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FINANCING PUBLIC SERVICES IN NEBRASKA 1968

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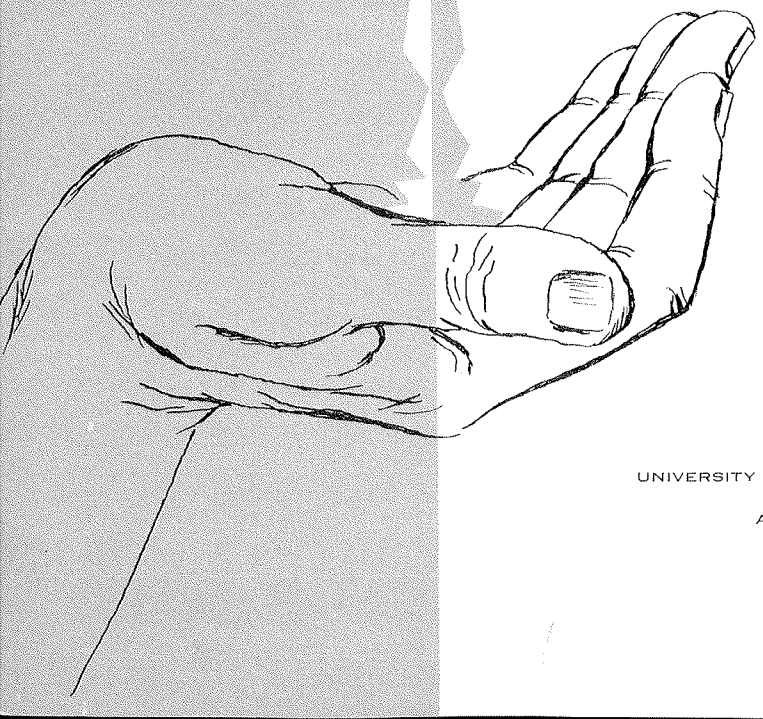


UNIVERSITY OF NEBRASKA COLLEGE OF AGRICULTURE AND HOME ECONOMICS
EXTENSION SERVICE
AND U. S. DEPARTMENT OF AGRICULTURE COOPERATING
E. F. FROLIK, DEAN J. L. ADAMS, DIRECTOR

FOREWORD

Nebraska citizens as individuals, as members of organizations, as business managers, as legislators, and as administrators of public institutions and agencies are concerned with state and local public finance problems.

These problems are: demands for more and better public services; the number and types of local governmental units; the increasing costs of state and local government; and the methods of raising revenue to finance public services.

The expenditure and revenue system of Nebraska's state and local governments were substantially overhauled by the 1967 Legislature. These changes directly or indirectly affect all the citizens of the State. The application of the sales and income taxes and the appropriation of funds are, in part, related to other aspects of the tax system because we have an interdependent tax system, not a set of separate levies.

The purpose of this publication is to provide Nebraska citizens with factual information on current expenditure patterns and revenue systems of state and local governments, on the operation of major taxes, and on the effects of possible changes now under discussion.

CONTENTS

	Page
GOVERNMENTAL ORGANIZATION IN NEBRASKA	3
WHERE THE MONEY GOES	4
SOURCES OF REVENUE	7
PROPERTY TAX IN NEBRASKA	8
SALES OR CONSUMPTION TAXES	11
Operation of Nebraska's Retail Sales Tax	13
STATE INCOME TAXES	15
Nebraska's Income Tax	17
SALES INCOME TAXES IN NEBRASKA'S TAX SYSTEM	20
Possible Changes	21

FINANCING PUBLIC SERVICES IN NEBRASKA - 1968

by

Everett E. Peterson and Jack D. Timmons
Agricultural Extension Economists

GOVERNMENTAL ORGANIZATION IN NEBRASKA

Organization to provide public services is the basic function of government, whether local, state or federal. Public services in Nebraska are provided by nearly 4,400 different governmental units. These include the state government, 93 county governments, and a multitude of cities, villages, townships, school districts and special districts as shown in Table 1.

Table 1. Local governments in Nebraska.

Type	Number of governmental units in:			
	1942	1957	1964	1967
School districts	7,009	4,942	2,680	2,322
Special districts	198	610	802	952
Municipalities	530	534	537	538
Townships	476	478	478	478
Counties	93	93	93	93
Total	8,306	6,657	4,590	4,383

State Government

State government is composed of three branches: (1) the one-house legislature, responsible for the enactment of all state laws; (2) the executive, composed of the various administrative agencies; and, (3) the courts, which interpret the laws and resolve disputes between the government and individuals, between individuals and between agencies of government.

The state government is the basic key to all governmental activities. Not only does state government itself perform a wide variety of functions, but all activities carried on by other units of government must first be authorized by the Legislature as provided in the State Constitution. Of course, this does not mean that a city, township or other unit must ask permission of the Legislature each time it wishes to add a service. It does mean that the program must be one authorized in general legislation and within the limitations and procedures prescribed by the Legislature.

Local Government

As shown in Table 1, major changes have occurred in numbers of school and special districts. School districts have decreased in number by 67 percent since 1942, but Nebraska still has more school districts than any other state in the nation. Nebraska also depends more on local revenue for public schools than any other state. Ninety percent of public school revenue is local and 95 percent of that comes from the property tax. State aid payments are scheduled to begin in the 1968-1969 school year.

WHERE THE MONEY GOES

State Government Services

Expenditures for Nebraska state government have been increasing during the post-war period as they have in other states. The main reasons for increases are: citizens' demands for more and better public services; rising general level of prices and wages; and "catching up" from drought, depression and war periods. Since the 1947-49 biennium, state government expenditures have risen 361% as shown in Table 2. The increase from the 1965-67 biennium to 1967-69 is 38%, including state aid to local governments.

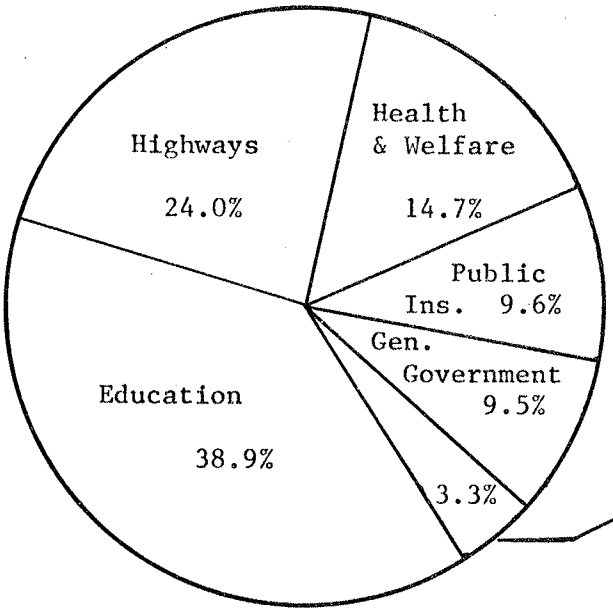
Table 2. Nebraska state government expenditures, 1947-49 to 1967-69.

