RESEARCH BRIEF

Louisiana's Taxes: Problems, Solutions and the Controversy of Reform

April 2013

Executive Summary

Louisiana's tax system can be improved. The right changes could upgrade the state tax code to encourage business development, lower rates, reduce exemptions and tax breaks, simplify filings, shift more responsibility to local governments and provide a more efficient collection and compliance mechanism.

While the Governor's Plan A proposal attempted to meet several important goals, it eventually became a large package of repeals, tax breaks, entitlement programs and other expenses that were difficult to offset with sufficient new revenues. Based on estimates that were still under development, the anticipated annual revenue losses and other costs were well more than $4 billion. It is doubtful that the plan would have provided a simpler, fairer or more evenly applied tax system, which are primary goals of a good tax policy.

The lessons and observations about the Plan A tax swap should be kept in mind as alternative plans are introduced. Several other tax reform plans have been suggested, including some that would repeal individual income taxes in the near or long term. The real costs of these plans should be weighed, especially in light of the recent experience with Plan A.

The public discussions of tax repeals should not overlook an important factor: the elimination of a tax carries a greater revenue cost than just the amount of money the tax collects. Tax credits that are now counted against those tax collections will reappear as a state expense unless the credits, too, are eliminated.

More importantly, the real problems with Louisiana's tax system need to be recognized and addressed. A repeal of the individual income tax, if accomplished, might still leave the state with a long list of nagging tax problems and cost burdens. And the state might have less flexibility in dealing with them.

This report outlines the major tax problems facing the state and reviews some of the potential solutions to improve the system. The report also reviews the approach taken by Plan A, which offers lessons about alternative tax plans. Considering the collapse of this plan, and the lateness of the hour, and the current lack of consensus on tax reform strategies and their financial impacts, neither a major tax-swap overhaul nor a repeal of the individual income tax should be the goal of this legislative session.

For this session, officials have missed the opportunity of crafting a well-conceived plan with broad public support and understanding. There is loose talk of moving forward with profound long-term tax cuts and letting future leaders inherit the hard choices and problems that would flow from that decision. That approach lacks courage and real leadership.

The Legislature can begin to establish a new set of priorities for tax reform in light of the full spectrum of tax problems facing the state. The issues outlined here could be discussed, evaluated and estimated for their potential fiscal and political impacts. A new consensus could be formed about meeting the real needs of the state in a realistic manner.

Problems, fixes and reforms in the state tax system

What are the major shortcomings or competitive disadvantages of Louisiana's system of taxes and exemptions? And what are the potential solutions? What follows is an outline of key tax issues and the problems associated with them. The report also identifies potential solutions worthy of discussion and in some cases notes some of the advantages or disadvantages of those strategies. These solutions may not be the only ways to address the challenges, but they illustrate that reform is possible.

Corporate franchise tax

Problems: The complicated corporate franchise tax can be a disincentive to capital investment and headquarters operations. It creates serious compliance headaches for business and regulators. It is estimated to generate about $84 million next year, a significant amount in a tight budget but a relatively minor source of revenue for the state that feasibly could be offset.

Potential solutions: The state can eliminate it entirely or reduce it to a small, simplified, capped tax liability. The elimination of some sales tax exemptions could be one way to offset the revenue loss.

Noteworthy: A repeal could cost the state somewhat more than $84 million if some tax credits are retained.

Corporate income tax

Problems: The corporate income tax carries an upper rate on net corporate income of 8 percent, which is on the high side for the Southeast region. But 8 percent is not the actual effective rate that many companies pay: deductions and credits make for lower tax bills. These exemptions add complexity and obscurity. Corporate income taxes are by their very nature volatile revenue producers because they are based on corporate profits that sway with boom and bust economic cycles.

Potential solutions: The state could change the tax brackets to arrive at a decreased upper rate. To offset reduced rates, the state could consider changes to reduce exemptions, including the federal tax deduction and modifications to the net operating loss exemption.

Noteworthy: If the corporate income tax were repealed, the state would continue to bear the large cost of the inventory tax credit and other ad valorem credits if those programs were retained. (See below.)

