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State Income Taxes in Nebraska

This is one of a series of NebGuides on financing state and local government. This publication describes how income taxes support state government functions.

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State government in Nebraska has levied a tax on income since 1968. This tax applies to income earned by individuals, fiduciaries (trusts and estates) and corporations.

Prior to 1987, Nebraska's income tax for individuals and fiduciaries was based on a percentage of federal income tax liability.

Beginning with the 1987 tax year, the base for individual and fiduciary income taxes was changed to Nebraska taxable income. The base for corporation income taxes also was adjusted in 1987 so that, after a phase-in period, taxes for multi-state taxpayers would be levied only on net income allocated according to sales within the state.

State income taxes, together with general sales and use taxes, provide most of the revenues for the state's general fund. In fiscal year 1990-91 (hereafter FY 1991), net state income tax collections amounted to $691.3 million.

Historical Perspective

In 1861, the federal government imposed the first personal (individual) income tax to help finance the Civil War. It subsequently was repealed in 1872 because its revenues were no longer needed.

In 1894, the federal government again felt it necessary to impose an income tax. This one was even more short-lived than the Civil War tax because the Supreme Court declared it unconstitutional.

Later, ratification of the 16th Amendment to the Constitution resolved the constitutionality issue. With the path thus opened in 1913, Congress quickly adopted an income tax system that applied to both individuals and corporations.

World War II revenue needs forced a massive expansion in income taxes and established the overriding importance of personal and corporation income taxes in the federal tax structure. Since then, specific provisions within the federal income tax code have been changed many times.

Many states used low-rate, locally administered income taxes in the 19th century, but these taxes yielded little revenue. Not until Wisconsin imposed an income tax in 1911, with state control of administration, did income taxation begin to play a significant role as a revenue source for states.

Thirteen states adopted the tax by 1930 and another 15 were added during the Depression. From 1937 until the early 1960s, no new states were added to the list. Nebraska was a relative late-comer to income taxation, waiting until the state property tax was abandoned in the late 1960s before shifting to income and sales taxes as the primary sources of revenue for the state general fund.

By 1991, all states except Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming had a state individual income tax. Eleven states plus Washington, D.C. also had local (city or county) income taxes, with particular emphasis on such taxes in Maryland, Ohio and Pennsylvania. Local income taxes have never been authorized in Nebraska.

Major Features of the Nebraska Individual Income Tax

Calculation of the individual income tax obligation in Nebraska begins with the federal adjusted gross income. To this, add non-Nebraska tax-exempt bond interest, and subtract interest on U.S. Government securities.

Deductions are given for personal exemptions ($1,290 in 1991), and either the Nebraska standard deduction or the federal itemized deduction less any state or local income taxes in the itemized deduction, whichever is greater. For tax year 1991, the standard deduction is $3,400 for single taxpayers, $5,000 for heads of households and $5,700 for couples filing jointly.

Individual income tax rates are arrayed in four brackets, ranging from 2.37 to 6.92 percent of Nebraska taxable income in 1991 (*Table I*). Rates within brackets are set on the basis of a predetermined percentage of what is termed the primary rate. The primary rate for 1991 is 3.70 percent. As recently as 1989, the primary rate was 3.15 percent, resulting in rates within brackets of 2.00 to 5.90 percent.

Table I. Nebraska individual income tax rates, 1991.

		Nebraska Taxable Income		
Bracket No.	**Tax Rate (%)**	**Married, joint return**	**Head of household**	**Single**
1	2.37	$0-3,000	$0-2,500	$0-1,800
2	3.63	3,000-28,000	2,500-23,000	1,800-16,800
3	5.62	28,000-45,000	23,000-38,000	16,800-27,000
4	6.92	Over 45,000	Over 38,000	Over 27,000

Source: Nebraska Department of Revenue, unpublished data.

The legislature sets the primary rate based on two major criteria: 1) the need to generate sufficient funds to meet the state budget, and 2) expected amounts to be raised from other sources, especially general sales and use taxes.

Nebraska income taxes actually due from an individual taxpayer may be affected by certain state credits.

For example, taxes paid on motor vehicle fuels that have been used for non-highway purposes may be claimed as a credit. In addition, credit may be allowed certain elderly and disabled persons, and for taxes paid in other states.

Most rules for the collection of state income taxes are similar to federal regulations. For example, individuals earning salaries and wages have their state tax withheld each pay period. Self-employed persons make quarterly tax payments just as they do for federal tax purposes. Perhaps the biggest difference is that state tax payments are made to the Nebraska Department of Revenue, not the Internal Revenue Service.

