[LB362 LB373]

The Committee on Revenue met at 1:30 p.m. on Wednesday, March 22, 2017, in Room 1524 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on LB373 and LB362. Senators present: Jim Smith, Chairperson; Curt Friesen, Vice Chairperson; Lydia Brasch; Mike Groene; Burke Harr; Brett Lindstrom; and Paul Schumacher. Senators absent: Tyson Larson.

SENATOR SMITH: Good afternoon and welcome to the Revenue Committee public hearing. My name is Jim Smith, I represent the 14th Legislative District in Sarpy County and I Chair the Revenue Committee. The committee will take up the bills in the order posted on the outside of the room. Our hearing today is your public part of the legislative process. This is your opportunity to express your position on the proposed legislation that's before us today. To best facilitate today's proceedings, I ask that you abide by the following rules or procedures. First, please turn off your cell phones and other electronic devices or put those on vibrate mode so as not to disturb the person that's at the table testifying. The order of testimony will be introducer of the bill, proponents of the bill, opponents of the bill, those testifying in a neutral capacity, and then we will have closing remarks by the person introducing the bill. If you will be testifying, please complete the green form and hand that to the committee clerk when you come up to the table to testify. If you have written testimony or exhibits for the committee and you would like to have those distributed, please hand those to the page as well when you come up to the table to testify. We will need 11 copies of whatever you do want distributed as to have enough for the committee members and the staff. If you need help making those copies, please let us know. We're more than happy to help you with that. When you do come to the table to testify we will need you to start by stating and spelling your name so we can get it accurately into the record. We will use the light system today. Based on the number of people I see in the room currently, we're going to use the light system and have testimony last for approximately five minutes. You don't have to take the full five minutes, of course. The green light will be on for four minutes and then it will turn to an amber color for that final minute. If you will use that time to wrap up your testimony we would greatly appreciate that. If you would like your position to be known but do not wish to testify, please sign the white form that's at the back of the room and that will be included in the official record. The microphone does not really amplify your voice. You will need to speak loudly so that people behind you will be able to hear you well enough. That microphone really is to capture your testimony for the transcribers so that that can be put into the record. Let me introduce the staff that's with us today. To my immediate right is legal counsel, Mary Jane Egr Edson. To my immediate left is research analyst, Kay Bergquist. And then to my left at the end of the table is committee clerk, Krissa Delka. We do have pages with us today that are here to assist us and to assist you. We have Marilyn Synek from Kearney. Did I pronounce that right, Marilyn? Okay. And Marilyn is a junior at UNK studying political science. And we have Trenton Buhr from Cortland, Nebraska. Trenton is a sophomore at UNL also studying political science. We do have members of our committee that have obligations in other committee hearings and so they may come and go during this hearing. Please don't take offense at that. Joining us a bit later will be Senator Larson and Senator Groene. And next...

SENATOR LINDSTROM: Brett Lindstrom, District 18, northwest Omaha.

SENATOR FRIESEN: Curt Friesen, District 34, Hamilton, Merrick, Nance, and part of Hall County.

SENATOR BRASCH: Lydia Brasch, District 16, that's Burt County, Cuming County, and Washington County.

SENATOR SCHUMACHER: Paul Schumacher, District 22, that's Platte and parts of Colfax and Stanton Counties.

SENATOR SMITH: Okay, very good. And I think we are ready to get started with our hearings for the day. And Senator Schumacher is first up with the introduction of LB373, also known as the kitchen sink, right? [LB373]

SENATOR SCHUMACHER: And everything else. [LB373]

SENATOR SMITH: Yes. Welcome. [LB373]

SENATOR SCHUMACHER: Thank you, Chairman Smith and members of the Revenue Committee. My name is Paul Schumacher, S-c-h-u-m-a-c-h-e-r, and I'm here today to introduce LB373. LB373 or the kitchen sink, as it's become known to be, has already disappointed me, because my object was to get so many people in here that I could say I do more opposition to a bill than Governor Heineman did a couple of years ago with his proposed tax reformations. I haven't quite done that. But at any rate, this bill has several functions. One, to introduce some of the newer committee members to what actions we've taken, attempting tax relief in a significant way over the last ten years. What the bill does is it...I went back ten years and looked at anything that had a negative impact on revenue greater than $5 million a year. I think I caught most of them, but undoubtedly I'm sure that somewhere along the line I missed one or two, but I listed those out. And I'm hoping to draw a bit of examination to those items by the committee and by the people who benefit from them to see if we can justify continuing them, whether in retrospect they were a good idea or a bad idea, and get a little bit of an audit function because unlike the appropriations function these tax expenditures are not really reviewed in detail on a year-by-year basis. We get a report that usually lasts an hour or so and then we're done. And so this is a list of some of them. Now one thing that's always concerned me a bit is, you know, we have this income tax rate of 6.84 percent, which I know people pay. Professional people pay it, particularly if you have two well-paying jobs in a household and you get hooked pretty close when you look at your state return to 6.84 percent. There's a little bit shaved off of that because of the various deductions, but it's over 6.5 percent. And yet the effective rate of taxation for our top tier is somewhere in the 4 percent range. Well, that almost means that somebody is paying a whole lot less. So where is the special deal at? Where's the gimmick, as I wouldn't mind knowing so I can get in on it. And you think, well, maybe it's in charitable contributions. Maybe it's in mortgage interest deductions. You know, but those never seem to add up to enough to really make up the difference. And so I reached out to people and what's before you is a lot of work by a lot of people. And I kind of under...using the old prosecutorial technique that they use with snitches said, you know, tell me, how does it work? Because we can read something and we can look at something and it looks okay on paper and we pass it through and push the buttons, but we never really know how the thing is working. And accountants and lawyers who work in the field know how it's working and they will tell you in some degree of confidence how the system works and where the big loopholes are, but they surely aren't going to appear at a hearing because they've got to make a living too. And their clients wouldn't necessarily be happy with them exposing how the system works. So thus we have LB373. We'll start out with the items and go down the list. And if any of them catch the committee's attention or fancy as being a good thing to look at, we'll have had a hearing on them and maybe can incorporate them into some type of a system and try to deal with it. The first one is a thing called a special capital gains election. In an employee-owned firm that fit the criteria may make a once-in-a-lifetime election to sell their ownership shares in the firm and realize a capital gain that is excluded from taxable income. The initial election was passed in 1987 as part of LB775 and was expanded in 2007 to also include a thing called extraordinary dividends and again in 2013 to allow ESOPs, employee stock ownership plans, to participate. We know a lot of farmers now can't sell their farms because they have to end up paying taxes and so they got to die with their farm. Well, you might read between the lines on this one as to how you can get around that. A special capital gains election is a resident who is an employee of a corporation and who acquires shares of ownership in the firm through the course of employment may elect to subtract from their income the capital gain realized from the sale of the shares. Now this little pup is worth $20.8 million give or take in calculations a year in lost revenue, so it's worth looking at. Somebody is making out pretty well on it. The election can be made only once in a lifetime. The transaction must fit certain criteria. The corporation has to have been around for three years; not too hard to do. There must be at least five shareholders and at least two of the shareholders or groups of shareholders are not related and those groups each own 10 percent of the stock. And then an extraordinary dividend is one that exceeds 20 percent of the market value of the stock when the dividend is declared. Now this $20 million lost in revenue because we have this thing addressed it to this particular exemption is going to be, in all probability, exasperated by a Supreme Court case decision. And that case decision just came down in 2006. And what happened there is the folks who owned the corporation and were going to sell it "gimmicked" around to add some of the prospective buyers in as shareholders in order to get to the five shareholder criteria. And the Department of Revenue protested and said, wait a minute, you're just conducting a sham transaction so that you don't have to pay capital gains tax on a transaction you'd otherwise have to pay capital gains tax on and, no, we're not going to honor shams. And the Supreme Court said, guess what? The way we read the law the Legislature doesn't care, so we're going to allow these type of situations where you expand to meet the five criteria, because we think that's what the Legislature meant. And so this makes it a whole lot easier to take advantage of this particular thing and so the $20 million a year probably is going to go up. Now the arguments for this, no other state offers this type of capital gains exemption. We are unique. You would think a lot of people would be flooding into the state to take advantage of it. Benefits a very small segment of wealthy Nebraska taxpayers. The number of returns claiming the election--I think this is based on 2014 figures--were 740, one-tenth of 1 percent of the tax returns claim this election. Eighty-eight percent of the total exclusion used in 2014 was claimed by taxpayers with adjusted gross income in excess of $500,000. And 80 percent for those greater than a million dollars in adjusted gross income. When it was first passed there was a concern that the provision would be subject to abuse if we didn't have the five unrelated taxpayer provisions. But, in fact, it's been widely used, far widely used than it was thought and it's going to be far wide more use now that that judgment is. Farmers theoretically could benefit from the election if they acquire the proper number of shareholders before selling their farm and thus they could avoid paying capital gains tax on the sale of their farm. Some of the opposing ideas would be that it was passed to keep people in the state, because otherwise--you guessed it--everybody would move out of state to sell their things. And that the...by letting a shareholder sell their stock income tax free, they'll have more money for their retirement and, thus, are less inclined to go on the public welfare roles. So that's number one. Number two is worth $84 million. This is a unique little thing and it will be very interesting to find out the justification for it, because the legislative history back in 1987 is very, very unclear as to why we even have this thing. It pops up in a very short introduction of amendment and it got passed and it's on our books. And it is kind of a neat little thing, because if I were to go down and decide I was some type of a consultant and go to another state, say a non-income tax state like Florida, and I'd do a service, whether it's legal service or I consult with somebody, well, I'd have to report that income on my Nebraska income tax. Now guess what I can do? I can set up an LLC, do the same thing with the Florida income, and I get an exclusion. I don't have to pay tax on it. As long as there's not meaningful Nebraska income, income gained from a Subchapter S corporation or an LLC out of state, we don't tax. The reasons on the repealing of the Subchapter S exclusion is...the conventional approach is to the entire distributable share of income in state taxable income and grant a credit for taxes paid in other states. But it's not clear if any other states have adopted this approach to taxation from Sub S and LLCs not apportionable to Nebraska. If they do, it's a clear minority. What it does, if you deal and funnel your income to a nontax state, this allows you to operate a business and not pay tax on that income in Nebraska. And apparently it's done on a wide, wide basis, because of the high fiscal cost. Eighty-five percent of this exclusion is claimed by taxpayers with federal AGIs of at least a million dollars in...per year...tax year 2014 figures. Similarly, taxpayers with an AGI of at least $5 million claimed 60 percent of this exclusion. One typical case that was analyzed individually, a family excluded $540,000 of taxable income as a result of this exclusion and had an effective tax rate of 3.8 percent. You can see...I mean, it's an economic disincentive program to invest in Nebraska. If you were going to...if you had a million dollars to invest and you had a bright idea for a, just call it an Internet company of some kind, and you set it up in Nebraska you would get taxed on the income. You set it up in another state and don't draw much income out of Nebraska...much sales in Nebraska, you're tax free. Why would you ever want to set something up in Nebraska? This is big time money. And there is no easy way to ascertain who exactly is benefiting from it. But there's a gimmick. If you set up out of state an LLC--it needn't be a Nebraska LLC--and have your income from out of state, you escape taxation on it. Not bad. And I was just shocked that the price tag was $84 million. Next item, of course, was one that we've discussed before--I won't spend much time on it--to sunset the Nebraska Advantage Act. And we all have heard the numbers there, ranging around $75 million to $125 million a year in credits. We won't be able to get rid of that one very fast, because those commitments are out there for a long, long time. But we are continuing to make those commitments. Right now, even as those...highly questionable program. We don't know for sure how well it's working, how well it's not working. The Performance Audit Committee report was highly ambiguous. One would say that if it was a kid you were sending to college, you'd probably tell them to take a few semesters off and grow up a bit, because it wasn't working very well and you wouldn't be too anxious of paying more tuition. But I think the committee is aware of the Advantage Act issues. Let's call that give or take $100 million a year. And, for example, 58 out of the 78 Nebraska Advantage companies participated in at least one other economic development program, so they're eating out of more than one pot. Only 9 out of the 78 companies with Advantage Act projects were new to Nebraska. And that's a report that those of you who had been on the committee earlier this...before the turn of the new Legislature knew it was not a very glowing report for the Advantage Act. And it is a big expenditure. And most of our jobs are created in the state, most of our investment is done in the state without getting a smell of it, just not getting a smell of it. It's an exclusive little club. Fourth one is worth $10.7 million a year and this one would repeal the sales tax exemption on contract labor. Contract labor, including repair labor performed upon real property was originally added to the sales tax base in 2002. Contractors complained of the difficulty in applying the tax to different types of labor performed when invoicing their customers. In 2006, it repealed the application of sales tax upon contractor labor applied to residential structure was followed by the repeal of sales tax on any contractor labor performed upon real property the following year. This would restore that. Now some of these would be a good idea to restore and repeal, some maybe not. Maybe this is one that's not. This exemption is an inconsistency in the treatment of sales tax on labor; that's one reason to repeal it. Repair or installation labor performed on tangible property is taxed. Expanding the tax base is good tax policy. Expanding the tax base allows local option sales taxes on it. The other side of the coin: In