Individual income tax

Problems: The individual income tax carries an upper rate of 6 percent, starting at $50,000 of taxable income for single filers and $100,000 for joint filers. This upper rate is on the high side for the Southeast region, but it is a more competitive tax overall when the rates, brackets and deductions are taken into account. Deductions and credits make for a lower effective rate but add complexity. The allowance for federal tax deductions is a source of state income tax instability. Because federal income tax deductions reduce a filer's state taxable income, higher federal taxes result in lower state income taxes, and lower federal taxes result in higher state income taxes.

Potential solutions: The state can eliminate deductions -- such as the federal tax liability and excess itemized deductions -- and lower the rates. To do this, the state could reduce the existing bracket rates or create a flat tax. The tax would need to be structured so that the new rates would not result in a higher tax bill for people in the lower income ranges. Standard deductions would be one way to address that circumstance. As for the destabilizing relationship between federal deductions and state taxes, the federal deduction should be eliminated or reduced, not only to allow lower tax rates but to provide more stability to state taxpayers and state income tax revenue. Lower rates could be achieved by other reduced exemptions, including the rebate for the Citizens property insurance assessment, private school tuition deduction and the limitation or eventual sunset of tax credit programs.

Noteworthy: Unlike corporate and sales taxes, the individual income tax is easy to administer and creates few compliance problems, although it is abused by false returns and identity theft. The tax is slightly more volatile than the existing sales tax but provides stronger annual revenue growth for the long term.

Sales taxes

Problems: Louisiana's overall sales tax rate is high. The state has the third highest combined state and local sales tax rate in the nation and the fourth highest per capita sales tax burden. The average local sales tax in Louisiana is the highest of any state in the nation. Higher sales taxes tend to place a disproportionate tax burden on lower-income individuals and families. High sales tax rates encourage groups to seek legislative exemptions, thereby redistributing the tax burden unevenly. Local governments have become heavily dependent on a combination of sales taxes and state subsidies to run their operations and schools. Any increase in the overall sales tax rate could have consequences for local governments pursuing sales tax renewals or new initiatives. The sales tax in Louisiana has become a complicated mix of state versus local exemptions and rates that vary from place to place. Compared to individual income taxes, the sales tax creates more administrative and compliance headaches. Louisiana's sales taxes are based on the sale of goods but only on a few services, which make up a growing portion of the economy.

Potential solutions: The state should resist higher sales tax rates. In fact, the state could decrease sales tax rates by eliminating some exemptions. An expansion of the sales tax base to services could be pursued in the interest of lowering sales tax rates and broadening the base, provided the tax would not apply to business purchases that would create the damaging effect of tax pyramiding. (See discussion below.) However, such a policy move would have a significant tradeoff: the compliance and regulatory system would become more complicated and less transparent for both the government and taxpayers. Any such broadening of the sales tax base must be carefully and deliberately imposed.

Noteworthy: In Louisiana, sales taxes on goods have provided a relatively stable source of state revenue while the individual income tax has provided stronger revenue growth more in line with the economy over the long term.

Sales tax collections

Problems: The sales tax collection system in Louisiana -- divided between the state and parishes – is outdated, inefficient and out of line with best practices in most other states. The collection and audit system is an unnecessary burden on businesses. Louisiana is one of only a few states in which local sales taxes are administered and collected by local taxing authorities. The current system is unnecessarily complicated and time-consuming for businesses that operate in multiple parishes.

Potential solutions: The state should simplify and centralize sales tax collections and compliance. This move could be a first step toward eventual compatibility with proposed federal legislation that would facilitate the equitable collection of sales taxes for online and other remote purchases. The new system should be designed to eliminate redundant audits and inefficiencies in administration for government and business. Ideally, a new system would ensure that Louisiana is consistent with those other states that have adopted modern, unified tax collection and administration methods for traditional and e-commerce transactions. The improvement should result in the collection of revenues that otherwise would be lost due to poor, inconsistent and inequitable enforcement by an outdated system.

Noteworthy: Local sales tax collection authority is protected in the state Constitution. The most effective way to streamline collections would be to enact a state constitutional amendment allowing a more efficient structure.

Fuel taxes

Problems: Louisiana fuel taxes – the basis of state revenue and matching federal funds for roads, bridges and transportation infrastructure – are on a flat growth line with diminishing buying power. Like the federal fuel tax, the state's taxes on gasoline and diesel fuel are an excise tax charged by the gallon, not by the value of the product. Only 10 other states have a lower gasoline tax. Louisiana's combined state and federal tax on gasoline is 38.4 cents per gallon compared with the national average of 48.7 cents. Louisiana diesel fuel taxes have a similar ranking. Motorists benefit directly from the lower tax but also may be disadvantaged indirectly from the resulting level of road work.

