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The Tax Rate Review Committee met at 10:00 a.m. on Monday, July 17, 2017, in Room 1003 of the State Capitol, Lincoln, Nebraska. Senators present: Dan Watermeier, Chairperson; Jim Scheer; Jim Smith; and John Stinner. Senators absent: None. Others present: Tax Commissioner Tony Fulton; Legislative Fiscal Analyst Michael Calvert.

SENATOR WATERMEIER: Well, it is 10:00 and I think we'll go ahead and get started with the Tax Rate Review Committee, the no-name committee. I am Dan Watermeier, Senator from southeast Nebraska representing District 1. Think we'll just go ahead and go around the room here, starting with Senator Smith, if you'll introduce yourself.

SENATOR SMITH: Yes. Jim Smith and I'm Chair of the Revenue Committee.

SENATOR WATERMEIER: Commissioner?

TONY FULTON: Tony Fulton. I'm the Tax Commissioner.

SENATOR STINNER: Yeah, I'm John Stinner, District 48, and I'm Chair of Appropriations.

SENATOR SCHEER: Jim Scheer, Speaker.

SENATOR WATERMEIER: Helping me today is my committee clerk...or, excuse me, my AA and clerk for me, Laura Olson. Also here today is Mike Calvert, Fiscal director. Don't know of anybody else that we need to introduce in the room here. We'll just turn it over to you, Mike.

MIKE CALVERT: Very good.

SENATOR WATERMEIER: We have attendance already taken and we'll turn the report over to you.

MIKE CALVERT: Right. I know we're running a tight schedule.

SENATOR WATERMEIER: Yeah.

