LOUISIANA FISCAL REFORM

A FRAMEWORK FOR THE FUTURE

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A FRAMEWORK FOR THE FUTURE

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EXECUTIVE SUMMARY AND A MENU OF TAX REFORM SOLUTIONS

Executive Summary

Louisiana convened its 2015 legislative session with seemingly insurmountable problems: a $1.6 billion budget shortfall, difficult-to-navigate funding dedications, and a governor who pledged he wouldn't increase taxes. If that combination seems intractable, it was—the session closed with a patchwork of short-term, temporary fixes to plug the budget hole with promises that legislators would be back the next legislative session to focus on fiscal issues.

Louisiana has reached a fiscal reform crossroads. While the most recent legislative session shows that short-term budget fixes are not tenable, the exercise pushed many to ask the right questions. How can the tax and fiscal system be updated to reflect a changing economy? Why, in the midst of economic expansion, are tax collections failing to meet the state's needs?

Over the course of five months, our team of tax economists met with stakeholders from all walks of Louisiana life, including small business owners, local government officials, trade associations, industry representatives, state officials across the political spectrum, and ordinary taxpayers. We also reviewed the history of the fiscal system, previous tax reform studies, and historical revenue and economic trends.

The result is this book, which is meant to help Louisiana achieve the goal of true fiscal reform—reform that benefits all taxpayers by addressing the many long-term hurdles the state budget has faced, finally bypassing the need for temporary fixes. It's meant to start the conversation about what Louisiana does well, but also what it could do better—by recognizing strengths, diagnosing challenges, and prescribing real, workable solutions.

We undertook this project as an independent national organization familiar with tax developments in many states, with the view that tax systems should adhere to sound economic principles. We formulated these recommendations in the spirit of providing useful information and observations for Louisiana policymakers, journalists, and citizens as they evaluate the state's fiscal system.

During our meetings, several themes arose:

- Louisiana needs a tax structure that mitigates the volatility of the economy and current fiscal system, providing revenues that grow with the economy. The state economy is diversifying, and the tax system needs to reflect this new environment—something that the current tax code does not.
- The Louisiana fiscal system faces a long-term structural deficit. Any changes to the tax code need to address this reality so that the state no longer requires short-term, temporary fixes to plug unexpected budget shortfalls each year. Louisiana lawmakers, both state and local, require an increased degree of flexibility in raising revenue and cutting costs. For example, state legislators are limited by the high level of dedications in the state's fiscal system, while local officials are hindered as a result of strict state-imposed limitations on raising revenue. These problems and their implications deserve thoughtful deliberation.

- Louisiana's fiscal system desperately needs administrative improvement. In particular, lawmakers should consider removing multiple duplicative tax regimes by unifying state and local sales tax collections, tax administration, and tax bases under an independent, state-local commission. By doing so, the state would be able to take advantage of increased sales tax revenues collected on remote transactions when federal online sales tax legislation is inevitably passed.
- Most of the state's taxes suffer from narrow bases. Some of this problem stems from the partial repeal of the Stelly Plan, but it has also been exacerbated by the generous use of tax incentive programs, the shifting nature of consumption from brick-and-mortar stores to online venues, and the failure of the sales tax to apply to services, which are a large and growing share of the American economy. While base expansion is a laudable goal, it should be done carefully to ensure economically detrimental changes are not enacted.
- Above all, the tax system should retain elements that ensure Louisiana improves its competitiveness in both the national and global arena.

In the following pages, we provide background on Louisiana's economy (Chapter 1) and on its overall fiscal system (Chapter 2). We then review each major tax, outline concerns, and propose alternatives (Chapters 3, 4, 5, and 6). Chapter 7 proposes some additional reform ideas that fall outside of these four major tax types.

The Committee of 100 commissioned the Tax Foundation to prepare this review of the Louisiana tax system and recommend possible solutions. While they supported our study, neither the Committee nor any of its sponsors directed this analysis or any of the recommendations.

A Menu of Tax Reform Solutions

Sales Taxes

Louisiana's sales tax is one of the most unique and challenging of any in the country. Business owners note how the cumbersome system is one of the chief tax elements holding the state back. However, it is also important to acknowledge how important the sales tax is to local government operation, and to be mindful of concerns about the impacts of possible changes.

Our **sales tax solutions** eliminate duplicative tax collection and administration and simplify the tax base, making Louisiana eligible for collection of tax on remote transactions when federal legislation (such as the Marketplace Fairness Act or the Remote Transactions Parity Act) is enacted. Moderate base broadening options are also included.

We've provided three different alternatives for lawmakers to consider, some more expansive than others. Unification changes are administrative and thus would be revenue neutral, apart from implementation costs, while sales tax base expansion would increase revenue. If a net increase or decrease in revenue is desired, the tax rates in each option can be dialed up or down, respectively, to achieve a tax cut or tax increase.

Option A would move Louisiana from having one of the most challenging tax codes in the country to one that is streamlined and has low compliance costs. It would modestly broaden the tax base as well. Option A would:

- Unify state and local sales tax collections and audits by creating an independent, joint-run state-local sales tax authority composed of representatives from local tax collection bodies and the state department of revenue. This unified collection and audit commission would make Louisiana compliant with pending federal legislation allowing for sales tax collection on internet purchases.
- Unify state and local sales tax bases on all transactions.
- Expand the sales tax base (state and local) to include select services that currently enjoy exemptions. We provide detailed options for small, medium, and large sales tax expansion in Chapter 3.

Option B includes some elements of Option A, but is less comprehensive. It would unify collections and audits while broadening the tax base. (State and local base unification would not occur under this option.) Option B would:

- Unify state and local sales tax collections and audits by creating an independent, joint-run state-local sales tax authority composed of representatives from local tax collection bodies and the state department of revenue. This unified collection and audit commission would make Louisiana compliant with pending federal legislation allowing for sales tax collection on internet purchases.

- Expand the sales tax base (state and local) to include select services that currently enjoy exemptions. We provide detailed options for small, medium, and large sales tax expansion in Chapter 3.

Option C is more limited, but would still unify the state and local sales tax base with some exceptions. In addition, it would broaden the sales tax base.

- Unify state and local sales tax bases on all transactions except for food for consumption and prescription drugs.
- Expand the sales tax base (state and local) to include select services that currently enjoy exemptions. We provide detailed options for small, medium, and large sales tax expansion in Chapter 3.

Individual Income Tax

Our **individual income tax solutions** improve the tax code by broadening the tax base and reducing tax rates, making the state more competitive with its neighbors and the system more neutral and fair. We've provided three different alternatives for lawmakers to consider.

Each of the following options are designed to be revenue neutral within themselves. If a net increase or decrease in revenue is desired, the tax rates in each option can be dialed up or down, respectively, to achieve a tax cut or tax increase.

Option A would retain the current three-bracket structure, but reduce tax rates. It also includes base broadening components and resembles the income tax structure recommended by Dr. Jim Richardson of Louisiana State University and Dr. Steven M. Sheffrin and Dr. James Alm of Tulane University. Option A would:

- Retain the existing three-bracket structure, with rates reduced to 1 percent, 3 percent, and 4.5 percent.
- Eliminate the deduction for federal taxes paid.
- Retain the current Earned Income Tax Credit of 3.5 percent of the federal credit.
- Eliminate excess itemized deductions.
- Retain the existing personal exemption but adjust the tax brackets and personal exemption for inflation.

Option B converts the progressive income tax into a single, flat rate on all income levels, while providing additional relief to low-income taxpayers. Option B would:

- Move from three brackets to a single, flat-rate tax of 4 percent on all income levels.
- Eliminate the deduction for federal taxes paid.
- Increase the personal exemption to $10,000 per filer and index it to inflation (maximum of $20,000 per family).
- Increase the Earned Income Tax Credit from 3.5 percent of the federal credit to 10 percent of the federal credit, nearly tripling benefits for low-income households.
- Retain current itemized deductions.

Option C is the most broad-based option of the three, retaining the single-rate structure of Option B, but eliminating more preferences to bring the overall rate lower. Option C would:

- Move from three brackets to a single, flat-rate tax of 3.5 percent on all income levels.
- Eliminate the deduction for federal taxes paid.
- Increase the personal exemption to $10,000 per filer and index it to inflation (maximum of $20,000 per family).
- Increase the Earned Income Tax Credit from 3.5 percent of the federal credit to 10 percent of the federal credit, nearly tripling benefits for low-income households.
- Eliminate excess itemized deductions.

Corporate Income Tax

Our **corporate income tax solutions** would make Louisiana more competitive with neighboring states by bringing its rate from the highest in the region to the lowest among neighboring states that levy a corporate tax. It also includes base-broadening elements and helps mitigate tax uncertainty for businesses.

This option is designed to be revenue neutral. If a net increase or decrease in revenue is desired, the tax rate can be dialed up or down, respectively, to achieve a tax cut or tax increase.