Increased fuel efficiencies for freight trucking and passenger vehicles affect fuel consumption and therefore curb revenue growth. This form of excise tax provides a stable revenue stream but offers a limited prospect for growing with the economy. If Louisiana reaches a point where it is leaving large amounts of federal money on the table because of insufficient state federal matching dollars, we will know that a critical stage has been reached.

Potential solutions: A serious discussion is needed about the prospect of restructuring the state's source of revenue for transportation projects. It is a tough problem. Nationwide, ideas have been suggested to base road taxes on vehicle mileage, but no consensus has formed on how to implement such a system effectively. If applied fairly and efficiently, a mileage tax would be a good solution.

Highway and bridge projects are often financed with bond packages that rely on steady annual sources of revenue. Some implementation of a sales tax based on value could be considered, although this avenue might also produce volatile revenue receipts over time. To deal with this possibility, the state could use a value tax but set a floor for how low the per-gallon tax could go, which was proposed in Virginia.

An important consideration: if Louisiana fuel prices are not competitive with other states, then interstate truckers could discriminate about where they buy their fuel. Louisiana's fuel tax rates are tied with Texas, slightly higher than Mississippi and slightly lower than Arkansas.

A simple solution would be to keep the current tax and index it for inflation, although this is not necessarily a permanent solution in light of fuel consumption trends. A 2008 state law was intended to boost road work with money from vehicle sales taxes and truck registration fees, but money has not been shifted because of tight budgetary conditions; the framework of this law could be revisited.

Noteworthy: The amount of fuel tax revenue for the state transportation trust fund was less last year than it was 10 years ago. The revenue fluctuated upward at most 6 percent during that period. Importantly, after a four-year hiatus, the state last year again began tapping the trust fund for State Police operations, leaving less money for transportation projects.

Inventory tax and credits

Problems: Louisiana's inventory tax system is a growing expense for the state. In Louisiana, businesses pay an ad valorem tax on inventory to local governments. The state offers a tax credit to those businesses that pay the local levy. So the locals receive inventory tax revenue, while the state compensates the companies for the expense. Basically, the state is paying taxes to local governments through this mechanism. Most of this annual cost for the state is embedded as credits in the corporate income and franchise taxes, so the state expense does not show up as a spending item in the annual appropriations budget. Not all companies that pay an inventory tax get the state tax credit.

The use of the tax credits is expanding; further economic development in the state could expand its use even more. If corporate taxes are eliminated and the inventory tax credit program is retained, the program will still be a major state cost – presumably in the form of cash payments. Inventory tax credits will cost the state about $388 million this year; additional ad valorem tax credits will cost about $55 million. Within three years the overall ad valorem tax credits programs could cost the state more than $600 million annually.

Potential solutions: All potential solutions to this problem are controversial. Based purely on best practices in other states, Louisiana should have no inventory tax and no offsetting state tax credit. Of course, if the inventory tax were eliminated, local governments would lose a substantial source of revenue. Another idea would be to repeal or phase out the inventory tax and let local governments compensate by raising or phasing in new revenue through other means. The state could limit the tax credit program by setting caps or by offering the tax credits at less than 100 percent coverage. This plan would limit or reduce the state's liability, but would place a new cost on business.

Another potential solution would be to eliminate the inventory tax and establish a new form of state subsidy directly to local governments to make up for the lost revenue. Under this plan, businesses would be free of the tax and the state would continue to subsidize local governments, but the state's cost would not have to increase annually at the high inflationary rate as it does with the tax credit program. This solution would be complicated by the fact that not all companies paying the inventory tax are eligible for the tax credits.

Noteworthy: Some parishes rely on inventory tax collections more than others. So, a local replacement tax might not be equitable for all local governments.

Incentive programs

Problems: Overly generous or misaligned incentive programs should be re-evaluated. Some state incentives to encourage particular economic activities or to offer rewards for job creation are becoming expensive and need better maintenance or limitations to ensure greater efficiency and to protect the broader public interest.

