PROPOSED NEVADA BUSINESS LICENSE FEE INCREASE & GROSS RECEIPTS MARGIN TAX

EXECUTIVE SUMMARY

The proposed Business License Fee increase & Gross Receipts Margin Tax (BLF/GRMT) has the potential to generate only 216,000 commercial recordings in the Secretary of State's Office for fiscal year (FY) 2016, which is 124,000 less than the Governor's projection of 340,000 recordings. We believe this to be a conservative estimate.

The proposed Business License Fee increase & Gross Receipts Margin Tax will overstate current State revenue projections in Fiscal Year 2016 by approximately $42 million and overstates FY 2017 revenue projections by $65 million.

The proposed Business License Fee increase & Gross Receipts Margin Tax will reduce New Filings by an estimated 44% in FY2016 and 63% in FY2017.

The proposed Business License Fee will result in a decrease in the range of 8 to 12 percent in BLF compliance for small business entities with either no or minimal Nevada employees.

The Proposed Business License Fee & Gross Margins Tax will irreparably damage Nevada's "Business Friendly Image" that the state has invested millions of dollars to promote over the last twenty-five (25) years. Moreover, the proposed actions of the Governor will result in the growth of anti-Nevada marketing campaigns on the part of traditional supporters.

Due to the lack of transparency of the Governor's proposal, this report does not include the potential near and long-term revenue losses or administrative cost increases that will result from the implementation of the Gross Receipts Margin Tax segment of the Governor's proposal.

The Nevada Secretary of State's Office should conduct a full examination of its product pricing strategies. This examination must focus on maximizing the State's revenue streams while maintaining the competitive advantage of Nevada business formation. Unlike the Governor's proposal, this examination must include consultation with and input from key industry stakeholders to avoid the type of mistakes inherent in the current proposal.

Assembly Committee: Taxation
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Submitted by; Matthew Taylor

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OVERVIEW

This report analyzes the effect of Governor Sandoval's proposed Business License Fee Increase and Gross Receipts Margin Tax on revenue and volume of commercial recordings in Nevada. Many well-respected authorities have already weighed on the Governor's proposal with, as expected, significantly different perspectives.

Our examination finds that the Governor's proposal will NOT increase revenues to the Secretary of State's Office of Commercial Recordings to the extent projected and therefore, will not help meet the "education needs" of the State.

Our assessment of the Governor's proposal conclusion is based upon a detailed analysis of the Secretary of State's Division of Commercial Recordings' revenue streams. More importantly, our detailed analysis focused on the tens of millions dollars of high margin-minimal cost revenues generated by the more than 200,000 "non-Nevada employee "or "Foreign Entity" segments of the stream that are highly mobile and sensitive to increases in price. The current proposal assumes that the Business License Fee is inelastic. This is not the case and our analysis of the price elasticity of the Business License Fee segment of the proposed Business License Fee Increase/ Gross Receipts Margin Tax confirms this finding. Recent improvements in the economies of both the United States and Nevada will not change this conclusion.

INTRODUCTION

Over the last twenty-five (25) years the State of Nevada has cultivated the image of a business-friendly state through a series of legislative and executive actions. These changes were specifically designed to target business founders and entrepreneurs with incentives to form or locate their business enterprises within Nevada. These efforts were overwhelmingly successful, and the State was rewarded with substantial revenues in the form of high margin business formation fees and entrepreneurial activities. Additionally, these actions spurred the growth of a state-wide network of private financial, tax, and business formation professionals to support these businesses. Now, Governor Sandoval seeks to irreparably tarnish the State's business-friendly reputation (and eliminate the high margin revenues currently collected) through a series of tax and administrative actions.

Specifically, on January 15, 2015 Governor Brian Sandoval announced his FY2016 – FY2017 budget would include substantive revenue increases as a result of the reformulation of the existing "Business License Fee" into a modified Business License Fee and Gross Receipts Margin Tax. The proposal not only doubles the existing Business License Fee (from $200.00 to $400.00), but the tax has an additional increment based upon a complicated set of gross receipts tax formulas developed in the State of Texas. Governor Sandoval argues that the tax has the best attributes of a gross receipts tax[1], margin tax, and business license fee structure.

Proponents of price increases cite a mixed history of fee increases that led to revenue increases without a significant effect on volume. They argue that it is currently the only acceptable and expeditious way to address the perceived "education needs" of the State. Opponents of the Business License Fee price increases assert that higher prices will drive businesses away, reducing revenue and exacerbating the loss of volume (transactions) to alternative jurisdictions (e.g., Wyoming). Moreover, opponents draw upon a more recent history that purports to support their position.

Nevada businesses currently pay a flat $200 state-level business license fee each year. This is one of the more expensive annual business license fees in the United States and does not include the $125 annual requirement for officers and directors and the initial $75 filing fee for Articles of Incorporation (These fees are in addition to initial organizational costs and local filing fees.) The governor's proposal would change the current flat business license fee

[1] It is important to note that less than three months earlier Nevada voters overwhelmingly (4 to 1) defeated a tax ballot initiative that would have imposed a 2 percent Texas-style tax on businesses with more than $1 million in annual revenue. The alleged purpose of the proposed Business License Fee increase and Gross Receipts Margin Tax is to raise revenues to be earmarked for Nevada's public educational system.

to a minimum fee of $400.00 **(bringing the total first year fee expenditure to $600.00)**[2] plus an incremental financial extraction based upon an entity's total revenue, which would generally include all business receipts. Certain types of interest, dividends, and capital gains, wages reported on W-2's, and gifts would be excluded in determining a taxpayer's total revenue. Additionally, gaming revenues subject to the "percentage fee" would likewise be exempt from the proposed business license fee. The fee, which would be paid on a quarterly basis, would be based on a revenue range in which the business falls and a rate applicable to the fee payer's NAICS code.

Governor Sandoval's January 15, 2015 proposal anticipates that there will be approximately 30 NAICS categories, each with its own rate. The lowest annualized fee under the revised structure would be $400 for foreign entities, and the highest fee imposed is estimated to be "more than $4 million" for a taxpayer with gross revenue in excess of $1 billion. Material distributed by the Governor's office indicates that the rates for each industry are adjusted to reflect the margins for each sector as well as the average cost of goods sold and average labor costs. "Adjusted" rates reflected in the material from the Governor ranged from a low of 0.056 percent for Mining to 0.362 percent for rail transportation. We were unable to understand the basis of the adjustments and methodology other than the references to Texas, which are designated in the Spreadsheet (Spreadsheet 1) submitted by Governor Sandoval to local media outlets.

In order to properly evaluate the Governor's Business License Fee Increase/ Gross Receipts Margin Tax, it is imperative that the Nevada Legislature have a complete understanding of the most likely financial outcome of Governor Sandoval's proposed tax. We believe that a full examination of the Governor's proposal will lead even the most steadfast supporter of the Governor's budget to reject this proposal as fiscally impoverished and harmful to the sustainability of the State of Nevada's business competitiveness.

Our detailed financial and economic analysis suggests that the proposed Business License Fee Increase and Gross Receipts Margin Tax will:

(1) Substantially fail to meet the short and long-term revenue projections due to the enormous size of the deadweight loss of the proposed extraction;

(2) Permanently and irreparably damage the "Business Friendly Image" the State of Nevada has cultivated over the last several decades; and

(3) Fail to address what the Tax Foundation in its 2014 Las Vegas Metro Chamber of Commerce study so succinctly reports, which reads in part as follows:

[2] These exclude sole proprietors (that only pay the business license fee) and other entities such as non-profit entities.

"Broadly:

- Nevada should consider fixing what is broken with the current system….
- The tax system should retain elements that ensure Nevada economic competitiveness."[3]

In examining Governor Sandoval's proposal we were dismayed to discover that the proposal was not vetted with any key Business License Fee (BLF) stakeholders, to include both the Secretary of State's Office Division of Commercial Recordings, the commercial registered agent membership that represents over two-thirds (210,152/307,608 entities)[4] of the business organizations in the State of Nevada and entrepreneur support and business development organizations.

