thank you. [LB281]

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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SENATOR HADLEY: Senator Pirsch, maybe it's too soon to tell but while they have used up the money before the end of the year in DED, have there been any successes so far in the Angel Investing in moving companies along or maybe somebody behind you can testify to that. [LB281]

SENATOR PIRSCH: Yeah, do keep in mind that the first full year of allocating these investments was last year, 2012. We just finished that year. And do keep in mind what type of companies that we are looking at funding, and where the whole or the sore need for the state has been is with the startups, so these are not short-term propositions. They're not big companies that we're attracting like Pac Life from California. We have other investment type of programs for them, but this is the type of startup that fills the hole that Battelle said does not...you know, those companies do not exist in large numbers in our state even though they do in neighboring states and that those are going to be critical for the future success of the state. [LB281]

SENATOR HADLEY: Okay. Thank you. Senator Schumacher. [LB281]

SENATOR SCHUMACHER: Thank you, Senator Hadley. Thank you, Senator Pirsch. But if they've already dumped the first \$3 million into the system, we should have a pretty good indication of the nature of those companies, the number of people they employ or plan to employ, where the location of those investors are, if they're in-state, out-of state, we must have written checks for at least 35 percent of the \$3 million already, so we've wrote a million dollars worth of checks to somebody because this is a refundable credit, wouldn't it be a good idea before we up the ante by two-thirds that we know...you know, we've got a lot of data to judge whether or not we're happy with the way this is going at this point. Should we kind of look at that before we up the ante? [LB281]

SENATOR PIRSCH: I would just say substantively, you know, when you look at qualitatively, I don't know that we have a whole lot of data at this point in time for which we can judge the program, and need much substantively more than we do. Certainly, I can tell you, I can get information to this committee about down to, I believe, to the company about such as the name of the company, where they're located, what type of activity...type of company they are, what the investments, where the investments last year went to. I don't know that you'll be able to...I mean, in terms of saying, and then how did that company end up, did they hire a lot of more employees, did they end up being profitable? They're not...these are not type of companies that are 6-month plays or even 12-month plays. So I'm not sure that I'm going to be able...that we're situated...and I guess that's the point of my bill. We're not, right now, the original bill just took effect in 2012. You know, I think I've caught it early enough in 2013 that I think that we can stand by that 2017 date for reviewing the overall effectiveness of it. But I don't think...I mean, I can give you some basic data about the first year's allocations, but I

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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don't think I'm going to be able to provide you any more reassurance that the program is...I mean, definitive assurance that the program is working in a 12-month period. So, I think we're still operating under the assumptions and the theories that we did when we originally initiated the program and got a first full year under our belt which ended less than 60 days ago. [LB281]

SENATOR SCHUMACHER: Thank you, Senator. [LB281]

SENATOR HADLEY: Thank you, Senator Pirsch. [LB281]

SENATOR PIRSCH: You bet. [LB281]

SENATOR HADLEY: First proponent. [LB281]

RICHARD BAIER: (Exhibit 7) Good afternoon, Senator Hadley and members of the committee. For the record, my name is Richard Baier, B-a-i-e-r. I am appearing before you today as a registered lobbyist for the Nebraska Chamber of Commerce in support of LB281. I am also testifying--I apologize to the page, I've got a list here I keep adding to, so, the Nebraska Chamber, the Greater Omaha Chamber, the Lincoln Chamber, the Nebraska Bankers Association and the NFIB. Let me do a couple of things. Senator Pirsch did a nice job talking about sort of a history and how the credit works, and again I'm a little distant. I've been out of DED for more than a year, but I will tell you that the program has been oversubscribed every year. As mentioned by Senator Pirsch, in 2011, for example, there were 73 applications requesting almost \$5 million in credits. And again by the third or fourth month they were turning people away. Similar kinds of activities in 2012. One hundred and thirty-eight applications were received, 23 of those projects received investments, and those investments then totaled \$7 million in 2012. I do want to discuss a couple of things that I heard in committee and I'll be happy to open it up for questions, but I know you've got a long day...had a long day and would like to wrap things up, but in terms of companies that have used it, and I'll just share with you an example. Joseph Knecht is a young man that lives here in Lincoln. Joseph is head of our State Chamber Innovation and Technology Council. Joseph owns a software company. He's originally from Brooklyn, New York, and came here to go to graduate school and stayed. And his family has now moved down here. His parents bought a cabin out on Lexington at the lake, so he's slowly bringing the whole East Coast clan to Nebraska, so we appreciate that. He owns a company called i2rd here in Lincoln and underneath that they have six separate companies that they operate, all of them in software speciality kinds of products. And I will tell you as an example, one of the companies that was funded is a firm that does verification of employment...or certification verification for hospitals. So if I'm a longtime employee, at my meeting, my CEUs for nursing or CPR, those kind of things, they actually developed a software program to verify that for hospitals. That's grown from a startup two years ago to probably north of 50 to \$60 million in sales this year. Those are the kinds of companies