Biennium	Expenditures in millions
1947-49	$133.0
1949-51	151.4
1951-53	167.9
1953-55	176.2
1955-57	228.6
1957-59	264.7
1959-61	296.4
1961-63	330.6
1963-65	375.4
1965-67	444.5
1967-69	623.4

Education, highways and welfare account for almost 80% of state government expenditures as illustrated in Figure 1. Several significant changes in state expenditures took effect in the 1967-69 biennium. Education has replaced highways as the major functional area of expenditures. For the first time in more than 60 years, Nebraska's Legislature appropriated substantial state aid to local governments. Table 3 shows major expenditure areas for state government and comparisons

between 1965-67 and 1967-69. Notice that highway appropriations remained the same for 1967-69 while education received a sizeable increase. Together, these two functions amount to about 60 percent of the state budget.

FIGURE 1. Percentage Distribution of State Government Appropriations by Functions, 1967-69



Purpose	Millions
Education	$238.1
Highways	147.3
Health & Welfare	90.6
Public Inst.	58.6
General Govern.	58.1
Protection to person & property	20.4
Total	$613.1*

*Does not include $10 million city-county aid.

Table 3. Comparison of state government appropriations for 1965-67 and 1967-69.

	1965-67		1967-69	
Function	Millions	Percent	Millions	Percent
Education	$123.0	27.7	$238.1	38.9
Highways	147.3	33.1	147.3	24.0
Health & Welfare	62.7	14.1	90.6	14.7
Public Institutions	47.6	10.7	58.6	9.6
General Government	48.8	11.0	58.1	9.5
Protection to person & Property	15.1	3.4	20.4	3.3
Total	$444.5	100	$613.1*	100

*Does not include $10 million city-county aid.

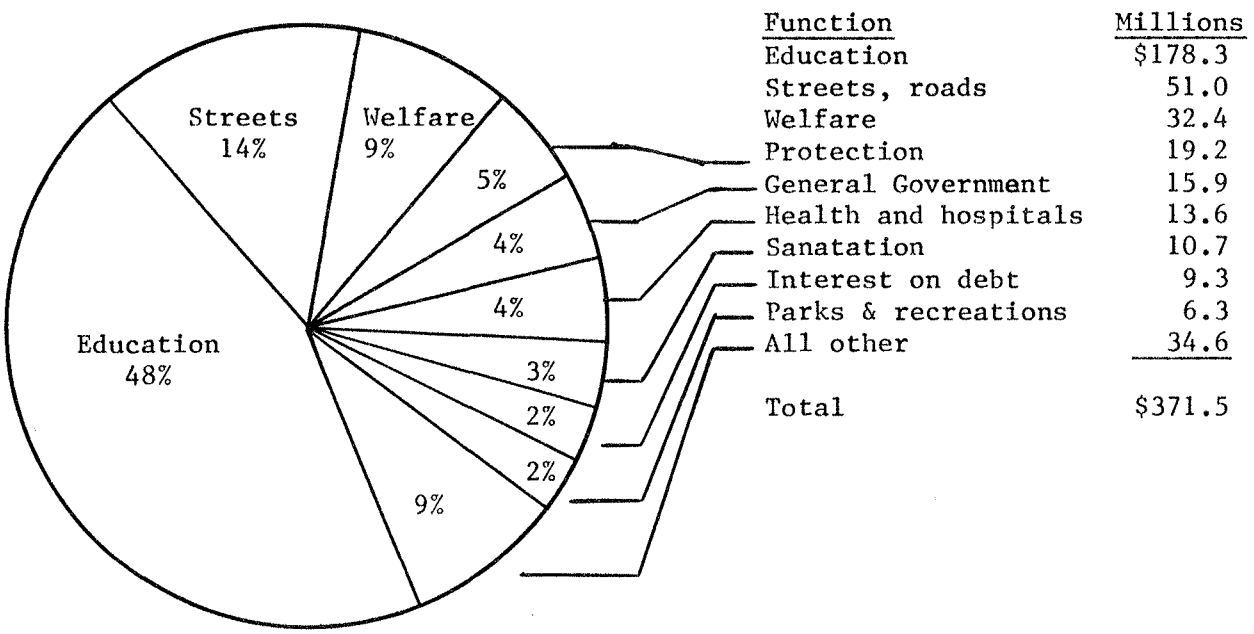
The 1967 Legislature appropriated $40 million in aid to local units of government. This is composed of about $25 million for elementary and secondary schools, $10 million for cities and counties and $5 million for junior colleges and the University of Omaha. Part of this need for state aid originated when the head tax and intangible and household personal property taxes were repealed for all local government purposes as of December 31, 1967. The sales-income tax was designated as the source for this replacement revenue. All of the money appropriated for counties and cities is for this purpose and $10 to 15 million of school aid funds will replace this lost revenue source.

Local Government Services and Costs

Nebraska depends more heavily upon local government for providing public services than most other states. This has been particularly true of education since most other states have provided some form of state aid to local public schools for several years. Nebraska will start such a program in the 1968-69 school year.

Of total local expenditures, 62% goes for education and streets and highways; see Figure 2. Local school districts, providing primary, elementary and secondary education, account for most of the expenditures for education. However, there are four junior colleges, one university (Omaha), and, since 1966, area vocational schools financed by local funds. The junior colleges will receive some state funds in 1968-69. The University of Omaha becomes part of the University of Nebraska on July 1, 1968.

Figure 2. Local Government Expenditures by Functions, Nebraska, 1966



Local streets and roads are financed in part by shares of the state gasoline tax, motor vehicle license fees and federal funds, but most are financed by the general property tax and from special assessments.

Although the remaining functions comprise only about one-third of total local expenditures, there have been increasing pressures on local government, especially cities and towns, to expand these functions and improve those already provided. The greatest demands at present appear to be for more and better hospitals, improved sanitation, better police and fire protection, and expanded recreational facilities.

SOURCES OF REVENUE

Recent Changes

The tax system in Nebraska has undergone major revisions since 1964 and more changes are being considered. The 1965 Legislature enacted a state income tax which would have replaced state property taxes as the Constitution then required. This law (LB797) was repealed by the voters when placed on the ballot by referendum petition in November, 1966. Also placed on the ballot by initiative petition in this election was a constitutional amendment to prohibit state government from using the property tax as a revenue source without regard to alternative taxes. This amendment was approved by the voters.

The effects of these actions were to: (1) eliminate state property taxes after 1966, the source of about 17% of the state government's income; (2) repeal the tax that would have provided the needed replacement revenue; and (3) put the 1967 Legislature in a "forced action" situation.

The 1967 Legislature enacted a tax law (LB377) which provided a general retail sales tax starting June 1, 1967, and individual and corporate income taxes effective January 1, 1968. The Legislature also repealed the head tax and local property taxes on household goods and intangibles. The revenue from sales and income taxes is being used to replace that formerly coming from state property taxes, to provide state aid to public schools, to reimburse local governments for revenue lost by the repeal of local property and head taxes and to finance larger appropriations for state government services.

The state general fund levy on property formerly served as the "budget balancer" for state government. The rate was set each year by the State Board of Equalization to raise the amount of money needed to equal the amount appropriated by the Legislature, after estimating receipts from all other sources. The state income tax now has this flexibility feature with the Board setting the rate each year to balance the budget. Such flexibility is necessary in the State's tax system because bonded indebtedness is limited to $100,000 by the Constitution.

