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The Committee on Appropriations and the Committee on Revenue met at 1:30 p.m. on Friday, November 4, 2016, in Room 1113 of the State Capitol, Lincoln, Nebraska, for the purpose of a briefing on the 2016 Nebraska Tax Expenditures Report. Appropriations Committee senators present: Heath Mello, Chairperson; Robert Hilkemann, Vice Chairperson; Kate Bolz; Tanya Cook; Ken Haar; Bill Kintner; John Kuehn; John Stinner; and Dan Watermeier. Revenue Committee senators present: Mike Gloor, Chairperson; Paul Schumacher, Vice Chairperson; Lydia Brasch; Burke Harr; Jim Scheer; Jim Smith; and Kate Sullivan. Senators absent: Al Davis.

SENATOR MELLO: Good afternoon. Senator Harr, good afternoon.

SENATOR HARR: Good afternoon, Chairman Mello.

SENATOR MELLO: Yes. Good afternoon and welcome to the joint hearing of the Revenue and Appropriations Committee. My name is Heath Mello, I represent south Omaha in the 5th Legislative District and serve as Chair of the Appropriations Committee. I'd like to start off today by having senators do self-introductions, starting first with Chairman Gloor.

SENATOR GLOOR: Mike Gloor, District 35, Grand Island, Chair of the Revenue Committee.

SENATOR SCHUMACHER: Paul Schumacher, District 22.

SENATOR SCHEER: Jim Scheer, District 19.

SENATOR SULLIVAN: Kate Sullivan, District 41.

SENATOR SMITH: Jim Smith, District 14.

SENATOR BRASCH: Lydia Brasch, District 16.

SENATOR HARR: Burke Harr, Libra.

SENATOR BOLZ: Kate Bolz, District 29.

SENATOR KINTNER: Bill Kintner, District 2.

SENATOR HAAR: Ken Haar, District 21, and a lame duck.

SENATOR MELLO: Sitting next to Senator Haar would be Senator Dan Watermeier from District 1 in southeast Nebraska.

SENATOR KUEHN: John Kuehn, District 38.

SENATOR COOK: I'm Tanya Cook, District 13, Scorpio. (Laughter)

TONY FULTON: You guys are killing me.

SENATOR STINNER: John Stinner, District 48.

SENATOR HILKEMANN: Robert Hilkemann, District 4, west Omaha.

SENATOR WATERMEIER: Senator Watermeier from Syracuse.

SENATOR MELLO: Assisting the committee today is Krissa Delka, the Revenue Committee clerk, and our page this afternoon is "Bri" Hellstrom, who's a junior at the University of Nebraska-Lincoln. Today we will be hearing a presentation of the Tax Expenditure Report from the Nebraska Department of Revenue. This is an invited testimony only hearing, and once we've heard from Commissioner Fulton we will open it up for questions from either one of the committees. As a general matter of committee policy, I'd like to remind senators that the use of cell phones and other electronic devices...not laptops, I would argue, because the reports, as we specifically told everyone, your report was given to you via an e-mail available electronically on the Department of Revenue's and the Legislature's Web site. Otherwise, all other electronic devices are not allowed during public hearings. And at this time I would ask all of us, including senators, to please make sure that our cell phones are on silent or vibrate mode. And with that, we'll begin today's public hearing on the Tax Expenditure Report from Commissioner Tony Fulton.

