POLICY BRIEF: CONSUMPTION TAX

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The consumption tax proposal in LB 79 would require a rate of 22.1 percent to be revenue neutral, OpenSky analysis conducted with the Institute on Taxation and Economic Policy finds. This rate is nearly three times greater than what is proposed in the bill.

Further, OpenSky estimates that if the consumption tax were to be enacted as written in LB 79, it would amount to an annual revenue loss of $7.4 billion.

Technically, the rate we present in this report is the "budget neutral" rate, meaning the rate needed to maintain current state and local services, though we use the phrase "revenue neutral" to convey the same concept as it is a similar and more familiar term. Under LB 79, nominal revenue would need to increase simply to hold services steady because the cost of providing public services would rise by the amount of tax that state and local governments pay to themselves under LB 79. This issue is discussed more in Appendix B.

2023 proposal not the first

The consumption tax proposal has been introduced several times in the Legislature in recent years. The proposal would substantially alter Nebraska's revenue structure by eliminating many current forms of state and local taxation – including income and property taxes – and replacing them with a greatly expanded sales tax. The current iteration of the proposal, introduced in 2023 as LB 79, is the fourth proposal in as many years. Accompanying this year's proposal are two legislative resolutions, LR 6CA and LR 7CA, which would amend Nebraska's constitution to implement the consumption tax as the state's only form of taxation apart from excise taxes and prohibit the state from collecting a tax on groceries.

The consumption tax proposal was first introduced in the 2020 legislative session. Although the different iterations of the proposal have changed, the basic concept has remained the same: eliminate the state's and local government's ability to raise most taxes except for a greatly expanded sales, or consumption, tax. The rates at which the tax would be levied have varied by proposal. In the 2021 proposal, the rate was 10.64 percent, which was estimated to reduce state revenue by about $4 billion annually after four years of implementation (Legislative Fiscal Analyst 2021). In the 2023 proposal, the proposed rate is 7.50 percent.

The consumption tax concept stems, in part, from interest in reducing the state's reliance on local property taxes, which has intensified in recent years due to increases in land valuation. Proponents have also framed the tax as an issue of fairness and emphasize that all Nebraskans would contribute under the proposal (EPIC Option 2023). The objectives of the tax are to create jobs, increase investment, simplify the tax code and grow the economy (Burke et al. 2021).

Prebate removed in 2023, groceries excluded

Previous versions of the proposal included a prebate, which was designed to send monthly checks to every household in the state to help cover the cost of the consumption tax (Burke et al. 2021). It was intended to spare low-income Nebraskans from the generally regressive effects of such a tax. LB79, however, does not include the prebate. Instead, the 2023 proposal is accompanied by a proposed constitutional amendment that would exempt groceries from the tax.

Although groceries are excluded, the proposal would still be regressive, as lower- and middle-income households spend a greater portion of their income on average on non-grocery purchases than wealthier households do. State consumption taxes have consistently been found to be regressive by agencies such as the Texas Comptroller, Minnesota Department of Revenue and Colorado Department of Revenue. In Nebraska, general sales taxes paid by individuals comprise 3.4 percent of income among the lowest 20 percent of Nebraskans (annual income under $24,400) while they comprise 0.5 percent for those in the top 1 percent, with incomes greater than $462,600 (Wiehe et al. 2018). And at the calculated rate of 22.1 percent, the tax would have a far greater impact on low- and middle-income households.

Determining the revenue-neutral statewide sales tax rate

To determine the statewide sales tax rate required to replace all current state and local revenue, the state's tax base under the proposal and the revenue to be replaced must be determined. The following section explains the OpenSky and Institute on Taxation and Economic Policy (ITEP) methodology in determining these numbers. From there, it is a matter of dividing the revenue needed into the base to obtain the rate.

Estimating the cost of replacing lost state and local revenue

As the proposal is intended to be a different tax system that generates the same amount of revenue, the amount currently collected from state and local taxes is assumed to be the amount of revenue needed to be replaced (Stoddard 2023).

Table 1: 2023 Estimated State and Local Tax Revenue to be Replaced

Tax Type (State/Local)	Revenue to Replace (in billions of 2023 dollars)
Individual Income Tax (State)	$3.2
Corporate Income Tax (State)	$0.5
Sales and Use Tax (State, Includes Build Nebraska)	$2.6
General Fund Spending Reduction (State)	($0.4)
Sales and Use Tax (Local)	$0.6
Property and Inheritance Tax (Local)	$5.0
Total	$11.5

Source: Institute on Taxation and Economic Policy.