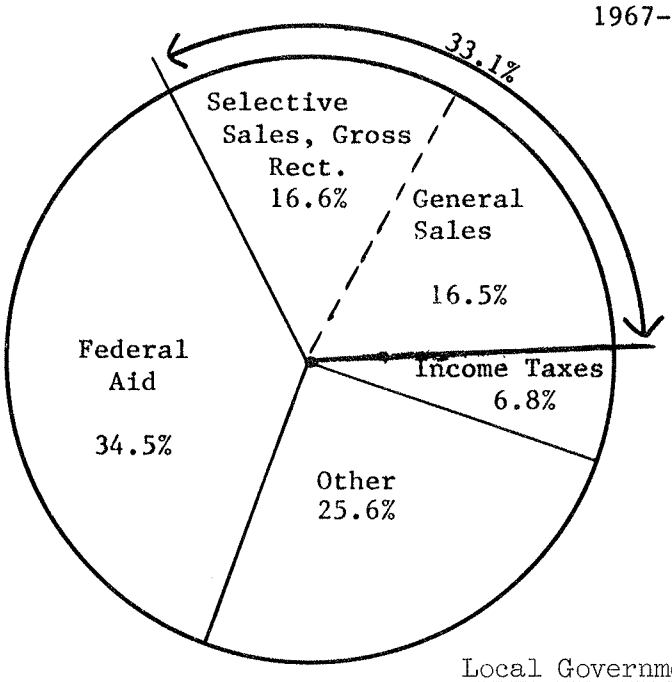
The Legislature has final control over the income tax rate through appropriations since the rate can be set only high enough to meet expenditures authorized by the Legislature.

State Government Revenue

Total revenue for state government comes from four major sources. Federal aid, mostly for highways, education, research and welfare, is the largest single source of income. Second in importance are the general and selective sales taxes of which motor fuels taxes are earmarked for roads and streets. The state income tax, now only 6.8% will provide a larger share of total revenue in future bienniums when it will be in effect for the full two years. The general retail sales tax

and the state income tax are now the main sources of revenue not earmarked to finance specific functions. Other sources of revenue include payments made by counties for patients in state hospitals, student fees, and other fees and charges. The comparative importance of these revenue sources is summarized in Figure 3.

Figure 3. Estimated Revenue Sources for State Government Services 1967-69 Biennium



Source	Millions
Federal Aid	$225
Selective Sales & Gross Rct.	109
General Sales	107
Income Taxes	45
Other	167
Total	$653

Local Government Revenue

Local governments, as "creatures of the state," derive their revenue powers from the State Legislature and the Nebraska Constitution. The Legislature, within the limits of the Constitution, grants specific methods of taxation to local units of government.

The property tax is the most important source of revenue for local governments, amounting to 94% of all local government tax revenues and 58% of all revenues in 1966. Sources of revenue other than tangible property taxes are: shares of the gasoline and grain taxes; motor vehicle license fees and operators' permits; federal aid to municipalities; state aid; and numerous fees.

THE PROPERTY TAX IN NEBRASKA

The property tax was first levied by the territorial auditor in 1854. The territorial legislature adopted the Iowa revenue code in 1857. During the first 50 years of statehood, Nebraska had no other significant source of revenue. After 1920, its importance declined as a source of state government revenue until it was eliminated entirely in 1966. It remains the main source of revenue for local government in Nebraska and other states.

The present property tax is based on the 1903 Revenue Law, which provided for continued taxation of tangible property and made special provisions for taxing capital stock, shares of banks, railroads, and insurance companies. Subsequent

legislation and amendments to the Constitution have provided special methods for assessing cattle and motor vehicles and special methods of taxing domestic corporations, building and loan associations, motor carriers, airline equipment, and grain and seed. Some types of property have been exempt from taxation, most recently, household goods not used for income-producing purposes, and intangible personal property. A constitutional amendment will be submitted to the voters in November, 1968 to authorize the Legislature to exempt other tangible personal property, such as business inventories and equipment, and farm machinery and livestock.

Operation of the Nebraska Property Tax

The county assessor is responsible for listing real estate and improvements on the tax rolls and determining their assessed value. The taxpayer is responsible for reporting tangible personal property, but assessors are required to examine personal property returns. The total value of all property subject to taxation is the base upon which the property tax is levied and collected.

All real and personal property must be valued at actual value but assessed at 35% of actual value under present law. Real property values are supposed to be determined every year, but in practice values are generally carried over from one year to the next. A law passed in 1963 requires periodical reappraisal in all counties.

Detailed schedules are provided to county assessors for determining values of motor vehicles, farm machinery and equipment, livestock, coin-operated laundry equipment, bowling alley equipment, and industrial earth moving equipment. Uniform depreciation schedules based on book value are provided for pipe line companies, oil and gas well equipment, telephone equipment, REA lines, and business furniture, fixtures and equipment. The value of merchants' inventories is determined from the taxpayers' account books and related financial records. These records may be checked against federal income tax returns. Total 1966 assessed valuations of major classes of tangible property in the state are shown in Table 4. Note that real estate accounts for 73% of the total.

Table 4. Assessed valuation of tangible property in Nebraska, 1966.

	Class	Assessed value	Percent of total
		(Millions)	
1.	Rural land and improvements	$1,679	38.8
2.	Town lots and improvements	1,642	33.8
3.	Business schedules	276	6.4
4.	Motor vehicles	269	6.2
5.	Cattle	168	3.9
6.	Tractors and farm machinery	121	2.8
7.	Special schedules	119	2.8
8.	Franchises, railroads and pullman	93	2.1
9.	Household goods	83	1.9
10.	Oil and mineral interests	15	.4
11.	Hogs	13	.3
12.	Feeds	9	.2
13.	All other	16	.4
	Total	$4,323	100.0

The taxpayer may appeal the assessed valuation of his property and, therefore, his share of the cost of government by going to his County Assessor, County Board of Equalization, District Court, and State Supreme Court. The County Board of Equalization consists of the County Board of Supervisors or Commissioners. It equalizes assessments within the county, hears complaints, and can change individual assessments and add property omitted from the tax rolls. The State Board of Equalization and Assessment, consisting of the Governor, Secretary of State, State Auditor, State Treasurer, and Tax Commissioner, equalizes assessments among counties, taxing districts, and classes of property.

Property tax levies are determined each year by dividing the property tax portion of the fund requests of the various units of government by the total assessed valuation of the taxing district. The County Clerk receives such requests for funds from each unit of local government: county, township, school district, municipality, and special districts.

The County Board of Equalization then establishes the mill levies needed to collect the requested funds. For example, if the assessed valuation of a school taxing district is $30 million and the district needs $600,000, the mill levy would be 20 mills per $1 of assessed value or $20 per $1,000. Most local property tax levies are characterized by flexible rates. Each taxpayer's share of local property taxes is determined by applying these mill levies to the assessed valuation of the taxpayer's property.

