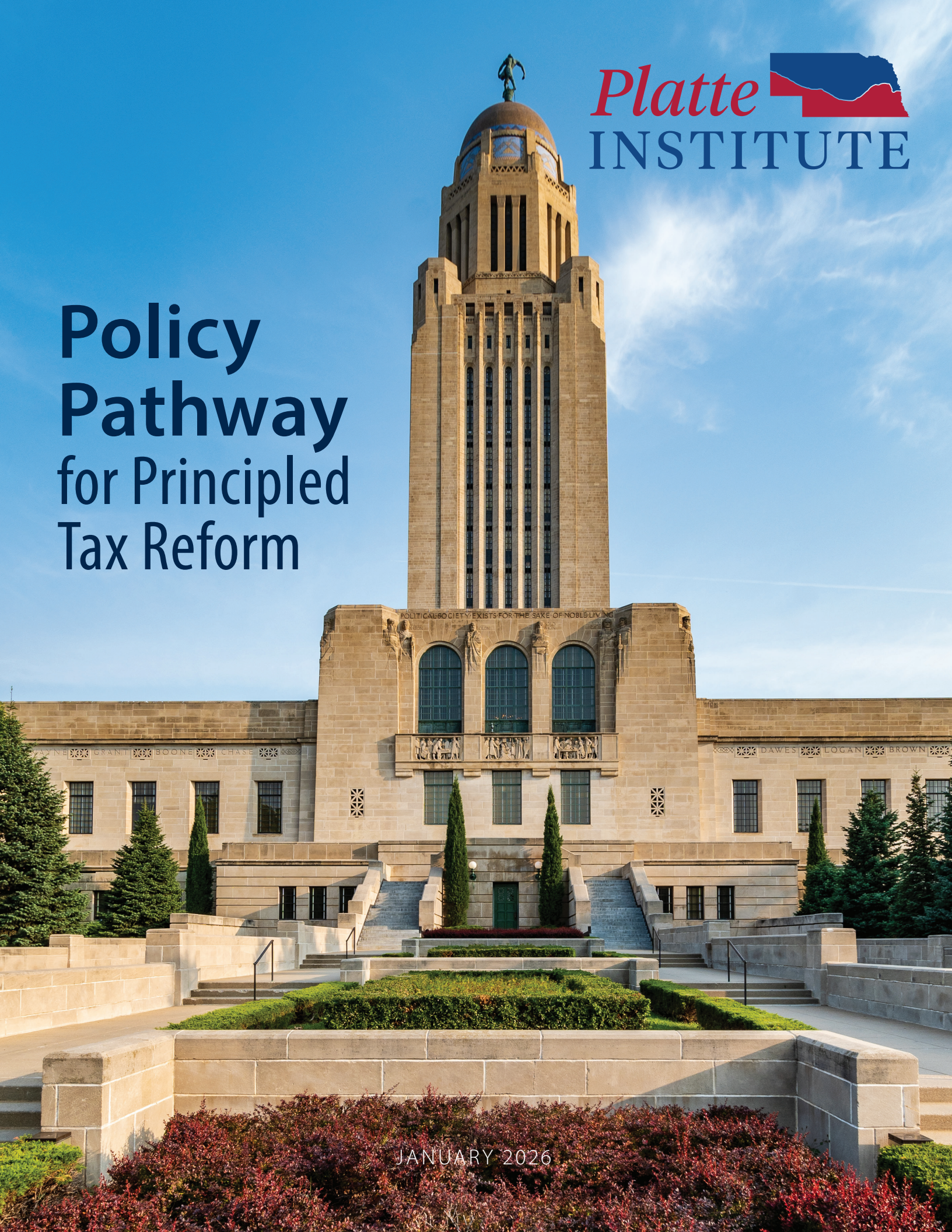


Policy Pathway for Principled Tax Reform



"The Platte Institute's 'Policy Pathway for Principled Tax Reform' offers a comprehensive outline of thoughtful and compelling concepts for policymakers to consider in conversations on tax reform. I applaud the Platte Institute's steadfast advocacy for a sound, predictable and equitable tax system that serves Nebraskans and supports the state's economic vitality."

