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Frequently Asked Questions About the Margin Tax

1) The tax rate of 2% in IP 1 is double the maximum 1 percent rate in Texas and two and one half times higher than the rate in the proposal discussed by the Legislature in the 2011 Session. Can you give us your reasoning as to why this higher 2% rate was chosen? Do you have any concerns that a margin tax rate of this magnitude will totally eliminate the margin and profitability of those low-margin businesses operating in Nevada?

Corporate taxes paid in other states are significantly more burdensome. In addition, Texas has other business taxes that Nevada does not and the tax package proposed in the 2011 session included a tax on services that this proposal does not.

Apportionment is largely identical. Effective tax rates on revenues will less than 2 %:

- A NV company with revenues of $1,500,000 would pay 2% on 70% of $1,500,000 or .02 * $1,050,000 = $21,000. That would equate to an effective tax rate of .014 (1.4%) on revenues.
    - If the first $1 mill is exempted the tax is 2% on 70% of $500,000 = $7,000 –
- For a company with $50 million of revenues: $35 million * .02 = $700,000 for an effective tax rate on basis of .014 on revenues.
    - Again, if the first $1 mill is exempted this would be a tax on 70% of $40 mill = $560,000.

Note that if cost of goods or comp basis is less than the 70% basis, effective rates would be less.

2) Would an unprofitable business be required to pay the tax under this IP?

Big business in this state has, for too long, avoided paying their fair share. Are there businesses that work with accountants to minimize their tax liability, of course there are. Does the margin tax resist tax planning strategies? Yes, it is hard to find loopholes with this tax. Does a businessperson stop paying other taxes and fees when they are not profitable? Are they somehow excused from the cost of business and would they not plan for that cost?

3) In the IP, it appears that gross revenues from the gaming industry that are subject to the gross gaming tax are exempt, but gross revenue from the mining industry that is subject to the net proceeds of minerals tax appears to be subject to the tax. Can you tell us why this decision was made?

We felt that the Gaming Tax was such a large part of state tax receipts that it was important to provide some relief for those paying that tax. Notice, that receipts from other aspects of the Tourism Industry are not exempt. We felt that once we began exempting receipts beyond the gaming tax we would run into problems deciding where to stop.

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4) Do I understand this initiative correctly that it provides an exemption from the Margin Tax for all non-profit organizations that are 501 (c) entities? Can you provide a description or list of the entities included under 501 (c) as this seems to be a pretty broad group of entities as I generally recall providing an exemption to 501 (c)(3) entities, which are charitable organizations. Can you tell me what type of organization the Nevada State Education Association is and whether they are exempt from the Margin Tax? How much tax would NSEA pay under the Margin Tax if not exempt? **Note: NSEA is organized as a non-profit 501 (c)(5), which are labor, agricultural, and horticultural organizations. Second, the Margin Tax proposal discussed during the 2011 Session only provided an exemption for 501 (c)(3) entities and not all 501 (c) organizations.**

The decision was made to exempt all non-profit organizations as a matter of policy, and to just apply the margins tax to those organizations whose purpose is earning a profit, with an eye toward ensuring big businesses pay their fair share for a quality public education system. No distinction was made between those non-profits that are charitable, and those that engage in certain types of advocacy for their members, various constituencies, and/or the general public and that thus foster civic engagement.

5) Is the definition of cost of goods sold comparable to the definition used for federal income tax purposes? If not, can you provide an explanation for the definition included in the IP?

Determining the cost of goods sold for purposes of the Internal Revenue Code can be a time consuming and frustrating process. In contrast, the Initiative lists which specific costs may and may not be used if an entity elects to "subtract the cost of goods sold" for the purpose of computing its taxable margin. The definition was based on AB 582, which in turn was based on the Texas margin tax law. The Texas margin tax "cost of goods sold" provision has been in practical application for several years, and tax practitioners have stated that it does differ from the federal "standard."