This option would:

- Flatten tax brackets into a single rate of 5 percent.
- Eliminate the deduction for federal taxes paid.
- Increase net operating loss carrybacks from zero to three years.

Property and Related Taxes

Property taxes are a local levy, and localities depend on their revenue to fund government functions. While the state has authority over changing the parameters of these taxes, care must be taken to ensure that any property tax reform be considered with impacts on local government finance in mind.

Our **property tax solutions** broaden the local property tax base and eliminate distortionary and economically damaging taxes. These alternatives would:

- Repeal the inventory tax and inventory tax credit.
- Permanently limit the total annual value of the industrial tax exemption program to 80 percent.
- Allow localities to approve or reject any extensions of the industrial tax exemption program (that is, the second five-year exemption period).

Additional Important Improvements

Below, we provide recommendations that do not fit into the four major tax categories above, but warrant their own separate discussion. We provide solutions that would address lackluster transportation infrastructure and prevent budgetary distress brought on by revenue volatility.

Addressing Lackluster Transportation Infrastructure

- Increase the excise tax on gasoline and diesel fuel.
- Index the gasoline and diesel excise tax to inflation to keep up with transportation demands.
- Consider further tolling of vital roads and bridges to help pay for repairs and enhancements.

Preventing Budgetary Distress Brought on by Revenue Volatility

- Devote 2 percent of revenues to a rainy day fund each year to make for a healthy nest egg to protect against calls for tax increases during economic downturns.

Our Objective

We hope these solutions continue the tax conversation in Louisiana by providing a framework upon which legislators and citizens can make further decisions. The menu of choices we present all ensure that the state builds a tax system for a diversified economy and positions itself as a destination for investment, entrepreneurs, and talented individuals in the years ahead. If the most robust of these reform recommendations were implemented, Louisiana's ranking in the *State Business Tax Climate Index* would move to 10th best in the nation.

CHAPTER 1: LOUISIANA'S ECONOMY

Introduction

Louisiana has made substantial economic progress and job gains in recent decades, outranking many regional competitors. However, the state still trends below U.S. averages on several key economic metrics (such as state gross domestic product per person and personal income per person).

With a manufacturing sector more robust than most other states' and access to international ports, Louisiana has a unique economy with a sectoral breakdown that is quite different from the U.S. as a whole. However, the state economy tends to be more volatile on average than the rest of the country—in part due to the state's dependence on more volatile industries such as manufacturing and mining.

The illustrations in the following pages are meant to provide an overview of the Louisiana economy and context for future chapters, giving readers a broad background on where the state has been economically and where it might head in the future.

State Gross Domestic Product (GDP)

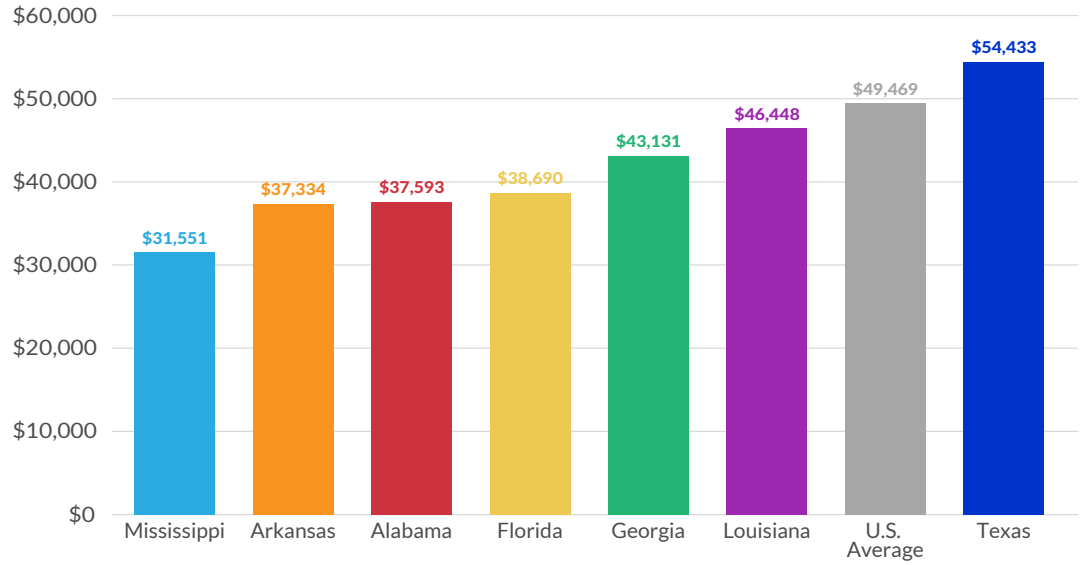
Louisiana had the 24th largest state economy in the U.S. in 2014 (based on total production).[1] When compared to regional competitors, Louisiana's economy is similar in size to that of Alabama (26th largest in the country), a bit bigger than Arkansas and Mississippi (34th and 36th largest, respectively), and smaller than Florida (fourth largest), Georgia (tenth largest), and Texas (second largest).[2] The large size of the Florida, Georgia, and Texas economies are mainly driven by population—these are some of the most populated states in the U.S. (Florida was the third most populated state in the country in 2014, while Georgia was the eighth and Texas was the second most populated.)[3]

After adjusting for population, Louisiana fares better. In 2014, Louisiana had the second highest inflation-adjusted state gross domestic product (GDP) per person when compared to select regional competitors, trailing only Texas. At $46,448, Louisiana's state GDP per person was slightly below the U.S. average of $49,469 per person.[4] See Figure 1a for a comparison of Louisiana's real state GDP per capita to select regional competitors' and the U.S. average.

Figure 1a.

State Gross Domestic Product per Capita

Louisiana, Select Regional Competitors, and the U.S. Average (2014)



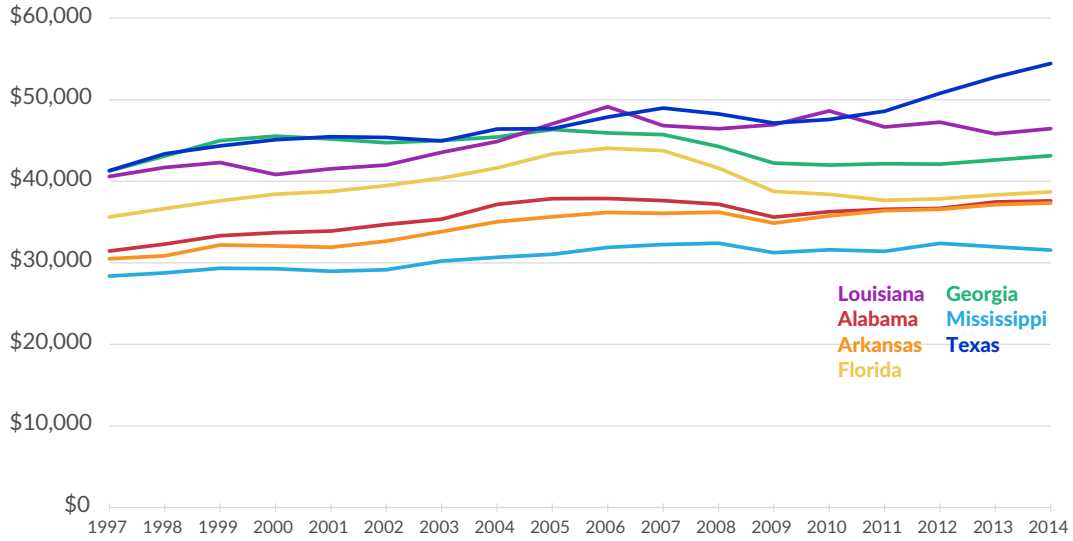
Source: Bureau of Economic Analysis, *Regional Economic Accounts*, Gross Domestic Product (GDP) by State.

1 Bureau of Economic Analysis, Regional Economic Accounts, *Gross Domestic Product (GDP) by State*, "Gross domestic product (GDP) by state (millions of current dollars)."
2 *Id.*
3 Bureau of Economic Analysis, Regional Economic Accounts, *Annual State Personal Income and Employment*, "SA1 Personal Income Summary: Personal Income, Population, Per Capita Personal Income."
4 Bureau of Economic Analysis, Regional Economic Accounts, *Gross Domestic Product (GDP) by State*, "Per capita real GDP by state (chained 2009 dollars)."

Figure 1b.

State Gross Domestic Product per Capita

Louisiana and Select Regional Competitors (1977–2014, in 2014 Dollars)



Source: Bureau of Economic Analysis, *Regional Economic Accounts*, Gross Domestic Product (GDP) by State.

Figure 1b shows real state GDP per person over time for these same states.[5] Though Louisiana has seen growth on this metric over the long run, recent years have been stagnant.

Figure 1c.

Annual Percentage Change in Real State GDP

Louisiana and U.S. (1998–2013)

Note: Dollar amounts were adjusted for inflation and expressed in 2013 dollars prior to calculating percentage changes using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.
Source: Bureau of Economic Analysis, *Regional Economic Accounts*, Gross Domestic Product (GDP) by State;
Bureau of Labor Statistics, *Consumer Price Indexes* (All Urban Consumers).

