TONY FULTON: Yeah, I'm still here.

HILGERS: OK, thank you. Good morning, everyone. Welcome to the meeting of the Tax Rate Review Committee. We'll start with self-introductions. Mr. Speaker.

SCHEER: Jim Scheer. I represent District 19, northeast Nebraska.

LINEHAN: Lou Ann Linehan, District 39, western Douglas County.

STINNER: John Stinner, District 48, all of Scotts Bluff County.

HILGERS: Commissioner.

TONY FULTON: Tony Fulton, Tax Commissioner for Nebraska.

HILGERS: Thank you, Commissioner. Mike Hilgers, I represent District 21. Pursuant to statute, I'm Chair of this committee as Chair of the Exec Board. And with us is Mr. Bergquist. So we are here today by statute. We have to meet within a specific period of time, I think by-- let's see, when do we have to meet by?

TOM BERGQUIST: Today.

HILGERS: Yeah, after July-- basically today. And so we'll start with a report and update from head of Fiscal, Mr. Beergquist, please.

TOM BERGQUIST: Thank you. By statute, the Tax Rate Review Committee is supposed to meet with the Tax Commissioner within ten days of July 15. Normally, that date is right in between the end of the legislative session and the start of the next session. So this-- this is a very unique situation. We have never had this meeting in the middle of a legislative session. So it kind of creates a very strange situation. I left all my notes back on my desk. I was trying to type them up. So I'm going to have to wing it. I think I'll concentrate what's probably really on everybody's mind is an updated status and what the Forecast Board did yesterday. Right at the beginning, '20, '19-20 became an actual revenue. That's in part one. That situation we were $265 million below the forecast in '19-20. Now $255 million of that is attributed to the income tax shift from '19-20 to '20-21 due to the extension of the filing date. So if you adjust that, the current '20-21 forecast is high, inflated by $255 million; the '19-20 is understated by 255. When you strip away the 255, the '19-20 shows only about a 10 million reduction over the February Forecast Board which would indicate that economically-- from an economic standpoint, '19-20 wasn't affected that much by the epidemic and the economic conditions. One of my suspicions, and there's not really a way to prove it, is that when they made the February forecast for '19-20, we were actually on pace of being $70 million above the forecast for '19-20. The first month after they did the February forecast was $40 million above the forecast. So in reality, they were probably-- we were probably on pace of being $70 million below the forecast when we came in at negative 10. So it's kind of hard to prove that we-- that whether the impact was minus 10 or whether the impact was minus 80 because $70 million was income that was never in the forecast. It's kind of hard to follow, but I think some of the impact was hidden inside of that. Let me go straight to number five, which is what happened basically yesterday at the Forecast Board. The little table on item five, on page two, that shows what was the forecast number from February and what we've been using as our LFO preliminary number. You can see the three changes in essence in the forecast. The revised forecast that's been the current status is what shows July 23 NEFAB and average LFO/NDR. The change where it shows net change, that's the actual difference in the forecast and it breaks down the components. It gets kind of a mess because the change in the forecast has incorporated the revenue impact of the CARES Act, the impact of the tax deadline shift, and then the difference is what's attributed to change in economic activities. So in the '20-21 fiscal year, the net change in terms of net receipts available in the status is only a $50 million decline. That's what takes us in our financial status. When we get to page three, that drops us from the 138 that we were on the previous status to plus 90. The most significant difference is in our preliminary number in the out-year the board did not do a forecast for '21-22 and '22-23. We had been using what I call the average-- the historical average methodology, which is in the long run, in the absence of a forecast, what growth would you need in order to get to a five-year average of about 4.5 percent? So that number would stay fixed and the growth rate would fluctuate depending on what happened in the first three years. That methodology has worked well when, for example, the board comes in next October, we'll have a brand new two out-years that comes in. At that time, that out-year is anywhere from three to five years away. So when-- when we're a long ways away from that out-year, that methodology works well. What we're in a situation now is we're only barely three months away. It might be only about two and a half months away when the Forecast Board is going to actually come back and make those forecasts. And that out-year is not three to five years away. It's only one to two. So at this time, we shifted to the average growth of our IHS econometrics. That was the closest that the Forecast Board was to our actual forecast for '20-21. So we had-- so we-- to make a long story short, the method, the forecast we're using for the two out-years in essence is basically what they're likely to see in October when they do come in and meet. That's the closest that they'll probably be when the Forecast Board comes in, in October. If we had stuck with our other methodology, that out-year number would have averaged between 7.5 and an 8 percent growth, which would have been a very, very high number. A little bit on the board estimate yesterday, the board was significantly higher than any of our forecasts. They were-- the board ended up 144 million higher than what was the average of our four forecasts; 110 million higher than the average of our IHS econometrics. The bulk of that was about 90 million higher in the corporate number. There was a lot of discussion about the tax impacts of the PPP that companies received. Both us and the Department of Revenue, we did not have a specific adjustment for that. That-- because that was not-- we make an adjustment if it's a federal law change. That wasn't a federal law chang. It was how that might flow through in the tax system.