OpenSky and ITEP arrived at the amounts for individual and corporate income taxes and state sales tax by utilizing data for FY 2022-23 and FY 2023-24 from the Nebraska Economic Forecasting Advisory Board (NEFAB). For the state sales tax, the proceeds from the one-quarter cent diversion from the general fund to the Build Nebraska Act was added (N.R.S. 39-2701 to 39-2705). A state general fund reduction of about $400 million was also assumed, as that is the amount of money each year the state dedicates to offset property taxes through the Homestead Exemption and Property Tax Credit. These are general fund dollars currently allocated to offset property taxes and so wouldn't need to be replaced.

Similarly, the revenue generated from local sales taxes is included. If this weren't included in revenue needing to be replaced, it would not represent a true revenue-neutral rate as the legislation would bar localities from levying general sales taxes as they exist today.

To estimate the local revenues lost to elimination of the property tax and inheritance tax, the fiscal note from LB 133 (2021) was used. The full impact at implementation from the fiscal note in future years was deflated to 2023 dollars.

Estimating the state's tax base under LB 79

Next, the tax base was examined as it would exist under the proposal. LB 79 would expand both the sales tax base and sales tax rate to include a wide range of purchases and services, including many currently exempted from the state sales tax. No other state applies a sales tax to many of the items included in the LB 79 tax base. For this part of the analysis, OpenSky and ITEP used official government measures of consumer spending, namely personal consumption expenditures (PCE) from the U.S. Bureau of Economic Analysis (BEA).

To accurately use PCE data for this analysis, a thorough review was conducted to identify the amount of consumer spending that would actually be taxable under LB 79. OpenSky and ITEP adjusted PCE data to exclude items that are exempt from tax in the proposal. Similarly, items excluded from PCE data but that would be taxed in LB 79 were added to the estimated base. The largest item added was non-resident spending occurring in Nebraska. Also added were new residential structures for personal use.

Goods and services that cannot legally be taxed under federal law were removed, such as Internet access and airfare. Medical and dental services purchased by people covered with insurance were also removed, as specified in the bill, as were groceries. Federal purchases were also excluded, as the state is largely preempted from taxing these purchases (Federal Acquisition Regulation 29.302 2022). A full list of additions to and subtractions from PCE can be found in Appendix B.

Finally, OpenSky and ITEP made an adjustment for tax evasion and avoidance. Under the 7.5 percent tax rate written into LB 79, the state could expect an evasion rate roughly on par with the 6 percent evasion rate seen in Minnesota's sales tax (Hoheisel 2018). If the rate in LB 79 were raised to 22.1 percent to achieve revenue neutrality, the incentive for evasion and avoidance would increase significantly which is reflected in this analysis with a 10 percent adjustment.

Although the consumption tax proposal would not take effect until 2026, it is not possible to forecast the spending and tax data in a reliable manner to that point, so the analysis was conducted in 2023 dollars.

Estimating the rate required

Given the revenue needing to be replaced and the estimated tax base in LB 79, OpenSky and ITEP calculated the revenue neutral rate at 22.1 percent (the calculated rate accounts for a 0.25 percent allowance for registered sellers to cover the cost of collecting the tax, as outlined in the bill). Applying the 7.5 percent tax rate contained in LB 79, by contrast, to the base calculated by OpenSky and ITEP produces an expected tax revenue yield of just $4.1 billion (see Appendix Table B.3), after accounting for the somewhat lower evasion rate associated with that lower tax rate. That $4.1 billion yield comes up $7.4 billion short of the yield needed to replace all the state and local revenue collected in 2023 through taxes that would be repealed by the bill (estimated at $11.5 billion).

Table 2: Calculating the Tax Base (Amounts in Billions of Dollars)

Baseline	2021 Nebraska Total Personal Consumption Expenditures (PCE)	$90.7
Adjustments	Additions to PCE	$8.1
	Subtractions from PCE	($46.9)
	Base Loss From Tax Evasion and Avoidance	($5.2)
Result	2021 Tax Base	$46.7
	2023 tax base	**$52.0**

A list of adjustments to PCE can be found in Appendix B.