5 *Id.* Adjusted for inflation using Bureau of Labor Statistics, *Consumer Price Indexes*, "Consumer Price Index – All Urban Consumers" (not seasonally adjusted, U.S. city average, 1967=100, Series Id: CUUR0000AA0).

Louisiana's state economy has historically been more volatile than the U.S. economy as a whole. Louisiana's output, at least since 1997, has fluctuated more severely during economic cycles than the national economy, as demonstrated by its higher peaks in Figure 1c. However, it is interesting to note that Louisiana's economic "troughs" are similar in severity to those of the U.S. (notice how the low points in Figure 1c are similar for both Louisiana and the U.S.).[6]

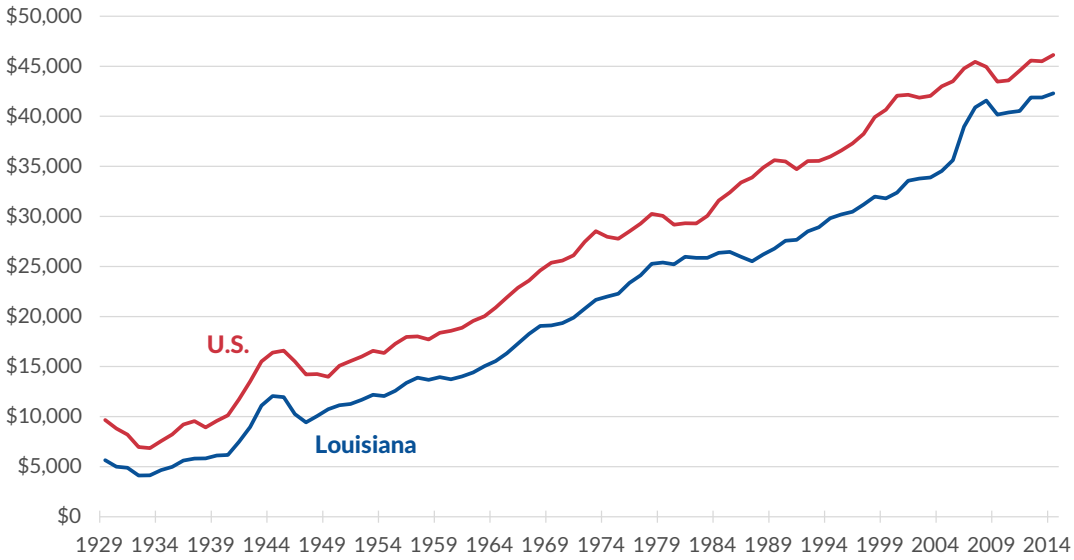
Personal Income

In 1929, the average personal income of a Louisiana resident was $5,654 (when adjusted for inflation)—well below the U.S. average of $9,663, as seen in Figure 1d. Both national and Louisiana income levels have risen significantly since that time, but the U.S. average has always remained above Louisiana's over that time period. The two tend to follow the same pattern over time, however, dipping in the most recent recession and finally recovering to pre-recession highs in 2012.[7]

Figure 1d.

Personal Income per Capita

Louisiana and U.S. (1929–2014, in 2014 Dollars)



Note: Dollar amounts are adjusted for inflation and expressed in 2014 dollars using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.
Source: Bureau of Economic Analysis, *Regional Economic Accounts*, Annual State Personal Income and Employment; Bureau of Labor Statistics, *Consumer Price Indexes* (All Urban Consumers).

6 Bureau of Economic Analysis, Regional Economic Accounts, *Gross Domestic Product (GDP) by State*, "Gross domestic product (GDP) by state (millions of current dollars)." Adjusted for inflation prior to calculating annual percentage changes using Bureau of Labor Statistics, *Consumer Price Indexes*, "Consumer Price Index – All Urban Consumers" (not seasonally adjusted, U.S. city average, 1967=100, Series Id: CUUR0000AA0).

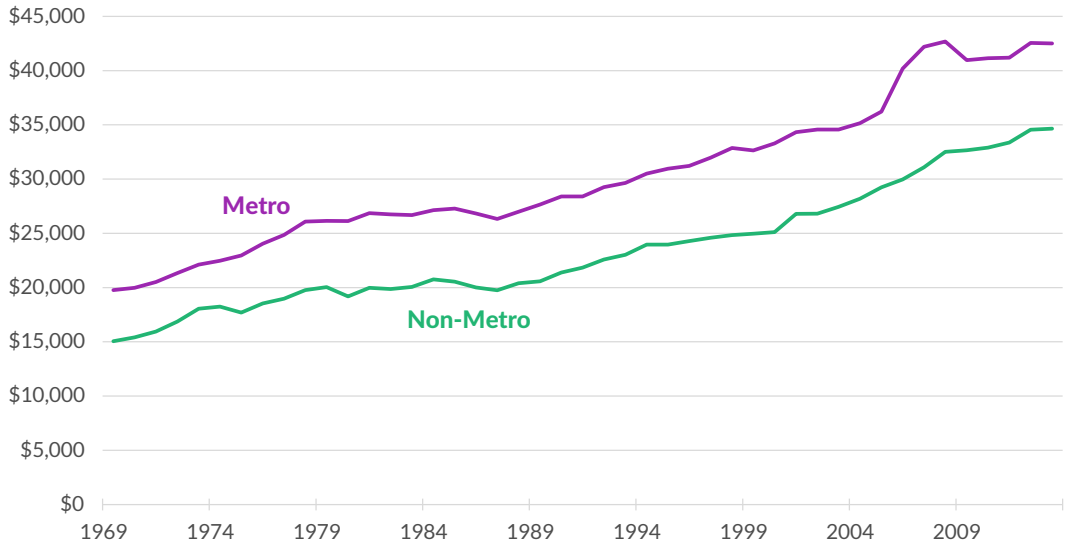
7 Bureau of Economic Analysis, Regional Economic Accounts, *Annual State Personal Income and Employment*, "Personal Income Summary: Personal Income, Population, Per Capita Personal Income" (Table SA1). Adjusted for inflation using Bureau of Labor Statistics, *Consumer Price Indexes*, "Consumer Price Index – All Urban Consumers" (not seasonally adjusted, U.S. city average, 1967=100, Series Id: CUUR0000AA0).

It's also important to go beyond state-by-state comparisons to look at intrastate incomes, since different areas of a state tend to have differing economic composition. While both metro-area and non-metro-area personal income per capita have increased over time (controlling for inflation), non-metro personal income per capita tends to be much lower than income in metro-area Louisiana (see Figure 1e). Also worth noting is the stability of personal income per capita in non-metro Louisiana compared to the fluctuations seen in metro areas in the years before, during, and after the most recent recession. Metro-area income per capita sharply increased in the years leading to the recession, and then dipped immediately after, while non-metro income per capita continued to increase during that time.[8]

Figure 1e.

Personal Income per Capita

Metro Louisiana and Non-Metro Louisiana (1929–2013, in 2013 Dollars)



Note: Dollar amounts are adjusted for inflation and expressed in 2013 dollars using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.
Source: Bureau of Economic Analysis, *Regional Economic Accounts*, Local Area Personal Income and Employment; Bureau of Labor Statistics, *Consumer Price Indexes* (All Urban Consumers).

8 Bureau of Economic Analysis, Regional Economic Accounts, *Local Area Personal Income and Employment*, "Personal Income Summary: Personal Income, Population, Per Capita Personal Income" (Table CA1). Adjusted for inflation using Bureau of Labor Statistics, *Consumer Price Indexes*, "Consumer Price Index – All Urban Consumers" (not seasonally adjusted, U.S. city average, 1967=100, Series Id: CUUR0000AA0).