After the individual's tax bill has been determined, the County Treasurer may bill him for the amount of personal property taxes due. This is customarily done in Nebraska. The County Treasurer is not required to notify real property owners of the amount of taxes due. Thus, it is the taxpayer's responsibility to find out how much tax he owes and when it is due. Real estate taxes become due January 1, except in the city of Lincoln where the date is the previous December 1. The taxpayer may pay half by the following May 1 and the second half by September 1. These optional dates are April 1 and August 1 in Douglas County. Thus, 1967 property taxes are being paid in 1968.

Unless at least half the taxes are paid by May 1, the real estate tax becomes delinquent and draws interest at 7% per year from the due date. The County Treasurer may sell tax certificates to recover delinquent taxes. These tax sale certificates represent a first lien against the property. The purchaser of such certificates receives the interest. He may obtain a tax deed to the property after three years and title to the property by foreclosing within two years after that. The owner may redeem the property by paying delinquent taxes plus interest and advertising costs during this five-year period.

Tangible personal property, like real property, is assessed at 35 percent of actual value and taxed at the same rate as real estate within the same taxing district. Personal property taxes are due on November 1 and may be paid in two installments--half by December 1 and the second half by the following July 1. Delinquent personal property taxes also draw interest at 7 percent from the date due. The penalty for failure to report tangible personal property is 50 percent of the amount of taxes due plus interest at 7 percent. Note that even though the property tax on household goods was eliminated as of December 31, 1967, those taxpayers who did not pay the entire amount by December 1 will have to pay the second half in 1968.

Effects of Changes in Property Taxes

Individual taxes for 1968 will be reduced by the amount of head and intangible and household property taxes which would have been paid under our former tax system. The amount of state aid to public schools and junior colleges will also reduce local property taxes where such aid exceeds increases in local government expenditures. Even where increases absorb all state aid, the local property tax will be relieved; otherwise such increases in the cost of public services would have been financed entirely from increased property tax levies. New levies to be established locally in August, 1968, will reflect state aid. First payments to aid school finance will be made in December, 1968, and April, 1969; the first payments to counties and cities will be in January, 1969.

Elimination of state property taxes has already been reflected in 1967 property taxes which are paid in 1968. Any increase in 1967 local property tax levies is the result of higher local government costs or reductions in assessed values of real property which shifted taxes to tangible personal property in some areas. Some taxpayers, especially in rural areas, have already experienced as much as 20-40 percent decrease in real property taxes as a result of elimination of the state levy.

Although the full effects of property tax changes have not yet been realized by Nebraska property owners, the total amount of "relief" in 1968 is estimated at $95 million. Total property taxes of $308.3 million were collected for all purposes in 1966. This property tax relief consists of: repeal of all state property taxes; repeal of household goods and intangible taxes; and state aid in financing local public schools, junior colleges and the University of Omaha. Property taxes are now used exclusively by local units of government in Nebraska.

Summary of Changes Affecting Property Taxes

Property Tax Dates for Taxpayers

Tax	Date of Expiration	Date of Final Payment
State property taxes	December 31, 1966	September 1, 1967
Intangible taxes	December 31, 1967	July 1, 1968
Household goods tax	December 31, 1967	July 1, 1968
Head tax	December 31, 1967	July 1, 1968

Payment Dates for State Aid to Local Government

Type	Source of funds	Date of First Payment
Junior Colleges	Sales and income taxes	March, 1968
University of Omaha	Sales and income taxes	March, 1968
Public Schools	Sales and income taxes	December, 1968
Counties and towns	Sales and income taxes	January, 1969

SALES OR CONSUMPTION TAXES

Sales taxes are levies on consumption of certain items by individuals or business firms. The main types are: the gross receipts tax levied on total sales

of retailers or wholesalers and usually included in prices paid by final consumers; the specific sales tax levied on sales of certain items such as gasoline, cigarettes and liquor; and the general retail sales tax levied on sales of all items not specifically exempt and stated separately from price.

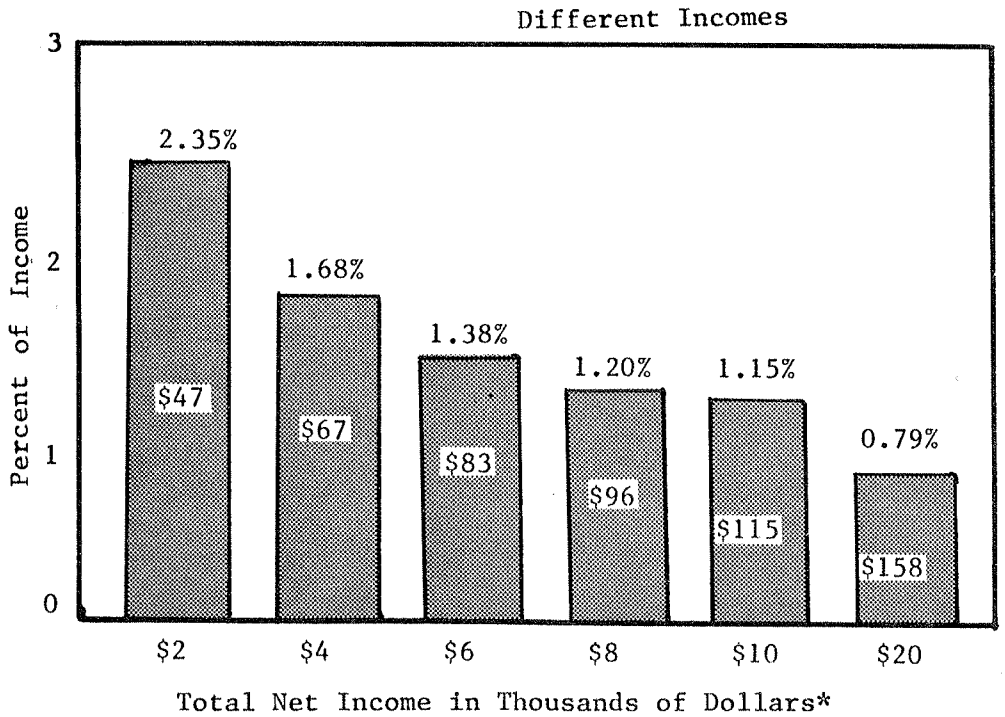
The first general sales tax was enacted by Mississippi in 1932; it is now used by 44 states, including Nebraska. Exemptions vary widely and several states apply the tax to service charges in addition to sales of tangible personal property. Rates range from 2 to 6 percent. It is also used by some cities and counties as a source of revenue. The amount paid in state sales taxes is a deductible item in figuring the federal individual income tax.

The main advantages of the general sales tax are:

Individual taxpayer	Government	Society
1. Convenient to pay	1. Stable revenue source	1. Widespread sharing in cost of government
2. Simple and certain	2. Good yielder of revenue	2. Tax awareness
3. Economical (no forms or records)	3. Economical to administer	3. Little effect on economic activity

The chief disadvantage of the general retail sales tax is that it is regressive. It takes a larger share of the income of low-income families and of the income of large families than of the incomes of higher income taxpayers. This tendency is illustrated in Figure 4 which shows the amount of Nebraska sales tax paid by families of four persons in different income situations. Note that the percent of income declines from 2.35% with $2000 of net income to 0.79% with $20,000 of net income. The reason for this is that low-income and large families spend a larger share of their incomes on items subject to the sales tax. The purpose of exemptions and tax credits is to reduce this regressivity.

