



# **Enacting a Fair Tax in Nebraska**

**Equality**

**Simplicity**

**And**

**Economic Freedom**

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## Introduction

First of all, I am not a lobbyist. I'm not making a single penny upon the publication and distribution of this report, and I did not write it to make a profit. I wrote this report on my own personal computer and at my own expense, mainly in response to the backlash of the two tax reform bills introduced in the Nebraska Legislature this year: L.B. 405 and L.B. 406.

I was a big supporter of both of these bills. However, like most of you, I disagreed with a few of the provisions in both of the bills; most notably, the selective removal of sales tax exemptions from certain activities or business operations. Of note, numerous farmers and business groups were vocal opponents of the bill's plans to tax water for irrigation and manufacturing, seeds for commercial use, agricultural machinery, agricultural chemicals, and energy used in agriculture, to name just a few. I disagreed with these and similar provisions not because I would have been personally affected, but because it did not seem fair how these exemptions were summarily taken away from some groups and not from others.

If we are going to pay for the removal of our state income taxes with additional sales taxes on previously exempt items, then the selection of these replacement sales taxes must be fair, equitable, and shared equally amongst all those affected. Clearly, neither L.B. 405 nor L.B. 406 accomplished these goals. At this point the question is: How can we achieve tax reform in our state that is fair to all Nebraskans?

In this report I will demonstrate that we can accomplish the goal of equitable tax reform in our state by instituting a consumption tax modeled after the national FairTax® plan. The proposed Nebraska Fair Tax would replace our current individual income taxes, corporate income taxes, and sales taxes. To demonstrate how this can be accomplished, I will answer the following questions:

1. What is the FairTax® and where did it originate?
2. What tax rate would be needed?
3. Can we enact this type of tax in Nebraska?

As you read my report, please keep in mind that I share Governor Heineman's goal of completely removing income taxes as a means of raising revenue from Nebraskans. Taxing income is not only regressive, unfair, and often complicated, but has the negative side effect of penalizing success. The more you make, the more you are taxed. With this type of taxation system in place both at the federal and state level, Americans in general and Nebraskans in particular are eager to succeed, but fearful of the large tax bill that will surely follow.

Like most of you, the only things I want (and my most important goals) are to achieve economic success based solely on the efforts that I put forth, to provide for my family, and to continue living The Good Life in Nebraska. I will prove to you in the following pages that a Nebraska Fair Tax is an excellent first step to take towards these goals.

To make the discussion of "taxes" more palatable, I have made all efforts to keep this report brief and to speak in the voice of ordinary Nebraskans - using an easily understood, conversational style.

## The National FairTax® Plan

So where did the national “FairTax®” originate? The FairTax® was first conceived by a group of businessmen in Houston, Texas, in the late 90’s. Their goal was to determine if there was a better method than the present income tax system for generating federal revenue.

Several years and \$20 million dollars of research later (yes, \$20 million in scholarly research was conducted) their end result was a bill introduced in the 106<sup>th</sup> U.S. Congress by then-Congressman John Linder (GA) - H.R. 2525, The Fair Tax Act of 1999. The FairTax Act has been re-introduced in every subsequent Congress including the 113<sup>th</sup> Congress by Congressman Rob Woodall who succeeded Congressman Linder upon his retirement. Currently, the bill is numbered H.R. 25 in the U.S. House and S. 122 in the U.S. Senate. The FairTax Act has more co-sponsors than any other tax reform legislation currently before Congress.

The FairTax® Plan, in its most basic terms, eliminates taxes on wages while taxing wealth and borrowing when spent. It eliminates the current federal income/payroll tax system and replaces it with a single, national tax on consumption. Employees take home their gross pay – no more federal tax deductions. All taxes on income are eliminated including dividend, interest, capital gains, payroll (FICA), business (partnerships, sole proprietors, corporations), alternative minimum taxes, estate taxes, death taxes, etc.

At the state level, in February 2013 the State of Kansas introduced H.B. 2355, The Kansas Fair Tax Act of 2013. This bill would accomplish at the state level what H.R. 25 does at the federal level.