Potential solutions: In particular, the movie tax credit program and the Enterprise Zone program need adjustments, and the administration has proposed good reforms. Other tax credit programs should be considered for adjustments or eventual phase-out. For all programs, the state should refrain from expanding the terms and expense of the incentives unless a strong return on investment can be convincingly demonstrated. The state should resist creation of new programs and set firm goals and expectations for existing incentive programs.

Noteworthy: If corporate and individual income taxes are repealed and the state keeps its incentive tax credits, the incentive programs would be a continued annual expense that the state would have to maintain, either by finding a different tax offset or by converting the business subsidies to cash payments.

Property taxes
Problems: Louisiana's unusually high homestead exemption on property assessments and the disparities in property value assessments in some areas have the effect of spreading property tax burdens unevenly among homeowners and between residents and business.

Potential solutions: Louisiana's homestead exemption for property tax assessments should not be increased. Also, the state should not create more exceptions that allow higher exemptions for homeowners in special circumstances. The state should consider lowering the homestead exemption over a period of years to assist local government. Similarly, other tax exemptions, such as the industrial exemption, should be reviewed and evaluated. The scope and ownership of properties subject to the property tax should also be reviewed and evaluated.

Noteworthy: Over time with increasing home values, the revenue impact of the homestead exemption will become less significant, unless it is raised.

Dedicated revenues
Problems: New sources of tax revenue intended to support the general fund should not be broken into pieces to create permanent dedicated income streams for minor special funds and projects. This practice erodes the general fund, builds pressure to maintain higher tax rates and undermines the Legislature's authority to make priorities in the annual appropriations process.

Potential solutions: For example, if the state decides to raise tobacco taxes to offset tax cuts, the full new revenue stream should be available to the general fund.

Noteworthy: Many people view higher cigarette taxes as a smoking deterrent, and therefore a health policy, rather than as a tax and revenue generator. At some point, higher tobacco taxes could result in less revenue.

Insurance premium taxes
Problems: Louisiana has relatively high tax rates on insurance premiums compared with other states. (As in other states, these taxes are based on insurance company premium receipts, not profits, and are a relatively stable form of state revenue.) The high rates create some negative effects and deter insurers from establishing headquarters operations in Louisiana.

Potential solutions: The Department of Insurance and the Legislature should form a consensus long-term plan for reforming the premium tax that would address fairly the interests of business, government, taxpayers and the insured.

Noteworthy: Insurance companies can seek tax relief by offsetting some of their premium taxes from their corporate income taxes.

Local versus state responsibility
Problems: Discussions about tax reform often overlook the role that taxes play in Louisiana's structure of government. Louisiana's tax structure corresponds to the relationship and the assignment of responsibilities between state and local governments. To some extent, Louisiana emphasizes state revenue collection and spending to the detriment of local autonomy and responsibility. Louisiana is not exceptionally unusual in this regard but it places more emphasis on state financing than neighboring Texas. For example, in Texas, local

governments generally take greater responsibility for education and community colleges. Louisiana provides many subsidies for local governments in the form of school funds, law enforcement support, business incentives and, indirectly, the inventory tax credit. Tax code changes could move the state closer to or further from this practice.

Potential solutions: The framework for discussion about tax reform in Louisiana needs to be elevated beyond the single concern about which tax types are best for the state. We should be looking at our state and competing states to consider how local and state governments can best share the responsibility for public services and the distribution of tax revenues.

Noteworthy: Interesting food for thought about community development in the global economy can be found in the recently published book "The New Geography of Jobs" by Enrico Moretti.

The Governor's Plan A

Although the governor has set aside his so-called Plan A tax proposal due to the lack of popular support, a number of other options are on the table for discussion this legislative session and more are sure to be suggested in the months and years to come. The lessons of Plan A – what went wrong and what went right – offer important guidance about the next stages of the tax reform debate.

Plan A called for the elimination of the individual and corporate income taxes and the corporate franchise tax. The administration was committed to devising a plan that would be revenue neutral, meaning that lost revenues and other costs to the state would be offset by new revenue sources. The administration also tried to devise a plan that would not increase the tax burden on the poor or those with modest retirement income from the government. The offsets were to be achieved mainly with a higher sales tax rate and an expansion of the sales tax to include many services and some goods not currently taxed. Higher cigarette and tobacco taxes were also in play. Early on, a state property tax was considered and then rejected.