Major Features of the Nebraska Corporation Income Tax

Corporate income tax rates also are linked to the primary tax rate. Specifically, the corporation income tax rate on the first $50,000 of taxable income is 150.8 percent of the primary rate. Taxable income above $50,000 is taxed at 211 percent of the primary rate. Thus, in 1991, the main tax rates were 5.58 and 7.81 percent, respectively. (As a temporary measure, LB 829 implemented an 8.98 percent rate on income above $200,000 for tax year 1991 only.)

Two laws passed in 1987 (LB 775 and LB 270) offer tax credits to certain non-retail corporations and other business entities that increase investment and employment in their Nebraska operations. Individual corporations may pay less income tax than is indicated by the brackets and rates above.

Income Taxes as a Revenue Source

Net receipts of individual income taxes in FY 1991 amounted to $609.4 million (*Table II*). Another $81.9 million was collected from the corporate tax. Overall, just over half of the state general fund revenue came from these sources.

Table II. Net receipts from state individual and corporate income taxes, selected years.

Fiscal Year	Individual ($ mil.)	Corporate ($ mil.)	Total ($ mil.)	Total as a percent of general fund receipts
1970	53.8	8.6	62.4	35
1980	271.2	57.7	328.9	53
1990	501.1	71.9	573.0	50
1991	609.4	81.9	691.3	51

Source: Nebraska Legislative Fiscal Office, unpublished data.

Individual income tax collections grew at 12.49 percent annual rate from FY 1968 through FY 1991. When considered in 10-year blocks, the average annual increase of 9.39 percent in the decade ending in FY 1991 was less than the 14.66 percent recorded between FY's 1971 and 1981.

Part of the growth in individual income tax collections has been necessitated by inflation-related expenditure increases. More importantly, however, inflation-adjusted (real) spending on state aid for individuals and local units of government has increased dramatically.

In FY 1992, for example, appropriations for more than 50 different forms of state aid (including aid to local units of government, individuals and miscellaneous community-based activities) totals $900.9 million dollars or 58.7 percent of the general fund budget.

In contrast, in FY 1971, state aid amounted to only about $50 million (25 percent of the state budget) and was concentrated in three areas: aid to public school districts, aid to cities and counties, and homestead exemptions. With no changes in the scope of state aid, inflation alone would have increased expenditures to only about $175 million during this period.

Nebraska individual income tax receipts amounted to $386 per capita in FY 1991, up significantly from $270 per capita only three years earlier. Traditionally, Nebraska's income tax collections on a per capita basis have trailed adjacent states (except South Dakota and Wyoming, which have no such tax) and the U.S. average.

It is likely that when state-by-state comparisons become available for 1991 and subsequent years, Nebraska's ranking will rise because of a combined 17.5 percent increase in rates that occurred in 1990 and 1991.

Corporate income taxes traditionally have accounted for a modest portion of state tax revenues in Nebraska. In FY 1991, only 6.0 percent of the total came from this source. This compared to 6.2 percent in FY 1990 and 9.3 percent in FY 1980.

Beginning with the imposition of corporate income taxes in FY 1968 and continuing through FY 1991, corporate income tax collections grew at an average annual rate of 11.93 percent. For the most recent decade, FY 1981 to FY 1991, the annual growth rate was only 4.23 percent.

More modest increases in corporate tax collections in recent years probably can be attributed to a soft economy in the first half of the 1980s, a change in the corporate income tax base in 1987, and the initial effects of LB 775 and LB 270.

Two final points should be noted with respect to corporate income tax collections.

First, despite relatively modest overall growth over the past decade (and some year-to-year declines), collections reached a new all-time high in FY 1991.

Second, the proportion of state and local tax revenues coming from corporate income taxes is only about half as much in Nebraska as nationally, according to the Washington D.C.-based Tax Foundation.

Income Tax Progressivity

In a general sense, individual and corporate income taxes in Nebraska are progressive. Those with higher taxable incomes pay a larger percentage in taxes than those with lower incomes.

It initially may appear that the individual tax is more progressive than the corporation tax because the former has four brackets, compared to two for the latter. In making comparisons, however, it's important to note that the top bracket begins at a higher income level for corporations. Even more importantly, various credits may significantly alter actual taxes paid for both individuals and corporations.

In short, comparisons of progressivity of individual and corporate income taxes are difficult, if not impossible.

An April, 1991 study by the Citizens for Tax Justice (CTJ), a national lobbying group for middle- and low-income families, examined the impact of various taxes on families in each of the 50 states and the District of Columbia. In each state hypothetical four-member families were divided into five average income quintiles: the lowest 20 percent, second 20 percent, middle 20 percent, fourth 20 percent, and top 20 percent (which is comprised of the next 15 percent, next four percent, and top one percent).

