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July 19, 2012

Senator Jack Donahue
P.O. Box 94183
Baton Rouge, LA 70804

Dear Senator Donahue:

Thank you for initiating the Revenue Study Commission and its task of evaluating the state's credits, exemptions and rebates. This type of study is timely and could prove to be a worthwhile endeavor. Many of the programs you will be examining have served to help keep the state competitive for business growth and could have a strong positive impact on the economy and jobs. Yet, in its review, the new commission might be able to identify low-performing or antiquated tax preference expenditures that deserve reevaluation. The commission's work might also give us a clearer picture of the actual cost of these programs.

This letter is to inform you of concerns that PAR has about the administration of tax credits and exemptions in Louisiana. First, there is a serious lack of available information on some of these programs. There is also evidence that some of these programs are not receiving adequate follow-up and implementation after they are passed into law. These are systemic problems that could impair your work, and PAR recommends these issues be considered in the work of your commission.

The Louisiana Department of Revenue annually produces a Tax Exemption Budget, a document released along with the executive budget proposal prior to each legislative session. This budget is intended to estimate the expenses the state will incur (or the dollars the state would not collect) by providing existing tax credits, exemptions and rebates. The budget provides estimates of such expenses for the current fiscal year as well as the next fiscal year.

In this document, a large collection of various sales tax exemptions are grouped under a single category. For example, the most recent edition – Tax Exemption Budget 2011-12 – shows \$866.5 million in "other exemptions." Among the variety of exemptions under this category, no one knows how much each one is costing the state. The reason is that businesses taking one or more of these exemptions are not

required to report which particular exemptions they are taking. Their exemptions are noted in tax filings under the single category of other exemptions. In some cases, such as for tax-free charitable purchases, there may be practical reasons for this on the retail level. The Department of Revenue currently has no way of accurately tracking the financial impact of specific exemptions in this category. When the Revenue Study Commission prepares to review this group of exemptions, the members will have no reliable data.

PAR staff discussed this problem with the former Department of Revenue secretary in the spring of 2011. At the time the department was in full agreement that this information should be tracked, and the agency had a plan to change the tax forms and upgrade the agency computing system to delineate the dollars for the various exemptions. This new system was scheduled to be phased in beginning in early 2012. This was welcome news and PAR commended the Department of Revenue in our 2011 Legislative wrapup for this planned work.

http://www.parlouisiana.com/s3web/1002087/docs/session_2011_commentary.pdf

Earlier this year, PAR revisited this issue with the Department of Revenue to check on the progress of the reporting change. We were told that the change had not been made and that other computer system upgrades had taken priority. Timing and costs of computer upgrades may have been a legitimate factor. Also, many businesses report on paper forms, which are an obstacle to compiling data easily.

PAR does not assume that the tax exemptions in this category need to be reduced or changed. They might be useful for incentives or worthy charitable causes. If the basic numbers could be tracked, the commission and the public would have a better opportunity for that discussion.

Tracking of every exemption may not be necessary, and consideration should be given as to whether new tracking requirements might impose an overly complicated reporting system. For example, more detailed reporting by retailers for tax-exempt charitable purchases might be impractical.

Your study resolution asks the commission to determine effective models to determine the economic impact of tax preference expenditures and to establish criteria for the identification of low-performing programs. This is a goal of a high order. But the starting point for any analysis must be a basic accounting of the actual value of the tax preferences that we know can be counted.

PAR recognizes that the sales tax collection system in Louisiana is complicated and requires the compliance of businesses. Steps must occur for this exemption information to be available. Tax forms must be adjusted and computer systems programmed in a process that could take one or more years.

The sooner this could be addressed the better. The department has explored other ways to address the information gap, such as sample analysis, and these deserve consideration.

