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May 13, 2002

Guy Hobbs, Chairman
Governor's Task Force on Tax Policy in Nevada
c/o Legislative Counsel Bureau
401 South Carson Street
Carson City, NV 89701

Dear Guy:

I am writing in response to your request for comments regarding the "structural deficit" of the State's budget.

The job before the Task Force is substantial as is recognized in the authorizing resolution. This has required that a lot of effort be placed in defining the budgetary challenges facing the State of Nevada. The up-front work on the relationship of the State's projected budget deficit and the revenue and expenditure trends need thorough analysis. While the resolution does not specifically address issues on the expenditure side of the budget, these items must be looked at carefully, as it is the projected expenditure side, which also creates the "structural deficit" in the State's spending plan. Therefore, the first step in the Task Force's work is to clearly define what creates the projected budget deficit and to the extent that it is a revenue problem, a number of tax related issues must be addressed. However, to the extent that the deficit is due to an inflated projection in expenditures, more effort will need to be directed at controlling expenditure growth rather than on the revenue side of the budget equation.

The second major challenge facing the Task Force is the entire discussion on tax policy. It would appear that there are a number of conflicting policies as they relate to taxes and revenue generation for the State of Nevada, as well as for local governments. The overall discussion on tax policy needs to look at the limits on our existing tax structure and our ability to expand the capacity of existing revenue sources before implementing new levels and types of taxes within the State. Secondly, the stability of these revenue sources needs to be examined to ensure that they provide a stable budgetary environment for government operations throughout the State and for each level of government.

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Current Stability of Primary Tax Revenue Sources

In reviewing information provided by the State Controller in a recent "Citizens' Assets" newsletter and information available from the Department of Taxation, it appears that the stability of the State's primary funding sources is good. From a preliminary review of the information, it would appear that the real per capita revenue for the State has remained relatively constant from 1990 through 2001. The State has experienced growth in total revenue and per capita revenue. Given the State's ability to maintain this level of revenue growth during a time of rapid population growth speaks well of the existing tax base.

The same type of trend analysis would need to be done on the expenditure side of the budget to measure the ability to meet the needs of our residents. The other factor that needs to be analyzed is the State's capacity to serve, in that there are a number of services that do not grow proportionally with population. Also, we should look to productivity gains in State government, to ensure that we are taking advantage of technology and other means to enhance overall productivity, thereby further reducing the direct relationship between population growth and budgetary expenditures.

If one looks at the major indicators of growth and revenues from existing revenue sources, for the past three fiscal years it has been substantial. This includes growth in the areas of sales tax, gaming win and assessed value (property tax revenues) as well as those driven by job growth such as the employee tax. Given the ability of these revenues to grow over time, the trends appear to support the fact that we have relatively stable revenues within the State. While the tragic events of September 11 did severely impact our State's economy this should not be the standard by which we set tax policy.

In looking at the major economic indicators for fiscal years 1998 – 99, 1999 – 2000 and 2000 – 01, the State's revenue growth was strong during a time in which inflationary pressures were relatively limited. During these three fiscal years the State of Nevada enjoyed a job growth rate averaging 5 % per year. Growth in taxable sales and gaming win each averaged approximately 7%, with growth in assessed valuation averaging 10%. During this same time the consumer price index for all cities averaged less than 3 %. Given this type of revenue growth in three of the largest revenue components of the State creates a concern over the ability of the State to handle the expenditure side of its budget, when it is experiencing revenue growth at a rate of two to three times that of inflation.

Based on what we are seeing in revenue growth, it is important that the Task Force spend time in a critical evaluation of the projected budget deficits, and work at both sides of the budget equation.

Capacity of Existing Revenues

Prior to implementing proposals for new taxes, the public policy questions related to the capacity of existing revenue sources must be examined. In general, property tax is seen as stable revenue for government services. As noted above, the State has seen a healthy increase in assessed value, resulting in additional revenue growth. This is not as true for local governments, which have seen variations in assessed value, with a number of counties within the last fiscal year seeing drops in assessed value.

While property tax is generally seen as a stable revenue source, we have also implemented a number of policies that tend to limit or narrow the revenue potential from property tax. This includes the depreciation schedules for both real and personal property, which erode the capacity of the property value to drive additional revenues. The legislatively imposed tax rate cap of \$3.64 further limits the growth in revenue in local government jurisdictions, creating an equity problem across the State. The tax rate on school districts of 75 cents forces them to rely only on growth in assessed value. These public policy issues that restrict the capacity of property tax to generate ongoing revenues need to be addressed.

An additional limit on property taxes is the fact that 87+ % of the State of Nevada is under federal management, leaving only 13% to the private sector, which generates our property tax revenue base. In the long term, public policy statements should be considered for shifting additional property from federal management to private ownership, to expand the property tax base and other revenues. If property tax is to remain a stable and expanding revenue source for the State and local governments, specific State policy should be drafted which create wealth through new investments, thereby expanding the tax base.

Sales tax also appears to be a relatively stable revenue source in terms of its ability to grow and will continue to grow, based upon the State's ability to generate new jobs and enhance the overall wealth of our residents. Most likely, sales tax has the greatest ability to expand in terms of its capacity to generate revenue. This expansion could easily be done through the elimination of exemptions from sales tax and/or the application of the tax to services. Such an expansion would not need to include basic living necessities such as food, medicine or medical services.

The question on whether or not a reduction in the sales tax component should be pursued, appears to run in contradiction to the goals of the Task Force, which is to look at the expansion of the tax base rather than its contraction. The shifting of the tax burden from

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one segment to another will ultimately end up the same as what has happened in the past, resulting in the projected structural deficit that we are grappling with today.

Gaming revenues also continue to experience growth as a revenue source for the State of Nevada. This particular source provides more limited revenues to local government, as most local governments are limited to set fees based on the number of machines or tables. They do not see the types of growth experienced by the State, which has a percentage tax base. No analysis will be complete without consideration given to at least a small increase (1 – 2%) in the gaming tax rate.

While the State can only do certain things to enhance our overall tourism market, which is impacted by national and world economies out of the State's control, Nevada appears to continue to have an attractive tourism draw. A number of casinos also rely upon a locals market, which is directly related to the various jurisdictions' ability to generate job growth and to import wealth into their communities. A portion of this wealth is then expended through gaming activities.

Once agreement is achieved on the nature of the structural deficit, then a multi-part approach should be taken. There are simple steps that can be taken to expand each of the State's primary revenue sources. Any increase in these revenues should remain as part of the State's General Fund, and go to meet all of the State's needs and not be directed to specific expenditures. Earmarking these funds will result in a deficit problem in other areas.

Finally, the State's tax system must have clear policy goals to reduce the piecemeal approach that now characterizes much of our State's fiscal condition. The outcome of a well-balanced tax policy will recognize and support the interrelationships between the State and local government. The needs of the State cannot be fully met without involving or impacting local government.

I trust that these comments will be beneficial as you continue your work. If we can be of any assistance, don't hesitate to call.

Sincerely,



Daniel C. Holler
Douglas County Manager