Governor Sandoval's office initially released three media documents (Business License Fee Facts, BLF Spreadsheet 1, & a NAICS Guide) and a State Budget to provide information on the proposal. However, the data contained in these documents was insufficient and failed to address how Business License Fee is constructed. Therefore, we were unable to ascertain exactly how the projected budget revenues were derived. The Governor's proposal not only lacks transparency, it is without empirical justification.

Unlike the justifications provided by the Governor, our examination draws upon discussions with key stakeholder groups, which include: (1) staff in the Nevada Secretary of State's office (as well as that of competing Secretary of State's offices); (2) the Nevada Registered Agent Association (NRAA) (the organization that represents a majority of the Nevada commercial registered agent organizations affected by the proposed Business License Fee Increase & Gross Receipts Margin Tax) as well as commercial registered agents that are not members of the NRAA); (3) law firms with Nevada business organization practices; (4) Nevada-based financial planners and Certified Public Accountants; and (5) others involved in the business formation process, including tax experts, academics, Nevada businesses, professional organizations, and government officials.

After a review of the relevant public policy literature and consultation with the business formation community, we conducted a survey of "active foreign entities with state business licenses" through the cooperation of the NRAA membership. Questions in the survey were designed to answer key inquiries concerning the mobility, price sensitivity and tax knowledge (salience) of their clients. These data allowed us to statistically estimate the

[3] Las Vegas Metro Chamber of Commerce Nevada Tax Study Executive Summary, The Tax Foundation, 2014
[4] Estimate of Jeff Landerfelt, Deputy Secretary of State for Commercial Recordings February, 2014. Data estimated from FY 2014 Nevada Secretary of State's commercial recordings database

elasticity of the Business License Fee segment of the proposal. In addition, we statistically sampled the Nevada Secretary of State's database to develop a typology of Nevada businesses in order to statistically quantify and triangulate the potential impact of the Business License Fee Increase & Gross Receipts Margin Tax on State revenues. When the survey and the database sample we completed, we reviewed our findings with key stakeholders, which provided a verification of them.

If Governor Sandoval's proposed Business License Fee Increase & Gross Receipts Margin Tax is approved it will signify a turning point in the perception of Nevada as a business friendly state. Determining the right tax requires an understanding of the State's economic and political landscape.

BUSINESS FORMATION BACKGROUND

Entrepreneurs and business founders go about the business formation process in a variety of ways. Historically most businesses were formed as sole proprietorships, partnerships, corporations, limited liability companies and the like based upon the seasoned input of accountants, financial planners, lawyers, and other traditional business advisors.

Although these traditional business advisors remain key to many entrepreneurs and start-up managers, other actors, most notably registered agents, and national incorporation firms, have also developed large business formation practices over the last two decades. National incorporation firms (e.g., LegalZoom) often market largely through the Internet, while Nevada-based organizations use both traditional and Internet marketing methods. These enterprises are particularly important in the growth and sustainability for foreign entity business filings. Often these businesses operate as both registered agents and business formation/information providers. Most importantly, in Nevada, these organizations have been critical in the marketing of the State to foreign entities.

Nexus

Nexus is a term of art used by lawyers to describe a legal connection. Typically, commercial firms are deemed to have a substantial nexus with a state if the firm has a physical presence in the jurisdiction, which need only be demonstrably more than a slightest presence. In most states, nexus is established when a firm is physically present in the state if the entity has property or employees in this state. A firm is also physically present in this state if the person, either directly or through an agent or other representative, engages in activities in this state that are significantly associated with the firm's ability to establish or maintain a market for its products in this state.

In certain states, an “economic nexus” standard rather than a “physical presence” standard was created with regard to certain activities. It requires some businesses earning “apportionable income” (including activities subject to the service and other activities) from state customers to be subject to taxes whether or not they maintain offices in the state or have any physical presence.

Registered Agent

All Nevada foreign entities must have a designated registered agent that is listed of record with the State. Technically, a registered agent is a responsible third-party who is registered in the same state in which a business entity was established and who is designated to receive service of process notices, correspondence from the Secretary of State, and other official government notifications (usually tax forms and notice of lawsuits) on behalf of the commercial entity

Commercial entities that do not have a physical location within the state in which the business is registered must identify a registered agent to accept documents (process of service) pursuant to Nevada statutes (NRS).

State Selection

There is no legal requirement to form a new corporation, LLP or LLC in one's home state (the state where the principal business is located). For a small business corporation that primarily or exclusively does business in its home state, there is rarely an advantage to incorporating in another state because it will still be required to register an out-of-state (foreign) corporation in the home state and pay the same fees and taxes.

The federalist nature of corporate law in the United States allows each state to develop its own jurisprudence and cost structure for business enterprises and their respective owners. The variety of these factors drives the marketplace within which entrepreneurs and business owners operate. Founders and business organizers often seek jurisdictions that best adapt to their governance and financial needs.

Their decision on the selection of jurisdiction includes various economic, operational, financial, and legal considerations. Typically, these are initial start-up costs and maintenance existence expenses, the scope of legal liability for owners, directors, members and officer, the scope of shareholder protections, and the availability of takeover defenses and merger considerations. In addition, businesses often consider subjective issues such as the state's body of case law or overall reputation.

Although many jurisdictions have developed jurisprudence and fee structures that benefit specific business sectors and/or industries, three states (Delaware, Nevada and Wyoming) have developed reputations as "preferred locations" for foreign corporations based upon their governance flexibility, investor protections, privacy, liability protection, jurisprudence, tax structure, and other cost considerations.

Historically, Delaware had been the choice for incorporation. This premier position is typically attributed to Delaware's reputation, statutory framework, and extensive body of corporate case law. In fact, according to Delaware's Secretary of State, over sixty percent (60%) of the Fortune 500 companies are incorporated in Delaware.

However, over the last three decades, Delaware corporate law has become very complex due to formalities, officer and director accountability, and minority shareholder participation. In fact, many venture capitalists and other investors require their investments be incorporated in Delaware because of Delaware's strong protection of minority shareholders. Moreover, Delaware's fees are based on the entity's capital structure and can be extremely costly to maintain.

Nevada distinguished itself from Delaware by codifying management-friendly standards of care for actions taken in response to takeover attempts, and maintaining favorable limited liability protection for directors and officers. General business organization law is located in Chapters 78 and 92A of the Nevada Revised Statutes. Nevada adapted the Model Business Corporation Act (MBCA) to add uniform procedures for mergers, exchanges and conversions of equity.

Nevada has maintained a business friendly tax climate that includes no business income or franchise taxes, no personal income taxes, and the constitutional requirement that all tax increases be approved by a super-majority in the Legislature. To promote the Business friendly culture, the Secretary of State's office has established a website that is designed to attract businesses to the state and distinguish the state from other states with an eye toward Delaware with direct comparisons of Nevada and Delaware statutes.[5]

Since there is no requirement to incorporate/form/organize a business in the state(s) it will operate the, it may choose any of the 50 states. The decision regarding which state to incorporate/form/organize is typically based on a balancing of a variety of Nexus, Legal (Privacy, Jurisprudence, and Liability Protection) and Financial (Taxes & Fees) considerations:

Nexus

Nexus is an important part of the selection process. "Nexus can be a hidden danger for a company with a multistate presence. Certain activities might cause nexus for sales and use tax, income tax, franchise tax or other business taxes. One key to successfully navigating these widely varying provisions is for tax professionals to review the statutes and rulings of each state in which a business client might be considered as doing business. The connection might not be obvious, particularly for sales and use tax. And some states levy types of taxes that might not be familiar to business owners and managers, such as those on gross receipts or business activity. "[6]

States are not permitted to tax income of a corporation unless four tests are met under *Complete Auto Transit, Inc. v. Brady*: [7]

- There must be a "substantial nexus" (connection) between the taxpayer's activities and the state,
- The tax must not discriminate against interstate commerce,

[5] See WhyNevada.com
[6] Navigating Nexus Journal of Accountancy, Diana DiBello & Sylvia Dion October 31, 2010
[7] Substantial nexus is a Constitutional requirement that is subject to interpretation

- The tax must be fairly apportioned, and
- There must be a fair relationship to services provided.

