Property Tax Reform Policy Vision

Purpose

The purpose of Platte Institute's tax vision statement is to lay out the principles that Platte Institute believes should guide the ongoing property tax reform efforts.

First, we will lay out actions to avoid with explanation. Then we will argue for accomplishing fundamental policy deliverables that are necessary for the successful delivery of property tax relief.

Background

Nebraska lawmakers made history in 2023 with the most significant tax reforms in the country.[1] Record revenue growth was leveraged against sound tax principles to deliver generational income tax and property tax relief. Income tax brackets were consolidated, rates were slashed, and the community college property tax was eliminated altogether. Yet demand for property tax relief rightfully persists.

Iowa's 2024 income tax reform acceleration[2] reminds Nebraska lawmakers that states can fall behind by simply standing still on tax policy. Iowa's income tax rate will fall to a low, flat 3.8% on January 1, 2025. Iowa citizens will vote on constitutional amendments to require a 2/3 supermajority to raise any taxes, and to require that Iowa permanently keep a flat rather than progressive tax structure.

Iowa's reforms do not mean that Nebraska must return to cutting income tax cuts rather than property taxes. But Iowa's reforms do mean that any reforms enacted in Nebraska must make the competitive most of each tax dollar used, and must be guided by sound vision of tax policy.

First, do no harm.

Nebraska's tax discussion shifted from an income tax focus in 2023 to a property tax focus in 2024. Governor Pillen has repeatedly called for $2 billion in property tax relief, with the first $1 billion already accounted for by eliminating the community college property tax and deploying income tax credits for property taxes paid to direct school property tax relief.[3]

Such an ambitious goal for property tax relief can lead to solutions that inadvertently create more problems. And at the same time, Pillen has warned that Nebraska's property tax burden could quickly zoom from $5 billion to $6 billion, substantiating the need for strict property tax controls.

Therefore, here are steps that would represent a false start towards property tax reform and thus should be avoided:

6910 Pacific Street, Suite 216 | Omaha, NE 68106
402.452.3737 | platteinstitute.org

Defend the 2023 tax reform victory. Nebraska's 2023 tax reforms were a sterling state achievement. They should not be unwound or delayed for any reason short of substantial and unforeseen fiscal disruptions. If revenue allows, lawmakers should consider accelerating the 2023 reforms just as Iowa accelerated and deepened its already-scheduled income tax cuts in 2024.

Not only do the 2023 tax reforms enhance Nebraska's competitiveness, they represent an agreement with households and businesses on the correct direction for tax relief. Unwinding or delaying the 2023 tax plan would be like a political breach of contract and sew confusion among taxpayers about whether the 2023 tax plan was flawed.

The 2023 tax reforms were excellent and essential. They should be defended.

Ensure long-run fiscal stability. Any new tax relief must result in balanced state finances and be built upon dependable revenue sources. Ambitious tax cuts from 2023 must be allowed to phase in smoothly, and any new tax cuts must not disrupt Nebraska's long-run fiscal balance.

Neither taxation of digital advertisements nor taxation of cigarettes are dependable revenue sources. Taxation of digital advertisements is constitutionally suspect and is being challenged in Maryland. Revenues derived from digital advertisements can completely disappear via judicial declaration, imperiling any tax changes made contingent upon the taxation of digital advertisements.

Further, cigarette taxes are a notoriously unreliable and shrinking source of tax revenues. A tax reform plan should avoid depending on a cigarette tax that drives inter-state smuggling and is altogether undependable.

Avoid any "perpetuity" claim on state resources. Nebraska's tax discussion became centered around LB 388 at the end of the spring 2024 legislative session.[4] The most concerning provision of LB 388 would have created a perpetual local government claim on any real growth in state tax resources. This type of policy should be strictly avoided.

The LB 388 provision dedicated all state revenue growth above 3.5% to local governments. In fact, national inflation is presently running at 3.5%. The LB 388 provision would have meant that all real state revenue growth would go to local governments. That would leave no room for the state to ever cut state taxes again, or to increase spending in the case of an emergency. Local governments would have a full claim on all real revenue growth.