2016, a similar proposal in Missouri led the real estate industry to launch a successful petition drive prohibiting the expansion of a sales tax base altogether. Petition drives in this state are considerably more difficult. It could potentially increase the cost of construction and is often seen by something that as already taxed since the people who are working on their house or hiring a contractor already have paid taxes on that income. Five, this item is worth $11.5 million. It reinstates the phase-out in the standard deduction, personal exemption, and itemized deduction. As a general rule, under the proposal for these particular exemptions, the more income you make the less of the exemptions that you're entitled to take. And eventually when you get up to a high enough income you're not entitled to take them at all. These are progressive things and they affect higher income taxpayers much more than lower income. On the other side of the coin, depending on the threshold set for the phaseout of the standard deduction, things like that could catch middle-income individuals who are likely to itemize...more likely...less likely to itemize than high income. The next one is $5.6 million. It undoes the changes that we made to make life easier for folks in 2014 in the homestead exemption. If we did not do that we would have perhaps more money for education and for TEEOSA and elderly folks seem to be hit a little bit higher. But this is going to become more problematic because as baby boomers age they are more inclined to be able to take advantage of this exemption and it's going to go up. The next one affects $20.1 million. It redirects the sales tax on motor vehicles above 5 percent to the General Fund. LB904 changed this so that all sales tax money was going to (Department of) Roads; this would put some of it back to the General Fund. Next one is $7.2 million. It repeals the sales tax exemption on molds and dyes that has existed since 1995. A mold, when they make that in order...it's something that becomes like a tool, which they make a finished product. And they're in manufacturing could be considered a finished product. It's similar that when a construction company buys a hammer it pays sales tax on the hammer. Next one would return ag land to 80 percent of market value. This increases resources in the TEEOSA formula, which reduces state aid without cutting schools. In place in fiscal year '17 the amount of TEEOSA savings would be $9.1 million. The next one repeals the Property Tax Credit Act. And this was the one that we passed and now have $224 million in property tax credits. Those are going to local governments, as we know, and we have to send out a postcard to remind people how much that they're getting. The Property Tax Credit (Cash) Fund allows local government to spend money and we pick up the bill. I think that's one the committee has discussed some and there's no need to go into more detail on it. It redirects sales tax on leased vehicles to the General Fund amounting to $14.9 million. And the reason basically it puts that back into the General Fund, rather than into the local government funds or I guess this was the (Department of) Roads funds. Returns income tax brackets, and this is one...LB970 in 2012 cost us $61 million a year. And had we not done that in 2012, rather, we would have an additional $87 million. Next one is we repeal the state tax exemption for community-based energy development wind projects, and that's $1 million. I'm not sure how this made it to the list because we had a cut-off point of $5 million before it made it onto the list. Next one undoes the increase in the earned income tax credit, returning it to 8 percent. And that one would produce $5.65 million. And I think there's an error in that calculation and it is somewhat more than that. Next one reinstates the estate tax, would generate $30.5 million. We did away with the estate tax in order to make life easier for folks who had some significance of an estate. For example, in 2007, the Tax Commissioner estimated that only 250 families had reason to file an estate tax return. It's a highly progressive revenue stream. The argument for getting rid of it is that if you were mobile and you could, you left the state to die, and we were going to try to keep people there. But the idea that...and tax relief there was $30 million. That was quite a big chunk of loss of revenue. Next item prohibits new application under the Sports Arena Financing Act. That was basically one in which we funneled back money back into the area around a sports center. That produced $3.25 million. The Build Nebraska Act, this is one in which a great deal of popularity in this particular act. It generates about $76.2 million a year for (Department of) Roads and is distributed 85 percent to the state, 15 percent to cities and counties versus the gas tax increase that we did, which actually gave two-thirds of the money to the local governments. We've treated (Department of) Roads really, really well and we're building a lot of roads and those are good things. But what this does do is, it removes (Department of) Roads from the normal budgetary process as far as this particular quarter cent sales tax is concerned. And that is...in doing so, they are not subject to the same review as some of the other expenditures we make. Next one we did to help out youth groups, over a biennium it's $6 million, otherwise it's just $3 million and it's costing more than what is anticipated for YMCAs and things like that and some tax exemptions for them. Next one is repeal the New Market Tax Credit. It was intended to support low-income areas, but the use of census tract has allowed higher areas with low-income census tracts to receive the credits. The credits have gone to programs that most likely would have been done before. It was done in order to bring into Nebraska some federal money from a complementary federal program. That program has recently taken on some bad press and is high overhead. It will reinstate the alternative minimum tax. This was another thing that we did as tax relief and the argument was, the alternative minimum tax you had to pay, regardless of your deductions and exemptions, a certain amount of...and certain percentage of your income as tax. The federal government has one, we have it, too. In fact, I sponsored this particular bill and it passed unanimously on the argument that what happened was, it was affecting basically higher middle-class people who were working on a job, had some investments, were getting clipped on the tax. And that was not how it was supposed to work. But, nevertheless, in doing so we generated $12.2 million in tax relief in that year, as did the repeal of the net operating carry forward extension to 20 years from 5 years. That lost us another $12.2 million a year, which was tax relief on income tax. The bill also repeals the sales tax exemption on repair and replacement parts for agriculture machinery. Well, what we did there is we granted tax relief in the order of about what's now costing us $15.6 million a year so that when repair parts and replacement parts that were bought, they were not sales taxed. Basically, the argument was made that folks near the border were using farm dealerships to buy their parts on the other side of the line and, thus, we were pushing a lot of business out of state. Nevertheless, $15.6 million in savings to the taxpayer and in tax relief. The bill also puts into play the exclusion on Social Security and certain military retirement income that we put in, in

2014. That cost us right at a million dollars a year; not quite sure how that made the list here. But, again, tax relief where we did what we could. The big one that we started and there was some advice that we shouldn't have done it, that it was smarter to do it in a different way but we didn't listen, was automatic indexing of tax brackets for inflation so that the bracket differences kicked in at different years or different amounts each year, depending upon inflation. That's now costing us $21 million and that goes up every year, incrementing by roughly $10 million a year, because we do an automatic tax adjustment. The advice that we were informally given at that particular point was, don't do it that way. If you do it that way people will take it for granted. What you do is, you let it build up a little bit then you declare a rate decrease and people will be appreciative. But at any rate, I don't think there's been any thank you letters sent on that one and it's now in 2014 already was at $21 million and it's going up. But that's a automatic $10 million a year tax decrease. The next one would be prohibit new applications under the Historic Job Creation and Mainstreet Revitalization Act. We've already had a hearing on that and know the issues involved in that and I won't go into that. But that's $15 million a year that if we do cancel it, it will phase in because this, like the new market credits, you just can't cut off because you made commitments that take a while to feather out. Next one repeals--and this is worth roughly $15 million to $19 million--the Personal Property Tax Relief Act that we started in 2015. It's not targeted. It shoots out across all different spectra of personal property tax liabilities. Twenty-four percent is benefiting utilities and railroads, when the original argument for it was that it was trying to target and help small businesses. And the last item here--I apologize for taking so much time, but like I said, the people who put this together are not apt to come to testify because they have clients that they do not want to get mad at them--and this is $6.3 million a year. And it arises from a mechanism...I'm not sure I completely understand how it works, but basically I'll go through this with you. In 1987, Nebraska passed LB772, which changed the method of apportionment from a three-factor apportionment formula on payroll, property, and sales to one based solely on a firm's sales, known as a single sales factor method. While determining whether or not a sale of tangible goods takes place, Nebraska is fairly uncomplicated. States have had to pass guidelines for when to consider a sale of service or a intangible good as located in the state. Prior to 2012, Nebraska used the cost of performance method for apportioning service-based revenue and income from the use of intangibles. Under this all-or-nothing approach, revenue was apportioned to the state in which the greatest proportion of the firm's cost, such as wages and leases, were located. LB872 in 2012 changed Nebraska's method of sourcing sales of intangibles from cost of performance to a market sourcing mechanism which allots service-based revenue to the state in which a benefit of the service is received and will be used. By changing from a cost of performance method to a marketing source method, this allowed the state to tax out-of-state service providers with customers within the state while holding harmless or reducing Nebraska income taxes for instate service providers. However, this change when combined with the single sales factor formula created a loophole which a company might not pay any tax on a portion of their service-based revenue. This scenario occurs when a company's home state is a market-based sourcing state with single sales factor like Nebraska and the destination state is a cost of performance state with single sales factor apportionment. The revenue would not be assigned to the home state, since the service was delivered to an out-of-state customer. Additionally, the revenue would not be sourced to the destination state since the income-producing activity was performed outside the state. Effectively, this is a tax-free transaction since both states would be allocated zero revenue from this source. The single sales factor can also result in double taxation when a taxpayer is located in a cost of performance state and is providing service for a customer in a market-source state. At any rate, the bottom line on that tax change is costing us $6.3 million a year. That's kind of an overview of the tax changes we've made over the years, put into the bill to put them on the table in the event we want to make any changes or ask any questions of it. The two things that stand out the most--and I will be interested to hear very much so the opposition to and where that comes from--is repealing the special capital gains tax election, $20 million a year. And then repealing the exclusion for income arising out of state through a Subchapter S or limited liability company, $80 million to a handful of people. And those two alone are $100 million. And it's really, really hard to say why those breaks should be given. If we're going to give a break in taxes when you sell your business, why not give it to a mom and pop shop? Where did the idea of you have five shareholders come from? Why not give it to a farmer selling his farm? Why does this small number of people who now can fudge to get into the category of having five shareholders, why do they get such a break? What's a possible justification for it? And the amount of benefit are really high income people, as is the very limited number of people who get that Subchapter S break; very limited number of people and really, really high incomes with taxpayers of federal AGI of $5 million claim 60 percent of that exclusion, 90 people. There's something wrong with that. And if we're looking for money and everybody to pony up a little until we get to the other side of the rainbow, those are two prime things to begin to look at. So I'd be happy to take any questions and continue the discussion. [LB373]

SENATOR SMITH: Thank you, Senator Schumacher, for your opening on LB373. Well, you may not have bested Governor Heineman's record for the number of people showing up in Revenue to testify, but I think your introduction was longer. [LB373]

SENATOR SCHUMACHER: Not as long as the one that I gave in Judiciary Committee on the Medicaid recapture bill. [LB373]

SENATOR SMITH: All right. [LB373]

SENATOR SCHUMACHER: That was 45 minutes. I'm done at 40 minutes. [LB373]

SENATOR SMITH: Okay. Very good. [LB373]

SENATOR SCHUMACHER: But seeing as how I expect a long list of supporters, you'll make up for it on that. [LB373]

SENATOR SMITH: No, you did a great deal of research on this and a lot of information there that was covered. So do we have questions? Senator Harr. [LB373]

SENATOR HARR: Thank you. And let me first start out by saying, thank you for bringing this bill so we can have a conversation about this and until Senator Smith filed AM223 yesterday I thought this was the kitchen sink that included everything, but we're going to be back next week with even more. So thank you for bringing this. I looked at the fiscal note on this and it might surprise some people, I had some questions about the fiscal note. You mentioned how much each one of these exemptions cost. I look at the fiscal note and I don't see that number. Where did your numbers come from or why...and if you got them...let's start with that. [LB373]

SENATOR SCHUMACHER: Okay. The numbers came from two sources, the Legislative Fiscal Office and most of it was like I think 2014 they were working off of and the Tax Expenditure Reports. [LB373]

SENATOR HARR: Okay. [LB373]

SENATOR SCHUMACHER: And we tried to get so that we could say, okay, where's the difference at with the Fiscal Office and we could not get a...they just wanted to talk in terms of the total. [LB373]

SENATOR HARR: Okay. [LB373]

SENATOR SCHUMACHER: We could not say, oh, this is where the difference is. [LB373]

SENATOR HARR: And that's disappointing. Okay? I'll just leave it at that. I don't want to have a soliloquy. I'm looking at the fiscal note and I went back and looked at the fiscal note on LB405 as well and it was done similar to this. And it's disappointing. In there they included local option sales taxes and the effect it has on our local municipalities and maybe a lowering property taxes. I don't see that anywhere in here. Do you have...because we eliminated a lot of sales tax exemptions. Do you have what the effect is on the local sales option? [LB373]

SENATOR SCHUMACHER: No. It did not get into what the effect is, except that we know that it's a percentage of the...if it's a sales tax item, a percentage in most cases of the state sales tax.

It's usually 2 cents and the state's 5.5 cents. And so that's, you know, I guess you can back into the number. The criteria we were looking for is an impact on the General Fund revenue. [LB373]

SENATOR HARR: Okay. This could have an effect on lowering property tax on the local level. [LB373]

SENATOR SCHUMACHER: Right. [LB373]

SENATOR HARR: Heaven forbid LB373 passed as drafted. [LB373]

SENATOR SCHUMACHER: What was that? [LB373]

SENATOR HARR: I said, heaven forbid LB373 went as drafted. It would have probably a positive effect on local option sales tax and probably lower property taxes. [LB373]

SENATOR SCHUMACHER: It probably would, but there's also provisions in here that I think pretty much we can uniformly, at least for right now, agree on that were probably good decisions. The roads need to be built. Whether it was good to fund it this particular mechanism, there's no outcry against fixing those roads right now. And that's probably a good spot to put money that, even though it's a little inequitable because at least under the gas tax part of it comes from...it's kind of regressive with people drive cars and have their rims bent and front end alignments, just like anybody else. [LB373]

SENATOR HARR: Okay. I think that's all I have for right now. I would hope for LB223, if Fiscal Office is listening, when we have our hearing next week on LB223...the amendment, AM223, excuse me, that we have a breakdown what each one of those exemptions or credits that we're looking to eliminate cost. [LB373]

SENATOR SCHUMACHER: You know they had to have a list in which they added together to get the total. [LB373]

SENATOR HARR: And all we're asking is to show the math. [LB373]

SENATOR SCHUMACHER: Show the math. And, you know, that's...maybe it's just too hard for them to pin down. But I think we know that we've had issues with these fiscal notes. [LB373]

SENATOR HARR: Again, that's my frustration is I see these totals, but I don't know...it's hard to argue with the numbers or to say, this is a good one to pull out, this is a bad one, when we...let me just state--and this is my own comment, personal comment, personal privilege--this is no way to make policy is when we don't know what anything cost. And if we're going to repeal it, we need to know the cost of it. If for no other reason, this bill is valuable for future Legislatures so they can go back and see what each exemption cost. We have it in the record. We don't have it in a fiscal note and I would like to see that. [LB373]

SENATOR SCHUMACHER: That's very true, Senator, and if in fact the amount of tax benefit by taking some of these actions that is projected here is accurate, they're significant. Twenty million dollars, eighty million dollars, and if those are off base, if somehow there's another thing that we haven't calculated in and we've done so far, then we should be told, hey, this isn't $20 million, this is $15 million or it's $25 million. And, no, the Subchapter S exemption that affects less than 1,000 people, you're off base. It's not $85 million, it's only $32 million. Let's find it. [LB373]

SENATOR HARR: Let me follow up on that Subchapter S exemption that you're talking about. Do you know what type of businesses they are generally or how large or how small, how many employees they produce? [LB373]

SENATOR SCHUMACHER: No. Obviously, they're not producing very many in Nebraska or, in fact, you're disincented to set up your business in Nebraska. You'd be better off setting it up in a nontax state completely, just sitting in Nebraska owning the shares. [LB373]

SENATOR HARR: Can you explain why that is? I don't understand what you're trying to say. [LB373]

SENATOR SCHUMACHER: Well, basically, Subchapter S income that isn't based in Nebraska isn't taxed, even if you're a Nebraska resident living here. If you were practicing law in that other state, not as a corporation, not as a Sub S or LLC, you would have to pay that tax. And somewhere in the process it looks like the state is losing $80 million. Somebody is making money off of it, Subchapter S corporations living in Nebraska. [LB373]

SENATOR HARR: Is that income then captured in the state where the income is produced? [LB373]

SENATOR SCHUMACHER: Not if they are not an income tax state. [LB373]

SENATOR HARR: Okay. [LB373]

SENATOR SCHUMACHER: And what an incentive for setting up a business in a state that doesn't have an income tax. If you had a million dollars to invest in a housing project, would you put it into a Sub S company here in Nebraska and build something out in western Nebraska or would you put it in a state with no income tax and sit here in Nebraska and get your return on your housing investment? [LB373]

SENATOR HARR: Okay. [LB373]

