Guinn Center

ECONOMIC AND FISCAL POLICY REPORT

The FairTax Act of 2023: Potential Implications for Nevada

A Policy Brief

Meredith A. Levine

Director of Economic and Fiscal Policy, Guinn Center

Lead Researcher

Published October 2023

1664 North Virginia Street
Mail Stop 0289
Reno, NV 89557

GUINNCENTER.ORG

(775) 682-5083 info@guinncenter.org

The FairTax Act of 2023: Potential Implications for Nevada

The FairTax Act of 2023 (H.R.25) proposes to repeal the income tax, payroll taxes, and estate and gift taxes, replacing them with a federal sales and use tax. If enacted, the legislation would represent a shift in the basis of federal taxation from income to consumption. It envisions devolution of authority from the federal government to the states in administration of the tax, given states' "practical experience" in taxation oversight. Division of powers aside, variations in states' demographic composition, economies, and governance structures could mean that the impacts of such a policy change may not be uniform across states.

It would be premature to draw any conclusions about the implications of H.R. 25 for Nevada, though the scholarship on income and consumption, as well as their related taxes, is extensive. This brief is intended to highlight avenues for further inquiry that our initial review of the legislation has prompted. Among others, the research agenda might encompass a literature review, economic modeling, and scenario-based analysis. We note here that the legislation is extraordinarily complex, as it entails a substantial restructuring of the system of taxation in the United States. Below, we identify potential intersections with individuals and families in Nevada, along with the state's economy and governance structure, which we follow with infographics that may be of interest as Nevada's congressional delegation takes H.R. 25 under advisement.

Tax Rate. The FairTax Act of 2023 proposes a "rate of tax [that] is 23 percent of the gross payments for the taxable property or service" in 2024 (this rate seemingly increases in subsequent years). In Nevada, the sales tax rate is imposed on gross receipts. The relevant distinction thus is between the tax-inclusive rate and the tax-exclusive rate.

Consider a state that has a statewide sales tax of five percent on gross receipts. For a $10.00 purchase, we multiply that price by five percent, for a total sales tax of $0.50 (fifty cents). The tax-exclusive rate is five percent (5.00 percent), but the tax-inclusive rate is total sales tax as a share of the after-tax purchase price, or $0.50 ÷ $10.50 ≈ 4.76 percent. Arithmetically, it may not be possible to define an equivalent tax-exclusive rate that would equal a tax-inclusive rate of 23 percent, which yields a tax on gross receipts of approximately 29.9 percent. However, the tax-exclusive rate only approaches the tax-inclusive rate of 23 percent.

For reference, Appendix A contains a table of Nevada's 6.85 percent minimum statewide sales tax rate and its components, while Appendix B maps Nevada's sales tax rates, by county. This raises the question of how the tax-inclusive rate in H.R. 25 would align with Nevada's tax-exclusive rate(s). Conforming state legislation likely would be necessary. Moreover, any changes to the State Sales Tax, or the two percent rate, would have to be approved by the voters under the *Nevada Constitution*, which requires that any statute initially passed by the voters – in this instance, the Sales and Use Tax Act of 1955 – not be amended without being returned to the voters.

Exemptions. The legislation would provide certain exemptions from levy, such as that for fuel. Among others, the *Nevada Constitution* exempts durable medical equipment, oxygen delivery equipment, and mobility enhancing equipment from taxes on retail sales. The voters also ratified an exemption "of food for human consumption," except prepared food for immediate consumption and alcoholic beverages. (This exemption is codified in law, along with additional exemptions, such as feminine hygiene products, and those exemptions approved by the voters, if amendments were necessary, would need to be approved again by the voters, as discussed in the section above.) The rule of thumb is that groceries, generally, albeit not unequivocally, meet the exemption criteria, while food served at a restaurant, or otherwise prepared, does not. Groceries often are exempted from retail sales taxation as they are considered "necessities," meaning that taxation of these goods could be unduly burdensome for lower income individuals, though there is a family consumption allowance, as discussed below.