MIKE CALVERT: (Exhibits 1, 2, and 3) A couple people need to hit the road here pretty soon, so I'll try and be very brief. Tax Rate Review Committee background, since we've got four people that have really never sat in on this meeting before, kind of has its origins back to about 1984, thereabouts. There used to be a Board of Equalization that met periodically. The last time was November of 1983. And that Board of Equalization consisted of your executive officers of state government, I believe the Governor, the Auditor, the State Treasurer, and then I seem to recall the Tax Commissioner may have been a member. And the whole process at that time was that board would set tax rates and it was on the heels of the Legislature setting a budget in the prior legislative session. So in November, because of some relatively long delays in terms of tax processing data, they would meet in November and make a determination if tax rates were sufficient to meet obligations. Well, that last meeting was November of '83. Senator Warner, who was then Chair of Appropriations, decided, well, you know, I think it's probably a good idea for the Legislature to have a snapshot of the financial situation periodically, so selected July and November, created this committee which originally didn't have a name, and they met starting I think in 1984, possibly '85, in July and November of each year. The purpose for July was it was immediately on the heels of the finish of the fiscal year and, again, it was set because time frame in terms of lag on tax receipts data gave you an opportunity to actually evaluate the situation. And then in November was kind of the last gasp going into the next legislative session that, if financially things had deteriorated sufficiently, that was a last opportunity, literally, to petition the Governor to call a special session, which the statutes are the guidance that you have for this committee speaks to that, is that you have the opportunity to petition the Governor to call a special session should financial situation warrant. So that's the short story, long story, whatever, in terms of background. The report we have supplied to you is as of the completion of the fiscal year ending June 30, 2017. The first page is just the statutory requirements that set forth the existence of the committee. The second page is the summary of events that have transpired since sine die. Actual receipts, as has been widely reported, were $34.2 million before the forecast used at sine die for the General Fund. There were no additional revenue bills enacted in the session that affected '16-17. That forecast was the Nebraska Economic Forecasting Advisory Board as of April. If you look at growth, year over year on the summary, page 2, tax rate and base adjusted revenue growth for '16-17 were about three-tenths of a percent, compared to what was originally estimated a 1 percent growth in the April forecast. When I say rate and base adjusted, what we do is we look at the actual revenues and then make adjustments for one-time extraordinary events that are nonrecurring. It's kind of an effort to try and say, okay, in terms of your tax revenue growth, how much economic push is behind it and not statutory and/or other changes that are nonrecurring? In this particular case, the difference between the adjusted rate of growth of three-tenths of a percent versus a minus 1 percent in terms of nominal, I mean we actually decline in terms of revenue collections compared to the prior year. The difference comes down to Nebraska Advantage Act and LB775 sales tax refunds were about $33 million different. Amazon sales tax, you may recall, there was an agreement whereby starting in January they would start submitting sales tax of $11.2 million a year. Well, compared to the prior year, that wasn't in the base so that was kind of a one-time extraordinary adjustment for that year. Fund lapses were different by $10.8 million, and we had also a withholding change. The Tax Commissioner can affirm this, is that there had been announced last summer that there was a change in the withholding rates that created a $12.9 million adjustment. So that really comes down to the difference in terms of how we calculate nominal rate, base adjusted. The projected General Fund financial status for the current biennium when compared to sine die declines a bit from an imbalance going $45.4 million above minimum reserve to $22.8 million. Note that the minimum reserve statutorily is 2.5 percent, okay, for this biennial period only. If you go to page 4, that shows you the adjustments, how did we get from the sine die situation of being above the minimum reserve by $45 million and then how...what transactions got us to line 11, the current financial status, at about $24.8 million? As I mentioned, revenue was below estimates by $34 million. There was an adjustment for our transfer in, coming in, in the current year of $50 million. There were some accounting adjustments that are itemized in the middle section of about $3.1 million. Number 8, assumed lapses of about $20 million, what that is, is we estimate that portion of the appropriation at the end of the fiscal year that will be unspent and will, in effect, expire. Therefore, it becomes a fund available to the bottom line. That number is going to float because there is a process by which those obligations at year-end are certified between state agencies and the state Accounting Office. That takes some time, usually is not done until latter part of August. Twenty million is a relatively conservative estimate. It could be somewhat higher. In other words, more funds might be freed up through that process of certification, but it's not going to be a huge amount. I think we preliminarily had estimated maybe up to about $40 million, but there was about $20 million we really had some doubts about so it should go through that certification process. Then all of these changes result in recalculation of the minimum reserve. So in either scenario, 2.5 percent reserve requirement is met. The accounting adjustments are listed in the middle of the page. I mentioned the process by which certification will occur. There is a Cash Reserve Fund status on page 9 and you can see the history for the Cash Reserve Fund, which is your backstop. The original purpose of the Cash Reserve Fund when it was first created was to create a pool of funds that was literally a line of credit for the General Fund. If at any point in time the General Fund balance was projected to be negative on a day-to-day basis, there is a process by which transfers are automatically made from the Cash Reserve Fund to the General Fund. Maintains liquidity for the General Fund. You can pay bills tomorrow. And then the law automatically says that if you then have a sufficiently large enough balance, the General Fund pays it back. There is an obligation so it's automatically paid back. When you go through periods of financial distress, as we are experiencing now, that Cash Reserve Fund balance becomes significant in terms of what kind of a safety net you have. Processwise, we have a significant thing that needs to yet occur. We have closed out a fiscal year. As of Friday, the revenue forecasts that are used for the budget to be balanced this biennium was certified. I agree with the Tax Commissioner. We write a certification in terms of here's the valid revenue estimate so it's cast in stone. That's your revenue target for the fiscal year. That certification includes a distribution by month. That will be turned over to the state Accounting

