

# Nevada Supreme Court Upholds Margin Tax Initiative



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**Revenue**

With the Nevada Supreme Court upholding an initiative that seeks to enact a state-level margin tax, the proposed tax statute now moves to the forefront of the Nevada Legislature's agenda. The Legislature has only until March 15 to enact or reject the proposed margin tax without change or amendment, but it may also enact an alternative measure if the initiative is rejected. If the Legislature rejects the proposed margin tax or fails to act, the tax will go before the voters in 2014. This article describes the proposed margin tax, Nevada's initiative process, and the court rulings with respect to this proposed tax.

## Nevada Supreme Court Upholds Margin Tax Initiative

BY ALFRED PALADINO AND DAVID RENNIE

### Overview

In a unanimous opinion issued on Jan. 31, 2013, the Nevada Supreme Court reversed an earlier Carson City District Court (the "District Court") decision that had ruled invalid an initiative petition that seeks to amend the Nevada Revenue and Taxation Code to add a new state-level margin tax.<sup>1</sup> By overruling the lower court, the Supreme Court's decision upholds the initiative, thus sending the matter to the Nevada Legislature for further consideration. If legislators reject the initiative or fail to act, it would go before voters in 2014. Liability for the tax would begin to accrue on Jan. 1, 2014, if the initiative is enacted by the Legislature and approved by Nevada Gov. Sandoval; or on Jan. 1, 2015, if approved by voters.

<sup>1</sup> *The Education Initiative PAC v. Committee to Protect Nevada Jobs and Ross Miller, Nevada Secretary of State*, Supreme Court of the State of Nevada, Case # 61996, 129 Nev., Advance Opinion 5 (Jan. 31, 2013), slip op. at 23.

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The Nevada Supreme Court's decision may be viewed as one of several incremental steps toward what could eventually become Nevada's first margin tax, a levy similar to the margin tax currently applicable in Texas. In this article we describe the proposed Nevada margin tax, outline Nevada's initiative process, review the lower court rulings, and summarize the Nevada Supreme Court's decision.

### Nevada's Proposed Margin Tax

Patterned after the Texas margin tax, the proposed Nevada tax, if enacted, would be imposed at a rate of 2 percent on a base (taxable margin) calculated on the lesser of: (1) 70 percent of total revenue, or (2) total revenue minus the cost of goods sold or compensation.<sup>2</sup> With some general exceptions for tax exempt organizations and certain passive entities, all businesses that exceed a \$1 million gross revenue threshold would be subject to the tax.<sup>3</sup> Business entities that are part of an affiliated group engaged in a unitary business would be required to file a combined group return.<sup>4</sup>

<sup>2</sup> See, *The Education Initiative, Initiative Petition—Statewide Statutory Measure*, State of Nevada, filed with the Nevada Secretary of State (Aug. 7, 2012), accessible at: <http://nvsos.gov/Modules/ShowDocument.aspx?documentid=2425>, §§22,23.

<sup>3</sup> *Id.* at §22. Note, however, casino gaming revenue would be exempt, although casinos would appear to be subject to the tax with respect to their hotel, entertainment, and restaurant revenue. *Id.* at §24.6(b).

<sup>4</sup> *Id.* at §27.

If the proposed new tax is enacted by the Nevada Legislature and approved by the Governor, the administration of the tax would be paid for from funds generated by a temporary increase in the Modified Business Tax on financial institutions (per Nev. Rev. Stat. §363A.130) from 2 percent to 2.29 percent, which would begin on July 1, 2013.<sup>5</sup> The rate would then return to 2 percent on July 1, 2015.<sup>6</sup> If the proposed new tax is not enacted and approved by the Legislature and Governor, but is instead approved by the voting public, then the Modified Business Tax on financial institutions would be increased temporarily to 2.29 percent beginning Jan. 1, 2015, further increased temporarily to 2.42 percent beginning July 1, 2015, and then reduced back down to 2 percent beginning July 1, 2016.<sup>7</sup> Financial institutions paying the Modified Business Tax would be allowed a credit against the proposed margin tax.<sup>8</sup> A similar credit would be available to other taxpayers that pay the regular, generally-applicable Modified Business Tax per Nev. Rev. Stat. §363B.110.<sup>9</sup>

### Initiative Process

The Nevada Constitution provides the state's citizens with "the power to propose, by initiative petition, statutes and amendments to statutes . . . ."<sup>10</sup> The constitution requires proponents of an initiative to file a copy of the document with the Nevada Secretary of State ("NSOS") and then gather a required number of signatures from registered voters who support the proposal contained in the initiative.<sup>11</sup> Nev. Rev. Stat. §295.009 includes two additional requirements. The petition must first "embrace but one subject and matters necessarily connected therewith . . ." (the "single-subject requirement").<sup>12</sup> A petition will be deemed to satisfy the single-subject requirement if "the parts of the proposed initiative are functionally related and germane to each other in a way that provides sufficient notice of the general subject of [the initiative] and the interests likely to be affected."<sup>13</sup> Second, the statute provides that the petition must "in not more than 200 words [describe] the effect of the initiative . . . if [it] . . . is approved by voters" (the "description of effect requirement").<sup>14</sup> It is these two requirements that have been the focus of litigation in the District Court and were recently addressed by the Nevada Supreme Court.