6) Can you provide an explanation for the 70% of total revenue rule provisions for determining taxable margin? How does this rule relate to the cost of goods sold or cost of compensation rules for determining taxable margin. **Note: The 70% of total revenue rule to determine taxable margin implies that the margin of the business is 70% of their total revenue.**

This option was included for those businesses that have little in the way of compensation or cost of goods sold (typically capital intensive serves businesses, such as those in transportation or telecommunications).

7) How was the $1,000,000 total revenue exemption amount determined? Can you provide any statistics on how many businesses in Nevada have total revenue less than $1 million? To make sure I understand this tax, if I have $1 million or less in total revenue I don't have to pay the Margin Tax. However, if I have $1 over the $1 million total revenue threshold, then my full

margin is subject to the tax there is no dollar threshold on the taxable margin amount that is exempt from the tax. Is this correct?

The $1M threshold was chosen to insulate small businesses. Along with the middle class and poor, Nevadans are already subjected to some of the most regressive taxes in the nation. We made a judgment call, based on states like Texas who adjusted their exemption twice before settling on $1M as a fair and effective way to ensure big business in the state pays their fair share.

Do I understand the provisions of the IP correctly that there is no adjustment for inflation to this $1 million total revenue exemption amount? Was there no consideration given to the fact that inflation may cause a business's total revenue to increase resulting in entities originally being exempt from the tax becoming subject to the tax?

Most states don't index their taxes, when needed, they come back and readjust them. Assemblies can't bind future assemblies, preventing a long term fix on the rate. After three years, there is a provision for adjustments to IP1. We would certainly argue over the past five to ten years teacher salaries have not matched the rate of inflation and are certainly due for an update. We would hope that in the next three years, after IP1 has taken effect and hopefully teacher salaries are brought into the 21st century, that inflation doesn't so far outpace the cost of their labor that it needs a significant revision upward.

8) Under the cost of compensation provisions in the IP, it appears that a business cannot claim more than $300,000 in wages and compensation per employee per tax year. Can you explain how the $300,000 amount was determined? Similar to the question regarding the $1 million revenue exemption amount, do I understand the provisions of the IP correctly that there is no adjustment for inflation to this $300,000 amount? So as compensation increases over time, the effect of the $300,000 compensation threshold decreases over time, which may result in increases in the taxable margin subject to tax under the cost of compensation approach to determining taxable margin?

This was a policy decision. It's a judgement that's only set in stone for three years. If it's not a sufficient exemption, it can be revised. Additionally, if a ceiling is not placed on compensation, you may encourage employers to hide money from the tax by inflating salaries.

9) Can you explain the difference, if any, between the definition of total revenue in the IP, used to calculate taxable margin, and the definition of total income, used to apportion that part of taxable margin that will be subject to the Nevada Margin Tax?

As a matter of federal constitutional law, a business that operates in Nevada and elsewhere may be taxed by Nevada only on that part of its income attributable to activities here. So, "total income" is very broadly defined to include total amount received from all sources without subtracting any costs or expenses. This amount is used in Sec. 28 to create a fraction with total

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income in Nevada on top and total income from entire business on bottom. The entity's margin (determined using "total revenue") is multiplied by this fraction so that an entity will not be taxed on its out of state business.

"Total revenue" is a term created by the IP solely for purposes of determining taxable margin under the IP and is tied to various federal income taxation formulas and differs for the type of business entity. It is a more specific term used for a specific purpose and would not accomplish the purpose of preventing the taxation of an entity's out of state business. Therefore a different and more broad term was necessary for purposes of apportioning income to Nevada.

10) Are there any issues or concerns that should be considered for this Margin Tax by coupling to the federal business and personal income tax laws? For example, if Congress enacts legislation in the future that changes the definition of income that results in a lower amount, then the yield for this Margin Tax would also be negatively impacted. Is this not a correct interpretation of how things could unfold for this tax?

Most states adapt the working of the federal tax code in various aspects of their corporate or business taxation. Congress routinely changes those definitions and criteria. States also routinely change their legislation to reflect changes at the federal level.