Office. They will fold that into a system by which they can estimate cash flow and literally create a projection of revenues and expenditures on a daily basis for this next fiscal year. That should be available in the next week or two. So we will have a picture of cash flow for the General Fund, independent of the Cash Reserve Fund. What that does is it gives us an indication into the future as to where we might have some liquidity problems, if any, through this fiscal year. My guess is if we have any problems it will be in March or April. Our typical low point in terms of cash flow is almost always April, right before April 15 time period. Okay? So that's one of the other factors that we'll be looking at. I can't imagine that that is going to be a very large number if it does run into a negative. And, quite frankly, we're running at a Cash Reserve balance now, after legislative session transactions, free and clear over about $370 million. So that's your safety net in terms of liquidity, okay? That's the outlook. One of the things I handed out to you is a "Consensus 'One Year Ahead' Forecast." And I kind of like viewing this in terms of a chart analysis almost in terms of like the stock market. You have chartists that study patterns. And it's a busy chart, but focus in on the red lines and the black lines. The red lines generally are those time periods where there's fiscal stress, and that's going to be the time periods where your revenues come in below estimate. The pattern is one of looking at what does the forecast error look like for that year; what does the change in terms of percentage growth rates look like on a nominal basis and on an adjusted basis. And as you can see, they kind of cluster. And if you go to the far right-hand side in terms of adjusted growth rates, you can see the alternating pattern of red and black in terms of growth rates being relatively above average, which is about...we project about 4.7 percent into the future average General Fund revenue growth, rate and base adjusted. We have patterns where we're above that and we have patterns where we're below that, and it has a tendency to be somewhat cyclical. And one caution is if you stop and think about it, this probably only really represents maybe four or so economic cycles.

SENATOR WATERMEIER: Yeah.

MIKE CALVERT: That's not a lot of observations.

SENATOR WATERMEIER: Mike, what...

MIKE CALVERT: So somebody 20 years from now is going to have to look, hopefully, look at this same thing and perhaps has more observations and more of an assurance that this is a kind of a pattern that you can kind of point to.

SENATOR WATERMEIER: What was the 4.7 percent you're saying? Was that an average number that you just know in your head?

MIKE CALVERT: Yeah. What...no, no, no. What Tom has done and we've done over the years is look at, historically, since about 1980,...

SENATOR WATERMEIER: Right.

MIKE CALVERT: ...gone through a process of looking at revenue growth year over year and then go through and make those adjustments that I talked about in terms of the one kind, nonrecurring things. So we're looking at just your sustained revenue base year over year. In the long run since then, about early '80s, about 4., well, it actually in the early '80s it was about almost 5 percent. But then with some recent changes to the individual income tax in terms of indexing, there has been a little bit of erosion in terms of the long-run growth. So our projection into the future is probably closer to 4.7 percent in terms of the long-run average growth.

SENATOR WATERMEIER: Right.

MIKE CALVERT: Now again, is that...do we have a sufficient number of observations to say that's, you know, something we're absolutely 100 percent certain? No, but it sure does look like there's some kind of a pattern here...

SENATOR WATERMEIER: Right.

MIKE CALVERT: ...that's worth looking at and worth knowing. So, you know, probably the critical time period for us is going to be between now and September. July, August, and September is your first fiscal quarter. I expect the General Fund balance, I think we closed out at about $275, then it dropped to around $150-$160 in the early part of July. You don't have that in front of you.

SENATOR WATERMEIER: Oh.

MIKE CALVERT: I'm just kind of saying...and that's normal. We usually have a drop in the early part of July because we have a large payment for retirement and then there's some other obligations that come very early. And then it gradually climbs through September and October. In fact, typically the peak is somewhere between September and November, maybe December, and then it starts gradually going down through December to April. That's all I got.

SENATOR WATERMEIER: All right. Questions? Speaker Scheer.

SENATOR SCHEER: Well, not to Mike. Thank you, though.

MIKE CALVERT: Yes, sir.

SENATOR SCHEER: The information was very informational. More to the Director Fulton, Commissioner Fulton, we are now into the new year and we've got fiscal projections monthly by the Forecasting Board. From what you've seen, and it's July so far, are we going to be able to meet those projections? And you know we're only halfway through. But my concern is if you look at where we ended the last year at 4.2 and change, and the projections based on 4.6 and change, about an 8 percent increase that we're going to have to (inaudible)...