Top administration officials with the Department of Revenue and Louisiana Economic Development worked vigorously over many months and consulted with many experts and industries to construct Plan A. They encountered practical and political obstacles along the way that were difficult to foresee, and in many cases they made adjustments to the realities as they saw them. This process is very important as a reference for future policymakers. Current and future reform efforts are sure to run into some of these same issues, and we should learn from them.

Plan A became a very large proposition with an overall price tag of $4.4 billion in revenue losses and other costs that had to be offset, using fiscal year 2015 as the target year to demonstrate revenue neutrality. In the end, that cost proved difficult to surmount even with a high sales tax rate and controversial revenue measures to offset it. While in theory a tax swap might have been devised to reach the goal, the administration's plan by the beginning of the session was still in development and had not established a firm grip on revenue neutrality.

Based on state estimates and committee testimony, the program had several major cost components. The individual income tax was valued at about $2.8 billion and the corporate income and franchise taxes were valued at $340 million. The administration wanted to keep a number of tax-revenue based economic development incentives (while downsizing or tailoring some of them) at a cost of more than $400 million. More than $600 million in inventory tax credits and other ad valorem credits, which are counted mostly against corporate income tax, would have been maintained and had to be counted as a cost to the state under the plan. A subsidy for low-income people – potentially with 650,000 recipients forming the largest entitlement program run by the state social service agency – plus a subsidy for certain retirees would have cost about $200 million. Various other tax credits costs were added. The overall amount was nearly half the size of the annual state general fund.

Offsetting these costs and revenue losses would not be easy. The existing 4-percent state sales tax was bringing in about $2.7 billion (plus vehicle sales taxes of $416 million), and officials had to expand that tax to generate new revenue. A higher state sales tax rate of 5.88 percent was proposed, later raised to 6.25 percent. This would have created a combined state-local sales tax rate in the neighborhood of 11.25 percent for most purchases in many places, giving Louisiana the distinction of the highest overall sales tax rate in the nation. Even at this rate applied to existing taxable sales, the administration was only about a third of the way toward its goal to become revenue neutral. An expanded taxable sales base was needed to generate more revenue.

The first place to look was at the $2.5 billion in sales tax exemptions allowed by nearly 200 exclusions or exceptions under state law. In the end the administration identified 76 sales tax exemptions to eliminate. But they were of small or zero value, totaling less than $100 million. Why was the administration able to target for elimination only 4 percent of the $2.5 billion in sales tax exemptions? This exercise was instructive. Many of the biggest sales tax exemptions are tax breaks aimed at the general population, and the Jindal administration left these alone. Sales of food for home consumption, prescription drugs and residential utilities are not taxed by the state, taking $900 million of potential tax revenue off the table. Gasoline and diesel fuel are levied an excise tax rather than a sales tax, but the state nevertheless counts that as a sales tax exemption valued at almost $400 million. Purchases by state and local governments are free of state sales tax, offering an exemption worth more than $200 million.

With all of those general public exemptions untouched, the administration looked at what others remained, which was about $1 billion worth of exemptions mostly affecting businesses. The administration had hoped these would provide a rich mine of items to be extracted from the exemptions list. From the start, exemptions for the sale of manufacturing machinery and equipment and business utilities were left alone, partly because the state had made these a significant symbol of economic development competitiveness. Agricultural interests also were allowed to keep their breaks. One after another, the other exemptions on the list presented dilemmas. Some were on the books because they protected the Interstate Commerce Clause of the U.S. Constitution, some were there to prevent double taxing of certain lease transactions, and others were simply legal clarifications.

The administration also avoided taxing business inputs on goods. For example, a business input might be materials consumed in a manufacturing process; sound tax policy would not place a sales tax on those goods, but only on the sale of the end product. Doing otherwise would cause tax pyramiding, in which the end product's price is higher due to a series of embedded taxes along the manufacturing process. In adopting sound tax policy on goods, the administration was hurting its chances of obtaining revenue neutrality for its tax plan.

The next exercise was to expand the sales tax to services. The administration picked a list of services to be taxed. The list included service transactions for accounting, architecture, engineering, scientific consulting, software development, data management, haircuts, taxi rides and many others. Off the list were legal fees, construction, financial transactions and many more. Working for the administration, consultants with the Ernst & Young accounting firm added up the value of all business revenue in these proposed taxable sectors in Louisiana. They used federal government data and discounted for certain factors that appeared to be reasonable assumptions. For example, they figured the state would capture taxes on only 75 percent of service sales to Louisiana customers from vendors outside the state.