TONY FULTON: (Exhibit 1) Thank you, Chairman Mello, members of the Revenue and Appropriations Committee. My name is Tony Fulton, T-o-n-y F-u-l-t-o-n, and I am your Tax Commissioner. We are presenting here on the Tax Expenditure Report that you would have received on October 14, I believe was the date on which that was sent over. Okay, there will be two presenters today. I will present here in the beginning and I will be covering these first three topics in the outline. And then Dr. Hoa Phu Tran will...he's our economist, our Ph.D., and he will be presenting on really the meat and potatoes of the report. So we'll cover just an introduction to the Tax Expenditure Report; we'll actually define what a tax expenditure is via the statutes; we'll talk a little bit about sales taxes; and then we'll get into the estimation of fiscal impact. Okay. The purpose of the Tax Expenditure Report...there are a lot of reports to which...which are made available to you. And most of the time they're statutorily provided. And just remember, it's always useful to have that pointed out why you are receiving such report. This report is to provide a mechanism which will enable the Legislature to better determine those sectors of the economy which are receiving indirect subsidies as a result of tax expenditures. Per the statute--this is 77-380 I'm reading--"The Legislature recognizes that the present budgeting system fails to accurately and totally reflect the revenue lost due to such tax expenditures and that as a result undetermined amounts of potential revenue are escaping public or legislative scrutiny. The loss of such potential revenue causes a narrowing of the tax base which in turn forces higher tax rates on the remaining tax base." And, yeah, I cited the statute there. Full reports have been published biennially since 1979, and that switched to even-numbered years in 1992. A supplemental report on selected sales tax exemptions is published biennially in odd-numbered years. I believe it was 2014 with the passage of a legislative bill that put forward that supplemental report, and so there's a cycle...a four-year cycle through which all of the different tax categories will in some way be covered through the Tax Expenditure Report. It was LB989 in 2014 that caused that to happen. So, 2016, the full report, which you again received back in October, that contains all the tax programs. Twenty-seventeen you see sales tax exemptions implemented after 2016; services purchased for nonbusiness use and telecom will be covered in that coming report. That will be...that's a supplemental report. Twenty-eighteen is an even-numbered year, so you'll get a full report again. And in 2019, consumer goods, energy, and food will be covered. And then the cycle repeats. And here are the tax categories covered in this Tax Expenditure Report. I will spare you the reading. The main categories are...the big ones are Section A and Section B, and those are what Dr. Tran will be focusing on in his presentation today. The presentation there will focus on sales tax exemption and then also income tax exemptions, deductions, and credits. And there, what I just said. Okay? Okay, tax expenditure definition, and I've cited the statute there: A revenue reduction that occurs in the tax base of the state or political subdivision as a result of an exemption, deduction, exclusion, tax deferral, credit, or preferential rate introduced into the tax structure. So that is what...statutorily how a tax expenditure is defined. We thought we'd provide you with a real-life example of a tax expenditure; so one would be prescription drugs. The exemption of prescription drugs from sales and use tax is a tax expenditure, because prescription drugs fit the description of a good, that is, tangible personal property sold to consumers, which is ordinarily subject to sales tax unless otherwise exempted. In this case, it was exempted for a policy decision of the Legislature, that being due to its nature as a life necessity. There are other sales tax exemptions that are listed in the report that are outside the scope of the definition of a tax expenditure, because they are not ordinarily included in the definition of the normal tax base. An example is a business input, such as electricity used in agriculture or industry. This is exempt because electricity is used in the manufacturing of food and tangible personal property, so taxing intermediate goods such as electricity used in, in this example, used in production introduces a tax pyramiding effect that magnifies the sales tax burden shouldered by the final user. The most efficient sales tax is levied only once on the final sale to consumers. So that's another example. These will be covered in the Tax Expenditure Report. Okay. Sales tax, and we have listed here sales tax basics. But my time as the Tax Commissioner, I can tell you that basics might be open to interpretation. The Nebraska Revenue Act of 1967 enacted an income tax to replace statewide property tax. Many of the exemptions originally included as part of the 1967 Revenue Act remain intact today. An interesting fact for you: Nebraska was among the last states to implement a sales tax. And so we Nebraskans had the benefit of access to other states' sales tax codes that had been improved and refined for decades previous. So we came in a little late to the game and we allowed others to...we were able to learn from others' mistakes and triumphs as a result. Many of the original 1967 exemptions are among the most common sales tax exemptions across states, such as component and ingredient parts and sale for resale, which are not part of any state's sales tax bases. Yeah, and we have some of those exemptions listed here. Yeah, I'll let you look at that. Other...only those services specified specifically in the statute as being taxable are included in the tax base, so they must be positive. Some examples: pest control, building cleaning, and security services are services that are specifically subject to sales tax. Services are typically added to the sales base in an ad hoc manner as bills are introduced each year. The number of services that Nebraska taxes is similar to that of neighboring states, except South Dakota whose wide tax base compensates for the lack of an individual or corporate income tax. And again, I could list some examples, but I will move on. At this point, I'm going to be turning this presentation over to Dr. Tran. And there will be an opportunity to ask questions at the end, but while I'm here, if you have any broader questions that the Tax Commissioner might take a stab at, I'd be willing to entertain those now.

SENATOR MELLO: Any questions from the committees? Senator Harr.

SENATOR HARR: Just quickly, Senator Fulton, you're Tax Commissioner, right?

TONY FULTON: (Laugh) And I'm a Libra.

SENATOR HARR: Okay. And you're appointed by the Governor?

TONY FULTON: That's correct.

SENATOR HARR: Okay. And you serve at the leisure of the Governor?

TONY FULTON: That's right.

SENATOR HARR: That's all I wanted to know. Thank you.

TONY FULTON: Okay.

SENATOR MELLO: Any other questions from the committees? Senator Schumacher.

SENATOR SCHUMACHER: Thank you, Chairman Mello. Welcome, Commissioner Fulton. One just question, that when you defined the tax expenditure as an exemption, reduction, exclusion, a tax deferral, a credit, or preferential rate, in which of those cubbyholes would the stepped up basis that you receive on death that enables you to escape the tax on the capital gains that accrued during your lifetime, which of those cubbyholes does that fit in?

TONY FULTON: That's a good question. I suppose you'd have to...one could look at that philosophically, I guess. I need to think about that a little bit.

SENATOR SCHUMACHER: Okay. Just curious, because it seems to have the same flavor, but does it...

TONY FULTON: I'm sure it fits on one of those.

SENATOR SCHUMACHER: Thank you.

TONY FULTON: Yeah.

SENATOR MELLO: Thank you, Senator Schumacher. Are there any other questions from the committees? Seeing none, thank you, Commissioner Fulton.

TONY FULTON: Thank you.