TONY FULTON: Uh-huh.

SENATOR SCHEER: ...off. That seems pretty aggressive.

TONY FULTON: Yeah.

SENATOR SCHEER: I'm just wondering if so far, you know, if you've been able to notice anything from a previous year that would give us pause or give us a little joy.

TONY FULTON: Uh-huh. Well, I'd agree that that 8 percent figure seems aggressive. That's just a hunch. We haven't had...we don't have enough in July to really be able to say. I can say July so far so good, but we're July 17. July 21, I think it is, I believe it's the 21, when sales tax comes in or when it's due, so we'll know a little bit more there. But July is not the biggest month. So even after July, there's still going to have to be some more data apprehended. Like Mike said, it's the quarter, September. I think September is our big month, isn't it, Hoa Phu? Yeah. So, so far so good in July, but it's small numbers. We're talking about small numbers thus far. The big numbers in July haven't even come in, and July itself isn't a big month, so.

SENATOR WATERMEIER: Mike, did you have something to add?

MIKE CALVERT: Yeah, I'd like to qualify. I agree, you know, 8 percent sounds terribly optimistic. However, you have to keep in mind, and that's why we lay side-by-side nominal, which is what your actual receipt estimate is, what you're actually thinking you're going to collect, and adjusted, which adjusts for those one-time events. One of the significant one-time events you have that reconciles that difference, that 8 percent includes some significant increases in fund transfers that we treat as a miscellaneous receipt, significantly higher than normal. So on a nominal basis, it pushes that number up. But when we try and estimate the actual underlying growth, it's, in our estimate, it's closer to 5.6 percent in terms of a normal growth rate. You budget on nominal, but you have to evaluate it on the adjusted basis. You have to understand some of those unusual changes. So, yes, I expect we'll get some feedback saying 8 percent is ridiculous. Well, you got to understand what you're counting in there. There's some...and those fund transfers, you can rely on those. Those are going to happen.

SENATOR WATERMEIER: Well, some of them would be reliable year in and year out. Some of them we took...

MIKE CALVERT: Yeah.

SENATOR WATERMEIER: ...would be one...we've kind of gotten them down to (inaudible).

MIKE CALVERT: Yeah. Our normal pattern on fund transfers, we've got certain funds that I would consider cash cows. They're probably about...

SENATOR WATERMEIER: Yeah.

MIKE CALVERT: ...$30 (million) to $40 million a year.

SENATOR WATERMEIER: Right.

MIKE CALVERT: We're way above that.

SENATOR WATERMEIER: Right. Exactly. Good point. Senator Stinner.

SENATOR STINNER: Just looking back on the 12 months, and this is for either Mike or the Commissioner, one of the things that causes you pause is to take a look at the gross receipts at .6 percent, which was a $33 million increase. Embedded in that, of course, corporate income tax was off $37 million. We saw a revival of, in the last quarter, of the corporate income tax. Any observations or clues about what's happening on the corporate side?

MIKE CALVERT: (Laugh) You go ahead and take that.

TONY FULTON: I'll take a swing at it. Should...just to bear in mind, corporate, most of the taxation comes in the form of individual income tax and that's because the companies are largely, as corporations, LLCs and pass-through entities. So those corporate entities truly are corporate entities. So that's one. The actual amount of corporate tax collected with respect to (inaudible) all the tax receipts is relatively small, although to have the turnaround that we did in the fourth quarter certainly helped. Predicting into the future, we talked earlier off the microphone, there's a (inaudible) tax plan (inaudible) there's just no way anyone can possibly predict. And since I have been in this position, that is...I mean I've seen that. It's the truth. You just...it's hard to put a finger on it.

SENATOR STINNER: The other one that really catches your eye is net refunds increased $75 million, of which $36 million was sales tax refunds. Now that was...that whole refund category was up 7.3 percent. That causes you pause as to what caused it, what's behind those numbers, how do you project that into the future?

SENATOR WATERMEIER: Mike, did you...oh, (inaudible).