According to the study, the average family in the lowest income quintile pays no state income tax (*Table III*). Families in each succeeding quintile do pay taxes, with the proportion of income paid in taxes increasing successively through higher income categories.

Table III. Nebraska individual income taxes as shares of income for families of four, 1991.

Family income group	Average income	State income tax as a percentage of income
Lowest 20%	$11,700	0.0%
Second 20%	23,900	1.5%
Middle 20%	33,200	2.0%
Fourth 20%	46,100	2.5%
Top 20%		
-----Next 15%	70,200	3.2%
-----Next 4%	143,200	4.2%
-----Top 1%	582,900	5.3%

Source: Citizens for Tax Justice (CTJ). *A Far Cry From Fair, CTJ's Guide to State Tax Reform*, April, 1991. (Reported in Nebraska Tax Research Council, "Today's Taxes." Report No. 167, October 10, 1991).

On the average, those whose income is in the top one percent of all Nebraska taxpayers pay an average of 5.3 percent of that income in state income taxes.

Comparison of Nebraska's income tax system with other states also leaves one with the impression that Nebraska's individual income tax system is more progressive than many, perhaps most, other states.

As of October 1, 1987, four states (Illinois, Indiana, Michigan and Pennsylvania) had flat individual income tax rates across all income levels. Another 30 states reached the top rate at levels below Nebraska's $45,000 (for married taxpayers filing joint returns). That left only eight states (out of a total of forty-two with individual income taxes at that time) that appeared to have more progressive systems than Nebraska's. And that counts New Jersey, which had a top bracket beginning at $50,000, with a top rate of only 3.5 percent.

Corporate income tax rates were flat across all income levels in 30 of the 45 states with such a tax on October 1, 1987. Another six states had lower top brackets than Nebraska. Only Alaska, Hawaii, Iowa, Kentucky, Louisiana, Maine and New Mexico had higher top brackets and rates than Nebraska. Vermont's top bracket also began at $50,000, but with a rate of 10.5 percent, considerably above Nebraska's 5.9 percent at the time.

Income Tax Critique

Students of public finance often suggest that from a *fairness* standpoint, taxes should be levied on the basis of ability to pay or benefits received.

Income taxes probably meet the ability to pay principle better than any other tax. Many would argue that income taxes are even more equitable if applied with progressive rates and appropriate exemptions and deductions. This can result in the *transfer* of income from those relatively better off to those less well off, particularly with respect to social service programs.

In addition, when considering a total tax system, income taxes can compensate for the weaknesses of sales and property taxes, neither of which is based directly on the ability to pay nor has progressive rates.

However, income taxes may not be viewed as fair when considered from the perspective of benefits received. To the extent that income tax revenues are directed to the less fortunate in our society, the benefits received principle may be almost completely ignored -- even though there may be good public policy reasons for using public funds for this purpose.

Convenience is another desirable attribute for a tax. Individual income taxes on wages and salaries are conveniently paid through withholding. Quarterly payments are required on other income that exceeds specified levels.

From the standpoint of *simplicity*, Nebraska's individual income tax system has merit because it is based on federal adjusted gross income, from which relatively few adjustments must be made to determine Nebraska taxable income.

Generally speaking, trade-offs exist between simplicity and fairness. Thus, any further moves toward simplicity may not be desirable in an overall sense. Administration and compliance also are enhanced by linkage with the federal income tax.

Policymakers like the way income taxes, especially progressive income taxes, respond to income increases. According to one analysis, each 10 percent increase in economic activity automatically increases state income tax collections 15 to 18 percent. This helps reduce the frequency with which tax rates have to be increased.

On the other hand, during recessions income tax revenues are much less *certain*, or dependable than, for example, property taxes. Income tax obligations can decline more rapidly than income.

Other objections to income tax are that: 1) states should not duplicate taxes that already are being imposed at the federal level; 2) exemptions and deductions assure that a significant percentage of Nebraskans pay no -- or very small amounts of -- taxes. Sometimes it's argued that every citizen should pay at least some taxes.

The corporate income tax provides some revenue and makes the individual income tax somewhat more acceptable, politically. In addition, it may preclude opportunities for other states to find indirect ways of taxing corporate income earned in Nebraska.

Critics charge that corporate income taxes are shifted to stockholders, suppliers, employees and consumers. Therefore, needed revenue might be obtained more equitably through the individual income tax.

It's also argued that the 1987 employment incentive acts (LB 775 and LB 270) altered the projected revenue stream from the corporate income tax so that it no longer is predictable from a planning standpoint.

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