Tax Reform in Nevada: Ideas for Creating a More Stable Revenue Structure

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Tax Reform in Nevada

Ideas for Creating a More Stable Revenue Structure

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Abstract:

Recurring and fluctuating levels of economic activity known as the business cycle have a profound impact on state legislators trying to balance their finances. They result in higher unemployment, declines in revenues and a corresponding increase in the need for social welfare and public services. This makes state budgeting particularly complex during times of contraction when the state needs to do more with less. Nevada, with its limited tax base, biennial budget making, and overreliance on an industry that is highly volatile in response to economic fluctuations, experiences particularly dramatic upswings and shortfalls. Contractionary fiscal policies such as tax increases and spending cuts can slow economic recovery but are unavoidable in order to balance the budget during times of recession.

This policy brief will contend that Nevada needs to reform its revenue structure in order to better stabilize budgetary volatility in response to the business cycle and more effectively reflect the 21st-century economy. While tax reform is an issue that is revisited regularly by Nevada lawmakers with each legislative session and promises on the campaign trail, little actual progress is made because of Constitutional obstacles, special interests, lack of political will because the risk of reprimand at the ballot or poorly implemented political strategy. This brief will identify the historical and recurring barriers to tax reform in Nevada as well as list four recommendations for creating a broader, fairer and more stable tax structure including closing loopholes, diversifying and broadening the base, reflecting contemporary consumption habits, and tapping into Nevada’s unique opportunity to create a recession-proof revenue stream. Finally, it will provide a possible roadmap for how these policy changes can more effectively become a reality. The ideas discussed here are by no means comprehensive as there are a myriad of further reform possibilities, particular in regard to the relation of county and municipal taxes.
Barriers to Entry:

The idea of tax reform in Nevada is one that has been revisited countless times in its history and either fails in the face of significant obstacles or becomes so muddied by the process that the resulting solution is sometimes worse than the affliction itself. The subject is a regular rhetorical campaign fixture, and at times even advocated for by the gaming industry, the mining industry, the Retail Association, various Chambers of Commerce and other industries within the state as well as progressive activists. Governors Bob Miller (Democrat) and Kenny Guinn (Republican) advocated for different tax reforms while leadership of each legislative session regularly introduce some form of tax reform proposal. An amendment to Nevada’s constitution that now requires a 2/3rds vote from both houses of the Nevada legislature to increase taxes, electoral backlash of the Guinn tax reforms in 2003 coupled with a surge of limited-government sentiment amongst voters in 2010 and a historically reluctant popular will for tax increases in Nevada has resulted in elected officials being hesitant to aggressively push for any sort of tax reform unless it is passing the responsibility along to another level of government including raising the gas tax for infrastructure projects and sales tax increase for more cops or school construction, the latter two of which were only later to be killed by reluctant county representatives.

Taxes of any kind can impact the economy in a variety of ways and some are more efficient than others. Most people or industries are typically resistant to a tax that they perceive that they will be subject to or in disproportionate burden than other individuals or industries. Low income voters are likely to oppose sales taxes which are seen as regressive whereas some business leaders see sales or in the rarer case, payroll, taxes as the fairest way to apportion the burden of taxation. Individuals are more likely to support a perceived or unintended pass-
through tax on businesses rather than agree to a direct tax on themselves. Businesses subject to an industry-specific tax are more likely to advocate for a broad based business tax in place of the existing burden that falls disproportionately on their industry. Many economists will agree that the fairest tax and least damaging through manipulation of the economy, is one that is as broad and low as possible. With so many competing interests, it is hard to build the political consensus around any one tax proposal nor deny the risks associated with a governmental body re-allocation of burdens from one part of an economy to another.

Despite wide agreement amongst a diverse and otherwise contentious array of players that Nevada needs a more stable revenue structure, and the self-preservation motivation factors delaying consensus around what that reform should entail and who it should impact, there are a multitude of barriers that further hinder the policy process of arriving at a reasonable conclusion.

