TO: MEMBERS OF THE COMMITTEE ON REVENUE

FROM: BILL LOCK, RESEARCH ANALYST FOR THE COMMITTEE

RE: EXECUTIVE SUMMARY: NEBRASKA SALES TAX -
LR 161, Cornett/ An examination of the Nebraska Sales Tax
LR 166, Dierks/ Interim study to conduct a comprehensive review of state and local taxes in Nebraska
LR 97, Pahls/ Interim study to examine the major sources of state and local tax revenues

DATE: DECEMBER 1, 2009

Nebraska's sales tax was originally established by passage of three separate bills in the 1967 Legislature. That tax focused on the final sale, at retail price, of any item of tangible personal property or goods. Sales of certain services were specifically made subject to tax by law. Goods, or tangible products, were automatically subject to tax unless exempted by law. Services sold to the final consumer are not taxed unless specifically mentioned in the sales tax law. This structure is similar to that used in most of the other 45 states that have a retail sales and use tax. Nebraska was one of the last states to implement a sales tax, and its original structure appears to be the result of implementing what was well established policy in other states. Nebraska's sales tax contains the same exemptions and structure as most other states.

One prominent sales tax expert has described the ideal sales tax in these terms: "The guide for such an ideal retail sales tax is straightforward: The retail sales tax should apply to all expenditures for personal consumption purposes but not to any transactions involving use in a business activity. This guide, coupled with an effort to maintain uniformity, neutrality and reasonable cost of collection, provides the standard against which the state sales tax structures would be gauged." John Mikesell, page 132, State Tax Notes, January 10, 2005. Mikesell suggests that Nebraska's sales tax structure contains fewer exemptions for business inputs than this ideal. His review ranks Nebraska less than ideal on this structure because in 2004 Nebraska had a higher than average state sales tax rate. It appears Nebraska maintains an above average state sales tax rate (5.5 percent) at this time.

The Syracuse Tax Study, done for the Nebraska Legislature in 1987, stated that the sales tax exemptions found in Nebraska's law were "largely justifiable". Two exemptions suggested for repeal by the Syracuse study were the exemption of food items, and the trade-in value exemption for motor vehicles. That study recommended Nebraska add exemptions of manufacturing equipment and agricultural machinery. The manufacturing and agricultural machinery exemptions were later passed. Nebraska policymakers have not repealed the food sales tax exemption because of concerns about equity for low income households. This same policy of food purchase exemption is followed in 32 of the 45 states using the sales tax. The automobile trade in value exemption has been continued.

In recent years, the "Burling Tax Study Commission" suggested an expansion of the sales tax base which would generate an additional $750 million of sales tax revenue. That expansion would have involved repeal of the food sales tax exemption. Repeal of this exemption would result in increase of approximately $150 million in state taxes, or less, if accompanied by some refund of food sales tax to low income households. The Burling Commission appeared to recognize that some food purchases would remain exempt as part of enforcement of federal law on funding for the food stamp program. Also recommended was an expansion to tax all services, except medical, which is estimated to raise approximately $450 million. After these two policy changes, the $750 million expansion figure could be met by repeal of $150 million or $180 million of other exemptions, depending on the size of the food sales tax refund to be offered. The Burling Commission made no specific recommendations for repealing exemptions beyond the food sales tax exemption. They did recommend a review of all exemptions be done. The Burling Commission provided no policy principles for guidance on those deserving repeal. To date, the Legislature has not implemented any of these recommendations.

Our review of Nebraska's sales tax exemptions and taxable services suggests that the Nebraska sales tax law and structure is like that found in other states, including the structural exemptions granted on sales of intermediate goods and business to business sales. One published national review suggests that Nebraska exempts fewer business purchases than most states. Nebraska is like other states in its exemptions for medicine and medical goods. Exempting food is common among the states using the tax. It appears that even in those states where food remains taxable, the state policy is to lower the rate or grant a refund to low income households. Motor fuel is subject to sales tax in few states, but not in most, a policy Nebraska shares with the majority of states.

In general, Nebraska's sales tax base appears broader than many states. Nebraska taxes numerically more services than most states. Nebraska appears to tax energy purchases by households and business users more broadly than some border states.

No unusual exemptions have been identified by past tax studies and in the course of our review. It appears Nebraska may grant fewer business input exemptions and greater exemptions to households and consumers than several of its border states.

The Syracuse tax study summed up their 1987 review of Nebraska sales tax structure with this statement: "The Nebraska state-local sales and use tax system, as it currently stands, is a relatively satisfactory tax in many respects. Nebraska, as one of the last states to introduce a sales tax, benefited from the experience of other states and avoided some of the major complications and other undesirable features found in some states. "

Reviewing this same sales tax structure some twenty years later, and comparing it with other states, we concur with this assessment.

hTO: Members of the Committee on Revenue

FROM: Bill Lock, Research Analyst for the Committee on Revenue

RE: LR 161, Cornett/ An examination of the Nebraska Sales Tax
LR 166, Dierks/ Interim study to conduct a comprehensive review of state and local taxes in Nebraska
LR 97, Pahls/ Interim study to examine the major sources of state and local tax revenues

DATE: December 1, 2009

This report is published in response to LR 161 introduced by Senator Abbie Cornett, Chair, and the members of the Revenue Committee. The report is also intended to address issues raised by LR 166, introduced by Senator Cap Dierks, the Revenue Committee Vice Chair, and the sales tax issues raised in LR 97, introduced by Senator Richard Pahls. A copy of each resolution is found in Appendix A of this report. Each of these resolutions calls for an examination of the sales tax. LR 97 calls for a much broader examination of the state's tax system.

The report begins by examining the structure of the current Nebraska sales and use tax. The sales and use tax code or statutes are primarily found in Nebraska Revised Reissued Statutes, Sections 77-2701 through 77-2713. This current sales tax code is compared to the sales tax code or base originally passed in 1967 by the Nebraska Legislature. In describing the original 1967 sales tax law, we have examined the transactions or activities taxed, and those that were exempted or not taxed in that legislation.

Current Sales Tax Structure in Nebraska

Shown below is a recently published description of the Nebraska sales tax found in the 2006 Annual Report of the Nebraska Department of Revenue.

"*Nebraska sales tax is imposed upon the gross receipts from all sales, leases, or rentals of tangible personal property made at retail in this state and upon the gross receipts of selected services; gross receipts of every person engaged as a public utility or as a community antenna television service operator; the gross receipts from the sale of admissions in the state; the gross receipts of persons selling, leasing, or otherwise providing intellectual or entertainment property; and the gross receipts from the sale of warranties, guarantees, service agreements, or maintenance agreements when the items covered are subject to tax. Property is defined as all tangible and intangible property that is subject to tax in the above paragraph.*

All gross receipts from the sale of the items listed above are subject to tax unless an exemption is specified by law. Sales tax exemptions are generally based upon the nature of the seller, the nature of the property sold, the nature of the purchaser, or the purchaser's intended use of the product.

The sales tax was established by the Nebraska Revenue Act of 1967. From 1970 to 1983, the sales tax rate was determined each year by the State Board of Equalization and Assessment. Beginning in 1984, the Legislature set the tax rate. Currently, the state sales tax rate is five and one half percent.

Business and Individual Consumer's Use Tax

The use tax is a complement to the sales tax and is paid directly to the state by the consumer. The consumer may be a business or an individual. The tax is imposed on the storage, use, or consumption in this state of tangible personal property and certain taxable services when the appropriate sales tax has not been paid. Examples of purchases that may be subject to consumer's use tax include items purchased from an out-of-state vendor, and inventory items purchased for resale that are withdrawn from inventory for personal or business use.

Retailer's Use Tax

The retailer's use tax is a component of the state sales and use tax. Out-of-state retailers who do not have sufficient business contact with Nebraska may voluntarily become licensed to collect the appropriate sales tax for their Nebraska customers. The tax applies to items delivered to a customer's home or business in Nebraska for storage, use, or consumption."
Page 33, 2006 Annual Report of the Nebraska Department of Revenue.

(See Appendix B of this report for a copy of Nebraska Department of Revenue's Regulations 1-001 and 1-002 outlining the nature of the sales tax and the consumers use tax.)

In this brief description shown above the Department focuses on the basic structure of the sales tax. This structure, originally established by passage of three separate bills in the 1967 Legislature, can be described as focusing on the final sale at retail of any item of tangible personal property or goods. Sales of certain services were specifically made subject to tax by passage of a law making them subject to tax. Goods, or tangible products, are automatically subject to tax, unless exempted by law. Services sold to the final consumer are not taxed unless specifically mentioned in the sales tax law.

Prior to passing the 1967 Sales Tax Act, the Legislature had commissioned a study to examine Nebraska's tax system. A portion of that study focused on the design of a retail sales tax. This study was done by Harold F. McClelland of Claremont College. It was commissioned and published in 1962 by the Committee on Taxation of the Nebraska Legislative Council. McClelland made suggestions and recommendations for structuring the sales tax in Nebraska. Many of these recommendations appear to have been followed in writing the 1967 act. McClelland's report recommended the use of what are called the sale for resale and component parts exemptions. He also recommended other business to business sales or business inputs as exemptions. This was to be done in order to avoid the imposition of a tax on several transactions before taxing the final consumption and purchase. This practice was followed in other states which had implemented a retail sales tax. The following quote taken from McClelland report explains why this is recommended.

"But the general rule is to levy equally on all goods and services purchased by consumers. Commodities sold other than for final consumption — that is, goods sold in the production and marketing process which will be sold again later — should be exempt. For example, a tax levied on textiles when they are sold to the manufacturer, levied again when the finished suit of clothes is sold again to the retailer, and levied still again when the retailer sells it to the consumer, involves multiple taxation on the consumption of that suit of clothes. To avoid taxing some consumer commodities more than others, every attempt must be made to levy only on final sales to consumers.", page 429, State and Local Finance, A Report of the Nebraska Legislative Council Committee on Taxation, November, 1962.

The Nebraska Department of Revenue is required by law to issue an annual report on the structure of the sales tax and the cost of sales tax exemptions each year. (Required by Sections 77-379 through 77-385, the Tax Expenditure Reporting Act.) That law requires analysis of each major type of tax used in Nebraska, exemptions, and costs of the exemptions. This provides an annual examination of the cost of various provisions of tax law. Untaxed items are not quantified and examined, so the cost of untaxed services is generally not reported. However, in the 2002 version of the Tax Expenditure Report, the Department did identify the potential yield from taxing many services. More recent versions of the report do not contain this analysis.

