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Tax Rate Review Committee
July 17, 2009

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The Tax Rate Review Committee met at 1:00 p.m. on Friday, July 17, 2009, in Room 1003 of the State Capitol, Lincoln, Nebraska. Members present: Senator John Wightman, Chairperson; Senator Abbie Cornett; Tax Commissioner Doug Ewald; Senator Mike Flood; Senator Lavon Heidemann. Also present: Legislative Fiscal Analyst Michael Calvert.

SENATOR WIGHTMAN: Well, we'll call to order the Tax Review Committee...Tax Rate Review Committee. This is a committee, select committee, designated by statute. It meets every July and November. As required by law, and the purpose is, is to review periodically, twice a year, where we are as far as the tax rates.

SENATOR CORNETT: Lavon.

SENATOR HEIDEMANN: Yes, ma'am.

SENATOR CORNETT: Can you sit just a hair closer? I'm really having a hard time hearing you.

SENATOR WIGHTMAN: Okay, that's John Wightman you're having a hard time hearing. I plead guilty. I put the speaker closer to me. How are we doing now?

SENATOR CORNETT: Much better.

SENATOR WIGHTMAN: Okay. Thank you. So we have everybody present that is part of this committee, except for Abbie Cornett who is Chair of the Revenue Committee. And so just for the record, we have Mike Calvert, the Fiscal agent; we have...I'm starting from then my right, Mr. Ewald, the Tax Commissioner's Office; committee clerk or serving as committee clerk today anyway, Jessica Shelburn; myself, John Wightman, serving as Chair of the Executive Committee; the Speaker, Mike Flood; and Lavon Heidemann. So that does makeup the committee. With that...

MICHAEL CALVERT: And present, may I add, Senator Cornett is here by virtue of speaker phone.

SENATOR WIGHTMAN: Right, Senator Cornett is here by speaker phone. So with that, I will call upon the Fiscal Analyst to present his report, which has been I think distributed to all the committee members previously. So with that,...

MICHAEL CALVERT: (Exhibits 1, 2) Thank you, Senator Wightman. My name is Michael Calvert, Legislative Fiscal Analyst. I'm going to refer to the report that was distributed to you about a week ago. Primarily, I'm probably going to just speak from the

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summary page on page 2, and then perhaps refer to some of the charts. As you pointed out, Senator, this is a statutorily required review every July and November. The objective is to give a financial outlook for the General Fund and give you, as the leadership of the Legislature and a key representative of the executive branch, a financial outlook for the General Fund for the foreseeable future. You probably are well aware that the recent press release indicated that General Fund receipts were less than estimated for fiscal 2008-2009 by about \$36.5 million below the forecast that was used at sine die during the 2009 Session. If you look at the year-over-year growth rates of General Fund, the net receipts for the fiscal year adjusted for rate base changes, by our calculations it represents about a 4.4 percent decline over the prior year. It's an adjusted growth rate. It's the lowest in about the last 28 years that we've been keeping data in terms of an adjusted growth rate. It is, obviously, not unexpected given the current economic situation we find in this country. With additional adjustments, there's a table on page 4 that shows that, in terms of an impact to our General Fund status at sine die, the actual ending balance is about \$47.1 million below the minimum reserve calculated for the next budget biennium. This is primarily driven by the shortfall on revenue, as I had mentioned, the \$36.5 million. But on page 4, there are other adjustments. There are some accounting adjustments by a magnitude of about \$6.9 million. And on item 8 in the listing, when actual results come in and things were retabulated, the reserve calculation, it's kind of a moving target so there's an adjustment there. So in terms of the financial status at sine die, we are, with the revenue shortfall and the adjustments that I mentioned, about \$47.1 million below the minimum reserve. The assessment that we have, one of the things I know that has been a question in past years when we've gotten into some financial difficulties, I have a separate handout I put at your places and it's basically a chart and it's titled "Preliminary Projected General Fund Monthly Balance for Fiscal '09-10." What we do after the end of the legislative session is work with Department of Revenue, come up with a monthly schedule of revenues based on the forecast for the new fiscal year '09-10 and we break that down by month and break it down by major tax types. The State Accounting Office then takes that monthly distribution and breaks it down to a daily distribution based on filing dates for tax receipts. Sales tax typically comes in after the 25th, so they work out a schedule daily on the revenue side and then, likewise, they work out a schedule on expenditures based on the budget as enacted. So, in effect, what you can then do is, based on the timing of those revenues and expenditures, calculate a daily balance for the General Fund and then project out into the future based on that schedule. And that's what this chart represents. It summarizes all of the daily data that we got yesterday, and it is preliminary. There might be some adjustments, but I don't think they'll be significant. But I think it's a reassurance, if you will, that in terms of cash flow for this next fiscal year, the General Fund looks like it should be in pretty good shape based on the current revenue forecasts and based on the budget as enacted by the Legislature. And what the chart shows is the monthly range of General Fund balances that were computed based on the work done by the State Accounting Office, and it shows graphically and also in tabular form the high, the low balance in a month, and then the little tick mark