HOA PHU TRAN: All right. Good afternoon. My name is Hoa Phu Tran, H-o-a P-h-u, last name Tran, T-r-a-n, and I will pick up where Tony left off just here. So when putting this exemption together, since we exempt the tax we don't really have any way, like raw data that we collect from consumer or from any other sources, to basically say how much tax loss we basically lost due to the exemption. So we realize on a lot of federal data sources such as the Bureau of Economic Analysis, agriculture, education, energy, all those agency where they collect kind of more detail level on consumer spending on certain types of goods and services and we try to scale them back down to the Nebraska level. There are some income tax exclusion, credit, and thing like that do show up on the tax return. And when those become available we use our own data source to compute those estimation. As for the nonprofit organization, they have to file a Form 990 to the IRS, which we will use in determination of wherever they fit into. So there's a wide array of data source out there that we try to pick up and try to do an estimation to the best of our knowledge to most accurate as this can be. A few note on the estimating of this expenditure. Again, some case there's just no data exists, so there's no estimation. A lot of the technique ind the data source are inspired by other state. We go out, we talk to other people, we see how they do their tax expenditure report, because Nebraska is not only one who put the report together. So we talk to other people, see what the best practice is, and we learn from them and they learn from us. The key here is the estimate is static and not dynamic, meaning we do not assuming the money that save from the sales tax gets spent elsewhere, which increase economic activity. We do not assume that. We do a static fiscal impact. And the estimation are independent of each other, therefore, they may overlap. Example, business input, we have a component/ingredient part estimation on the report. That basically overlap with any other business input that's listed on there. So my point is, if you look at the report and you add up our number and say, you repeal all this you're going to get this amount of money, that is not correct, because some of those number do include in other places in the report throughout. All right? And the estimation value here, basically refer to the value in fiscal year '15-16. So a few selected consumer good exemption, first off is motor vehicle, automobile trade-in. This is where you go buy a car, you trade your old car in, you get a deduct on the sales tax on the value of the trade-in. This comes up to be roughly $71 million. Newspaper, whoever issues at least once a week, those are tax exempt. It costs us about $3 million a year. Food for home consumption, go to grocery, you buy grocery, meat, whatever that is, is for home consumption. Those are exempt except for prepared food, obviously, and vending machine. Those cost $158 million. Certain medical equipment and medicine, $156 million. A note on the medical equipment and medicine is, this amount of $156 million is the tax derived from the total spending in that core category, regardless of who the payer is, meaning if you repealed the exemption we still cannot tax Medicare of Medicaid, because under federal law you cannot tax federal spending. So if you repeal this, you might not get $156 million, just a heads up. A few selected agriculture exemption: agriculture machinery and equipment, anything that a farmer buy to operate in his or her operation, are exempt from sales tax in terms of depreciable agriculture machinery. And those come at the cost, roughly $200 million. Agricultural chemical, anything that used to fertilize the agricultural crop, those are exempt, $138 million. Seed sold to commercial producer, roughly $60 million. And water for irrigation and manufacturing, those come at a cost, roughly $19 million. Some agricultural exemptions that's new: animal life for human consumption has come in at $8 million. And again, this cost list with food for home consumption, they overlap. It's another example. And then grain to feed their animal has come in about $273 million in total sales tax lost. Some of the energy exemption: motor fuel, we don't collect sales tax on motor fuel; that's subject to another tax, motor fuel tax. But the sales tax on that is roughly $178 million. Energy used in industry, manufacturing spent more than 50 percent of energy used for the purpose of manufacturing they exempt from sales and use tax of the entire thing, which is $93 million. Energy used in agriculture, similarly to manufacturing, cost $58 million. And then aviation fuel, which is $4.1 million. Some of the exempted service: legal service, $55 million. And this service in the report this lists as nonbusiness use exemption, but the estimation does include them because there's no way we can separate out who used legal service, the consumer or the business. So the estimation here is both the consumer and businesses. Legal service come in about $55 million. Accounting service, $6.1 million. And pet-related service, grooming, thing like that, $15 million. All the real estate service, real estate agent, real estate appraisal, those are not subject to sales tax of $32 million. All the professional service, investment advice, travel agency, tour operator, thing like that are also exempt, come at a cost of $260 million. Select notable exemption of room rental by certain institution, healthcare, student dormitory, come at a cost of $71 million; container, $27 million; telecommunication and personal service come at about $10 million apiece. Some recently added exemption--this is covering from 2014 up to now, which is agriculture repair part exempt in '14. That's come at cost about $16 million. And then membership for admission to zoo, a small one, $.7 million or roughly $1 million. Now, to income tax, the basis for Nebraska income tax, we have a progressive income tax rate with four bracket and four rate; lowest bracket being 2.46 percent, the highest bracket now being 6.84 percent. And the bracket index every year to inflation. Corporate income tax is 5.58 (percent) and then 7.81 (percent) for anything over $100,000 of taxable income. Following this we will discuss some of the exemptions and the value of...what the price have for those. So state income tax refunds, when you have a state income tax refund you...it's subtracted through your AGI, which come at a cost of $9.7 million. Nebraska standard deduction, Nebraska get to deduct for married filing joint roughly 12.8 (percent) or 12.6 (percent), somewhere around there. That come at a cost of $556 million. An assumption here is that if we...no...the assumption for the $556 million is that if you repeal the standard deduction, then they cannot claim itemized deduction either. So deduction is off the table, so it's basically zero. That comes at a cost for us, $556 million. And for itemized deduction, come at a cost of $150 million. An assumption there is, if there's no itemized deduction and those itemizer will go back and take the standard deduction rather than go back to zero. Dividend and capital gain deduction, a resident can, first, can subtract federal AGI from taxable income off the capital gain to select it, come at a cost of roughly $21 million. Non-Nebraska S Corp and LLC, they can deduct non-Nebraska loss from other state to the taxable income in Nebraska; that come in at $84 million. The credit, refundable unearned income tax credit, come in about $30.8 million or $31 million. Personal exemption credit I think for 2016 is $131 per exemption; that come in about $188 million. So those are the main, the bigger number on that report that you see. And that is I think all I have. Question on those exemption?

SENATOR MELLO: Thank you for your testimony, Dr. Tran. Are there any questions from the committees? Senator Brasch.

SENATOR BRASCH: Thank you, Chairman Mello. And thank you, Dr. Tran. I'm curious if it's a accounting term. You keep using the word "cost," everything "cost." Cost...and you're using that word because it's...because the owner...

HOA PHU TRAN: Let me put it this way.

SENATOR BRASCH: Who is it costing?

HOA PHU TRAN: If we go into that detail of terminology, then I should have said the tax revenue forgone by not taxing those service.

SENATOR BRASCH: Okay.

HOA PHU TRAN: You could replace that with all the cost term I just used. Sorry for that.

SENATOR BRASCH: So we are clearly talking about dollars earned by the laborer, by the taxpayer that we are...we've either given a credit to or we've assessed to. But it's...the money is not the state money. The money comes from an individual so the cost is...when you say cost, it's as if it belongs to the state, where it does not belong to the state. We ask for it.

HOA PHU TRAN: Actually, as a state, we have forgone in those revenue where we could have get it. It's more of an opportunity cost for not collecting the tax on the service. Example is...

SENATOR BRASCH: And are any states at 100 percent?

HOA PHU TRAN: A hundred percent?

SENATOR BRASCH: I mean other states...it's just what we have assessed as a portion of...due to a tax program. Right?

HOA PHU TRAN: I mean, every...like one of some example here is like the unearned income tax credit on the income tax return. I mean, every...most state have those in their tax book for a reason.