However, the Ernst & Young figures did not discount for service sales to governments or for service transactions that might contribute to tax pyramiding. The week before the session, the Council on State Taxation released a study by the same Ernst & Young consultants, who sharply criticized the practice of tax pyramiding by taxing business service inputs. At this point, the amount of sales tax revenue that the administration had projected to get from services was in question and was being re-evaluated. Either the administration would have to revise its figures or remain on the road toward unsound tax policy. Meanwhile, the Legislative Fiscal Office, which would have the final word on the cost and revenue projections, was still a long way from completing its own calculations and was raising many questions about the plan.

Whatever the many reasons the Governor had for "parking" Plan A, the tax swap at that point had yet to demonstrate with confidence that it would become revenue neutral unless additional changes were made. Part of its problem was that its architects were willing to recognize and incorporate some of the less apparent costs and inflationary factors associated with the plan, and part of the problem was that the process entailed an enormous learning curve for everyone involved. The task called for bewildering calculations with such huge consequences at stake.

Alternative tax plans

The lessons of Plan A are vitally important to the debates on alternative plans, especially those involving the elimination of income taxes. The cost of repealing the individual income tax is more than the cost of the lost revenue from the tax. That's because any retention of tax breaks and credits must be counted as a cost also. Likewise, the corporate income tax can be repealed, but the cost of the state inventory tax credit and other credits would live on unless they, too, were changed. Tax swaps that involve higher sales taxes are likely to punish the poor, which leads to political confrontations and potential additional costs to make such a program work equitably.

These lessons help put into perspective some of the claims made on behalf of particular tax proposals. The Governor has complained repeatedly that two years ago the state went in the hole on the corporate income tax because companies took advantage of loopholes. In fact, had the Governor's Plan A been in force that year, the state would have been in an even deeper hole because of the tax credits allowed under his proposal. As far as corporate income taxes are concerned, his plan was far more generous to business than the corporate income tax system we have today. The plan would have eliminated corporate taxes and let corporations keep the tax credits, too.

Still, the net effect of Plan A would have been to shift the overall state tax burden more to business, mainly because of the effect of taxing business services and raising the sales tax. But this is not an aspect of the Governor's proposal that he emphasized.

In the current session, lawmakers have filed bills to eliminate the individual income tax over a period of many years. In combination with this initiative, some legislators have been tempted to think that a revenue-neutral plan is no longer necessary, and the Governor's Office has encouraged this mindset. In this scenario, the incorrect lesson drawn from the failure of Plan A is that concerns over revenue neutrality should be tossed aside, since that approach did not seem to work either numerically or politically.

This attitude could be read as an official admission that a revenue-neutral income tax swap is simply unachievable. But in fact many other ways to approach a tax swap have not been closely examined or vetted, such as using property taxes for offsets or shifting some business entities from an individual to a corporate-style tax return. Even if plausible, a tax swap with such new ingredients is not going to be adequately crafted and understood in the time left for this session.

Lawmakers should follow a path that is fiscally responsible for the long term. That means tax cuts should be addressed squarely with spending cuts or replacement revenue. We should not make the dual empty promises of tax cuts and the continuation of the current level of public services while hoping that time and unpredictable events will solve our fiscal problems. That is a common complaint about the federal government. This approach to fiscal planning reminds us of the late 1980s and early 1990s, when the state restructured deep debt payments for public employee retirement systems to pass the cost to the next generation. That invoice for the state's unfunded accrued liability is being served now; we are making payments in escalating amounts each year and continuing for at least 16 more years, and its burden on the state budget is heavy.

Conclusion

As reviewed in this report, Louisiana's tax system has faults, including anti-competitive tax rates, a large number of tax credits, a fuel taxing method that is placing the state's transportation infrastructure in jeopardy, a remarkably expensive and inefficient sales tax system, and a questionable structure of state government subsidies and authority.

The state has an opportunity to address these real problems. Elimination of the individual income tax has a popular appeal to some people. But we should recognize the real costs of that move. Most of all we should recognize that at the end of the day, if we do repeal the individual income tax, we could be left with the same long list of tax system problems that we have now. And we will have less flexibility to deal with them.