**Please note: The remainder of this report discusses the application of a Fair Tax at the state level in Nebraska, and is similar to what Kansas has proposed with H.B. 2355.**

If a Fair Tax plan were implemented in the State of Nebraska it would completely remove all Nebraska individual income taxes and corporate taxes; current sales and use taxes would effectively be amended.

A Fair Tax plan accomplishes this by taxing all new goods and services at the retail level when they are consumed, in the case of NE, by using the same 7% rate as our current sales tax. The tax would already be included in the total price you pay at the register, so one single item that you purchase at the grocery store with a listed price of \$100 will cost you exactly \$100 at the cash register. You will receive a receipt, which shows the total price paid (\$100), 7% of the total is Nebraska Fair Tax (\$7), and the actual pre-tax cost of item purchased (\$93).

In other words, the NE Fair Tax will already be priced into the goods you buy. For example: \$200 of groceries will cost you \$200 (of which \$14, or about 7% will be for taxes), and a \$1,000 plasma television will cost you that same \$1,000 (of which \$70 or about 7% will be for taxes). The Nebraska Fair Tax would not apply to used goods. If you purchase a used car or an antique lamp at a garage sale, no taxes will be due. *Fair, simple, and transparent.*

Don’t forget, under a Nebraska Fair Tax, since there is no longer an individual income tax, the Nebraska taxes that used to be withheld from your paycheck no longer need to be taken out. This provision enables all Nebraska taxpayers the opportunity to spend, save, or invest their hard earned wages when and how they see fit. Additionally, under both a national FairTax® and



a Nebraska Fair Tax plan, April 15 is no longer a dreaded day – it is just another spring day to do with as you wish.

You may be thinking that this sounds like a great idea but what about lower-income individuals? Wouldn't this tax hit them the hardest because they earn less? The answer is no.

The Nebraska FairTax avoids this problem by offering a monthly “Prebate” (a check in the mail) to all eligible households (legal citizens). For 2013, this means that a family of four, with two children, would receive about \$181 per month by check, electronic deposit, or on a cash card. The purpose of the prebate is to ensure that each Nebraska family unit (as determined yearly by the U.S. Department of Health & Human Services) can consume essential goods and services tax-free up to poverty-level spending. This has the overall effect of making the Nebraska FairTax progressive in application and especially beneficial for poor and middle class families.

As an example, for a single person this year the annual poverty spending level is \$11,490. In order to allow this individual to purchase essential goods and services tax free - up to the poverty level – under the Nebraska FairTax the individual would receive a monthly “Prebate” or “tax rebate” of \$67 per month. Taking into account the (Prebate) a check in the mail at the beginning of the month on the amount of FairTax figured on (poverty level spending) the consumer has not effectively paid any tax on spending up to (poverty level spending). It should be noted, however, that each individual determines what, where, and when they consume new goods and services.

## **Business Purchases**

The proposed Nebraska Fair Tax does not apply to business-related purchases or business inputs. Those agricultural chemicals, machinery, and seeds that L.B. 405 was seeking to tax are part of the production process of food or other goods, so they are not taxed under this plan. Using the farm example, the first instance of taxes that a farm product incurs is at the final, retail level when the consumer buys a package of bacon or a box of Corn Flakes.

The proposed Nebraska Fair Tax has numerous other advantages including Nebraska income taxes no longer being hidden in the cost of the goods and services that we buy. Whether you realize it or not, all goods or services that we purchase include a hidden portion of the costs that covers the producer's federal corporate taxes, payroll taxes (Social Security and Medicare), plus Nebraska state income taxes.

By removing these hidden taxes, the prices of our goods and services should drop. This would make Nebraska even more competitive with “no state income tax” states like Wyoming, South Dakota, and Texas. Under the proposed Nebraska Fair Tax, prices should go down, which will drive business *into* our state rather than fleeing out of it. Equally important, Nebraskans will have more money to spend and save, and overall we will see an economic boom occur in our state.