SENATOR BRASCH: All right. No, it's just the cost, it sounded like we are...that term, I didn't know if it was a mathematicians' term or if it's just a...

HOA PHU TRAN: I use that term loosely. Sorry about that. And if I can repeat, then I will probably say this say this is tax revenue forgone for not collecting the tax on those services. It's an opportunity cost...

SENATOR BRASCH: It's a collection that we...

HOA PHU TRAN: Technically, we...not we...

SENATOR BRASCH: I understand.

HOA PHU TRAN: It's more a policy that we do it because we believe it's helping the consumer, but that come at a price. And the price is we're not collecting the amount of money that we could have if we enforce a tax on that, for not exempting any other income.

SENATOR BRASCH: Okay. They're exemptions to one's income that...

HOA PHU TRAN: Yes.

SENATOR BRASCH: ...that we've determined either by what another state has established or competitive, because states compete for tax relief or incentives. Correct? Somewhat...

HOA PHU TRAN: When you get to incentives then there's a different policy for tax incentive as a whole, which you all determine the policy expert. And the tax incentive is different in the sense that we sometimes collect the tax and give them back. That's the incentive part.

SENATOR BRASCH: I understand. Okay.

HOA PHU TRAN: This tax expenditure is, we remove it from tax base, from taxing it at the beginning. So technically we, like some of the sales tax, like trade-in for motor vehicle, we basically not seeing the revenue come in and then refund it. That's some differences on the incentive versus regular kind exemption. We exempt it from the tax base. Those activity do not face tax for doing...engaging in that kind of purchase or business (inaudible).

SENATOR BRASCH: I just when I kept hearing the word cost, it was associated with something other than that. But I do understand. You're saying that that's revenue that...

HOA PHU TRAN: Forgone.

SENATOR BRASCH: Yes.

HOA PHU TRAN: Yes, we didn't collect it.

SENATOR BRASCH: Very good. I have no other questions, thank you.

SENATOR MELLO: Thank you, Senator Brasch. Any other questions from the committees? Senator Bolz.

SENATOR BOLZ: I have a couple of questions about some of our recent tax changes. The first is that I noticed that the exemption on ag machinery has increased significantly. I think in 2014 it was $75 million and now it's almost $200 million. And I just...I wondered if there was anything you could share with us about why that cost has increased or the opportunity cost, the fiscal impact of that healthy change, why that has reached $200 million and if we expect it to increase or if there's any way of knowing whether or not we've reached a plateau.

HOA PHU TRAN: Back in 2014, the best data available was the 2012 census data. Those are done (inaudible) census data. And those are done on a ten-year basis. So now we got 2012, which is a ten-year apart on that data set. And by looking at it I know the ag machinery and equipment, the total sale of those material increased by roughly 162 percent. So that's where the cost come in. Ten year from now, when we have 2022 census, you can expect that number to be bigger. And over ten year, there's also inflation building into those cost estimates that the census provide. So this is more data driven than our methodology.

SENATOR BOLZ: So if I'm hearing you correctly, some of the explanation has to do with how current the data was available for your original estimation?

HOA PHU TRAN: Yes, yes, yes.

SENATOR BOLZ: Okay.

HOA PHU TRAN: The data set is basically ten-years long. Right? That's as good as the data that's out there.

SENATOR BOLZ: And similarly--and it's okay if you don't have an answer to this question--but we put the personal property tax relief legislation into place recently and the estimation was that it would be $19 million in the fiscal note. And I wondered if you knew if that was...if we were close, if we were far? That's newer. You may not have that data yet. I just wondered if it was available.

HOA PHU TRAN: Yeah, we don't. We don't know yet. I think we should know by the end of this year when the real data come out, because we collected those at (inaudible).

SENATOR BOLZ: Okay. So we may have a real world fiscal impact of that policy change by the end of the year?

HOA PHU TRAN: Yes.

SENATOR BOLZ: Okay.

HOA PHU TRAN: (Inaudible) estimation, yes.

SENATOR BOLZ: Very good. Thank you, sir.

SENATOR MELLO: Thank you, Senator Bolz. Senator Harr.

SENATOR HARR: Thank you, Chairman Mello. I want to follow up on...dig a little deeper on what Senator Bolz was talking about, because it's something that's a mystery to me and maybe I've got a chance to find out, be enlightened a little bit. Fiscal notes, they're done dynamic. I saw you had a page earlier where you talked about these are estimates, right?

HOA PHU TRAN: Uh-huh.

SENATOR HARR: And what we found is that sometimes fiscal notes aren't accurate, right? They sometimes they cost more; sometimes they cost less. And I think your explanation, if you want to flip back to that screen, is because estimates are static, not dynamic. Correct?

HOA PHU TRAN: Correct.

SENATOR HARR: Okay. And I think that accounts for some of it. But my question to you is--and if you know, great, I'd love to hear. If you don't, just let me know. And I don't want to put you in an uncomfortable position, but does the Department of Revenue ever go back and look at their fiscal notes and then look at the actual cost and compare them?

HOA PHU TRAN: Sometime we do and most time we don't, I must be honest with you. We don't.

SENATOR HARR: Okay. And when do you decide to and when do you decide not to?

HOA PHU TRAN: Over my four year of doing this, I basically have not looked back on my estimation. If there's a few that reoccurring, we look back. And the last time I looked probably on the incentive...

SENATOR HARR: Oh, maybe I wasn't very clear. Let's say there's a bill that passes. For instance, Senator Bolz gave the example of the personal property tax. And, well, we saw it here, right? We saw it with the ag.

HOA PHU TRAN: Uh-huh.

SENATOR HARR: So my question is...and some it's because it's dynamic. It's what you talked about, using some that's based on 2014 data.

HOA PHU TRAN: Yes.

SENATOR HARR: But some of it may be...because I see in here you use the word "assumptions" or you use "estimates."

HOA PHU TRAN: Yes.