Fees & Taxes Comparison[8]

There are two major categories of Fees/Taxes considerations: Initial Business Formation Fees and Annual Fees & Taxes. These costs vary widely and it would be impossible to describe all of the various permutations in this document. Therefore, we have selected the three most common states, outside of the founder's home state, that are considered by most entrepreneurs and business formation professionals: Delaware, Nevada, and Wyoming.

Initial Business Formation Fees

The Delaware Secretary of State requires a minimum fee of $89, which is increased incrementally as the amount of authorized capital increases beyond $75,000. The fee to file a document of formation is $90 for an LLC and $200 for LP, LLP (per partner) and statutory trust.

Nevada charges a flat fee of $75 to form an LLC, an LP or an LLP, and $100 to form an LLLP. For corporations, Nevada bases the amount of fees on the value of authorized share capital (fees start at $75 for the capital of $75,000 or less and gradually increase to $375 for capital valued at less than $1 million, with incremental increases to a maximum fee of $35,000). There also is a requirement to file an initial officer and director/member and manager/general partner list with an accompanying fee of $125.

Wyoming charges a flat fee of $100 to initially form any of its business entities.

These price differentiations among the three states (Delaware, Nevada, and Wyoming) indicate that currently: (1) it is relatively inexpensive to form an LLC in any one of them; (2) Nevada and Delaware are more expensive places of incorporation for larger businesses because they calculate the filing fees based on the amount of capital stock; and (3) Delaware and Nevada generally have higher fees to form an LP, LLP, LLLP and trusts than does Wyoming.

[8] Fees and costs are subject to change and interpretation. Contact the Secretary of State in each State for current fees & costs.

Annual Fees and Taxes

Compared to Nevada and Delaware, Wyoming is the least expensive incorporation state in terms of annual fees and taxes.. Wyoming's annual license tax is based solely on the value of all assets located and employed within Wyoming. The minimum fee is $50 and it increases based on the amount of assets within the state.[9] Additionally, Wyoming has no corporate income tax, personal income tax, inventory tax, tax on intangible assets such as stocks or bonds, and there is no legislative plan to implement these types of taxes.[10] Nevada charges a yearly $125 ($175 for some LLLPs) officer and director filing fee and currently imposes an additional business license fee of $200 per year on corporations, LLCs, LP, LLPs and LLLPs (last increased on July 1, 2009).[11] There also is a requirement that domestic and foreign corporations (including close and professional corporations) pay an annual list fee calculated based on the amount of authorized stock, with a minimum fee of $125 and a maximum fee of $11,100. Neither Nevada nor Wyoming charge a corporate income tax, franchise tax, personal income tax, inventory tax or tax on corporate shares at this time.

In Delaware, all corporations have to file an annual report and pay a filing fee of $50. In addition, all corporations have to pay a franchise tax for the privilege of incorporating in Delaware, which is calculated based on the number of authorized shares or assumed no par capital (minimum tax is $175 and a maximum tax is $180,000). GPs, LPs, and LLCs do not file an annual report but pay an annual fee of $250, and LLPs and LLLPs have to file an annual report and pay $200 per partner. [12] Delaware also levies a corporate income tax on domestic corporations. However, corporations that do not conduct business in the state are not required to file a state tax return if they do not conduct business in Delaware. .[13] While Delaware does not impose a state or local sales tax, it does impose a gross receipts tax on the seller of goods (tangible or otherwise) or provider of services in the state.

[9] Wyoming requires its business entities to file an annual report on or before the first day of the anniversary month of the company's incorporation and pay a license tax (except for statutory trusts). The cost is $50 or two-tenths of one million on the dollar ($.0002), whichever is greater, on the portion of the corporate assets located and employed in Wyoming. See Wyoming Secretary of State, Frequently Asked Questions, available at http://soswy.state.wy.us/FAQ.aspx (last visited Mar. 25, 2010).
[10] See Wyoming Department of Revenue, Income Tax, available at http://revenue.state.wy.us/.
[11] See Nevada Secretary of State, Forms and Fees, available at http://nvsos.gov
[12] See Delaware Division of Corporations, How to Form a New Business Entity, available at http://corp.delaware.gov.
[13] See Delaware Division of Revenue, Filing Corporate Income Tax

Privacy

Concerns about privacy may be the deciding factor for some businesses if asset protection issues are involved. Nevada requires that all business entities file annual lists with the state that contain the name and registered or business address of partners, officers, directors, managers or managing members of business entities incorporated in Nevada. It is possible to search the state's website for business-related information not only by the name of the business but also by officer's name. In Nevada, shareholders can vote by proxy, valid only for 6 months, unless the appointment document provides a different length of time, not to exceed seven years. [14]

Wyoming's annual update reports do not require the disclosure of the names of business owners, with one exception - the person signing the report. Wyoming also allows nominee shareholders (designated persons to appear on public record instead of the actual persons involved) as well as action by lifetime proxy. [15]

Similar to Wyoming, Delaware does not require disclosure of the names of business owners, directors or officers of business entities in its filings, allows nominee shareholders and provides for lifetime proxy.[16] Therefore, it appears that Wyoming and Delaware laws offer greater privacy protection to the business owners of the entities formed in their states than Nevada.

Delaware has long been touted as one of the best states in which to incorporate. In the past, Delaware had the most liberal incorporation statute in the country, which gave management great flexibility in operating the corporation's business. This flexibility was a great advantage to huge corporations that do business and have shareholders nationwide (or worldwide). However, this advantage is usually not important for smaller corporations. Also, most states have modernized their corporation statutes to make their laws more comparable to Delaware.

One long-standing advantage in Delaware is the existence of a separate court for the resolution of business disputes. Cases are often resolved more quickly and have the benefit

[14]See NEV. REV. STAT. § 78.355 (1991)
[15] Effectively, it is possible to appoint lifetime proxies, as Wyoming Business Corporation Act provides for the appointment of proxies for an 11-month period unless a longer period is expressly provided for in the form of appointment. See Wyo. Stat. Ann. § 17-16-722(c).
[16] DEL. CODE. ANN. Tit. 8, § 212(b) (providing that a proxy is for a period of three years, unless the proxy provides for a longer period)

of judges that are experienced in business cases rather than potentially being decided by a former prosecutor judging a complex business case.

However, the advantage Delaware may offer to a Fortune 500 publicly traded company is not likely to apply for a small business where complex business litigation is a remote possibility.

Nevada is often promoted for legal considerations to include superior liability protection for the personal assets of the owners and better privacy to operate as an officer, director, or shareholder in a Nevada corporation. However, one must also consider that:

- Nevada, like all states, requires a corporation to file an annual report (in Nevada it is called an Annual List of Officers and Directors) that lists the names and addresses of the corporation's officers and directors. This is a public record that anyone can access directly on the Nevada Secretary of State website.
- While shareholders' names and addresses are not required by Nevada's Annual List, neither are shareholder names required in the annual reports of virtually all other states.
- The personal liability protection offered by a Nevada corporation is often no greater than it is in other states.

In short, there is now less of an advantage (or in certain cases a limited advantage) for most businesses located outside of Nevada to incorporate in Nevada versus Wyoming.

METHODOLOGY

Our analysis addresses the primary question of interest, namely, "Will the Governor's proposed Business License Fee /Gross Receipts Margin Tax result in the increased revenues identified in the Governor's budget?" To answer this question we first attempted to review the Governor's revenue projection methodology. However, we were unable to locate, and therefore duplicate, the Governor's methodology. We were only able to deconstruct the revenue projections based upon the Governor's FY2016-FY2017 Budget documents found on-line and the media information released by the Governor's office in late January 2015.