– Senator John Arch,
Speaker of the Nebraska Legislature

"Reducing Nebraska's property tax burden must remain a priority for policymakers. This paper lays out a framework for evaluating reforms that improve affordability while maintaining long-term fiscal stability. I appreciate the Platte Institute's continued dedication to sound tax policy."

–Senator Robert Clements,
Chairman of the Appropriations Committee



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Platte Tax Principles

Nebraska's policy pathway to a superior tax system must be guided by the principles of sound taxation. Applying the first principles of sound taxation to Nebraska's policy approach will ensure that lawmakers continually drive the state's tax code toward a more sound and pro-growth system that will mean greater fairness and prosperity for Nebraskans.

Platte Institute supports the first principles of transparency, simplicity, stability, neutrality and pro-growth economic efficiency as the proper metrics to apply to any proposed tax reform. A tax code that abides by these principles will produce predictable and sustainable tax revenue to fund core government services with fair tax treatment across industries and families along with the minimum cost in economic growth.

The ideal tax code provides adequate and stable revenue for core government services without standing in the way of economic success. Over the past five years, Nebraska policymakers have improved the state's tax code in response to revenue growth and when confronting policy tradeoffs. Yet there remains significant room for improvement and reforms that should be revisited with the following first principles kept at the forefront.

A **transparent** tax system allows taxpayers to see how taxes are collected and used along with the amounts that are collected. A transparent tax system reinforces a democratic system because taxpayers feel fully informed about the collection and use of their hard-earned dollars. For example, a well-crafted Truth-in-Taxation law provides property taxpayers the opportunity to fully understand and engage with the local budget decisions that drive property taxes higher.

A **simple** tax system is easy for taxpayers to understand and comply with. Simplicity encourages compliance because it minimizes the administrative burden and costs of paying one's taxes. For example, a low, flat income tax rate is simple to understand and easy to comply with: all income is taxed at the same low rate.

A **stable** tax system delivers predictable and consistent revenue streams without unexpected changes or severe revenue disruptions. A stable tax system is part and parcel of a stable fiscal system and should be built with low tax rates applied across a broad tax base.

A **neutral** tax system raises revenue without unduly influencing or distorting economic decision-making. The tax system should not meaningfully change what people would otherwise do, or how they might structure their business or earn their income. Ideally, a neutral tax system should result in economic decision-making that is as similar as possible to a model where there are no taxes. For example, levying taxes on goods but not on services is non-neutral and distorts decision-making on the margin in favor of economic activity associated with services rather than economic activity associated with goods.

An **efficient** tax system generates sufficient revenue at the minimum cost to economic growth, or economic deadweight loss. In general, taxation imposes costs on economic growth because taxation removes resources from the more-productive private sector to the less-productive government sector and because it is non-neutral. Yet a dollar of tax revenue can be generated in ways that are either more or less costly to economic growth. For example, research regularly finds¹ that consumption taxes are less costly to economic growth compared to income taxes.

A properly structured tax code will result in a broad tax base with low tax rates that produce predictable and sustainable revenue to fund core government services such as education, infrastructure, and public safety.

To use a recent example, Nebraska made significant strides in pro-growth tax efficiency with the income tax reforms achieved in 2023. The income tax is currently being transformed from an uncompetitive progressive tax structure with top rates of 6.84% (individual) and 7.25% (corporate) into a much more competitive and simple top rate of 3.99% by 2027. This reform, achieved in LB 754,²

made Nebraska's income tax more transparent, simple, neutral, and economically efficient. LB 754 transformed the state income tax, which had previously been a barrier to economic opportunity, into a cornerstone of Nebraska's more pro-growth tax system. This general approach should be replicated across Nebraska's major taxes.