SENATOR HARR: Excuse me, it's estimates. So my question to you is, because we can all...let me restate that. I can always learn from my mistakes or I can learn how to do things better. What do you...when do you look back and say, okay, here was an estimate or assumption we made that was incorrect; going forward we better change that? And if you don't do that, just tell me you don't do it. But I'm asking if you do.

HOA PHU TRAN: I have not done that, I'm going to be honest with you. And one other problem of going back and look is, say it's for sales tax exemptions, once you exempt something we no longer (inaudible). We don't collect the data. So going back to, you know, to look at comparing that know that you do when assumption was make based on the best information given to you on that day and we go back and compare when it become reality, it's like making a forecast and then you come back two year later and then why we off by certain amount?

SENATOR HARR: Well, but you do look back, don't you, so you can learn from your mistakes or get better?

HOA PHU TRAN: No, we do not. I mean, we learn a new technique. Every day new data come out. We keep searching for the data source that is best fit to do some of this data. For some example, I mean, we did go back and we use a new data set to...even though the number is significant different, which I knew is going to bring up question. But we still have to put it down because that is the best information that's available to us at the time we do the estimation. And on defending those fiscal impact, I do...we at our office doing as good of a job as we can do given the resources we have and the data that is available.

SENATOR HARR: So let me ask you this. Going forward, because what I'm hearing today--and correct me if I'm wrong--is that fiscal notes aren't always accurate. They're guesstimates, right? Is that correct?

HOA PHU TRAN: It's an analysis...

SENATOR HARR: Well, we have proof. We have proof here that they weren't accurate. So I think safe to say they aren't accurate. Right? They're guesstimates. I'm not trying to corner you.

HOA PHU TRAN: I'm not saying we guessing. I would not use that term.

SENATOR HARR: Okay, what term would you use?

HOA PHU TRAN: They might not be accurate, but they're education guess and data analysis go into (inaudible). We don't just pull a number out from nowhere and give it.

SENATOR HARR: And I'm not saying that. I'm not saying that. But my question to you is, they aren't always...the cost that we have in a fiscal note isn't always the real world actual cost. That correct?

HOA PHU TRAN: Possible.

SENATOR HARR: Okay. My question to you is, we, as policymakers, have to make decisions. And one of the ways we make decisions are based on the cost. And fiscal notes are very important to us. Now, this side of the room, Revenue, we have to look at the--and I don't want to use the word "cost"--I'll say, forgone revenue of a tax exemption. And we also have a certain amount of money that that side of the room reserves, we say, for the floor, which means they spend the budget and they leave a certain amount in the budget for us. And so we...the amount on this side of the room is a lot less than the amount on that side of the room. And so we have to be very judicious with that money. Okay? And we, I don't want to use the word "fight," but we scratch at each other to make sure that our bills get through. And those fiscal notes are so important to us. Okay? Now my question to you is, how do I know that that fiscal note...how do I know what the assumptions that go in that fiscal note so that if I think it's high--you come in and say it cost $20 million and I say it only cost $10 (million)--how am I to look at that data? How am I supposed to do my own, I'll say, Daubert care, to use a legal term?

HOA PHU TRAN: Well, that's why you have the Fiscal Office. Right, Mike? We do our best estimate.

SENATOR HARR: Well, but, no, I'm not asking...I'm asking how I...how do I know what goes into those figures, because now we have proof that they aren't always...the note and reality aren't the same. So if I disagree with you, how am I...I have Mr. Calvert over there, and the Fiscal Office does a wonderful job. But now let's pretend, just hypothetically, I don't agree with theirs either. What do I look to as your assumptions and your basis that you make so that I can see if I agree with those, because it's very difficult for me...and again, I'm going to come back as a lawyer. Before I can introduce expert testimony, I have to have what's called a Daubert hearing. And we, in a Daubert hearing, you look at what is the analysis used? And you look to see, is that scientifically proven? And can you judge it? That's more or less what a Daubert hearing is. And then you're allowed to testify as an expert. Well, we don't have that ability here to look behind the curtain. And sometimes, as we all admit, real world and fiscal notes don't work out. Sometimes it's because it's static and not dynamic. But sometimes it's, we don't agree with the assumptions that are made. But I don't know what the assumptions are. Or maybe I will agree. How do I get to the basis of how you get these fiscal notes, I guess is what I'm trying to say after a seven-minute speech?

HOA PHU TRAN: I seriously don't know how to respond to your question there. But Tony want to cover it.

SENATOR HARR: Okay.

TONY FULTON: Allow me.

SENATOR HARR: Please.

TONY FULTON: This is Tony Fulton, T-o-n-y F-u-l-t-o-n, Tax Commissioner, returning to the witness stand. Senators have...and I say this with all due respect to the legislative branch. I'm saying this because of the experience I had over here. Senators always have the ability to make their own case for a fiscal note. There were numerous fiscal notes with which I disagreed. Some of them came from the Department of Revenue. I can tell you that the integrity of our fiscal note...I am able to sit here today and tell you that it's solid, because it's not any one person who's making it. We have a system in place. And ultimately, I think what you're looking for here is answered in the separation of powers that exists between the executive and legislative branches. That, honestly, I think is what is in play here. We put forward our best estimate on what a certain bill is going to cost. But during...if you look at those fiscal notes, it's not just the Department of Revenue who puts forward a fiscal note. There are other...depending on what committee a bill is going to go to, there are other places where that fiscal note will come from. So ours is but one estimate.

SENATOR HARR: And I agree with that. I guess, oh, I agree that yours is just one of many. But you say it's solid.

TONY FULTON: I'm sorry.