A major consideration in any research project is the availability and quality of the sources of data to be used in the quantitative analysis. For example, the Governor's FY 2016-2017 Budget contains the following estimates of "new business licenses" as follows: FY2015: 325,000; FY 2016 340,000 and 2017 340,000. We are unable to determine how the FY 2016 and FY 2017 estimates have been constructed. Specifically, we are unable to ascertain the assumptions by type of licensee segment; key economic assumptions: data sources; or data quality underlying the two fiscal year budget estimates that would be subject to the proposed doubling of the Business License Fee increase. These assumptions would be useful in a fuller examination.

Enterprises subject to the Business License Fee include certain types of sole proprietorships, but exclude others. Whether or not the fee applies is based upon definitions identified in the Nevada Revised Statutes. Our analysis of the Business License Fee also adjusts for non-compliance/tax avoidance considerations of the sole proprietorships subject to the Business License Fee increase. Approximately 30,000 sole proprietorships currently obtain business licenses per year. We recognize that these entities are not highly mobile and therefore are unlikely to leave the State due to an increase in the Business License Fee. Nonetheless, these enterprises are more likely to consider other avoidance strategies. Our non-compliance estimates consider historical IRS compliance statistics. Additionally, these estimates consider the cost of compliance versus probability of enforcement and the penalties for non-compliance resulting from the proposed Business License Fee increase.

Estimating the impact of the proposed Business License Fee on Foreign Entities without employees requires assumptions as to the geographical location or "home state" of the foreign corporation since traditionally founders compare the costs and benefits of formation versus their "home state". Moreover, this analysis may also include the additional costs, if any, of registering their Nevada entity with their "home state". The State of Nevada does not have complete access to founders' "home state" information. Therefore, we have estimated this information based upon non-random sampling information and NRAA survey data. It is important to also note that time constraints prevent us from examining the potential of negative "multiplier effects" that will reduce the size of Nevada's community of registered business agents.

In addition to the data and time constraints we face in this analysis, there is a lack of clear definitions for numerous terms found across the materials we were able to analyze. In some cases, the term "commercial recordings" is used, while in others, "new business licenses", or "incorporate" and "business entities" are found. This lack of clarity can result in significant variations in the estimates provided by the State and other stakeholders. For example, traditional sole proprietors, although not subject to certain business formation fees, must file for an annual Business License with the State of Nevada. They are included in some data sets but not others.

Lastly, it is most important to understand and isolate the impact of a variety of internal and external variables on the formation and recording of commercial entities over the last two decades. Of particular importance are: (1) the administrative decisions of the Nevada Secretary of State concerning the "home-base" status exemption of many commercial enterprises in 2010-2011 that lead to a substantive decrease in the exemptions sought or granted under Title 7 of NRS; (2) changes in the California Franchise Tax Board's treatment and enforcement of tax compliance for foreign and pseudo-foreign entities; (3) changes resulting from economic variations such as the Great Recession.

Due to the data constraints and data definition issues noted above as well as the time constraints affecting the filing of this report , we developed an integrated research strategy that consisted of four activities: (1) A review of the US Census Bureau's Business Dynamic Statistics to examine the national business formation trends; (2) Development and Implementation of a Survey of Nevada Registered Agent Association members (representing 210,000 of the 308,000 commercial registrants) to identify the potential mobility of current business entities and the potential impact on new business formation; (3) Implementation of a random sample survey of 804 organizations listed in the SilverFlume Database to confirm that the commercial registered agent data was statistically representative; and (4) Estimation of the Price Elasticity of Demand of the Dominant Market Products of the Nevada Secretary of State. *Additionally, it is important to note that our analysis was limited to the for-profit active commercial entities registered with Nevada Secretary of State that had either "no-Nevada employees" or a "no-Nevada nexus."* We explain these terms later.

We also undertook a Delphi Method analysis to validate our findings. The Delphi method is a widely used technique for gathering data from respondents within their domain of expertise. The technique is designed as a group communication process aimed at achieving a convergence of opinion on a specific real-world issue. Our experts consisted of government officials (e.g., Nevada Secretary of State staff members), national on-line business organization firms, financial planners and accountants, law firms with business organization/corporate law practices, academia, taxpayer and business organizations, and economic development agencies & corporate relocation specialists.

Our central focus on product pricing and therefore, price elasticity, is a result of the consensus that Nevada no longer has a competitive product advantage over several other states. Because the Business License Fee is effectively a product and, as such, subject to price elasticity Nevada policy makers and Legislators should consider the use of price elasticities to properly analyze the effect of proposed tax changes (increases or decreases) on revenue changes.

In examining the demand for a product (e.g. incorporation in Nevada), price elasticity measures the responsiveness of demand after a change in price. The formula for calculating the co-efficient of elasticity of demand is: *Percentage change in quantity demanded divided by the percentage change in price.* In general terms, when price increases lead to decreased revenue the demand for the product is said to be price elastic. When the price increases cause revenues to increase demand is inelastic.

We use the concept of price elasticity to measure customer (e.g. business founders) response to price changes for a product (e.g. incorporation in Nevada). From the seller's (e.g., The State of Nevada Secretary of State Commercial Recordings Division or Nevada Budget Office) point of view; the price elasticity of demand is important information for determining appropriate product (e.g., articles of incorporation fees) pricing strategies.

The "own price elasticity of demand" specifically measures the degree of response of a product's volume (demand) to changes in the product price. Since the demand curves are generally downward-sloping in product price, "own price elasticities" are almost always assumed to be negative, so price increases reduce quantity demanded, all else being equal. "Own price elasticities" less than unity in absolute value are termed "inelastic", if the volume response is larger in percentage terms than the price change, then the elasticity is greater than 1 in absolute value and demand is "elastic".

To determine if the Governor's proposal will generate the revenues he alleges, we estimate the price elasticity of demand for the Nevada Secretary of State's Commercial Recordings Division's dominant goods by "foreign business organizations" only. That is, for businesses licensed in Nevada that are physically located or have a principal place of business somewhere other than Nevada (e.g., Wyoming). We use the "no-Nevada employee" and "no

Nevada nexus" as proxies for "foreign business organizations". As such, we estimate the elasticity of both initial and recurring filings of these entities and whether recent changes to the commercial recoding markets necessarily imply increasing own price elasticities for the Commercial Recording Division's current market dominant positions are sustainable.

Basically, the Governor's Office views the Business License Fee Increase segment of the Business License Fee & Gross Receipts Margin Tax as an "own price inelastic product" that will increase the State's revenues. In the wake of the proposed Business License Fee Gross Receipts Margin Tax, many parties have claimed that this same product has, in fact, become more price elastic over time. The reasons for this claim include factors such as increased competition from other jurisdictions and/or increased price sensitivity of registered agents and their customers as a result of the Great Recession. These claims bear on a number of important pricing issues, including the utility of exigent Business License Fee increases, and the effects of potential Business License Fee rebalancing of certain Secretary of State products.

The history of "own price elasticities from demand" models can provide convincing indications of the sensitivity of results to the inclusion of data from more recent years. If adding data to the end of the demand model sample causes a large increase in the measured elasticity, it would be appropriate to conclude that demands were becoming more elastic over time. However, it is possible that short (in terms of history) sample periods and other model assumptions could attenuate changes in elasticities, so the lack of longer-range trends in the elasticity histories is not dispositive to the question of whether own price elasticities are increasing.

Another important consideration in determining the impact of the proposed price increases on consumption is taxpayer behavior. A central assumption in public finance is that individuals optimize fully with respect to the incentives created by tax policies. Recent empirical work suggests that the salience of a tax dramatically shapes taxpayer behavior: the more salient a tax—i.e., the more prominent a good's after-tax price—the more taxpayers respond. Policymakers make decisions about tax salience, whether they intend to or not, every time they impose a new tax, yet the normative implications of those decisions remain poorly understood. The more salient a tax is, the more taxpayers adjust their demand in response to changes in the taxed good's after-tax price. High-salience taxes tend to be efficient when consumption of the taxed good generates negative externalities

SUMMARY OF TECHNICAL FINDINGS

The analysis resulted in six findings, each of which concerns the price elasticity of demand of the Business License Fee increase & Gross Receipts Margin Tax:

- The demand for Nevada Secretary of State Commercial Recordings' dominant products and services cannot be treated as "own price inelastic" for No-Nevada employee (foreign) entities. This implies that the proposed increases in the real prices of the market dominant commercial recordings products we evaluated(i.e., Incorporations, LLC, LLP, & LP)-specifically applied to the 200,000+ "No- Nevada Employee entities"- will not result in increased revenues for the State of Nevada in the near-term or long-term. Moreover, our analysis suggests that the proposed Business License Fee Gross Receipts will likely result in a reduction of 124,000 commercial recordings (LLC, LLP, LLLP, LP, and Incorporations) by Fiscal Year 2016 and a drop of 55% in new entities in FY2017. The majority of these are represented by members of the Nevada Registered Agent Association.