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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that we were looking for when this project started and we are starting to have an impact in Nebraska. We haven't seen it reflective yet, Senator Schumacher, in the macro numbers. We're looking forward to seeing some of those national studies really begin to reflect that. But we hear from companies every day that are going through that process and coming up with creative kinds of software, but we are also seeing it in manufacturing. And I don't know if they qualified. I'll tell you one of the applicants happened to be a project at western Nebraska, company designed a deer deflector for semis. Not something you would normally think about. It was actually out by Wallace, and the company when they put it on the first semi, not only did it keep the deer from damaging the truck in a collision, it also improved fuel efficiency. So those are the kinds of projects that we're starting to see in Nebraska and that was really...we had a real shortage of what I'm going to call ideas in business opportunities and we're starting to see those and we're slowly building an ecosystem in a culture that supports that kind of growth and so we want to thank Senator Pirsch for looking at sort of reinvigorating and going back to the original \$5 million level that was recommended as part of the Battelle study. I was part of the negotiation that took it to \$3 million because we were trying to control cost at the time. But I think the initial indication after a year and a half really of the program is that's it's making a difference and we want to give it some time to work and \$5 million seems to be a number that works. The other thing I would mention is Senator, you are right, it's going to be a \$5 million program cost. The fiscal note is \$2 million because the \$3 million is already programmed in. It wouldn't be any different than what you might see if you had a change in TEEOSA formula. You would only see the change in the fiscal note, not necessarily the whole state aid formula. So, with that, I would be happy to take any questions you might have. [LB281]

SENATOR HADLEY: Mr. Baier, I would hope, you know, we've had conversations in this committee over the last few weeks about lack of a better word, accountability on some of the statutes we have to encourage businesses and such as that. It would seem to me this would be an excellent bill to really keep...or concept to really keep track of the successes or failures so that we do have hard data when we get around to the sun side--that's not easy to say--sunshine date that we have, we're you come in and say, this is where it's been successful, this is where it's not been successful so we're not up to...not having to face the problem of how do you measure whether it's successful or not. [LB281]

RICHARD BAIER: Absolutely. We would agree with that and we believe that's good public policy. And as I think I said last week on my testimony on LB627, we believe the numbers on all of these programs will speak for themselves. If you look at Nebraska over the last few years, one of the lowest unemployment rates in the country, per capita income now is at the national average. Our population, three out of the last four years is growing faster than the national average. We think we're making a difference. It's a little bit like running a marathon. We've got a long way to go. We don't want to run a 100-meter sprint and run out of gas, but we do have a long way to go in making our

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

---

state better. The other thing I would tell you, I've spent the last year and a half with the Chamber talking about this Forging Nebraska's Future Initiative and looking at, what is the next generation looking for? And that's really what we're talking about and even something I think maybe has gotten forgotten in our conversations about tax reform as well. This next generation is going to look a lot different than those of us sitting around this table. You know, John Cederberg referenced the '80s. In the '80s the only tax policy I was worried about is how they were taxing beer, but I've obviously gotten a lot more interested in tax policy since then. And I think it's an important discussion about how we're going to make sure we grow the population and make ourselves attractive to that next generation of Nebraskans. [LB281]

SENATOR HADLEY: When you mentioned the 100-meter dash, my knee started hurting. (Laughter) Senator Harr. [LB281]

SENATOR HARR: Thank you, Chairman Hadley and thank you for coming here today, Mr. Baier. I'm intimately familiar with one of the companies. Two things, I guess, first of all, the only plan I heard about the program was when it rolled out, the rules and regs didn't come until the last second. But it's been wildly successful. My question is, are the number of applicants...are there enough quality applicants to justify the \$5 million? You say you spent the \$3 million, but not everyone who applies gets it, is that correct? [LB281]

RICHARD BAIER: That's correct. [LB281]

SENATOR HARR: So is there enough money to justify...or enough applications to justify the \$5 million price tag? [LB281]