Proposal hardly expands the base

The derived taxable base of $52 billion in LB 79 is just about $1 billion higher than the current taxable base under the existing sales tax (Bureau of Business Research 2022). This very modest expansion in the tax base relative to the current general sales tax is a function of various carveouts from the base in LB 79 that do not exist in current law, including most notably purchases made with a business or investment purpose. In this light, it is clear that the proposal makes only minimal expansions to the overall size of the consumption tax base relative to current law, and that its primary effect is to shift the incidence of the state's consumption taxes off businesses and onto individual purchasers instead.

Conclusion

The tax rate as proposed in LB 79 is well below what would be required for the proposal to be revenue neutral. OpenSky and ITEP analysis indicates a rate of 22.1 percent would be required, while the bill itself stipulates a rate of 7.5 percent. At the rate proposed in the bill, the revenue shortfall to the state would be significant – $7.4 billion. Such a tax would fall disproportionately hard on low- and middle-income Nebraskans because a much greater portion of their wages goes to purchases that would be subject to tax.

Appendix A

Methodological comparison between OpenSky/ITEP and Beacon Hills Institute

As noted earlier, in 2021 the Beacon Hill Institute (BHI) analyzed a previous version of the EPIC Option Consumption Tax Act (Burke at al. 2021). This section discusses differences in the results between that study and the OpenSky and ITEP findings.

Changes in the proposal

LB 79 contains a narrower tax base than previous versions of this legislation as it excludes groceries, insurance claims, and various items subject to existing excise taxes. LB 79 also differs significantly from past proposals in that it lacks a prebate. For this reason, direct comparison between the 2021 BHI analysis and this report is impossible, but we can still highlight some important differences in our approaches.

Changes in the proposal

This report uses the same foundation as the BHI analysis in measuring consumption subject to tax: the personal consumption expenditure (PCE) data from the U.S. Bureau of Economic Analysis (BEA). The BHI analysis, however, contains several errors and omissions that lead to inaccurate results.

For instance, BHI does not remove items such as Internet access and airfare from the PCE which the state is prohibited from taxing under federal law. Moreover, BHI does not make any adjustment for tax evasion or avoidance, which is a necessary step in translating the PCE concept into an administrable tax base (every consumption tax in existence is subject to some level of evasion).

BHI also includes state and local expenditures in the revenue side of the calculation without making a corresponding adjustment on the spending side of the ledger. Payments of tax from a state or local government to itself do not improve the net fiscal position of government and cannot be counted as replacement revenue unless the analysis also accounts for the need for an offsetting increase in government outlays to finance those tax payments. Taken to its logical extreme, the BHI analysis suggests that elimination of most of Nebraska's taxes could be paid for by levying a high tax rate solely on state and local government expenditures; however, a payment from a government to itself does not generate real budgetary resources.

Together, these issues with the BHI study cause it to significantly overstate the potential tax base and understate the tax rate needed to achieve true budget neutrality.

Static versus dynamic CGE modeling

The issues with the BHI study described above are compounded by its use of a specific dynamic economic model to arrive at its final tax rate calculation. BHI utilizes its Nebraska-specific STAMP (State Tax Analysis Modeling program) model. STAMP is a computable general equilibrium (CGE) model, which attempts to analyze economic activity at the state level by using equations to link data from different sectors.

ITEP published a critique of BHI's STAMP model in 2014, finding its "methodological shortcomings are reflected in its unreliable results," and that its findings "have been contradicted by academic researchers, state revenue officers, and the actual track record of states that have followed BHI's recommended low-tax path" (ITEP 2014).

Partly, the issue is one of certain assumptions by BHI and indeed, other researchers have warned that these kinds of models "rely heavily on assumptions" by those who made the model (Bluestone et al. 2019). More fundamentally, however, scholars have warned that "dynamic revenue analysis has not proved to be a particularly appropriate tool for budgetary decision-making or forecasting" because of a "high level of uncertainty" and "lack of precision" in such estimates. (Bluestone et al. 2019).

BHI's static analysis indicates that the consumption tax rate under previous legislation similar to LB 79 would need to be 9.94 percent in FY 2023-24 (Burke et al. 2021). After applying its dynamic impact estimates, the rate necessary for revenue neutrality is estimated to fall to just 8.88 percent with the prebate or 7.40 percent without it.

Conclusion

The difference between this report and the BHI analysis is not being driven primarily by differences in static versus dynamic modeling. As seen in Table A.1, the greatest methodological difference between OpenSky/ITEP and BHI modeling is in use of the PCE to determine the taxable base before any dynamic estimation is performed. BHI assumes a static base that is twice the size found by OpenSky and ITEP in this report—a result driven partly by issues in BHI's use of the PCE data and partly by reductions to the taxable base contained in LB 79 relative to the earlier version of the legislation analyzed by BHI in 2021.