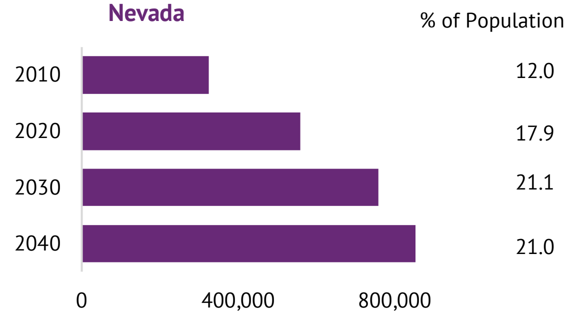
One question H.R, 25 raises, if approved, is how recipients of the Supplemental Nutrition Assistance Program (SNAP) and the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) would be affected, as these benefits are not subject to sales taxes. How many households in Nevada would be affected, and to what extent?

Distributional Effects. The distributional effects of the legislation have yet to be determined. Additional analysis is necessary to ascertain whether there are disproportionate burdens along the income distribution. The overarching question is whether the income effects would offset the consumption effects. That is an extremely difficult question to answer, as every individual's and family's tax circumstances are different, and various formulas govern the applicability of deductions and credits.

To take one example, the Earned Income Tax Credit (EITC) is a "tax break" for low- to moderate-income workers and families. Filing status, marital status, number of children, and income determine whether a family is eligible for the credit, and, if so, the amount of the credit. Under the FairTax Act of 2023, the EITC would be repealed. However, certain families would qualify for the Family Consumption Allowance, which is pegged to poverty guidelines, as established by the U.S. Department of Health and Human Services (HHS). Like the EITC, the Allowance also would account for qualified family size and marital status, but the formulas differ. Therefore, it is possible that some families who might qualify for the EITC may not be eligible for the Family Consumption Allowance. Quantification of the number of families that could fall into this gap would be useful, particularly as some will be just over the threshold where income gains would not offset the retail sales tax in the absence of an allowance. In addition, a question remains: All else being equal, is it possible to determine the "breakeven point" where income gains offset consumption costs?

Population Subgroups. It is beyond the scope of this summary to identify all population subgroups for which this legislation would have a more pronounced effect, but we make note of two here: (1) senior citizens; and (2) non-citizens.

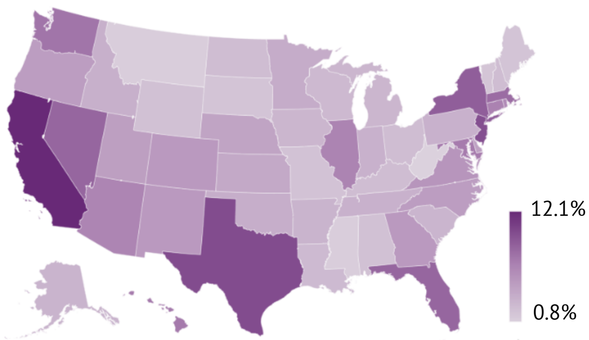
Figure 1: Projections of the Older Adult Population in Nevada



Between 2020 and 2040, Nevada's senior population (65+) is projected to increase by **50.2%**, which is the **4th-fastest** rate of growth in the nation
Source: University of Virginia, Weldon Cooper Center for Public Service

The population in the United States is aging, and Nevada is projected to have the fourth-fastest growth rate of those aged 65 or over among all states and the District of Columbia (see Figure 1). Many senior citizens live on fixed incomes, and taxation is based on a number of factors. Whether H.R. 25 has the potential to disadvantage them (or be advantageous for that matter) is an open question. Some seniors pay federal taxes, whereas others do not (the former could benefit from not having to pay income taxes). The extent to which benefits and, for some, income, intersect with the Family Consumption Allowance merits further analysis.