RICHARD BAIER: Well, last year it looks like 23 of the 138 companies that applied received credits, so that leaves you with north of a hundred...if my math is any good, 115 companies that didn't get funded. So I think there's some opportunity there. The other thing is, it gets back to that ecosystem conversation between what's going on and the work that's going on invest Nebraska, the work that's going on in this program, the work that's going on in innovation campus. We think there's going to be more and more of this opportunity because the other thing I would tell you is, those young people are much more interested in starting their own company than they are working sometimes for corporate America. And so, I think there's going to be an increasing demand for this kind of an opportunity. [LB281]

SENATOR HARR: Okay. Thank you. [LB281]

SENATOR HADLEY: Senator Schumacher. [LB281]

SENATOR SCHUMACHER: Thank you, Senator Hadley. Thank you, Mr. Baier. Of

Transcript Prepared By the Clerk of the Legislature  
Transcriber's Office

Revenue Committee  
February 20, 2013

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the...the young entrepreneur comes out and has an idea for whatever, and he goes out looking for investors of some equity capital, finds them, those investors get a 35 percent kickback check from the government, what percentage of that business do those Angels then own? [LB281]

RICHARD BAIER: You know, Senator, that's going to vary a little bit from company to company. [LB281]

SENATOR SCHUMACHER: Are they looking at 80 percent, 15 percent? [LB281]

RICHARD BAIER Typically, and it will vary that. I think it's usually in that 50 range but again I'd be happy to look at DED and ask that question. That's not...I've been, again, 18 months away from the program. I'm not sure, but typically, 80 wouldn't be a fair number probably. [LB281]

SENATOR SCHUMACHER Because this seems to be small enough numbers, not only in the amount of money that's being involved, but also in the number of companies that are being able to get into the program, that we should be able to get a real good feeling of what it's doing, the pace it's doing, whether we're getting our, so far a million dollars or so worth of good out of it, and really dissect this frog because this one we can understand. Some of the others with the bigger monies and more complicated things, it gets really hard. But this one, is there a mechanism in place for us to ask those questions and get answers to those questions? [LB281]

RICHARD BAIER: Absolutely. I would encourage you to contact DED for the reference. I would tell you and this is...I apologize, it's noted up because I was writing it on the back of the room. They put out a monthly report that lists the number of applicants, the amount of credits used, the amount of credits. You know, obviously, when you set aside an allocation of credits, they don't get used automatically so it tracks that as well. And I do know that they can provide you with the names of the companies, so I think there's a way to look at that. [LB281]

SENATOR SCHUMACHER: Because, I mean, to get right down and get a real feel for this, we might have an "oh, wow" moment and say, gee, why are we just doing \$5 million, we should be doing \$15 million? Or we might say, you know, after you pencil it all out and argue all the sides, you know, we didn't get a million dollars' worth of good out of it. So we need...this is a good little program to try to figure out how we develop a protocol for approaching the more complicated ones. [LB281]

RICHARD BAIER: Sure. Absolutely, I'd agree. [LB281]

SENATOR HADLEY: That's exactly...it was exactly my thought too. [LB281]

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Transcriber's Office

Revenue Committee  
February 20, 2013

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RICHARD BAIER: Yeah. They do a good job measuring and so I'd encourage you to ask the DED folks about those numbers. [LB281]

SENATOR HADLEY: Thank you, Mr. Baier. Any other questions? Thank you. [LB281]

RICHARD BAIER: Thank you. [LB281]

SENATOR HADLEY: Any other proponents? Opponents? Neutral? Senator Pirsch, you wish to close? [LB281]

SENATOR PIRSCH: Very briefly. Thank you for all the questions and let me just say this, I couldn't agree more with Senator Schumacher's statements. I agree wholeheartedly with that. This is an ideal sized program that we ought to be able to do that. And I think also as part of this, we may want to look at adding as part of this a perform...and I'll leave this up to the wisdom of the committee, but whether we should incorporate also into this a performance audit to be conducted prior to the sunset day in enough time that the Revenue Committee has a chance to, I think, punch the final numbers and determine if this is, in fact, a project that they're interested in re-upping on. So with that, I am very open to providing whatever...you know, helping to facilitate whatever information the Revenue Committee needs to get a sense of how in these early days the program is performing. [LB281]

SENATOR HADLEY: Thank you, Senator Pirsch. [LB281]

SENATOR PIRSCH: Thank you. [LB281]

SENATOR HADLEY: With that, I will bring the hearings today to a close. [LB281]