Don't raise rates. Low tax rates applied to a broad tax base are the signature of sound tax policy. Nebraska policymakers have considered higher sales tax rates in order to fund property tax relief. Raising the state sales tax rate would simply make Nebraska less competitive. Swapping higher state sales tax rates for the potential of lower property tax rates is a bad trade that will not make a dent in Nebraska's high tax system, and will in fact result in an increase in overall taxing and spending.

Don't tax business inputs. While a broad tax base and low tax rates are the signature of sound tax policy, a tax base can be "overbroad" when it results in multiple layers of taxation on the same economic activity.

For example, when business inputs are taxed when businesses purchase them, the result is "tax pyramiding," or multiple layers of taxation upon the same business activity. Sales should be taxed at the point of retail purchase. Neither business advertising should be taxed, nor should farm machinery inputs or other business purchases.

Second, phase out the third-party payer problem.

A third-party payer problem exists when Party A spends money, Party B benefits from the spending, and Party C foots the bill.

All too often in Nebraska, local government spends, local residents and service providers benefit from the spending, and state government foots the bill. The inevitable result is inefficient local spending with low transparency and accountability. Ultimately, this leads to Nebraska's high overall tax and spending program.

When the State of Nebraska replaced and eliminated the community college property tax, it largely avoided a third-party payer problem because the state sets the spending levels and the state footed the bill. The reform delivered dollar-for-dollar property tax relief.

On the other hand, when the state creates property tax credits to offset high local property taxes, the state is effectively subsidizing the spending decisions of local officials without imposing accountability on those decisions. Even worse, when the state simply sends money to local governments without stringent controls, overall taxation and spending skyrockets. The result is that local governments feel free to spend more knowing that the state will offset the spending by perpetually-growing credits to offset property taxes or other state funding for local spending decisions.

Any property tax reform plan should reduce rather than exacerbate the third-party payer problem. That means any state resources must be imposed with dollar-for-dollar tax relief and strong property tax caps and ongoing transparency measures going forward. Falling short of this target will further mix up state and local spending policies and result in higher overall taxes and spending without transparency and accountability.

When local governments spend and state government pays the bill, Nebraska taxpayers lose.

Third, always keep the overall tax burden in mind.

Property tax relief should not come at the expense of raising Nebraska's total state + local tax burden.

Efforts to reduce the property tax are well-directed. However, the state should not reduce the property tax in such a way that raises overall taxation and spending levels. This can easily happen if, for example, $100 of state spending for property tax relief only results in $95 of property tax cuts. Such a tax swap would raise overall tax and spending levels while reducing transparency and accountability. Nebraska would be worse off.

Lawmakers should always keep in mind that any tax rebalancing must be done in such a way that holds harmless the total tax burden.

A state dollar appropriated to reduce property taxes should result in a dollar of property tax relief and not one penny less. Otherwise, the swap simply raises overall taxes and spending.

Nebraska's state and local tax burden is already high. A tax rebalancing should not make it worse.

Fourth, enforce strict property tax controls

Total government tax and spending will grow in any instance where state money subsidizes local spending decisions without strict property tax caps. Platte Institute believes that the following measures are fundamental and essential for any property tax reform plan, and that without these measures, a property tax reform plan will fail.

100% rate roll-back to end unlegislated tax hikes. Each year the property tax rate should automatically be reduced to fully offset any jurisdiction property valuation increase along with any new aid from the state. In the new year, the rate should be automatically rolled back to such level to raise the exact same amount of total revenue as the previous year. Any action to raise any new revenue from the property tax should require an affirmative vote of the local board to raise the rate.

Impose truth in taxation for the first $1 in levy increase. Truth in taxation creates healthy citizen engagement in local government fiscal decisions. It is exactly the transparency measure Nebraska needs to ensure local spending accountability. Citizen engagement should begin with the first dollar of property tax increase, which should be imposed by a tax rate increase. In other words, if a jurisdiction will raise any new funds, it should have to raise its tax rate, and it should undergo truth in taxation to fully engage local citizens in a transparent fiscal process.