MIKE CALVERT: Yeah, on the projection part, yeah. You've picked out probably two of the things that are the biggest hair pullers for a revenue forecaster. In terms of the sales tax refunds, you can estimate the liability over time but the way our tax refunds are structured, at least up until now, you don't know when they're going to show up and it becomes discretionary for corporations and businesses that have earned tax credits that apply to sales tax when they're going to take it. And one of the concerns I've got is increasingly I think we've got some major investments occurring that could result in a significant influx of sales tax in the near term, next year or two, and conceivably will go out the door within the next year depending upon the choice and discretion of a company. And not having a good handle on that inflow is really distressing because you know you're going to have an obligation and a liability sometime in the future. Now corporate income, if you look at the long-run history in terms of forecasting error, corporate income year ahead estimate, if you're within 15 percent you have a victory, plus or minus 15 percent. So that's a 30 percentage point spread, high to low, in terms of your band of error on corporate income. Now, luckily, it's a relatively small revenue stream, but you start talking in those...that kind of magnitude in terms of an error, all of a sudden that can be pretty significant. I think Tax Commissioner Fulton alluded to the fact that for the...well, and we talked about this. When I looked at the first three quarters of actual corporate receipts on net, we were over $80 million behind the prior year in terms of net collections. And in the fourth quarter, that difference got cut in half. We picked up $40 million and I haven't a clue why and I suspect Tony doesn't either. (Laugh)

SENATOR STINNER: But you know on the LB775 as well as Nebraska Advantage Act, I do get a report, as well as Senator Smith does, projecting six months in advance.

MIKE CALVERT: Uh-huh.

SENATOR STINNER: And I just added up the last one and it was well over $60 million, annualized $120 million. Now that's an observation. I don't know what we do with that information other than the fact that we have to enter it in and make it...

MIKE CALVERT: I watch that. That's shared with our forecaster. That becomes part of the forecasting effort. On a month-to-month basis we track actual and then add the six-month ahead, so I could kind of see how it matches up on actuals as we go through time. So it's a bit of information that we use. I haven't found the last little bit of magic to try and narrow that down better. I mean that's been very, very worrisome for a long time is the timing of the refunds. You can get an idea on liability. You just don't know when you're going to liquidate them.

SENATOR WATERMEIER: Exactly. Speaker Scheer.

SENATOR SCHEER: Well, this committee is the Tax Rate Review Committee. And I don't get the sense from...I've not talked to the Commissioner but from any of the rest that we are inclined to suggest raising tax rates by any stretch of the imagination. But having said that, I do think we, at least the four of us that are in the Legislature, have an obligation to watch this closer and maybe, rather than let it get too far down the line, might suggest that the four of us get together perhaps the last week in September and review. At least by then we will have July and August full, and maybe they are small smaller months, but they are something that we can compare with.

TONY FULTON: Uh-huh, trajectory.

SENATOR SCHEER: And things can change, I get that, but I don't want to get us in the same problem we had last year if we go into the legislative session having to immediately reduce expenditures in a six-month period. That becomes fairly burdensome for every agency to be able to accomplish. So I might suggest that the four of us do get together the last week in September. That would give time for all the rest of the receipts for both previous two months to come in. And perhaps if we see something, obviously the Governor's Office will as well, but perhaps have our conversation to see what might be on the Governor's mind in relationship to if we do have a significant problem with funding.

SENATOR STINNER: I'd like to be proactive in this. Obviously, the last session still lingers in my mind, but trying to get in front of some of this stuff is much more preferred.

SENATOR WATERMEIER: I think that's what our role is, but I do also think--and Mike and I had talked about this briefly--that I'm not sure we can actually set a date and meet formally. But I think informally the four of us can meet, outside of Commissioner Fulton. And we can meet and if we really decide individually this is something we need to pursue, we'll push ourselves individually. So it's a good idea.

