PAR Tax Advisory Group

TAX POLICY GUIDANCE

January 15, 2013

The Public Affairs Research Council of Louisiana established a Tax Advisory Group in November to consider tax policy reforms for Louisiana. The Group also anticipated that the governor would propose a tax reform agenda. So far the Group has discussed many, although by no means all, of the key issues and has heard from stakeholders, content experts and policy leaders. Administration officials have engaged in an open and constructive dialog with the Tax Advisory Group.

Although the work of the Tax Advisory Group is not complete, the public discussion is moving rapidly forward because of the reforms that will be considered in the upcoming legislative session. As an early stage effort to help guide public policy, the PAR Tax Advisory Group is presenting its consensus on principles and initial recommendations based on its work so far.

These are not final or complete recommendations but they do address several key elements of tax policy. Other policy considerations are sure to emerge but this document reflects the items in which the Group found consensus support. As the governor's proposal becomes more clear, we welcome more detail and further dialog on his important initiative.

The PAR Tax Advisory Group is comprised of the following members: Co-Chair: Jim Richardson, Louisiana State University economist and past PAR Chairman; Co-Chair: Robert Travis Scott, PAR President; Facilitator: Angele Davis, management consultant and former commissioner of administration; J.H. Campbell, Jr., Associated Grocers Inc. and PAR board member; John Dean, Heard, McElroy & Vestal LLC; Chris Dicharry, Kean Miller LLP; Mark Drennen, Cornerstone Government Affairs Group, former commissioner of administration and former PAR President; Nicole Gould, Breazeale, Sachse & Wilson LLP and former Department of Revenue attorney; Jerry Luke LeBlanc, University of Louisiana Lafayette, former commissioner of administration and former House Appropriations Chairman; John Pierre, Southern University Law Center; William Potter, Postlethwaite & Netterville; Kimberly Robinson, Jones Walker LLP and former attorney at the Department of Revenue and governor's office; Tim Ryan, University of New Orleans economist; William Scheffy, former banker and CFO and PAR board member; Steven Sheffrin, Tulane University economist.

For more information about the PAR Tax Reform Group, please contact Robert Travis Scott, President, Public Affairs Research Council of Louisiana at 225.926.8414 x 221 Office or 225.276.0794 Cell.

PAR's Mission is to be an independent voice, offering solutions to critical public issues in Louisiana through accurate, objective research and focusing public attention on those solutions.

Guiding principles of tax policy and reform

● The goal of state tax policy should be to provide sources of revenue to support efficiently financed and well run government operations, services and infrastructure that are necessary or essential for the public.

● Taxes should be broad-based with low rates and few exemptions so that the weight of responsibility for revenue is widely spread and reasonably allocated among taxpayers and citizens.

● A tax system should maintain a fair, competitive, and consistent environment for businesses and individuals.

● A balanced tax system that draws from diverse sources helps ensure that unusual spikes or drops from a single source can be countered by other sources to stabilize overall revenue streams.

● A solid tax structure should reflect the benefits of economic growth, keep up with inflation and meet the state's long-term revenue needs. It should provide long-term stability that restrains the inclination for sharp or repeated tax increases or adjustments.

● A tax system should be enforceable and clear enough to prevent frequent evasion or avoidance and simple enough to prevent burdensome administration and excessive compliance costs.

● Before moving forward with a new policy, the impact of proposed tax changes must be accurately estimated and firmly understood with fact-based evidence and confidence.

● Adjustments to state tax types should be evaluated by their impact on: the state's business climate; economic and population growth; the burden borne by various taxpayers; the stability of the state's revenue base; and the effect on local governments' taxing capacity, flexibility and fiscal circumstances.

Louisiana's current tax structure

- As in any state, Louisiana's tax structure corresponds to the relationship and the assignment of responsibilities between state and local governments, and any tax policy reforms should take this relationship into consideration. To a large extent, Louisiana emphasizes state revenue collection and spending to the detriment of local autonomy and responsibility. Major changes in tax structure could improve or worsen this situation.

  Louisiana is a relatively low-tax state for individuals. According to the Tax Foundation, only three other states impose a lower overall tax burden on their citizens. Louisiana's individual income tax burden is not exceptionally high or low compared to most other states and generally is not considered to be an unusually difficult or complex tax to administer or comply with. In contrast, Louisiana's property taxes, which provide an important source of revenue for local governments, are the lowest in the nation for homeowners and among the lowest in the nation overall. Presently, Louisiana's combined state-local sales tax rate is the third highest in the nation. The state's gas tax, which helps fund road and infrastructure construction and maintenance, is well below the national average.

- The state's tax costs to business vary greatly in the national rankings depending on the type of business. Louisiana's top marginal corporate income tax rate is relatively high, although the corporate tax is subject to many exemptions. Based on profits, and therefore vulnerable to recessions, the corporate income tax provides a widely fluctuating source of state revenue that is hard to predict from year to year. Louisiana is among 20 states that levy some form of a corporate franchise tax. Louisiana's franchise tax is considered to be relatively aggressive, which tends to give the state lower rankings as a place to do business.

<u>Recommendations</u>

State and local sales/use tax

- Implement a centralized, single sales and use tax administration system based on best practices. This would help to ensure eventual compatibility with proposed federal legislation. Louisiana is one of only a few states that have a sales tax system in which local sales taxes are administered by local taxing authorities. The new system should 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. The system should reduce unnecessary administrative burdens on business, eliminate the regular need for multiple audits, and maintain tax collection practices at least on par with those run by the most efficient states. Policy makers must ensure that this new system does not adversely impact state and local governments' collections or timeliness of collections. The lack of a uniform sales tax base in Louisiana is a key challenge that can and should also be addressed.