Figure 4. Estimated Nebraska Sales Tax Paid (Rate 2½%) Families of Four Persons, Different Incomes



* Total net income from wages and salaries; net income from business (amount entered on Line 9 of IRS Form 1040).

From the governmental standpoint, the main disadvantage is that the sales tax rate is inflexible. The rate is usually fixed by the Legislature and revenue is determined by volume of retail sales rather than by level of appropriations. This could result in surpluses and deficits. Other disadvantages are that it is not well adapted to local use unless administered by the state. Administration may be complicated by exemptions and by definitions of what constitutes a taxable sale.

Operation of Nebraska's Retail Sales Tax

The Nebraska Revenue Act of 1967 (LB377) provided for a general retail sales tax and an income tax as sources of state government revenue. The sales tax went into effect on June 1, 1967 at $2\frac{1}{2}$ percent; the rate is scheduled to go to 2% on January 1, 1969. Some examples of the amount of sales tax paid on purchases of different sizes are given in Table 5.

Table 5. Tax bracket examples, $2\frac{1}{2}$% rate.

Amount of sale	Sales Tax Paid
$ 0.15- 0.59	$0.01
0.60- 0.99	0.02
1.00- 1.39	0.03
1.40- 1.79	0.04
1.80- 2.19	0.05
5.00- 5.39	0.13
25.00- 25.39	0.63
39.80- 40.19	1.00
79.80- 80.19	2.00
99.80-100.19	2.50

The Sales Tax Base

The sales tax is imposed on all retail sales of tangible personal property, including lease or rental of such property, on gross receipts of public utilities and from the sale of admissions, and on rent of lodgings for less than 30 days.

A companion use tax is also provided in the law. It applies to use, storage, or consumption of items bought, leased or rented by Nebraska residents from sources outside the state. The purpose of the use tax is to prevent evasion of the Nebraska sales tax by buying items in other states.

The Nebraska sales and use taxes apply to most items bought in retail stores, to gas, electricity and water used in the home, to restaurant meals, to hotel and motel rooms, and to machinery and equipment bought by farm and non-farm business and industrial firms. The law exempts sales of certain specified types of items from these taxes.

Exemptions

Four types of sales are exempt from sales and use taxes; this exempt status is due to: the nature of the seller; the nature of the property; the nature of the purchaser; or intended use of the property.1/

Examples of the first type of exemption are: meals and food items sold by schools and churches and their related organizations unless open to the general public; and meals, food products and rooms provided to patients in hospitals and to inmates of public institutions.

Sales exempt because of the nature of property sold or leased include: motor fuels used in vehicles on public roads, streets and highways, subject to the specific sales tax; aircraft fuels; daily and weekly newspapers; prescription medicines, false teeth, eye-glasses, braces, etc.; and livestock and poultry used to produce food for human comsumption.

Purchases by the federal government are exempt. Sales to state and local government agencies, and to schools, hospitals, orphanages, religious organizations and similar agencies in excess of $100 are exempt.

In the fourth category are "producer's goods", items which become an ingredient or component part of products made for ultimate sale at retail. This represents an effort to avoid double taxation. Examples of such sales are: livestock and poultry feed; seeds and plants for farming purposes; fertilizer, insecticides and other chemicals applied to farm crops (but not to livestock); electricity, coal, gas, gasoline, diesel and other fuels used for business, industrial, agricultural or commercial purposes; items purchased for resale (retailer buying from wholesaler); and all products which become integral parts of products to be sold at retail.

Some states exempt food sales from their sales taxes; this is not done in Nebraska. The law does provide a $7 annual food sales tax credit per Nebraska resident to reduce the impact of the sales tax upon low-income and large families, i.e., to reduce its regressivity. This credit will be applied against the individual's state income tax liability when he files his return for the 1968 tax year. When this tax credit is larger than income tax liability, the taxpayer will receive a refund from the State. See explanation of this procedure under the section on state income tax.

Administration and Collection

The State Tax Commissioner's Office is responsible for administering the sales and use taxes.

The sales tax is collected from purchasers by every retailer doing business in the State, including mail order houses. Each retailer must obtain a permit from the Tax Commissioner, keep appropriate records and remit taxes collected each month. The retailer is allowed to keep 3% of the monthly sales tax receipts to cover his collection costs. On automobile sales, the buyer pays sales tax when he applies for his registration.

1/ For a detailed list of exemptions, see Rules and Regulations for Sales and Use Tax; Nebraska State Tax Commission, Lincoln, June 1, 1967, pages 7-9.

Any Nebraska resident who buys or rents an item in another state for use here is liable for the use tax on the transaction. Sales taxes imposed by other states may be used to offset the Nebraska sales tax when a receipt of payment is obtained. The buyer may pay the Nebraska tax to the out-of-state retailer who is willing to remit the tax to the Nebraska Tax Commissioner; otherwise, he is required to pay the tax directly to that office. Forms for reporting sales subject to the use tax are available from banks, county treasurers, and other local sources. The law provides for a penalty of up to $500 for each violation of use tax provisions.

Sales Tax Revenue

Total revenue from sales and use taxes is expected to be about $55 million in the fiscal year 1967-68. This will be reduced to about $53 million in 1968-69 if the rate is permitted to drop to 2% on January 1, 1969. If the 1969 Legislature should raise the rate to 3% on March 1, 1969, the 1968-69 revenue would be about $60 million. A 3% rate for a full 12-month period would yield $70-75 million.

Cost to Taxpayers

The amount of sales tax paid by Nebraska residents will vary with size of family, income level, and spending patterns. Figure 4 shows estimated dollar amounts of sales tax paid, and these amounts as percent of income for families of four with different incomes. Sales tax payments are based upon amounts allowed as deductions for federal income tax purposes when detailed records are not kept.

Since state sales taxes are allowable business and personal deductions in computing federal income tax, net cost to those who itemize deductions is somewhat less than shown in the chart.

STATE INCOME TAXES

Thirty-eight states and the District of Columbia use individual income taxes. Two other states have special income taxes on dividends and interest. New Jersey taxes income of residents working in New York who would otherwise pay a similar tax to New York State. Several cities use income taxes in addition to state and federal levies. Corporate income taxes are used by 40 states and the District of Columbia.

Definition of Income

For tax purposes, the concept of net income is generally used as the basic element. This includes: total money income of an individual; less expenses for earning that income; plus the value of "in kind" payments, such as home produced food, rental value of a house, individual and family use of goods taken from business inventory, etc. The income tax usually applies to income actually realized during a specified taxing period plus realized capital gains from assets that have been sold.

Income Tax Bases

The base for an income tax is the amount to which a rate is applied for determining tax liability. Three generally accepted bases are used in the United States: (1) total net income, sometimes called "adjusted gross income"; (2) federal taxable income; and (3) federal income tax liability.

