Tax Reform

For decades, Nevada lawmakers have discussed possibilities of tax "reform." Indeed, they have commissioned a growing library of studies to examine tax-reform possibilities only to later entirely ignore those studies' recommendations. Instead, "reform" has disingenuously become conflated with layering new taxes on top of the existing mix.

Nevada's most prominent fiscal challenges have occurred on the spending side of the ledger – not the revenue side. After all, excluding cyclical spending for unemployment benefits, Nevada's total spending has grown at an average annual rate of 9.3% over the past decade.[1] Given this reality, there is little reason to believe that Silver State government does not have sufficient revenue to sustain ongoing programs.

Nevertheless, Nevada Policy recognizes that no tax structure is perfect and that Nevada's taxing system could be improved, on a revenue-neutral basis, by designing reform around the considerations outlined here.

Key Points

Tax reform should minimize revenue volatility. Volatility in tax revenues exacerbates the tax-and-spend cycle. During periods of economic growth, upward volatility showers legislatures with unusually high revenues. Lawmakers have historically used these revenues to expand government programs and liabilities, even though such expansion regularly proves unsustainable when economic recession arrives.

When downturns do occur, downward volatility enlarges the deficit between revenues and the inflated spending levels previously committed to by lawmakers during the period of economic growth. Lawmakers have historically responded to this deficit by calling for new or higher taxes – only to once again over-commit tax dollars as soon as economic growth returns.

The tax structure should be designed to minimize distortions in economic behavior. Taxes that penalize specific behaviors or consumption patterns discourage individuals from engaging in those behaviors. These tax-induced distortions in decision-making push individuals away from welfare-maximizing behaviors and toward second-best alternatives. For instance, taxes on saving and investment such as capital gains taxes discourage individuals from saving and encourage immediate consumption, even though more savings might be preferable.

Compliance costs should be kept to a minimum. Complicated taxing mechanisms, such as the federal income tax, carry additional costs as filers must devote thousands of man-hours to understand the tax code and ensure compliance. The Tax Foundation estimates, for example, that compliance costs associated with the federal income tax amounted to $313 billion in 2022.[2]

Nevada lawmakers should avoid tax instruments that use complex arrays of deductions, stratified income brackets, or assessments at different rates depending on industrial classification.

Reform should protect tax equity. Taxpayers in similar circumstances should face similar tax burdens (horizontal equity). Taxpayers at different points along the income scale should also face a proportionally similar tax burden (vertical equity). Tax structures that are either overly regressive or overly progressive can obstruct economic growth and opportunity.

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[1] See "Understanding Nevada's Budget."

Recommendations

If lawmakers are to pursue tax reform, it should be on a revenue-neutral basis. As this publication makes clear, current tax revenues in the Silver State are already more than adequate to sustain high-quality government services.

To the extent Silver State governments have failed to deliver high-quality services, the failure has resulted from poor policy design or implementation. The recommendations in this volume will correct for this.

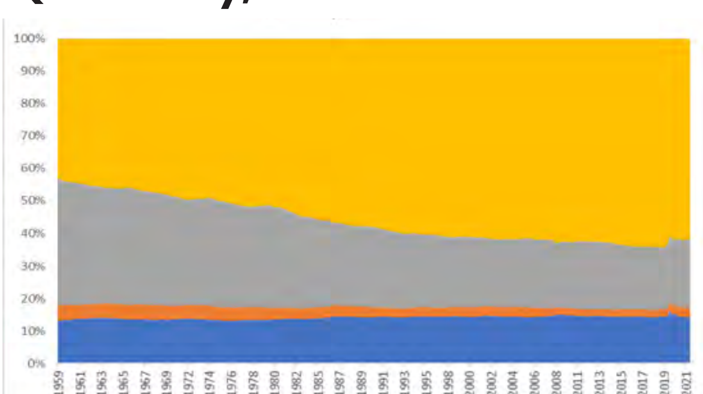
All four major objectives of tax reform can be accomplished through a revenue-neutral expansion of the sales tax base. Nevada Policy has laid out a plan for expanding the sales-tax base with a consequent lowering of the statewide sales tax rate to 3.5%.[3] That analysis should serve as a primary guideline to any potential tax reform.

Volatility levels of mayor tax instruments in NV, F99-FY09

Tax Instrument	Short-Run Elasticity (NV Personal Income)	Short-Run Elasticity (U.S. Personal Income)
Taxable Gaming Revenues	0.595	1.949
Sales & Use Taxes	1.031	2.211
Modified Business Tax	1.731	2.270
Insurance Premium Tax	1.193*	1.538*
Real Property Transfer Tax	-1.070**	-1.103
Liquor Tax	0.639	1.706
Cigarette Tax	0.305	1.204
Live Entertainment Tax	1.409	1.883
Governmental Services Tax	2.146*	1.297*
Corporate Income Tax (National Average)***	-	2.61

*Less statistical probability; indicating that variability is likely not associated with the business cycle.
**Declining sales in the real estate market preceded the decline in the overall economy, creating the statistical illusion that revenues from this tax instrument are counter-cyclical.
***Volatility values for state corporate income taxes were generated by analysts at the Federal Reserve Bank of Kansas City.
Source: Geoffrey Lawrence, "One Sound State, Once Again," NPRI policy study, 2010.

United States household consumption by mayor type, Quarterly, 1959 - 2022



Source: U.S. Department of Commerce, Bureau of Economic Analysis

Housing Durable goods
Nondurable goods Services

[2] Tax Foundation, "The Tax Compliance Costs of IRS Regulations," August 2022.
[3] Geoffrey Lawrence, "One Sound State, Once Again," Nevada Policy Research Institute policy study, 2010.