11) Under the provisions of the initiative, the modified business tax on nonfinancial businesses is increased to provide the funding for the initial and ongoing costs by the Department of Taxation to implement and administer the Margin Tax. In fact, it appears that the tax rate is initially increased from 2.0% to 2.29%, almost a 15% increase, and then increased from 2.29% to 2.42%, another 5.7% increase in the tax rate. Can you provide your reasoning or justification for why financial businesses were chosen to bear the costs for the Margin Tax? **Note: subsection 4 of Section 22 allows a credit against the Margin Tax liability only up to the amount of Margin Tax due with no credit carry forward, if the MBT tax paid was greater than the Margin Tax liability.**

Article 19, Sec. 6 of the Nevada Constitution requires that an initiative petition cannot create an unfunded mandate--the Initiative must pay for itself. Once the margin tax is up and running, it will pay for itself and ensure a much needed stable source of continued funding for K-12 education in Nevada, but Article 19(6) requires that it pay for itself from the start; therefore, a temporary tax increase is necessary to cover the start-up costs. The proceeds from the modified business tax are a known and thus generally predictable source of revenue; however, unlike the modified business tax paid by financial institutions, the modified business tax paid by entities that are not financial institutions are subject to modification on July 1, 2013, and thus although a generally known source, relatively speaking they are not truly predictable, and thus not truly reliable.

12) Can you explain for me the reasoning or justification behind allowing a credit for the modified business taxes paid against the Margin Tax due? Aren't wages part of the cost of

goods sold or cost of compensation that are used to calculate taxable margin, so wages and salaries paid are a deduction used to compute the Margin Tax liability? Isn't it possible that we have the Department of Taxation bearing the costs of administering and collecting the MBT only to have the tax collections being netted out against the Margin Tax, which seems a little like a zero-sum game or less than zero since Taxation and taxpayers have to continue to administer and pay the tax each quarter?

The Initiative will provide a much needed, guaranteed, stable source of funding for K-12 education in Nevada, but we must be sensitive to the tax burden imposed upon Nevada businesses; therefore, good policy and basic fairness warrant providing an "offset" or "credit" for businesses that are also subject to the modified business tax. Although the wages of employees are a factor in determining the amount of the modified business tax and wages of employees may also be used to determine taxable margin, the end result of the calculations are utilized for two distinct taxes. Yes, in order to protect businesses from being overburdened, it is likely that some businesses will receive a complete offset for margin tax liability based on modified business tax payments; but in the case of many other businesses, there will still be substantial and meaningful margin tax collections for K-12 education in Nevada, which for these businesses will constitute an investment in our children and Nevada's economic future.

Questions regarding the distribution and use of the tax proceeds

13) The provisions of the Initiative require the proceeds to be deposited in the Distributive School Account. However, based on the K-12 education funding provisions for the DSA, will the Initiative guarantee additional funding for K-12 education? **Note: The Legislature could decide to reduce the General Fund appropriation to the DSA and keep the level of funding the same or limit the amount of growth in K-12 funding due to the receipt of Margin Tax proceeds in the DSA.**

The initiative guarantees funding for education. It clearly says and has been supported unanimously by the State Supreme Court to say that it clearly funds K-12 education. A reduction of funding to education must come from the legislature. Since the beginning of this session, with NO money, and NO plan for funding proposed programs, NO legislator has proposed reducing the education budget.

14) Can you provide an explanation for how the Margin Tax proceeds deposited in the DSA will be distributed amongst the 17 school districts in Nevada? Will the amount of the Margin Tax distributions amongst the school districts create any issues or problems regarding the funding of the school districts throughout the state?

NSEA agrees there are problems with distribution of funds. What NSEA and Nevadans have been saying for 25 years is that there isn't enough. This question is concerned solely on how and who divides up the pie. We're saying there is not pie. There are only crumbs and that is a disservice to our kids.

15) Will proceeds deposited in the DSA and distributed amongst the school districts be considered part of the pool of money that the teacher's union will be able to use for collective bargaining purposes?