Table A.1: Differences in Statewide Sales Tax Rate Calculations Between OpenSky/ITEP and BHI

	BHI (Dynamic Modeling)	**OpenSky/ITEP**	**BHI as a Percent of OpenSky/ITEP**
Nebraska Tax Base (2023)	$124 billion	$52 billion	138%
Cost of Taxes to be Replaced	$10.9 billion	$11.5 billion	(5%)
Calculated Statewide Sales Tax Rate Without Prebate	**7.4%***	**22.1%****	**(67%)**

**BHI values are for FY2024 whereas OpenSky and ITEP values are for CY2023. BHI data cover an earlier iteration of the EPIC Consumption Tax Act whereas OpenSky and ITEP examine LB 79 of 2023.*
***This is the rate needed assuming the prebate remains in place. LB 79 replaced the prebate with an exemption for groceries. Absent the prebate, BHI concluded that the rate would have needed to be 7.40% in FY2024 on a dynamic basis, but this assumes a tax base broader than what has been proposed most recently in LB79 of 2023.*

Appendix B

OpenSky and ITEP's detailed notes for calculating the statewide sales tax rate methodology

The foundation of this analysis is the personal consumption expenditure (PCE) data from the Bureau of Economic Analysis (BEA). These data have been used by other analysts to evaluate past versions of the EPIC Option Consumption Tax Act as well as similar national legislation known as the Fair Tax Act (Burke et al. 2021; Legislative Fiscal Office 2021; Gale 2005). No other data source offers a more accurate or comprehensive measure of overall consumption in Nebraska.

Our calculation begins with 2021 level PCE data, the most recent year available at the time this analysis was conducted. While LB 79 (AM 314) would not take effect until 2026, it is not possible to reliably forecast the full suite of spending and tax data needed for this calculation to 2026 levels and thus we conduct the analysis in an illustrative way at 2023 levels.

As a check on our work, we also performed the analysis using 2019 level base data to test for the possible on-going effects of pandemic-induced spending changes in the 2021 economic data on which our analysis relies and did not find a meaningful impact on our final results. While the method outlined below calculates a budget neutral consumption tax rate of 22.1 percent under LB 79, using a 2019 base year and aging those data to the present day yielded a similar 21.2 percent budget neutral rate.

Table B.1: Overview of Derivation of Revenue Neutral Tax Rate

Amounts are billions of 2021 dollars unless otherwise stated

$	90.7	Personal consumption expenditures (PCE) in Nebraska
$	8.1	Additions to PCE (structures, nonresident spending, etc.)
$	(46.9)	Subtractions from PCE (exemptions, federal preemption, etc.)
$	(5.2)	Base loss from tax evasion and avoidance
$	46.7	2021 tax base
$	**52.0**	**2023 tax base**
$	**11.5**	**2023 revenue collected at 22.1% rate (after 0.25% allowance)**

Source: ITEP analysis of BEA Personal Consumption Expenditure data and various other sources. See Table 3 for the full calculation.

Adjusting the PCE data to align with the unique tax base proposed in LB 79 required adding some taxable items to the base that are not included in PCE and subtracting an even longer list of items that are specifically exempted by the bill or that cannot be feasibly or legally taxed under federal law. Some of these adjustments were performed using the detailed PCE data by product type while others required bringing in outside data to illuminate aspects of consumption in Nebraska not visible in the PCE tables. Moving from a pure economic measure of consumption to an administrable tax base also requires an adjustment for inevitable tax avoidance and evasion. All these adjustments are outlined in Table 1 and explained in more detail below and in Table 3.

Additions to PCE

Nebraska PCE data reflect spending by Nebraska residents even when that spending takes place outside of the state's borders and excludes spending by nonresidents taking place in Nebraska (Bureau of Economic Analysis 2022b). The single largest addition we make to Nebraska PCE is therefore to add most of the nonresident spending occurring in Nebraska aside from airfare and hotel accommodations, both of which would be exempt from the tax as explained below (Dean Runyan Associates 2021).