Nebraska lawmakers should focus on opportunities to restructure other sections of the tax code to achieve similar success for Nebraskans. Economic growth is an important goal, and that can be coupled with a simple, transparent, stable and neutral tax system that Nebraskans can intuitively understand and support.

Different components of the Nebraska tax code have different strengths and deficiencies in comparison to Platte's ideal tax principles. Therefore, our tax approach will be laid out first in principled approach form, and then practical applications of those principles will be described to move Nebraska toward a sounder tax system.

Property Tax Principles

Nebraska's property tax is the most poorly structured tax in the state and incredibly burdensome. The property tax generates more than \$5.3 billion of revenue for local governments each year.³ In addition, Nebraska applies a variety of other taxes on property that do not fit the traditional definition of the property tax such as the capital stock tax and the inheritance tax.

Nebraska has the fourth-highest property tax rate in the country behind only Illinois, New Jersey, and Connecticut.⁴ Nebraska's tax burden does not reflect the state's dedication of \$1.2 billion in annual property tax credits⁵ against a total burden of \$5.3 billion because Nebraska's Property Tax Credit Fund and School Property Tax Relief Fund provide an indirect mechanism of delivery that does not directly change the levy. Leveraging these relief funds for a direct levy reduction would significantly improve Nebraska's property tax burden ranking.

The Cornhusker State's exceedingly high property tax burden is only one part of the problem. Despite recent reforms, Nebraska's property tax scheme is non-transparent, overly complicated, and strongly biased against certain types of economic activity. As a rule of thumb, property taxes are less inhibiting to economic growth than income taxes. Yet Nebraska levies property taxes upon certain tax bases that make the tax particularly harmful to economic growth.

Nebraska's property tax presents the state's most significant opportunities for tax reform. Not only is the overall burden fourth highest in the country, Tax Foundation ranks Nebraska 45th for overall property tax competitiveness due to its high rates combined with the overbroad tax base that punishes certain economic activities.⁶ Notably, the two states with the highest property tax burden score better than Nebraska for overall property tax competitiveness with New Jersey ranked 43 and Illinois at 41. This is because their property tax structure has improved compared to Nebraska's even though their overall burdens are higher.

Lawmakers' focus should be trained on reforming Nebraska's property tax in coming years with a concerted effort to bring it in line with the principles of sound taxation. That will require a dual effort to directly lower property tax rates combined with fixing Nebraska's property tax base.

Property Tax Transparency, Simplicity and Stability

A transparent property tax system allows taxpayers to see how their taxes are collected and used, thereby giving them a stake in local government decision-making. Tax decisions should be tightly tied to the provision of local government services. Indeed, a well-functioning property tax should reflect the benefit principle of taxation with local services being largely funded by local property taxes paid by residents who benefit from the services.

Property taxes should be kept as simple and transparent as possible. That means circumscribing the tax base to real property, which includes land along with any

permanent structures and improvements attached to it. A variety of other forms of property are sometimes captured in a property tax base such as tangible personal property, inheritances, and capital stock. Taxing these forms of property diminishes a property tax code's adherence to the principles of sound taxation.

Property tax relief works best when it is applied to directly reduce levies so that levies are lowered to a new starting base that can be monitored by taxpayers. Applying tax relief in roundabout ways diminishes transparency and simplicity for taxpayers and raises general confusion about the total tax burden.

Property taxes provide a stable revenue source because local governments can adjust the tax rate applied against the tax base to achieve their sought-after revenue. Nonetheless, Nebraska has experienced a different form of instability in that property taxes have soared without justification in the post-pandemic years. Valuation spikes are being captured for new revenue by maintaining the same tax rate even after valuations soar. As a result, tax bills are significantly outpacing wage growth. For example, Douglas County property taxes continue to grow significantly faster than wages.⁷

Therefore, effective policies are needed to circumscribe the tax base to real property and to limit property tax growth. Nebraska has a variety of such tax limitations in place that are functioning as a complicated way to *not limit* property tax growth.