Motivated by self-preservation and protection, various special interests have engaged in rent-seeking and similar behavior, establishing several barriers to reform. Major industries within Nevada employ a substantial number of professional lobbyists whose quantity and quality are often commiserate to their size and influence on the state’s economy. This not only discourages proposals that they may perceive as overly-burdening their clients but also ensures that the dominant players preserve their hegemony over smaller interest groups that are have less capital to expend upon informing elected officials of their need or the impact of various reform proposals have upon those that they represent.

Another barrier to reform is political will. The 2003 legislative session became an entrenched battleground for tax reform that yielded minimally effective results other than a political backlash as voters punished several legislators with early retirement who had compromised on supporting the final reform package. The fear of a similar or greater backlash
by a population largely hesitant of net tax increases has made many lawmakers on either side of
the aisle wary about championing aggressive tax reform legislation and even reluctant to often
address the topic at all. Despite many of the most powerful interests in the state coalescing
around a 2011 proposal that would’ve created a Texas-modeled margins and services tax, many
of Nevada’s political leaders and most vocal representatives had been elected or re-elected
during the 2010 election cycle which saw the ascendency of the national Tea Party Movement
which was particularly opposed to perceived excesses of government spending and resolute in its
stance that all taxes of any kind were off the table. With a Governor towing a hard line against
any new tax increases, and supporters of tax reform not having enough time to produce a
supermajority to pass a bill and overcome a potential veto, the proposal was dead on arrival.
Nevada Assembly leadership proposed an Entertainment and Admissions’ Tax that could
potentially fare better politically than a broader services-tax package, but the resistance among
many against new taxes endured. Exhausted with the process, teachers introduced a modified
version of the margins tax proposal as a ballot initiative for the 2014 election. With much of
organized labor and the business community actively united against it, there is once again little
political will to champion the issue.

Perhaps the biggest obstacle, however, is the Constitution of the State of Nevada itself.
Article 10 explicitly prohibits the taxing of inheritances or personal and business incomes. This
has made various reform proposals regarding implementation of a broad-based business tax
particularly complex as supporters have had to navigate potential legal challenges and ensure the
constitutionality of how such taxes would be implemented. An amendment to the Constitution in
1996 now requires a two-thirds majority vote of the legislature for “any public revenue in any
form, including but not limited to taxes, fees, assessments and rates, or changes in the
computation bases for taxes, fees, assessments and rates[,]” dramatically limiting the flexibility of the legislature to impact revenues of any kind (Nevada Constitution Article IV, Section 18(2) n.d.). Any discussion of tax reform in Nevada must address the limitations of the process along with the proposed solution.

Closing the Gaps:

Tax loopholes emerge as a result of special-interest advocacy, protection of critical or developing industries, or genuine attempts at incentivizing economic development in target areas. In practice, however, they are not always the return on investment that they may have been intended to be and their cost in terms of lost revenues that could be reinvested into critical infrastructure or necessary services are often greater than their benefit.

An example of questionable exemptions in current Nevada law are large, outdoor events such as the Las Vegas Motor Speedway, the Electric Daisy Carnival (EDC), and Burning Man. These are large outdoor entertainment events that are not subject to the Live Entertainment Tax (LET) like most indoor performances in both large and small venues are. Meanwhile, NASCAR generated $240 million in non-gaming revenue in 2012 and EDC brought $207 million in to Clark County while only returning $13.1 million in state and local tax revenue. UFC Events generated $77 million sales receipts and only $3.3 million in state and local taxes. Nightclubs are also not subject to the LET while Las Vegas is home to eight of the top ten grossing nightclubs in the U.S. (Applied Analysis 2013). When a consumer is already willing and able to pay hundreds of dollars for a single night of significantly higher-than-average-priced drinks and entertainment, sacrificing a little more to the benefit of the community and compensating for the infrastructure that brought them there is neither cost-prohibitive nor will drive the entertainment
industry out of Las Vegas. It would also reflect the evolving makeup of Nevada’s tourism industry as gaming revenues decline and Las Vegas seeks to expand its branding as the Entertainment Capital of the World.