Figure 2: Non-Citizen Share of the Population, 2021

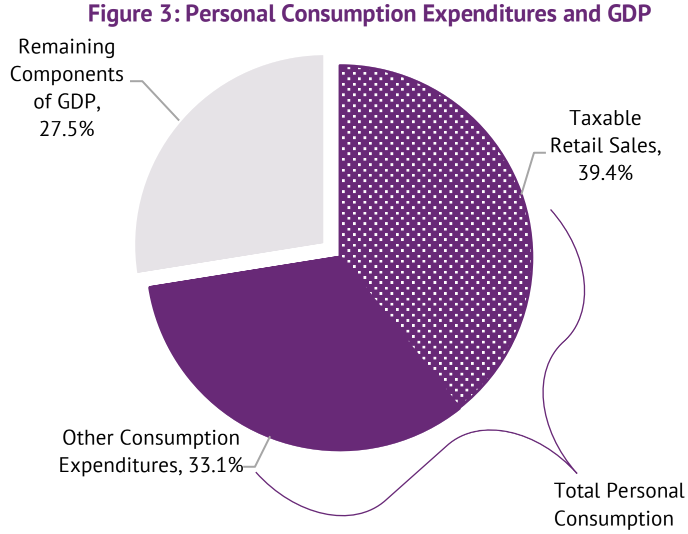


Nevada's share is **8.4%**, for a rank of **5th** in the nation
Source: American Community Survey, 1-Year Estimates

The same holds true for non-citizens (see Figure 2), though even more complexities may emerge. Much would depend on how non-citizens' status would be defined for the purposes of the FairTax Act of 2023. For many benefit programs, "[q]ualified aliens are not eligible for federal means-tested public benefits until five years after they enter the United States in a qualified alien status." However, a "resident alien" who was in the United States at least six months of the year with a valid Social Security number qualifies for the EITC. While some "qualified aliens" are lawful permanent residents, the extent to which either category aligns with "resident aliens" for tax purposes is not immediately clear. However, there would be a disproportionate burden on non-citizens who qualify for the EITC (generally and/or as a result of immigration status), but not for the Family Consumption Allowance. Nevada ranks fifth in the nation in its share of non-citizens; though if the number of individuals that qualify for the EITC but not for other federal benefit programs could be ascertained, it would strengthen an analysis of H.R 25's impact.

Nevada's Economy and Governance. The directionality of the impact to Nevada's economy of a shift at the federal level from an income-

Figure 3: Personal Consumption Expenditures and GDP



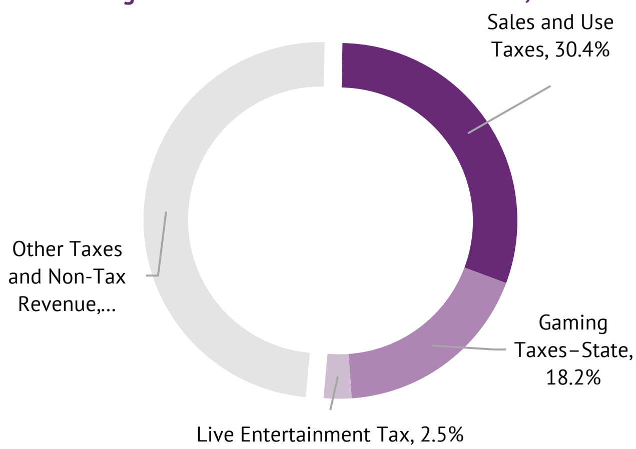
In 2021, total Personal Consumption Expenditures (PCE) in Nevada amounted to **$140.9 billion**, for a **72.5%** share of state Gross Domestic Product (GDP), which neared $**194.5 billion**. Taxable retail sales amounted to nearly **$76.6 billion**, accounting for **54.3% of PCE** and **39.4% of state GDP** in 2021.

