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DATE PREPARED: March 23, 2006
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LB 968

Revision: 02

FISCAL NOTE

LEGISLATIVE FISCAL ANALYST ESTIMATE

Revised to reflect amendments

ESTIMATE OF FISCAL IMPACT – STATE AGENCIES *

	FY 2006-07		FY 2007-08	
	EXPENDITURES	REVENUE	EXPENDITURES	REVENUE
GENERAL FUNDS	5,112,546	(84,399,000)	19,532,638	(78,503,000)
CASH FUNDS	33,150	5,000,000		
FEDERAL FUNDS				
OTHER FUNDS				
TOTAL FUNDS	5,145,696	(79,399,000)	19,532,638	(78,503,000)

*Does not include any impact on political subdivisions. See narrative for political subdivision estimates.

As amended, LB 968 impacts three different areas of taxation: sales tax, property tax, and income tax. Furthermore, the bill also provides for a transfer to the EPIC Fund and has an affect on political subdivisions.

<u>Sales Tax</u>
Effective July 1, 2006, sales tax on contractor labor is changed to exempt single family dwellings and duplexes. Moreover, a refund is allowed for sales tax paid on contractor labor for other owner-occupied units (primarily condominiums). Finally, the definition of “major renovation” is changed for the purposes of commercial property. Also, the Department of Revenue (DOR) estimates the following expenses will be associated with the implementation of the changes to contractor labor:

Expense Item	FY07	FY08	FY07	FY08
Revenue Operations Analyst II	1.5 FTE	3.0 FTE	39,469	81,306
Revenue Senior Auditor	0.25 FTE	0.5 FTE	10,053	20,708
Benefits			15,104	31,624
Operating Costs			38,150	5,000
Total			102,776	138,638

Revenue Operations Analysts II: The DOR states that these on-going positions are necessary in order to handle the estimated 20,000 extra sales tax refund requests that will be submitted by owner-occupied condominium residents.

Revenue Senior Auditor: In order to ensure compliance with four different sets of rules, which are applicable over a three year period, per case, the DOR will require the extra on-going FTE’s stated for this position.

Operating Costs: Operating costs consist of a one time expense of $33,150 for tax payer assistance, which will be paid out of the Contractor Enforcement Fund, and an on-going expense of $5,000 for computer processing costs.

Floor Amendment 619, effective October 1, 2006, exempts housing agencies from paying sales and use taxes on building materials and construction services.

The DOR estimates the following General Fund revenue impact for the sales tax aspect of LB 968:

Impact of Sales Tax Changes (Revenue)			
	FY07	FY08	FY09
Change contractor labor provisions	(30,414,000)	(30,978,000)	(33,648,000)
Exempt housing agencies	(738,000)	(1,152,000)	(1,242,000)
Total	(31,152,000)	(32,130,000)	(34,890,000)

Property Tax

As amended, LB 968 reduces the level of assessment of agricultural land from 80% to 75%. Because of a loss of an estimated $1,576,160,123 in taxable valuations, the Fiscal Office estimates the amount of State Aid for equalized systems will increase by up to $12,500,000 in FY08 and $13,000,000 in FY09.

As amended, LB 968 changes the maximum value of a homestead that can qualify for the homestead program. Furthermore, it provides a larger property tax exemption for those who qualify. These provisions will be operative for applications filed in calendar year 2007.

- The maximum exemptions are increased from 80% and 100% to 100% and 120% of the assessed value for the over 65 and disabled portions of the program.

- The maximum valuations are increased from 150% and 200% to 175% and 225% for the over 65 and disabled portions of the program.

The DOR and the Fiscal Office estimate the following General Fund expenditures for the property tax aspect of LB 968:

Impact of Property Tax Changes (Expenditures)			
	FY07	FY08	FY09
Change ag land valuations		12,500,000	13,000,000
Changes to Homestead Program		6,894,000	7,068,000
Total		19,394,000	20,068,000

Income Tax

As amended, LB 968 provides for a refundable earned income tax credit (EITC) equal to 8% of the Federal EITC allowed under §32 of the IRS code. The credit is for tax years beginning January 1, 2006.

Based on the number of Nebraska filers taking the Federal credit in 2004, the Department of Revenue estimates between 111,000 and 113,000 returns claiming this credit.

The DOR states that there will be a one-time implementation cost of $42,920 in FY07 for computer programming.

As amended, LB 968 changes the income tax rate schedule for tax years beginning January 1, 2006. Furthermore, the phase-outs of the personal credit, itemized deductions, and standard deductions are eliminated.

Old Brackets		New Brackets	
Single:	$2,400, $17,000, $26,500	Single:	$2,400, $17,500, $27,000
Married filing jointly:	$4,000, $30,000, $46,750	Married filing jointly:	$4,000, $31,000, $50,000
Head-of-household:	$3,800, $24,000, $35,000	Head-of-household:	$3,800, $25,000, $35,000
Married filing separate:	$2,000, $15,000, $23,375	Married filing separate:	$2,000, $15,550, $25,000

The DOR estimates the following General Fund revenue impact for the income tax aspect of LB 968:

Impact of Income Tax Changes (Revenue)			
	FY07	FY08	FY09
EITC 8% credit	(16,450,000)	(17,024,000)	(17,598,000)
Tax brackets and phase-outs	(36,797,000)	(29,349,000)	(31,212,000)
Total	(53,247,000)	(46,373,000)	(48,810,000)

Transfer

As amended, LB 968 calls for two $5,000,000 transfers from the General Fund to the EPIC Fund, one in FY06 and one in FY07. The FY07 transfer is shown in the Estimate of Fiscal Impact as a General Fund expenditure and as Cash Fund revenue.

Impact on Political Subdivisions

Under the sales tax section of 968, political subdivisions will lose an estimated $7.16, $7.4, and $8.0 million in FY07 through FY09, respectively, in city sales and use tax returned to municipalities.

Under the property tax section of 968, a loss of $1,576,160,123 in taxable valuations translates to a loss of approximately $27,000,000 in property tax collections for political subdivisions. It is possible that some of this loss would be recovered by increasing tax levies to the extent that local political subdivisions are under the levy limit.

DEPARTMENT OF ADMINISTRATIVE SERVICES

REVIEWED BY	Lyn Heaton	DATE 3/24/06	PHONE 471-4181

COMMENTS

The Department of Revenue's estimate of the need for 3.0 additional FTE for processing of the refund claims related to the sales tax exemption for owner-occupied units within multi-family dwellings appears excessive. The department's assumption that approximately 21,000 of these units exist in the state is reasonable. However, it is assumed the percentage of the owners of these units that will avail themselves of the opportunity to apply for a refund of sales tax paid will be lower than what is assumed by the department. The great majority of the qualifying projects creating eligibility for a refund will be of a low cost nature and as such the available refund will not be seen by the homeowner as large enough to justify the effort needed to file a refund claim. For purposes of our analysis, the DAS-Budget Division is assuming no more than 1.0 FTE Revenue Operations Analyst II will be necessary to process the refund claims.

Further, we disagree with the department's estimate of the need for 0.5 FTE Revenue Senior Auditor. It is true that LB 968 creates a new exemption that will need to be understood by contractors. However, it is assumed any questions related to compliance and follow-up by the department to ensure compliance will be temporary and will not require a new permanent position beyond the existing audit staff.

All other costs included in the department's fiscal note are either one-time or minimal relative to the department's base appropriation and can be managed within existing resources.