We also add purchases of new residential structures for personal use, improvements to residential structures, and brokers' commissions as measured nationally in the National Income and Products Accounts (NIPA). The NIPA data lump brokers' commissions together with real estate transfer tax collections and we remove the latter from the base using data from the Annual Census Survey of State and Local Government Finance. The Nebraska portion of these spending categories was estimated using Nebraska's share of nationwide real estate sector GDP.

LB 79 would also apply taxes to the portion of personal interest payments in excess of a basic interest rate. Total interest payments are available in the NIPA. We estimate the portion attributable to rates above the basic interest rate using a method developed by Bill Gale at the Tax Policy Center and then predict Nebraska's share of relevant personal interest and nonprofit interest using its share of nationwide private sector GDP, and its share of relevant mortgage interest using Nebraska's share of nationwide imputed rental value of owner-occupied nonfarm housing (Gale 2005).

Subtractions from PCE

Next we make five different kinds of subtractions from PCE to compute a measure of spending in line with the tax base envisioned in LB 79. Those include subtractions for consumption that is not feasibly taxable, preempted by federal law, exempted for business or educational purposes, exempted to avoid double taxation, or exempted to improve the perceived fairness of the tax. Some subtractions fit into more than one of these categories.

The most notable subtractions for items not feasibly taxable include the imputed rental value of owner-occupied housing and farm dwellings. These are economic concepts that are not thought of as consumption by most individuals and are not feasibly taxable. The rationale behind these items is that any homeowner could, if they so wished, rent out their homes to someone else and that by choosing not to earn that rental income they are essentially spending that foregone money on rent. This implied "spending" would not be taxed under LB 79.

We also subtract purchases of Internet access and airfare, neither of which Nebraska is allowed to tax under federal law, as well as spending by Nebraskans away from their home state. For the latter, we compare estimates of the magnitude of domestic travel spending as reported by the U.S. Travel Association to overall nationwide PCE to calculate the share of Nebraska PCE we expect to be attributable to travel by Nebraskans outside of Nebraska. Then we remove airfare and lodging from the subtraction as these items would not be subject to consumption tax under LB 79 and are already being subtracted elsewhere in our calculation.

PCE transactions include the cost of general sales taxes and excise taxes (Bureau of Economic Analysis 2022a). Evaluating the net effect of LB79 therefore also requires removing a portion of state and local sales taxes from PCE, as these taxes would no longer exist under the legislation. We assume that three quarters of Nebraska state and local sales taxes appear in the 2021 Nebraska PCE estimates either through direct taxes on consumers or through business-paid taxes passed forward to consumers, and we therefore subtract that amount from our tax base. The other quarter are assumed not to be reflected in Nebraska PCE as they are either paid by visitors or, in the case of business-paid taxes, by the owners or workers employed by those businesses.

LB79 includes a sweeping exemption for "any taxable property or service used for educational purposes." Educational services and books are reported as separate line items in the PCE and we remove those from our tax base calculation. We expect that this exemption would apply to a broader range of school supplies beyond books, but in the absence of reliable data on spending on computers, notebooks, backpacks, and other goods for educational purposes we leave those items in the tax base. We therefore expect that we are underestimating the degree of base erosion associated with the exemption for items purchased with an educational purpose.

We also make a small subtraction for food furnished to employees as we expect this consumption would be exempt from LB 79 as having a business purpose.

Section 8 of the bill contains a long list of exemptions for items subject to other forms of Nebraska taxes that would not be repealed by the legislation. Table 3 shows the impact of exempting these items and provides references to the specific language in the bill exempting gasoline, tobacco, alcohol, insurance, and hotel accommodations.

The bill also contains a generalized exemption for used goods. The only used good broken out separately in the PCE data is the net purchase of used motor vehicles, which we remove from the base. Other used goods such as clothing and furniture are included in the PCE only to the extent that those purchases are made from businesses or governments. Sale of used goods from one individual to another net out to zero in the PCE (Bureau of Economic Analysis 2022a). We are aware of some data sources estimating the overall volume of used good purchases in the U.S. economy but devising a method for isolating the share of those purchases not already being netted to zero in the PCE poses a challenge. Ultimately, we opted not to remove any used goods aside from vehicles from the tax base and we expect that we are slightly overstating the tax base, and understating the budget neutral tax rate, as a result.

One of the most significant subtractions in our calculation is done to account for Section 7 of LB 79, which stipulates that insurance claims will not be taxed. The bulk of health expenditures contained in the PCE are paid by government or private insurance (McCully et al. 2007). We isolate the taxable, out-of-pocket portion of personal health care expenditures using National Health Expenditures Accounts data. Those data are adjusted to Nebraska levels using the state's share of nationwide personal consumption expenditures on health care.