Each exemption found in the law is identified in this annual report and costs are estimated for these specific statutory exemptions. This analysis includes examining and reporting on the cost of the original exemptions found in the act, including those we would describe as part of the structure of the retail sales tax. These "structural" exemptions include sales for resale exemptions and component parts exemptions which were part of the 1967 sales tax law, and are found in all the states using a retail sales tax structure. Exemptions for many other business inputs originally found in the Nebraska sales tax code are described and quantified in that report. The structural exemptions originally granted in 1967, and found in almost other states which use a "retail sales" tax, account for over 75 percent of the quantified dollar amount of exemptions reported in 2008.

That the tax is focused on the final consumption or use of the good or service is one of the basic "structural" principles of the tax. The original 1967 law passed by the Legislature was written in such a way as to eliminate or reduce pyramiding of the tax through the economy, by making the intermediate purchases exempt from taxation. This is done first and primarily through the sale for resale exemption sections of the original act. This language is currently found in Section 77-2701.16 and 77-2701.34. In terms of structure of exemptions, this most basic sales tax exemption is granted because the purchaser intends to resell the item at retail. This exemption is part of the structure of a tax which the 1967 Legislature designed to focus on the final consumption of a good or service. The cost of this exemption is $1.6 billion per year. This is the single largest dollar value tax exemption granted under the law. This exemption and tax policy were found in the 1967 sales tax law passed. These same structural exemptions were found in the majority of states which had already implemented a "retail sales" tax.

The transaction which is exempt under sales for resale can be described using this example. A retailer purchasing 100 washing machines from a wholesale warehouse or manufacturer would obtain a sale for resale exemption permit and pay no sales tax on the 100 washing machines purchased. The retailer would sell these tangible personal products at retail and collect the retail sales tax from the final purchaser and consumer of the product. Focusing the tax liability on the final purchaser avoids pyramiding tax burdens through the economy, which if done would hide the actual total tax burden imposed. This assumes that each transaction and its sales taxes were passed along as costs to the final purchaser. States which use the "retail sales" tax all have a sale for resale exemption to avoid this result. The 1967 legislation which created our retail sales tax contained this language. The current law retains this structural principle.

The second largest dollar value exemption quantified by the tax expenditure report is the ingredient or component parts exemption. An example of this policy is sheet metal purchased to construct a washing machine. The manufacturer is not required to pay the retail sales tax on the metal purchased if it becomes a component part of the washing machine which will be sold to the final consumer. This reflects the same economic or policy principle mentioned above, to avoid pyramiding the tax costs and hiding these costs in the final retail price which is subject to tax. The cost of this exemption is estimated at $800 million per year. The combination of these two structural exemptions, sale for resale and component parts, represent 55 percent of the total cost of exemptions found in the tax expenditure report for 2008.

Again, this exemption was found in the 1967 sales tax code passed by the Legislature, and is found in every state "retail sales tax" code used in the United States. Court decisions here and legislation passed have changed the view of what constitutes a component or ingredient over time, but the fundamental principle or policy of granting an exemption to avoid pyramiding in sales tax burdens remains the same.

An extension of this policy or structural principle is the exemption given to other business inputs that are not component parts or ingredients. Examples of this in Nebraska are exemptions granted to the sale of animal life whose products constitute food for human consumption. The inputs used to care and grow such animals are also exempted. In addition an exemption exists for agricultural chemicals and agents used in commercial agriculture, as well as seed and annual plants sold to commercial agriculture businesses. These exemptions were found in the 1967 sales tax law and remain in place today. These exemptions cost nearly $500 million in 2008.

Combining these three categories of exemptions into one total based on this same policy principle, we report here that approximately 75 percent of the total exemption amount reported in the 2008 tax expenditure report is based on this policy and creating this structure of the retail sales tax. When analyzed as part of the tax study done for the Legislature in 1987, this category, described as intermediate purchases, constituted over 82 percent of the tax amount exempted at that time. (Syracuse Tax Study, 1987.)

Other examples of this policy of exempting business inputs to avoid tax pyramiding are also found in Sections 77-2704.13(1) and 77-2704.13(2). This section of the current sales tax law exempts energy purchases of certain energy products when the energy is used directly in irrigation or farming, and when the energy is used directly in manufacturing, processing, or refining of property, or by any for profit or not for profit hospital. The exemption also applies to fuel purchased for use in the generation of electricity. The combined cost of these exemption categories is $227 million. While this exemption of energy inputs was found in the 1967 sales tax act, the exemption was actually broader in the 1967 law than that found in current law. The original 1967 sales tax legislation exempted any energy purchased by any type of business enterprise. The current law limits this exemption to a narrower range of business types. A narrowing of this exemption took place in the 1985 session of the Legislature, through LB 715. In that bill, the exemption for energy purchases was confined to manufacturing, processing, refineries, irrigation or farming. Hospitals and power generators retained the exemption as well. The same bill granted a refund for sales tax paid on certain newly acquired manufacturing equipment.

Railroad rolling stock or aircraft used by a common carrier were exempted in the 1967 sales tax code, just as they are today under the provisions of current statutes 77-2704.26 and 77-2704.27. This exemption is granted as recognition of the difficulty of administering and collecting a tax on items purchased by businesses engaged in interstate commerce. This exemption is estimated to cost $10 million annually. This policy recognizes that such businesses could easily avoid imposition of sales tax by purchasing the item in another state where no tax is charged.

Our estimate is that of the total of $4.4 billion of exempt sales which are quantified in the tax expenditure report, 75 percent of that amount is due to the policy adopted of avoiding pyramiding through exemption of intermediate transactions and business inputs. This leaves approximately $1.0 billion of taxable sales exemptions designed with some other policy rationale or principle in mind.

One of the other large exemptions granted in the current sales tax code include those for purchases by state and local governments. This exemption was found in the 1967 sales tax law, and has been broadened by adding more types of local governments since passage of that law. This exemption costs $233 million in 2008. The basis of this exemption is to prevent the taxpayers paying the cost of the retail sales tax, which would be paid from other tax dollars. Most other states do exempt governmental purchases from retail sales tax. The McClelland report cited here previously suggested that these purchases should be taxed, based on consistent taxation of consumption. However, that report also suggested that local governments sales tax paid might need to be refunded by the state, and federal government purchases would be exempt under U.S. Supreme Court rulings. In the 1967 sales tax code adopted by the Legislature, the purchases made by federal, state and local governments were all made exempt. Additional types of local governments have been added to the list of those exempt found in the 1967 Act.

An exemption was also granted to certain non profit organizations in the 1967 Act. These enumerated organizations were deemed worthy of an exemption because they provide services to the community or are established for religious purposes. Current law, Section 77-2704.12(1), describes these organizations. Similar provisions were found in the 1967 sales tax code. These provisions are applicable to private schools, private non profit health care institutions and organizations which provide social services. The cost of this exemption is $45 million annually. Similar exemptions are found in most states.

A third category of exemptions described here is the exemptions granted for household or final consumer purchases. The food sales tax exemption is the largest of these. Nebraska's food sales tax exemption structure is common among the states, 32 of the 45 states using the sales tax exempt food. Other states tax food at a lower rate, or grant a refund to low income households.

An exemption is provided for consumer's purchases of prescription drugs and other medical goods recommended by health care professionals. This exemption is provided for in Section 77-2704.09(1). This exemption was part of the original 1967 sales tax code, and has expanded since then, based on the same policy principle. The basis of this exemption is an equity or hardship concern, recognizing the economic burden placed on taxpayers by poor health. Based on recent data from the Federation of State Tax Administrators, we believe 39 states exempt prescription drugs from sales taxation. This exemption is estimated to cost the State of Nebraska $63 million in 2008.

An exemption granted to consumers of automobiles in the original 1967 Sales Tax Act is currently found in Section 77-2701.35 (3) (d) (ii). This exemption is granted for the trade in value of an automobile or motorboat, when taken in trade for the sale of another motor vehicle or motorboat. This prevents the tax being imposed on the total sales price of the automobile. The taxable price is the sales price less the trade in value. The estimated cost of this automobile and boat tax exemption is $136 million annually.

In 1987 the Legislature authorized a tax study referred to as the Syracuse Tax Study. In that study, the authors suggested that there is no appropriate rationale for this trade in value exemption, and recommended its repeal. However, the 1965 McClelland report referenced earlier recommended this exemption. The basis was McClelland's view that the consumption value left in the car, as evidenced by the trade in value, should not be subject to tax twice. We found that most states grant such an exemption in our review of state sales taxes.

An exemption is granted in Nebraska law for consumer purchases of motor fuels used in motor vehicles. This exemption is found in 77-2704.05 of state law. The 1967 sales tax code granted this same treatment. The sale of motor fuels was in 1967 subject to an excise tax, based on cents per gallon. The basis for this exemption appears to be that a tax of another type, a cents per gallon tax, had already been imposed for a lengthy period and legislators did not wish to change policies. The McClelland report suggested that the sales tax be imposed on motor fuel in addition to an excise tax. The excise tax was viewed in this case as a benefits tax, with a specific goal of funding the extra benefits of a publicly available highway system funded through a motor fuel purchases tax. In this view, if the combined sales tax and the excise tax were viewed as excessively high, the sales tax should be imposed and the excise tax lowered. The 1967 Legislature did not adopt this policy. The Syracuse tax study also closely examined this same question but ultimately did not recommend imposing a sales tax on motor fuels. This exemption is currently estimated to cost $279 million annually. Nebraska has recently begun to develop a policy of an excise tax structure with a wholesale price modification.

Finally, we note that consumers or households who occasionally sell items normally subject to sales tax have been granted an exemption since 1967, and are today through the provisions of Section 77-2701.24(2) and 77-2704.48. The estimated loss from occasional sales is $1.77 million annually. A garage sale would be a typical example. Actions of the 2009 Legislature in LB 165 extend the same occasional sales principle to the consumers who use the internet to sell items infrequently. This exemption would apply to persons who are not selling items as a business or occupation. Those in the business of selling items over the internet as a regular business activity will remain subject to enforcement of the sales and use tax.