Hard cap on all property taxes. A hard cap should be imposed to prohibit spending increases that exceed the greater of 3% or inflation. If local government wants to raise tax revenue beyond this threshold, then they should ask citizens for permission through a tax referendum. After all, getting sign-off from local citizens is the ultimate form of local control.

Furthermore, a hard cap is the critical step to ensure that any funds sent from the state government to local governments are strictly applied to property tax relief. Sending relief without a hard cap worsens both the state and local tax regimes.

For example, suppose a jurisdiction raised $100 in property taxes last year. This year, valuations went up by 15% and the state sent the jurisdiction $10 in net new funding. The jurisdiction's tax rate must be automatically reduced to offset the 15% valuation increase and the $10 in new state funding so that the rollback rate produces the same $100 in total tax revenue as the previous year.

Fifth, put tax and bond referenda on popular elections.

Bond referenda too often appear on springtime and special election ballots with low turnout. This functions as a workaround on local spending control decisions. Local governments get to spend bond funds today, and taxpayers foot the bill in the future.

Tax and bond decisions should be consolidated on November general elections. Short of that, they should be consolidated onto primary election ballots.

Bond referenda should be treated as equivalent to a tax cap override referenda because bonds are a form of deferred taxation. Bond issuances should not be allowed to be leveraged as a workaround to tax and spending controls.

Finally, show proof of concept.

Nebraska created the Education Future Fund in 2023 to boost state funding of education beyond what is provided for through Nebraska's Tax Equity and Educational Support Act (TEEOSA). The fund was seeded with $1 billion and another $250 million is added per year. The fund is to support $300 million in annual state aid to schools with the goal of "dollar for dollar replacement of property taxes."[5]

Nebraska's school property taxes went up year-over-year despite this substantial new source of aid to offset school property taxes.

In 2023, Nebraska school property taxes went up by $105 million despite $300 million of new annual school aid to offset property taxes.[6] The $405 million school spending increase (state subsidy plus property tax growth) was effectively a massive 13.5% increase in school property taxes, all subsidized by new state spending because property tax hard caps were not in place.

Deliver 2024 direct property tax relief.

Platte Institute endorses the local property tax control protocols described above as the necessary pre-condition to deliver property tax relief.

With the above protocols put in place, the 1107 income tax credits for school property taxes paid can be deployed as direct aid to school districts with dollar-for-dollar tax relief.

Front-loading the 1107 credits with a strict hard cap on property taxes will result in property tax relief for all Nebraskans, as was the intent of the 1107 credit. It will remove the requirement to file for a tax credit on the taxpayers' income tax return.

Achieving all of the above would be a massive, transformational property tax reform, and it would accomplish half of Governor Pillen's goal all while slowing the growth of local government spending. Once proof-of-concept was established in deploying the 1107 credits for dollar-for-dollar property tax relief, Nebraska could consider further property tax reduction measures in future years.

Endnotes

1. https://www.nationalreview.com/2023/07/nebraska-leads-the-great-plains-tax-sweep/
2. https://platteinstitute.org/iowa-accelerates-tax-reform/
3. https://nebraskapublicmedia.org/en/news/news-articles/pillens-push-for-lower-property-taxes-met-with-skepticism/
4. https://nebraskalegislature.gov/bills/view_bill.php?DocumentID=49980
5. https://governor.nebraska.gov/press/gov-pillen-highlights-public-education-funding-back-school-news-conference
6. https://revenue.nebraska.gov/sites/revenue.nebraska.gov/files/doc/pad/research/valuation/2024/histvt_subdiv_State%2693cnties_2013-2023.pdf

Platte INSTITUTE

6910 Pacific Street, Suite 216 | Omaha, NE 68106
402.452.3737 | platteinstitute.org