HILGERS: And you're speaking specifically to the forgiveness portion or just [INAUDIBLE]

TOM BERGQUIST: The forgiveness portion and how if if it was declared as income and how that then translates down into the tax. One of the confusing parts is our forecasts are based on both Moody's and IHS Economics, Moody's and IHS Economics incorporated the provisions of the CARES Act into their projections. We then take their-- we take their projections and then incorporated into Nebraska's tax model, which translates that from their numbers down to our numbers. Now, how they treat it, if they boosted up their estimate of state and local taxes because of the provisions of the CARES Act, that's one that we don't necessarily have specific details on. So a lot of the board discussion was that that was going to cause a big increase, the way that was going to translate doesn't count as income, the deductibility and all that stuff. So to great extent that was argument that was they ended up with a corporate number that was 90 million higher than everything else we had. And if that is true as it comes through, we're going to be spending a lot more time in the next couple of months before October as to what really if we can identify inside of everything. In either case, that's going to be a one-time, considered a one-time revenue number in the '20-21 fiscal year. So just was going to make that. That's why it's-- the situation was significantly we're better than they would be. If they had come closer to the average of a four, our plus 90 would have been in the range of a minus 10, minus 20.

LINEHAN: The way it was explained to me, Senator Hilgers, is that the PPP money is not taxable, but they're also not going to be able to deduct the wages they would have paid. So in a sense, it comes in tax free, but then you don't get to deduct what you didn't. So they said all the-- their CPAs and CPAs they've talked to have told the companies they need to start putting money away because they're going to get hit with a higher income tax.

HILGERS: Which will show up next year.

LINEHAN: Which will show up next year because they don't-- they can't-- obviously, you can't use the PPP money to pay your salaries and then turn around and deduct salaries.

HILGERS: Thank you, Senator.

LINEHAN: Can't double dip, yeah.

_______________: You could try.

LINEHAN: You could try, but their CPAs are telling them that's probably not going to work.

HILGERS: Thank you, Senator Linehan.

TOM BERGQUIST: And it's going to take us a little because we need to try to go through that whole scenario.

LINEHAN: Because it's $3.3 billion, right?

TOM BERGQUIST: Well, that-- the question is the PPP is that in addition, on top of the normal income that they would have had, or does it replace the normal income they would have had? And it's not taxable, regardless of-- if you don't call it, if you can't tax it as income, it's not going to be in the tax part.

LINEHAN: No, but my question was, as a breakdown, almost $10 billion that came to Nebraska from the CARES Act.

TOM BERGQUIST: [INAUDIBLE]

LINEHAN: Or was it $3.3 billion that was PPP money?

TOM BERGQUIST: Yes. Now all $3.3 billion of that is not going to translate down into taxable income.

LINEHAN: None of it is taxable income.

TOM BERGQUIST: I know, but whether there's $3.3 billion of unused itemized deductions which then raise taxable income, even though the income isn't taxed, I mean, it's gets-- it gets very difficult following it down through the process.