SUMMARY OF TANGIBLE PERSONAL PROPERTY EXEMPTIONS

Our review of the tangible personal property exemptions found in the current Nebraska sales tax code suggest that almost all were adopted at the time of passage of the original 1967 act by the Nebraska Legislature. The largest dollar amounts of exemptions are what we have described as "structural" features of a retail sales tax. The tax is designed to be imposed on final consumption of the taxable item. These exemptions in most cases are the same structural and historic tax policy choices used by other states to design and structure a tax on final consumption, or a retail sales and use tax. The main "structural" exemptions are sale for resale exemption, component parts and ingredients, and exemptions of business inputs. The exemption of business inputs is the area where changes have been made over time by some states, including Nebraska. Two examples mentioned here are the taxation of energy purchases and some types of business equipment. Exempting energy purchases by all businesses was the original policy, which has since been narrowed to only certain types of businesses. This policy of broadening or narrowing of energy purchases exemptions may be a policy which current legislators wish to reexamine, given the history of past legislatures' adoption of policies to limit this exemption, and broaden the base of the sales tax by doing so.

EXEMPTIONS ADDED SINCE THE PASSAGE OF THE 1967 SALES TAX CODE

The largest exemption added since the passage of the original sales tax code in 1967 is the exemption for food not intended for immediate consumption. (Restaurant food and food for immediate consumption remain subject to tax.) The 1967 sales tax legislation did not exempt food of any type from taxation. This exemption began in 1983. The tax was removed after 13 years of granting a food sales tax refund to taxpayers through provisions of the income tax code. At the time of exemption, it was estimated that over 60 percent of the yield from taxing food was being refunded through this provision. For the 2008 tax expenditure report, this food sales tax exemption has an estimated current cost of $147 million. We note that states that attempt to tax food broadly will face loss of certain federal funds, when that food is purchased with what are commonly referred to as food stamps or coupons. (Section 77-2704.56 of Nebraska law provides for this exemption.)

The vast majority of the 45 states that have a sales tax now have exempted food. Nebraska, however, borders three states, South Dakota, Kansas, and Missouri, which continue to tax food. Missouri taxes food at a reduced rate of the state sales tax. In addition, while Iowa exempts most food Nebraska exempts, Iowa began taxing items defined as candy and some drink beverages in 1985. Wyoming taxed food up through 2006, at which point they declared a two year sales tax holiday on food. In 2008 Wyoming joined the list of states which have repealed the tax on food. This policy choice was implemented during a time of state surpluses created by high energy tax revenues. Colorado's state sales tax exempts food, but local governments are allowed freedom to tax food, and some Colorado cities are reported as taxing grocery store food. In summary, Nebraska borders three states which tax a broad food base, and two which have broader taxation of food in certain places or for certain types of food exempt in Nebraska.

The basis for this Nebraska food exemption is an equity concern. The policy of exempting food for home consumption is viewed as reducing the burden of the sales tax on low income households, which spend a higher percentage of their income on food. Some states which continue to tax food for home consumption do provide a tax burden reduction by offering a refund to low income families and households. Data available from the Federation of State Tax Administrators suggests 32 states now exempt food from sales tax. This same source suggests that an additional nine states that continue to tax food tax it at a lower rate than other items. (Missouri is one of those states.) Four states appear to provide a refund or credit to households for taxes paid. This is limited to lower income households in those states. South Dakota is one of those states, as is Kansas. In summary, the vast majority of states using the sales tax now recognize the equity policy principle as justifying an exemption, reduced rates or refunds to low income households.

Another significant exemption added to the Nebraska sales tax law is the tax treatment of business equipment. In 1985, the passage of LB 715 allowed a refund of sales tax paid on certain manufacturing equipment, if the equipment was being used to produce a product not previously produced by that manufacturer. This bill also narrowed the energy exemption given to businesses, making more business energy purchases subject to tax, and subjected transportation charges to sales tax. It also resulted in the taxation of custom software. The policy changes combined to simultaneously narrow and broaden the sales tax base.

In 1987, the Nebraska Legislature adopted a jobs incentive act which allowed sales taxes paid on business purchases to be refunded if the company paying the tax was approved for tax incentives available for creating new jobs. (LB 775) The State of Nebraska's policy of granting sales tax refunds for items purchased by businesses only to businesses creating jobs under tax incentive laws continues at present.

In 1995, special order molds and dies for making parts were added to the list of exemptions. (See 77-2704.40.) This exemption expanded the definition of business inputs not subject to tax. Molds and dies were not viewed as component parts. The policy rationale invoked here is again avoiding the pyramiding of the sales tax cost through to the final price paid by the consumer, where it would again be subject to tax.

A recent exemption granted narrowing of the base is the exemption granted for the purchase of manufacturing equipment, found in 77-2704.22(1). This exemption was recommended in the previously cited 1987 Syracuse Tax Study, along with the repeal of sales tax on agricultural machinery. The agricultural machinery exemption was added in 1992. The manufacturing equipment exemption was adopted in the 2005 session of the Legislature. These exemptions follow the general policy of exempting business inputs in order to avoid pyramiding the sales tax through the economy and tax system. Nebraska's policy of granting sales tax refunds for items or equipment purchased by businesses creating jobs under tax incentive laws also continues to be found in law. This refund provision passed earlier reduced the fiscal loss impact of extending the sales tax exemption to all manufacturing equipment purchases. The current tax expenditure report estimates this NET cost at $17 million. This is an estimate of the net new sales tax dollars from repealing the exemption, given the ability of some companies to continue to get the sales tax refunds available under job creation tax incentives legislation. The actual cost of the exemption may be $45 million, according to one source.

The 2006 session of the Legislature exempted fine art when purchased by museums. (See Section 77-2704.56.) This exemption is reported as costing $62,500 in 2008.

An additional exemption for community based renewable energy facilities was also recently passed. (LB 367 of 2007 was the source of both these exemptions.)

In the 2008 session of the Legislature, the sales tax exemption mentioned earlier for non profit health care facilities was extended to assisted living facilities.

The 2009 session of the Legislature considered a large number of proposed tangible personal property exemptions, the most fiscally significant of which were not implemented. The energy exemption found in 77-27-2704.13 was expanded by adding two more fuel types to the list of those exempted for the list of businesses which are currently allowed an exemption (LB 9). Mineral oil used in dust suppression was also added to the list of exempted business inputs (also LB 9).

Also in the 2009 session, LB 420 would have extended the non profit hospital exemption found in Section 77-2704.12 to include health care clinics and other licensed facilities. This legislation was pulled back from the Governor's desk for reconsideration. It now awaits action in the 2010 session. The additional cost of this exemption is estimated at $1.8 million.

As mentioned above, sales tax exemptions or refunds have been granted as part of economic development incentive legislation by amending state laws in recent years. LB 775, passed originally in 1987, included refunds of sales tax paid by certain businesses creating jobs. The job creation targeted refund structure has been added to through the years. The most recent of these was the passage of LB 561 in 2009, a policy which increased the applicability of that exemption granted in LB 367 of 2007. This sales tax refund is for business organizations building new wind energy projects.

In summary, some narrowing of the sales tax base and reduction of taxes imposed on tangible personal property has occurred since 1967. Some expansion of the base also occurred, specifically when the 1967 energy sales tax exemption was limited to certain business types rather than all forms of business ownership. In 1987, LB 775 passed. In this bill, job credits can be obtained by claiming sales tax refunds to industries creating new jobs. Manufacturing industries (and some other businesses with corporate headquarters) are allowed to claim job credits to reduce income and sales taxes paid under this law. This job creation based refund system remains in law. A manufacturing equipment sales tax refund was possible under this law, but available only to a business creating new jobs. In 2005, the Legislature extended the manufacturing exemption to all purchases of such equipment.

Some narrowing and erosion of the base due to court decisions and legislative actions to change definitions has also occurred. For the most part, however, the major fiscal exemptions described in the tax expenditure report are those granted in the 1967 sales tax law. These created the structure of retail sales and use tax which is designed to have the tax fall on the final consumption of a tangible personal property, and a few selected services. (Expansion to additional services has occurred, and will be discussed in a later section of this report.)

The Syracuse Tax Study, done for the Nebraska Legislature in 1987, stated that the sales tax exemptions reviewed at that time were "largely justifiable". Two exceptions to this statement and suggested for repeal by the Syracuse study were the exemption of food items, which had been granted in 1983, and the trade in value exemption for motor vehicles. That same study recommended the exemption of manufacturing equipment and agricultural machinery. The latter two policies have been adopted, although taxation of repair parts for agricultural equipment remains a tax policy of the state. Food remains exempt due to the concerns of legislators about equity in tax policy.

SUMMARY OF THE CHANGES TO THE 1967 SALES TAX STRUCTURE

Major areas where the Legislature has created new exemptions and altered existing ones since 1967 include:

> Exemption of food passed in 1983.
>
> Exemption of manufacturing equipment, first with 1985 refund legislation, then 1987 job credits refunded sales tax, and most recently the manufacturing exemption in 2005.
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> Exemption of energy use by businesses: In 1967 all business use was exempt. Legislation passed in 1985 narrowed the exemption to manufacturing, refining and processing businesses. Hospitals remained exempt, and energy used in irrigation and farming remained exempt. Additional energy types used were made eligible for exemption in 2009 in LB 9.

The Nebraska sales tax code grants a broad exemption of food and all food products which makes Nebraska stand out from its border states. As noted earlier, South Dakota, Kansas, and Missouri continue to tax food. Missouri taxes food at a 1 percent rate. (Missouri's border state of Illinois also taxes food at a reduced rate.) Iowa taxes some food items like candy and certain beverages which Nebraska does not tax. Colorado allows its local governments to tax items which it does not tax as a state. In some Colorado jurisdictions this includes food. Wyoming and Nebraska are the states in the border state region which share a broad policy of exempting food. Both states tax food for immediate consumption and restaurant purchases.

As a final part of this review we compared the 1987 tax expenditure analysis of exemptions and their cost provided by the Syracuse Tax Study to the current list of tax expenditures for 2008. The cost of tax expenditures in 1987 was identified as $2.2 billion. That cost was calculated using the 1987 state tax rate of 3.5 percent. That cost in 2008 is $4.4 billion, calculated using the states current 5.5 percent tax rate. The Syracuse study identified these exemptions or tax expenditures in three categories. These were Exempt Organizations, Intermediate Commodities, and Exempt Final Goods and Services. The fastest growing category of tax expenditures over the period we examined (1987-2008) was Exempt Final Goods and Services. (These are final consumer purchases.) The fastest growing tax expenditure listed was the trade in allowance on automobiles, which grew from $11 million per year in 1987 to $136 million in 2008. This tax expenditure or exemption was followed in the fastest growth rate category by prescription drugs and the motor fuel tax exemption, both of which grew by over 300 percent, in rate adjusted terms.