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that's in the line there represents the ending balance for the month. And if you look at the table at the bottom, you can scan across the numbers. And I'll just simply point out that, based on the cash flow work and estimates done by the Accounting Office, the low point for the fiscal year, as typically often happens, is in April and it is \$167.6 million. That would be the low point. Probably occurs in the first half of the month. But you can see that the range, high to low in any month, can be pretty substantial but we simply wanted to point out, in terms of a low point, that appears to be our low point, in the approximate magnitude of \$167 million. So we're not cash poor like a lot of states. We've read a lot about California and other states issuing IOUs. Based on this cash flow, that does not appear to be a risk. Additionally, our Cash Reserve Fund, based on this report, shows that we have an unobligated balance, based on legislative actions during the 2009 Session, and I emphasize unobligated balance, of \$324.7 million. Because we have transfers that occur in this year, next year, and perhaps the year thereafter, we look at the Cash Reserve balance in terms of an unobligated balance. In terms of actual dollars that will be in the fund at the end of this fiscal year and next fiscal year, it will be more than that; but in terms of unobligated, \$324 million. The status is based on the existing revenue forecasts that were done in April and adjusted for legislation that was enacted during the 2009 Session. The next Forecast Board meeting will be in October. I would like to point out that the current forecast, as it now stands because of the current year, came in below estimates. We would calculate the implied growth rate for the current year at about 2.1 percent over the year that we just finished, so a slight positive. As a basis of comparison, if you look at the long-run average in terms of General Fund revenue growth adjusted for rate and base changes, it's about 5.2 percent over the last 28 years. So 2.1 percent, it's a positive albeit below average by a substantial margin. The status also shows projections for the following biennium. We have obviously completed a budget through June 30, 2011, but we have included in our status a multiyear view, as we have done for many years, that looks into the following biennium through 2013. And as we had anticipated at sine die, a relatively large imbalance has grown even larger because of the revenue shortfall in the year that we just finished. That is growing to about \$510 million and it is also based on an implied revenue growth rate that's above average in those years. So that is a risk factor that we have to evaluate as we go forward for the next year or two. Just recently, just anecdotal information, the Bureau of Labor Statistics issued unemployment rate estimates for the states this morning. Nebraska's estimated unemployment rate for the month of June is estimated at 5 percent. They revised the previous estimate for May. Originally, when it came out a month ago, it was estimated at 4.4 percent. They revised it upward to 4.8. By basis of comparison, that's the second lowest unemployment rate in the country based on the release this morning. The lowest is North Dakota; I think it was at 4.1 or 4.2. Nebraska is at 5, and South Dakota is at 5.1. And the highest is Michigan at over 15 percent. So overall, the revenue shortfall for the fiscal year we just finished obviously carries forward. We have risk factors in terms of potential forecast revisions in October, but we have some things working for us in terms of cash flow that appears to be reasonably able to remain positive for this fiscal year and a Cash Reserve balance in

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excess of \$300 million as an asset for dealing with future budget balancing as we go through the next two sessions. Are there any questions?

SENATOR WIGHTMAN: I'd have one. As we look at this graph that you've just given us today,...

MICHAEL CALVERT: Yes, sir.

SENATOR WIGHTMAN: ...typically it will go up. You indicated that the low is usually reached during April...

MICHAEL CALVERT: Yes.

SENATOR WIGHTMAN: ...and that's just before the April tax receipts, income tax receipts, come in, I suppose, so you get a pretty good infusion of cash in May, in the May report at least. Is that correct or...?