LINEHAN: Right.

TOM BERGQUIST: How that translates down through.

LINEHAN: What would a billion dollars more income in Nebraska mean in income taxes for Nebraska, for-- for the state?

TOM BERGQUIST: Well, at a billion dollars, 6 percent of taxable income. Would it be 60 million?

LINEHAN: Yeah.

TOM BERGQUIST: Now.

LINEHAN: Or 3 billion would be 24.

TOM BERGQUIST: Right.

LINEHAN: Two hundred and forty million.

TOM BERGQUIST: Right. The issue is the amount of increase in taxable income isn't due to the PPP payment. It's due to the lack of itemized deductions in the tax. That-- that's the difficult part of translating is not just taking the PPP amount, because it has to go through how that floats through everything and becomes taxable income due to the lack of itemized deductions. So it gets very, very messy. And on top of that, it's virtually impossible to identify what's already flowed down into our estimates due to how IHS and Moody's handled that when they incorporated the impact of the CARES Act. So it's--

LINEHAN: But what--

HILGERS: Well, can't-- oh, go ahead, Senator.

LINEHAN: Go ahead. No, you go ahead.

HILGERS: Well, so can't you-- but I hear you on that although isn't there-- and I'm not-- [INAUDIBLE] No one knows the precise impact. But if you're just thinking big picture and how this will flow through, isn't-- can't you make some rough, I mean, we're not here to make rough guesses; but I'm just trying to think this through over the next year. I mean 3.3 billion, some probably decent proportion-- a portion of that will be used on things that then will be forgiven. And if that's-- and then if you cannot deduct what has been forgiven, those aren't really the itemized flowing, I don't think of those as itemized deductions that flow through the individual taxpayer. I mean, those are just the business deductions which would deduct against other-- other income [INAUDIBLE]. So if you don't have those deductions, then that other income would then be taxable. The non-PPP income would be taxable to the extent there is some. So couldn't you make some sort of rough calculation, say, you know, again, not as part of this, but just as you're projecting forth, it could be a significant amount of money that could flow as part of the PPP because those funds are not deductible and that wouldn't show up till next year. Isn't that right?

TOM BERGQUIST: Well, yeah.

TONY FULTON: Can I-- this is Tony. Can I answer--

HILGERS: Please, Commissioner, yeah.

TONY FULTON: What you're saying, Senator Hilgers, is accurate. You could make, you know, back of the envelope prediction, because there's been PPP funds with a period of about two months. And so if you look at the average payroll that's paid for all of these corporations, remind you these are C corporation-- I'm cutting up. Can you still hear me? Can you still hear me?

HILGERS: Yes, Commissioner.

LINEHAN: Yes.

HILGERS: Yes.

TONY FULTON: Yeah, so these are C corporation, the deductibility on the back end it would basically be one sixth, about 2 months over a 12-month period. That's the length of the PPP. So that's how I would do it. But here's the thing. What Tom is trying to say and I'll back him up on it, that was baked into the projections from LFO and Revenue already because IRS-- the IRS gave a ruling on the deductibility of those PPP funds. The ruling was that indeed if they're not deductible.

Now Congress is supposedly going to come in and address that. They haven't done it yet. But that being said, that ruling drove the IHS and Moody's projections and estimates, economic estimates that we used in putting together our projections. So we would say it was already baked into our numbers. And NEFAB, you know, they-- they added a little bit more state revenue as a result.

HILGERS: Got it. Thank you. Thank you, Commissioner. That's helpful. Speaker Scheer.

SCHEER: Thanks, Senator Hilgers. Commissioner, can you hear me? This is Jim.

LINEHAN: Are our mikes on?

SCHEER: Commissioner Fulton, this is Jim. Can you hear me?

TONY FULTON: Yeah, go ahead.

SCHEER: Real quickly, showing the $255 million reduction from last year, popping it into essentially last week, have you seen the magnitude of funds coming in in the last 10 days that would substantiate those numbers going back and forth?