Total Net Income

This base, when used by the state, generally allows for at least a $600 exemption for each person from net income since it is not reported for federal tax purposes if less than that. Various exemption adjustments can be allowed from this base depending on the desires of the state. This is the largest base and allows for the lowest rate in order to raise adequate government revenue. Indiana uses this income tax base. This was essentially what was proposed in 1962 in the McClelland Report to the Nebraska Legislature. It was introduced in both the 1963 and 1965 legislatures but was not passed. LB797, repealed by Nebraska voters in 1966, was a considerably modified version. This type of income tax could have either a proportional or progressive rate. A proportional rate would apply the same percentage of tax to all levels of income while a progressive rate would apply an increasingly higher percentage of tax as income rises.

Federal Taxable Income (line 11d, IRS Form 1040)

This base allows all exemptions and deductions of the federal income tax system including the same loopholes and social reform provisions built into that system.

Taxable income is a much smaller base than net income and consequently would require a higher rate of tax in order to raise the same revenue. Because of exemptions and deductions, it would eliminate about 25 percent of the potential taxpayers in Nebraska - those who have no taxable income remaining after deductions and exemptions are taken. Use of the taxable income base creates a somewhat progressive tax, even with a proportional rate, because low income individuals thus have a greater proportion of their income exempt from the tax. In addition, a progressive rate could be applied, as most states do.

Federal Income Tax Liability (line 12, IRS 1040)

Two states, Alaska and Nebraska, use this tax base. It allows for the same progressivity and all the deductions, exemptions and other allowances of the federal government except for the special credits (e.g., investment credit).

The income tax liability base requires the highest rate since it is much smaller than the two described above. It also allows for elimination of about 25 percent of taxpayers because of exemptions and deductions.

Evaluation of the Income Tax

Advantages:

Individuals	Government	Society
1. Fair--according to ability-to-pay principle	1. Economical-if use federal definitions	1. Equitable
2. Convenient--if withholding and quarterly payment required	2. Adequate source of revenue	2. Not easily shifted
3. Simple and economical--if based on federal forms and definitions	3. Flexible rate can be applied to meet appropriations	3. Non-interference with economic growth

Disadvantages:

Individuals	Government	Society
1. Some differential treatment under federal rules	1. May be unstable source of revenue	1. If highly progressive may discourage saving
2. Complex if departs from federal definitions	2. Costly if departs from federal definitions	2. Federal definitions depart from neutrality
3. High progressivity may affect incentive	3. Local government use difficult	3. Exemptions and deductions may eliminate many taxpayers

Most of the disadvantages of the income tax depend on the type of income base used and the exemptions and deductions allowed. Use of federal definitions reduces the cost of the system for both the individual and state government. However, use of those definitions also builds in some of the loopholes and faults attributed to the federal income tax structure.

Nebraska Income Tax

Major features

The second part of the 1967 tax law provides for individual and corporate income taxes. The individual income tax is based on adjusted federal income tax liability. It allows all exemptions and deductions as does the federal income tax, except for special credits (e.g., investment credit), and has the same level of progressivity as the federal tax provides. In addition, the food sales tax credit is applied against the state income tax liability.

Individuals earning salaries and wages will have their state tax withheld each pay period just as the federal government now does. Employers are responsible for making this withholding and remitting it to the State Tax Commissioner. Most of the same rules apply to state income tax that apply to federal income tax. For example, most farm wages are exempt from withholding according to federal rules and regulations and will also be exempt for state tax purposes. This means farm wage earners will be treated the same as self-employed and must submit quarterly payments themselves based on estimated tax.

Self-employed individuals will file estimated income declarations and make quarterly tax payments just as they do for federal tax purposes. Again, farmers are allowed to make just one payment, because many of them only receive income toward the end of the year, just as is allowed under federal rules and regulations. Estimated tax forms can be obtained from banks, County Treasurer's offices, tax practitioners or the Tax Commissioner.

The corporate income tax is levied against all taxable corporation net income from Nebraska sources. The Legislature estimated that one-fifth of the individual rate applied against corporate net income, rather than federal corporate tax liability, would provide approximately the same effective tax from corporations. This approach was used because of the problems in allocating corporate earnings among

the several states in which they may be doing business. However, since this is applied against net income rather than tax liability it is a proportional rather than a progressive tax.

Establishing the Rate

To provide the flexibility needed for meeting state appropriations without surpluses or deficits, the income tax rate is established by the State Board of Equalization each year in the same way the property tax levy was set before 1967. Estimates are made of the amount of revenue expected from general sales, cigarette and liquor taxes, and other miscellaneous sources. The Board then determines the amount needed to balance the budget and estimates the total federal income tax liability during the year in Nebraska. Revenue required is divided by estimated total federal tax liability of Nebraska taxpayers to establish the rate. In 1968 the individual rate is 10% of federal tax liability. The corporate rate is thus 2% of corporate net income earned in Nebraska.

How to Compute the Individual Tax

The following example of income tax computation for a typical family illustrates how an individual can arrive at his state tax liability:

Average income per household----------	$8,984
Typical family of 4 ($600 per exemption)-------	-2,400
	6,584
10% standard deduction ($8,984 x 10%)---------	- 898
Federal taxable income----------	$5,686
Federal tax before credits on $5,686----------	$ 849
Nebraska income tax ($849 x 10% less $28)------	$ 57

If an individual has income from federal securities income (e.g., bond interest), he would subtract this from the federal taxable income figure before computing the federal tax liability for purposes of state tax computation. The above example assumes that the person does not itemize expenses. With itemization, the tax might be lower than indicated.

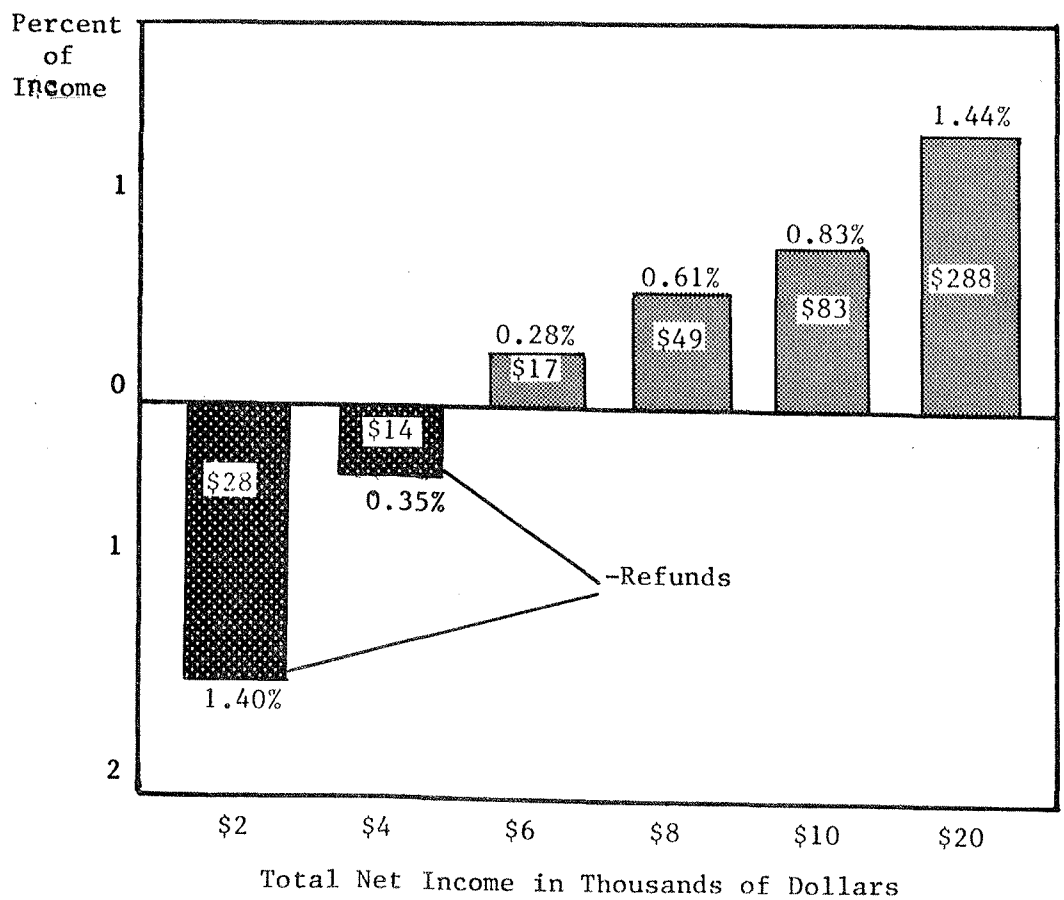
Table 6 shows estimated state income taxes to be paid by individuals and families of various sizes and income levels. The 10% standard deduction is again assumed rather than itemizing expenses for medical care, charity, interest, taxes, and other deductions allowable under the Federal Internal Revenue Code. The income figures at the top of each column are net income figures. Negative figures indicate income tax liability less than food sales tax credit, and that a refund will be paid.