SENATOR HARR: Right? You said it was...your fiscal notes are solid. That was your words you used. I wrote it down. But that's a conclusionary statement. Right? And often, fiscal notes are conclusionary statements. And what I want to see is let's say you say something cost $100 million. Let's say you say it cost $1. And there are assumptions built into what those costs are. And we get a line-by-line item. But it's also...sometimes we do and sometimes we don't get a line by line of what it cost, like reprogramming, $15,000, which I always am amazed at how much that costs. I'm in the wrong business. But I understand that there's an expense to that, and I won't object to that. But there is theory that goes into a lot of these numbers and we don't get to see those. We just get to see, as Dr. Tran talked about and what you say, the results are solid. It's solid. But you don't say, well, here's what I think. And if it's static, I would understand it would probably go over my head...or dynamic goes over my head. But these are static. And I guess my concern is that we are in a budget crunch right now and we're going to be fighting more and more over dollars. And we got to make sure we go over and we have...there is a separation of powers, your branch, my branch. But there's also, we got to look at the numbers and the data behind those numbers, and we never have solid access to that data. We don't house data in our branch and so we have to be reliant upon you. And I feel sometimes--and again, this is my feelings--as though there isn't a transparency. It's solid. Our numbers are right, instead of saying, well, here's how we came at that, here's the theory at how we came at this estimate. And then what I'd love to see is, two, three years down the road, say, hey, here's what it was. Here's why it was wrong or here's why it was right. Here's why this theory has worked so well. This is why we rely on this. Or, as we saw, the numbers were wrong. Well, here's why they were wrong. But we don't get that feedback. And I think it's becoming more and more important as we get...as we become more and more efficient as a state, we have less chance for error. And so I think it's imperative upon us, as a state government, to have better transparency, to be more exact, and to learn from our mistakes and look back at them. And I just...I guess that's the point I'm trying to make is...and allow for disagreement. I don't know if there's always allowances for disagreements. And I'll just leave it at that, I guess.

TONY FULTON: Fair enough, Senator. With respect to reporting back on what such and such a program cost, those...yeah. For instance, incentives, one can look at our annual report and go back and see now what incentives have done, for instance. One can go and see there are any number of reports that we'll put out that one can go back and check. So in that regard, there is...

SENATOR HARR: But there's not an explanation of why they're off, right, if they are, if there's a difference.

TONY FULTON: Well, if you're predicting what the future is going to hold and you get it wrong, if you get it wrong egregiously, then I would call into question anything that's predicted into the future. If you don't get it wrong egregiously, then I'd say, well, the guy was trying to predict the future, that was his estimate, and this is what he put forward. That, in essence, is what a fiscal note is. So if there is a fiscal note that's well off, then...that's why we put these...that's why the results of any tax program are put out publicly, and that's where you take the figure off.

SENATOR HARR: But if you get it wrong...yeah, if you get it wrong the question is, was one of our assumptions wrong? Was it we didn't look at here was something that happened we couldn't have predicted or we should have seen this but we didn't see it? We're going to apply this in the future. Right? Or is it there was a housing bubble and that threw everything off? Or there's a change of fiscal policy on the federal level, we can't predict it? And that's fine. But you can at least explain and go back and say, okay, this is what we missed and why we missed it or this is not why we...this is how we got it right. But I don't see that. And all I see is this is what we look at, right? And that's fine, but what I don't see us is reviewing. I learn so much more from my mistakes than I do my...and I don't see anything on here about learning from mistakes.

TONY FULTON: Yeah, the problem that I see there, Senator, is for every single bill that gets introduced, should the executive branch be policing itself for every bill and report back on every bill or would it be better to simply, as I am here in front of you, if there is a fiscal note--and I said this, I've met with all of you--if there is a fiscal note that you don't like, just say something to me and I'll look into it, give you my best explanation. Otherwise, every single...I mean, every bill that I've introduced or that I did introduce that I don't like the fiscal note on, you take that times 49 senators, we'd have an entire branch of the Department of Revenue dedicated to going backward to learn how that fiscal note panned out. I don't know that that's feasible either. The system that we have now, I freely admit, I've experienced, I didn't like how some of the fiscal notes came out and so I put that before you. If there's a fiscal note you receive from my department on any of your bills, say something to me and I'll do my best to respond as to why it is that way.

SENATOR HARR: And I don't want to monopolize time too much, but we're spending a lot of money. And by the way, it's not our money. It's the people's money.

TONY FULTON: Yeah.

SENATOR HARR: And I think we have a duty to go and question and to look backwards and to see what worked, what didn't work, what's right, and what's wrong. And you know we...

TONY FULTON: That is done in the department. That is part of our process.

SENATOR HARR: Well, and maybe we, as a legislative branch, should house some of this information ourselves so that we can look at it, too. I mean, you may call it redundancy; I call it a second set of eyes. And maybe we'll look at some and maybe we'll see something different. So, all right. Well, thank you for your time. Thanks for coming here today. It's always a pleasure to have you back. Look forward to talking to you next session as well.

TONY FULTON: Very good.

SENATOR MELLO: Thank you, Senator Harr. Senator Brasch.

SENATOR BRASCH: Thank you, Chairman Mello. And thank you, Commissioner Fulton. I need to...again, I thank Dr. Tran for explaining some of the terminology here, but my intent truly...and to give credit to the Revenue Department, because I did in another lifetime spend almost 15 years there. And as I look, there's a lot of expertise there. Cliff (phonetic) has been there probably close to 40 years, right? Same with Ellen (phonetic). I thought I saw Len (phonetic) was in here; there he is. You're not new kids on the block. There's a lot of expertise. And I know you learn a lot every time. And when it talks to farm machinery, that bill was implemented...and this is...I don't know how in the world you would catch it...implement, pun on words. But there is a lot of border bleed. So how do you pin down what was gained, what was lost? You say there's $200 million, but did we gain a lot of sales? Did people quit sneaking off to Kansas and Iowa and everywhere else to...so I think it would be very, very difficult. So I give you credit, I guess, for the difficulty of what's happening. And I think the challenge is going to be in a state with little population growth is to maintain the appetite for state dollars needed to run all of the entities that require taxes, because if we don't have enough people, the take isn't with the growth. We need to be able to keep that revenue coming and not a deterrent to live here, I guess, is what...but there is expertise. And it's not learning from mistakes. I think they've learned. You can't help but learn a lot in the positions that you've had. And I know you're fairly new there, but I have a lot of confidence in what they're trying to do. And I think it would have been very difficult to predict the exemptions on machinery since...and other taxes, you know, if there is border bleed or on-line purchasing. That's why there's an Audit Division. I think there's still a audit division there in Revenue.