SALES TAX ON SERVICES: 1967 TAXATION COMPARED TO CURRENT TAXATION OF SERVICES

Services were not subject to tax in Nebraska unless specifically described in the 1967 law which created the sales tax. Additional service base expansion occurred only when taxable services were added to the base by legislative action. These actions are described in the next section of this report. This topic is addressed in order to respond to the study request made by Senator Dierks in LR 166.

As noted in the opening sections of this report, the structure of the Nebraska sales tax is such that all tangible personal property is subject to tax unless exempted. In contrast, services sold to consumers are exempt unless specifically described by law. The 1967 sales tax code or laws described the services or gross receipts from services taxable as follows:

Gross receipts of every person engaged as a public utility shall mean:

(i) In the furnishing of telephone communication service, the gross income received from furnishing local exchange telephone service and intrastate message toll telephone service;

(ii) In the furnishing of telegraph service, the gross income received from the furnishing of such telegraph services; and

(iii) In the furnishing of gas, electricity, sewer, and water service except water used for irrigation of agricultural lands and manufacturing purposes, the gross income received from the furnishing of such services upon billings or statements rendered to consumers for such utility services.

In addition to utility services described above, admissions to certain events were subject to tax in the 1967 law. Admissions to certain school and non profit events were exempted.

Other than these items, few services provided to consumers were enumerated in the 1967 sales tax laws.

Nebraska's taxation of all forms of household electrical and natural gas energy services consumption since 1967 in certain respects makes its current "base" broader than border states. In Iowa, for example, the Legislature began a phase out of the STATE sales tax <u>RATE</u> on residential energy in 2002, repealing the STATE sales tax <u>RATE</u> in January of 2006. Under the Iowa policy option, however, the sale remains taxable for local governments using the local option sales tax. <u>Local governments are allowed to continue taxing the use of energy in residences.</u> This also appears to be the case in Kansas for residential energy use, with no state sales tax imposed, but energy subject to local taxation. So in both states, household energy consumption remains taxed as part of the base but only taxed by local governments. Missouri under state law exempts all energy for home residential consumption from sales tax. Wyoming and Nebraska tax household energy consumption.

Other states in the region have different policies. Under Colorado state law, energy purchases by manufacturers, for use on farms and by <u>residences</u> are exempt from state sales tax. However, local governments with city charters retain the ability to tax differently than the state. In regard to energy services, our brief review of a few city charter provisions suggests that the cities of Colorado appear to have different policies on taxing household energy and water services, and some do tax this service.

TAXATION OF SERVICES: EXPANSION SINCE 1967

Actions have been taken since the 1967 Legislature passed the sales tax code to tax more services. Among those added was taxation of cable and satellite television service, neither of which were as widely used in 1967.

Shown in Appendix B is the definition section of gross receipts for providing a service found in law in 2009. (Section 77-2701.16, subsection 3 and 4.) <u>Most of these listed services have been added and/or redefined since 1967.</u>

Legislative actions in LB 1085 in the 2002 session and LB 282 in the 2003 sessions of the Legislature expanded the services taxation base to include many of these services. The text below is from a Nebraska Department of Revenue report submitted to the Federation of Tax Administrators in 2002. It describes the expansion of the sales tax base.

"Beginning October 1, 2002, providers of the following services are retailers and must collect and remit the Nebraska and applicable local option sales and use tax on the sale of such services:

Building cleaning and maintenance services; Pest control services; Security services; Motor vehicle washing and waxing; Motor vehicle towing; Motor vehicle painting; Computer software training; Installation and application labor; and labor associated with the sale of property by an Option 1 contractor. <u>Source</u>: Nebraska Department of Revenue report submitted to the Federation of Tax Administrators 2002.

The sales tax was imposed on contractor services in legislation passed in 2002 and 2003. The base broadening potential of these contractor labor provisions when passed was initially estimated at 35 to 40 million dollars. The cost of this exemption granted may be estimated at this figure. LB 968 of the 2006 session repealed and modified some construction labor provisions. The bill provided a new sales tax exemption for construction labor performed on single family homes, duplexes, and a refund for owner-occupied condominiums, effective July 1, 2006. This was estimated as granting a 30 million dollar exemption. LB 367 of the 2007 repealed the sales tax on construction labor for commercial projects, effective Oct. 1, 2007. This latter bill had an estimated $9 million dollar cost for that exemption.

RECENT TAX STUDY RECOMMENDATIONS ON NEBRASKA SALES TAX

In recent years, the "Burling Tax Study Commission" suggested an expansion of the sales tax base by $750 million. This recommendation has not been implemented to this date. The expansion recommended would have involved repeal of the food sales tax, for a net increase in taxes of up to $147 million, or less when accompanied by some refund of food sales tax to low income households, and continued recognition of the federal prohibition of sales tax imposed on the food stamp program.

Also contained in this recommendation was an expansion to tax all services except medical. We estimate this expansion would raise approximately $450 million, based on work done on legislation recently considered by the Legislature. This would leave approximately $150 or $180 million of sales tax exemptions recommended for repeal, depending on the size of the food sales tax refund offered, and the treatment of food purchased with food stamps. The Burling Tax Study Commission made no specific recommendations for exemption repeal beyond the food sales tax exemption. The study did recommend a review of all exemptions be done. The Burling Commission study provided no other policy principles or guidance on those deserving repeal.

We will mention here that one past tax study which reviewed the sales tax code of Nebraska in detail, the Syracuse Tax Study, recommended the repeal of the trade in value deduction on automobiles. This repeal would generate $136 million of additional state sales tax in the current year. This would leave approximately 20 to 40 million of exemptions remaining for repeal to meet the Burling Commission target of $750 million of sales tax expansion. Other repeal options exist, of course, including specific combinations of the other exemptions.

Some sales tax exemptions listed below are those that appear to have no specific policy basis in a recommended or standard structure of the sales tax. This standard recommended structure is a tax on final consumption of products or services that are not intermediate goods, or business to business transactions. This was the structure adopted in 1967 by the Nebraska Legislature and largely unmodified since that time. The basis of other original and existing tangible personal property exemptions and generally offered include equity, (food and medicine), ease of administration or feasibility of taxing activity, (railroad rolling stock and delivery charges for interstate shipments), or federal mandates (food stamps and a sales tax service tax prohibition on internet service provision). The basis for exemptions on intermediate purchases is the policy of avoiding the pyramiding of the tax through the pricing structure of consumer goods. It is a policy established based on the view that taxing these purchases makes the actual effective burden of the tax higher and less transparent than focusing the tax on the final purchase of a good or service.

Many other exemptions, including the government and non profit exemptions are found in all other states. A total of these amounting to the dollar figures identified by the Burling Commission's general statement is possible, but would involve splitting some of these exemptions into categories in order to adjust the total exemption repeal revenue to that total necessary to meet this dollar target. The following is a list of exemptions with no identified policy basis in the standard structure of a sales tax on final consumption, or in any published tax studies of the sales tax in Nebraska.

Some sales tax exemptions listed here are those that appear to have no specific policy basis in a recommended or standard structure of the sales tax. They are commonly found in other states sales tax structures.

Section 77-2701.35(3)(d)(i)
The value of trade-ins taken in connection with a sale of property. $4,270,000.

This section of law reflects the same exemption policy rationale as the automobile sales tax trade in deduction recommended for repeal by the Syracuse Tax Study. However, It does not appear to be specifically mentioned in the Syracuse tax study recommendations.

Section 77-2704.07
Newspapers issued at least once a week. Newspaper advertising supplements actually distributed with newspapers. $6,260,000.

This consumer purchase has been exempt since the 1967 sales tax act was passed and is typically exempted in the state sales tax codes we examined.

Section 77-2704.14
The use of coin-operated machines used for laundering and cleaning except the cleaning or washing of motor vehicles. Cost $756,000.
Administration of this tax may be viewed as difficult, although administration and enforcement of sales tax from coin operated motor vehicle washing services is now imposed and enforced.

Section 77-2704.38
Lottery tickets sold pursuant to the State Lottery Act. $5,962,000.

No policy basis for this exemption is offered here. The good purchased is sold by government. Arguments made for this exemption include the impact on marketing and sales of tickets, and reduced revenue for beneficiaries of the lottery.

Section 77-2704.56
Sales and use tax shall not be imposed on purchases of fine art by a museum as defined in section 51-702. $62,500.

Taxpayer support for the purchase of fine art by public museums is the basis for this exemption.

NEBRASKA TAXATION OF SERVICES COMPARED TO TAXATION IN OTHER STATES

LR 166 introduced by Senator Dierks specifically asks for a review of services not taxed by the State of Nebraska which are taxed by other states. To answer this question, we have attached a table developed by the Federation of State Tax Administrators. This table shows the services taxed by other states and Nebraska as of tax year 2007.

Table 1 suggests that Nebraska taxes 77 services. This would place Nebraska in the top ten of the states in terms of the <u>number</u> of services taxed. This is the case even though Nebraska taxes less than half of the maximum number of services that are taxed by any state in the United States. The total shown as taxed is 168 services which are taxed by any of the states with a retail sales tax. Nebraska's ranking is above average because most states with a retail sales tax structure continue to tax very few services.

Another version of this table showing Nebraska's border states and the services taxed by them is also shown (Table 2). Table 2 illustrates that the State of Nebraska taxes more specific services than three other states in the region. South Dakota taxes a high number of services, and appears to rank fourth in the nation based on the <u>number</u> taxed. Iowa taxes slightly more services than Nebraska, while Nebraska and Kansas are approximately equal in the number of services taxed.