Property Tax Neutrality and Efficiency

Taxes on real property are neutral and economically efficient, causing minimal distortions to decision-making and economic growth per dollar of revenue. Real property is the ideal tax base for property tax. Both exemption from and extension to the tax on real property should be avoided.

Property taxes that extend beyond real property violate the principles of neutrality and efficiency. For example, taxation of tangible personal property (TPP) distorts economic decision-making by driving businesses to move

such property to a state without a TPP tax. Taxes on inheritances incentivize moving valuable property out of state and taxation of business capital stock incentivizes minimizing investment within a state.

Economic efficiency is not the end-all-be-all of taxation. Yet taxes on TPP, inheritances, and capital stock also violate the other principles of sound taxation on top of causing economic deadweight losses for Nebraska. Incentivizing avoidance of the state for tax purposes is an ultimate form of economic loss that can be easily avoided by removing the taxes causing the loss.

Nebraska Property Tax Applications

Property Tax Levy Buydown

Nebraska's K-12 school property tax credit will exceed \$800 million in minimum relief amount in 2026. These credit dollars are applied at the county level to reduce tax bills. This program can be simplified and made more transparent by transferring the funds directly to school districts with a requirement of a dollar-for-dollar reduction of property tax levies. Such a change will make Nebraska's tax system simpler, more transparent, and engage local taxpayers in the tax reform process. Dedicating Nebraska's credit funding to direct relief would result in Nebraska falling from 4th to roughly 14th highest property tax burden.

Lasting property tax reform requires aligning the system with the principles of sound taxation.

Eliminate Education Service Unit Property Tax

The ESU property tax should be eliminated with the next \$55 million of property tax relief funding. Community college property taxes are being eliminated by a similar mechanism. This will simplify the tax code and result in a transparent removal of another line item from tax bills.

Consolidate and Harden Property Tax Cap

Nebraska's property tax cap system allows property taxes to grow significantly faster than incomes. Furthermore, Nebraska's property tax caps are complicated, with different caps applied to different units of government. School caps can be easily avoided by a vote from the local school board. Meanwhile, public safety spending is exempted from tax caps for cities and counties. Applying different caps for different local subdivisions is non-neutral. In sum, Nebraska's caps don't apply to much of the tax base, and the caps that apply are not tied to inflation or another ability-to-pay metric.

Nebraska's tax caps should be consolidated into one unified cap that is tied to inflation rates rather than government spending growth rates. Tax restraints can be overridden in a referendum to allow spending beyond inflation-tied rates. These changes will promote transparency, simplicity, neutrality and economic efficiency.

Effective property tax caps tie revenue growth to inflation and prevent taxes from consistently outpacing incomes.

Reform Truth-In-Taxation Law

Nebraska's Truth-in-Taxation (TNT) law is fantastic in concept but comes up short in execution. A well-designed Truth-in-Taxation law is fundamentally pro-transparency. Nebraska has a TNT law on the books that should be improved to deliver transparency that taxpayers deserve.

First, the TNT timeline should be moved up so that the entire process occurs before budget decisions are made. Transparency must come before fiscal decision-making for transparency to be meaningful. Second, the TNT process should be precipitated with the first dollar increase in property tax.

Automatic Rate Rollback

When valuations soar, property taxes will also soar unless tax rates are lowered. Unfortunately, too many local governments choose to seize the windfall of soaring valuations to overfill local government coffers. These tax increases can occur without a vote by keeping the tax rate the same against significantly higher valuations.

When valuations rise, rates should automatically ratchet down to limit revenue growth. It's not unheard of for valuations to increase by 15% in a single year, and for all that increased value to be taxed at the old rate to capture new revenue. This change would significantly improve the transparency of the property tax system and slow the inexorable rise in the property tax burden. New property would be outside the cap, and local governments could still raise revenue above the cap, but they would need to hold a vote to do so.