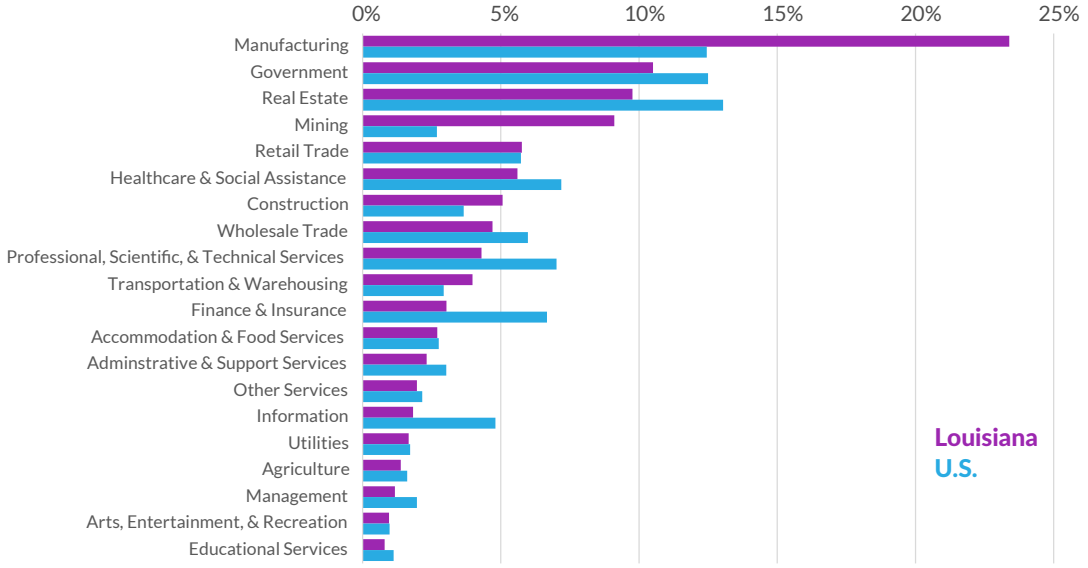
Major Industries

Louisiana's industry mix differs greatly from the rest of the U.S. (see Figure 1f). In particular, manufacturing and mining are much more prominent in Louisiana than they are in the U.S. as a whole. Manufacturing made up 23.4 percent of Louisiana's output in 2013, while it only comprised 12.5 percent of U.S. output as a whole during that same year. Similarly, mining comprised 9.1 percent of the Louisiana economy but only 2.7 percent of the U.S. economy in 2014. Ranked in order of magnitude, the largest industrial sectors in the state in 2014 were manufacturing (23.4 percent of total output), government (10.5 percent), real estate (9.8 percent), mining (9.1 percent), retail trade (5.8 percent), and healthcare and social assistance (5.6 percent).[9]

Figure 1f.

Percent of Total State Gross Domestic Product by Industry

Louisiana and U.S. (2013)



Source: Bureau of Economic Analysis, *Regional Economic Accounts*, Gross Domestic Product (GDP) by State.

Since 1997, manufacturing has always been the largest sector in Louisiana, though its share of the total state economy has fluctuated over time. Manufacturing was 17 percent of total output in 1997. It reached a peak of nearly 30 percent of the state economy in 2005, dipping down sharply after that (in part due to Hurricanes Katrina and Rita). It has now since leveled off, sitting at 23 percent of total output in 2013. Mining's share has also been fairly volatile over time. Figure 1g shows Louisiana's seven largest sectors' share of the total state economy since 1997.[10]

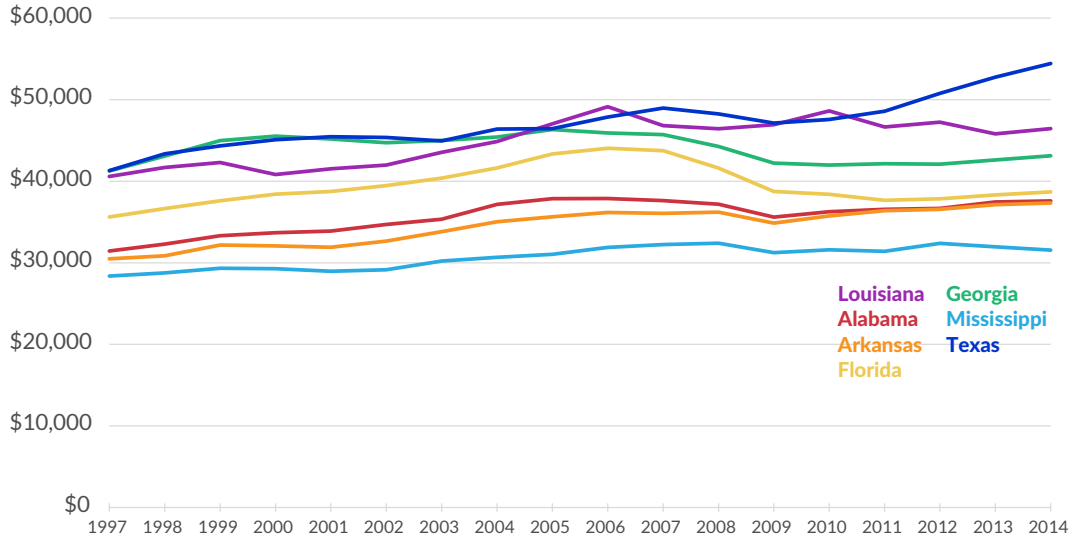
9 Bureau of Economic Analysis, Regional Economic Accounts, *Gross Domestic Product (GDP) by State*, "Gross domestic product (GDP) by state (millions of current dollars)."

10 *Id.*

Figure 1g.

State Gross Domestic Product per Capita

Louisiana and Select Regional Competitors (1977–2014, in 2014 Dollars)



Source: Bureau of Economic Analysis, *Regional Economic Accounts*, Gross Domestic Product (GDP) by State.

Goods-producing sectors are much more prominent in Louisiana than in the U.S. as a whole (the goods share of output in Louisiana was 44 percent in 2013, compared to only 23 percent for the whole country) due to the state's large manufacturing sector. While the share of service-providing sectors has grown in the country as a whole over time, the opposite is true in Louisiana. In 1997, goods made up 36 percent of private sector output within the state, and services made up 64 percent. In 2013, the goods share had grown to 44 percent of total state output, while the services share had decreased to 56 percent. [11]

11 *Id.*

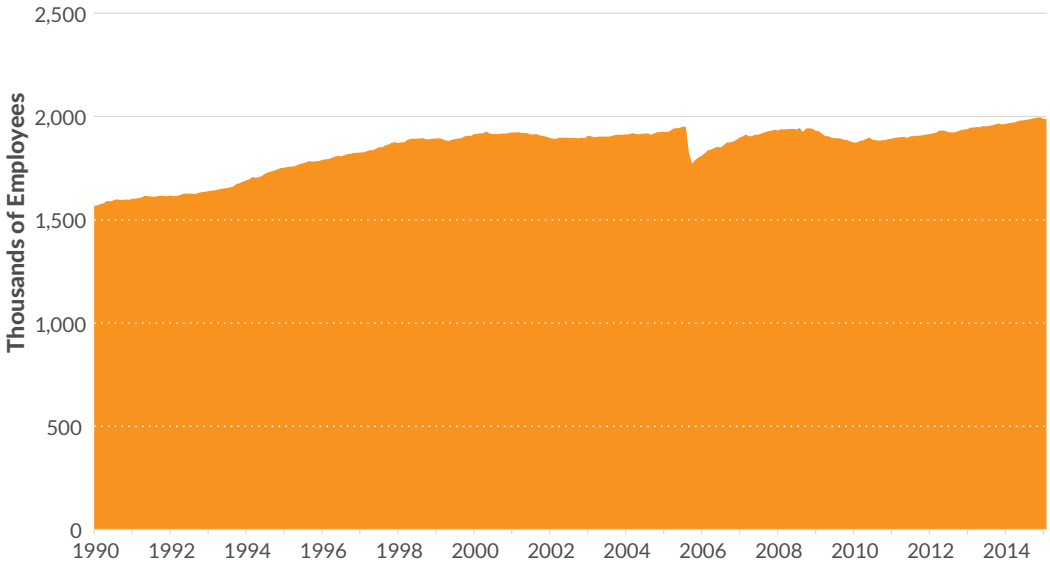
Employment

Employment in Louisiana since 1990 has seen a slight upward growth trend, with employment in January 1990 sitting at 1,567,000 employees and increasing to 1,988,000 in February 2015 (an overall increase of 27 percent), as shown in Figure 1h. The most pronounced period of job loss occurred in mid-2005 in the aftermath of Hurricanes Katrina and Rita. Employment loss in the state during the most recent recession was fairly moderate, with only a slight dip in the late 2000s.[12]

Figure 1h.

Total Nonfarm Monthly Employment

Louisiana, Seasonally Adjusted (January 1990–February 2015)



Source: Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*

The largest share of nonfarm employment in Louisiana occurs in the Trade, Transportation, and Utilities sector with 20 percent of total state nonfarm employment. Most of these jobs are in retail (this category includes retail and wholesale trades). The next largest employment sector is government, employing 16 percent of total nonfarm employees in Louisiana. Figure 1i shows the breakdown of nonfarm employment within the state, organized by broad sector categories provided by the Bureau of Labor Statistics.[13]

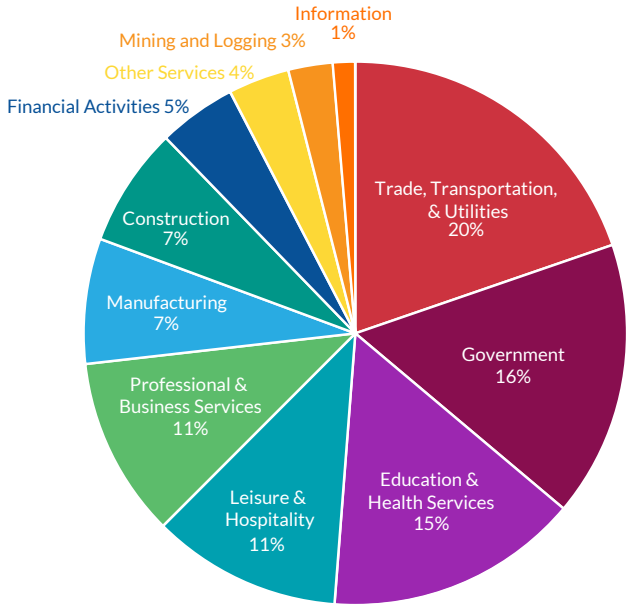
12 Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings*, Total Nonfarm Employment (Louisiana Statewide, All Employees, Seasonally Adjusted), Series ID: SMS22000000000000001.