Source: U.S. Bureau of Economic Analysis, State Annual Summary Statistics; U.S. Bureau of Economic Analysis, Personal Consumption Expenditures (PCE) by State by Function 1; and Nevada Department of Taxation, Monthly Taxable Sales Statistics. *Note*: Calculations are approximate, as definitions may differ across federal and state sources.

based taxation system to a consumption-based taxation system is inestimable. The policy change would interact with a Nevada economy in transition. Historically grounded in leisure and hospitality, the state has made strides since the Great Recession in diversification, with includes, among others, the expansion of the technology sector in Northern Nevada and, more broadly (i.e., statewide), the development of an "innovation ecosystem." Nevertheless, its economy remains procyclical, or, more colloquially, "boom-bust," with higher highs and lower lows during expansions and contractions, respectively. As shown in Figure 3, personal consumption expenditures (PCE) account for 72.5 percent of Nevada's Gross Domestic Product (GDP), which is 4.3 percentage points higher than the national average of 68.2 percent, but consumption includes services, not just taxable sales. However, retail sales still represent a substantial portion of consumer spending in the state, even in the services sector. For example, statewide Food Services and Drinking Places taxable sales in October 2021 amounted to nearly $1.2 billion (18.1 percent of monthly total taxable sales). Were the FairTax Act of 2023 enacted, the question for Nevada is whether macro-level income effects would offset consumption costs and the extent to which the effects, if any, would be amplified or muted in accordance with economic expansion and contraction, respectively.

As such, the impact of H.R. 25 likely would be most visible in state revenues. Nevada's General Fund, the state's major operating fund, is not only reliant on sales and use taxes, but also on gaming taxes and the Live Entertainment Tax, which are influenced heavily by visitation (see Figures 4 and 5).

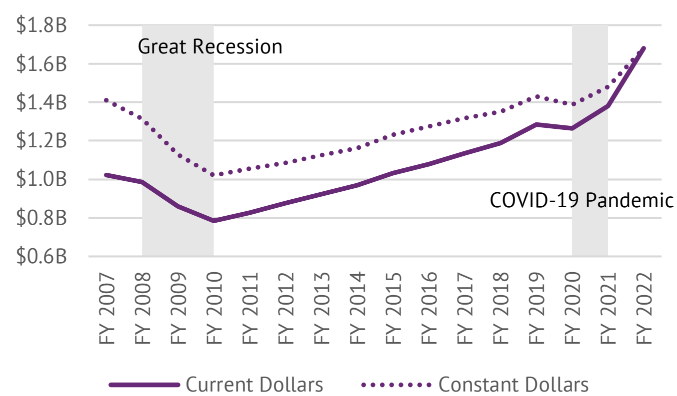
Figure 4: Nevada General Fund Revenues, 2021



The General Fund is Nevada's major operating fund. Collectively, sales and use taxes, state gaming taxes, and the LET made up **51.1%** of State General Fund revenues in FY 2022. Gaming taxes and the Live Entertainment Tax (LET) rely heavily on visitation.

Source: State of Nevada, Economic Forum: May 1, 2023. *Note*: Before tax credits.

Figure 5: Sales and Use Taxes in Nevada's General Fund

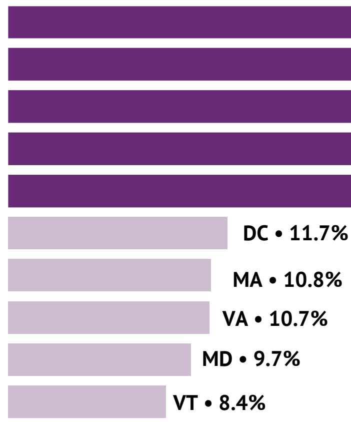


The behavior of sales and use taxes in the State General Fund varies with economic conditions. While inflation-adjusted collections decreased during the Great Recession, they increased during the COVID-19 Pandemic. This may be attributed to the underlying fundamentals associated, specifically, with those economic contractions.

Source: State of Nevada, Economic Forum Forecast Reports (Selected Years)

Differential impacts of the FairTax Act of 2023 in other states thus could be salient, given the importance of domestic tourism to Nevada. Sales taxes can be resilient during economic downturns, with the caveat that the factors influencing a given recession and the extent of federal relief/stimulus can be deterministic (see Figure 6).