SENATOR SMITH: Senator Friesen. [LB373]

SENATOR FRIESEN: Thank you, Chairman Smith. Yeah, I need a little more clarification on the Subchapter S. So if...you're saying if an individual is living in Nebraska sets up a Subchapter S elsewhere, Florida... [LB373]

SENATOR SCHUMACHER: You could even set it up here. But at any rate, yeah. [LB373]

SENATOR FRIESEN: Well, you set it up in a state with no state income tax,... [LB373]

SENATOR SCHUMACHER: Right. [LB373]

SENATOR FRIESEN: ...Florida. [LB373]

SENATOR SCHUMACHER: Right. [LB373]

SENATOR FRIESEN: So you're still living here. The business is here. Headquarters is in Florida. They would pay no taxes in Nebraska? [LB373]

SENATOR SCHUMACHER: As long as the Nebraska...revenue from Nebraska was negligible. So if you said, orders from Nebraska not accepted, you'd be pretty safe. Or if you hid it through several levels of... [LB373]

SENATOR FRIESEN: But if the revenue was generated here, then it would be taxed? [LB373]

SENATOR SCHUMACHER: Right. [LB373]

SENATOR FRIESEN: But it could be generated from multiple other states through that Florida location and the profits brought back here with no tax. [LB373]

SENATOR SCHUMACHER: Right. You would not have any tax. On the other hand, if it wasn't a Subchapter S company, if you were doing it as an individual, just you and a partner or as a regular corporation and pulling dividends out you'd be taxed on them here. [LB373]

SENATOR FRIESEN: Right. [LB373]

SENATOR SCHUMACHER: And this...what stands out on this, this is a few people who are or a lot of people who are eating out of this pot. It apparently is a very limited number of people. Eighty-five percent of the--and this is 2014 figures--eighty-five percent of this presumably $85 million is claimed by a federal taxpayer or taxpayers with a federal AGI of at least a million dollars. That represented 620 returns. Similarly, taxpayers with a federal AGI of at least $5 million claimed 60 percent of this exclusion or 90 returns. We're talking about somebody is really, really, at $85 million, assuming those numbers are anywhere close to being good enough for government work is making it, cutting the fat off. [LB373]

SENATOR FRIESEN: So if this bill would pass this year, are all of these tax credits...would they be available immediately? They're not something that's earned for use down the road or this is...this would be an immediate impact? [LB373]

SENATOR SCHUMACHER: These, the first two we talked about, that's pretty immediate because we allow them to exclude on a year-by-year basis. Some of these deals where we don't have the contracts with new markets and made a term of commitment for payout over a number of years for historic credits, where they've been granted the credit but haven't finished gutting the old building yet, those we'll have exposure for regardless of what we do for a number of years until they run their course. I think both of those run their course like five years. [LB373]

SENATOR FRIESEN: But the savings that you showed from some of those would be yearly and then growing? Or is that just if they were... [LB373]

SENATOR SCHUMACHER: Well, on the Sub S ones? [LB373]

SENATOR FRIESEN: No, on these others, historic tax credit, do they just...would they ramp up with time then? [LB373]

SENATOR SCHUMACHER: No. Historic is $15 million a year tops. [LB373]

SENATOR FRIESEN: Okay. [LB373]

SENATOR SCHUMACHER: But it's got like a five-year life span. And it didn't kick in with actually costing credits until I think the first two years off. Part of the gimmick there was, was there was no fiscal note if you made it effective two years into the future. So it was a something-for-nothing bill. [LB373]

SENATOR FRIESEN: Okay. Thank you. [LB373]

SENATOR SMITH: I see no further questions. Thank you, Senator Schumacher, for your opening. [LB373]

SENATOR SCHUMACHER: Thank you. [LB373]

SENATOR SMITH: Now, you have a bill in another committee. Are you going to remain? [LB373]

SENATOR SCHUMACHER: Well, they haven't...if they come and get me I will...seeing as how the bill after my bill is long, long and controversial, I'd like to get squeezed in. But I will come back if they call me. [LB373]

SENATOR SMITH: Okay. [LB373]

SENATOR SCHUMACHER: And if they don't, then I'll be here till 9:00 at night waiting to present in the other committee. [LB373]

SENATOR SMITH: Very good. Thank you. We now move to proponents of LB373. Those wishing to testify in support of LB373. Welcome, Ms. Fry. [LB373]

RENEE FRY: Thank you. Good afternoon, Chairman Smith, members of the Revenue Committee, my name is Renee Fry, R-e-n-e-e F-r-y, I'm the executive director of OpenSky Policy Institute. I'm here in support of LB373. I will tell you I think that this is probably one of the most informative bills that I think that we have ever looked into. We have reduced revenue by a significant amount over the last decade and I think it's a really important conversation for us to be having right now as we weigh tough choices that I recognize that the Legislature will be making this year. And I think it's great that we have everything on the table. I thank Senator Schumacher going through provision by provision. I'm looking forward to hearing from other supporters, but particularly opposition in terms of the reasons for these various bills and statutes, what the impact is, and I think it's a really valuable process for us to be going through and one that I think would be great for all committees to emulate every other year as we have a new committee before us. So I very much appreciate having had the opportunity to look at this bill. I did tell Senator Schumacher that I hope to bring the bill back again next year, but go back even earlier, particularly back to 1986 because in doing this research on the bill we realized that there were some pretty significant changes that took place in 1987. And since my time is limited, I just want to focus on a few of those earlier changes as I think they're important for us to think about in the greater context. So in 1987, it was a time of desperation in the Nebraska Legislature. The farm economy was just starting to recover. Enron had left the state. ConAgra was threatening to leave. And as a result, the Legislature made several changes that have had a huge impact on our state's revenue and continue to do so today. Senator Schumacher spoke to the special capital gains election as well as the S corporate LLC exclusion, some of those statistics that we also found in the statistics in income in the Tax Expenditure Report, so I don't need to repeat those. But I do want to touch on perhaps the most notorious outcome of 1987 was the passage of our state's first tax incentive program, LB775. And while that's not part of our bill, it did establish an expectation, I think, that our state would go to great lengths to keep Nebraska businesses here. And as a result, our tax incentives--as I've said to this committee before--according to Dr. Bartik, with the Upjohn Institute, finds that our incentives are about 79 percent higher than the Nebraska average. Since 1987, Nebraska has spent over $3.2 billion on LB775 and Nebraska Advantage. And it's worth noting that we currently have another $1.2 billion in future obligations from these two programs. So I think that's really important for us to understand and think about. And while I don't have the expertise to speak with a lot of confidence about how we apportion income in Nebraska, this may be worth pursuing at a later date, because in 1987 when we adopted LB775 we also changed how we apportion income in Nebraska. And we went from a three-factor apportionment rule that determined a corporation's profits based on the percent of property, sales, and payroll in the state to a single sales factor approach which, instead, determines the corporation's profits subject to taxation based on sales in Nebraska alone. Many companies surely benefit quite handsomely from this change and other companies may actually pay more in taxes as a result. The question that we have about this and the reason it came up was because of a provision in 2012 that passed that had to do with apportioning of intangible services in Nebraska. And so our question is, under a single sales factor, it does appear that there are companies who could escape income tax in Nebraska altogether. And when you couple that with incentives, we can't help but wonder whether a company could escape almost all state and local taxation. And with the payroll withholding provision that companies are allowed to keep their employees' payroll taxes, we wonder if it's conceivable that some Nebraska companies might actually have negative tax liability in Nebraska. I don't know what the answer is, but the question did occur to us and I think it would be worth pursuing at a later time. So when looking at all these provisions together that are in LB373, I think it gives us a much better understanding of why effective tax rates on the higher end of the spectrum in Nebraska are well below our state's marginal tax rates. There are many tax rates and loopholes that would be reversed by LB373 that are used by relatively small segments of Nebraska residents. And so it occurred to you to look closely at whether this revenue could be better spent elsewhere, such as helping to address their budget shortfall or address concerns or address concerns about property taxes. With that, I'm out of time. Senator Harr, I could speak briefly to the fiscal note question. And with that, I'd be happy to answer any questions. [LB373]

SENATOR SMITH: Thank you, Ms. Fry, for your testimony. Senator Harr. [LB373]

SENATOR HARR: Thank you, Chair Smith. I'm going to have to disagree with you that this is an informative bill, because I look at the fiscal note and I know nothing. Senator Schumacher came up with figures from 2014. We're in 2017. It's dated material. Farm economy has changed dramatically since 2014. In 2014 we had a surplus. Today we have a billion dollar shortfall. So the fact that we have the answer but not how we got that answer is, to quote Vice President Biden, malarkey. I don't know what...I mean, I now know what I don't know, which is an advantage I had before. But I have no idea how we came up with any of these numbers. I don't know how to make any budgetary decisions. I hope...I've never really sat in a Appropriations (Committee) hearing. I hope Appropriations doesn't sit there and use figures from 2014. I hope that Appropriations has better access to...if we're going to do a program or not do a program how much it cost, not here are a whole bunch of programs. You guys either vote them up or down and maybe we know what the price is, maybe we don't, maybe we're right, maybe we aren't. Now that's at least forward thinking. All I'm trying to figure out is what things cost in the past. This, to me, just gets me frustrated. This is, to me, I know it's been one of my bigger frustrations here, is how do we know what anything cost? And if we don't have even an idea, how do we make a policy decision? So I'm going to strongly disagree with you that this is an informative bill. I think this is just...it's informative in that it points out I don't know anything. And that's embarrassing. So it's more of an embarrassing bill than an informative bill for me. So let me ask you this quick question. You mentioned apportionment of intangibles. How much does that cost? I can't figure that out from here. That was the one you talked about the last time; it was hanging in my head. [LB373]

RENEE FRY: Right. So according to the document that Speaker Hadley handed out, he had Legislative Fiscal Office put together a document that had a list of bills that had passed since 2005 or 2006. According to that document, that particular provision cost $6.2 million. [LB373]

SENATOR HARR: That was the fiscal note on it. [LB373]

RENEE FRY: Yes. [LB373]

SENATOR HARR: Okay. Do we know how much it cost, if that fiscal note was right or wrong? [LB373]

RENEE FRY: We do not have...it does not appear that there is a number from the Tax Expenditure Report. So what I have in front of me, which I am happy... [LB373]

SENATOR HARR: Right, but that's the frustration. [LB373]

RENEE FRY: Right. So...may I? Thank you. I understand your frustration. We firmly believe that...I mean, first of all, I want to say that I think our Legislative Fiscal Office does a fantastic job with the resources that they have. And we have actually...a few years ago when Senator Harms was here we had several conversations looking at the way that the equivalent of the Fiscal Office works in Florida. They actually have...we can visit off-line about this, but they actually have some folks and some more people and the way that they're structured, they actually do more in terms of fiscal analysis, not only looking forward, but also looking backward. But I believe that our limitation here is really limited resources that the...and limited bodies to do the work. But we believe...we completely agree with you that we make much, much better policy decisions with really good information. And that good information and how much things are costing moving forward and looking back is critically important. [LB373]

SENATOR HARR: All I'll say is, I wish I could do my taxes where I say this is how much I owe and I don't have to show anyone the input. [LB373]

RENEE FRY: Right, right. [LB373]

SENATOR HARR: And that's what this is. [LB373]

RENEE FRY: Right. [LB373]

SENATOR HARR: They go through and list individually this repeals or terminates the following and they list probably 15, prohibits new applications for 5, changes income taxes as follows, so that's maybe 15. I have no idea what each one of these cost. All you have to do is put a little line at the other end of the paper and say, this cost blank, this cost blank and go down. All I have is I owe taxes...I told you I owe tax at $20, don't worry how I got there. [LB373]

RENEE FRY: No, I understand your frustration. We have gone through all the provisions in the bill to try to identify...I mean, our numbers are not matching up with the fiscal note either. There could be a variety of reasons for that. And in some cases and maybe, for example, Nebraska

Advantage, if we stop collecting...taking applications for Nebraska Advantage today, even though it's costing us $86 million a year or in the most recent...in 2015 Tax Incentive Report had it listed at $86 million. But if we stop taking applications today, that doesn't mean that we're going to automatically see a savings. We're just going to limit our future applications, right? And some of the provisions may be different from the Tax Expenditure Report or the Tax Incentive Report if it's a partial year versus a full year. So...but I'm happy to put together what our fiscal staff put together looking up the document that LFO prepared for Speaker Hadley at the time as well as identifying the numbers from the past Tax Expenditure Reports and Tax Incentive Reports. [LB373]

SENATOR HARR: And I appreciate that. I'm just not sure it's your responsibility. As a legislator, I want to have a nonpartisan office of the Legislature do it as opposed to relying upon outside sources. Not that I'm doubting what you do, but it would be nice if we invest in ourselves and had the ability to turn to our own people and say, give me your unbiased numbers on what you think it is. [LB373]

RENEE FRY: Yeah. And I would say that all these numbers are taken from either the Department of Revenue or the Legislative Fiscal Office. But you're right, we did have to do the legwork to come up with these. [LB373]

SENATOR HARR: Thank you. [LB373]

RENEE FRY: But I'm happy to share those. [LB373]

SENATOR SMITH: Senator Friesen. [LB373]

SENATOR FRIESEN: Thank you, Chairman Smith. You know, when I, just in the short amount of time that I've been here, you see how people write bills these days. And so they are intentionally trying to mislead the fiscal note. So some of us, we've done this to ourselves. But in the end, looking back, we have to realize the actual cost. And when you look at these, that is probably one of the things that we do is we...would you say that we don't look back to see if the results were what we paid for? [LB373]

RENEE FRY: Yeah, I think that's fair. I mean we firmly believe that you do need to do that retroactive analysis. And by doing so, you're only going to make better policy moving forward. But if you pass bills and assume one thing and it's actually another and you don't have that information, then your hands are really tied in terms of making... [LB373]

SENATOR FRIESEN: We're always trying to stimulate the economy, do what we do, create jobs, whatever. I, for one, say the government doesn't create jobs but we get out of the way of business. So in hindsight though when you've looked at some of these programs, are there any that stick out to you as though they've done what they should have done and the cost benefit ratio is good? [LB373]

RENEE FRY: That's really hard to know I think, because I don't think we're structured to really...the Legislature, as Senator Harr was speaking to, we don't really...other than the Performance Audit Committee, which I think has done a really great job in recent years trying to dig in on these issues to take a look and see what the return is on investment, without that sort of analysis I think we are a little bit just shooting in the dark. So... [LB373]

SENATOR FRIESEN: Performance Audit, though, they just make sure that we're meeting the specifications of the law that was passed. They're not looking at whether it was efficient or not, are they? [LB373]