SENATOR SMITH: I agree. I think that's a prudent plan and it gives us a couple of months then to prepare for the next Tax Rate Review Committee meeting, right, which is November?

MIKE CALVERT: It's in November.

SENATOR WATERMEIER: Yeah.

MIKE CALVERT: Between the 15 and 25.

SENATOR WATERMEIER: Mike, did you have something to add?

MIKE CALVERT: Yes. I was going to say the only point I made to Senator Watermeier is there's nothing explicit in the statute that says other than...it says you meet in July and you meet in November; doesn't say anything about any other kind of meeting. But on the other hand, it doesn't say you can't. But I think the option of an informal meeting, kind of walk through some stuff,...

SENATOR WATERMEIER: Uh-huh.

MIKE CALVERT: ...I think that makes sense.

SENATOR WATERMEIER: If you'd be open to that, we'll probably line that up on the calendar...

MIKE CALVERT: Sure.

SENATOR WATERMEIER: ...to see how everybody feels.

MIKE CALVERT: That's fine.

SENATOR WATERMEIER: Senator Stinner.

SENATOR STINNER: Just to follow up on some of the things that I've tried to look at, I would recommend you take a look at the State Policy Reports, and it's a formalized document out of the...it's compiled by the Department of Labor. But there are three key measures for economic vitality. Personal income growth, we were 48 out of 51--I guess they got the District of Columbia in there--but at 1.2 percent growth. Employment growth, interestingly, we're 32 at a 1.2 rate. Population growth, we're 18 at .7. Those three were compiled into a momentum indicator. We were 41 in the nation with a negative .98. That might give you some indication of what's happening from the individual tax receipt side along with the sales tax. We just don't have the momentum. There isn't inflation. That's another piece of the cause of revenue to go off, but inflation in our state was less than 1 percent.

SENATOR SMITH: Relative to the region, how does that compare to other states in the region?

SENATOR STINNER: Well, that...you'd have to dig that out. I didn't do the regional analysis, but it has the, you know, 51 states along with the District of Columbia, and it has the average for the United States in the report. But it's an interesting read. It's kind of reflecting back on what's happening on the (inaudible).

TONY FULTON: Is this the BLS you're (inaudible)?

SENATOR STINNER: Yes.

SENATOR WATERMEIER: Mike.

MIKE CALVERT: And I'm familiar with that report. That comes out I think at least annually if not semiannually.

SENATOR STINNER: Yes.

MIKE CALVERT: The one...and I'm not disagreeing. I think that report in terms of current terms is spot on. But it can move a lot in terms of where you are in the rankings as you move through time. You can move around quite a bit.

SENATOR WATERMEIER: Well, Senator Stinner, you made a comment right after you introduced the report that it was put out by the...did you say the Department of Labor?

SENATOR STINNER: Oh, the state Department of Labor...

SENATOR WATERMEIER: Okay.

SENATOR STINNER: ...actually...that's where the compilation...

SENATOR WATERMEIER: Yeah.

SENATOR STINNER: ...of stuff. It's State Policy Reports.

SENATOR WATERMEIER: Right, SPR.

MIKE CALVERT: Yeah, State Policy Reports publishes the aggregate data.

SENATOR STINNER: Yeah. Information for states.

SENATOR WATERMEIER: Got it. Any further questions? I would accept a motion to adjourn.

SENATOR SMITH: So move.

SENATOR WATERMEIER: So moved by Senator Smith. Seconded by Speaker Scheer. Call the roll.

LAURA OLSON: Speaker Scheer.

SENATOR SCHEER: Yes.

LAURA OLSON: Senator Smith.

SENATOR SMITH: Yes.

LAURA OLSON: Senator Stinner.

SENATOR STINNER: Yes.

LAURA OLSON: Senator Watermeier.

SENATOR WATERMEIER: Yes. We are adjourned. Thank you for attending. Thank you, Mike.

MIKE CALVERT: Thank you.

SENATOR WATERMEIER: Thank you, Commissioner.