The final subtraction we make is for groceries, which refers to food purchased for off-premises consumption. Consistent with REG-1-087 we assume that this exemption would include nonalcoholic beverages within its scope.

Government spending

While LB 79 seeks to tax federal purchases of taxable property or services, the state is largely preempted from doing so as explained in Federal Acquisition Regulation 29.302. We therefore do not include federal purchases in the tax base.

As for the treatment of state and local purchases, it is important to note that the core purpose of our analysis is to calculate the tax rate that would be needed under LB 79 to maintain state and local services at current levels, which we refer to as the "budget neutral" rate. This is different from the revenue neutral rate in important ways.

LB 79 would substantially raise the cost of providing state and local services by requiring states and localities to pay tax on many of their purchases. While these tax payments would technically increase the revenue flowing to the state (and to any locality choosing to levy an add-on consumption tax), those revenues would do nothing to improve the net fiscal position of the state or its localities. That is, there is no budgetary benefit to state and local governments from paying taxes to themselves.

Bill Gale has also made this observation in the context of his analysis of national Fair Tax proposals, noting that "if the real size of the federal government is held constant, taxing federal government purchases in a federal retail sales tax does not affect the required tax rate; it simply raises required federal spending by the same amount as it raises federal revenues" (Gale 2005).

We therefore choose to exclude taxable state and local government purchases from our calculation of the tax base, but we emphasize that including those purchases and raising the required revenue target for budget neutrality by a corresponding amount would have no effect on our estimate of the budget neutral tax rate.

Effects of repealing other taxes

As described above, our calculation takes into account the fact that removing state and local general sales taxes from the economy would reduce PCE for purposes of the consumption tax envisioned in LB 79. This is a straightforward mechanical effect.

There are also good reasons to think that the broader tax swap envisioned in the legislation could further lower PCE beyond what we include in our calculation. Moving to a consumption-only tax base would unavoidably lower taxes most sharply for high-income families as they consume only a small fraction of their income. This can be seen already in states opting for a heavy reliance on consumption taxes (Wiehe et al. 2018). To raise a budget neutral amount of revenue, then, it would be necessary to collect higher taxes from low- and middle-income families, which would reduce their purchasing power and lead to lower overall consumption in the state.

We are aware of modeling by the Beacon Hill Institute purporting large economic benefits from this legislation but view those findings with great skepticism. Our analysis of the Beacon Hill STAMP model uncovered deep flaws in its design, including an assumption of hypersensitivity to taxes among high-income families (Institute on Taxation and Economic Policy 2014). More generally, the real-world experience with dynamic scoring at the state level has been fraught given the high level of complexity and imprecision in such analyses and, perhaps most importantly, the heavy dependence on economic assumptions rather than hard data. These effects have led experts at the Georgia State University Center for State and Local Finance to caution that "dynamic revenue analysis has not proved to be a particularly appropriate tool for budgetary decision-making or forecasting" (Bluestone and Bourdeaux 2019).

Evasion and avoidance

The best available evidence of sales tax evasion occurring in the real world comes from Minnesota, where the state Department of Revenue estimated a sales tax gap equal to approximately six percent of actual collections, putting aside remote sales tax evasion that has since been largely addressed by the Supreme Court's ruling in South Dakota v. Wayfair, Inc. (Hoheisel 2018). But the budget neutral tax rate required under the base laid out in LB 79 would be far above Minnesota's sales tax rate, and would create a far larger incentive for evasion and avoidance.

Moreover, LB 79 includes sweeping exemptions for items bought with a "business purpose," "investment purpose," or "educational purpose" that go far beyond any exemption available in Minnesota or any other state, and which would open entirely new avenues for both legal avoidance and illegal evasion of the tax.
Clearly, evasion under a budget neutral version of LB 79 would far exceed six percent and an unknown level of avoidance would occur as well. In the face of this uncertainty, we make the conservative assumption that evasion and avoidance together erode 10 percent of potential base.

In Table 3 we also present a revenue estimate for the LB 79 consumption tax if levied at the stated 7.5 percent rate ($4.1 billion). Under this much lower tax rate we use an evasion and avoidance adjustment factor in line with the six percent evasion rate calculated by the Minnesota Department of Revenue.