RENEE FRY: No, actually Performance Audit has been doing much more qualitative research, particularly around the incentive programs. Senator Watermeier had that bill last week and has a couple amendments that I think would really improve the quality of the analysis that they're able to do. But they are really trying to get at much more than just are they meeting statutory requirements. The Auditor looks at whether they're meeting statutory requirements, but Performance Audit is looking at much more qualitative data. They're trying to really get their hands wrapped around whether these programs are making good return on investment for the state. So are they creating high-paying jobs or are they creating jobs that receive other subsidies from the state? And so I know that they've been really putting a lot of time and effort to try to improve the quality of the research that they're able to do. But barring that, there really isn't a whole lot of analysis. There are some reporting requirements so, for example, in tax increment financing, for example, which isn't part of this, there's a report that's required to go to the Department of Revenue. But it just says...oh, it says what the property is and the value in it. And there's no sort of qualitative component to the report. And the personal property tax credit, for example, you know if you look at that 24 percent of the personal property tax credit is going to utilities and railroads. But we don't have any sort of analysis beyond that, just sort of what the distribution is and that was what was required in the report. And so I think it is difficult and that's why I think this conversation is really important to try to discern whether, in fact, there are a lot of these programs...however many Senator Schumacher mentioned, whether these programs really make sense, whether we should be investing in these programs or whether we should be using those taxpayer dollars differently. [LB373]

SENATOR FRIESEN: Thank you. [LB373]

SENATOR SMITH: I see no further questions. Thank you, Ms. Fry, for your testimony. [LB373]

RENEE FRY: Thank you. [LB373]

SENATOR SMITH: We continue with proponents of LB373. Welcome. [LB373]

TRACI BRUCKNER: (Exhibit 1) Good afternoon, Chairman Smith and members of the Revenue Committee. My name is Traci Bruckner, T-r-a-c-i B-r-u-c-k-n-e-r, and I am the research and policy director of the Women's Fund of Omaha. I'm here today to testify in support of LB373 simply because I think the current budget shortfall calls for a balanced approach where tax provisions should be part of the discussion all the same as spending cuts. Out of LB373, though, we do oppose cutting the earned income tax credit being included in that. That is the one tax tool that's targeted to low-income families and has been highly effective at lifting people out of poverty. Between 2009 and 2011 it kept 20,000 children out of poverty. Just a little bit about the Women's Fund. Since our founding the Women's Fund, we've invested nearly $11 million in programs that support women and girls. These programs are identified through our research and those that best impact the issues that face women and girls. Issues like payday lending reform and broader economic security issues, domestic violence, sex trafficking, leadership development, and so on. While those investments are impactful, they make a very small dent in the needs that exist, which is why we're saying state funding for programs that provide critical support for public-private partnerships really help us broaden the impact. When the budget cut discussions began this year, we had learned that the Department of Health and Human Services was planning to balance some of their cuts by making a sweeping 50 percent cut to domestic violence programs. We understand that that has since been taken off the table but if the budget shortfall worsens or if they can't meet the final gap that they're trying to meet, this funding cut could still be on the table. So just to give you a picture of what that means, that funding amount for these services has historically been extremely low, with the only increase over the last 15 years consisting of $134,000 that's split across 20 domestic violence programs and four tribal domestic violence programs. To give you a picture of the needs for these programs the 2015 National Census of Domestic Violence Services for Nebraska looked at just one day in the state and saw that the program survey concluded there were 105 unmet requests for services and out of those 76 percent were for housing. So should the budget gap worsen or should we not find another way to close the remaining $288 million, this cut of 50 percent could be reconsidered. And that would force...exponentially more women and children would be denied services they need to escape domestic violence. Those numbers tell the story, I think, that our state has a revenue problem rather than a spending problem and I would say that it's just one example of many. And so when we're faced with significant budget gaps, as we are now, I think everything needs to be on the table, including all the tax provisions that we have authorized over the years. And so, with that, we would urge the committee to strongly consider which provisions within this bill merit examination and could help increase state revenues to prevent further damaging cuts to programs that really help impact everyday lives. Thanks for your time. And with that, I would take any questions. [LB373]

SENATOR SMITH: (Exhibits 2, 3, 4) Thank you, Ms. Bruckner. Are there questions from the committee? I see none. Thank you. Next proponent of LB373. We do have letters for the record from Mike Marvin, Nebraska Association of Public Employees; Jason Hayes, NSEA; and Troy Loeffelholz, GNSA. Those letters were sent in for the record in support of LB373. We now move to opponents. Those wishing to testify in opposition. Give me a show of hands roughly how many we have. Okay, we have a fair number. Thank you. Please come on forward. Welcome. [LB373]

DAVE MLNARIK: (Exhibit 5) Thank you. My name is Dave Mlnarik, D-a-v-e M-l-n-a-r-i-k. I'm the executive director of the Nebraska Sports Council. I am here to testify on behalf of our organization and our long-time partners, the YMCAs of Nebraska, in opposition to LB373 and specifically the tax exemptions this legislation would remove pertaining to fees charged for statewide sport events, instruction, and leagues. These can be found on the bottom of page 29 and the top of page 30 of the legislation. This proposed language represents a dramatic departure from how the Department of Revenue is currently operating, dating back 28 years. And Nebraska YMCAs have been in existence in our state for 145 years and have operated without such a tax burden. LB373 is also inconsistent with the longstanding treatment of nonprofit 501(c)(3) organizations at the federal, state, and county levels. These exemptions exist in recognition that nonprofit organizations exist for the public good and the charitable nature of our activities, services, and programs that benefit communities in which we serve. The events and programs of our organization, the Nebraska Sports Council, especially the NE150 Challenge and the Cornhusker State Games, provide motivation for thousands of Nebraskans to be physically active and engage in healthy habits, which undoubtedly leads to lower healthcare costs. Our events also generate millions of tourism and subsequent state sales tax dollars annually. The return on investment provided by YMCAs--which are volunteer led and are a community asset--is enormous. A sales tax would diminish the ability of the YMCAs to provide programs to the underserved, low-income children, individuals and families that need the YMCAs the most and have come to count on these programs. We can ill afford to create additional financial barriers to our children and families becoming more physically active, especially at a time when obesity and chronic disease are on the rise in our state and we know that low-income, hardworking families statistically are in greatest need to be engaged in health and well-being activities. Today I respectfully ask for your support to retain the sales tax exemption for nonprofit organizations that has been removed in LB373. Thanks. If there are questions. [LB373]

SENATOR SMITH: Thank, Mr. Mlnarik. Senator Harr. [LB373]

SENATOR HARR: Thank you. Thank you for coming, Mr. Mlnarik. Let me just play devil's advocate with you. So there are four really ways that we create tax policy, according to...there's a Nebraska professor who said that. One is probably innovation. And the second is intelligence, meaning there's an action, there's a consequence, we've evaluated that consequence, and we like what that...where a tax policy is. So I would say there was an action. I wouldn't go back as far 145 years, because we only changed the elimination of the tax exemption, whether it was collected or not, probably three or four years ago, maybe five. So two differentials. So tell me what is the cost, if you know, of this exemption, because I don't. Hopefully, you do, and that's the state, and then also tell me what is the consequences of the elimination of this tax exemption. [LB373]

DAVE MLNARIK: Good questions. I can't speak for the Y on the cost. I do know that on an annual basis over, let's say, the past five years the average sales tax that could be collected on entry fees into the Cornhusker State Games and it would also apply to admissions, for instance if someone came to the opening ceremonies and paid $5 or $10, somewhere between $50,000 and $60,000 a year would be applied to sales tax and charged to the participants. So I can't tell you what the consequence would be, but our price would go up by the amount of the sales tax. Our participant base has shown sensitivity to a $2 increase. Right now, our average entry fee for Cornhusker State Games is about $30, so whatever the sales tax would be added to that. [LB373]

SENATOR HARR: Five and a half percent? [LB373]

DAVE MLNARIK: Yeah, for the state's part of it. [LB373]

SENATOR HARR: And you think that would be enough to keep people from going to the Cornhusker State Games...playing devil's advocate? [LB373]

DAVE MLNARIK: Yeah, in the past when we've done a $2 increase participation has gone down. I don't know if it's exactly because of that. I mean, there's so many reasons why someone might enter or might not enter. But I think going back to the testimony, that any barrier to someone doing what's proven to help them be healthier right now is not a good idea. And the fact that this has been in place since before me, and it was modified four years ago, and there are actually a lot of organizations that were for profit that are now paying sales tax on their participation fees. The modification made it pretty clear that the Nebraska Sports Council events were the only multisport event...the State Games are the only multisport event associated with a national organization in the state. So it's pretty specific that number seven on there to the Nebraska Sports Council and we had the opportunity to host a national version of State Games back in 2015. The economic impact was estimated at between $20 million and $25 million on that, so a sales tax collected was significant, as was a whole lot of other activities associated with it. Again, whether the sales tax applied to the entry fees would have changed that impact significantly, I'm not sure. I just know that it would be noticed. [LB373]

SENATOR HARR: Okay. Thank you, I appreciate it. Thanks for taking the time to come down and testify today. [LB373]

DAVE MLNARIK: You're welcome. [LB373]

SENATOR SMITH: Seeing no further questions, thank you for your testimony. Next opponent of LB373. Welcome. [LB373]

M.J. MYERS: (Exhibit 6) Hello, Senators. My Name is M.J. Myers, M.-J. M-y-e-r-s. I am a 9-year-old boy. I go to school and I am in the third grade. I live with my dad in Fremont in a single-parent family. I oppose LB373 taking away the tax exemption for youth sports. This will help the YMCA continue to provide programs and services for families, seniors, and kids like me. My dad is on a disability and we live on a fixed income. We are on a scholarship at the Fremont YMCA and we really appreciate it and all of our opportunities there. I want to start off by thanking everyone here for listening to my story about how the Fremont YMCA has impacted my life. I just wanted to talk about how the YMCA has helped me and my family. I know as the youngest in my family I could have never done as well or got as far without the generous financial help and support of the Fremont YMCA. The YMCA and everybody there has made so many donations to me. I am very appreciative. I can't help thank everybody enough. The YMCA is a wonderful, fun facility, and a safe place for me to go after school and meet my friends there. There is just so much to do there. My friends and I go skating, play hockey, play racquetball, and go swimming. It definitely raises my self-confidence when all the nice people at the YMCA make me feel so welcome there. I am also in the YMCA swimming instruction classes they offer and I love it. Just this summer alone, I passed two or three more levels and I love to be able to swim good. I feel like I belong to that swimming pool whenever I have free time. About four or five years ago my dad took me to the YMCA Sidner Ice Arena to see if I would like ice skating and I loved it. Ice skating made me feel wonderful, it was so fast and everything I skated past was a blur. I felt free. It gave me confidence. I felt like I was good at something. My dad could not get me off the ice. I skated and ended in the hockey class and I was loving it. My dad told me, look for clues from God on what we should be working on in our lives. I have been skating and working to get better at hockey ever since. I am now on the Fremont Flyers hockey team on a scholarship. I also have an older brother who is now all grown up, living in Omaha. He missed the opportunity to learn to skate at the YMCA Sidner Ice Arena, but he's always enjoyed playing in the football, basketball, and baseball leagues and programs with all scholarships offered through the YMCA. So like me, my brother, Zach, loves sports. He just graduated from UNO college with a sports science degree. I can't help think that the YMCA had some part in my brother's accomplishments. Getting a scholarship to play for a hockey team meant a great deal to us. I have learned so much playing on that team. Because of the support and help from our community, I feel that me and my family are on the right path, God's path, and I pray we can stay on that path in the future. I would just like to finish talking by saying there will be other kids like me this year that for a whole bunch of different reasons will be struggling financially and in other ways. And I can personally tell you, the Fremont Family YMCA may surprise them and motivate them to get on God's path and change their whole lives for the rest of their life. Thank you, Senators. God bless you! [LB373]

SENATOR SMITH: Well, Mr. Myers, let's see if we have some questions for you. But very, very nice job. And I want you to come back and testify in support of my bills in the future. So let's see if...Senator Brasch. [LB373]

SENATOR BRASCH: Thank you, Mr. Myers, and my bills, too. You've done an excellent job and I'm really impressed with all the activities that you have undertaken with the Y. I'm curious, how are your grades in school, pretty good? [LB373]

M.J. MYERS: Really good. [LB373]

SENATOR BRASCH: Really good. That's what I was hoping to hear. Well, I do think you have a future maybe even with the YMCA or the Ys here that they could probably use a recruiter like you. I'm ready to go join the Y again, so. [LB373]

M.J. MYERS: Yeah, that's even what I'm planning on being when I grow up, so. [LB373]

SENATOR BRASCH: Well, I think you're off to a good start. So thank you for coming here today. Well done. [LB373]

SENATOR SMITH: All right. I see no further questions, Mr. Myers. Thank you. Thank you for your testimony. Okay, who wants to follow that act? Welcome. [LB373]

STACY WATSON: I'm not going to be as exciting, that's for sure. Good afternoon, Chairman Smith and members of the committee. I am Stacy Watson, S-t-a-c-y W-a-t-s-o-n, and I am a CPA and a tax partner at Lutz, an accounting and business solution firm in Omaha and Lincoln. I am here on behalf of the Greater Omaha Chamber in opposition to LB373. Thank you for providing me the opportunity to speak with you about a very interesting proposal. Senator Schumacher has, in his thoughtful way, given us a lot to think about with LB373. Even if I were the only person here to testify today, there would not be time to touch on every corner of the proposal. Certainly, we are registering our opposition to repealing or rolling back so much of the economic development legislation enacted in recent years. That would include the Nebraska Advantage Act and all the employment investment it has fostered, the Build Nebraska Act and the funding it has provided for roads and businesses and consumers depend on, and the income tax increase that would come with increasing rates in the first three brackets, all stand out as issues of concern. I will also mention the labor tax on construction, the cost of performance issue or market-based, however you want to approach it, and the special capital gains exclusion. So here's to expand on these points: First, I'll start with AMT. Senator Schumacher, himself, put it so well in 2013 when during his introduction to AMT repeal bill he pointed out the sheer complexity of just figuring out if you fall under this tax. So you start here, you move there, you look at a table, you calculate some things, then you move to the next table. And he is well advised that this was an important exercise, as the tax kicks in well before most people would expect it to. There's a good reason why AMT isn't imposed in very many states. The net operating loss carry forward, while following the feds on AMT might be less than desirable, following federal policy on the 20-year net operating loss carry forward is a good policy. What the Legislature did in 2013 was take Nebraska from seemingly arbitrary 5-year period to a 20-year carry forward period and was to align the state treatment of C corporations with other businesses, conform with federal policy, and match what a majority of the states that impose income taxes provide. In doing that, Nebraska's competitiveness in attracting employment and investment was bolstered. This is particularly important for new and innovative businesses whose profitable years come further down the road. It's also important for those on a cyclical business because a 20-year cycle gives a way better picture of the business over time than that 5-year period. The indexing of the income tax brackets, a Chamber priority, is economic development efforts and encouraging higher wages. Though we have a favorable cost of living environment here in Nebraska, we also have an individual income tax that is both highly progressive and comes with a top tax rate that kicks in at a moderate income level. Indexing tax brackets, again per federal policy, is for many often simply a matter of treading water. Absent indexing and regular expansion of the brackets by the Legislature, a cost of living income increase can be lessened by having more income pushed into the higher brackets. As was noted by the sponsor, when the indexing was adopted this is a good method, helping families maintain purchasing power year to year. The construction service, we've been down this road before. I would like to call it Take Your Senator To Work Day. Here we have a three-option system. So the tax applies to your materials based on a certain option that you choose. Because of those options, it makes it difficult to tax the labor and bill your customers for that. It's just because of our three-option system that this tax was justifiably repealed. I think it's difficult to implement. I'd love to take you through it if you wanted to try it again. The cost of performance versus the market-based approach, in 2014, Nebraska began to tax services based on the market in which the service was received. This allows Nebraska's businesses to avoid double taxation and compete with Iowa, Minnesota, Missouri, and numerous states. They're all moving this way. The prior statute, the cost of performance statute, is more complicated and it's difficult to determine where the cost of performance is executed, especially as we move into a higher technology, constantly changing world. The market-based approach more fairly taxes the services that are received in the state. While looking back on previous legislation can provide context and inspire discussions, these provisions were previously removed and revised so Nebraska can move forward. In order to remain competitive we need to continue moving in that direction and pursue good tax policy that fosters growth. I just want to mention, I think there was some misinformation with the S corp stuff, too, so if you guys have any questions let me know on that. I am happy to take questions. [LB373]