13 Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings*. Data was queried for the following "supersectors," in addition to "Total Nonfarm Employment": "Mining and Logging," "Construction," "Manufacturing," "Trade, Transportation, & Utilities" (includes Retail Trade, Wholesale Trade, Transportation and Warehousing, and Utilities), "Financial Activities" (includes Real Estate), "Professional & Business Services" (includes Professional, Scientific, and Technical Services; Management; and Administrative and Support Services), "Education and Health Services," "Leisure and Hospitality" (includes Arts, Entertainment and Recreation and Accommodation and Food Services), "Other Services," and "Government" (includes Federal, State, and Local). Information was not explicitly reported by the Bureau of Labor Statistics and had to be extrapolated. All employment data is seasonally adjusted and corresponds to the entire state of Louisiana.

Figure 1i.

Percent of Total Nonfarm Employment by Industry

Louisiana, Seasonally Adjusted (as of December 2014)



Note: Data for the information sector was extrapolated.
Source: Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings*.

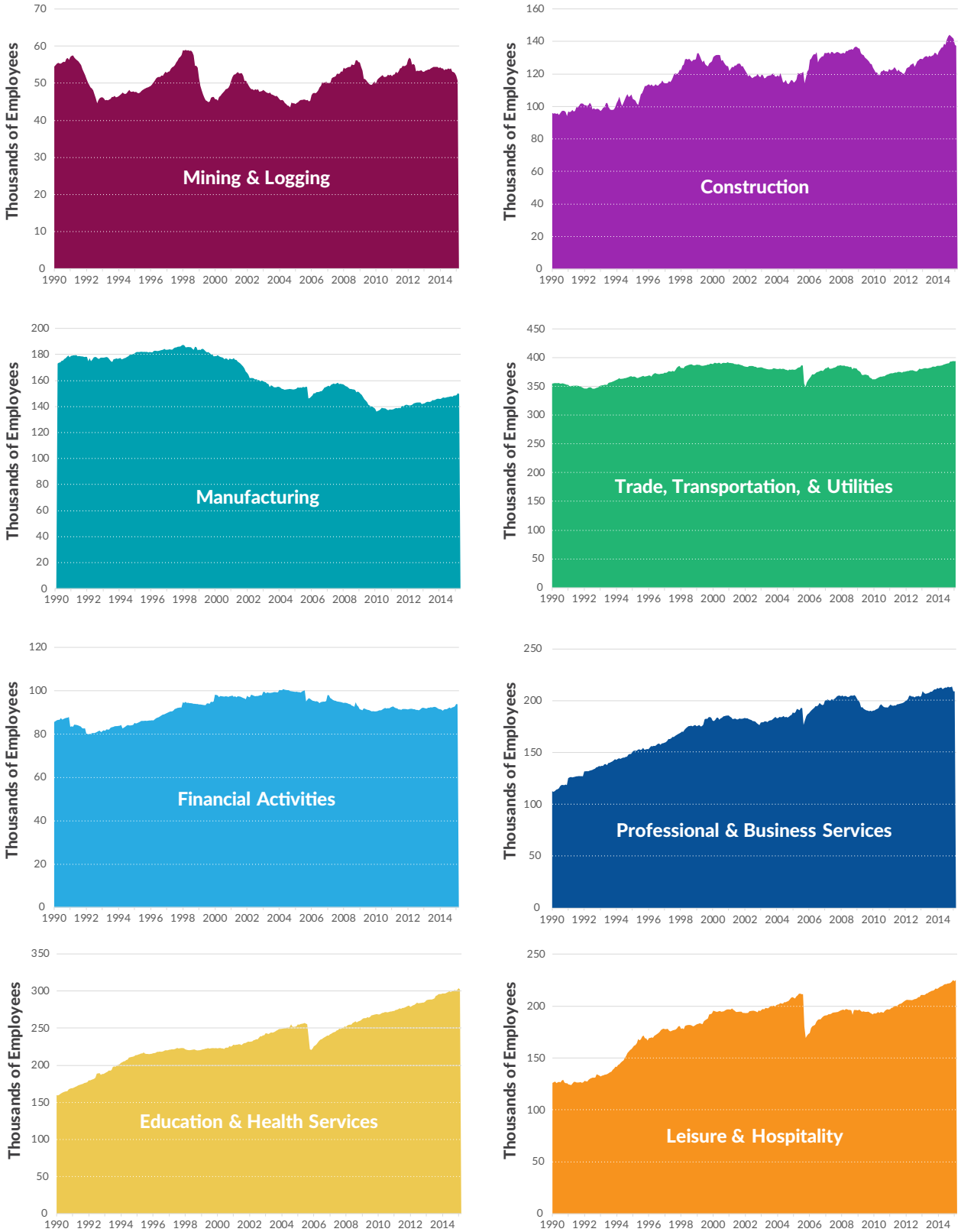
Each of these industries has fared differently over time (see Figure 1j). Some sectors' employment levels are more volatile than others (like mining and logging; construction; and trade, transportation, and utilities). Most industries saw a large dip in total employment in the aftermath of Hurricane Katrina in 2005. Manufacturing's employment level has seen sizable declines since the early 1990s. Financial activities and business and professional services have trended upward over time, with little impact from business cycles and Hurricanes Katrina and Rita. Education and health services and leisure and hospitality services have generally increased over time, though did see a large dip in employment in the wake of Katrina and Rita.

Figure 1j.

Monthly Employment by Supersector

Louisiana, Seasonally Adjusted, Selected Private Supersectors (January 1990–February 2015)

Note: Vertical axis scales differ for each chart below. Figures are not meant to show the magnitude of employment by sector, but changes over time (which can be seen by examining the shape of the charts below over time). For the industry's share of total Louisiana employment, see Figure 1i. All scales are in thousands



Source: Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings.*

Migration Patterns

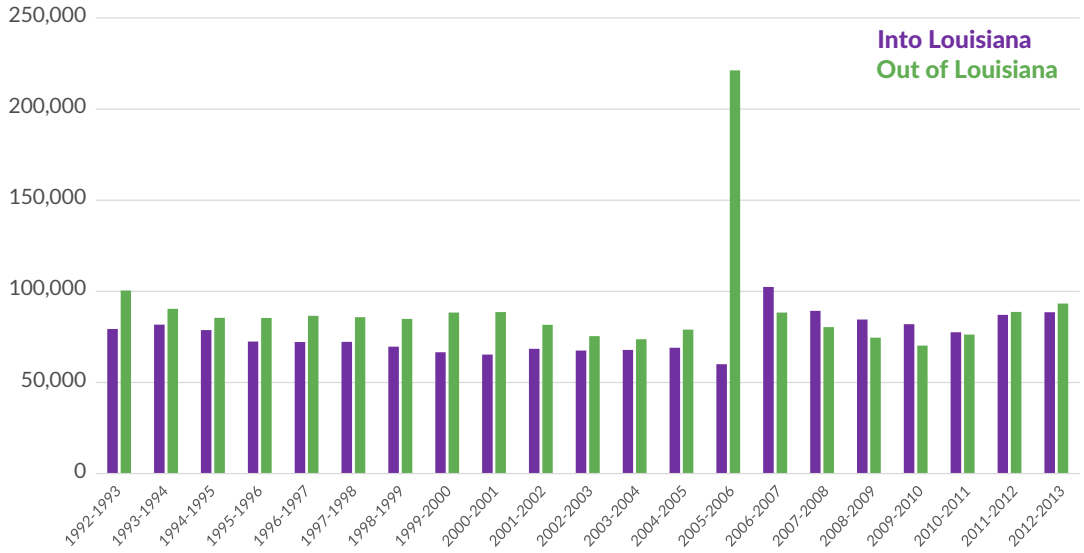
One way to examine migration patterns between states is to look at the movement of individual federal income tax filers over time, as shown in the Internal Revenue Service's State Migration Data.[14] Here, we measure "people" by the number of federal tax exemptions claimed.

Since the early 1990s, Louisiana has seen a net of 296,378 people leave the state. The most notable migration event in the state happened in the 2005 period, in the aftermath of Hurricanes Katrina and Rita. Prior to that, Louisiana experienced net out-migration in each year, but between 2006 and 2011, in-migration slightly exceeded out-migration each year. Between 2011 and 2013, however, out-migration has slightly exceeded in-migration. Figure 1k illustrates migration trends over time.