## **Compliance**

The proposed Nebraska Fair Tax simply requires taxpayers to go to the cash register and pay for their new goods and services – just like they do today. This drastically reduces the number of taxpayers that the Revenue Department must monitor.

Finally, the proposed Nebraska Fair Tax is revenue-neutral. As demonstrated on the next page, the Nebraska Fair Tax would collect about the same amount of revenue that we do today from our current state income tax system. It has been repeatedly documented that sales taxes are generally considered a more stable base of revenue than income taxes. This is most likely due to the regular course of the economic cycle, which causes both personal income and business income to fluctuate, thus resulting in a constantly changing tax base for income taxes. On the other hand, *everyone* has at least a minimum, unchanging value of purchases that they will reliably make each and every year: groceries, lattes, a new car, and other household goods. This stable, reliable stream of purchases (in regards to sales taxes) consequently results in a stable, reliable stream of sales tax revenue, as it would under this proposal.

## Rate Calculations

When approaching the issue of tax reform in the state of Nebraska, my answer is obviously a plan modeled after the national FairTax® Plan. However, what rate would be needed for our state in order to collect the same amount of revenue that the current income tax system does? Would we need to keep our current 7% sales tax rate or could we adopt a rate even lower than that?

To answer these questions, I first had to determine what effect a Nebraska Fair Tax bill would have on our state. I made two separate rate calculations and analyzed a third party's rate study; both of which serve to illustrate why I believe that the rate under this proposal should remain at about 7%.

The three analytical methods I used are:

1. Basic calculation using current Nebraska GDP and tax revenue figures.
2. Analysis of a study by The Beacon Hill Institute at Suffolk University.
3. My own calculation using the Beacon Hill methodology and the most recent figures for Nebraska.

First, as shown below for **CALCULATION #1**, total tax revenues under the proposed Nebraska Fair Tax plan would be equal to about 5.9% of Nebraska GDP:

### CALCULATION #1

## Enacting a Fair Tax in Nebraska

| Nebraska State-Level FairTax Rate Calculation<br>(Percentage of GDP method)   |   |
|---|---|
| <i>(Green figures in italics are calculated fields)</i>   |   |
| 89,600,000,000  | 2010 Nebraska GDP   |
| 30.00%  | Business consumption (estimated from 70% historical personal consumption) |
| <i>26,880,000,000</i>   | <i>Exempt Sales (estimated 30% business consumption)</i>                  |
| <i>89,600,000,000</i>   | <i>Total Sales of Goods &amp; Services</i>                                |
| <i>(26,880,000,000)</i>   | <i>Less: Business Consumption (exempt)</i>                                |
| <u><i>62,720,000,000</i></u>  | <u><i>FairTax Base</i></u>  |
| 2,064,233,000   | FY 06-30-2012 Income Tax Revenue  |
| <u>1,638,610,000</u>  | <u>FY 06-30-2012 Sales &amp; Use Tax Revenue</u>                          |
| <u><i>3,702,843,000</i></u>   | <u><i>Total Tax Revenue to Replace</i></u>                                |
| <br>  |   |
| <u><i>3,702,843,000</i></u>   | <i>Total Tax Revenue to Replace</i>                                       |
| <u><i>62,720,000,000</i></u>  | <i>Divided by: FairTax Base</i>   |
|   | = <b>5.90%</b> <i>Tax Revenues as a Percentage of FairTax Base</i>        |
| <p>* Note 1: 2010 GDP figures are used because they are lower than most recent 2011 GDP figures.<br/>           * Note 2: FYE 2012 Tax Revenue figures are used because they are higher than both FYE 2010 &amp; 2011 revenues.</p> |   |

This indicates that without a prebate payment feature, the rate could be set as low as about 6%. This is quite similar to our current state sales tax base rate of 5.5% (local sales taxes generally add another 1.5%) and below the total statewide sales tax rate of 7%.