Table 1

State Taxation of Services

. From Federation of State Tax Administrators Survey

Number of Services Taxed by Category and State - July 2007

	Utilities	Personal Services	Business Services	Computer Services	Admissions/ Amusements	Professional Services	Fabrication, Repair & Installation	Other Services	Total
Alabama	12	2	6	3	10	0	1	3	37
Alaska *	0	0	0	0	0	0	0	1	1
Arkansas	16	7	12	1	12	0	11	13	72
Arizona	12	2	7	0	9	0	2	23	55
California	2	2	7	2	1	0	3	4	21
Colorado *	4	0	2	1	2	0	3	2	14
Connecticut	10	9	20	6	10	0	10	14	79
Delaware *	9	20	33	6	10	9	19	37	143
District of Columbia	13	7	15	6	8	0	12	12	73
Florida	7	4	9	0	14	0	16	13	63
Georgia *	10	4	5	2	8	0	1	6	36
Hawaii	16	20	34	8	14	9	18	41	160
Iowa	13	15	18	1	14	0	13	20	94
Idaho	0	3	5	0	11	0	6	4	29
Illinois	12	1	1	1	0	0	1	1	17
Indiana	7	4	3	2	3	0	1	4	24
Kansas	10	11	9	1	13	0	15	15	74
Kentucky	11	2	4	0	6	0	4	1	28
Louisiana	10	8	5	3	9	0	13	7	55
Maine	9	1	6	0	3	0	4	2	25
Maryland	5	3	13	1	11	0	4	2	39
Massachusetts	9	1	4	0	1	0	2	1	18
Michigan	12	2	7	1	1	0	1	2	26
Minnesota	15	7	12	2	13	0	6	11	66
Mississippi	10	5	8	3	11	0	13	22	72
Missouri	8	1	2	2	10	0	0	3	26
Montana	12	0	0	0	2	0	0	4	18
Nebraska	14	9	14	3	12	0	13	12	77
Nevada	0	1	4	0	7	0	2	4	18
New Hampshire *	6	1	0	2	0	0	0	2	11
New Jersey	12	5	16	1	6	0	15	19	74
New Mexico	16	20	32	8	14	9	18	41	158
New York	4	4	13	1	6	0	14	15	57
North Carolina	10	4	5	0	9	0	1	1	30
North Dakota	6	1	4	2	11	0	0	2	26
Ohio	8	12	14	5	3	0	12	14	68
Oklahoma	9	3	4	1	10	0	0	5	32
Oregon	0	0	0	0	0	0	0	0	0
Pennsylvania	9	5	16	1	1	0	15	8	55
Rhode Island *	10	1	6	3	4	0	3	2	29
South Carolina	4	6	7	4	10	0	1	3	35
South Dakota	14	19	28	8	13	5	18	41	146
Tennessee *	11	10	7	3	12	0	13	11	67
Texas	12	10	14	8	12	1	10	16	83
Utah	7	8	6	0	11	0	15	11	58
Vermont	9	2	5	2	11	0	2	1	32
Virginia *	1	3	4	0	1	0	4	5	18
Washington	16	20	33	8	13	9	16	43	158
West Virginia	6	17	26	4	13	1	13	25	105
Wisconsin	11	11	8	3	14	0	14	15	76
Wyoming	10	6	6	2	6	0	16	12	58
Total Number in Category	16	20	34	8	15	9	19	47	168

* State did not respond, 2004 data reported
Source: FTA survey

Table 2
State taxation of services in Nebraska's region.

STATE IN REGION	services taxed	total services subject to tax nationally by any state	percent of national total	Most taxed Rank Nationally
South Dakota	146	168	86.9%	4
Iowa	94	168	56.0%	7
Nebraska	77	168	45.8%	10
Kansas	74	168	44.0%	12
Wyoming	58	168	34.5%	22
Missouri	26	168	15.5%	38
Colorado	14	168	8.3%	48

The fiscal or economic significance of the expansion of the sales tax base to untaxed services in Nebraska is a question that can be answered by examining a list of specific services suggested for taxation. Some untaxed services may yield more revenue than others given the cost of the service and the service's relative size within the economy.

The fiscal note on LB 583, introduced by Senator Dierks in the 2009 session, suggests that taxation of all services except medical services would generate approximately $460 million in Nebraska's economy. Another recently published report examining the issue of state sales tax on services suggests Nebraska may be able to generate $493 million of additional state revenue if the sales tax is expanded to a list of "feasibly–taxable" household consumer services examined in that report. The report's definition of "feasibly taxable" excluded health care, housing rents, education, transit, legal, funeral and certain banking and financial services. The author of that report suggested that some of the feasibly taxable services may already be taxed in Nebraska, and this along with other economic factors may make this a high estimate. See, Expanding Sales Taxation of Services: Options and Issues, Center on Budget and Policy Priorities, Michael Mazerov, July 2009.

An analysis done by the Nebraska Department of Revenue for the 2002 Tax Expenditure Report showed a potential yield from taxing services of over $700 million. After eliminating insurance premiums (taxed under different tax code provisions) and health care services from this analysis, the total is reduced to $450 million. Examining those identified as household consumer services and therefore taxed under a structure of retail sales tax which focuses on final purchases of such services, the potential additional tax yield may be limited to approximately $80 million.

A more limited expansion list was developed for this report, using a list of services currently not taxed in Nebraska. Items on this list are those that are taxed in either of two Nebraska border states, Iowa and Kansas. These same services are all taxed in South Dakota. This list of approximately 30 services would expand the list of services taxed and the tax base in Nebraska.

The expected yield from this expansion was estimated with information obtained from the Department of Revenue, based on prior analysis done for LB 583, past legislative fiscal notes, and tax expenditure analysis done prior to this time. The estimate of tax yield for this list is approximately $60 million of state tax revenues at the current 5.5 percent tax rate. Additional consumer sales and use taxes would also be paid to local governments on these sales if made taxable. In some cases, no analysis is available from past fiscal notes or reports.

IMPACTS OF SALES TAX EXEMPTION REPEAL AND SERVICES BROADENING ON THE REGRESSIVITY OR PROGRESSIVITY OF THE TAX SYSTEM

A consideration for legislators considering a repeal of exemptions or the broadening of the sales tax base to include additional services is the change in tax burden impact on taxpayers. As previously cited studies have noted, the regressivity or progressivity of a state and local tax <u>system</u> is impacted by the items and economic activities taxed. This is an important policy area to examine when considering broadening the sales tax to services, as some services are believed to be consumed and used more extensively by households with higher levels of disposable income. This follows from the assumption that households with more income will be more willing to pay someone else to provide services.

In two of tax studies previously mentioned in this report, the regressivity of the <u>entire state and local tax system was examined.</u> At the time of the "McClelland" report the Nebraska state and local tax system consisted of a property tax and several excise taxes, including those on motor fuels, cigarettes and alcohol. The creation of a broader based tax system using income and sales taxes along with property taxes and excise taxes was examined, and the regressivity and progressivity of such an expanded system were discussed. Two observations from the McClelland report seem worth repeating here. In discussing exemptions, McClelland made this comment.

"*The case for some exemption is short but compelling. Any change in Nebraska taxes should move toward establishing a proportional tax structure. The importance of reducing the tax burden on low income families, and of promoting equity between families purchasing and those growing their own food indicates that any sales tax not* ***accompanied by an income tax*** *should exempt food and medicines as well as utility services.*

Admittedly, a decision to exempt does override the basic principle of consumption taxation. Any Nebraska sales tax would replace state government property tax. Property taxes are regressive and impose a substantial burden on low income families. At least part of the property taxes paid by businesses will be included in prices, while the taxes included in tenants rents or paid directly by homeowners will be regressive because housing expenditures take a lesser percent of larger incomes than of smaller incomes. A sales tax, even without exemptions, which replaces state property taxes, *might reduce the regressivity of Nebraska's tax structure. One with exemptions moves farther towards proportionality, and therefore is recommended*."

(**emphasis added**) page 361, State and Local Finance, Nebraska Legislative Council, Committee on Taxation, November 1962, author Harold F. McClelland.

The McClelland report quoted above makes the point that when addressing questions of regressivity, progressivity and proportionality in tax burden, the entire structure and the proportions of the taxes used in the state and local tax system needs to be examined. We note that McClelland suggests that any sales tax implemented without an accompanying use of an income tax should have exemptions. Nebraska's sales tax was implemented along with a personal income tax. McClelland also suggested that a sales tax implemented to reduce a property tax use could result in a more proportional or less regressive tax structure, because in his view the property tax was regressive. An income tax can be progressive in design, and Nebraska's is progressive in its distribution of the tax burden.

Other authors have commented on the role that use of regressive or progressive taxes in conjunction with each other, and the relative proportions of each used, will impact overall progressivity or regressivity of the total state and local tax system. One report cited earlier suggests that a broadening of the sales tax to include services which are more often purchased by households with higher incomes could make the sales tax less regressive, and the general tax system more proportional, depending on what other taxes are used to finance public services and in what proportions they are used. See, Expanding Sales Taxation of Services: Options and Issues, Center on Budget and Policy Priorities, authored by Michael Mazerov, July 2009.

In summary, a broadened base, either by repealing current exemptions or taxing currently untaxed services will have tax burden impacts which are important issues to be addressed by the Legislature. The impacts on tax burdens are also effected by how the additional tax revenue is used, which can be substituting for other state or local taxes, or provide funding for maintenance of existing public services when tax receipts from the current taxes decline. In the latter case, the expansion would serve as an alternative to raising the rate of other types of state or local taxes.

The sales tax in Nebraska and most states, as currently imposed, is limited and consists largely of a tax on consumption of durable goods. In an economy where a growing share of household consumer spending is on services, governments will see sales tax growth which is slower than the growth in consumer spending. Rising state sales tax rates are sometimes attributed to this economic trend. Some estimates of consumer money spent show the share of consumer spending on services growing from 25.9 percent of the gross national product to 31.8 percent of the gross national product in the period 1964 to 1984. See page 228, General Sales Tax, John L. Mikesell, Reforming State Tax Systems, National Conference of State Legislatures, December, 1986. This trend has continued and is viewed by many as one reason for the sales tax base erosion which has occurred.

Broadening the sales tax base to services may produce a growth rate in tax revenue which is faster, more stable, and less sensitive to economic downturns, in the opinion of some authors. These same authors, however, suggest that an application of the sales tax to those services which can practically and appropriately be taxed will not dramatically increase the growth rate of the tax. Page 228, General Sales Tax, John L. Mikesell, Reforming State Tax Systems, National Conference of State Legislatures, December,1986. Other observers suggest that more stability in yield may result, depending on the services taxed and used by households.

SALES TAX BASE GROWTH AND RATE INCREASES

The sales tax base of Nebraska and most states is largely a tax on sales of tangible personal property. As noted here, Nebraska does tax some consumer purchased services. Nebraska taxes approximately half of the services which are taxed by any state. Economists who study public finance have made the observation that the growth in the sales tax is largely due to the states increasing the rate of the tax over time. This appears to be the case in Nebraska as well. As households and as consumer spending on services has become a larger part of the household budgets, a smaller percentage share of consumer dollars has been spent on the transactions most states do tax, which is the sale of durable and non durable goods. Accordingly, most assume sales tax growth would have been slower than consumer spending growth over the last 30 years, absent rate changes.