- If implemented, the proposed doubling of the Business License Fee on small business organizations coupled with the implementation of the Gross Receipts Margin Tax on larger businesses could lead to a mass exodus of small business commercial filings by existing business entities in the State of Nevada. Moreover, it will discourage the new filings within the State. It is an established fact that price elasticities are generally higher when competitive alternatives are more readily available. There are a number of close substitutes – the more close substitutes there are in the market, the more elastic is demand because consumers find it easy to switch. This is not only the result of Wyoming and other jurisdictions becoming increasingly viable in recent years, but the size of Nevada's actual and proposed Business License Fees in relation to the substitutes and other business formation costs. If in fact this exodus takes place, it will undoubtedly have a negative multiplier effect that results in a reduction in the size of the commercial registered agent community in Nevada.

- The growth and importance of the commercial registered agent community appears to be poorly understood in Nevada government circles. This community includes Nevada-based accountants and financial planners; Nevada-based lawyers; national business formation firms (e.g, Legal Zoom) and; most importantly, Nevada-based registered agents. This community's ability to quickly disseminate tax knowledge (increased tax salience) and alternative business formation strategies to their current and future clients will have an immediate and significant negative impact on the revenues of the Secretary of State.

- Current "jurisdictional switching" costs are generally minimal or mildly beneficial depending on the business concern's nexus with Nevada. The cost of switching between jurisdictions is minimal due to such competing state legislation as Wyoming's Foreign Limited Liability Company Articles of Continuance. This legislation allows Nevada LLCs to move the domicile of the LLC from Nevada to Wyoming and still keep the original date of organization. Moreover, the immediate, near- and long-term cost savings to the LLC could be significant. For example, if adopted, the State of Nevada's minimum $525 annual fee requirement ($400 Business License Fee + $125 annual List) will be ten (10) times that of Wyoming's $50 per annum fee.

- The price elasticity of demand for the State's business formation products will be significantly negatively affected by the increased cost for initial formation. Fees currently account for less than 25% of the average budget for business organizations in Nevada. The proposed fee increase will raise this to nearly 40% on average. This will result in a decrease in new Nevada business formations. The higher the percentage of the consumer's income that the product's price represents, the higher the elasticity tends to be - people will pay more attention when purchasing the product because of its cost. When the product represents only a negligible portion of the budget the income effect will be insignificant and demand inelastic. It is well established that the proportion of a consumer's income allocated to spending on the products that take up a high percentage of business equity or income will have a more elastic demand.

- Finally, we conclude that price estimates that use data only from an earlier, less competitive era will understate the elasticities of business formation costs today. For example, the fact that Nevada increased the Business License Fee in 2009 (from $100.00 to $200.00) and that this action resulted in a significant decrease in new filings represents this new, more competitive era, even though it was initially due to sunset in 2011. Thus, we believe we have now entered an era in which demand for a state business license has become price elastic. As such, we also believe that there will be a reduction rather than an increase in the demand for the increased price elasticity associated with the proposed increase of $200.00 per annum. When this increase is considered together with the added dimension of an insidious "Gross Receipts Margin Tax" on successful businesses, the reversal of previous Business License Fee increase, and the perennial threat of additional business tax increases, we believe there will be an increase in price elasticity that will result in even further declines in the demand for a state business license.

CONCLUSION

Overall, the message here is clear. The Governor's proposed Business License Fee & Gross Margins Tax should be rejected as detrimental to the State's near and long-term financial needs and pro-business reputation. Existing research and a cursory review of broad data aggregates show that a significant decline in revenues should be anticipated in the "foreign entity" business license segment of the proposal. Moreover, the proposal will increase non-compliance and filing avoidance by small businesses that have employees or nexus in Nevada.

Nevada policy makers often inquire about the impact of fee and tax changes on "small business" and "small business owners". Although many considerations motivate their concerns, two are particularly relevant. First, it is widely believed that small enterprises operate at a competitive disadvantage to their large competitors in terms of cost of capital and economies of scale. Second, these firms are perceived to generate a large share of overall economic and job growth. For these reasons, Nevada policy makers should take extra care in actions that excessively and unnecessarily burden small businesses or their owners.

Additionally, over the last twenty-five (25) years the Nevada Legislature together with the State's legal, accounting, financial planning, registered agent, and business formation professional communities developed and executed a series of strategic legislative actions with the intent to grow the business formation industry in Nevada.. This proposal seeks to undo all of that investment by gouging the "foreign entity" business community.

This technical paper has a narrow focus, so it did discuss the myriad of tax and fee-related issues that affect Foreign Entities or small businesses in Nevada. Our findings stop short of identifying what should be done to raise additional revenues, "in lieu of" the Governor's proposal or whether the proposed increased revenues have merit. Doing so requires a more complete knowledge of today's budgetary issues.

Finally, many large businesses in Nevada argue that Nevada's small businesses get a "free ride" because of the design of the tax system. However, one could argue that in the case of the 200,000 plus "foreign entities" that create no service demands in Nevada, it is Nevada that is the "Free Rider".

ABOUT THE AUTHORS

Our key team members include:

David A. Swanson (Ph.D.) is Professor of Sociology at the University of California, Riverside and former Director of the Center for Population Studies at the University of Mississippi. He served as member of the U. S. Census Bureau's Scientific Advisory Committee for six years and chaired the group for two years. Dr. Swanson has authored or co-authored over 85 refereed journal articles on public policy, regional and economic impacts, gaming, taxes and demography.

Robert Schmidt (J.D., Ph.D.) is Director and Senior Fellow at DSII, a public policy consulting firm specializing in governance systems, economic development, demography and regional modeling. Dr. Schmidt has authored numerous peer-reviewed articles on: Nevada and federal tax policy, Nevada' educational system, regulatory schemes and public policy over the last two decades. Dr. Schmidt has taught graduate courses in management, international corporate governance and public policy in the U.S. and Europe. Dr. Schmidt has consulted on tax and education system design throughout the world.

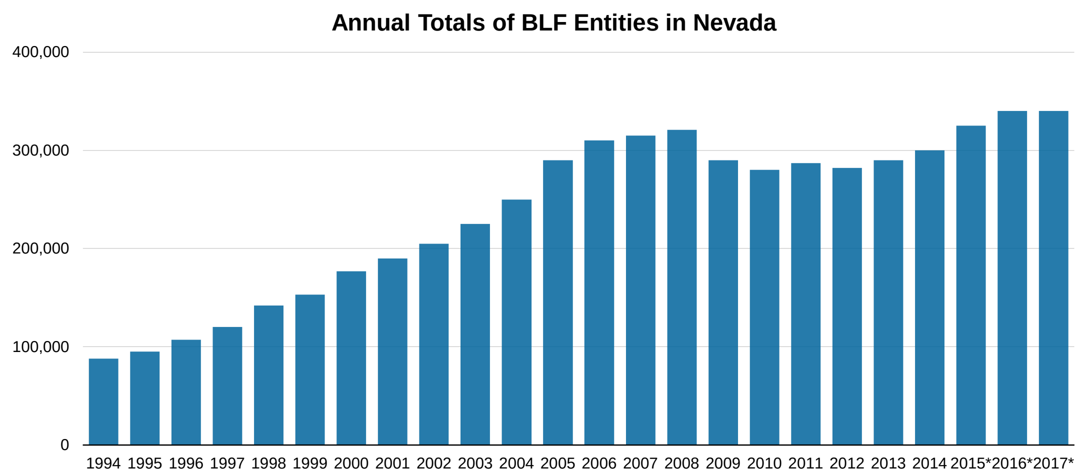
John Ziebell (M.A., M.F.A.) is Professor of English at College of Southern Nevada. John has written many papers on the educational system in Nevada and has also chaired numerous workshops on educational issues in Nevada. This work led to the growth of the vocational, charter and magnet school initiatives in Nevada. Mr. Ziebell has worked extensively with Nevada's high school teachers on college preparation issues.