Figure 6: General Sales Tax Share of Own-Source General Revenue, 2021



Nevada ranks **2nd** in the nation in general sales tax as a share of own-source revenue (general sales taxes exclude selective sales taxes, such as those on motor fuels and tobacco). Nevada is nearly tied with Washington, the highest-ranked state. Neither imposes an income tax. Alaska, Delaware, Montana, New Hampshire, and Oregon do not have statewide sales taxes.

Source: U.S. Census Bureau, State and Local Government Finances, 2021.
Note: The states with the highest and lowest rankings are displayed here.

Finally, it should be noted that Nevada does not impose an income tax, and the state receives property tax only to service debt. Schools are the primary beneficiary of property taxes, with 39.7 percent of property taxes (net of abatement) distributed to schools. However, state support for K-12 public education is heavily concentrated in the Local School Support Tax, as intended by the Nevada Legislature (for more on the tax, see Appendix A), which contributed to 60.6 percent to public education in FY 2022, in contrast to property tax at 25.4 percent.

Figure 7: Nevada's Pupil-Centered Funding Plan Account, FY 2022

The Pupil-Centered Funding Plan is the state's formula for the support of public education. Proceeds from the Local School Support Tax (LSST), or the School Support Tax, are obtained from the levy of the 2.6% component of Nevada's minimum statewide sales tax rate. Net of State General Fund distribution, the FY 2022 amount of the LSST was nearly **$2.1 billion**, constituting **60.6%** of state support for K-12 public education.

Source: State of Nevada, Nevada's Transparent Government Website

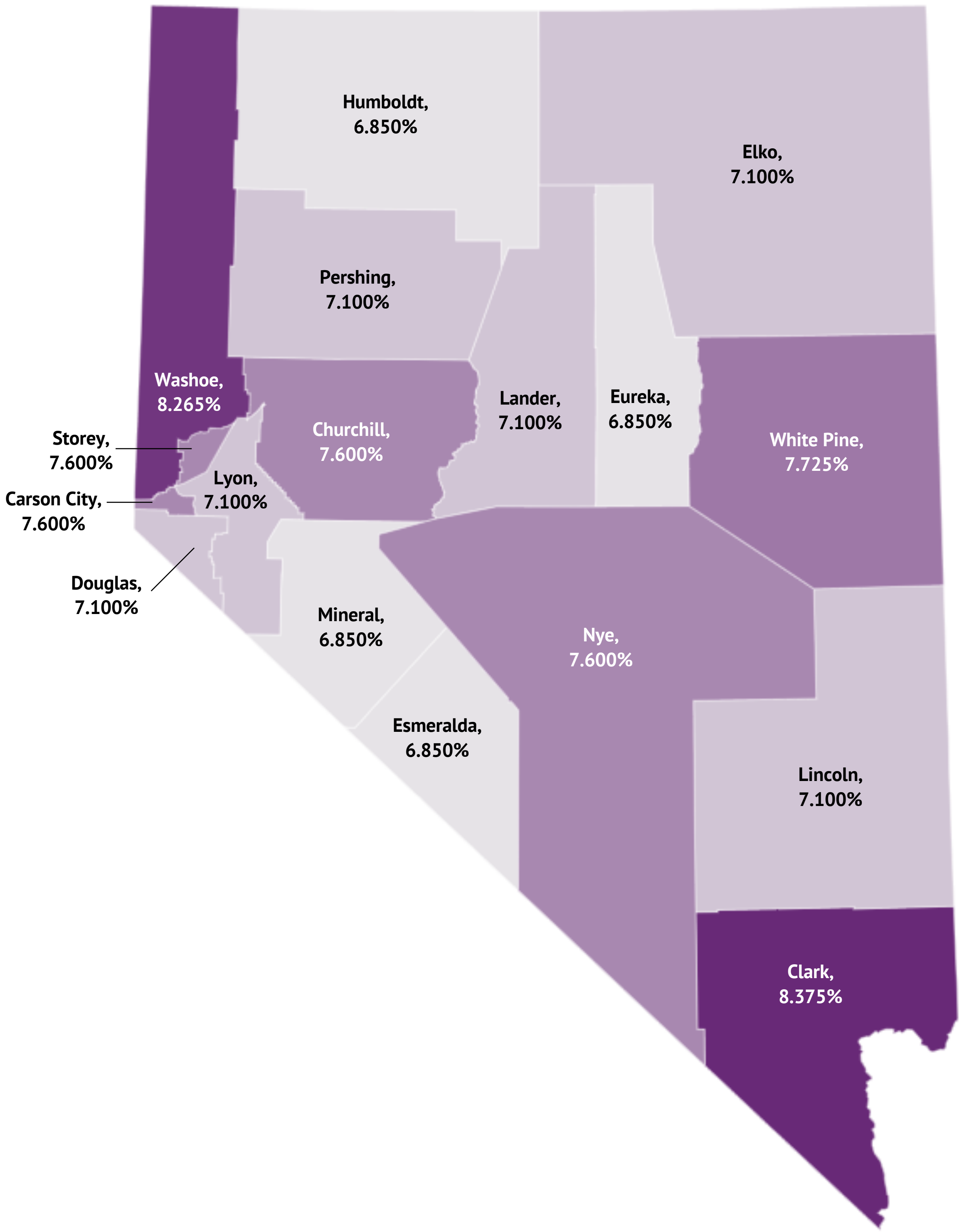
Appendix A. Nevada's 6.85% Minimum Statewide Sales Tax Rate