SENATOR SMITH: Thank you, Ms. Watson. Can you clarify what you mean about the miscommunication on the S corp? [LB373]

STACY WATSON: Yeah. So there is an S corp exclusion available. I wasn't around in 1980-whatever when they put it in. But just so you know, Iowa has one, so Iowa has a very similar exclusion for it. I don't think that...I wasn't sure about putting this corporation in where he's at, but basically how it works is if you have a Nebraska business you have to have nexus in at least one other state. So nexus is the ability for that other state to tax you. And then your income is apportioned based on the laws of Nebraska. And then if it goes to that other state and you're taxable in the state, you'll pay tax there. If you're not, it is excluded from your individual income tax return if you are an S corp or an LLC. It would be difficult...I guess if you wanted to do business in Nebraska and say, yes, I don't want to make a single sale here, then you're right. Some of that...you would have to have nexus in at least one other state, but then you're right, you may tax any of that income at the individual level. But I think it's difficult to look at it from the perspective that it doesn't encourage investment here, because if I'm a company I want to put my payroll here, I want to put all my people here, I want to put my assets here, and I want to ship services and I want to ship stuff out of this state, but I want to do all that investment here because I wouldn't be necessarily taxed on that, because we do have the one sales factor. But I think that it would be odd just to have a Florida corporation and assume that you were just consulting everywhere and not paying any tax here. And I wonder if they did that because Iowa does have that provision. Interestingly enough, they mentioned why we went to the single sales factor and now this market approach and we're losing $6 million or something like that. I think what happened with that bill is you guys are actually missing the component that brings economic nexus back into the state of Nebraska and taxes the out-of-state taxpayers on the services that they're selling here. So I think if you actually added that economic nexus into the bill, that we could tax out-of-state taxpayers on the services that they're providing here and maybe make up for part of our revenue shortfall. So I think it's kind of all...it all has to be meshed together, but you can't just look at a single piece by itself. [LB373]

SENATOR SMITH: Senator Harr. [LB373]

SENATOR HARR: Thank you, Ms. Watson. Thanks for coming...taking the time to come down here. You are an accountant, I think you said. [LB373]

STACY WATSON: I am a tax partner at Lutz. [LB373]

SENATOR HARR: Do you ever make decisions as an accountant as to whether something is good or bad based on the cost of whatever the item? [LB373]

STACY WATSON: Absolutely. [LB373]

SENATOR HARR: Okay. Do you think it would be a good idea if we knew how much each one of these programs cost then? [LB373]

STACY WATSON: Yes. I would love to know the exact number. [LB373]

SENATOR HARR: Okay. Thank you. And also on a final personal note, thank you. She gives the first Christmas card every year. Friday after Thanksgiving it's there like clockwork. So thank you. [LB373]

STACY WATSON: That would be true. It's the accountant in me. [LB373]

SENATOR SMITH: Other questions for Ms. Watson? I imagine you're a bit busy this year at Lutz... [LB373]

STACY WATSON: 'Tis the season. [LB373]

SENATOR SMITH: ...this time of year, right? [LB373]

STACY WATSON: Yeah, it is. But it's the fun part, right? [LB373]

SENATOR SMITH: No. [LB373]

STACY WATSON: No? I wish we could do what Senator Harr wants to do, just write what we owe on the line, right? [LB373]

SENATOR SMITH: Perhaps for you. Thank you for your testimony. [LB373]

SENATOR HARR: Thank you. [LB373]

STACY WATSON: Thanks. [LB373]

SENATOR SMITH: Next opponent of LB373. Welcome. [LB373]

SCOTT GUBBELS: Thank you. Good afternoon, members of the committee. I'm Scott Gubbels, S-c-o-t-t G-u-b-b-e-l-s, executive director and innovation at Nelnet. I'm testifying on behalf of the Nebraska State Chamber, the Lincoln Chamber, and the Nebraska Petroleum Marketers and Convenience Store Association in opposition to LB373. I believe we are all interested in advancing concepts that promote consistency, predictability, simplicity, and fairness. Some of the provisions within LB373 seem to run counter to these ideals. Many people are working very hard to foster a friendly business climate, one that attracts, retains, and enables growth and prosperities for its communities. I don't believe we should create a wall via enacted tax policy which is overly burdensome and punitive to a multitude of resident taxpayers. We do have a budget shortfall and numbers do need to add up. But this still seems counter and eliminate much of the great progress and modernization that's been done over the past few years. I'd now like to spend some time on many of the complex aspects of LB373 that create concern. A provision reverses and removes the inflation indexing of individual tax brackets, resulting in as much as .75 percent increase for a family making between $40,000 and $70,000. Another provision disallows small business owners from excluding non-Nebraska sourced income from Nebraska tax. This results in double taxation and an effective rate increase of 20 basis points. This bill will eliminate the Build Nebraska Act, which is a vital source of funding of our transportation system and infrastructure needs facilitating commerce, education, connecting rural and urban highway users, and is critical to continual maintenance and improvements. A section would begin subjecting Social Security benefits received by retirees and other beneficiaries to state income tax. LB373 provides a complicated calculation and hair cutting of certain deductions impacting individuals. This seems to create taxpayer complexity and challenges for the Department of Revenue's enforcement. Another provision shortens the time period in which net operating loss and capital losses may be carried forward. This section seems punitive to farmers, typical start-up companies that take years to break even, and those businesses that are capital intensive with significant investments and depreciation. Shortening this window for utilizing previous losses does not encourage growth within our state. I'm sure you've heard and read several bills proposing to amend the Nebraska Advantage Act. Some of these amendments may make a lot of sense and be good changes, but complete elimination of the act at this time and without other tax policy changes runs again counter to all the efforts of so many. Though changes may be warranted, complete elimination of the act would ultimately be detrimental. Perhaps the most punitive and outdated provisions is this rollback of corporate income tax sourcing from market-based sourcing to a greater cost performance methodology. In 2012, we modernized the Nebraska Tax Code to promote investment in people and property within the state. A large coalition of companies promoted this modernization and advancement, including rural and metro, large and small business, new upstarts, as well as established companies. That law created consistency across industries and taxpayer types in that service-based companies now pay tax on the same method as retailers and manufacturers, that being where the customer is located. The proposed change within LB373 would undo this and would penalize service-based companies from locating or expanding here. The proposed law says that if a company has one more employee or one more dollar of investment within Nebraska than any other state, 100 percent of its income is taxable in Nebraska. On the other hand, if a taxpayer puts one more employee or one more dollar of investment in any other state, they pay no tax to Nebraska, though the company is realizing the benefits of our commerce and legal systems, infrastructure, and market. As very few other states have this all-or-nothing approach, this clearly results in double taxation and active management of people and property to other locations. You may not realize this, but 24 other states have now adopted a sourcing methodology that Nebraska enacted in 2012. And if we reverse this legislation the state will be taking a big step backwards and then be one of only three states in the country taxing this old, outdated regime. It is important to note that many companies made business decisions specifically based on this new policy and invested millions of dollars back in its people and property since then. I hate to think of the ramifications associated with reversing course and going backward. In closing, I believe it is prudent and wise to periodically evaluate the effectiveness of tax policies implemented within the past decade, as well as analyze how to enact tax policy that shapes the desired future. That is all good and well. However, as I've noted, there are several provisions within LB373 that eliminate or diminish a lot of great work done by some of you, as well as your predecessors. Tax policy and related cost burden should not be a reason to detract companies as well as talent for coming to or staying within our state. Thank you for your time and consideration. I'm happy to answer any questions that you may have at this moment. [LB373]

SENATOR SMITH: Thank you, Mr. Gubbels, for your testimony today. We have questions from the committee. Senator Harr. [LB373]

SENATOR HARR: Thank you. Were you here earlier when I talked about good tax policy? [LB373]

SCOTT GUBBELS: Yes, I was. [LB373]

SENATOR HARR: Okay. There has to be an action, a consequence, and then a study to decide if we want to go forward or how we want to change that. And maybe I sound like a broken record, but if we don't know how much anything cost, how do we know if the action is worth the consequence? So, do you know how much approximately the Nebraska Advantage Act costs? [LB373]

SCOTT GUBBELS: I don't know, Senator. I also know that quite a few credits get generated that are never utilized. [LB373]

SENATOR HARR: What's that? [LB373]

SCOTT GUBBELS: Quite a few credits get generated but are never utilized, because the companies aren't incurring enough Nebraska tax. [LB373]

SENATOR HARR: Do you see there's room for improvement with the Nebraska Advantage Act? [LB373]

SCOTT GUBBELS: Yes. [LB373]

SENATOR HARR: And what were some of those recommendations you would have for improvement? [LB373]

SCOTT GUBBELS: I believe the way that employee compensation is calculated is one. I think the redistribution of property moved into the state is another. [LB373]

SENATOR HARR: Okay. Thank you. I think there's a bill out there that addresses that, so I appreciate it. Thank you for taking the time to come down here today. [LB373]

SCOTT GUBBELS: You're welcome, Senator. [LB373]

SENATOR SMITH: I see no further questions. Thank you, Mr. Gubbels, for your testimony. Next opponent of LB373. Welcome. [LB373]

JOE NEUHAUS: Thank you. Good afternoon, Chairman Smith and members of the Revenue Committee. My name is Joe Neuhaus, I am the policy and research director for the Lincoln Independent Business Association or LIBA and we offer our opposition to LB373 because, in part, it repeals the Build Nebraska Act. Enacted in 2011, the Build Nebraska Act took major strides toward recommitting our focus in our state's infrastructure needs. After years of difficulty in keeping up with the maintenance and construction of vital transportation projects, cities and counties have struggled to meet traffic and transportation demands. The Unicameral's efforts through LB84 have helped many cities and counties to complete much needed resurfacing projects, street repairs, and new road construction. The confluence of commercial heavy truck traffic and local traffic on a stretch of highway with multiple signalized intersections has resulted in Nebraska Highway 2 in the city limits of Lincoln facing serious safety issues. Just a few years ago, for example, Lincoln was faced with a truck accident that shut down traffic on Highway 2 on a Husker game day when a truck carrying a total of 34,000 pounds of radioactive waste saw one of two containers slide loose and strike the truck cab. Fortunately, no one was injured and the radioactive waste was fully contained, but the incident provides a clear example of the dangers posed by stop-and-go heavy truck traffic in Lincoln if the South Beltway is not completed. The Build Nebraska dollars earmarked for the South Beltway, which is to be completed in 2023, will help address serious safety concerns in Lincoln. In the past 16 years, 21 people have been killed in automobile accidents on Highway 2 within the city limits of Lincoln. Of these, five directly involved semi trucks. Pedestrian crossings on this major highway create even further risk as middle school students cross seven lanes of traffic at the intersection of 48th Street and Highway 2 to attend classes at Pound Middle School. Jeopardizing the completion of important projects across the state by repealing the Build Nebraska Act fails to acknowledge the seriousness of our transportation safety needs. According to the Nebraska Department of Roads in 2012, 22 percent of all traffic on Highway 2 in the city of Lincoln was heavy-truck traffic. In 2015, the city of Lincoln reported that traffic counts on the stretch of Highway 2 running through city limits averages up to 33,000 vehicles per day. As a result of Lincoln's large population growth and economic development, heavy truck traffic is forced to travel alongside local traffic commuting to and from work. If the Build Nebraska Act is repealed the primary funding source for the Lincoln South Beltway will be extinguished and the safety of Highway 2 will almost assuredly not be properly addressed. LIBA also has concerns about other provisions of the bill. It reinstates tax burdens on contractor labor, it terminates the Property Tax Credit Act, and it increases income tax rates, decreases credits, and removes adjustments for Social Security income. For these reasons, we ask the committee not to support LB373. Thanks. And I'd be happy to answer any questions. [LB373]

SENATOR SMITH: Thank you, Mr. Neuhaus. Senator Harr. [LB373]

SENATOR HARR: Thank you, Mr. Chairman. Thank you, Mr. Neuhaus, for taking the time to come down and testify. Do you understand the purpose of what we're trying...what Senator Schumacher is trying to do with this bill? [LB373]

JOE NEUHAUS: Yes. [LB373]

SENATOR HARR: And that's to determine the cost of certain programs. Is that correct? [LB373]

JOE NEUHAUS: Well, I guess by some accounts that's what the purpose is. I haven't asked the senator directly... [LB373]

SENATOR HARR: Okay. [LB373]

JOE NEUHAUS: ...for his purpose. [LB373]

SENATOR HARR: And LIBA, I would contend, is somewhat of a conservative group. Would be a fair, accurate assessment? [LB373]

JOE NEUHAUS: We advocate on numerous different issues and we have members of all philosophical preferences. [LB373]

SENATOR HARR: Well, let me restate that then. I believe you believe that government should be fiscally conservative or fiscally sound, is that correct? [LB373]

JOE NEUHAUS: We advocate for fiscal soundness, yes. [LB373]

SENATOR HARR: Responsibility? [LB373]

JOE NEUHAUS: Responsibility, correct. [LB373]

SENATOR HARR: And so it would be nice to know how much the majority of these bills or the items in this bill are based on tax credits, exemptions, deductions that were passed or changes in policy in the last five to ten years. Is that correct? [LB373]