The Nebraska income tax is a progressive tax, that is, it takes a higher proportion of the income of high income families in tax than of low income families. This is illustrated in Figure 5. The sales tax credit has been subtracted from the tax liability of each income class in this example; hence the first two income levels show refunds and negative percentages. Such families will receive refunds of amounts shown in dollars. Starting at about the $6000 level, there is a state tax liability for a family of four. Note that the estimated effect, even at the $20,000 income level, is less than 1.5% of net income.

Table 6. State income tax (10% - $7 each dependent).

	$2,000	$4,000	$6,000	$8,000	$10,000	$20,000
Single Individual ($7 credit)	$ 9	$ 43	$ 79	$ 106	$ 167	$ 510
(over 65) Married No children ($14 credit)	-14	0	31	63	97	302
Married Under 65 No children ($14 credit)	- 9	21	51	86	120	334
Married 2 children ($28 credit)	-28	-14	17	49	83	288
Married 4 children ($42 credit)	-42	-42	-19	13	46	244
Married 6 children ($56 credit)	-56	-56	-53	-24	9	200

Figure 5. Estimated Nebraska Income Tax Paid (10% of Fed. Tax), Families of Four, Different Incomes



Income Tax Revenue

Revenue from the state income tax for 1967-1969 is estimated at approximately $45 million. This is made up of about $36 million from the individual income tax and $9 million from the corporation income tax. Because of present federal tax reporting processes which lump many tax payments from other states into Nebraska totals, it is difficult to make an accurate estimate until the tax has operated for a year. However, the Tax Commissioner has estimated about $365 million in federal tax liability for individuals and $444 million in corporation net income subject to Nebraska tax levies in 1968. This means that each 1% of state individual income tax rate would raise about $3.5 million in revenue. The expected total revenue for a full year of a 10% state individual income tax and a 2% corporation tax would be about $45 million.

THE SALES-INCOME TAXES IN NEBRASKA'S TAX SYSTEM

Sales and income taxes form a basic part of Nebraska's state-local tax system. Each tax helps offset some of the defects of the other. The sales tax provides widespread participation in government financing and a sound, stable base for obtaining revenue. Its regressive effect partially offsets the highly progressive structure of the federally-based income tax.

The income tax, in combination with the food sales tax credit, offsets the regressiveness of the sales tax and provides a flexible source of revenue for meeting legislative appropriations, including state aid to local governments. It also reaches taxpaying ability that is not available through other types of state and local taxes. Today, education is the chief resource for income earning ability as contrasted with property ownership in the 19th Century. Education is also the major expenditure area for state and local governments. The income tax is a more effective method of obtaining a return on that public investment than is either the sales or property tax.

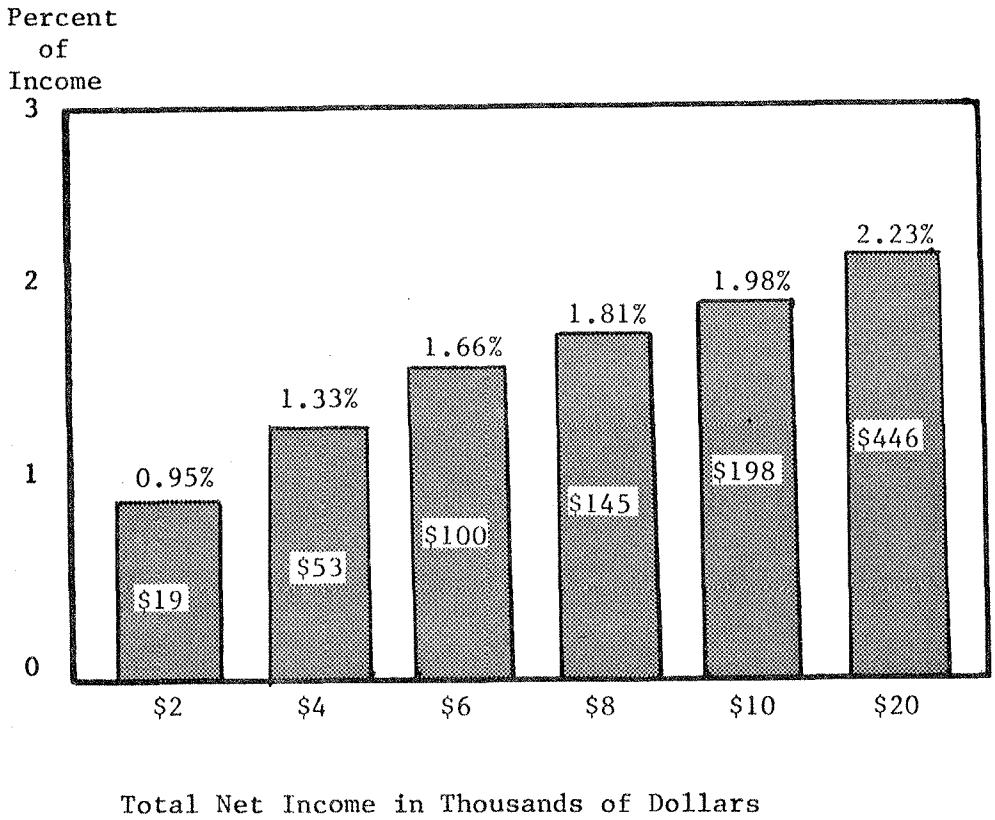
The two taxes together provide a slightly progressive tax system. As illustrated in Figure 6, some tax is paid by each income group beginning with the $2000 level, but each higher income level pays a somewhat higher proportion of income in taxes than the preceding one. However, the combined effect, even on the $20,000 income, is less than 2.5% of net income for a family of four. The progressive nature of the combined taxes offsets the regressivity of local property taxes.