(As an aside, the “other exemptions” category amounted to \$3.2 billion in the Tax Exemption Budget 2010-11. The lower figure for this year’s report, \$866.5 million, was the result of a change in modeling for what the Department of Revenue included as an exemption. The lower figure is not the result of a large decrease in the use of exemptions in this category.)

The recent controversy over the alternative fuels tax credit provides another example of questionable data. Among its provisions, this program passed in 2009 allows up to a \$3,000 corporate or individual income tax credit for purchase of a new alternative fuel vehicle. The final fiscal note in 2009 projected a five-year cost of \$907,000. The Tax Exemption Budget 2011-12, released in February, estimated that the alternative-fuel-vehicle credits for corporate and individual income taxes would cost \$1.1 million for the fiscal year that ended in June and slightly more this fiscal year.

In fact, until April 2012, the Department of Revenue had never created or promulgated rules to implement this tax credit program, although the law specifically calls for rules to be made.

In April the department released a Declaration of Emergency about the credit program and published a list of vehicles that qualified for the credit. This list is often referred to in media reports as an “expanded” list. After requesting a document and talking with department officials, PAR has not found evidence of any initial list, either an internal agency list or an external one. So the April vehicle list was likely the first and only list of qualified vehicles since the program was launched three years ago.

The Department of Revenue reported in June that the cost of the credit program since its inception and up to that point was about \$18 million. We have asked the department for an annual breakdown of figures to understand when the department had evidence that the vehicle tax credit had surpassed the \$1.1 million estimated yearly cost in its February tax exemption report. PAR is awaiting that information from the department. We do not know how much of the spike in the cost was due to the April publication of the vehicle list, or whether the program all along was running more expensively than the public knew.

Tax filers taking the credit are asked to provide proof of purchase of a vehicle. PAR encourages your study commission to ask what procedure the department used over the past three years to decide whether those vehicles qualified under the program.

So here we have a situation in which the Legislature passed a tax credit law assuming a very modest state fiscal impact. Subsequent reports – as recently as February – from the Department of Revenue also indicated a modest program impact. After nearly three years of the tax credit being enacted and citizens claiming the credit, no rules were in place even though there was apparently confusion between the private sector and the agency about which vehicles would qualify. Unless some new information comes to light to demonstrate otherwise, it appears that neither the Legislature nor governor's office

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asked to see proposed rules for the program, and they did not follow up to revisit the program's impact. When a list of qualified vehicles was finally published by the department and then withdrawn by the governor, it led to speculation about a much higher fiscal impact than anyone had previously predicted. One newspaper analysis put the cost at more than \$200 million.


How could the state be running a new tax break with an anticipated fiscal impact off by at least one and possibly two orders of magnitude? And how many more of these misjudgments are out there to be discovered for other tax breaks? The suggestion here is that the lack of accurate numbers, even simple numbers that can be calculated through mere addition, could be a symptom of a state system that fosters obscurity. The tax preference programs are so numerous that they have become difficult and potentially expensive to track. When legislators and governors support laws for tax breaks or subsidy programs, they should schedule steps to check or monitor the real fiscal impact and how the programs are being implemented.

The annual Tax Exemption Budget is not meant to provide forecasts and impact studies of the kind the commission is pursuing to evaluate state tax preferences. In fact, it is not even intended as an exact account of past tax breaks. Its figures in historical charts identifying fiscal impacts for past years are not updated even if new information would make them more accurate. In a nutshell, the Tax Exemption Budget may be useful in some respects, but it is not the best reflection of reality. This circumstance is important to keep in mind if the study commission wants to use the document as a starting platform for its review.

You and the study commission face a difficult but important job diving into this subject matter. Competing interests and bureaucracy will not make your work any easier. It will take diligence, better information and political fortitude to impact the system. PAR supports the intention of the commission and we will try to provide useful perspectives and information as you pursue this process.

Thank you for your efforts and your time on behalf of the state.

Sincerely,



Robert Travis Scott
President
RTS:an

cc: Secretary Jane Smith, Department of Revenue