Figure 1k.

Migration In and Out of Louisiana

Based on Number of Federal Tax Exemptions Claimed (1992–2013)



Source: Internal Revenue Service, *Statistics of Income Tax Stats – Migration Data.*

Between 1992 and 2013, Louisiana has lost people to 31 states, with most moving to Texas (183,713 people), Mississippi (27,536), Georgia (25,474), Tennessee (15,361), Florida (13,268), and Alabama (10,225). Other states to which Louisiana lost sizable amounts of individuals were Arkansas, Colorado, Missouri, Virginia, Oklahoma, Arizona, North Carolina, and Kentucky.[15] Louisiana gained individuals from 18 states over the same time period, most notably from California (14,716 people).[16]

14 Internal Revenue Service, *Statistics of Income Tax Stats – Migration Data*, "U.S. Population Migration Data."

15 The remaining states to which Louisiana lost individuals over this time period were (listed in order of decreasing magnitude) Nevada, Maryland, South Carolina, Kansas, Oregon, Minnesota, New Mexico, Idaho, Utah, Wyoming, West Virginia, the District of Columbia, Iowa, Montana, North Dakota, Indiana, Pennsylvania, and Vermont.

16 The remaining states from which Louisiana gained individuals over this time period were (listed in order of decreasing magnitude) New York, Michigan, Illinois, Hawaii, New Jersey, Connecticut, Wisconsin, Alaska, Massachusetts, Washington, Ohio, Rhode Island, Nebraska, Maine, New Hampshire, South Dakota, and Delaware.

CHAPTER 2:
AN OVERVIEW OF LOUISIANA'S TAX AND BUDGET SYSTEM

Introduction

Though recurring budget deficits have been the major topic of discussion in recent years, there are parts of Louisiana's budget and tax system that warrant attention as well.

Many elements of the state's system stand in the way of economic and tax competitiveness. The state's sales tax ranks the worst in the country, according to the *2015 State Business Tax Climate Index*. The state's corporate income tax rate is one of the highest in the U.S., but even with a high rate, the tax only brings in 3 percent of state tax collections.

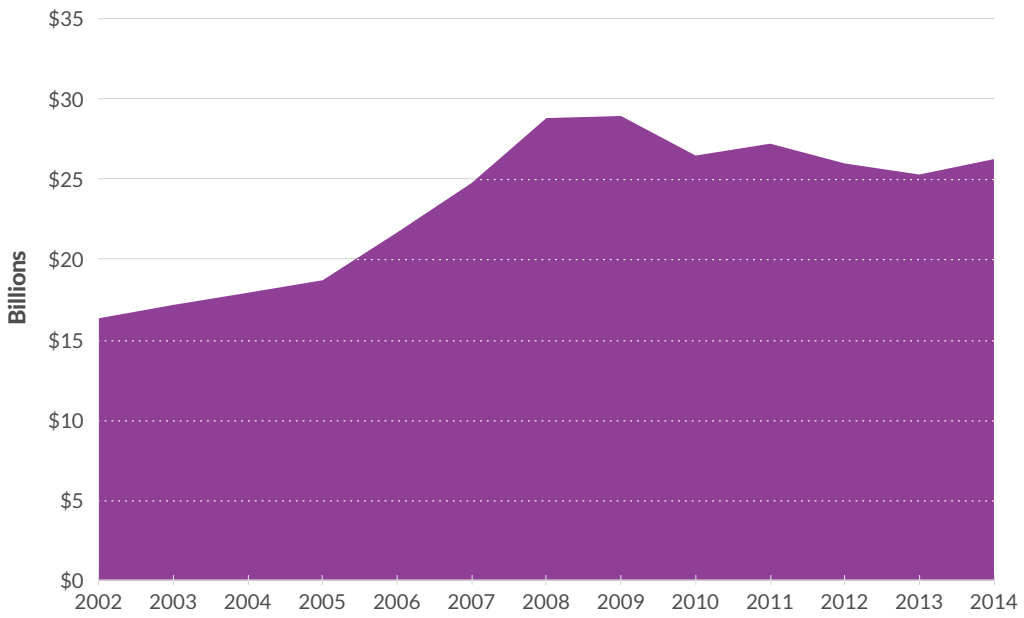
Another notable element in Louisiana's budget history is the temporary federal assistance in the mid-2000s, following Hurricanes Katrina and Rita. This assistance provided crucial resources as the state rebuilt but also makes understanding government growth a difficult task.

Tax and Spending Policy in the 2000s

Louisiana state spending increased 46 percent between 2004 and 2014, faster than inflation and the population, which grew 28 percent over the same time period (see Figure 2a).[17] With that said, much of the increase in spending was driven by rebuilding and restoration after Hurricanes Katrina and Rita. An influx of federal funds, plus the boost in tax revenue during the burst of rebuilding construction, led to healthier state coffers between 2005 and 2009. Spending has since fallen from its peak of $28.9 billion in 2009, settling around $26 billion today.

Figure 2a.

Louisiana Total State Expenditures (FY 2002–FY 2014)



Source: Louisiana *Comprehensive Annual Financial Reports* (2002–2014).

While the influx in federal funds allowed for important rebuilding and restoration programs, these changes have caused some problems in budgeting.[18] In the years following the two hurricanes, the state was operating under extraordinary, atypical budget conditions.

Between 2005 and 2009, while the budget was growing quickly, policymakers sought a repeal of the 2002 tax reform effort known as the Stelly Plan. The Stelly Plan, named for former Representative Victor Stelly, exempted groceries and utilities from the sales tax and offset those exemptions by lowering the kick-in for individual income tax brackets (that is, the level of income above which individual income taxes are due).[19]

17 Louisiana *Comprehensive Annual Financial Reports*, multiple eds., http://www.doa.la.gov/Pages/osrap/CAFR/CAFR.aspx; Bureau of Labor Statistics, *Consumer Price Indexes*, "Consumer Price Index – All Urban Consumers"; U.S. Census Bureau, *Intercensal Population Estimates by State*.

18 Federal Emergency Management Agency, *Louisiana Recovery Update: Katrina and Rita by the Numbers*, News Release, Aug. 24, 2015.

19 Public Affairs Research Council, *The "Stelly Plan": A Proposed Income/Sales Tax Swap*, PAR Analysis No. 305, Sept. 2002.

Common perception is that legislators "repealed" the Stelly Plan in 2008, but reality is hazier. Legislators were successful in rolling back individual income tax brackets to their pre-Stelly levels, but did not remove the exemptions that the Stelly Plan baked into the sales tax. While these exemptions for groceries and utilities (deemed "necessities of life") enjoy popular approval, they are also some of the most stable consumption categories and could be a large portion of the sales tax base.

When the dust settled at the end of the 2000 to 2010 decade, the various tax reform efforts resulted in a less robust sales tax base that grows slower than it otherwise would have and requires higher overall rates to bring in the same amount of revenue. This base narrowing has had a long-term effect, and some commentators credit the partial repeal of the Stelly Plan with creating the structural budget deficit the state has faced in recent years.[20]

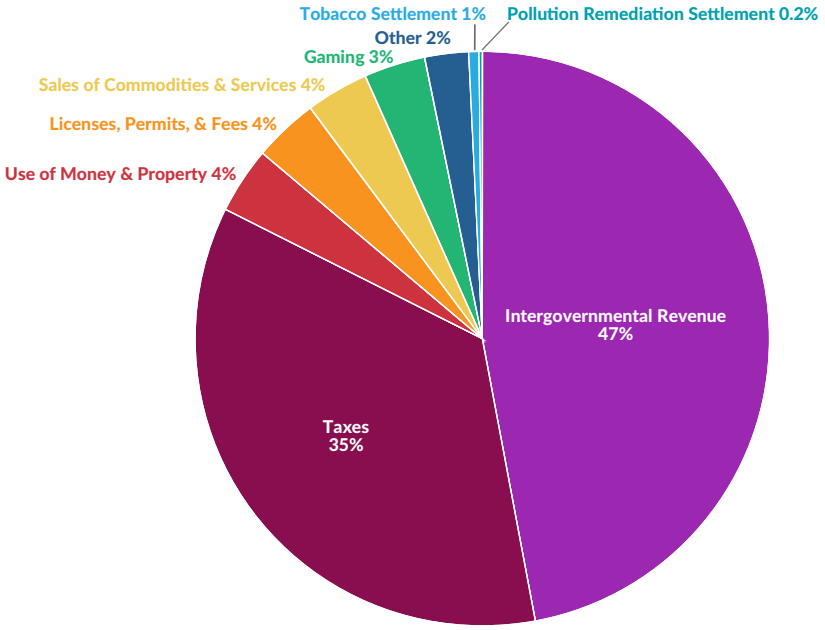
Louisiana's Budget Makeup Today

Federal Aid Comprises Almost Half of Louisiana's State Budget

When reviewing Louisiana's budget documents, the most apparent oddity is the amount of the state's budget that is derived from federal aid. In fiscal year 2014, for example, 47 percent of revenues were "intergovernmental," coming almost entirely from the federal government (see Figure 2b).