Forecasting to 2023 levels

We assume that taxable consumption under LB 79 will grow at the same rate that the Department of Revenue forecasts for taxable sales under the current general sales tax. Our budget neutral tax rate is relatively insensitive to this assumption. Even if taxable consumption grows twice as fast between 2021 and 2023 as the Department projects, the budget neutral tax rate would still be in excess of 20 percent.

Budget neutral tax rate calculation

The final step in our calculation is to determine the combined state and local consumption tax rate needed to replace all the state and local taxes repealed by the legislation: income, general sales, property, and inheritance.

Our estimate for the amount of revenue the LB 79 consumption tax would need to generate to be budget neutral is shown in Table 2. The Individual Income Tax and Corporate Income Tax estimates are based directly on official Nebraska Economic Forecasting Advisory Board (NEFAB) revenue forecasts for General Fund net receipts for Fiscal Years 2022-23 and 2023-24 (Legislative Fiscal Office 2022). For Sales and Use Tax, we make two additions to the NEFAB forecasts to account for non-General-Fund revenues: state sales taxes that are diverted to Highway Funds under the Build Nebraska Act, and Local Option Sales Taxes that LB 79 would eliminate and localities would have to replace through add-on consumption taxes.

Table B.2: Overview of Consumption Tax Revenue Necessary for Budget Neutrality

Amounts in billions of 2023 dollars

Individual Income Tax to Replace	$	3.2
Corporate Income Tax to Replace	$	0.5
State Sales and Use Tax to Replace	$	2.6
General Fund Spending Reduction	$	(0.4)
Property and Inheritance Tax to Replace	$	5.0
Local Option Sales Tax to Replace	$	0.6
Total	**$**	**11.5**

Source: ITEP analysis of Legislative Fiscal Office and Department of Revenue data.

To estimate local revenues lost due to elimination of Property Tax and Inheritance Tax, we relied on the Fiscal Note for a previous version of the proposal (LB 133 of 2021), adjusting the projected impact of full implementation shown for Fiscal Years 2025-26 and 2026-27 down to 2023 dollars (Legislative Fiscal Analyst 2021). We applied the same method to estimate reduced General Fund expenditure due to repeal of the Homestead Exemption and Real Property Tax Credit. Though the Real Property Tax Credit has been increased by the Legislature since the LB 133 Fiscal Note was completed, the credit is a direct offset of property taxes and thus should not affect the net amount of revenue the consumption tax would need to generate.

Together, these effects create a need for $11.5 billion in consumption tax revenues for the result to be budget neutral. Raising this amount of revenue would require a 22.1 percent state and local consumption tax rate in 2023 after considering the fact that 0.25 percent of the tax paid would be retained by registered sellers rather than remitted to the state. This finding is broadly consistent with past ITEP analyses using data from earlier years and we expect that it would broadly hold in future years as well.

Table 3. Derivation of Revenue Neutral Tax Rate Under LB 79 of the First Session of the 108th Legislature