The 2013 Legislature created an interim study to examine the effectiveness of existing tax breaks. The results will certainly reveal winners and losers but in the age of austerity, it is time for the state government to end costly tax breaks that are not yielding the return on investment that many may have once hoped.

**Diversifying the Tax Structure:**

While proponents argue that sales taxes are a more stable way to generate revenue, relying too heavily upon them or any one specific industry is not the solution either. Industry-specific taxes should be avoided unless they capture an industry-specific market failure that could be properly addressed through pricing the negative externality. Economists will argue for broad, low taxation while investors will contend that diversifying one’s portfolio is a smart and secure investment. Nevertheless, Sales and Use Taxes made up 32% of Nevada’s 2011-2013 biennial general fund tax revenues while industry-specific Gaming Taxes made up for another 26% of revenues (Applied Analysis February). Furthermore, Nevada’s economy is diversifying away from tourism, and the number of visitors to Nevada has been in decline for a decade as increasingly new gaming markets open up around the world.

Any new or additional tax increases require a supermajority in the legislature and income taxes and corporate income taxes, by extension, are completely off of the table. In their place, bitter and protracted legislative and electoral fights have resulted in a payroll tax, the Modified Business Tax (MBT), that directly disincentivizes hiring and paying higher wages, and a ballot
initiative for a margins tax which is overly-complex for accounting procedures and penalizes businesses regardless of their profitability or ability to pay. The state government must be able to explore and implement a broad-based business tax that is fair, responsible, effective, stable, and doesn’t overly-burden industries that are employee-intensive or genuinely cannot afford to pay but the legislative process, as it exists currently, does not allow them to have a comprehensive strategy for revenue diversification. The state legislature should remove these obstacles and have a serious conversation about how Nevada can broaden and diversify its tax base so that it is not exclusively dependent on any one part of the economy.

Recognizing 21st-Century Consumer Habits:

Nevada, along with its county and municipal sales taxes, imposes one of the highest sales taxes in the country on goods, regressively burdening families and small businesses who can least afford to pay. Simultaneously, services, which have dramatically grown to supplant goods and now represent over 67.2% of the state’s economy are nearly entirely tax free (Applied Analysis February). Concurrently, Nevada’s taxable retail sales declined by 18% between Fiscal Year 2006 and Fiscal Year 2011 (Applied Analysis February). As the goods-based sector of the consumption-based economy narrows, so does the tax base and the need to expand it increases. An overwhelming $87 billion of Nevada’s economy is not currently subject to Nevada’s sales and use tax. By broadening it to reflect the modern service-based economy, the burden on retailers can be lowered along with the existing tax rate making it more marketable to recruiting outside businesses. The 2013 legislature attempted to do this by including forms of services and entertainment that were largely discretionary, but narrowing the focus on a limited number of
services and industries is poor fiscal policy and easy political fodder. A broad-based sales tax plan that exempts critical services coupled with lowering existing taxes is the best approach both economically and politically.

Moreover, the proliferation and availability of online retail has created essentially a duty-free black market where any consumer can bypass a Nevada brick-and-mortar business to purchase goods from out-of-state online retailers without providing any revenue to Nevada. Growth rates in the number of e-commerce sales have rapidly outpaced their standard retail counterparts. Nevada has implemented the option to pay sales on online purchases at the consumer’s discretion but any rational actor may presume that their best benefit on the surface is to negate the tax and make their purchase tax-free. Alternatively, many may fail to pay the tax out of ignorance of its existence or purpose. This leads to window-shopping in conventional Nevada stores only to lose their business to an online marketplace with an unfair competitive advantage. The absence of a sales tax on goods purchased online harms Nevada retailers and the jobs they create and escalates the need for our higher-than-average sales tax disproportionately burdening a narrowing sector of the economy.