For **CALCULATION #2**, I included an excerpt from a study conducted by the Beacon Hill Institute, which looked at a variety of factors for each state and determined what FairTax rate would be appropriate for that state. These rates are presented based on the following three assumptions:

1. **6.82%:** The proposed Nebraska Fair Tax bill mirrors the national FairTax® Plan (H.R. 25) and the Kansas bill (H.B. 2355). (i.e. all income-based taxes are repealed and prebates are paid).
2. **3.03%:** Nebraska keeps income and sales taxes; however, the sales tax is amended to apply to all items that would be taxable under the national Fair Tax® Plan (i.e. no exemptions except for business purchases and used goods). Additionally, prebates are paid.
3. **2.43%:** Same as #2 except that no prebates are paid.

### CALCULATION #2

| State           | Net FairTax Base with Prebate | Gross Revenues to be Replaced (RS) | Adjustment for GN (GN x ti) | Admin. Credit (AC) | Net Revenues to be Replaced (Sales, Income, Gift & Estate Tax) | Sales & Gross Receipts Tax Revenue | FairTax Tax-exclusive Replacement Rates |                              |                                     | Existing Sales Tax Rate |
|-----------------|-------------------------------|------------------------------------|-----------------------------|--------------------|--|------------------------------------|---|------------------------------|-------------------------------------|-------------------------|
|                 |                               |                                    |                             |                    |  |                                    | Sales, Income, Estate & Gift Taxes      | Sales & Gross Receipts Taxes | Sales & Gross Receipts (no prebate) |                         |
|                 | \$ millions                   | \$ millions                        | \$ millions                 | \$ millions        | \$ millions  | \$ millions                        | percent                                 | percent                      | percent                             | percent                 |
| Minnesota       | 191,721                       | 13,602                             | 1,243                       | 116                | 12,243   | 4,833                              | 6.82                                    | 1.90                         | 1.57                                | 6.50                    |
| Mississippi     | 62,361                        | 4,648                              | 524                         | 40                 | 4,084  | 2,960                              | 7.01                                    | 4.15                         | 3.07                                | 7.00                    |
| Missouri        | 163,188                       | 8,122                              | 874                         | 106                | 7,142  | 3,264                              | 4.58                                    | 1.45                         | 1.14                                | 4.23                    |
| Montana         | 22,257                        | 960                                | 210                         | 14                 | 736  | NA                                 | 3.42                                    | NA                           | NA                                  | NA                      |
| <b>Nebraska</b> | 55,369                        | 3,944                              | 375                         | 35                 | 3,534  | 1,992                              | <b>6.82</b>                             | <b>3.03</b>                  | <b>2.43</b>                         | 5.50                    |
| Nevada          | 80,101                        | 3,579                              | 387                         | 51                 | 3,141  | 3,458                              | 4.17                                    | 4.01                         | 3.25                                | 6.50                    |

To complete **CALCULATION #3**, I utilized the same methodology from the Beacon Hill Institute study, but substituted the 2007 figures in the report with the most current Nebraska-specific data as follows:

**CALCULATION #3**

| Nebraska State-Level FairTax Rate Calculation<br>(Beacon Hill Institute Methodology) |                         |                                  |                             |
|--|-------------------------|----------------------------------|-----------------------------|
| <i>(Green figures in italics are calculated fields)</i>                              |                         |                                  |                             |
| <b>Tax Revenue to be Replaced</b>  |                         |                                  |                             |
| Gross Tax Revenues   | 3,702,843,000           | FYE 2012-06-30                   |                             |
| Less: Earned Income Credits  | <i>(29,000,000)</i>     | 2010 Tax Expenditure Report      |                             |
| <i>Total Tax Revenue to be Replaced</i>  | <i>3,673,843,000</i>    |                                  |                             |
| Less: Revenue Department Savings   | -                       | ?                                |                             |
| <i>Adjusted Tax Revenues to be Raised</i>  | <i>3,673,843,000</i>    |                                  |                             |
| <b>Adjusted Tax Base Components (Inclusive of Tax)</b>                               |                         |                                  |                             |
| Personal Consumption, Adjusted for Admin. Fee  | 56,976,486,000          | 99.5% of GDP less Govt. Spending |                             |
| State/Local Govt. Consumption, Adjusted for Admin. Fee                               | 12,306,576,000          | 99.6% of Govt. GDP Spending      |                             |
| Less: Revenue Department Savings Adjustment  | -                       | 0.16% of Dept. Savings?          |                             |
| Less: Prebate Base   | <i>(16,844,800,000)</i> |                                  |                             |
| <i>Adjusted Tax Base</i>   | <i>52,438,262,000</i>   |                                  |                             |
| <br>   |                         |                                  |                             |
| Adjusted Tax Revenues to be Raised   | <i>3,673,843,000</i>    | =                                | <b>7.01% Inclusive Rate</b> |
| Adjusted Tax Base  | <i>52,438,262,000</i>   |                                  |                             |
| <br>   |                         |                                  |                             |
| Adjusted Tax Revenues to be Raised   | <i>3,673,843,000</i>    | =                                | <b>7.53% Exclusive Rate</b> |
| Adjusted Tax Base less Adjusted Tax Revenues to be Raised                            | <i>48,764,419,000</i>   |                                  |                             |