Amounts are billions of 2021 dollars unless otherwise stated

Amount	Operation	Description	Rationale	Data Source(s)
Personal Consumption Expenditures (PCE)				
$ 90.7	**--**	**Personal consumption expenditures by Nebraskans**	**Starting point for calculation**	**PCE**
Additions to PCE				
$ 2.1	*Add*	New residential structures (not for business or investment)	Sec. 7(13)(a)	NIPA
$ 1.3	*Add*	Improvements to residential structures	Sec. 7(13)(b) and (c)	NIPA
$ 0.8	*Add*	Brokers' commissions	Sec. 7(13)(d)	NIPA, SL Finance
$ 2.2	*Add*	Visitor spending on items subject to consumption tax	Spending within Nebraska borders excluded from PCE	Runyan
$ 1.3	*Add*	Taxable personal interest	Sec. 27 through 30	NIPA, Fed, President
$ 0.4	*Add*	Taxable home mortgage interest	Sec. 27 through 30	NIPA, President
$ 0.0	*Add*	Taxable nonprofit interest	Sec. 27 through 30	NIPA, President
$ 8.1	--	**TOTAL ADDITIONS**	--	--
Subtractions from PCE				
Items Not Feasibly or Legally Taxable				
$ (9.2)	*Subtract*	Imputed rental of owner-occupied nonfarm housing	Not feasibly taxable	PCE
$ (0.5)	*Subtract*	Rental value of farm dwellings	Not feasibly taxable	PCE
$ (0.3)	*Subtract*	Internet access	Federal preemption under 47 U.S.C. §151 note	PCE
$ (0.6)	*Subtract*	Air transportation	Federal preemption under 49 U.S. Code § 40116	PCE
$ (3.6)	*Subtract*	Spending by Nebraskans outside of Nebraska	Spending on trips	USTA, PCE
$ (2.0)	*Subtract*	Three quarters of state and local general sales tax (GST)	Estimated share of GST included in PCE data	DOR
$ (16.2)	--	**TOTAL SUBTRACTIONS IN SUBCATEGORY**	--	PCE, USTA, EY
Items Exempted for Business or Educational Purposes				
$ (0.1)	*Subtract*	Food furnished to employees (including military)	Sec. 8(2)	PCE
$ (1.5)	*Subtract*	Education services	Sec. 8(4)	PCE
$ (0.2)	*Subtract*	Educational books	Sec. 8(4)	PCE
$ (1.8)	--	**TOTAL SUBTRACTIONS IN SUBCATEGORY**	--	PCE
Items Exempted to Avoid Double Taxation				
$ (13.4)	*Subtract*	Medical and dental spending by insurers	Sec. 7(14)(b) and 42 CFR § 423.440	NHEA, PCE
$ (2.9)	*Subtract*	Gasoline, fuel oil, other fuels	Sec. 8(1)(a), (g), and (i)	PCE, FHWA
$ (2.1)	*Subtract*	Insurance	Sec. 7(14)(a) and Sec. 8(1)(d)	PCE
$ (2.3)	*Subtract*	Used motor vehicles	Sec. 8(5)	PCE
$ (0.6)	*Subtract*	Tobacco	Sec. 8(1)(b)	PCE
$ (0.9)	*Subtract*	Alcoholic beverages purchased for off-premises consumption	Sec. 8(1)(c)	PCE
$ (0.3)	*Subtract*	Alcoholic beverages purchased for on-premises consumption	Sec. 8(1)(c)	CEX, PCE
$ (0.5)	*Subtract*	Accommodations	Sec. 8(1)(j)	PCE
$ (23.0)	--	**TOTAL SUBTRACTIONS IN SUBCATEGORY**	--	PCE, CEX, NHEA
Exemptions for Necessities				
$ (5.9)	*Subtract*	Food purchased for off-premises consumption	Sec. 8(6)	PCE
$ (5.9)	--	**TOTAL SUBTRACTIONS IN SUBCATEGORY**	--	PCE
$ (46.9)	--	**GRAND TOTAL SUBTRACTIONS**	--	See above
Final Calculations				
$ 90.7	--	Personal consumption expenditures by Nebraskans	Starting point for calculation	PCE
$ 8.1	*Add*	Additions to PCE	See above	See above
$ (46.9)	*Subtract*	Subtractions from PCE	See above	See above
$ 51.9	--	**Tentative tax base before considering tax evasion**	--	--
$ 48.8	***Multiply***	**Tax base after 6% evasion and avoidance**	Tax gap in line with best available evidence from Minnesota	MNDOR
$ 46.7	***Multiply***	**Tax base after 10% evasion and avoidance**	Larger tax gap to be expected with higher rate	MNDOR
$ 54.3	--	**2023 TAX BASE (6% evasion)**	Assuming 11.2% cumulative growth in line with DOR forecast	DOR
$ 52.0	--	**2023 TAX BASE (10% evasion)**	Assuming 11.2% cumulative growth in line with DOR forecast	DOR
$ 4.1	--	**2023 REVENUE AT 7.5% rate (6% evasion; 0.25% allowance)**	Rate proposed in LB 79	Various, see above
$ 11.5	--	**2023 REVENUE AT 22.1% rate (10% evasion; 0.25% allowance)**	Tax rate to fund current state and local services	Various, see above

Source: ITEP analysis of data from BEA Personal Consumption Expenditures (PCE), BEA National Income and Product Accounts (NIPA), Federal Reserve (Fed), Economic Report of the President (President), BLS Consumer Expenditure Survey (CEX), National Health Expenditure Accounts (NHEA), Dean Runyan Associates (Runyan), US Travel Association (USTA), Census Annual Survey of State and Local Government Finance (SL Finance), Nebraska Department of Revenue (DOR), Minnesota Department of Revenue (MNDOR), and Federal Highway Administration Highway Statistics Series (FHWA).

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