

Executive Summary

By a vote of 79 percent to 21 percent, Nevada voters on November 4, 2014 rejected a ballot initiative that would have established a 2 percent margin tax on business gross receipts. That debate was only the most recent example of an important state tax discussion that comes up in nearly every recent Nevada legislative session.

Why do taxes keep coming up? One reason is the volatility of the current system's tax collections. Another is the difficulty of understanding and complying with sales taxes and property taxes. Yet another is the simultaneous double taxation and complete exemption that exist in the Modified Business Tax and the Live Entertainment Tax. Revenue adequacy is also frequently cited.

This book is meant to continue this conversation by providing a framework for potential changes. In 2014, the Las Vegas Metro Chamber of Commerce commissioned the Tax Foundation to prepare a review of the Nevada tax system and recommend possible improvements. While they commissioned this report, neither the Las Vegas Metro Chamber of Commerce nor any of its sponsors directed this analysis or any of the recommendations.

We undertook this project as a national organization familiar with tax developments in many states, with the view that tax systems should adhere to sound economic principles, and in the spirit of providing useful information and observations for Nevada policymakers, journalists, and citizens as they evaluate their state's tax system.

Over the course of five months, we met with stakeholders from all walks of Nevada life, including small business owners, local government officials, trade associations, industry representatives, state officials, and ordinary taxpayers. We reviewed the history of the tax system, including previous tax reform studies, and available revenue and economic trends.

Broadly:

- **Nevada should consider fixing what is broken with the current tax system** instead of pursuing a brand new tax to layer on top of the narrowly based, complex existing taxes. A number of elements of the tax system exist only in Nevada, and those in particular should be scrutinized.
- Changes should address state revenue volatility, be fair, and reduce carve-outs that plague the system.
- The tax system should retain elements that ensure Nevada economic competitiveness.

In the following pages, we provide background on Nevada's economy (Chapter 1) and on the overall tax system (Chapter 2). We then review each major tax, outline concerns, and propose reforms for consideration (Chapters 3, 4, and 5). Chapters 6, 7, and 8 conclude with discussions of several related issues relevant to policymakers but are outside the scope of our recommendations.

Option A is a comprehensive tax reform proposal that includes the components of the other three tax reform options outlined hereafter (Options B, C, and D). It simplifies, broadens, and stabilizes the sales tax, Live Entertainment Tax, Modified Business Tax, Bank Branch Excise Tax, Business License Fee, and the property tax.

Option B stabilizes and modernizes Nevada's sales tax system and the Live Entertainment Tax, applying it evenly to all final retail transactions without special carve-outs. It would:

- Eliminate the current sales tax exemption for the service industry. As services grow to be an ever larger share of the economy, the sales tax becomes increasingly volatile and inadequate as it applies primarily to goods. We present three different scenarios of sales tax base expansion to services: small, medium, and large.
- Lower the 6.85 percent state sales tax rate, subject to revenue triggers.
- Exempt manufacturing machinery from the sales tax base. Nevada is one of just nine states that have this tax on capital investment, which double taxes final products.
- Exempt business inputs from the sales tax by issuing an identification number, registered with the Department of Taxation, to all businesses that pay the Modified Business Tax or the Business License Fee, which would exclude their business purchases from the sales tax base.
- Subsume the Live Entertainment Tax into the sales tax by repealing the current LET but applying the regular sales tax to all admissions charges and food, beverages, and merchandise sold at all venues that charge admission.

Option C further improves Nevada's already competitive business tax structure by applying the existing Modified Business Tax to all businesses and eliminating both special carve-outs and industry-specific rates. It would:

- Roll back the higher Modified Business Tax rate for financial institutions while adjusting the Modified Business Tax rate for general businesses.
- Repeal the \$85,000 Modified Business Tax carve-out, applying the tax to all businesses.
- Repeal the Bank Branch Excise Tax, which raises little revenue and has no public policy rationale.
- Increase Business License Fees while instituting a graduated fee structure.

Option D proposes changes that add stability to Nevada's property tax system and bring it in line with best practices from other states. It would:

- Change the assessment method from replacement cost to market value and eliminate the depreciation factor.
- Adjust and reform tax caps, preserving predictability for homeowners and restrain local government spending growth while eliminating the unexpected downward "ratchet" that materialized in the most recent election.
- Present an option for a circuit breaker for elderly and low-income homeowners as an alternative way to target more meaningful property tax relief for specific individuals.

We hope these options continue the tax conversation in Nevada by providing a framework upon which legislators and citizens can make further decisions. The menu of choices we present all ensure that the state builds a tax system for a diversified economy and positions itself as a destination for investment, entrepreneurs, and talented individuals in the years ahead.

Principles of Good Tax Policy

Creating sound tax policy is more than a question of how much revenue is being raised and whether that amount is too much or not enough. Public finance experts and economists generally agree that not all taxes are created equal, and certain types of taxes are more damaging to the economy than others.¹ Below are four tax reform principles that should be kept in mind when evaluating existing and possible future tax policies.

Simplicity

Time spent complying with taxes is a burden on individuals, and administrative costs are a loss to society. Complicated taxation also undermines voluntary compliance by creating incentives to shelter and disguise income. With the complexity of the federal income tax, state tax codes should strive not to add to that complexity. Taxes may be the price of a civilized society, as Justice Holmes once wrote,² but they ought to be as civil as possible.

Transparency

Tax rates and bases should be easily understandable by taxpayers. Tax changes should be made with careful consideration and input, allowing taxpayers to understand how much and how they will pay their taxes. Adam Smith, one of the first public finance experts, wrote, “The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.”³

Neutrality

The fewer economic decisions that are made for tax reasons, the better. Taxes are meant to raise revenue for necessary government services, not pick winners and losers in the economy. As much as is possible, the tax code should tax similar activities at the same rate, and tax liabilities should not be borne more by one similarly-situated group than another. Economists often refer to the best tax system as one with “a broad base and low rates” because this type of system minimizes economic distortions.

Stability

Frequent changes to tax codes make long term economic planning difficult and unpredictable. Temporary tax laws should be avoided.

¹ These principles were originally outlined in Adam Smith's *The Wealth of Nations*.

² See *Compania General de Tabacos de Filipinas v. Collector*, 275 U.S. 87, 100 (Holmes, J., dissenting) (“Taxes are what we pay for civilized society...”).

³ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* 779 (Random House 1937) (1776) at 778.

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The Tax Foundation is the nation's leading independent tax policy research organization. Since 1937, our principled research, insightful analysis, and engaged experts have informed smarter tax policy at the federal, state, and local levels.

About the Las Vegas Metro Chamber of Commerce

The Las Vegas Metro Chamber of Commerce is the largest business organization in Nevada. Founded in the early days of Las Vegas, the Chamber has a strong legacy of protecting and strengthening the Southern Nevada business community, helping its member businesses grow and thrive and providing a voice for those businesses in local, state and federal government.

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