- If needed as part of a strategy to lower Louisiana sales or income tax rates, the state should consider broadening and expanding sales taxes to include additional services similar to the services taxed in competing states. Likewise, the elimination or reduction of some sales tax exemptions deserve consideration, although exemptions for business-to-business trade generally should be maintained.

Corporate franchise and income taxes

- Eliminate the corporate franchise tax and identify ways to replace the annual revenue loss of approximately $74 million. The franchise tax is a complicated administrative burden on business and is often difficult to calculate, which leads to time-consuming regulatory problems and litigation. The current tax is a deterrent to capital investments and a disincentive to companies considering a headquarters operation in Louisiana. To offset the revenue loss partially, the state could consider a standard capped annual tax for corporations and/or other registered business entities.

- The state should reduce the top rate of the corporate income tax if the costs can be offset in an overall revenue-neutral manner. The state's top rate of 8% is relatively high compared to other states even though the typical corporation's income tax burden in Louisiana is often comparatively competitive. The current rate lowers Louisiana's competitive rankings for business recruitment and helps create the perception that Louisiana is a high-tax state. Consideration should be given to reducing the current rate to a more competitive level. One potential offset would be to remove the federal income tax deduction from the state corporate income tax filing, which would result in a revenue gain of approximately $153 million.

- In the interest of increasing competitiveness, the state should explore other initiatives such as reforming how income is classified and where it is taxed.

Individual income tax

- The state should remove the federal income tax deduction and disallow or limit excess itemized deductions while offsetting the revenue increase with lower income tax rates.

- The removal of these deductions would prevent federal tax changes from disrupting state tax revenues. If these deductions or other exemptions could be identified for elimination, then individual income tax rates could be reduced for a revenue-neutral offset. A lower income tax rate may improve the perception of the state's tax burden.

Property tax

- The Homestead Exemption should not be increased. Also, the state should not create more exceptions that allow higher exemptions for homeowners in special circumstances. Over time with increasing home values, the revenue impact of the exemption will become less significant.

- 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.

The PAR Tax Advisory Group's Initial Response to the Governor's Tax Reform Proposal

The governor has proposed the elimination of Louisiana's individual income tax and corporate income and franchise taxes. The revenue loss would be offset partly with a higher state sales tax and possibly by broadening the sales tax base, although the details of the proposal are still under development. The expected state revenue from individual and corporate income and franchise taxes is expected to total nearly $3 billion this fiscal year.

The following response to the governor's proposal represents the PAR Tax Advisory Group's initial guidance on the broad policy questions that arise. This response is not a final word on the matter and we welcome more detail and further dialog on this important proposal.

The individual income tax tends to grow with the economy and therefore is an important component of Louisiana's overall balanced and stable tax structure and revenue base. A repeal of the individual income tax could create a more attractive perception of the state's tax climate but such a move runs the risk of destabilizing the state's revenue base and would likely set the stage for increased taxes in the future.

Some states without an individual income tax have high property taxes or extraordinary revenues from energy or tourism and therefore may not provide a comparable example of the governor's proposal. For example, Texas has no personal income tax but has a business tax, a relatively high sales tax and high property taxes. If Louisiana were to eliminate personal and corporate income taxes and offset the revenue mainly with sales taxes, Louisiana's government and tax structure would still be quite different from Texas, especially with regard to state versus local taxing authority and revenue collected.

If the governor's proposal is implemented, state policymakers should consider several critical issues:

-Low income individuals and families pay little or no state income tax and therefore will be adversely affected with an overall tax increase if higher sales taxes replace the personal income tax. The state should find ways to lessen the negative impact on people in these categories if the proposal is adopted. The administration says it is seeking a solution.

-There are some categories of people who have an exemption from income taxes and could also be paying higher taxes overall under the proposal. These include public employee retirees, military retirees and those on disability. Also, Social Security retirement benefits are exempt from Louisiana income tax. Such exemptions are debatable as good policy but the impact on these categories of people should be noted.

-Eliminating the individual income tax would result in an annual revenue loss of $2.6 billion based on current-year collections. It should be noted that in future years the state's annual individual income tax revenue is expected to grow at a higher rate than that of its sales tax revenues. Estimates of the amount of money needed to offset an elimination of the income taxes should not be based solely on the revenue experience of past years.

-If higher sales taxes are implemented, the pressure for new exemptions for sales taxes will be intense. Each new or revived exemption will erode the sales tax base upon which the state would have become more dependent. The reform policy should therefore include tougher standards for the adoption of sales tax exemptions.

-A sales tax rate increase could be alleviated by broadening the base upon which the sales tax is applied, either through the elimination of exemptions or the inclusion of certain specifically identified services that are not currently taxed. This appears to be the direction the administration is taking.

-State business incentive programs that are related to the income tax would presumably have to be reinvented or modified, providing a good opportunity for serious re-evaluation. This too appears to be on the administration's agenda.

-With higher sales tax rates, Louisiana sellers would be at a competitive disadvantage to sellers in other states and at an even greater disadvantage to untaxed online sales, especially for high-cost items. After having obtained the highest sales tax rate in the country, Louisiana would be in uncharted territory as far as estimating how much revenue would be produced.