Restore TPP De Minimis Exemption

Nebraska is the only state in the country to remove a *de minimis* exemption to the tangible personal property (TPP) tax. The TPP tax is applied to movable property such as manufacturing machines and other business equipment. The reason to enact a *de minimis* exemption is to recognize that most businesses can be removed from the TPP tax rolls altogether if the first \$10,000 of TPP is exempt.

A TPP *de minimis* exemption will restore simplicity to the property tax code by removing small businesses from the compliance and paperwork involved in reporting a negligible amount of TPP. Nebraska lawmakers should restore and then build upon the *de minimis* exemption to move toward the gradual elimination of TPP taxation entirely.

Repeal or Reform Capital Stock Tax

Nebraska's capital stock tax is named the Corporate Occupation Tax. It imposes 43 different tax rates upon businesses based on the business calculation of how much capital stock is held in the state.⁸ Repealing the capital stock tax, or transforming it into a simple, flat fee, would result in improved simplicity and economic efficiency. Nebraska should not have a tax that is levied with 43 different rates, especially when it disincentivizes new investment in the state.

Repeal Inheritance Tax

Nebraska's inheritance tax violates all principles of sound taxation. Policymakers agree on the importance of removing the tax, but they cannot settle on a mechanism for repeal. The inheritance tax is not simple, stable, or transparent, and it is arguably Nebraska's most non-neutral and economically inefficient tax per dollar raised. Practically any other revenue source would be superior to generating revenue from an inheritance tax, or the tax can be gradually phased out over years without a replacement.

Income Tax Principles

Income Tax Transparency, Simplicity and Stability

The ideal income tax applies a low, flat rate to a broad income tax base that minimizes exemptions and deductions that erode the tax base.

Progressive income taxes are less simple and stable because of their multi-rate structure and revenue volatility through the economic cycle. Progressive rates also diminish transparency because a taxpayer's effective tax rate varies by income level.

Taxpayers should not be pulled into a state's income tax filing and reporting process because of spending a few days in the state. A safe harbor for short-term stays is important for maintaining simplicity and compliance with the tax code.

On the business side, the proper definition of business income is revenue minus costs. However, businesses are often required to write off their costs over years and even decades, depriving them of full cost recovery and damaging the simplicity and transparency of the corporate tax. Progressive tax rates should especially be avoided within the corporate tax code because corporate income does not scale with the income of the owners of the corporation. Business tax credits redistribute the tax burden in non-transparent ways.

The federal One Big Beautiful Bill (OB BB) creates state tradeoffs between the simplicity of adopting federal tax provisions against the temporary nature, base erosion and instability of some of these provisions.

Income Tax Neutrality and Efficiency

The greatest loss in neutrality and efficiency comes from highly progressive tax rates. Businesses and investors make decisions on the margin, so the top marginal rate is the one they will consider for investment purposes. Thus, a high top marginal rate can deter investment and growth opportunities.

On a per-dollar basis, economic efficiency losses also occur when businesses cannot immediately write off their investment costs in the year in which they are incurred. Lack of cost recovery for capital investment is non-neutral because full cost recovery is allowed each year for labor costs but not machinery costs, biasing the tax code against productivity-raising capital. The full expensing provisions of the federal tax law should be expeditiously adopted by the states.

In addition, states should avoid taxing business activities that occur overseas. Beginning in 2017, federal efforts to capture tax arbitrage by American corporations have resulted in some states bringing overseas economic

activity within their tax base. While most states have deferred on taxing overseas income, the tax remains across 20 states including Nebraska.

Income Tax Applications

Continue Tax Rate Reductions and Consolidation

Nebraska should adhere to the rate reductions and bracket consolidation enacted in 2023, which will inspire certainty in Nebraska's business and investment climate and improve the income tax code across all metrics. The individual and corporate income tax are scheduled to hit a top rate of 3.99% in 2027.

30 Day Safe Harbor

Nebraska should create a safe harbor for workers who are in the state for only a few days each year. This will improve simplicity and income tax compliance for individuals who are in the state for less than a month. This can be done in a way to retain taxation of super high-income earners such as professional athletes and performers while exempting workers for whom the tax compliance cost might exceed the actual tax cost.