JOE NEUHAUS: Well, the...I can't speak for all of them, but I wouldn't imagine that would be too far off. [LB373]

SENATOR HARR: Okay. And so it would be nice to know, probably you'd agree, if the fiscal note was consistent with the actual cost, to know if the policies are or are not working. Is that a fair assessment? [LB373]

JOE NEUHAUS: I can't argue with you there. I would appreciate to know the costs of these programs. I think that would be good information to have. [LB373]

SENATOR HARR: But having looked at the fiscal note we don't have those answers, do we? [LB373]

JOE NEUHAUS: Well, we have what it's going to do to move those funds to the General Fund. [LB373]

SENATOR HARR: I think...yeah, to correct the record I think we have a (inaudible) cost for Build Nebraska. But other than that, we don't have the individual cost of each program, do we? [LB373]

JOE NEUHAUS: We do have the cost for Build Nebraska, yes. But as to the others, it doesn't seem as though we have a direct number for what it costs. [LB373]

SENATOR HARR: So would you agree with me that it's very difficult to make policy decisions when you don't know how much each program costs? [LB373]

JOE NEUHAUS: I think that's helpful information to have, yes. And so not being the one to be in your position, but...although I can appreciate how difficult it must be, I think that's probably information that's beneficial to have and I agree with you. [LB373]

SENATOR HARR: Okay. Thank you very much. I appreciate you again taking the time to come down here and testify. [LB373]

JOE NEUHAUS: Thank you. [LB373]

SENATOR SMITH: Thank you, Mr. Neuhaus, for your testimony. [LB373]

JOE NEUHAUS: Thank you. [LB373]

SENATOR SMITH: Next opponent of LB373. Welcome. [LB373]

DICK LUDWIG: Thank you. Chairman Smith and members of the committee, my name is Dick Ludwig, D-i-c-k L-u-d-w-i-g, and I am testifying in opposition to LB373 on behalf of the Associated General Contractors, Nebraska Chapter. AGC is a trade association of heavy highway contractors who perform highway, bridge, and municipal utility infrastructure work. My members don't build Nebraska alone, but depend on the 47,000-plus construction workers who physically build Nebraska. AGC opposes the provisions of this bill which would repeal LB84, the Build Nebraska Act, which directs one-quarter of a cent of the state's existing sales tax towards new road construction. LB84 has been a good idea. It would be very costly to the state if LB84 were to be repealed. It would impact 12 major projects currently in progress or in the development stage, including projects in Hastings, Grand Island, Plattsmouth, Murray, Lincoln, and Omaha. Any funding delay risks the project being more expensive for Nebraska taxpayers due to construction inflation and potentially starting the environmental process all over again. AGC is also concerned about the loss of the jobs that this bill would bring. Our industry lost a large part of our skilled work force during the last turndown in the economy or in the budget. LB84 has put Nebraskans to work and helped allow contractors to invest in their work force, equipment, in IT, and expand their businesses. LB373 would stop this investment. Chairman Smith, members of the committee, I cannot stress enough the importance of the Build Nebraska Act to our state, its transportation system, and our economy. The first dollars from LB84 have already been put to work and important projects are being completed all over Nebraska. AGC urges this committee to kill the portion of this bill that relates to LB84. Please let LB84 continue to work for Nebraska by putting Nebraskans to work. Thank you. And if you have any questions, I will try to answer them at this time. [LB373]

SENATOR SMITH: Thank you, Mr. Ludwig. Senator Harr. [LB373]

SENATOR HARR: Thank you, Mr. Ludwig, for taking the time to come down here. As you can see, Senator Schumacher is sitting in the audience, so I have a dead horse next to me and I'm going to continue to beat it, so. I want to thank you for again taking the time to come down here. Many times...well, if there is an expenditure on the state level, every year it has to be renewed and there is a hearing in Appropriations. With tax credits that does not occur. We pass it one time and we hope that it's good policy and we really don't get a chance to review it and we don't get a chance to review how much it cost. It might surprise you, we can't find out how much a lot of the programs cost. Yours we do. And I want to thank you for taking the time to come down here, explain to us how much...why it's a good policy and why we should continue to have it. That hasn't happened on the other tax credits. But I want to thank you for taking the time to come down here. I feel I can make an intelligent decision as to whether Build Nebraska should be continued or not. Thank you very much. [LB373]

DICK LUDWIG: Thank you. [LB373]

SENATOR SMITH: Senator Groene. [LB373]

SENATOR GROENE: Sir, at least your program, tax dollars are being spent on public services, right? Roads? [LB373]

DICK LUDWIG: Right. [LB373]

SENATOR GROENE: So the taxes are taken and taxes are spent on...we just sped up the process of fixing roads. [LB373]

DICK LUDWIG: That's correct. [LB373]

SENATOR GROENE: So you're a little different than the ones where we give somebody a tax credit and they just go out and buy a nicer suit... [LB373]

DICK LUDWIG: Absolutely. [LB373]

SENATOR GROENE: ...and live better. They don't help build the roads. So there's a big difference between your program and a lot of these where these folks aren't helping to build those roads, because they're not paying taxes. [LB373]

DICK LUDWIG: Correct. [LB373]

SENATOR GROENE: Wouldn't you say that? [LB373]

DICK LUDWIG: Yes. [LB373]

SENATOR GROENE: So you're in a different category than some of these other tax credits. [LB373]

DICK LUDWIG: I would say so, yes. [LB373]

SENATOR GROENE: Thank you. [LB373]

DICK LUDWIG: (Exhibits 7-11) I have additional letters in opposition to share with the committee: Nebraska Trucking Association; Lancaster County Board of Commissioners; Professional Engineers Coalition; Metropolitan Area Planning Agency; and the American Council of Engineering Companies. [LB373]

SENATOR SMITH: All right. Very good. We'll get those distributed. [LB373]

DICK LUDWIG: Thank you. [LB373]

SENATOR SMITH: Thanks for coming in today for your testimony. And we appreciate your members helping to build Nebraska. [LB373]

DICK LUDWIG: Thank you very much. [LB373]

SENATOR SMITH: (Exhibits 12-30) Next opponent of LB373. I do have a number of letters for the record. Now, were there any other opponents of LB373? Okay. Letters for the record in opposition to LB373, we have: Larry Dix representing NACO; Jeff Randall, Omaha, Nebraska; Brad Wegner, National Utility Contractors Association of Nebraska; Barbara Bettin, Lincoln YMCA; Judy Ziola, Grand Island YMCA; Beth Klosterman, David City, Nebraska; Mayor Douglas Kindig, United Cities of Sarpy County; Michael McMeekin, Omaha by Design; Trevor Jones, Nebraska State Historical Society; Keith Marvin, Marvin Planning Consultants; Robert Stubbe, city of Omaha; Gerry Stilmock, Nebraska Bankers Association; Ash Grove Cement Company; Lynn Rex, League of Nebraska Municipalities; Ashley Olson, The Willa Cather Foundation; Julia Tse, Voices for Children in Nebraska; Ag Leaders Working Group; Josh Moenning, 4 Lanes 4 Nebraska; Mayor Chris Beutler, city of Lincoln. We now move to those wishing to testify in a neutral capacity, neutral capacity. Welcome. [LB373]

ADAM THIMMESCH: Good afternoon, Chairman Smith, members of the committee. My name is Adam Thimmesch, T-h-i-m-m-e-s-c-h, I'm an assistant professor of law at the University of Nebraska College of Law. I should note I'm here in my personal capacity. The views that I express today are my own views, not necessarily represent the views of the College of Law or of the university. I'm here to testify in a neutral capacity on what's been referred to as the S corp exclusion. I'm testifying in a neutral capacity, because obviously there are a number of provisions in LB373 I haven't studied or looked at, but this particular change is consistent with how the vast majority of states treat S corporation or LLC owners and the bill would move Nebraska into conformity with the majority approach and would remove a unique economic distortion from Nebraska's Tax Code. So I thought it worth the time to come down here and give you a little bit of background on why I felt that that was the case and why it might be something that's worth the committee's time to consider. At the outset, it is important to note that Nebraska's approach to this S corp/LLC income is unusual. There was a reference to Iowa having a similar approach. Iowa does have an election for S corporations that operates similarly. In my look I haven't seen other states that have done anything similar. What most states do--and this is the vast majority, Iowa--I've seen references to other states, I've tried to track them down. But as you can imagine, 50 states' state tax law regulatory research takes a little bit of time. What I've seen is that most states adopt the same approach for LLC or S corp income that they do for individual resident income. Just like any one of you or I working in the state, earning income from out of the state, state of Nebraska has constitutional authority to tax all of the income of its residents and most states do just that. What they then do is provide a credit for Nebraska residents for taxes that they pay to other states, so what we would normally do for any sort of Nebraska income earner. It's that credit mechanism that generally reduces the risk of double taxation that raises constitutional concerns. So the proposal in the bill would move Nebraska to the approach that the vast majority of states use. It would be on firm footing and in line and would not raise constitutional issues in that regard. Now, obviously, this is not necessarily the best reason to make a policy choice, just to be like everybody else. So what's interesting to me in evaluating this proposal as I saw it, was that the current way that Nebraska treats S corp and LLC income does create a tax-induced distortion in the law that is aimed specifically at a limited subset of Nebraska taxpayers, those who own LLCs or S corporations. And because it applies to only those limited types, some people like to put this under the category of picking winners and losers, some people like to talk about it as creating tax distortions. What it does is, it allows a different tax regime for people who do business as an S corp or an LLC versus a partnership or a sole proprietor. Same economic activity taxed differently, depending on the type of entity that you form. That's generally what I refer to a this tax-induced distortion generally disfavored as a matter of tax policy, one of the reasons that this is of particular interest to me, why I'm here today. The distortion is particularly pronounced here because it can result in what we tax folks call nowhere income, and there was a little bit of reference to this earlier. The typical approach of a state taxing all of the income of its residents and providing a credit for taxes paid to other states ensures that the residents' income is taxed somewhere. Under this approach, what Nebraska does is simply excludes all of the out-of-state income from the Nebraska tax base without regard to whether or how another state taxes that income. So that might mean that a Nebraska resident who can do business as an LLC or an S corp pays less Nebraska tax, but it also might mean that they have tax that just goes untaxed anywhere. So for those reasons, I know you've got a lot of different tax policy proposals on your plate, but I thought the committee would be well served by getting this particular proposal good consideration. I see my light is on. [LB373]

SENATOR SMITH: Senator Harr. [LB373]

SENATOR HARR: Thank you, Chairman Smith. Do you...thank you for coming down here today. Do you know, is there any certain type of business or industry that's more or less likely to take advantage of these S corporations, LLCs? [LB373]

ADAM THIMMESCH: I don't know that as an economic matter. As a base proposition, there's not any particular reason that a particular type of business would gravitate because of this provision. [LB373]

SENATOR HARR: Thank you. [LB373]

ADAM THIMMESCH: Obviously, the more out-of-state income that you can generate the better of a deal that this can generate, because that's more income that Nebraska is just saying, we're not going to tax at all under any circumstances. But I'm not sure that that's an industry specific issue. [LB373]

SENATOR HARR: Thank you. [LB373]

SENATOR SMITH: Senator Groene. [LB373]

SENATOR GROENE: So LLCs don't pay any taxes. They send out the income to the owners and then they pay the tax. Right? [LB373]

ADAM THIMMESCH: Right. [LB373]

SENATOR GROENE: So if the LLC is in Nebraska and you're saying if somebody lives outside the state and one member lives inside the state, the member on the inside of the state reports it as his income. The member outside the state does not. [LB373]

ADAM THIMMESCH: So the way that this would work is that the Nebraska resident owner of the LLC on his or her personal income tax return just does not report any income from non-Nebraska sources, without regard to whether another state taxes it or not. [LB373]

SENATOR GROENE: It goes both ways, is what you're saying. [LB373]

ADAM THIMMESCH: So non...so this a provision that specifically applies to resident Nebraska taxpayers because of the different constitutional structure that applies to residents versus nonresidents. Nebraska can only tax Nebraska-source income of nonresidents. But under the Constitution, very firm constitutional principal, Nebraska has the constitutional right to tax all of the income generated by a resident. And so this provision applies specifically to change that. [LB373]

SENATOR GROENE: I guess one thing at a time. [LB373]

ADAM THIMMESCH: Yes. [LB373]

SENATOR GROENE: If you are a member of an LLC and you live in Kansas, an LLC that makes it's money in Nebraska, let's say a farming operation, a family farming, that's pretty common...inherited. So you're living in Kansas and you get sent your check from the accountant after when he splits it up at the end of the year. You do not, living in Kansas, pay the taxes in Nebraska? [LB373]

ADAM THIMMESCH: So the Kansas LLC member would pay tax on Nebraska-source income. And that would be true regardless of this particular proposal. [LB373]

SENATOR GROENE: And you would pay it in Nebraska because he earned it in Nebraska. [LB373]

ADAM THIMMESCH: Yes. Yes, depending on the sourcing rules, those complications, but, yes. [LB373]

SENATOR GROENE: So we do get his taxes? [LB373]

ADAM THIMMESCH: Yes. [LB373]

SENATOR GROENE: But the Nebraska resident who's a part of a LLC in Kansas, when he gets his money he doesn't pay taxes to Kansas? [LB373]

ADAM THIMMESCH: Would not pay tax on income that is from the other states. So... [LB373]

SENATOR GROENE: Because he's paying in Kansas. [LB373]

ADAM THIMMESCH: This applies regardless of whether he's paying in Kansas or not. So under this proposal, if I go and I do work in another state as an individual, I would pay tax on that income to Nebraska. And if I paid tax to the other state I would take a tax credit and I wouldn't be double taxed. If I simply form an S corporation or an LLC, I don't pay tax on that income in Nebraska regardless of what the other state does. And so that's why I said, the way that this is structured creates a distortion. It creates a preference for forming a certain type of business entity and it changes your tax based solely on whether you do business as a sole proprietor. As a partnership, you pay the Nebraska tax. If you decide, ah, I don't want to do that, I'm going to form an LLC or an S corporation, you could avoid it. But that's based solely on the type of entity that you choose and not economic activity. And so that's why I say that this falls within the category of those tax policy choices that we generally think of as just tax distortions or the winners/losers argument, whichever one you particularly like to label (inaudible). [LB373]

SENATOR GROENE: So do you have any idea how many dollars of tax revenue we're talking about? Have you looked at other states, like-sized states and see how much they collect on that? [LB373]

ADAM THIMMESCH: Yeah, I'm not an economist. I haven't done the economic research on that. I did look at the 2016 Tax Expenditure Report, just on the Department of Revenue's Web site, saw the $84 million figure. That's about all that I can do. Again, I'm not an economist, I don't have expertise on that. I saw that Revenue estimate. That's the number that I've seen and that was the source, I believe, was the 2016 Tax Expenditure Report. [LB373]