### The Lower Court Rulings

On Aug. 6, 2012, the District Court issued a decision in a lawsuit filed in opposition to the initiative by the Committee to Protect Nevada Jobs (the "Committee"). The District Court ruled that the initiative violated the state's single-subject requirement because it included

<sup>5</sup> *Id.* at §§50, 83.1(a). Note that the Modified Business Tax on financial institutions is a quarterly payroll excise tax measured by wages paid. *See*, Nev. Rev. Stat. §363A.130.

<sup>6</sup> *The Education Initiative*, Initiative Petition at §§50, 83.1(c).

<sup>7</sup> *Id.* at §§50-52, 83.2 (a)-(c).

<sup>8</sup> *Id.* at §22.4.

<sup>9</sup> *Id.*

<sup>10</sup> Nev. Const. art. 19, §2(1).

<sup>11</sup> Nev. Const. art. 19, §2(2), (3).

<sup>12</sup> Nev. Rev. Stat. §295.009.1(a).

<sup>13</sup> Nev. Rev. Stat. §295.009.2.

<sup>14</sup> Nev. Rev. Stat. §295.009.1(b).

both the proposed margin tax and a provision that would require the Nevada Department of Taxation ("DOT") to publish information identifying the taxpayers paying the tax and the applicable amount paid.<sup>15</sup> The District Court's ruling enjoined the NSOS from submitting the initiative petition to the Nevada Legislature in 2013, or to the general election ballot in 2014.<sup>16</sup> The ruling did not, however, preclude the re-filing of the initiative petition. In response to the court's decision, proponents of the proposed tax, The Education Initiative PAC ("EI PAC"), re-filed the initiative petition with the NSOS on Aug. 7, 2012, absent the DOT information publication provision.

On Aug. 22, 2012, the Committee filed a new lawsuit with the District Court in opposition to the revised initiative petition. Ruling on this second lawsuit, the District Court on Oct. 23, 2012, held that although the initiative did not violate the single-subject requirement, the initiative was invalid because language used therein to describe the effect of the proposed tax was "incomplete, deceptive, [and] misleading . . ." and thus in violation of the description of effect requirement.<sup>17</sup> The court's ruling also enjoined the NSOS "from submitting the Petition to the 2013 Legislature and from placing the Petition on the general election ballot in 2014."<sup>18</sup> EI PAC appealed the case to the Nevada Supreme Court.

### Nevada Supreme Court Decision

On Jan. 31, 2013, the Nevada Supreme Court reversed the District Court's Oct. 23, 2012 decision.<sup>19</sup> The first issue before the Supreme Court was whether the initiative satisfied the description of effect requirement. As noted previously, this requirement specifies that the initiative as circulated for signature gathering purposes must describe its effect if the initiative is adopted into law.<sup>20</sup> Regarding this requirement, the Committee raised what the Supreme Court labeled as a "multitude of issues . . . [to] be spelled out" in the initiative.<sup>21</sup> The Committee argued that:

The Initiative's description of effect misstates how certain tax revenues generated by the margin tax would be used by stating that "[r]evenues from the tax would be deposited in the State Distributive School Account" without noting that a portion of these funds will be used to fund the Department of Taxation's costs of administering the tax.<sup>22</sup>

<sup>15</sup> *Committee to Protect Jobs v. The Education Initiative PAC and Ross Miller, Nevada Secretary of State*, First Judicial District Court of the State of Nevada In and for Carson City, Case # 12 0C 00198 1B (Aug. 6, 2012), slip op. at 3.

<sup>16</sup> *Committee to Protect Jobs*, Case # 12 0C 00198 1B (Aug. 6, 2012), slip op. at 8.

<sup>17</sup> *Committee to Protect Jobs v. The Education Initiative PAC and Ross Miller, Nevada Secretary of State*, First Judicial District Court of the State of Nevada In and for Carson City, Case # 12 0C 00277 1B (Oct. 23, 2012), slip op. at 3.

<sup>18</sup> *Committee to Protect Jobs*, Case # 12 0C 00277 1B (Oct. 23, 2012), slip op. at 8.

<sup>19</sup> *The Education Initiative PAC*, Case # 61996, 129 Nev., Advance Opinion 5 (Jan. 31, 2013), slip op. at 23.

<sup>20</sup> Nev. Rev. Stat. §295.009.1(b).