We examined the increases in Nebraska's state sales tax rate over time and concluded that rate increases appear to have occurred in times of economic recession, or when the Legislature desired to shift taxes from property tax to other sources of revenue.

One important example of growing consumer household spending not taxed by most states is the use of subscription internet service. A few states began to tax this service as it emerged in the marketplace. The United States Congress banned the state imposition of sales tax on this service and that ban has yet to be lifted. Internet service is now estimated as available to 75 percent of United States households, and used in perhaps 65% of households. Those households using the service may be spending $300 to $600 per year for internet service. As household's budget and spend their limited income, more of their dollars are spent on this and other non taxed items. One other untaxed item may serve as an illustrative example of this aspect of the sales tax. The national health care debate has stimulated a discussion of the rising costs of health care. As households and businesses spend more on prescription drugs (untaxed by most states) and other medical items, these households will have fewer available dollars to spend on taxable items.

As consumer spending increases on this and other non taxable purchases like health care, sales tax growth from those items taxed are capturing a smaller share of the consumer spending dollar. As states experience sales tax growth which lags economic and personal income growth, the rates are raised to adjust the rate of sales tax growth to the rate of sales tax revenue growth desired by governments. Higher rates may have an impact on the consumption of taxed items relative to untaxed items.

Another factor in erosion of the sales tax growth is the increasing volume of consumer purchases taking place by mail order or internet purchases. Nebraska has participated in an attempt by other states to counteract this trend, described in the next section of this report.

STREAMLINED SALES TAX AGREEMENT

In 2003, the Legislature enacted LB 282. This bill ratified the Streamlined Sales and Use Tax Agreement, as adopted by a group of 35 "implementing states" on November 12, 2002. Through ratification, the state of Nebraska is now authorized to participate in a multi-state sales tax collection system that offers the states the option, by working together, to enforce their sales and use tax collection responsibilities on sellers located in other states. Such a policy would go a long way toward "leveling the playing field" between main street businesses and competing out-of-state retailers operating through mail order catalogue and internet sales systems.

The agreement requires the use of uniform definitions for products including food, clothing and drugs. These have been treated differently by states for years. However, in adopting all the conforming changes in definitions, LB 282 made no changes in the Nebraska sales tax base. No transactions previously taxed have become exempt or vice versa due to the requirements of the Agreement. This is nothing short of remarkable under the circumstances. Many, if not most, other states that adopt conforming legislation had at least some change in what is taxed by that state.

The agreement, and the terms of LB 282 itself, place some restrictions on the state in making changes in the sales tax. Changes in the rate of tax, or the transactions covered by the tax may only be made at the beginning of a quarter after at least 60 days notice. Interpretations of the meaning of certain terms or administrative requirements of the agreement may be made by states collectively rather than by the Department of Revenue by rule and regulation. Nebraska must accept retailers licensed by another state as qualified to collect Nebraska sales tax. Restrictions like these are offset by the advantages of interstate uniformity and resulting better enforcement of the state’s sales and use tax.

All in all, LB 282 represents the largest change, both statutory and regulatory, in Nebraska sales and use taxes since the adoption of the tax in 1967. As of this writing, over 20 states have adopted legislation which brings their states into compliance with the requirements of the agreement. These states represent slightly more than 20 percent of the population of states with a sales tax. This meets the participation thresholds necessary for the agreement to become effective. The agreement became operative in these states, including Nebraska, on October 1, 2006.

Provisions of the agreement direct the states that are members that non uniform sales tax rates within the state sales tax code must be held to a minimum. This is done for ease of administration. For this reason, food cannot be taxed at a different rate than other items by participating states, as some states in our region do. Sales of certain items, including energy sources and automobiles may, however, be subject to different rates.

EXAMINATION AND COMPARISON OF STATE SALES TAX STRUCTURES

One national expert on the structure of the sales tax has published a study containing a quality index ranking each state's sales tax structure. This index was done by John Mikesell, and published in State Tax Notes, January 10, 2005. Mikesell, of Indiana University, has offered his view of the ideal standard structure of the sales tax and compared each state to this ideal standard. The state policies evaluated were those in place in 2004. Mikesell describes the ideal sales tax structure in these terms.

"The guide for such an ideal retail sales tax is straightforward: The retail sales tax should apply to all expenditures for personal consumption purposes but not to any transactions involving use in a business activity. This guide, coupled with an effort to maintain uniformity, neutrality and reasonable cost of collection, provides the standard against which the state sales tax structures would be gauged." John Mikesell, page 132, State Tax Notes, January 10, 2005.

From this basic guide, Mikesell devised a ranking system for the 45 states using a sales tax, and scored states relative to several factors. These factors were: State Statutory Rate, Business Exemptions, Household Inclusion, Agricultural Inputs, Services, Non Profit Organizations and Type of Tax. States were ranked on a maximum number of points, with no state scoring the total amount of points equal to Mikesell's ideal. States ranking high (those with a high number of points) had a lower than average state tax rate, and a sales tax structure which continued to tax food (7 of the 10 highest scoring states taxed food). These states also had broader exemptions for business and agricultural inputs than other states. Taxation of services, at least those consumed by households, also gave more scoring points to states. Nebraska ranked low in this scoring, in part because it had a 5.5 percent state rate in 2004, slightly higher than the nationwide state rate average as calculated by Mikesell of 5.3 percent. Nebraska also scored lower than other states because it exempted food, taxed <u>more</u> business purchases than other states, including more agricultural inputs, and taxed fewer <u>consumer</u> services than some other states. In total, Nebraska scored 40th lowest of the 45 states on this ranking and quality index. Kansas, a border state, ranked in the top ten (9th best) due to its continued taxation of food, and broader exemption of business and agricultural inputs.

This Nebraska ranking was developed prior the exemption of manufacturing equipment passed in 2005, but after some sales tax on services broadening in 2002 and 2003. It appears the sales tax on services broadening did not satisfy the consumer services focus found in the ideal system advocated by Mikesell. Rankings for Nebraska, its border states, and the high and low states in the nation are shown below in Table 3.

TABLE 3.
IDEAL SALES TAX RANKED PUBLISHED BY JOHN MIKESELL

	Mikesell Score	Mikesell Rank	
Oklahoma	477.4	1	Oklahoma scores high with a low rate, food taxed, and business inputs exempt.
Kansas	457.4	9	Kansas scores high with a slightly lower rate than average, food taxed, and exemptions for business inputs
Colorado	426.2	20	Colorado scores above average, with a very low state rate, and broad business input exemptions.
Iowa	424.3	23	Iowa scores above average, with a below average state rate, and broad business input exemptions.
Wyoming	421.9	26	Wyoming scores well, with food taxed in 2004, and a lower than average state rate. Business input exemptions were narrow.
South Dakota	420.5	28	South Dakota had below average state rate, taxed food, but taxed more business inputs than ideal.
			South Dakotas consumer services taxation raised the score.
Missouri	416.9	31	Missouri had a low state rate, taxed food, and gives broad business input exemptions.
Nebraska	388.6	40	Nebraska's 5.5% rate was above average. Nebraska exempts food, resulting in a lower score.
			Nebraska also taxes business inputs more extensively than other states, resulting in a low score.
Vermont	370.3	45	Vermont ranked lowest because it has a high state rate, and exempts food.

Policymakers could use these same ranking factors and data, and reverse the ranking if they feel that the "ideal" tax structure should differ from that offered. For example, policymakers who hold the view that food should be exempt, and taxation of more business inputs than other states would be desirable which reverse the ranking. In this alternate view, Nebraska would rank 40th best of 45. Nebraska has exempted manufacturing equipment since the ranking was developed. Exempting food has been adopted by even more states since this 2004 examination, including Wyoming. Several state tax rates appear to have increased, while Nebraska has remained at 5.5 percent, making Nebraska's ranking perhaps higher relative to Mikesell's 2004 rank.

FINAL SUMMARY

Since 1967, when the Nebraska Legislature first passed a sales tax law, very few fundamental changes in the structure of that law and exemptions have been made. An exemption for food was passed in 1983, following a period of refunding the majority of the receipts received from this tax. The taxation of business energy purchases has been altered, with fewer businesses being allowed an exemption from the tax on energy purchases. Manufacturing equipment and agricultural machinery have been exempted. The exemption of manufacturing equipment followed a long period of allowing a refund of the sales tax to businesses which create new jobs. In two times of fiscal stress, 1985 to 1987, and more recently 2002 and 2003, the base of the sales tax has been expanded to include more services. Most of this expansion was in the areas recommended by some Legislative tax studies. Some of this base expansion, that applying to contractor installation labor, was repealed in 2006 and 2007.

Our review suggests that the Nebraska sales tax law and structure is much like that found in other states, including the Nebraska exemptions granted for sales of intermediate goods and business to business sales. One national study goes so far as to suggest that Nebraska exempts fewer business purchases than most states.

Nebraska is typical in its exemptions for medicine and medical goods. (Forty five states exempt prescription drugs.) Exempting food is common among the states using the tax. Thirty two states exempt food, as Nebraska does. Other states have either a reduced rate on food, or a low income refund policy. Motor fuel is subject to a retail sales tax in a few states, but not in most, a policy Nebraska shares with most states.

In general, Nebraska's sales tax base appears slightly broader than many states. One exception is food taxation, where Nebraska has a broader exemption for food than its border states, but matching that of most states imposing a sales tax. Nebraska taxes more services than most states, although it taxes fewer than its border states of Iowa and South Dakota. Nebraska appears to tax energy purchases by households and other consumers of energy more broadly than its border states.

No unusual exemptions have been identified by past tax studies done and reviewed in the course of this report. The Syracuse tax study, in 1987, summed up their review of Nebraska sales tax structure with this statement.

"The Nebraska state-local sales and use tax system, as it currently stands , is a relatively satisfactory tax in many respects. Nebraska, as one of the last states to introduce a sales tax, benefited from the experience of other states and avoided some of the major complications and other undesirable features found in some states."

That report went on to suggest the following "defects" in the sales tax structure. These are shown below. We have added text in bold to explain the actions taken since that "defect" was identified by the Syracuse tax study.

