Commentary
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Reach for the Best Option

A highly recommended initiative should anchor Louisiana's 2018 tax reform debate

Now is the time to move forward with a Louisiana state income tax reform that truly creates greater simplicity, stability and lower rates. The Governor and the Legislature should work together to support passage of a constitutional amendment that would eliminate or limit the federal tax deduction for state filers while lowering income tax rates. The potential Congressional reform of federal income taxation is all the more reason to move ahead with this state reform. This move is in the best interests of Louisiana taxpayers and the state's fiscal outlook.

The expiration of temporary taxes in July 2018 -- mainly the 5th percent of the sales tax -- will represent approximately $1.1 billion less in annual state tax revenue. The Governor yesterday announced his plan for dealing with this looming "fiscal cliff" and establishing a new sales and income tax structure in Louisiana. The appropriate duty of the Governor is to propose a specific plan to the Legislature and to call a special session in February to address it, which now is his stated intention. That's progress.

Also, the Governor says he wants to maintain state tax funding at current levels and he is not calling for a net increase in state tax revenue collections, which are reasonable goals for a stable plan for the future. His plan does not address the potential higher state income taxes that could result from the federal reform coming out of Washington. Still, the Governor's plan is a starting place for serious discussion, and PAR encourages the Legislature and the public to engage, negotiate and produce results.

One significant option should be on the table: We should lower income tax rates as a result of discontinuing the state's deduction of federal taxes paid. This deduction, which is taken by individuals, families and many businesses on their state individual income tax form, adds up to a value of about $900 million in less taxes annually. By eliminating this deduction, tax rates could be lowered by about 25% while still maintaining the same level of state revenue, studies have shown. This or other variations of rate or bracket adjustments could be made.

This idea is a good one for many reasons. It allows a lower rate and a broader tax base, which are attributes of sound tax policy. It is a more competitively appealing structure versus the tax systems in other states; Louisiana's income tax burden is not among the higher taxing states, but its high rates offer the appearance of a comparative disadvantage. This initiative also provides greater stability in our outlook for taxation and revenue streams for the future, because the fortunes of state taxpayers will no longer be tied to the fluctuations of federal income tax changes. And it would create a simpler and more predictable tax system.

A parade of tax studies and think tanks for years have advocated this change for Louisiana, including the PAR Tax Advisory Group in 2013, the Louisiana Tax Study commissioned by the Legislature in 2015, the Tax Foundation report for the Louisiana Committee of 100 the same year, and the legislatively created Task Force on Structural Changes in Budget and Tax Policy in 2016-17. These reports showed that the elimination of the federal tax deduction, even with a revenue-neutral approach, would produce positive results in the form of stability, fairness, simplicity and competitiveness. In fact, this was the first and foremost option recommended by the state Task Force.

No wonder that Louisiana is joined by only five other states in allowing a federal tax deduction on state individual income tax filings. And only two other states join Louisiana in allowing a full deduction. The overwhelming majority of states want to control their own destiny with their tax system and avoid the external, up and down impacts of federal taxation, which can vary from changes in the economy or the federal tax code.

This is a propitious time for this change. Congress is on the verge of passing a federal tax bill. The overall thrust of the bill will be to lower the federal taxes paid by businesses and individuals, although specific filers may see varying results. Under the current Louisiana system with the federal tax deduction, the impact of these federal changes would result in higher state income taxes – and higher state revenue -- in Louisiana. An elimination of the federal tax deduction, along with calibrated decreases in tax rates, would allow the state to better control its revenue from income taxes in a healthier and more predictable framework. The state's credit rating likely would tend to be viewed more favorably as well. Likewise, for those concerned that a future Congress might backtrack and raise federal taxes, then the elimination of the deduction would again prove to be good, stable fiscal policy.

This change would require an amendment to the Louisiana Constitution. A two-thirds vote in both the House and Senate followed by a majority vote on a state ballot would be needed to enact the new policy. (Portions of the current proposal by the Governor would also require a two-thirds vote in the Legislature though not a statewide vote.) The change could affect both the individual income tax and the corporate income tax. An amendment to cut the deduction only for corporate filers failed with voters last year, but a more comprehensive and well supported attempt should fare better. Companion statutory measures would be needed to implement the changes and new rates. As with the Governor's proposal, a stable revenue bridge could be implemented until the plan takes effect. The goal of the amendment should be to eliminate the federal deduction or allow the Legislature to eliminate or limit the deduction through statutes.

Whether your perspective is to prevent a large state income tax increase resulting from the new federal tax bill or to better refine our state revenue goals in line with avoiding the fiscal cliff, an elimination of the federal deduction for state income tax filers along with lower rates or adjusted brackets is one of the most forward-looking, meaningful and recommended reforms that the Governor and the Legislature can make. A new federal tax bill will make that conclusion even more evident. The bottom line is that Louisiana should master its own bottom line.

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