<sup>21</sup> *The Education Initiative PAC*, Case # 61996, 129 Nev., Advance Opinion 5 (Jan. 31, 2013), slip op. at 14.

<sup>22</sup> *Id.*

Rejecting this argument, the Supreme Court pointed out that:

The description of effect recites that the modified business tax “would temporarily be increased . . . to provide money for the Department to begin to administer the margin tax.” This statement recognizes the need for the Initiative to provide the Department with enough money to cover the administrative costs of the margin tax . . . . With the description . . . limited to a mere 200 words, expecting this description to state specifically that a fraction of the revenue generated by the tax will be used for administering the tax would be unreasonable. Moreover, as all statutes enacted by initiative must be self-funding, the inclusion of this information is wholly unnecessary and its omission does not render the description misleading or incorrect.<sup>23</sup>

As part of its “multitude of issues,” the Committee raised “additional . . . omissions that it believes should have been included” as follows:

specifically the amount of revenue to be generated by the margin tax, the fact that even unprofitable businesses will be required to pay the tax, the fact that businesses subject to the tax might incur compliance costs, the absence of explanations of the meaning of certain key terms, such as “total revenue” and “cost of goods it has sold” as used in the Initiative, the fact that, if enacted, the law will not be capable of amendment or repeal for at least three years . . . .<sup>24</sup>

In its rejection of these arguments, the Supreme Court explained: “While this is all information that may ultimately be useful for voters, in light of the 200-word limit placed on descriptions of effect, such a level of detail far exceeds what a proponent can constitutionally be required to include in a description of effect.”<sup>25</sup> The court further pointed out that the level of initiative specificity that the Committee argues is required would, if adhered to, threaten to undermine the constitutionally permitted initiative process. As explained by the court,

[A]n initiative’s description of effect . . . need not . . . mention every possible effect of an initiative. Instead, a description of effect must identify what the law proposes and how it intends to achieve that proposal, all within a 200-word limit. Given this constraint and in light of its statutory function to facilitate the initiative process, a hyper-technical interpretation of the requirements for a description of effect may impede the people from exercising their constitutional right to propose laws and is therefore an inappropriate method for assessing the adequacy of a description of effect.<sup>26</sup>

Finally, the Supreme Court addressed the Committee’s argument that the description of effect was mis-

leading with regard to the initiative’s overall impact on education funding. As argued by the Committee, the statement in the initiative that margin tax revenue would be “used for the support of K-12 education” was “misleading because it does not clarify that the margin tax revenues may serve only to *replace* existing education funds if the Legislature chooses to spend the existing funds elsewhere.”<sup>27</sup> The Supreme Court noted that the lower court had agreed with Committee’s argument in this regard:

Specifically, . . . [the District Court] concluded that the margin tax’s effect “is to free up funds for the Legislature to use as it wishes, for education or non-education purposes.” Without explaining why the description of effect, as written, is necessarily misleading in this regard, the District Court concluded that this effect is “something those being asked to sign the petition should know” and that the description of effect’s failure to provide such an explanation renders it “deceptive and misleading.”<sup>28</sup>

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### **Initiatives should be scrutinized by applying a “holistic approach.”**

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In addressing this issue, the District Court and the parties had focused on the meaning of the word “support,” an approach viewed by the Supreme Court as grounded, *incorrectly*, on the “idea that a reviewing court should apply principles of statutory construction in examining information articulated in a description of effect.”<sup>29</sup> As explained by the Supreme Court:

Given the limited function ascribed to an initiative’s description of effect and the fact that these descriptions are relevant only at the early stages of the initiative process, we conclude that it is inappropriate to parse the meanings of the words and phrases used in a description of effect as closely as we would statutory text. Such exacting scrutiny comes at too high a price in that it carries the risk of depriving the people of Nevada of their constitutional right to propose laws by initiative, something this court has expressly stated that it will not do. *Nevadans for Prop. Rights*, 122 Nev. at 912.<sup>30</sup>

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### **Exacting scrutiny comes at too high a price in that it risks depriving the Nevada people of their constitutional right to propose laws by initiative.**

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Instead of applying principles of statutory construction, the Supreme Court concluded that initiatives should be scrutinized by applying a “holistic approach

<sup>23</sup> *Id.* at 14-15.

<sup>24</sup> *Id.* at 15.

<sup>25</sup> *Id.* at 15-16.

<sup>26</sup> *Id.* at 9.

<sup>27</sup> *Id.* at 17 (first emphasis added).