As we mentioned in question 14, this is a question of distribution, but bargaining occurs at the local level. It's never been a consideration before. Teacher contracts are a matter of local bargaining. This question is not germane to this tax, there's nothing about this tax that creates something unique to the existing framework of bargaining.

16) If the $800 million estimate for the Margin tax is accurate, then it will generate an amount not much below the $1 billion generated by the 2.6% Local School Support Tax rate or close to the $800 million in revenue generated by the 75 cent property tax rate. Can you provide the reasoning or justification for K-12 education needing an additional $800 million per fiscal year? Can you convince the citizens and businesses of this state that this extraction from the private sector will result in measured and reportable improvements in K-12 education? Basically, can you guarantee a return on this investment?

We're one of the most inadequately funded states in the nation. We have cut the education budget by $1B over the last decade. This additional funding would bring us to a level of funding with our peer states. The $800M figure is an estimate, but we are able to guarantee that continuing an investment consistent with the amount that has been paid by big businesses in this state for the past 25 years will promise a consistent yield: underfunded programs, poor graduation rates, a failure to provide an equitable education to communities of color. Doing the same thing we've been doing will most certainly guarantee a return on that investment.

If the $800 million estimate for the Margin Tax at 2% is accurate, then could you not have provided enough funding at a 1% rate, which would generate around $400 million, and not be as burdensome of Nevada's businesses?

Estimates on programs needed to fund education adequately far exceed the $400M figure presented. $400M is a lot of money and money doesn't solve every problem, but the funding formula and the lack of dedicated, predictable funding has decimated our education system. The programmatic fixes, everyone agrees would improve our K-12 system requires a greater investment than $400M.

Questions regarding potential impact of the Margin tax after implementation

17) Can you provide us with any statistics on the number of business that will be subject to the Margin Tax and what the potential impact on them will be if approved and implemented?

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Yes, the most important statistic is that all businesses that have a revenue more than $1M dollars will be subject to the tax. The potential impact will be an investment in a sorely needed resource in this state: a workforce that is well prepared for the workforce and an economy of the future.

18) Do you have any concerns about the potential impact on the state budget during the next downturn or recession in Nevada's economy after the proceeds from this Margin Tax get incorporated into the budgets of the school districts and teacher's salaries?

We would have far greater concern of the effect of a deep recession or downturn if action is not taken today to properly fund education. As you know, education funding is not an option, it is required by the legislature. That requirement has been met with inadequacy and has rewarded this state with poor graduation rates and a failure to invest in our future.

19) I understand that under the constitutional provisions for initiative petitions that if this IP is approved by voters at the 2014 General Election, it cannot be amended by the Legislature for three years. Do you have any concerns that should the IP have language problems regarding implementation or administration or the 2% tax rate proves to be devastating to the business sector, there is no recourse to fix the problems until the three-year period has expired?

A reformed margin's tax was implemented in Texas prior to the greatest financial disaster the country has seen since the great depression. The tax was not modified or rescinded. Additionally, with this tax and all the other taxes that Texas had, ranking it 19th highest among state business taxes and above the national average, it has still maintained the highest rating as a state to do business in. There is evidence that states that grow the fastest make an investment in education. It is an economic development tool that other states and other nations have identified.

20) Can you provide any information on the ability to accurately estimate the yield from the Margin Tax in Texas? Do you have any feeling for the ability to accurately forecast the amount of revenue from this new complicated tax structure in Nevada? If the proceeds from this tax cannot be estimated with any accuracy, then don't you increase the potential for impacting the state's General Fund budget through the school funding provisions in the DSA?

The purpose of the tax is to raise new revenue, revenue that has been denied education for decades. It was the experience with Texas that billions of dollars was raised. $3.1B in 2007. $4.5B in 2008. $4.3B in 2009. $3.9B in 2010. This represents billions of dollars raised during the great recession. Texas did not consider, or plan for the greatest economic disaster this country had seen since the great depression. I'm not sure anyone budgeted for that. But, the fact is, the margin tax in Texas provided dedicated funding that can be estimated.