1. The taxation of industrial machinery and equipment except for firms subject to the new incentives legislation, and the taxation of farm machinery and equipment. ***The Nebraska Legislature has since this time exempted both types of purchases, although repair parts for agricultural machinery remain taxable.***

2. Exemption of sales of equipment to common and contract motor carriers while equipment sold to private carriers is taxed. ***This policy involves Nebraska's policy of exempting sales tax on equipment used in interstate commerce, since owners of such equipment can choose their state of purchase and avoid taxation. This policy applies to interstate trucking firms, railroads and airlines. This is a common policy among states when taxing purchases made by interstate businesses which can easily avoid payment by making purchases in exempt states.***

3. The failure to apply the sales tax to motor fuel. ***This policy has not been changed. Nebraska did recently introduce into law a policy of modifying its motor fuel excise tax, in part based on changes in wholesale prices. There are a few states that apply a sales tax to motor fuel sales. These include California, Georgia, Hawaii, Illinois and Indiana. Although the final Syracuse report cited here identifies this as a defect, a separately published Syracuse Tax Study Report on Nebraska Sales Tax Expenditures, Staff Paper No. 13, stated "Given the existing level of excise taxes on gasoline and the considerations of optimal tax theory, it would be difficult to support a recommendation to levy the general sales tax on motor fuel." This suggests that the Tax Study staff had conflicting views on whether this was a policy defect. The Legislature has chosen not to tax motor fuel with an additional retail sales tax.***

4. Exemption of food***. LB 583, currently under consideration in the Revenue Committee, removes this exemption and creates a refund of sales tax for low income persons and families. Several attempts to broaden the sales tax to food items, including snacks and certain beverages, have been rejected in recent years.***

5. Failure to tax real property contract work, including installation, adequately, with substantial misapplication of tax. ***Expansion of the tax to this area was undertaken in 2002 and 2003, and for the most part repealed in 2006 and 2007. Difficulties enforcing sales tax on contractor labor persist. One alternative approach might be a contractors tax, as in the contractors excise tax found in South Dakota.***

6. The rule with regard to local sales tax, that the tax is due to the jurisdiction of delivery, as opposed to the location of the vendor***. This remains the policy of the State of Nebraska. This policy makes it possible for purchasers living outside the limits of a city which imposes the sales tax to have the item delivered to their home or business and not pay the local sales tax which***

would have been imposed at the store when purchased. This policy matches the policy of the states who have become parties to the Streamlined Sales Agreement, a Nebraska policy which may help main-street retailers and preserve the sales tax base of Nebraska.

In summary, we believe criticisms of the Nebraska sales tax structure as containing unusual exemptions are not well founded. This is based on our comparison with other states. Our review of Nebraska's structure of the sales tax suggests that most Nebraska exemptions have existed since 1967, and are the same types of structural exemptions created by other states.

Repealing a large number of these structural exemptions would create a sales tax like no other found in the region or the United States. Past recommendations for repeal of food sales tax exemptions and motor fuel exemptions, and automobile trade-in value exemptions have not found support in the Legislature.

We observed that Nebraska taxes more services than most states using the sales tax. Nebraska could, if legislators desire a sales tax base broadening tax, tax services more broadly than it does now. A list of services taxed in three of our border states is available.

Any extensive repeal of exemptions, or extensive broadening to include all other types of services, has the potential to make Nebraska's sales tax structure so unlike those found in other states that it may become an uncompetitive business location. This would also create a higher sales tax burden on households and consumers than that found in most states. This would result because Nebraska already has a higher combined state and local sales tax rate than many states, and particularly its border states, with the exception of Colorado.

Appendix A. Interim study resolutions

LEGISLATIVE RESOLUTION 97
Introduced by Pahls, 31.
PURPOSE: The purpose of this resolution is to conduct a study of the major sources of state and local tax revenue, including sales and use taxes, income taxes, and property taxes. The committee conducting this study shall review the major tax sources, identifying what is taxed and what is not taxed and who pays and who does not pay, by sector and by demographics under each source of revenue and in total. The committee shall prepare a report to be disseminated to the members of the Legislature indicating, by sector and by demographics, the tax burdens each group bears under each major source of revenue and under the major sources in total. The committee shall draft legislation for introduction in the 2010 legislative session to restructure the balance of the tax burdens on sectors and citizens by adjusting tax rates, expanding or narrowing tax bases, and eliminating or creating exemptions to fairly spread the tax burdens while still raising the revenue needed to meet state and local revenue needs.

NOW, THEREFORE, BE IT RESOLVED BY THE MEMBERS OF THE ONE HUNDRED FIRST LEGISLATURE OF NEBRASKA, FIRST SESSION:

1. That the Revenue Committee of the Legislature shall be designated to conduct an interim study to carry out the purposes of this resolution.

2. That the committee shall upon the conclusion of its study make a report of its findings, together with its recommendations, to the Legislative Council or Legislature.

LEGISLATIVE RESOLUTION 161
Introduced by Cornett, 45.
PURPOSE: The purpose of this interim study is to examine Nebraska's sales and use tax provisions. The study shall include, but not be limited to, an examination of the role of the sales tax as a revenue source in state and local fiscal systems.

NOW, THEREFORE, BE IT RESOLVED BY THE MEMBERS OF THE ONE HUNDRED FIRST LEGISLATURE OF NEBRASKA, FIRST SESSION:

1. That the Revenue Committee of the Legislature shall be designated to conduct an interim study to carry out the purposes of this resolution.

2. That the committee shall upon the conclusion of its study make a report of its findings, together with its recommendations, to the Legislative Council or Legislature.

LEGISLATIVE RESOLUTION 166
Introduced by Dierks, 40.

PURPOSE: The Revenue Committee of the Legislature shall conduct a comprehensive study and review of state and local taxes in Nebraska with the objective of developing alternatives in taxation and funding which will substantially reduce reliance on property taxes. In conducting this study, the committee shall first assemble or cause to be assembled the following information:

(1) Specific sales tax exemptions, which shall be put into the following categories:
  (a) Seller-based;
  (b) Item sold;
  (c) Buyer-based; and
  (d) Item use;
(2) Information regarding each exemption showing the estimated amount of the sales tax base, the taxes not collected because of the exemption, and the year the exemption was enacted;
(3) The services subject to the sales tax and when the tax was imposed, including the tax base and the amount collected from the tax on each service;
(4) Services not currently taxed by the State of Nebraska but taxed by other states and an estimate of such tax base in Nebraska; and
(5) The income tax basis and rates for individuals and corporations in South Dakota, Iowa, Missouri, Kansas, Colorado, and Wyoming.

NOW, THEREFORE, BE IT RESOLVED BY THE MEMBERS OF THE ONE HUNDRED FIRST LEGISLATURE OF NEBRASKA, FIRST SESSION:

1. That the Revenue Committee of the Legislature shall be designated to conduct an interim study to carry out the purposes of this resolution.

2. That the committee shall upon the conclusion of its study make a report of its findings, together with its recommendations, to the Legislative Council or Legislature.

Appendix B. Service taxation in Nebraska law. 2009

Section 77-2701.16

(3) Gross receipts of every person engaged in selling, leasing, or otherwise providing intellectual or entertainment property means:

(a) In the furnishing of computer software, the gross income received, including the charges for coding, punching, or otherwise producing any computer software and the charges for the tapes, disks, punched cards, or other properties furnished by the seller; and

(b) In the furnishing of videotapes, movie film, satellite programming, satellite programming service, and satellite television signal descrambling or decoding devices, the gross income received from the license, franchise, or other method establishing the charge.

(4) Gross receipts for providing a service means:

(a) The gross income received for building cleaning and maintenance, pest control, and security;

(b) The gross income received for motor vehicle washing, waxing, towing, and painting;

(c) The gross income received for computer software training;

(d) The gross income received for installing and applying tangible personal property if the sale of the property is subject to tax. If any or all of the charge for installation is free to the customer and is paid by a third-party service provider to the installer, any tax due on that part of the activation commission, finder's fee, installation charge, or similar payment made by the third-party service provider shall be paid and remitted by the third-party service provider;

(e) The gross income received for services of recreational vehicle parks;

(f) The gross income received for labor for repair or maintenance services performed with regard to tangible personal property the sale of which would be subject to sales and use taxes, excluding motor vehicles, except as otherwise provided in section 77-2704.26 or 77-2704.50;

(g) The gross income received for animal specialty services except (i) veterinary services, (ii) specialty services performed on livestock as defined in section 54-183, and (iii) animal grooming performed by a licensed veterinarian or a licensed veterinary technician in conjunction with medical treatment; and

(h) The gross income received for detective services.

(5) Gross receipts includes the sale of admissions which means the right or privilege to have access to or to use a place or location. An admission includes a membership that allows access to or use of a place or location, but which membership does not include the right to hold office, vote, or change the policies of the organization. When an admission to an activity or a membership constituting an admission pursuant to this subsection is combined with the solicitation of a contribution, the portion or the amount charged representing the fair market price of the admission shall be considered a retail sale subject to the tax imposed by section 77-2703. The organization conducting the activity shall determine the amount properly attributable to the purchase of the privilege,

benefit, or other consideration in advance, and such amount shall be clearly indicated on any ticket, receipt, or other evidence issued in connection with the payment.

(6) Gross receipts includes the sale of live plants incorporated into real estate except when such incorporation is incidental to the transfer of an improvement upon real estate or the real estate.

(7) Gross receipts includes the sale of any building materials annexed to real estate by a person electing to be taxed as a retailer pursuant to subdivision (1) of section 77-2701.10.

(8) Gross receipts includes the sale of and recharge of prepaid calling service and prepaid wireless calling service.

(9) Gross receipts includes the retail sale of digital audio works, digital audiovisual works, digital codes, and digital books delivered electronically if the products are taxable when delivered on tangible storage media. A sale includes the transfer of a permanent right of use, the transfer of a right of use that terminates on some condition, and the transfer of a right of use conditioned upon the receipt of continued payments.

Appendix B. Continued.

Nebraska Department of Revenue

Regulation 1-001. Nature of the Sales Tax.

Regulation 1-002 Consumers Use Tax.

REG-1-001 NATURE OF THE SALES TAX

001.01 The sales tax is imposed upon the gross receipts from all sales, leases, rentals, installation, application, repair, or maintenance of tangible personal property, the gross receipts of every person providing or installing utility services, the gross receipts of a retailer of intellectual or entertainment properties, the gross receipts from the sale of admissions, the gross receipts from renting or furnishing accommodations or lodging for periods of less than thirty days, and the gross receipts from the sale or providing of certain enumerated services. (Reg-1-007, Gross Receipts)

001.01A For the purposes of the sales and use tax regulations, the term property shall mean all tangible and intangible property, rights, licenses, and franchises subject to tax under section 77-2703(1) of the Nebraska Revised Statutes.