MICHAEL CALVERT: Yes, April is always a pivotal month because of final payments. Leading up to that point in time, there's a large volume of refunds. So it is not unusual and, as I mentioned, typically April is probably your lowest point in any fiscal year. It's not always. On occasion, we've had low points in July but that's usually because we have a large transfer out of the General Fund in July. But more often...

SENATOR WIGHTMAN: Your graph...your graph starts with July, so we don't see what June was...

MICHAEL CALVERT: No.

SENATOR WIGHTMAN: ...of the previous year, I guess. But June is higher on the ending a little bit than July, it would appear.

MICHAEL CALVERT: Yeah, July tends to be a low point but typically not the lowest in a fiscal year.

SENATOR WIGHTMAN: Not as low as April then.

MICHAEL CALVERT: Right.

SENATOR WIGHTMAN: It looked like April and May were the lows of the year but...

MICHAEL CALVERT: Yeah. If you were to look at...

SENATOR WIGHTMAN: Well, actually, I guess on the ending balance, March was

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about as low as any on the ending balance.

MICHAEL CALVERT: On ending. Yes. Yes.

SENATOR WIGHTMAN: If the dot...

MICHAEL CALVERT: Yes.

SENATOR WIGHTMAN: ...represents a low or the ending balance,...

MICHAEL CALVERT: Correct.

SENATOR WIGHTMAN: ...then it was actually the low probably for the...

MICHAEL CALVERT: Right. But in terms on a daily flow, it's typically the first half of April. And if you look in the last four or five years, you look at July, I'd say at least half of the time that was probably the low point in the fiscal year. But again, it was because in the prior fiscal year we exceeded revenue estimates and there's an automatic transfer out of the General Fund to the Cash Reserve Fund and that could be well over...it's been over \$200 million in some years. So that shows up in July and brings that balance down substantially.

SENATOR WIGHTMAN: If we were to see a further slide, it's probably going to come from greater unemployment. Is that a fair assessment?

MICHAEL CALVERT: Well, if you look at...if you look at the way the revenues performed in the last year, and the Tax Commissioner can correct me if I'm wrong, but predominantly where we got hit was on individual income tax, and the vast majority of that probably occurred through the tax processing period of February, March, and April, okay, with final payments and refunds. I think we have seen, and the Tax Commissioner probably will concur, we monitor different tax types by month and estimated payments were probably very hard hit through the majority of this last fiscal year. Withholding, i.e., from basically salaries, held up pretty well. It was largely on estimated and it was on final payments. It was really tightly bunched in the tax processing season. Corporate income tax declined overall, roughly on a rate base adjusted basis I believe around 12 percent by our calculation, but corporate income tax is a relatively small dollar amount. But nonetheless, it declined. Sales tax, just to generally characterize it, the way sales tax performed in the last fiscal year is relatively flat, a small negative in terms of rate base adjusted growth but real close to the prior year. Makes sense--virtually no inflation, a weak economy so spending was down. So the fact that sales tax turned out fairly flat actually is not too bad. It was individual income tax that really hit us.

SENATOR WIGHTMAN: Which is not surprising, I guess.

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MICHAEL CALVERT: Right.

SENATOR WIGHTMAN: Senator Flood.

SENATOR FLOOD: On the sales tax issue, did I see somewhere in June...I mean what...did sales tax take a hit in June?

MICHAEL CALVERT: We had actually, I got to stop and think.

DAVE DEARMONT: (Inaudible).

MICHAEL CALVERT: Pardon?

DAVE DEARMONT: (Inaudible) tax and sales in the report in June they were down.

MICHAEL CALVERT: Okay. I just...

DAVE DEARMONT: (Inaudible) of the month (inaudible).

MICHAEL CALVERT: That's Dave Dearmont from Department of Revenue. He says that sales taxes were down in the month of June. I just couldn't recall the monthly results.

SENATOR FLOOD: What are other states seeing with their sales taxes, sales tax receipts, you know, in places where the unemployment is a lot higher? I'm trying to get a handle on it

MICHAEL CALVERT: Sure.

DOUG EWALD: Well, I think a lot of it depends on the forecast. I mean where are we in comparison to the forecast...

SENATOR FLOOD: Yeah.