You will notice question marks in two parts of the chart. Even the above rate calculation of 7% does not include the estimated costs savings achieved by the Nebraska Department of Revenue that would result from the abolishment of state income taxes, the reduction in the number of monitored taxpayers, and the assumed budget reductions that the department would now be able to enact. Even based on that lack of clarifying data, it seems clear to me that **a Nebraska Fair Tax would be revenue-neutral at a rate of approximately 6.8% to 7%.**

**Enacting a Fair Tax in Nebraska**

It should be evident that if a bill similar to the national FairTax® Plan (H.R. 25) were to be replicated at the state level in Nebraska, such a plan could accomplish all of the intended goals of L.B. 405 (the repeal of all income taxes), and some of the goals of L.B. 406 (repeal of corporate income taxes). It would also avoid the small, but critical missteps of those bills. Specifically, one rate would be applied to all Nebraskans equally, business purchases and production inputs would be exempt from tax, and the regressivity of the tax on lower-income Nebraskans could be avoided by pre-refunding all taxes up to the poverty level through use of a “Prebate”.

Is it really possible to enact something like this in Nebraska and achieve Governor Heineman’s goal of comprehensive tax reform? As I found out while conducting my research the answer is a resounding yes! In fact (as previously mentioned), Kansas has already introduced a similar bill in their House of Representatives. As I have spent time in the capitol this year educating our state representatives about the national FairTax® Plan, one of the things I frequently hear is that a consumption tax just isn’t politically feasible; it’s a great idea but the voters will never support it and the legislature will never pass it. I submit that once you fully understand the FairTax® plan and the economic benefits that would flow from it to the taxpayers and to our great state of Nebraska, those concerns become a moot point.



## Enacting a Fair Tax in Nebraska

After reading my report I hope you will embark on a journey to learn about and embrace a Fair Tax plan for our state. Every friend, family member, and acquaintance I have talked to about the FairTax® has been intrigued by the idea: no longer having to worry about filing a federal tax return or Nebraska 1040N, and no more Nebraska taxes withheld from your paycheck!.

As I have shown in this report, a Nebraska Fair Tax would very likely be acceptable to Nebraskans (i.e. politically palatable), could remove our need for any type of state income taxes, would generate the same amount of revenue as our current income tax system, and would completely remove the tax compliance burden currently on individuals and drastically reduce the burden imposed on businesses; all with a tax rate similar to our current sales tax rate. More importantly, if a 7% tax rate collects too much revenue, then another tax cut bill to reduce the rate can easily be introduced and quickly passed; something that would be highly agreeable to Nebraskans.

Finally, Nebraska has been collecting sales taxes for years; we already have the infrastructure in place to do this and do it well. All that is missing from the equation to enable us to completely repeal our state income tax system is the Nebraska Fair Tax bill, the support of all Nebraskans, and the will of our elected representatives. The people want tax reform – do those who represent them?

For these reasons, I respectfully request that you consider the proposed Nebraska Fair Tax plan as your best option for comprehensive tax reform. Economic freedom, equality, and simplicity: that's the FairTax®, done the Nebraska way.