One thing is clear about the collapse of the Governor's plan: the state is faced with great uncertainties about the financial impact of eliminating the income taxes. Unlike the legislative sessions that handled the Governor's initiatives for ethics, workforce development and education reforms, this session has begun with a lack of firm direction and purpose. There is no consensus on tax reform strategies or their fiscal impacts. At this late hour, a well-conceived and properly assessed major overhaul of the state tax code does not appear to be possible during this legislative session. But the Legislature should begin now to establish a new set of priorities for tax reform in light of the full spectrum of tax problems facing the state.

The Public Affairs Research Council (PAR) is a private, nonprofit, non-partisan public policy research organization focused on pointing the way toward a more efficient, effective, transparent and accountable Louisiana government. PAR was founded in 1950 and is a 501(c)(3) tax-exempt organization supported by foundation and corporate grants and individual donations.

P. O. Box 14776 Baton Rouge, LA 70898-4776
Phone: (225) 926-8414 www.parlouisiana.org

APPENDIX: TOP TAX EXEMPTIONS

A review of the highlights of Louisiana tax exemptions reveals that a relatively small number of exemptions account for major dollar portions of the breaks. Exemptions can include income, expenditures and transactions that are counted as tax deductions, exclusion from taxes, exceptions to types of taxes and tax credits. If a type of tax is repealed, the exemptions under that type of tax would be eliminated also. But some exemptions, such as many of the tax credit programs, would remain a state expense if they were kept as an incentive, such as a cash rebate or payment to qualified recipients. The administration had identified more than $1 billion worth of exemptions that it planned to keep alive in a new form. The figures used here are the annual value of the exemptions based on Department of Revenue estimates for next year.

Individual income tax exemptions
The individual income tax has 78 exemptions totaling almost $2 billion. A third of that amount -- $736 million -- comes from one deduction: the federal income tax deduction that is available to all state taxpayers who pay federal taxes. Federal excess itemized deductions amount to $354 million. The standard deduction is worth $256 million. Various retirement benefit exclusions add up to $198 million. Counting all the exemptions mentioned in this paragraph, just seven deductions make up three-fourths the dollar amount of exemptions for the state individual income tax.

Family, child care and related education exemptions, including the earned income tax credit, are worth $152 million. The private school tuition deduction provides $20 million in tax breaks. The deduction for net capital gains is $57 million. The rebate for the Louisiana Citizens Property Insurance Corp. assessment is not fully tapped by those who are eligible but still provides about $46 million in breaks. Credits for rehabilitation of historic structures cost $28 million. Various other programs aimed at promoting specific industry sectors – such a sugar, milk and solar power -- offer exemptions worth $33 million.

Corporate income tax exemptions
The state has 53 exemptions totaling $1.8 billion for the corporate income tax exemptions, but only five of those exemptions make up $1.7 billion of the amount. The largest is $483 million for the exemption for so-called Subchapter S corporations, a type of business that in fact pays taxes but files under the individual income tax instead of the corporate income tax. The inventory tax credit is taken mainly against the corporate income and franchise taxes at a value of $378 million. Corporations can get a break in the way they account for net operating losses, with a total exemption worth $330 million. Insurance company premium taxes can be offset against corporate income taxes, for a total break of $302 million. Corporations can deduct from their state income the federal income taxes they pay, for a total exemption of $207 million.

Sales tax exemptions
The state sales tax has nearly 200 exemptions valued at $2.5 billion. Sales of food for home consumption, prescription drugs and residential utilities are not taxed by the state, creating $900 million in exemptions. Gasoline and diesel fuel are levied as an excise tax rather than a sales tax, but the state nevertheless counts that as a sales tax exemption valued at almost $400 million. Purchases by state and local governments provide an exemption worth more than $200 million.

Other exemptions
Severance and natural resource taxes have 23 exemptions estimated at $492 million, although the real value of those breaks may be substantially less due to a decline in natural gas drilling. The state has 15 petroleum product tax exemptions totaling $178 million, of which $166 million are federally imposed. The corporate franchise tax has $11 million in exemptions but some of its calculations are blended with the corporate income tax. Exemptions on tobacco taxes are $71 million, of which $55 million are federally imposed.