Adopt Full Expensing

The OBBB made full expensing provisions permanent for capital expenditures in research and development and machinery and equipment. Nebraska should incorporate these provisions into the state tax code to generate the greatest benefit in terms of simplicity, neutrality and economic efficiency. Adopting full expensing is the greatest growth-enhancing reform available to Nebraska per dollar of foregone tax revenue.

In addition, Nebraska should consider adopting the temporary full expensing for certain production facilities provided in the OBBB. While the state should generally avoid temporary provisions that do not abide with the principles of sound taxation, full and immediate write-off for production facilities would greatly improve economic efficiency even if only for the 4 years of application in the OBBB. Revenue permitting, Nebraska should adopt this

provision and keep it after 4 years if it can be sustained on a revenue basis.

Stop Taxing Foreign Business Income

Nebraska has taxed foreign business income since the 2017 Tax Cuts and Jobs Act brought Global Intangible Low-Taxed Income (GILTI) into the U.S. corporate tax base. Taxing foreign income never made sense and causes economic deadweight loss in Nebraska's tax code by incentivizing businesses to invest and grow in the states that do not tax GILTI. Now, the OBBB has transformed the GILTI tax into net CFC tested income (NCTI), which has even less nexus with state activity than GILTI did.

Fewer than half of states taxed GILTI.⁹ State taxing powers have generally ended at the water's edge, meaning that they do not extend to economic activity that occurs outside U.S. borders.

Minimize Base Erosion from Temporary Deductions

The One Big Beautiful Bill contains a variety of temporary tax relief provisions that erode the tax base without comports with the principles of sound taxation. These include no tax on tips, overtime and car loan interest. Nebraska should avoid these changes which will induce temporary base erosion that will last for four years and instead focus on adopting the provisions from the OBBB that are permanent and have a significant alignment with the principles of sound taxation.

Sales and Excise Tax Principles

Sales and Excise Tax Transparency, Simplicity and Stability

Nebraska's sales tax is the most competitive element of its tax code in the Tax Foundation's scoring, ranking 12th among states. The sales tax is transparent and simple when the tax incidence occurs only at the retail level of final consumption. Ideally, customers see the tax at the point-of-sale separated from the price of the product.

Sales taxes can be embedded in the price of the product when retailers display the all-in price of the product with the tax included, as is common in the European Union under their Value Added Tax (VAT) system. For example, a product that costs 100 Euro with a 20% VAT is displayed as 120 Euro.

Nebraska and other states separate the sales tax from the price of the product, providing greater transparency. Yet transparency is eroded when the sales tax is applied multiple times within a production process, which results in the cost of the iterative taxes being layered into the final price in a non-transparent way.

The sales tax is a relatively stable revenue source that tends to fluctuate less than income taxes during economic downturns. Stability can be bolstered by applying the sales tax to the broadest possible base of final consumption at a low rate.

Excise taxes, on the other hand, are sales taxes on individual products or services. They can provide unstable revenue when high rates incentivize tax avoidance. Excise taxes are ideally leveraged when they function as user fees, such as how the gas tax is used to fund road construction. Excise taxes should not be raised to levels that induce avoidance, as often happens with taxes on tobacco, resulting in criminal inter-state smuggling.¹⁰

Sales and Excise Tax Neutrality and Efficiency

A sales tax is neutral when it provides equal treatment to different forms of retail consumption. Goods and services should both fall under the retail sales tax to optimize neutrality and economic efficiency in the tax code and broader economy. The service sector should not be favored over the goods sector, and decisions made by generations past to focus the sales tax on goods should be corrected.

The sales tax is a more economically efficient tax than an income tax because it incentivizes saving and investing rather than consumption. However, the taxation of

business inputs causes a pernicious loss in economic efficiency because taxation is layered into production processes at multiple points. Businesses with long production cycles bear the greatest burden of this non-neutral taxation, and some will even avoid states that allow tax pyramiding.