Figure 2b.

State Gross Domestic Product per Capita (FY 2014)



Source: Louisiana *Comprehensive Annual Financial Report* (FY 2014).

20 The Times Picayune Editorial Board, *It's up to the Legislature to come up with a long-term fix for the budget*, The Times Picayune, Apr. 12, 2015.

Federal revenue transfers to Louisiana are primarily driven by the Medicaid program, which extends health care services to lower income individuals in a jointly run, federal-state system. Because Louisiana has many Medicaid participants, these transfers are higher. Louisiana's heavy reliance on outside funding is one of the highest nationally, ranking second in the country as a percentage of its state budget in a 2012 tally.[21]

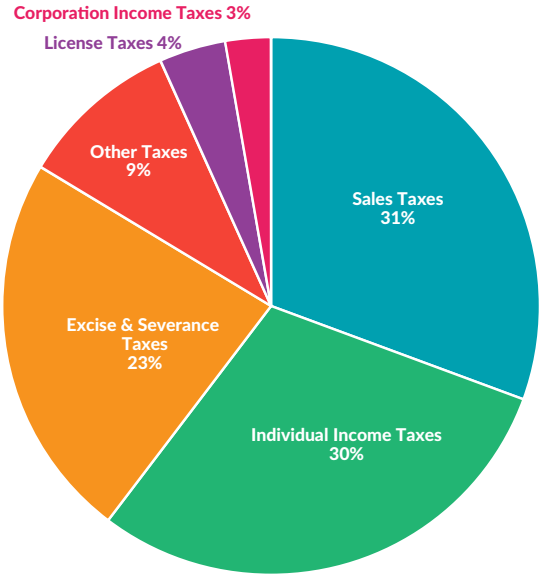
This heavy reliance means that Louisiana policymakers must be especially cognizant of the federal budget process, and it also underscores the importance of getting Louisiana's own-source revenue system right should there be any reduction in federal transfers.

Income and Sales Taxes Are Major State Levies

Within Louisiana's state tax system, the sales tax and individual income tax are the two largest levies, comprising 31 and 30 percent of total state tax collections, respectively (as shown in Figure 2c). The next largest components are excise and severance taxes, which together make up 23 percent of state government tax collections. Miscellaneous taxes make up 9 percent of state tax collections, and license taxes account for 4 percent of state tax collections.

Figure 2c.

Percent of Total Louisiana State Government Tax Collections (FY 2013)



Source: Census Bureau, *State and Local Government Finances* (FY 2013).

Notably, the corporate income tax, despite being thought of as a "major" tax, only brings in 3 percent of state collections. While most states have a similarly small reliance on the corporate income tax (there are only so many corporations in each state), this is notable in Louisiana because the state employs the highest top corporate tax rate in the southern United States at 8 percent (see Chapter 5 for more details on the corporate income tax).[22]

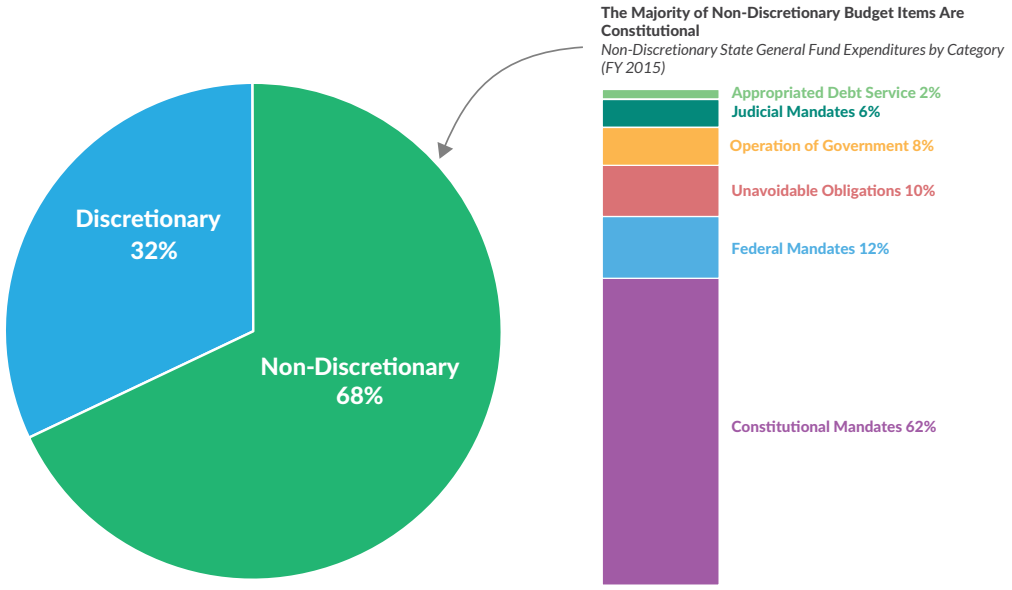
21 Liz Malm & Richard Borean, *Which States Rely the Most on Federal Aid?*, Tax Policy Blog, Tax Foundation, Jan. 8, 2015.
22 Census Bureau, *State and Local Government Finances*, 2013.

Spending Dedications Limit Budget Prioritization

On the spending side, much of Louisiana's budget is restricted by constitutional, statutory, or federal dedications that require funds to be spent on certain projects. In the most recent budget, 68 percent of state general fund expenditures were non-discretionary (shown in Figure 2d). Of that non-discretionary spending, 62 percent is constitutionally mandated (also shown in Figure 2d).[23] Because of these dedications, non-protected spending like higher education and health care are often targeted for spending cuts during tough fiscal years.[24]

Figure 2d.

Breakdown of Louisiana State General Fund Expenditures by Type (FY 2015)



Note: The "Due to Court Order" category not shown on this figure because it only amounts to 0.2 percent and is thus not visible.
Source: Louisiana Department of Administration, *State Budget Document* (FY 2014–2015).

While some have called for a constitutional convention to revisit these dedications,[25] this is not necessarily a panacea, as many of the dedications were put into place distinctly because they are politically favorable spending categories. The non-discretionary budget items shown in Figure 2d are described further below:[26]

23 Louisiana Division of Administration, Office of Planning and Budget, *State Budget - Fiscal Year 2014-2015*, Sept. 2014.
24 Public Affairs Research Council of Louisiana, *PAR Guide to the State Budget Crisis*, p. 10, Apr. 10, 2015.
25 See, *e.g.* KNOE News, *Would a Constitutional Convention Solve Louisiana's Budget Problems?*, Aug. 14, 2015.
26 Louisiana Division of Administration, Office of Planning and Budget, *State Budget - Fiscal Year 2014-2015*, Sept. 2014.

Constitutional Mandates (62 Percent of Non-Discretionary Expenditures)

- Salaries of statewide elected officials
- Cost of elections and ballot printing
- Non-public school textbooks and the Minimum Foundation Program
- Parish transportation and TIME Project funding
- Interim Emergency Board
- Revenue sharing
- Debt service (net state tax supported debt)
- Severance tax dedications to parishes
- Parish Royalty Fund dedication to parishes
- Highway Fund #2 dedications to the Mississippi River Bridge Authority and Causeway Commission
- Supplemental pay

Judicial Mandates (6 Percent of Non-Discretionary Expenditures)

- Representation for mental health patients
- Medical care for some state prisoners
- Various litigations involving community-based waiver options
- Elderly and disabled adult waiver litigation
- Instruction in special school districts #1 and #2—Juvenile Justice Settlement

Debt Service (2 Percent of Non-Discretionary Expenditures)

- Debt Management Program (Treasury)
- Debt service of state-owned buildings paid by Office of Facilities Corporation
- Rent in state-owned buildings paid by state agencies to Office of Facilities Corporation
- Corrections debt service (Louisiana Correctional Facilities Corporation)
- Higher education debt service and maintenance

Federal Mandates (12 Percent of Non-Discretionary Expenditures)

- Mandatory Medicaid services
- Federal Safe Drinking Water Act and Clean Air Act

Operation of Government (8 Percent of Non-Discretionary Expenditures)

- District Attorneys' and Assistant District Attorneys' salaries
- Local housing of state adult offenders
- Peace officer standards & training reimbursement to local law enforcement agencies
- Parole Board
- Medical care of prisoners
- Legislative expenses
- Judicial expenses

Other Unavoidable Obligations (10 Percent of Non-Discretionary Expenditures)

- Group benefits for retirees
- Maintenance of state buildings from state agencies to Division of Administration
- Legislative Auditor fees
- Adult probation and parole (field services program)
- Family preservation and children services offered by the Department of Children and Family Services
- Department of Health & Hospitals Eastern Louisiana Mental Health System (Forensic Facility)
- Corrections services (incarceration of adult inmates)

It is also worth noting that other states deal with spending dedication constraints as well. For example, in Texas in fiscal year 2013, 82.5 percent of general revenue and general revenue dedicated funds were restricted. A 2013 document produced by the Texas House Research Organization found that 46.5 percent of this revenue was restricted by constitutional or statutory dedications, 24.1 percent was "influenced or directed by federal laws, regulations, and court decisions," and 11.9 percent was influenced by statutory funding formulas.[27]

Measures of State Tax Competitiveness

Tax reform can accomplish many things; it can make budgeting easier and more consistent, and it can reduce complexities that cause headache. However, one goal of tax reform that is perhaps the most important is to improve state competitiveness.