The realization of capturing the growing e-commerce market hinders upon the action of the federal government. Based upon rulings by the Supreme Court cases National Bellas Hess v. Illinois Department of Revenue and Quill v. North Dakota, it is in Congress’ hands to grant states the authority to compel online retailers to collect sales tax at the time of transaction as retailers do. With the division and gridlock in an increasingly polarized Washington as it is, Nevada may be forced to seek other options to correct this issue. Recently, in absence of progress on the issue in Congress, major online retailers like Amazon have agreed to proactively administer and pay the tax to the state regardless (Vogel 2013).
Creating a Recession-Proof Revenue Stream:

Nevada’s two largest industries are gaming and mining with gaming picking up a substantially disproportionate share of carrying the state’s tax burden while mining enjoys a Constitutionally-protected minimal tax rate. Gaming does particularly well when times are good and poorly when times are bad; concurrently, mining fares better during periods of recession as apprehensive investors seek out more secure portfolios of gold and silver. While gaming-related tourism in Nevada has continued to decline, natural resources and mining have grown 379.5% in terms of Nevada GDP growth over the past ten years (Applied Analysis 2013). Since Nevada produces 75.3% of the gold production in the U.S. and maintains a substantial gaming and hospitality sector, equalizing the burden between the two industries may create a stable revenue stream through business cycle fluctuations that soften the blow of economic downturns on state budget-making. Moreover, mining, by its very nature, is an extractive institution that removes mineral wealth from the state without appropriately benefiting the long-term economy for the loss of its mineral wealth.

State lawmakers from both parties have recognized this potential and have initiated the process of removing mining’s Constitutionally-protected status, allowing them the ability to increase the state’s Net Proceeds on Mining Tax beyond its current limit of 5%. Nevada voters will vote on the measure in 2014. Increasing the Net Proceeds on Mining Tax, however, would also impact mining that does not uniquely strive during depressed economic climates, as well as other emerging Nevada industries such as oil, natural gas and geothermal energy generation. An alternative proposal may be to look at other Pigovian type revenue models and attempt to price the externality of gold and silver mining’s impact on the local environment or loss of its mineral wealth.
A Way Forward?

Rigid Constitutional mandates requiring state lawmakers to produce a balanced budget while simultaneously limiting their ability by taking certain tax options and industries off the table and making others practically infeasible by requiring a supermajority does not allow them the freedom for responsible budgeting and fiscal policy-making. The result is a divided state government developing piecemeal short-term fixes that create a heavier burden on businesses and citizens because of volatile and unpredictable consistency in fees, regulations and availability of public services.

The state legislature needs to reform and remove overbearing restrictions on the budget-making process, be willing to put all options on, and welcome all players to, the table, to build a consensus around long-term meaningful reform that represents Nevada’s modern demography and economy.

Taxpayers need to know what they’re paying for. State legislators should have specific proposals that they wish to fund, their anticipated economic impact, and quantify how much each investment will cost before talking about efforts to raise revenue.

State lawmakers advocating for tax reform need to better control their messaging. Tax reform should always be approached with the consideration that all taxes have some form of an affect on the economy so investment decisions need to be carefully vetted for their effectiveness and the tax reforms that are ultimately adopted need to marginalize their impact their economy by diversifying revenue streams and keeping them as low as possible so as to not inhibit one industry over another. Successively, the long-term return on investment of the new revenues should be spelled out clearly for both the legislature and the public so they know what they’re getting and what the true cost-benefit analysis really is.
Finally, the discussion needs to begin on the first day of the session or in the preceding interim, instead of waiting until the final days of the 120-day session to roll out an inevitably doomed tax package without time for debate and consensus building.

Recommendations:

**Tax Reform Solutions:**

1. End inefficient tax subsidies.
2. Diversify the tax base.
3. Broaden tax base to represent contemporary consumer habits.
4. Equalize burden between gaming and mining.

**How Do We Get There?**

1. Reform restrictions on budget-making process.
2. Specify and calculate specific spending proposals for funding.
3. Control messaging.
4. Start the conversation early.
Works Cited


"Nevada Constitution Article IV, Section 18(2)." http://www.leg.state.nv.us/const/nvconst.html.