VALUE ADDED TAX NEEDS MORE STUDY

The value added tax (VAT), or more specifically its close cousin the single business tax (SBT), has captured the imagination of the administration. No longer simply a trial balloon, the concept has been moving towards proposal in the April fiscal session. However, it has been flying largely below radar.

Only the general outlines of the potential SBT proposal are known at this point. The tax would be a low-rate, broad-based tax, levied on all forms of business and would likely replace the current corporate income tax, franchise tax and sales tax on machinery and equipment. An exemption would likely be given for small businesses. This and other possible exemptions (e.g. for medical services or favored businesses) could substantially alter the impact of the tax.

The administration has reportedly been meeting with consultants to develop an SBT proposal. To date, no real specifics have been released, no data has been produced and no in-depth studies have been announced. Only two months remain before the legislative session begins.

The Tax Study Committee of the Louisiana Law Institute chaired by Randy Ewing, has met for the past two months seeking a long-term solution to shortcomings of Louisiana’s present tax structure. In discussing optional reforms, the economists in the group have given high marks to the SBT concept, at least in its pure form. In (MORE)
theory, the broad base SBT is stable, simple, easy to administer, very productive at low rates and equitable. Also, it is said to grow with the economy and produce minimal distortions in business decisions.

Some very rough numbers have been suggested concerning rates that might be needed for a revenue neutral business tax trade and to raise additional revenue to meet a projected state budget gap and to fund teacher pay raises. These would, of course, depend on what is included in the tax base and how much of an increase was desired. The Ewing committee is developing data on the tax options but is depending largely on voluntary efforts of its economist members to produce SBT data.

At this point there has been no sophisticated analysis of the potential impacts of a Louisiana SBT, at different rates, on various types of business or upon consumers. Studies in other states indicate that even if the SBT tax switch were revenue neutral, tax burdens would shift dramatically among types of business and individuals.

Unlike other potential tax reforms such as those dealing with the property and income taxes, there is actual experience with an SBT in only two other states—Michigan and New Hampshire. However, these states’ economies have little in common with Louisiana’s. Several other states have been looking closely at the tax option. West Virginia’s governor has been speaking to business groups and promting an SBT for more than a year now following recommendations of a study group that met for a year and half before that. In the process, the proposal was subjected to a rigorous analysis by applying an input-output model to the state’s economy. In addition, a union group ran its own separate model that projected a shift in tax burden from upper income to lower income individuals. Sample returns are being sent to West Virginia businesses to further help determine the impact of an SBT, but specific legislation has not yet been drafted.

Louisiana will simply not have time to adequately study, analyze and discuss the SBT prior to the April legislative fiscal session. A number of questions need answers. What businesses would be covered? Would small business be exempt and, if so, how small? What rates would be levied? How would tax burdens be shifted among (MORE)
industries (e.g. between capital intensive and labor intensive firms)? How would inter-state competition among service firms be affected? How would the final incidence of taxes on consumers at different income levels be affected?

The administration is to be applauded for its recognition of the need to bring our industrial-age tax structure more in line with the emerging "weightless economy" and for seeking a more stable, productive and growth related tax structure. However, by dismissing out-of-hand property and income tax reform options, the administration has been forced to consider less common and less studied alternatives.

The single business tax has not been part of PAR's traditional tax reform package for Louisiana. This has been due more to its unique character than to any perceived flaws. However, without extensive study on the potential impact of the SBT on Louisiana taxpayers, PAR cannot support a rush to judgment on this issue. Taxpayers and consumers should have an opportunity to learn how they would be affected before such a major tax change is enacted. If the SBT is the key to the long-term reform of the state's tax structure, it should receive close and careful study.