TONY FULTON: Short answer is yes and maybe a little bit more. Dr. Tran, yesterday in NEFAB's presentation, he said that $255 million, that's a good number to use for-- for the shift from April to July. And he said it's probably going to be another $15 million. It may be as much as $270 million. And the reason we don't have it-- we don't have firm numbers simply because, you know, not done yet. We have refunds going out still and some payments coming in and, so, yeah, $255 million on the low end, $270 million on the high end.

SCHEER: OK, thank you.

HILGERS: Thank you, Mr. Speaker.

SCHEER: Sorry to interrupt, Tom.

TOM BERGQUIST: Yeah, no, no, appreciate it.

HILGERS: I know that you still have some left on your presentation.

TOM BERGQUIST: It's a complicated issue. All I was going to say is the one issue is the PPP was supposed, in theory, was supposed to replace the lost revenue, not add to existing revenues. So technically it's supposed to replace. So the theory was to keep it constant, not necessarily add to additional revenue. So how that's going to end up translating--

HILGERS: So from a forecasting perspective, in other words, the-- the new revenues would have-- you're sort of-- from a forecast perspective, you're shifting out some potential revenue, but sort of back filling.

TOM BERGQUIST: Right. In theory, if the revenue is supposed to replace lost revenue, you're replacing taxable income with nontaxable income. The question then becomes, how does the itemized deductions float in? And that's where it gets really complicated and messy.

HILGERS: Yeah, that makes sense [INAUDIBLE] Mr. Speaker.

SCHEER: Well, I think I'm following what you're saying, but I don't know that I necessarily agree with the [INAUDIBLE] to the extent that a great number of the people that I know that took the PPP were assuming that this was just additional money for the businesses to use. But quite frankly, it was used to pay the payroll, which was supposed to happen. But as far as any income production during that period of time was nil. So it may have replaced the-- the ability to keep those people employed. But if we're assuming that we're also paying the employees and then there was income being produced during that period of time as well, I don't believe that. You know, I just think most businesses were flat and breaking even at the very best.

LINEHAN: That's what I don't think we'll know. I-- I'm assuming some were flat, some were worse than flat, and some were fine.

SCHEER: Yeah. I mean, there were some industries that, you know, obviously excelled during those two-month period. But I think the vast majority, at least Main Street and a lot of the companies, manufacturing ones that I've talked to, I mean, sort of were sitting on their thumbs.

HILGERS: Now, it's interesting.

STINNER: I will say this, that of the $3 billion, how much went to corporations and how much went to LLCs and individuals?

LINEHAN: Right, yeah.

STINNER: I'm going to suggest to you, when I look at the number of corporations we have very limited relative to the rest of the body. So there's that piece, most of the PPP loans that I saw going out were to businesses that basically were kind of shut down, but keeping their payroll. Grocery store would be the exception, but they added people during that time--

SCHEER: Right.

STINNER: --because of what was happening. So I think the intent was to have it revenue neutral, come in tax free, can't deduct what we basically are subsidizing. So I'm going to have to sit down with the CPAs and [INAUDIBLE]

LINEHAN: [INAUDIBLE]

STINNER: --around. I've heard the same thing, but it just-- it's hard for me to get-- get through the tax return as far as that is concerned. But that's-- but I will say this, as Tom said, all of the four major pieces of legislation and the tax consequences were baked into what the forecast was. And I think that the director of Revenue also indicated that it's already in the forecast. Why they deviated by over $140 million, that's been-- I've been scratching my head, but they normally are pretty close, but we are where we are so.

TOM BERGQUIST: The other interesting question, one, is they put it all in the corporate and as Senator Stinner said, some of that's going to end up being corporate and individual, but that's just a tax category difference. The other one, which will be interesting is we will have to try to identify them sometime if the feds pass a law that specifically exempt everything from taxation. If they do pass a law that says none of this can be taxed, then we'll end up having another estimate of the impact of federal law, which would be a revenue reduction to us. And we may have to take it out next October if this is in-- if the feds change the tax implications of it. So that's the-- that's the other part. But again, we don't anticipate passage of federal law, so that's something yet to be seen.