Excise taxation, by definition, is an enhanced and inherently non-neutral application of sales tax to target a specific good or service. Excise taxes should be kept at or below those in surrounding states and should primarily be leveraged as a user fee to provide for associated services, such as how the gas tax funds road construction.

Sales and Excise Tax Applications

Base Broadening

Nebraska's sales tax base should be broadened to include a greater portion of final consumption. In practice, this means that more final service consumption should be included in the base such as digital goods and video services, groceries, motor fuel, fitness services and memberships, newspapers, entrance and membership fees, and repair labor. Business-like sales from non-profits should also be captured in the tax base. Base-broadening makes the tax code comport with all the principles of taxation, especially neutrality.

Taxing final consumption is transparent. Taxing business inputs creates an uncompetitive environment.

Rate Reduction

Any revenue gained from a sales tax base broadening should be applied to reduce tax rates. The most practical use of new revenues is to reduce the general rate for sales taxes, or to reduce the income tax rate. Sales tax base broadening improves tax neutrality and transparency, but it also creates an increase in the tax burden. The best way to deploy those new revenues is to reduce tax rates rather than new spending programs.

Input Exemption

Business-to-business transactions should be exempted from sales tax collection, especially for any base broadening. Lawmakers should avoid taxing business inputs from digital advertisements to farm equipment. While it's easiest to avoid input taxation when base broadening, lawmakers should also chip away at legacy business input taxation. Lawmakers can consider providing businesses with a sales tax exemption certificate for business purchases.

Taxation of manufacturing equipment and digital services becomes embedded in the price of final products and distorts production supply chains. For many products and services, the price of the final purchase is fully raised by the amount added to the production process by the taxation of business inputs,¹¹ but this impact is not clearly seen by the final purchaser. Taxation of business inputs violates every tax principle, but especially transparency and economic efficiency.

Minimize Discriminatory Taxes

Nebraska should reject any plans to levy new or higher excise taxes unless they are directly tied to providing a service that is connected to the tax levied. Excise taxes are by definition non-neutral, and thus should ideally be used in special cases and to fund necessary programs in compliance with the benefit principle of taxation.

Raising taxes on tobacco and nicotine products especially incentivizes smuggling and criminal behavior, which leads to higher law enforcement costs.

Conclusion

While the specific priorities before the Nebraska legislature will change from year-to-year, the principles of a sound tax system do not fluctuate. The ideal tax code is transparent, simple, stable, neutral and economically efficient.

Abiding by the principles of a sound tax code will increase the efficacy of Nebraska lawmakers' reform work. When a tax reform is built upon sound principles, it will not need to be repeatedly revisited and restructured in future years, allowing lawmakers to focus on making progress in new areas. Nebraska's property tax is a good example of a tax that has received a lot of attention from lawmakers, but that attention has not translated into lasting solutions. On the other hand, Nebraska's 2023 income tax reforms show the model of enacting sound tax reforms that abide by first principles. While Nebraska must continually revisit property tax reform, income tax reform is being phased in without needing to be revisited. Thus, first principles must be applied to finally land the right property tax reforms.

The property tax is not the only area in need of improvement even if it is the area where Nebraska lags furthest behind. In fact, the federal One Big Beautiful Bill will force the issue of income tax reform because Nebraska's legislature will need to choose which provisions to adopt and which to defer. While sales tax reform is not as immediately urgent, Nebraska needs to fix its sales tax base to include more final consumption, and to exclude taxation of business inputs and intermediate purchases.

Tax reform is an iterative process, with new opportunities and challenges each legislative session. Any sound tax reform must be inspired by the principles of sound taxation, which will move Nebraska's tax code ever closer to the principled ideal.

Endnotes

- 1 https://www.nber.org/system/files/working_papers/w12307/w12307.pdf?
- 2 <https://revenue.nebraska.gov/about/2023-nebraska-legislative-changes>
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