SENATOR GROENE: Thank you. [LB373]

SENATOR SMITH: Thank you, sir, for your testimony. I don't think you intended to say that LLCs don't pay any taxes. I mean, income taxes are on a passive basis, but do they pay payroll taxes? Do they pay property taxes? Do they pay sales taxes? (Inaudible.) [LB373]

ADAM THIMMESCH: Yes. So when we say the LLC...the LLC is a flow through entity for income tax purposes. [LB373]

SENATOR SMITH: Right. [LB373]

ADAM THIMMESCH: ...depending on the level you want to get, you could say that the LLC also doesn't pay those other taxes. Ultimately, the taxes are born by an individual, an investor, an employee,... [LB373]

SENATOR SMITH: An investor. [LB373]

ADAM THIMMESCH: ...or a customer. [LB373]

SENATOR SMITH: Right. Okay, thank you. [LB373]

SENATOR GROENE: But the income is passed through. [LB373]

ADAM THIMMESCH: The income is passed through. [LB373]

SENATOR SMITH: Senator Groene. [LB373]

SENATOR GROENE: I'm sorry. [LB373]

SENATOR SMITH: Go ahead. [LB373]

SENATOR GROENE: I'm sorry, Chairman. I shouldn't interrupt. Thank you, Senator. I'm talking about the income. At the end of the day after they've paid their payroll taxes and sales tax they split up the profits. The LLC has no profit then because it's been passed to the individuals. [LB373]

ADAM THIMMESCH: Yes. So on the income tax level, the LLC, the S corporation, the partnership, the sole proprietorship all look the same, but they are taxed differently currently under the way that the statute is currently structured. [LB373]

SENATOR GROENE: Thank you, Senator Chairman, for clearing that up. [LB373]

SENATOR SMITH: Thank you. [LB373]

ADAM THIMMESCH: Thank you. [LB373]

SENATOR SMITH: Others wishing to testify in a neutral capacity. Welcome. [LB373]

JOHNATHAN HLADIK: (Exhibit 31) Thank you. Good afternoon, Senator Smith and members of the committee. My name is Johnathan Hladik, that's J-o-h-n-a-t-h-a-n H-l-a-d-i-k, and I'm the policy director at the Center for Rural Affairs. We recognize--and I know everyone on this room does, too--that the Legislature has been faced this session with the unenviable task of closing a $900 million budget shortfall. While the actions to limit spending are important, LB373 clearly demonstrates that the Legislature's tax policy decisions over the past several years are at least in part responsible for the current revenue shortfall we're seeing today. While the center does not support every provision in LB373, thus the neutral testimony, the Legislature would be well-served, we feel, to review these recent changes and their effects before pursuing any new changes that will make balancing the state's budget a challenge for years to come. We know that the Appropriations Committee has considered spending cuts this year to items such as child welfare, criminal justice, behavioral health, and education. And we're recently seen some of this being debated on the floor. And it's worth considering whether the income tax changes of the past ten years would have encountered the same level of support at that time with the knowledge that they would cause large reductions in revenue than expected and result in significant cuts to some of Nebraska's most important programs and services for some of the most vulnerable Nebraskans. As this committee considered next challenges intended to reduce income tax revenue, LB373 we think provides an opportunity to examine the actual consequences of such changes. So in light of the substantial potential cuts to such important services, a number of provisions of LB373 provide a far more equitable path to balance Nebraska's budget. The provisions that primarily benefit Nebraskans with the highest incomes could be explored further. Senator Schumacher noted two, in particular, and they've been the subject of much discussion today, repealing the special capital gains election. Again, I'll repeat, in 2014, only .1 percent of Nebraska taxpayers took advantage of this loophole. Of these, 88 percent had an adjusted gross income over $500,000 and 80 percent had an AGI over $1 million. Eliminating the LLC/S corp exclusion, again, in 2014, only 100 Nebraskans took advantage of this. Of these, 85 percent had an adjusted gross income over $1 million. Approximately 60 percent goes to taxpayers with an AGI over $5 million. Other options have been discussed that also may merit additional consideration. While these have their drawbacks, they are all preferable to reducing, we feel, services to people with behavioral health needs, foster children, for example, or students. And I wanted to talk a bit about property taxes. We haven't heard much about that today, but I know it's important to the committee. Some provisions here would change...would not primarily benefit the highest income Nebraskans, but they have helped mitigate the dramatically increasing ag property tax burden that we're seeing. Increasing the taxable value of agriculture land and horticultural land 80 percent of actual value, as this bill suggests, would shift the burden for funding schools from the state onto ag property taxpayers. I think we know that since this change to 75 percent was made in 2006, property values in Nebraska have increased by just over 90 percent. And this is driven largely by increases in rural counties and agricultural land. For example, the two smallest increases were Lancaster and Douglas Counties with an increase of about 30 percent and at the same time 25 counties saw increases during this time period over 200 percent. The Legislature acted in 2006, because the agricultural property tax burden was out of balance. And since that time, I think it's safe to say that that imbalance has grown. Shifting more responsibility for government funding to ag property owners would make an ongoing problem even worse. The changes to ag property valuation in combination of repeal of the property tax credit would double the effect of shifting the burden to ag property tax owners. While many of the provisions in LB373 would roll back changes made up to ten years ago, repealing the property tax credit would undo the Legislature's decision just last year in LB958 to increase the amount of assistance to ag property tax owners. So in conclusion, these are difficult budget times and we appreciate Senator Schumacher's willingness to put tax policy on the table for debate. We know that this bill is a great vehicle for discussion and, in some elements, provides a more balanced approach to closing this biennium's projected budget shortfall and should also confirm the committee's consideration of any additional changes this year. Thank you for your time and I'm happy to answer any questions you might have. [LB373]

SENATOR SMITH: Thank you, Mr. Hladik. Questions? I see none. Thank you for your testimony. [LB373]

JOHNATHAN HLADIK: Thank you. [LB373]

SENATOR SMITH: Next person wishing to testify in a neutral capacity. Seeing no additional testimony, we invite Senator Schumacher back to close on LB373. [LB373]

SENATOR SCHUMACHER: Thank you, Chairman Smith and members of the committee. I thank you for the time that we've spent on this today and I hope that it was a good overview of the tax cuts, the tax perks, the tax benefits, the attempts to deal with business attractiveness that we've made over the last ten years. Two things I waited for testimony on and really didn't hear anything. Based...and from this whole experiment they stand out and I think we need to look at them. The first is $20 million a year that goes to the special capital gains election. Ma and pa grow a business and decide to sell it. They pay capital gains, which in Nebraska is the same as ordinary income, 6.84 percent on what started out as zero basis and graduated up in time to be maybe a few million. They pay it. The farm, same situation. You pay it. And in addition to that, you pay the federal capital gains tax. Well, we have this thing that applies to a limited number of companies--what was a limited number of companies--that if you met these requirements, five shareholders, been in business for three years, shareholders are kind of unrelated but not necessarily so, and you're a resident, and you acquire that through the course of your employment, you do not have to pay the 6.84 percent to the state of Nebraska. You're exempt. Why? I wanted somebody to come in here today and say, look at, this is why this is such a great deal. This is super. Boy, we're one of 50 companies who's able to attract high-quality help, able to pay high wages, whatever, on account of this. Not one testifier in support of this...keeping this special exemption. Looks to me like it's a real special deal, costing us $20 million a year. If it's such a good deal, then we should extend it to ma and pa, we should extend it to the farmer. Why not? Why who gets this? And why do we have it there? And why is it a great deal? And why did nobody show up today to testify that we shouldn't get rid of it. And I think it's going to be exacerbated because one of the things that stops you from selling your business, your farm, whatever before you die, when it gets a stepped up basis and you skate out tax free, is the capital gains tax at the federal level and at the state level. We have the Supreme Court decision that pretty well shows us the road to avoiding the state tax if you'd just hire a good lawyer and accountant and play a little game. If the federal tax change is--and we don't know what's going to happen there--but if it softens up on the capital gains tax, then the barrier to selling while you're still alive and enjoying your money at the federal level drops. This gimmick enables you to escape tax here if you have the five shareholders and you contort yourself into its parameters. There's no good reason we shouldn't take a real hard look at eliminating the special capital gains election. And the second one I was hoping to hear from somebody, I was hoping to hear somebody come up and say, well, gee whiz, I and a hundred other real prosperous Nebraskans, we own oil wells in Texas in Subchapter S companies. We own oil properties in North Dakota Subchapter S companies. And we shouldn't have to pay income tax on that income. We own a fleet of fishing boats in South Florida. Texas, South Dakota, Florida, no-tax states, income tax states, at least. And, boy, we'll move out of Nebraska just lickety-split if you repeal this. Didn't hear that. We had the professor tell us that there's no double taxation if you pay tax in another state, then you can take a credit for it; that we are unique in this; and the price tag of $80-some million a year going to who? Well, people who didn't care showing up today. Eight-five percent claimed by--and this is 2014, it may be higher, I would guess it probably is but close enough for government work--85 percent claimed by taxpayers who have an AGI in excess of $1 million a year. And 60 percent of that $89 million by folks who have a AGI of at least $5 million a year. Come on, folks, those two sore thumbs stick out of this whole exercise. And whoever those people are, they weren't showing their faces here today. And how do we look at all this budget cutting and the violin playing we're hearing on the floor when we cut this program, that program, the university, this, that, and the other thing and don't seriously look at saying, what is going on with these two items? There's a lot of other things we could split hairs on in the other bills as to a little debate on some of the discussion. For example, whether or not apportionment on intangibles is a problem or whether or not it's a single sales factor. Quite honestly, I don't completely understand it myself. But the big two sore thumbs are there. And if we don't do anything, we should at least know why we aren't doing anything. That's way too much money. A hundred million dollars on a table and no real argument presented today why we should not do something to get rid of that anomaly that dates back to a legislative record, at least the big one, the $85 million, in the late 1980s which really is almost nonexistent. We don't know why that amendment got put on the bill. Somebody paid a lobbyist really well. I'll answer any questions. [LB373]

SENATOR SMITH: Thank you, Senator Schumacher. Senator Groene. [LB373]

SENATOR GROENE: That's $84 million of income or $84 million in taxes? [LB373]

SENATOR SCHUMACHER: Tax loss. [LB373]

SENATOR GROENE: This is a dumb question. Why do we know there's $84 million if nobody had to report there's $84 million? [LB373]

SENATOR SCHUMACHER: The Tax Expenditure Report is where that number came from. I'm not sure how they computed it, but that's what it cost us in lost tax money. [LB373]

SENATOR GROENE: Do other states share information? Is that where it came from, like Florida fishing boats? [LB373]

SENATOR SCHUMACHER: I think there may be an exclusion line on your income tax form that they can pull that from and they apply your tax rate toward it. [LB373]

SENATOR GROENE: Well, if you got a 1099 or whatever you got from your investment in Florida and your accountant says, you don't have to claim this in Nebraska, why would you tell the state of Nebraska you...why would you put it on your statement? [LB373]

SENATOR SCHUMACHER: I'm pretty sure, but not 100 percent sure, that you have to report all your income and then you subtract out the stuff that isn't taxed. Maybe that's where they're getting the number. I don't think you can basically say, well, this is Florida income, I'm not putting it on the top line. I'm 99 percent sure, but not 100 percent sure. [LB373]

SENATOR GROENE: Did I ask to speak? I'm sorry, Chairman. It's been a long day. I...so you answered the question the original transcript when that was put in and why it was put in or...you don't have any example of a company or anybody? [LB373]

SENATOR SCHUMACHER: They didn't...there wasn't any. It wasn't part of a hearing. It showed up as an amendment to a bill and very little discussion, they were talking about a lot of other things and very little discussion as to why or how come. I do think there was a reference maybe that, ah, it won't cost much money. And a lot of times...and, you know, it's one of the reasons for this bill here is to look at what it's costing us. I agree with Senator Harr, the fiscal note was most unenlightening. It would sure have been nice to say...see in the fiscal note if they said, okay, $84,000, we agree with...$84 million dollars, we agree with Tax Expenditure. But they did it just a one lump sum figure and you can guess where it came from. [LB373]

SENATOR GROENE: And if they'd lived in another state, Kansas, and had that investment in Florida, they would have to pay here, right? [LB373]

SENATOR SCHUMACHER: According to both professors... [LB373]

SENATOR GROENE: They would have to pay in Kansas. [LB373]

SENATOR SCHUMACHER: Right. They'd have to pay in...and that's what the professor indicated. We're pretty much unique in this. And this is a special little perk that's, I think, one of the reasons we have an effective tax rate in that top bracket of 4.-something percent instead of 6.-something percent. [LB373]

SENATOR GROENE: Is that a corporation with five individuals? [LB373]

SENATOR SCHUMACHER: That's the other one. This is the Sub S. [LB373]

SENATOR GROENE: Did you find a record on it, when it was enacted and the transcript on it, why it was done? [LB373]

SENATOR SCHUMACHER: That was brought in with LB775 in 1987 and then in 2013 or in 2007 it was expanded to include a thing called extraordinary dividends. That's a dividend equal to at least, supposedly, 20 percent of the value of the stock. And then again expanded in 2013 to allow ESOPs, employee stock ownership plans, to functionally be a membership in there and account in that number of five, because there was I think one company--if I remember right--that had a...if they were...if they did not meet the criteria of five and because the ESOP plan, even though it had many members, employees who were eating out of the pool, they only counted as one. And so it was amended to say, oh, gee, gosh, whiz, we want you to be able to meet the requirement of the five. But now the Supreme Court pretty much says, hey, you can set up a scam here to beat the system and here's how you do it. And what you do is you have two people own it, ma and pa own it, and you have three people thinking of buying the company and so you sell them each a share of stock so that now you have the magic five. And then you go through a few other contortions and lo and behold the three buy out ma and pa and you're just fine. [LB373]

SENATOR GROENE: No capital gains. [LB373]

SENATOR SCHUMACHER: No Nebraska income tax. Still federal capital gains. But, man, if the federal government softens up the capital gains to take it down something from 15 percent, 20 percent where it is now to 5 percent, you're going to see a lot of people wanting to use this technique to... [LB373]

SENATOR GROENE: So they're saving the 6.8 percent on the capital gains... [LB373]

SENATOR SCHUMACHER: Exactly. Yep, exactly. [LB373]

SENATOR GROENE: ...in Nebraska? It doesn't make a difference which company? It's not tied to a new company with economic development or anything? [LB373]

SENATOR SCHUMACHER: No. This is one that you're an employee. One time you can do this in your lifetime. You must have been in business for at least three years and have at least five shareholders, two of which aren't relatives, and you're home free. [LB373]

SENATOR GROENE: Thank you. [LB373]

SENATOR SMITH: Senator Harr. [LB373]