TONY FULTON: Indeed.

SENATOR BRASCH: Yeah, indeed. So that's just my comment if you're...

TONY FULTON: Yeah. And I just...the Tax Expenditure Report, a lot of this is...these are estimates going forward. And so it comes from--I think you touched on it earlier--these are...a lot of this has to do with census data that's derived from the federal level. There's...it's difficult to derive from a state level.

SENATOR BRASCH: I have...that's more of a comment than a question unless you have a comment on my comment.

TONY FULTON: I agree with you. There are a lot of good people in that department.

SENATOR BRASCH: Thank you.

SENATOR MELLO: Thank you, Senator Brasch. Senator or Commissioner Fulton, I was just asking Chairman Gloor, I looked through the report on my computer and I think Chairman Gloor is looking at his physical copy as well. Does the department not include loss of sales tax revenue due to on-line purchases as part of their report, the sales...the Tax Expenditure Report?

HOA PHU TRAN: Those are technically not exempt. Those are...so the on-line people are technically not exempt; they're just not paying. There's a difference between that and exempting in terms on-line sales.

SENATOR MELLO: Is there any report that the Department of Revenue produces that tracks that dollar amount on an annual basis?

HOA PHU TRAN: Four or five years ago, we had a press release go out on our Web site that estimate how much money we'll be collecting. But until they report, we do not have anything. And the consumer won't pay and we can't go through their accounts, see where they're buying stuff.

SENATOR MELLO: Is there any data set or data source that you...I know you use a lot of federal data in regards to doing estimates. Four or five years ago, Amazon Prime didn't exist and that has now become the largest on-line seller in the world.

HOA PHU TRAN: Yes. Yes.

SENATOR MELLO: Is there any data sets that you guys are familiar with? I'll look at you, too, Commissioner. And since, Hoa Phu, any data sets that you guys can share with the Legislature? Is that a policy the Legislature should be considering for the next Revenue Committee to consider acquiring that to be part of this report moving forward to give a better world view of how much revenue is being lost right now or not being collected due to on-line sales?

HOA PHU TRAN: I mean, Amazon is a publicly traded company, so if we want to do an estimate on the loss on tax revenue from our sales tax base, we could look at their gross sales and derive it back to Nebraska level. I think that's how we did it when we compute those number on-line five years ago. It's still out there. And it's just five years ago, so the number did grow. I mean, there's no point on that. And Amazon, by looking at the gross margin, you saw them grow roughly 20 percent a year.

SENATOR MELLO: That number five years ago was roughly what, $50 million, $45 million?

HOA PHU TRAN: Somewhere around there, yes, $40 (million), $50 (million).

SENATOR MELLO: Forty-five, sixty? Senator Schumacher.

SENATOR SCHUMACHER: Thank you, Senator Mello. Thank you for your testimony. This may be more directed toward the Tax Commissioner. Commissioner Fulton, you're always such a good sport, so I...

TONY FULTON: I don't have an answer on your first question yet, too, I'm just...

SENATOR SCHUMACHER: You do have an answer?

TONY FULTON: I don't yet.

SENATOR SCHUMACHER: Okay. All right. You're good, but not that good. Okay. The first thing is a little bit of a follow-up on what Senator Harr mentioned, and that is the fiscal note situation because I think, I'm sure, you experienced it when you were on this side of the table, the frustration with fiscal notes. And the frustration is accentuated. Some, when they come like a day before the hearing, you don't even have time to absorb them or think of them. And if they're off in what you guessed or some constituent guessed they would be, there's really very little opportunity to revise them until you actually hit basically an amendment or Final Reading. So can you see any way that we can remedy that because, Senator Harr is right, they're a big deal? You know they can kill bills faster than any eloquent speech on the floor. And a lot of time is wasted getting a bill drafted and a hearing on a bill when, gee, you thought the fiscal note was going to be X and it turns out to be 30 times X. I mean, if you'd just known that ahead of time, you wouldn't even have brought the bill. Can you see a way that we can address that issue?

TONY FULTON: Yes. Let me ask a question first. Hoa. (Inaudible) I'm not positive in my response. I'm going to have to be...I'll have to give you my response and then check it. I believe we are required to provide our fiscal note, by the Fiscal Office actually, a certain number of days before. I think it's two days before. I'm not positive.

SENATOR SCHUMACHER: It's a very short period of time.

TONY FULTON: It may well be that you're receiving the fiscal note that...we have to provide our fiscal note to the Fiscal Office in a...with a certain amount of time. That's what I know. Is there room to improve that, I think there probably is. However, just like you guys, when the bills are introduced there are many, many of them, and they all have to have a fiscal note on it. And so then it becomes an issue of do we hire more economists to beef-up our fiscal notes during the period of time when the Legislature is in session and then you won't have work for them to do when the Legislature is not in session? Believe me, I have thought about that. It was the very first thing I asked when I got to the Department of Revenue. So, how do you guys do your fiscal notes? So I think there is some room for improvement, but what militates against that is just the sheer number that we have to get through.

SENATOR SCHUMACHER: But...and I'll just...I know you haven't had time to consider this, but all of us have had a wild idea of what might be a good idea but we didn't know how much it would cost. And so to get to that point we introduce a bill. We introduce a bill in the first ten days of the session; it goes into that rush that you guys have got to deal with. Whereas if we could, six months ahead of time, get an idea of what something cost, we may never go through the trouble of burdening Bill Drafting to draft the bill or even introduce it because the fiscal note is just, common sense, way too far out of line to even think about it. That would lighten your workload some, too, I would think, because that could be done in July rather than in January.