Dr. David Atkinson, (Ph.D.) Dean Emeritus at Helsinki School of Economics (now part of Aalto University) Dr. Atkinson has over seventeen years of experience as dean in three different deanships. He also has several years of experience in teaching political science, international business, and research methods.

Katriina Talja, (M.Sc.) Research Analyst, has a Master of Science in Economics and Business Administration. She has assisted in the conduct of several economic and tax policy projects.

Table 1

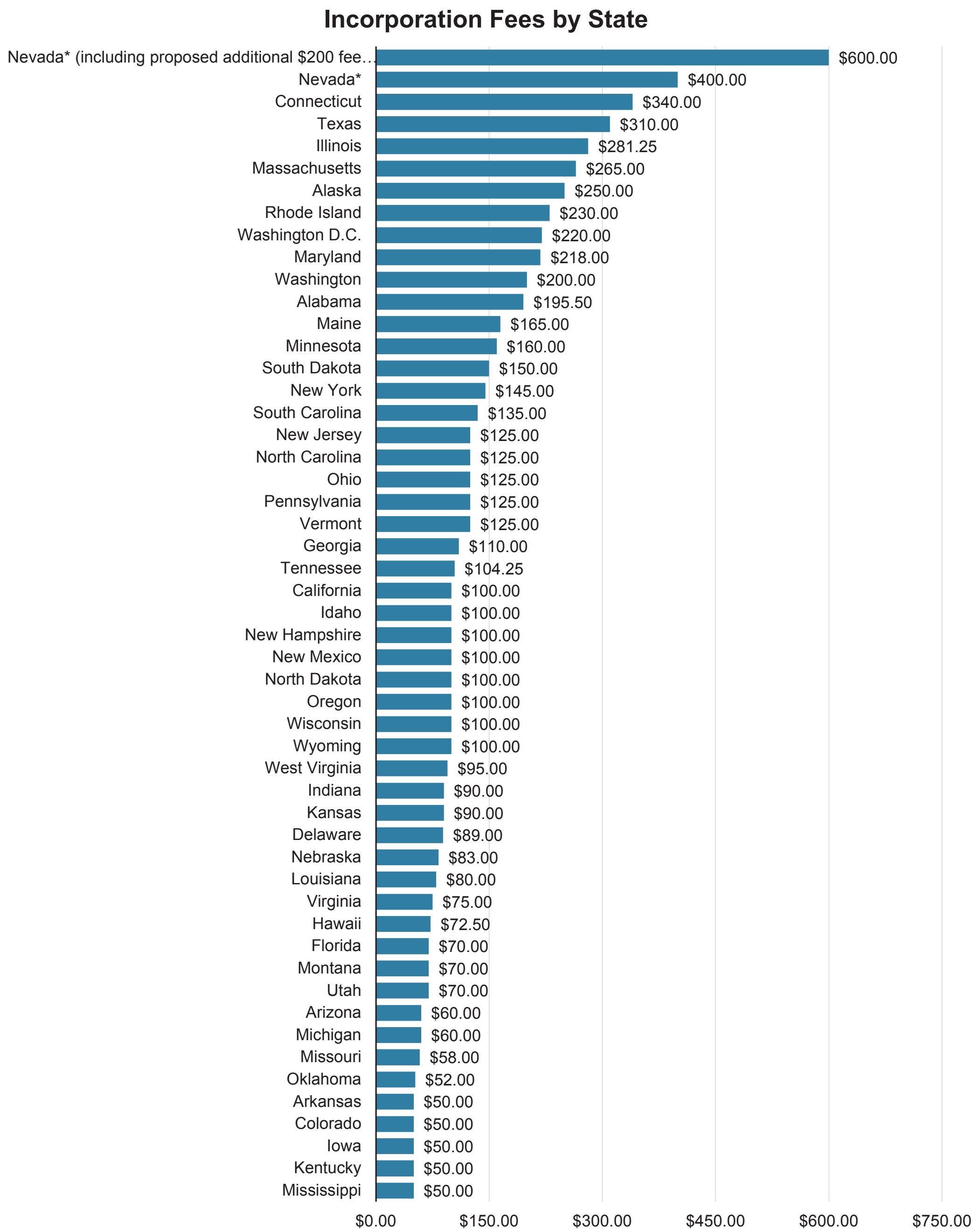
1994	88,000							
1995	95,000							
1996	107,000							
1997	120,000							
1998	142,000							
1999	153,000							
2000	177,000							
2001	190,000							
2002	205,000							
2003	225,000							
2004	250,000							
2005	290,000							
2006	310,000							
2007	315,000							
2008	321,000							
2009	290,000							
2010	280,000							
2011	287,000							
2012	282,000							
2013	290,000							
2014	300,000							
2015*	325,000							
2016*	340,000							
2017*	340,000							



*Projected

Sources:
FY 2015-2017 projections are from the Governor's FY2016-2017 budget
FY1994-2014 are from the Secretary of State's Office