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.* at 17-18.

to determine whether the description is a straightforward, succinct, and nonargumentative summary of an initiative's purposes and how that purpose is achieved, . . . and whether the information . . . is correct and does not misrepresent what the initiative will accomplish and how it intends to achieve those goals."<sup>31</sup> Applying this "holistic approach" to the facts before it, the Supreme Court explained that the initiative's descriptive effect is a "straightforward, succinct, and nonargumentative summary of what the Initiative is designed to achieve – raise funds to support Nevada's K-12 public schools – and how it intends to do so – enacting a margin tax."<sup>32</sup> The court reasoned that the description "is neither deceptive nor misleading, as it is substantively correct and does not misrepresent what the initiative will accomplish or how it will achieve those goals."<sup>33</sup> Based on the foregoing, the court concluded that "the Committee's arguments regarding the description of effect's insufficiency lack merit and, to the extent the district court relied on them to invalidate the Initiative, that conclusion was in error and must be reversed."<sup>34</sup>

Having addressed the description of effect requirement, the Supreme Court turned its attention to the single-subject requirement. As discussed previously, the statute requires that a law proposed in an initiative must "embrace but one subject and matters necessarily connected therewith . . ." <sup>35</sup> A petition will be deemed to satisfy the single-subject requirement if "the parts of the proposed initiative . . . are functionally related and germane to each other in a way that provides sufficient notice of the general subject of, and the interests likely to be affected by, the proposed initiative . . ." <sup>36</sup> The Committee argued that the initiative violates this provision because the initiative "seeks to implement a new margin tax *and* temporarily increase the existing modified business tax . . ." <sup>37</sup> In rejecting this argument, the Supreme Court reasoned that the functional relationship between the new margin tax and the temporarily increased Modified Business Tax support a finding that the single-subject requirement has been satisfied. As explained by the court,

[the] Initiative is constitutionally required to be self-funding, . . . meaning that it must provide the Department with enough money to cover its costs of administrating the margin tax. Thus, . . . [the] Initiative also seeks to provide the funding that the Department will need to administer and enforce the margin tax. To do so, the Initiative provides for a necessary portion of the margin tax revenues to be allocated each year to the Department. Once these revenues are allocated, all remaining revenues are to be deposited into the Distributive School Account. Since the Department will necessarily incur ad-

ministrative costs before margin tax revenues start accruing, the Initiative seeks to temporarily increase a different tax, the modified business tax . . . Thus, although the Initiative does seek to implement a new tax and temporarily increase an existing tax, both are functionally related and germane to the Initiative's clear purpose of funding public education.<sup>38</sup>

Based on the foregoing, the Supreme Court concluded that the initiative complies with the single-subject requirement and thus affirmed the lower court's finding on this issue.<sup>39</sup>

In its final holding the Supreme Court reversed the District Court's ruling that had invalidated the initiative and the District Court's "decision to enjoin the Secretary of State from presenting the Initiative to the 2013 Legislature and from placing it on the 2014 general election ballot."<sup>40</sup> Accordingly, the Supreme Court's decision sends the matter to the Nevada Legislature for further consideration. If legislators reject the initiative or fail to act, it would go before voters in 2014.

## Outlook - What Could Happen Next

The Nevada 2013 legislative session commenced on Feb. 4, 2013. In accordance with the Nevada Constitution, the petition initiative "shall take precedence over all other measures except appropriation bills, . . ." thus positioning the proposed margin tax at the forefront of the legislative agenda.<sup>41</sup> The constitution provides further that "the statute or amendment to a statute proposed [by a petition initiative] . . . shall be enacted or rejected by the legislature without change or amendment within 40 days."<sup>42</sup> Accordingly, the Nevada Legislature has until March 15, 2013 to enact or reject the proposed margin tax. As discussed previously, if the Legislature rejects the measure or fails to act within the 40-day time limit, the NSOS must submit the measure to voters in 2014. Also, if the Legislature rejects the proposed tax, the Governor may recommend and the Legislature may propose an alternative tax measure.<sup>43</sup> If the Governor approves an alternative tax measure, then that measure along with the proposed margin tax shall be submitted to the voters in 2014 for approval or disapproval.<sup>44</sup> If both measures are approved by the voters, the measure that receives the most votes will become law.<sup>45</sup>

Thus, Nevada taxpayers are currently faced with a "wait-and-see" approach. And, while the Nevada Supreme Court's decision was viewed favorably by the Nevada State Education Association, Governor Sandoval and many in the Nevada business community have voiced their disapproval of the proposed margin tax. Whether an alternative tax reform measure will be presented is yet to be seen. For now, however, the ball is in the Nevada Legislature's court.

<sup>31</sup> *Id.* at 18.

<sup>32</sup> *Id.* at 20.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> Nev. Rev. Stat. §295.009.1(a).

<sup>36</sup> Nev. Rev. Stat. §295.009.2.

<sup>37</sup> *The Education Initiative PAC*, Case # 61996, 129 Nev., Advance Opinion 5 (Jan. 31, 2013), slip op. at 22.

<sup>38</sup> *Id.* at 22.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* at 23.

<sup>41</sup> Nev. Const. art. 19, §2(3).

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

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