Nevada's 6.85% Minimum Statewide Tax Rate: Components, Recipients, and Revenue Amounts				
Description	Rate (%)	Recipients	Revenue (FY 2022)	NRS Provision
Sales Tax	2.00	– State General Fund	$1,613,341,781	NRS 372
Local School Support Tax	2.60	– State Education Fund – State General Fund	$2,082,255,259	NRS 374
Basic City-County Relief Tax	0.50	– Nevada counties, cities, towns, and special districts – State General Fund	$398,469,681	NRS 377
Supplemental City-County Relief Tax	1.75	– Nevada counties, cities, towns, and special districts – State General Fund	$1,394,248,088	NRS 377
Total	**6.85**	–	**$5,488,314,809**	–

Source: State of Nevada, Department of Taxation, Components of Sales and Use Tax Rates; Nevada Legislative Counsel Bureau, Fiscal Analysis Division, Revenue Reference Manual (2023); State of Nevada, Economic Forum: May 1, 2023.

Note: NRS refers to the *Nevada Revised Statutes*. Revenue amounts are net of distributions to tourism improvement districts or any payments made to economic diversification districts. Counties may impose optional sales taxes under certain legal authorities, and all but four counties do so. (See Appendix B.) Collectively, County Optional Sales Taxes amounted to more than $1.1 billion in FY 2022, of which $19.3 million was deposited in the State General Fund.

Appendix B. Sales Tax Rates in Nevada, by County



Source: State of Nevada, Department of Taxation, County Map of Nevada

ABOUT THE GUINN CENTER

The Kenny Guinn Center for Policy Priorities is a nonprofit, nonpartisan policy center addressing key challenges faced by policymakers in Nevada. We are affiliated with the University of Nevada, Reno, with researchers and collaborative partnerships at NSHE institutions across the state.

Founded in 2014 by a group of Nevadans who sought to advance new policy choices based on sound research, sensible and pragmatic thinking, and bold ideas, the Center is named for the late-Governor Kenny Guinn.

Our mission is to advance evidence-based policy solutions for Nevada through research, public engagement, and partnerships.

REPORT ACKNOWLEDGEMENTS

This report was funded through the generous giving of supporters of the Guinn Center for Policy Priorities.

The Guinn Center is the only independent, nonpartisan policy research center in Nevada -- and we can only do the work we do with financial support.

The Guinn Center doesn't receive government funding of any kind except in the form of research grants and contracts; to do independent -- or "blue sky" -- research, we rely completely on philanthropic giving.

Please consider supporting our work. Thank you.

DONATE TODAY

SUPPORT OUR WORK

CONTACT US