001.02 This tax is not upon the article sold, but upon the transaction called the sale. The term "sale" includes installment, conditional and credit sales, and includes any transfer of title or possession, segregation in contemplation of transfer of title or possession, exchange, barter, lease or rental, conditional sale, or otherwise in any manner or by any means for a consideration.

001.03 The amount of sales tax collected is a trust fund held by the collector that belongs to the state. Any sales tax that is improperly or erroneously collected also belongs to the state and must be remitted.

(Sections 77-2702.07, 77-2702.14, 77-2702.15, 77-2703(1), and 77-3905(6), R.R.S. 2003. October 1, 2003.)

REG-1-002 CONSUMER'S USE TAX

002.01 The sales and use taxes complement each other and together provide a uniform tax upon either the sale, lease, rental, use, storage, distribution, or other consumption of all tangible personal property and on any intangible property or services the gross receipts of which are included in the measure of the sales tax under section 77-2703(1). Use tax is not a duplication of the sales tax. The storage, use, distribution, or other consumption of any item is taxable if the purchase of the item would be taxable if the transaction was completed in this state.

002.02 The consumer's use tax is imposed upon the storage, use, distribution, or other consumption of any tangible personal property and on any intangible property or services the gross receipts of which are included in the measure of the sales tax under section 77-2703(1). The consumer's use tax applies when the sales tax has not been paid. It is presumed that any property or services sold, leased, or rented by any person for delivery in this state is sold, leased, or rented for storage, use, distribution, or other consumption in this state until the contrary is established. The burden of proving that any property or services delivered in this state is delivered for a purpose other than storage, use, distribution, or other consumption in this state is on the person who purchases, leases, or rents the property or services.

002.03 Consumer's use tax is paid directly to the Nebraska Department of Revenue by the purchaser. A permit is not necessary or required.

002.04 Consumer's use tax does not apply to the following:

002.04A Transactions upon which the Nebraska sales tax has been paid;

002.04A(1) See requirements for remitting sales tax by holders of direct payment permits in Reg-1-097 or certificates of exemption for direct mail, Reg-1-105.

002.04B Storage, use, or other consumption of property or services exempt from sales tax;

002.04C Transactions where the tax has been properly paid on the sale, purchase, use, or other consumption of property or services in another state at a rate equal to or greater than the rate in Nebraska. (Reg-1-071, Credit for Tax Paid to Another State);

002.04D Transactions where the item purchased has been used for its intended purpose in another state. This exemption does not apply to motor vehicles, motorboats, or airplanes; and

002.04E Transactions where the item was purchased in another state, is stored in Nebraska, and is subsequently taken to and used in another state without any use other than storage in this state.

002.05 Consumer's use tax will apply to the following:

002.05A Purchases for delivery in Nebraska from out-of-state retailers when the applicable sales and use tax has not been paid;

002.05B Retail purchases made in this state when the applicable sales tax has not been paid;

002.05C Purchases at retail from federal government agencies and instrumentalities not required to act as collectors of Nebraska sales or use tax;

002.05D Purchases where an exempt sale certificate was originally given, but the property or service is subsequently put to a taxable use;

002.05E Use of property or services originally purchased tax free for resale purposes but which is later consumed for personal needs or consumed by or within the business;

002.05F Purchases from out-of-state retailers of items exempt in the other state that are used in this state and would be taxable if purchased in this state; or

002.05G Purchases that are manufactured, processed, or fabricated in another state and that are not used for their intended purposes in the other state after its manufacture, processing, or fabrication.

002.06 If a purchaser who gives a Resale Certificate makes any use of the property other than retention, demonstration, or display while holding such property for sale, lease, or rental in the regular course of business, the use shall be taxable to that purchaser as of the time when the property is first so used. Except for a purchaser of aircraft as provided in Reg-1-067, Aircraft and Related Services, the sales price of that property to him or her shall be deemed the measure of the use tax and the tax rate to be applied will be the rate in effect at the time of use.

002.07 The amount of consumer's use tax is computed by multiplying the purchase price of the property or service by the applicable rate in effect at the time of use. The rate applicable for consumer's use tax is the same as the rate for sales tax. Purchase price means the total amount of consideration for the property or services received and includes cash, credit, property, and services rendered.

002.08 Those persons holding a sales tax permit shall on the return required thereby, report and pay all consumer's use tax for which they are liable.

002.09 Persons not required to hold a sales tax permit but who are liable for consumer's use tax shall obtain a consumer's use tax return and report and pay the tax directly to the Nebraska Department of Revenue. Unless otherwise required by the Nebraska Department of Revenue, such consumers shall file returns annually if the tax will not exceed nine hundred dollars ($900.00). If the tax is expected to be between nine hundred dollars ($900.00) and three thousand dollars ($3,000.00), the returns shall be filed quarterly. All others shall file monthly.

002.09A Persons who are Model 1, 2, or 3 sellers may follow the filing frequency guidelines outlined in the Streamlined Sales Tax Agreement.

002.09B Persons who are registered under the Streamlined Sales Tax Agreement, do not have a legal requirement to register in the state, and are not Model 1, 2, or 3 sellers may follow the filing frequency guidelines outlined in the Agreement.

002.10 Returns, properly signed and accompanied by remittance, will be considered timely filed if mailed, postage prepaid, on or before the twenty-fifth day of the month following the close of the reporting period. When the twenty-fifth day falls on a Saturday, Sunday, or an approved holiday, the return will be considered timely filed if mailed, postage prepaid, on the next succeeding day which is not a Saturday, Sunday, or an approved holiday. A United States Postal Service postmark will be conclusive evidence of the date of mailing for the purpose of timely filing a return.

002.10A The Tax Commissioner will comply with the format for filing methods and payment methods pursuant to the Streamlined Sales Tax Agreement for Model 1, 2, or 3 sellers.

002.11 Remittance must accompany the return and be in the form of a check, draft, money order, or other payment method as approved by the Tax Commissioner made payable to the Nebraska Department of Revenue. Cash, post-dated checks, or postage stamps must not be sent as payment. Cash may be used when payment is made in person at an office of the Department of Revenue.

(Sections 77-2704.30, 77-2704.31, and 77-2706(3), R.R.S. 2003, and sections 77-1702, 77-1784, 77-2701.37, 77-2701.42, 77-2703(2), and 77-2708(1), R.S.Supp., 2008; and Penney Co., Inc. v. Balka, 254 Neb. 521 (1998). February 22, 2009.)

Nebraska Department of Revenue

Estimate of Sales Tax on Services

Requested by: Bill Lock--Revenue Committee

Date: September 28, 2009

NAICS		Estimated taxable sales FY2010-2011 (in thousands of dollars)	Estimated Sales Tax (in thousands of dollars)
237100	water well drilling	N/A	N/A
311610	custom meat slaughtering	4,500	248
485300	limousine service with driver	3,229	178
493100	fur storage	N/A	N/A
523900	investment counseling	32,976	1,814
531100	household goods storage/mini storage	N/A	N/A
541380	test laboratories excluding medical	24,563	1,351
541400	interior design	28,889	1,589
561300	employment agencies	29,208	1,606
561420	telephone answering	14,745	811
561730	landscaping services	170,752	9,391
561790	swimming pool maintenance	N/A	N/A
561900	packing and crating	N/A	N/A
713120	coin operated video games	115,615	640
713120	pinball and other mechanical amusements	N/A	N/A
713900	fishing and hunting guides	N/A	N/A

713930	marina service	N/A	N/A
811110	labor charges, repairs to motor vehicles	269,661	14,831
811120	auto service, except repairs, including painting and lube	176,882	9,729
811190	auto service, except repairs, including painting and lube	66,088	3,635
812111	barber shop	10,833	596
812112	beauty parlors	78,368	4,310
812113	nail parlor	20,352	1,119
812190	massage services	N/A	N/A
812210	funeral services	79,953	4,397
812310	laundry and dry cleaning service(coin)	12,263	674
812320	laundry and dry cleaning service	28,446	1,565
812930	parking lots and garages	19,711	1,084
812990	dating services	N/A	N/A
	carpet and upholstery cleaning	N/A	N/A
	labor charges, repairs to railroad rolling stock	N/A	N/A
	labor charges, repairs to intrastate vessels	N/A	N/A
	temporary help agencies	N/A	N/A
	personal instruction	N/A	N/A
	Internet service providers-dial up	N/A	N/A
	Internet service providers- DSL or other broadband	N/A	N/A
	Total	**1,187,034**	**59,568**

Building cleaning and maintenance services include both interior and exterior cleaning of commercial and residential buildings, homes, apartments, outbuildings and agricultural buildings.

Pest control services consist of providing inspection or certification reports, and identifying, preventing, controlling, neutralizing or eliminating by use of chemical or mechanical means infestations of pests in or on buildings, trees, lawns, shrubs and other property.

Security services consist of consulting and training services on security matters, protecting property from theft, vandalism and destruction, or protecting individuals from harm.

Motor vehicle washing and waxing services include the washing, waxing, polishing and detailing the exterior or interior of a car, van, bus, truck, trailer, tractor and semi-trailer, recreational vehicle and motorcycle. Coin-operated facilities are included and may commingle the amount of tax in the selling price of the service.

Motor vehicle towing consists of towing, pulling, or transporting a motor vehicle and includes pulling or winching a vehicle out of a ditch and up-righting overturned semi-tractors and trailers or other motor vehicles.

Motor vehicle painting includes painting and refinishing processes on cars, vans, buses, trucks, trailers, tractors and semi-trailers, recreational vehicles and motorcycles

Computer software training charges are taxable when paid to the retailer of the software. The training can be conducted by the retailer of the software or on its behalf by another person. The charges are taxable regardless of whether the training is an optional or a mandatory part of the sale, lease, rental or licensing of computer software, or whether the training is provided at a different time than the actual sale of the software.

Installation and application labor is subject to tax when associated with property that is subject to tax. Charges for the installation and application of property are taxable whether performed by the seller of the property or another person.

Labor performed by an Option 1 contractor is subject to tax and consists of annexing, fabricating, installing, applying, and repairing building materials and fixtures annexed to real estate.