DOUG EWALD: ...if you know, how low or how high was that forecast at. The forecast appears to be fairly close with respect to net sales tax.

MICHAEL CALVERT: I just, just this morning, and I haven't had a chance to go through it and I was looking for that, it was a state revenue report from the Rockefeller Institute. My recollection...and I don't know, I mean there's different comparisons you can make in terms of what time periods. My impression was among states our sales tax growth year over year or for the time period was relatively flat to a very small negative growth,

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and I can't find the chart but my recollection was on a national basis for all states it was down 3 percent. So I mean we were doing a little better than everybody else on...but I don't have the state-by-state breakdown and I can't lay my hand on it here yet.

SENATOR FLOOD: Okay. That answers my question. I appreciate it.

MICHAEL CALVERT: And I guess one other comment I was going to make about the personal income tax, it seemed like one of the driving factors, much like what we saw in 2001-2002, was capital gains. And, Mr. Tax Commissioner, you can either confirm or deny.

DOUG EWALD: No, I...that's it. I mean the withholding, as he said, was...is tracking pretty darn close to the forecast. We lost over \$1 billion in capital gains. That's why the final payments were \$60 million short for the most part. And to the extent that you don't get capital gains to recover, the forecast may be a little bit heavy in that one particular aspect. But, you know, we're losing, you know, maybe \$10 million bucks a quarter, something along those lines, just in capital gains. (Inaudible) the estimated tax payments don't...aren't there...it reflects a lack of capital gains.

SENATOR FLOOD: Can you carry over your capital gains? (Inaudible) you can carry that over, what, two years...

DOUG EWALD: Well, your...

SENATOR FLOOD: ...against your earnings or against your (inaudible).

SENATOR WIGHTMAN: Capitol loss.

DOUG EWALD: Your capital gains and capital loss? You mean offset?

SENATOR CORNETT: Capital loss.

SENATOR FLOOD: Yeah.

DOUG EWALD: Yeah, your capital loss, you could carry forward that 15 years or something like that.

SENATOR WIGHTMAN: You can carry it over a lot of years but I don't know.

DOUG EWALD: (Inaudible) yeah, it's many years.

SENATOR WIGHTMAN: But the fact is that all of this isn't capital losses. A lot of it is capital losses that they would have offset against income, I would assume, and so they

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were used this year...

DOUG EWALD: Right.

SENATOR WIGHTMAN: ...to a large extent. And I don't know what you found in prior recessions, but in 2001-2002, and I happen to work in a law office that does a lot of income tax returns, capital gains continued to drop for a couple of years, two or three years, pretty substantially. You finally get to where there's no capital...almost no capital gains on the mutual funds, so people that were reporting \$20,000, \$30,000, \$50,000, \$100,000 of capital gains have zero if they hold mostly mutual funds, and that's where their collection or their capital gains were arising from. And I think we'll likely see that happen, that this year will be worse, would be my guess, in capital gains than it was last year, but...

DOUG EWALD: Could. Yeah, could be.

MICHAEL CALVERT: I agree. That's a real risk. Any other questions?

SENATOR WIGHTMAN: Anybody with any questions? There any motions that anyone would want to make?

SENATOR FLOOD: I make a motion that we specifically decide not to call a special session and we do not recommend any changes in the tax rates in the state of Nebraska.

SENATOR CORNETT: I'll second that, if I can over the phone.

SENATOR WIGHTMAN: We'll allow you to second it, Senator Cornett. We have a motion and a second. Committee clerk, want to call the roll?

JESSICA SHELBURN: Senator Wightman.

SENATOR WIGHTMAN: Yes.

JESSICA SHELBURN: Senator Cornett.

SENATOR CORNETT: Yes.

JESSICA SHELBURN: Commissioner Ewald.

DOUG EWALD: Yes.

JESSICA SHELBURN: Senator Flood.

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SENATOR FLOOD: Yes.

JESSICA SHELBURN: Senator Heidemann.

SENATOR HEIDEMANN: Yes.

SENATOR WIGHTMAN: Motion carried. Is there any other motion that anyone would make? If not, do we have a motion for adjournment?

SENATOR CORNETT: I'll make a motion to adjourn.

SENATOR HEIDEMANN: Second.

SENATOR WIGHTMAN: Second. Motion...the meeting is adjourned. Thank you, everybody, for attending.