TONY FULTON: Uh-huh. Yeah. If you're talking about can you get me an order of magnitude, get me in the ballpark. And that's the type of thing where I hope you'll reach out to me, and that's something we can do. We're not going to spend the time and put a fiscal note and say that's the way it's going to be when you introduce the bill, for, obviously, the bill may be different when it gets introduced. But if you're looking for an order of magnitude for just something to give you some knowledge as to whether you should invest the time to work on the bill, please do reach out. That's the type of thing I think that we can accomplish for you.

SENATOR SCHUMACHER: And I've been kind of mulling over here that intro quote about a tax expenditure being an exemption, a deduction, an exclusion, a deferral, a credit, or a preferential rate. Now in that context, is a credit taken under the Advantage Act the kind of credit we're talking about here?

TONY FULTON: Yes, that's included in the Tax Expenditure Report. I think it's Section U, the very last page. And what it does is, there's a reference to the July Incentives Report that was provided to the Legislature. I think it was July we provided that, of this year.

SENATOR SCHUMACHER: Okay. Now, along that line, one of the ways you can claim a credit under the Advantage Act is to deduct from your employee's paycheck their state income tax and just keep it. Okay? Do we know how much money a year is taken out of employees' paychecks and just kept by the employer under the Advantage Act?

TONY FULTON: Yeah, we should. Yeah.

SENATOR SCHUMACHER: Do we know what that number is off...or do you have to look it up?

HOA PHU TRAN: It's in the report. I don't have it on the top of my head. Back in July, when we did the Incentive Report, it's the compensation credit under that compensation credit (inaudible.) Whatever the compensation credit amount is, I don't have it on the top of my head.

TONY FULTON: Yeah. So, for the record, it's July of this year was when that Incentives Report was provided to the Legislature. There's a compensation credit within that report and that is what you'd be looking for. So that number would have been reported.

SENATOR SCHUMACHER: Okay. And if there is a credit wrongfully or unconstitutionally taken, how long do we have to go back and get it?

TONY FULTON: May be a lawyer question, Senator. I don't know the answer to that.

SENATOR SCHUMACHER: Okay. I think you may be picking up on where I'm going with that. Next question, on the...I noticed one of the items on the screen was the cost of not taxing legal services. Now, in that particular area, did that cost--which I think was $50-some million--was included in that the legal services bought by a business with in-house lawyers or is that just the little businesses where you go to the lawyer's storefront and pay him or her for her services?

HOA PHU TRAN: Those are not...

TONY FULTON: Get on the record.

HOA PHU TRAN: Those are not include in-house service. If you hire lawyer and you pay him or her a salary, you basically put them on the payroll.

SENATOR SCHUMACHER: So to the extent we would go after the lawyer who works behind his own shingle on Main Street or her own shingle...

HOA PHU TRAN: If you have a law firm and a business hire that law firm to do something, then that's still a service provided on behalf of them.

SENATOR SCHUMACHER: Okay. But it's not a service if they're on a payroll. So the big business that...big enough to hire a lawyer for their payroll doesn't have to pay sales tax on his legal services, if we were to tax legal services.

HOA PHU TRAN: That is correct.

SENATOR SCHUMACHER: But the guy who goes to a lawyer with a shingle hanging out has to pay it.

HOA PHU TRAN: That is correct.

SENATOR SCHUMACHER: Tell me which of the categories of tax preference or tax expenditure this one falls under. Again, those seem to be an exemption, a deduction, an exclusion, a tax deferral, a credit, or preferential rate. When we rent a capital item, let's say a car, we pay sales tax. When we rent capital, money, the interest, rental on the use of money, we don't pay sales tax. Which of those categories does that fit into that causes sales tax not to be paid on the rental of money?

HOA PHU TRAN: I have to defer that to a lawyer, too.

SENATOR SCHUMACHER: See, we make a lot of artificial distinctions in the world that have a great deal of impact. I think that artificial distinction costs us between $200 (million) and $600 million a year.

HOA PHU TRAN: And like I said, those estimates are static. And they assume full compliant, too. And there's a lot assumption go in those number, yes. I don't disagree with that.

SENATOR SCHUMACHER: Let me ask you this final question, then, I'll get on with life. When somebody owns a piece of real estate, they live out of state, and they live, let's say, in a tax-free or income tax-free state like Texas or Florida, and they sell that Nebraska piece of real estate. Okay? And they sell it at a profit from what they bought it from. Do they pay Nebraska tax on it, on that profit?

HOA PHU TRAN: No, I don't have an answer to that.

SENATOR SCHUMACHER: Okay. And then you also would not know how the Department of Revenue would ever know that sale took place. I think if the guy out of state sold the land, signed the deed, and pocketed the money, how would you guys even know that it was sold? Do you get something from the feds?

HOA PHU TRAN: That...on the real estate transfer, that go pretty deep into the Property Tax Division, which I'm not an expert in.

SENATOR SCHUMACHER: And that doesn't contain a Social Security number, so you really have no way of tracing it.

HOA PHU TRAN: That might be true, yes.

SENATOR SCHUMACHER: And on those 521 forms you kind of can fudge a name and instead of John you could put J. by the name, right?

HOA PHU TRAN: And it go through a county there, so, they do not even go to the state, so...

SENATOR SCHUMACHER: So...and a lot of land might be sold that way.

HOA PHU TRAN: Yes. And I think I remember a (inaudible) for you a couple of years ago, maybe, last time we did this fiscal impact.

SENATOR SCHUMACHER: Okay. I don't have any further questions. Thank you.

SENATOR MELLO: Thank you, Senator Schumacher. Are there any other questions from the committees? Seeing none, thank you Dr. Tran. Thank you, Commissioner Fulton. And that will end today's public hearing on the Department of Revenue Tax Expenditure Report.

HOA PHU TRAN: Thank you.