LINEHAN: So this doesn't anticipate the new stimulus package they're working on right now?

TOM BERGQUIST: No, I can't assume the passage of any of that stuff.

LINEHAN: But it may happen before we leave, be-- it may happen before August 13.

TOM BERGQUIST: It could, but at that point, we still can't revise it. We're still using the board's forecast. We would not--

LINEHAN: Well, the board's forecast, but what about-- these out-years are not the board's forecast.

TOM BERGQUIST: No.

LINEHAN: These out-years are the LFO forecast, right?

TOM BERGQUIST: Again, we could adjust it. Yes, there are forecast rough numbers going on the out-biennium. Now, how much? We'd have to see what they passed. Yes, in theory, yes, we could adjust those numbers to reflect the change. But there's always-- there's already so much variability as to what could happen two and three years from now with the economy. I don't know whether that will dramatically alter the numbers or not. You know, when you're talking about a hundred billion dollars of state personal income, it has to take a pretty good dollar change of things to move the needle.

LINEHAN: Can I?

HILGERS: Go, please go ahead, yeah.

LINEHAN: So I've been under-- I thought I understood, because I've been explaining this over and over and over again to schools and others, that we always base our out-years on the 20-year average or 30-year average. And we've been doing that since Chairman Warner was in charge of Appropriations.

TOM BERGQUIST: Right. When those out-year numbers were in long-term way. This has become--

LINEHAN: Have you done this before?

TOM BERGQUIST: No, because we've never been in this situation where the Forecast Board has been so close to--

LINEHAN: So we've never--

TOM BERGQUIST: [INAUDIBLE]

LINEHAN: --lowered [INAUDIBLE] We've never-- how many years have we used the 4.5 percent?

TOM BERGQUIST: Probably 30, 35 years. Now we will move closer. We'll go back to that methodology in October when the Forecast Board does their '21-22 and '22-23 official forecasts. But what is an out-year now will move into the current biennial budget in October; '23-24 and '24-25 will now move in as the new out-years. That will happen in October. And the board will not do the forecast for those two out-years. And because those years are three and five years away, we will go back to using that methodology because those two out-years are that far away. We're adjusting it now and changing that methodology, because this is a unique situation where the board is meeting so close to that out-year from when they're going to actually officially do it.

LINEHAN: And that's never happened before in 30 years--

TOM BERGQUIST: No.

LINEHAN: --even with special sessions--

TOM BERGQUIST: No.

LINEHAN: --even in the worst of times--

TOM BERGQUIST: No,

LINEHAN: --in the '80s during the ag--

TOM BERGQUIST: No.

LINEHAN: --not in 2008 or 2009?

TOM BERGQUIST: No.

LINEHAN: What would these numbers be if you used the 4.5 percent?

TOM BERGQUIST: If, if I use the historical average, the average revenue growth, which would freeze those two years, would be close to 8 percent per year, which is one of the reasons, again, which is showing when we get closer to what the board is.

HILGERS: All right. Go ahead, Senator Linehan. I don't know if you had additional follow-up. We have until 8:30 on this. Certainly we can go past, but in case anyone has to leave, want to make sure. Mr. Bergquist, do you have anything else to add there?

TOM BERGQUIST: No, I think we're again, this is unique. Normally, this is in the mid-biennium. We're six months before an update before the next session starts. This is-- never had one of these in the middle.

HILGERS: Mr. Speaker.

SCHEER: I make a motion the committee propose no change in current tack rates, tax rates.

________________: Second.

HILGERS: We have a motion and a second. Commissioner Fulton's ex officio member of the committee so he can't vote. He has a voice, but he has no say. Any discussion on that motion? All those in favor say aye. Opposed say nay. That motion passes. Pursuant to statute, we will submit this report electronically to the Legislature, and we will not be petitioning the Governor for a special session. Is there anything further from the committee? Thank you all for joining this morning. Thank you, Mr. Bergquist, for your work.

TOM BERGQUIST: Thank you.

HILGERS: And have a great weekend; thanks, all.