SENATOR HARR: I believe there's an additional requirement. I think they have to own 10 percent of the company as well. [LB373]

SENATOR SCHUMACHER: Yes. The two shareholders or groups of shareholders not related, each must own 10 percent of the stock. But that... [LB373]

SENATOR HARR: Yeah. And I've seen this done maybe firsthand. [LB373]

SENATOR SCHUMACHER: Okay. [LB373]

SENATOR HARR: And, for the record, I want to talk about what kind of...I apologize, Mr. Chair, it's not a question but more of a...I'll testify. The times these are used--and again, I'm just going to say for the record--is generally when you reward key employees. So your ma and pa are about ready to sell the company. Little Paul has helped build the company up. He's been a loyal employee for the last 20 years, he's a key employee. We want to find a way to reward him, so they bring Paul and Paul's wife or maybe Paul and Paul's partner, another person, in and sell it to them. They lose 10 percent. It's still a loss to those key employees, but overall it's a way of rewarding those key employees. That's where it's done. That one-year holding period that you talk about that was eliminated by the Supreme Court, that was never in statute. That's why the Supreme Court ruled the way they did. It was something that was impugned upon the rule of law by our Department of Revenue, but was never ever in statute. And that's why the Supreme Court ruled the way they did. So we're the policymakers; do we want to change it? Maybe. But it is something that's effectively done. It's a way of encouraging a business to be sold so it could be more efficient, rather than having to wait until ma and pa die and the stepped-up capital basis and the sons and daughters sell it. [LB373]

SENATOR SCHUMACHER: I think it's also done, not just a gift at the end to a good employee, but as people are given the stock interest in a company, it's equity interest in a company or options during the course of their employment. And when they get one of those, I think the basis of that is very low because the stock may not be worth very much or the option may not be worth very much. But then eventually when they sell it, like farmland, it's grown up to be a big boy. And this is a way that they are not taxed on that income. And also, when you roll this into these employee stock ownership plans I think it becomes big numbers and that's probably where a good part of the $20 million comes from. But $20 million plus $80 million here on the table. [LB373]

SENATOR HARR: And just to clarify on the record, they earn tax on the capital gain, not the income. It's a different source of revenue, but it's capital gains that is taxed, not the income. [LB373]

SENATOR SMITH: Okay. Very good. Thank you, Senator Schumacher,... [LB373]

SENATOR SCHUMACHER: Thank you. [LB373]

SENATOR SMITH: ...for your closing on LB373. That closes the hearing on LB373. We now move to LB362 to be introduced by Senator Riepe. We'll give a moment for the room to transition, Senator Riepe, so as not to interrupt you. All right. Well, very good. Senator Riepe, welcome to the Revenue Committee. And you're here to introduce LB362. [LB373 LB362]

SENATOR RIEPE: (Exhibit 1) I am. Thank you, Mr. Chairman, Chairman Smith and members of the Revenue Committee. I am Merv Riepe, it's M-e-r-v, last name is Riepe, R-i-e-p-e, I represent the 12th Legislative District, which is Omaha, Millard, and Ralston. Today I am here to address one part of my healthcare reform package that I introduced this session, healthcare savings accounts. Today I want to explore a state-based healthcare plan in the event states are awarded block grants. A visual is being distributed to support my talking points. Given the discussion of the repeal of the Affordable Care Act at the federal level I will ask you to hold this legislation in committee. The hold will afford me the opportunity to redirect in 2018. First, I want to talk about my approach. Most discussions start on healthcare with entitlement, healthcare is a right, essential benefits, quality access, and then affordability. We've had this discussion for years with great success in identifying ideal health models. All of these grand plans have failed because they are not financially sustainable. I will focus on the health plan that is affordable and is sustainable. To attain affordability we must address, one, eligibility; two, benefits; three, copays; four, deductibles; five, primary care preference; and six, individual responsibility over one's health; and financial accountability. I'd like to briefly--and I won't take up a whole lot of your time, but I wanted to switch to the visual--at the top of it by label it's called "Healthy Nebraska." That was very creative. The piece here though is about the Nebraska...the heart of it, the Nebraska Health Savings Account. And the intent here is to have a Nebraska Health savings account similar to the federal HSAs that are there. This plan as we or as I see it is, this would be the source of the streams of income that would come into it and those being on...as you have it in front of you on your far right would be the employer, who could contribute to this Nebraska HSA, similar to as they do to retirement plans in a 401(k). That percentage could be determined or it could be a range set. I want this to be as market-based and free market as it possibly can. The individual would be encouraged and asked to participate when they can. To your left, the state of Nebraska...there would be then for those individuals who are, for example, at 100 percent of the federal poverty line they're going to need some subsidy support. So that's where I would see the block grant coming in, if that's what we're going to get possibly for the start of it tomorrow at the federal level. With this HSA any funds that remain at the end of one's life would be able to go over to one's estate. So you'd be able to use this over into any kind of care, whether it's acute care, chronic care, but also it would...so it's not a situation where you want to encourage people just to spend it or lose it. Off of that the model then goes down, it would allow individuals to pay for their premiums. I have looked at this as, first of all, you know my affection for direct primary care. And, yes, there are not lots of direct primary care practices in the state of Nebraska, but the part that I really like about it and would want in the bill would be the prepaid side. In direct primary care, the doctor-patient relationship exists in the absence of an insurance company. The individual pays the physician approximately--and this range is (inaudible) of $75 a month--and for that one gets unlimited visits, gets electronic contacts, if you will, through smart phones and the doctor or practitioner--it could be a nurse practitioner--would, in that case, that's probably 80 percent of the healthcare cost. The reason that I like the direct primary care or let me say the prepaid model on this one is, for that $75 you have access in the agreement under our bill in direct primary care the physician has--or practitioner--has a relationship written with the patient and they have open access. But the key here is you have no copay and you have no deductible. And that's one of the real challenges in healthcare right now, as you know. So many people have deductibles of $3,000, $5,000, $7,000, $12,000 for families, which fundamentally is like...one might rename it and call it antibankruptcy insurance, as opposed to healthcare insurance because it really doesn't promote healthcare when it's needed. The second part of this on that little arrow that goes to your right, which is called the Nebraska Health Care Risk Pool, that's where...this is the catastrophic side. And this is where individuals who would be encouraged, again, to pay for that other HSA. It covers the pricey stuff, for which there would be a deductible. It covers the hospital, it covers the medical specialists, it covers the pharmacy, it covers the outpatient. And Nebraska or risk pool, in essence, that were around for a long time, then they fell out of vogue, but they're now making a comeback. And I was sharing with Senator Smith on the floor this morning that ALEC, which is an organization that he's well familiar with that does now and openly...and encourages risk-based pools, and even at the federal level under the new revisions, they're talking again about risk-based pools as one way to be able to consolidate that population, manage that population and then to be able to correspondingly lower the premiums, if you will, of others. The...on your far right is the commercial insurance. Because I am free market, I would want the opportunity for someone that does not want to go to direct primary care, does not want to use it, a high risk pool, a state-based risk pool, but wants to use his or her commercial insurance, free choice. And I would afford them the opportunity to do that. We feed into the--from the federal standpoint--into the federal HSAs is $6,750 per individual and if you're over 50, it's an additional $1,000. Now, so you can accumulate some money in your HSA. I want to have this thing held. I want to have it as an opportunity. Today while we're sitting here, as we all know, in Washington, they're sitting there and/or going office to office to try to get enough votes to make some movement on what this new replacement for the Accountable Care Act (sic) will be. But everything that I see talks about risk pools, talks about HSAs, talks about Medicaid being given to the responsibility of the state. And I think the biggest challenges there are who's going to get how much and where you already expanded Medicaid, who's going to get what and who's going to have to pay what? With that, Mr. Chairman, I respectfully will stop. [LB362]

SENATOR SMITH: Thank you, Senator Riepe. And as you mentioned, you're asking for this to be held in committee? [LB362]

SENATOR RIEPE: Yes, I am, sir. [LB362]

SENATOR SMITH: Okay. Senator Schumacher. [LB362]

SENATOR SCHUMACHER: Thank you, Chairman Smith. Thank you, Senator Riepe. Basically, this is a mirror image of the federal HSA? [LB362]

SENATOR RIEPE: Yes. [LB362]

SENATOR SCHUMACHER: Does it have--and I have not read the details of the bill, but does this have a minimum level of...do you have to maintain one of these highly deductible insurance policies like you have to under the fed? [LB362]

SENATOR RIEPE: I would hope that it has enough flexibility to afford the, as I see it, the direct primary care, which would be a very inexpensive entry level. [LB362]

SENATOR SCHUMACHER: Okay. [LB362]

SENATOR RIEPE: And the other part of it, it would not require...you know, my piece would be is, the risk pool would have to determine what that deductible needs to be. And this is all state. This would just be deductible from state income and one would have to have a federal program to take federal monies out as well. [LB362]

SENATOR SCHUMACHER: I seem to remember under the federal that in order to do a health savings account you had to have a high deductible insurance plan. [LB362]

SENATOR RIEPE: Okay. I would not encourage that. [LB362]

SENATOR SCHUMACHER: And what about folks on Medicare? Could they still take advantage of this? [LB362]

SENATOR RIEPE: Well, we have Medicare Advantage. I think that my interest...my primary interest here is to try to solve those that are falling through the gap. As I see it, there needs to be Medicaid that takes care of the most vulnerable in our society in our state. The next step goes up to those that are at 100 percent of the poverty line. And so this is for the working poor and the McDonald's workers or, quite frankly, others that want to participate and that aren't in a group. Then you go on up to maybe the commercial insurance and then you go on up to the Cadillac tax, high level, high benefits kinds. My interest is to look at this gap. Is there a way that we can fill this gap if we get some block grants? [LB362]

SENATOR SCHUMACHER: Thank you, Senator. I mean, you're very much on target. We should, depending on what happens in Washington, be prepared to fashion something rather quickly and take advantage of it. [LB362]

SENATOR RIEPE: It could break fast, is my sense. Or maybe that's foolishness on my part. Maybe anything out of Washington is going to go real slow, I don't know. And people have said to me, well, what do you think is going to come out of Washington? I say, I have absolutely no idea. I grab the paper every morning just to...like Will Rogers, all I know is what I read in the paper, so. [LB362]

SENATOR SCHUMACHER: It'll come in a tweet. [LB362]

SENATOR RIEPE: Yes. [LB362]

SENATOR SMITH: Senator Groene. [LB362]

SENATOR GROENE: Senator...Chairman Smith, thank you. I'm confused. You have a federal HH...health saving account, right? [LB362]

SENATOR RIEPE: Yes. [LB362]

SENATOR GROENE: How does this relate to that? [LB362]

SENATOR RIEPE: You can have two. [LB362]

SENATOR GROENE: And what does this one do that my... [LB362]

SENATOR RIEPE: Well, this one is going to be from state tax that you can take it off this. [LB362]

SENATOR GROENE: But you can also take the federal one. [LB362]

SENATOR RIEPE: Oh, okay. Well, I might need to get some clarification on that. This allows...I think one of the things I understand about the federal is you can't pay premiums out of the federal one. [LB362]

SENATOR GROENE: Yeah, you can't pay premiums right now. [LB362]

SENATOR RIEPE: This gives some more flexibility. And as we study and look at this more as it comes up, this may...if this is a better plan, I'd say then this could...a person could opt and use this in lieu of the federal plan if that's allowable at the federal level. Trying to get some under waiver... [LB362]

SENATOR GROENE: You can't deduct it on your federal taxes, though, could you if it's...? [LB362]

SENATOR RIEPE: Well, those are pieces that we really...we have...it's like a...it's...we've got to look. We just haven't spent a whole huge amount of time on it, getting down to the very details. We'd have to. [LB362]

SENATOR GROENE: The thing about the federal one, you have to be an employee basically to have one. You have it the same here. What about the individual who just wants to start a health savings? You cannot...by an experience I know of... [LB362]

SENATOR RIEPE: Yeah. [LB362]

SENATOR GROENE: ...if your company stops it, you can't put any more contributions into the federal one, because it has to be tied to an employer. I'm sure some lobby made sure that happened, that you had to work with insurance companies. [LB362]

SENATOR RIEPE: My encouragement would be is, we make it what works for us. [LB362]

SENATOR GROENE: So you could...an individual, a farmer, an individual says, I'm healthy, but I want to deduct some...put some money aside for in case I have an emergency and be able to deduct it instead of my health plan that came through the employer. This doesn't cover that. [LB362]

SENATOR RIEPE: I'd say this is farmers, in particular, this might be very attractive to them. I know I have family members that farm. It could be huge. [LB362]

SENATOR GROENE: Well, the frustrating thing about the federal thing is they force you to take it through employment. They don't allow you to go on the free market and then deduct your premiums or your deductions. I'm just saying it would be nice if somebody created something where an individual could take care of his own health, put some money aside and deduct it. [LB362]

SENATOR RIEPE: Well, I think it might be so it would be on this is if you can get...it's your money that you're spending at least some of this, that will be a little bit more conscientious. [LB362]

SENATOR GROENE: But the point is... [LB362]

SENATOR RIEPE: And I'm interested in taking away some of these central mandates that so people can custom this thing to their individual fit. [LB362]

SENATOR GROENE: The point is, if you are an individual and you work for a company that the health premium that the company pays for you is not taxable, it's not part of your income, if your company does not have healthcare and you take your own money and buy a premium, you cannot deduct that unless 3 percent or 2.5 percent of your gross income. I've always wondered why. [LB362]

SENATOR RIEPE: Well, I think a lot of discussion that I read and I think what we would want to do is to equal that table so that someone that's on their own money that they... [LB362]

SENATOR GROENE: It's the same (inaudible). [LB362]

SENATOR RIEPE: ...that they get the same advantage that the corporation gets. [LB362]

SENATOR GROENE: Or the employee who doesn't have to pay instead of that income. [LB362]

SENATOR RIEPE: Exactly. And we will be studying this more if it is held over the interim and watching what comes out of Washington to try to possibly be able to link this up with something, as was stated, so that maybe we can hit the ground running and we aren't flatfooted. [LB362]

SENATOR GROENE: Thank you. [LB362]

SENATOR SMITH: Very good. I see no further questions. Thank you, Senator Riepe, for your opening on LB362. [LB362]

SENATOR RIEPE: Thank you. Thank you very much. Thank you, sir. [LB362]

SENATOR SMITH: (Exhibit 2) We now will invite proponents, those wishing to testify in support. Seeing none, we do have a letter sent in support of LB362 for the record, Matt Litt, representing Americans for Prosperity. Those wishing to testify in opposition. Seeing none, those wishing to testify in a neutral capacity. Seeing none, Senator Riepe, would you like to close? Senator Riepe waives closing. And that concludes our hearings for the day. Thank you. [LB362]

SENATOR RIEPE: Thank you. [LB362]