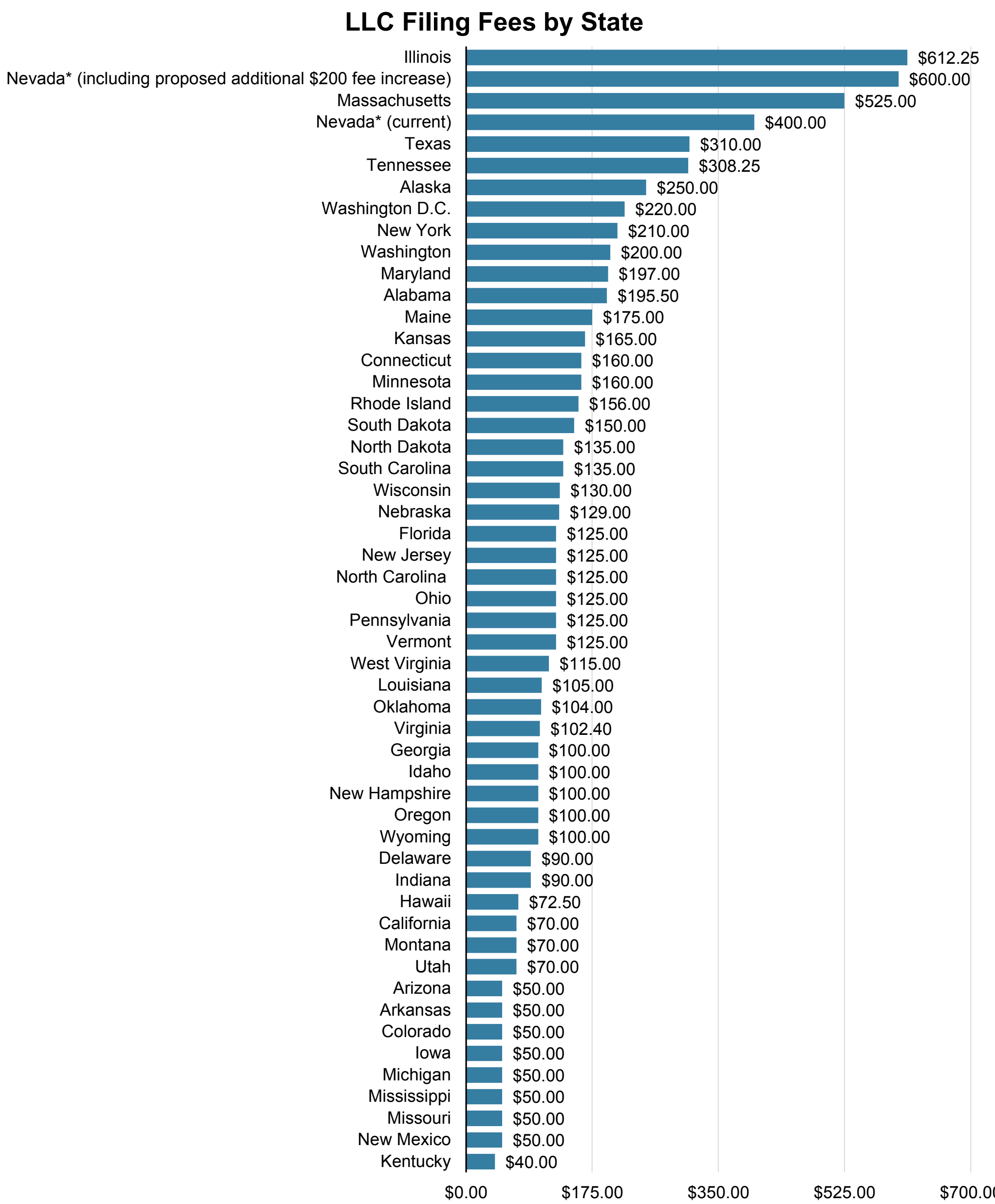
State	Incorporation Fee
Nevada* (including proposed additional $200 fee increase)	$600.00
Nevada*	**$400.00**
Connecticut	$340.00
Texas	$310.00
Illinois	$281.25
Massachusetts	$265.00
Alaska	$250.00
Rhode Island	$230.00
Washington D.C.	$220.00
Maryland	$218.00
Washington	$200.00
Alabama	$195.50
Maine	$165.00
Minnesota	$160.00
South Dakota	$150.00
New York	$145.00
South Carolina	$135.00
New Jersey	$125.00
North Carolina	$125.00
Ohio	$125.00
Pennsylvania	$125.00
Vermont	$125.00
Georgia	$110.00
Tennessee	$104.25
California	$100.00
Idaho	$100.00
New Hampshire	$100.00
New Mexico	$100.00
North Dakota	$100.00
Oregon	$100.00
Wisconsin	$100.00
Wyoming	$100.00
West Virginia	$95.00
Indiana	$90.00
Kansas	$90.00
Delaware	$89.00
Nebraska	$83.00
Louisiana	$80.00
Virginia	$75.00
Hawaii	$72.50
Florida	$70.00
Montana	$70.00
Utah	$70.00
Arizona	$60.00
Michigan	$60.00
Missouri	$58.00
Oklahoma	$52.00
Arkansas	$50.00
Colorado	$50.00
Iowa	$50.00
Kentucky	$50.00
Mississippi	$50.00



*Including $125 Initial List of Members/Officers Fee and $75 “Articles of Incorporation”

1

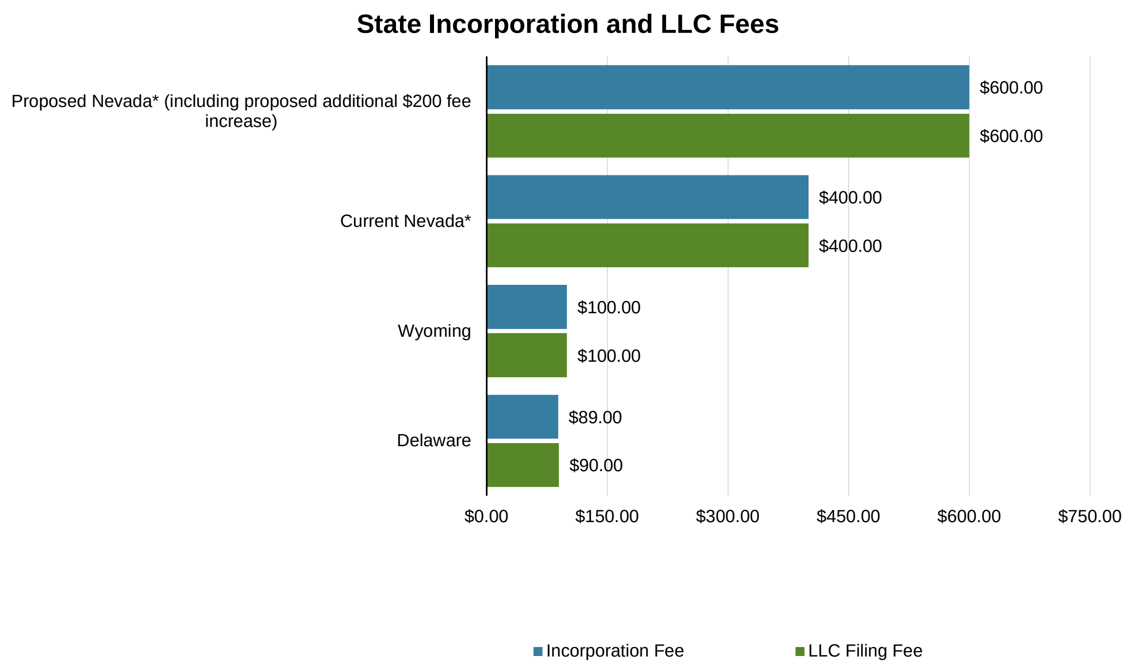
State	INC	LLC
Illinois	$281.25	$612.25
Nevada* (including proposed additional $200 fee increase)	$600.00	$600.00
Massachusetts	$265.00	$525.00
Nevada* (current)	**$400.00**	**$400.00**
Texas	$310.00	$310.00
Tennessee	$104.25	$308.25
Alaska	$250.00	$250.00
Washington D.C.	$220.00	$220.00
New York	$145.00	$210.00
Washington	$200.00	$200.00
Maryland	$218.00	$197.00
Alabama	$195.50	$195.50
Maine	$165.00	$175.00
Kansas	$90.00	$165.00
Connecticut	$340.00	$160.00
Minnesota	$160.00	$160.00
Rhode Island	$230.00	$156.00
South Dakota	$150.00	$150.00
North Dakota	$100.00	$135.00
South Carolina	$135.00	$135.00
Wisconsin	$100.00	$130.00
Nebraska	$83.00	$129.00
Florida	$70.00	$125.00
New Jersey	$125.00	$125.00
North Carolina	$125.00	$125.00
Ohio	$125.00	$125.00
Pennsylvania	$125.00	$125.00
Vermont	$125.00	$125.00
West Virginia	$95.00	$115.00
Louisiana	$80.00	$105.00
Oklahoma	$52.00	$104.00
Virginia	$75.00	$102.40
Georgia	$110.00	$100.00
Idaho	$100.00	$100.00
New Hampshire	$100.00	$100.00
Oregon	$100.00	$100.00
Wyoming	$100.00	$100.00
Delaware	$89.00	$90.00
Indiana	$90.00	$90.00
Hawaii	$72.50	$72.50
California	$100.00	$70.00
Montana	$70.00	$70.00
Utah	$70.00	$70.00
Arizona	$60.00	$50.00
Arkansas	$50.00	$50.00
Colorado	$50.00	$50.00
Iowa	$50.00	$50.00
Michigan	$60.00	$50.00
Mississippi	$50.00	$50.00
Missouri	$58.00	$50.00
New Mexico	$100.00	$50.00
Kentucky	$50.00	$40.00



*Including $125 Initial List of Members/Officers Fee and $75 "Articles of Incorporation"