Combined revenue from these taxes in the current biennium, July 1, 1967 through June 30, 1969, will be about $160 million and will be adequate to meet expenditures authorized by the 1967 Legislature for the two years. This includes state and local property tax replacement, state aid to local governments and increased appropriations for public services provided by the state. Increases for the state general fund amounted to $45.5 million over the 1965-67 biennum, mostly for higher education and state mental and corrective institutions. Under the previous tax system, such an increase in appropriations would have boosted the state property tax levy by about 5.2 mills, or 50% more than in 1966.

The present system has potential for providing additional local property tax relief through larger shares of state financial support for elementary and secondary schools and junior colleges. It could also replace revenue now coming from property taxes on personal property used for business purposes, such as, business inventories and equipment, livestock and farm machinery. The main argument for exempting such property is that it is now taxed two or three times: by sales tax when purchased, by local property taxes while owned, and by income tax on earnings

Figure 6. Estimated Nebraska Sales-Income Tax Paid, (Rates, 2½% & 10%)

Families of Four, Different Incomes



from its use. A constitutional amendment will be submitted to the voters on November 12, 1968 to authorize the Legislature to exempt such items from property taxation.

Possible Changes

Lower Sales Tax Rate: If the sales tax rate falls to 2% on Jan. 1, 1969, as now provided, the income tax for 1969 may need to be about 12% compared with the 10% rate for 1968.

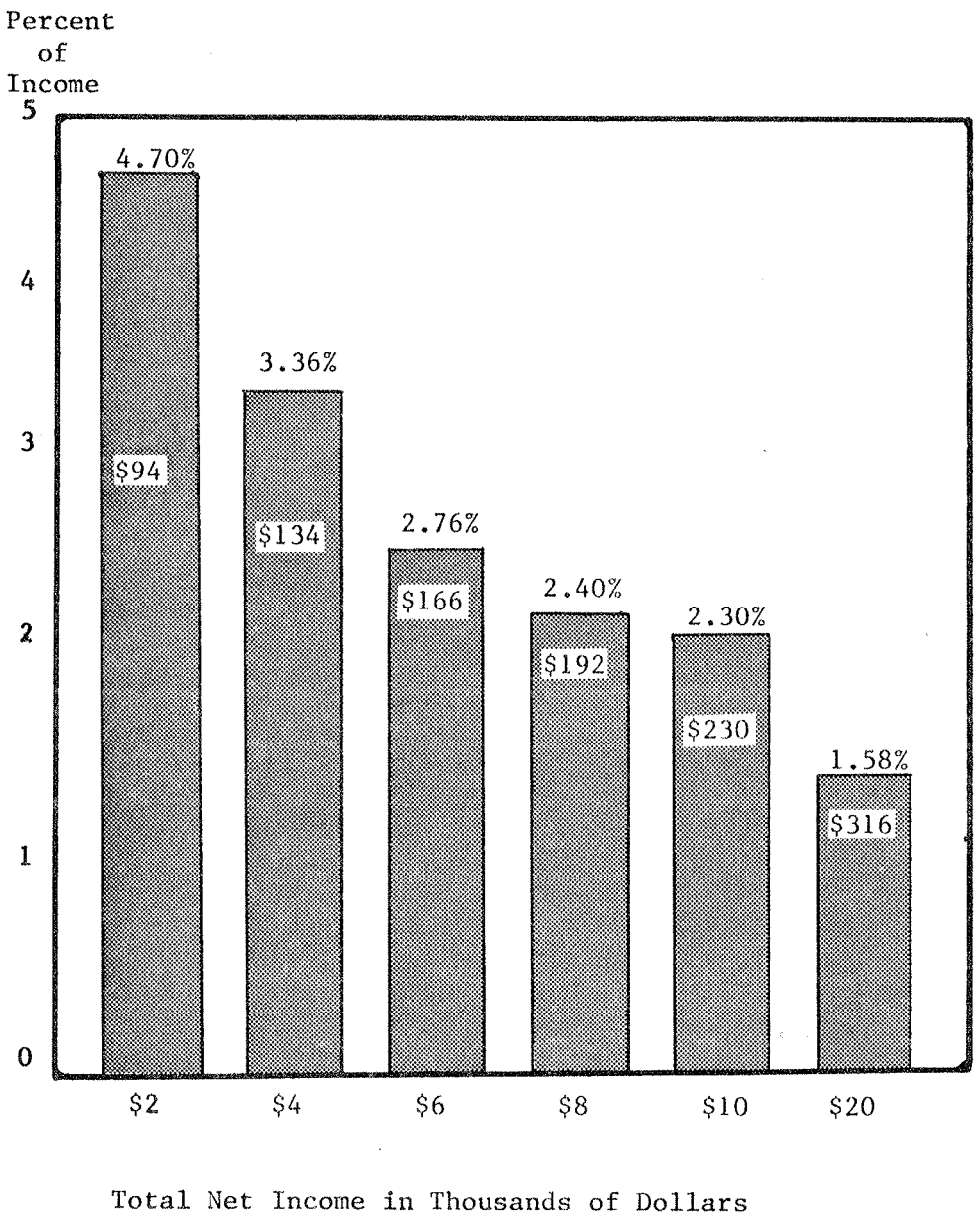
Higher Sales Tax Rate: If the 1969 Legislature should raise the sales tax rate to 3% effective early in 1969, the income tax rate could probably be held at about 10% or reduced slightly.

Elimination of State Income Tax: The possibility of a petition drive to place on the November ballot a constitutional amendment to prohibit the use of the state income tax in Nebraska is under discussion. If such an amendment should be approved by the voters, and if the present level of expenditures including the food tax credit and state aid to local governments is maintained, a sales tax rate of 5% would be needed.

The regressive effect of such a rate upon families of four people with different incomes is shown in Figure 7. With $2000 income, tax paid would be $94 or 4.7% of income, while at $20,000, tax paid would amount to $316 but only 1.6% of income. Cost of state government would be shifted more toward those with lower incomes and large families and away from those with more ability to pay as measured by income.

Figure 7. Estimated Nebraska Sales Tax Paid, (Rate 5%),

Families of Four, Different Incomes



Another serious effect would be removal of the flexible part of the tax system. This could lead to problems of deficits and surpluses in state government finance.

If food sales tax credit is eliminated, a 4.5% sales tax rate would be needed. If no aid is provided to schools and local governments, sales tax rate could be about 3.0 percent; or the rate could be held at 2.5% if both state aid and food tax credit were eliminated.

Exemption of All Personal Property: Local governments would need $45-50 million of revenue to replace that now derived from taxing tangible personal property except household goods. This could come from state sales and income taxes or from local sales or income taxes collected by the State and returned to local taxing units.

The state sales tax yields about $20 million for each one percent rate. The state income tax yields about $3.5 million for each one percent rate applied to federal income tax liability. These can be used to estimate rates needed to raise revenue for replacement purposes.

Homestead Exemption: Another proposed constitutional amendment, to be voted on in November, 1968, would authorize the Legislature to exempt part of the value of owner-occupied residences from property taxation. If approved, this would further reduce the property tax base available to local governments.