1

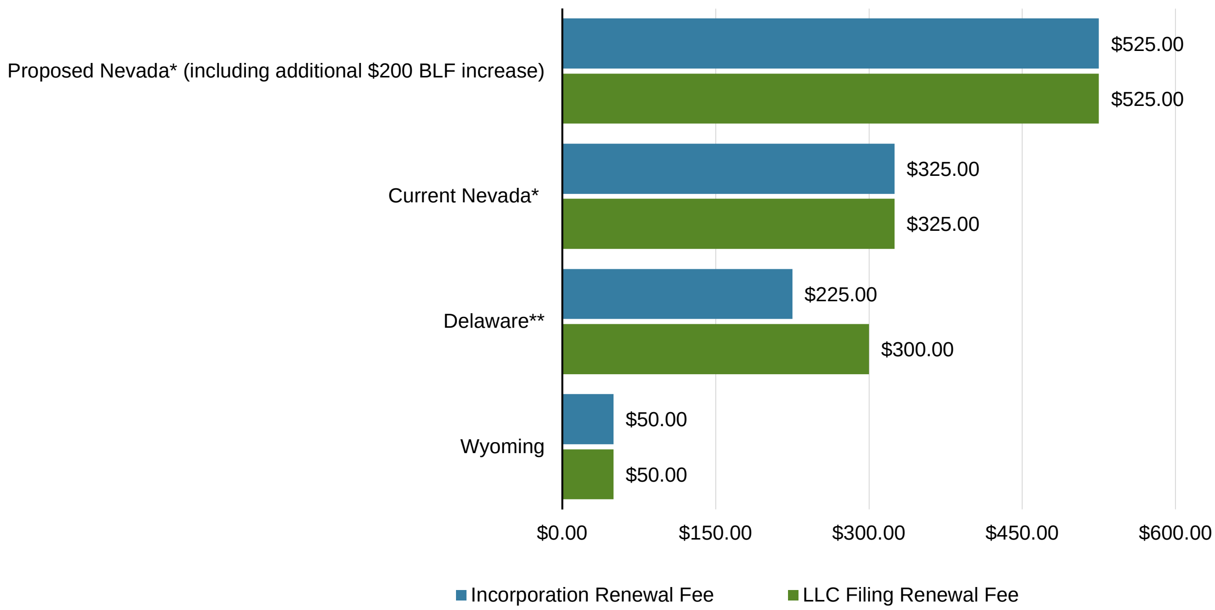
State	INC	LLC	
Proposed Nevada* (including proposed additional $200 fee increase)	$600.00	$600.00	
Current Nevada*	$400.00	$400.00	
Wyoming	$100.00	$100.00	
Delaware	$89.00	$90.00	



*Including $125 Initial List of Members/Officers Fee and $75 "Articles of Incorporation"

	Incorporation Renewal Fee	LLC Filing Renewal Fee		
Proposed Nevada* (including additional $200 BLF increase)	$525.00	$525.00		
Current Nevada*	$325.00	$325.00		
Delaware**	$225.00	$300.00		
Wyoming	$50.00	$50.00		

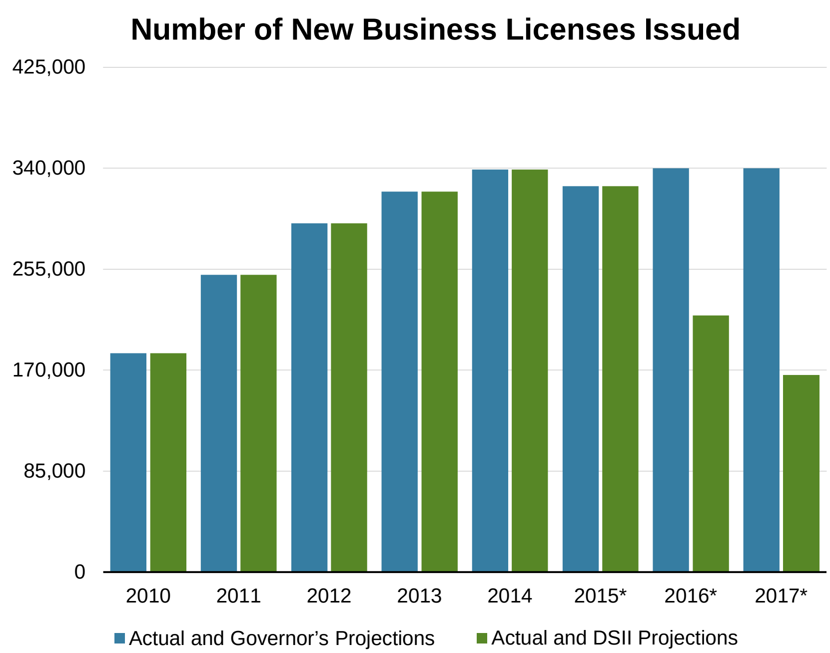
State Incorporation and LLC Formation Renewal Fees



*Including $125 Initial List of Members/Officers Fee and $75 “Articles of Incorporation”

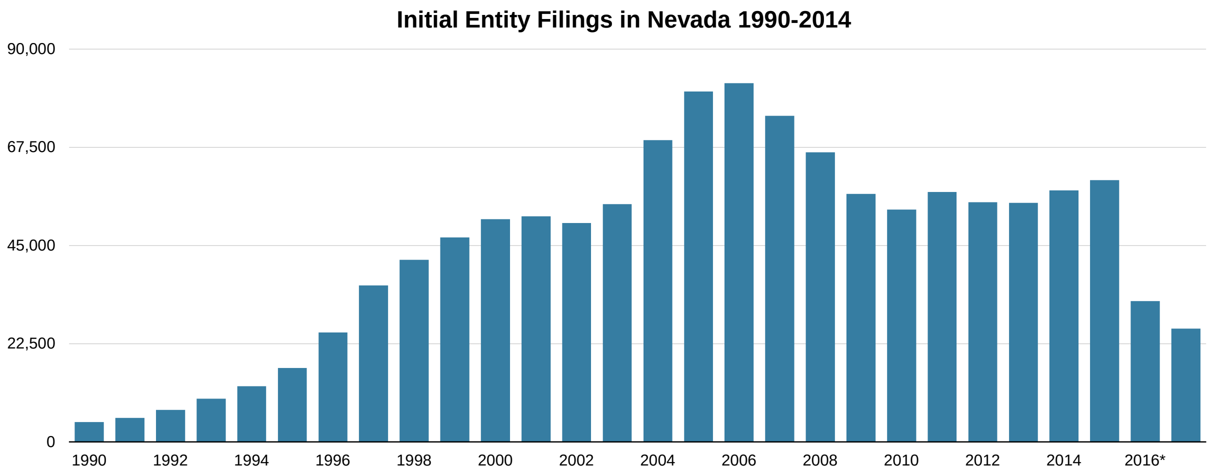
**Composed of $50 annual report fee and a minimum tax of $175

Year	New Business Licenses Issued	Actual and DSII Projections			
2010	184,101	184,101	Actual		
2011	250,236	250,236	Actual		
2012	293,500	293,500	Actual		
2013	320,231	320,231	Actual		
2014	339,015	339,015	Actual		
2015*	325,000	325,000	Projected		
2016*	340,000	216,000	Projected		
2017*	340,000	166,000	Projected		



*Projected Number of New Business Licenses Issued

Sources:
The actual numbers are from the Nevada Secretary of State's Office;
For FY2015-2017, the projected numbers in blue are from Governor Sandoval's Budget projections;
For FY2015-2017, the projected numbers in green are based on DSII projections



*Projected from DSII Report

Footnote: Slight differences in the data between fiscal year and calendar year conversions may occur

Incorporation Advantages in Delaware, Wyoming and Nevada

Advantages	Delaware	Wyoming	Nevada
Extensive Business Case Law	x		
Separate Business Court	x		
No state corporate income tax		x	x
No tax on corporate shares	x	x	x
No franchise tax		x	x
Minimal annual fees		x	
One-person corporations allowed	x	x	x
Stockholders are not revealed to the State	x	x	x
No annual report is required until the anniversary of the incorporation date		x	
Unlimited stock is allowed, of any par value	x	x	
Bearer stock can be used		x	
Nominee shareholders are allowed		x	
Share certificates are not required		x	x
Minimal initial filing fees		x	
No minimum capital requirements	x	x	x
Meetings may be held anywhere	x	x	x
Officers, directors, employees and agents are statutorily indemnified		x	x
Continuance procedure (State can adopt a corporation formed in another state)		x	x
Doesn’t collect corporate income tax information to share with the IRS		x	x