Here, we review two measures of tax competitiveness that matter for taxpayers: the *Annual State-Local Tax Burden Rankings*, and the *State Business Tax Climate Index*. Both of these measures have a different story to tell. The *Annual State-Local Tax Burden Rankings* report answers the very first question that most taxpayers ask: "*how much do residents in my state pay in taxes?*" The *State Business Tax Climate Index*, by contrast, answers the question: "*how well is my state tax system structured?*"

27 *State Budget: Restrictions on Spending, Fiscal 2014-15*, State Finance Report, No. 83-1, Texas House Research Organization, Jan. 31, 2013.

State and Local Tax Burdens

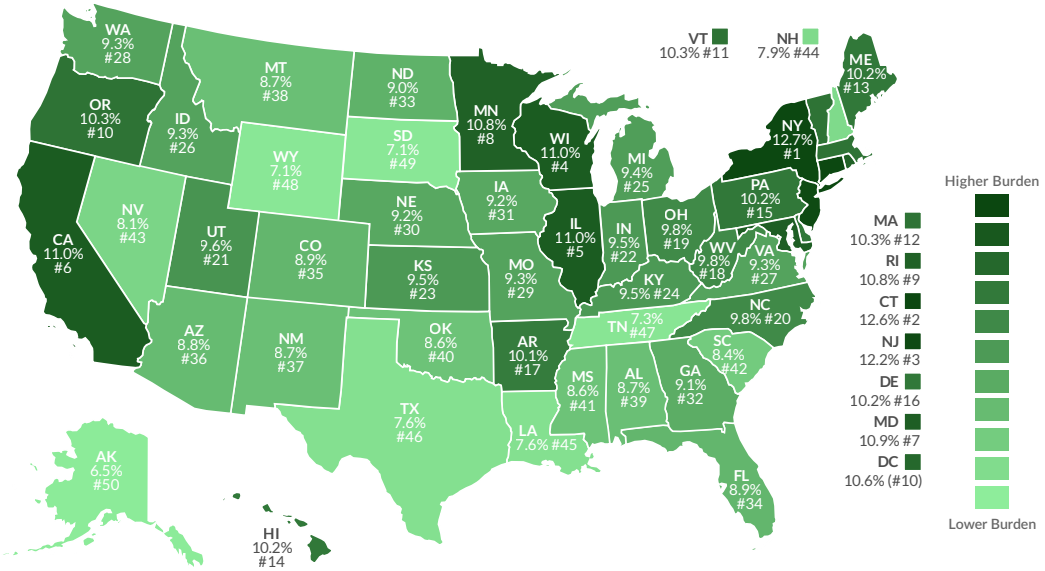
Many people are familiar with tax collections measures, which tally the amount of taxes collected by state and local governments. Tax burdens, however, measure the impact of those collections on taxpayers.

In the Tax Foundation's *Annual State-Local Tax Burden Rankings*, collections data are adjusted for tax importation and tax exportation, resulting in a full picture of the taxes Americans pay, in their home states and across the country. In fiscal year 2012 (the most recent year in which data is available), New Yorkers paid the most in state and local taxes (12.7 percent of total state income); Alaskans paid the least (6.5 percent).[28]

Louisianans have one of the lowest state and local tax burdens, ranking 45th nationally. In fiscal year 2012, residents of the state paid $2,950 per capita in all state and local taxes (including $997 in taxes to other states), amounting to an effective rate of 7.6 percent of total state income.[29] Figure 2e shows the total state and local tax burden of each state in the 2012 fiscal year. Of note, neighboring Texas scores only slightly more favorably in this metric. Residents of Alabama, Arkansas, Florida, Georgia, and Mississippi all pay more in state and local taxes than Louisianans.

Figure 2e.

State-Local Tax Burdens as a Share of Total State Income (FY 2012)



Note: DC's rank does not affect other states' rankings, but the number in parentheses indicates where if would rank if included.
Source: Tax Foundation, *Annual State-Local Tax Burdens Rankings FY 2012* (forthcoming).

28 Liz Malm & Gerald Prante, *Annual State-Local Tax Burden Rankings FY 2012*, Tax Foundation, forthcoming.
29 *Id.*

State Business Tax Climate Index

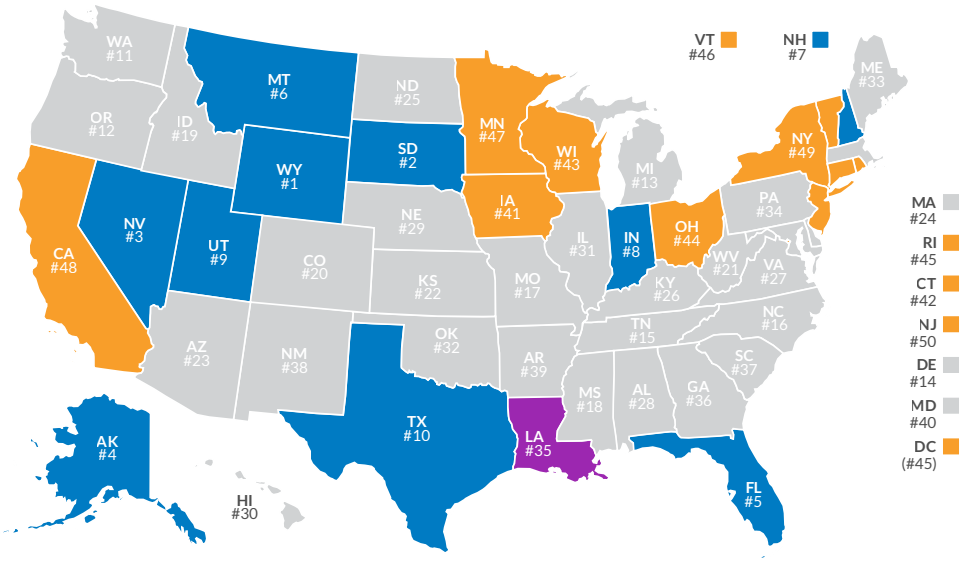
While how much is paid in taxes each year is an important consideration for competitiveness, equally important is *how* those taxes are paid. Taxes vary significantly, with certain levies being more harmful to growth, and others creating additional compliance costs.

Each year the Tax Foundation produces the *State Business Tax Climate Index* to enable business leaders, government policymakers, and taxpayers to gauge how these structural elements compare.[30] The *Index* examines over 100 variables in corporate tax, individual income tax, sales tax, property tax, and unemployment insurance tax categories to reduce these many complex considerations into a relative ranking.

In the most recent report (see Figure 2f), which gauges states as of July 1, 2014, the states with the best tax systems are Wyoming, South Dakota, Nevada, Alaska, Florida, Montana, New Hampshire, Indiana, Utah, and Texas. The states with the worst tax systems are New Jersey, New York, California, Minnesota, Vermont, Rhode Island, Ohio, Wisconsin, Connecticut, and Iowa.

Figure 2f.

State Business Tax Climate Index Rankings



Note: DC's rank does not affect other states' rankings, but the number in parentheses indicates where if would rank if included.
Source: Tax Foundation, *2015 State Business Tax Climate Index.*

Louisiana's *State Business Tax Climate Index* Overall & Subcomponent Rankings

Overall	35th
Corporate Income Taxes	23rd
Individual Income Taxes	27th
Sales Taxes	50th
Unemployment Insurance Taxes	6th
Property Taxes	24th

30 Scott Drenkard & Joseph Henchman, *2015 State Business Tax Climate Index*, Tax Foundation, Oct. 28, 2014.

Even though Louisiana has a competitive tax burden, its tax structure leaves much to be desired, ranking toward the bottom of the pack at 35th nationally. The most poorly ranked element of the state's tax system is the sales tax component, which ranks 50th in the country, chiefly due to its high rate and multiple parallel local sales tax bases (discussed further in Chapter 3).

Other components that contribute to Louisiana's poor *Index* rankings are the top statutory corporate income tax rate of 8 percent, which is among the highest nationally, the top individual income tax rate of 6 percent, which is one of the highest among nearby states, and the state's franchise tax, an arcane business tax system which contributes to a middle-of-the-pack property tax ranking, even though residential property taxes are quite low.

Fundamental tax reform is about improving these shortcomings so that Louisiana can collect the revenue necessary for government services, while maintaining a competitive position to attract new businesses and individuals and grow opportunity in the state. By broadening tax bases and lowering tax rates, the state can have a meaningful impact on the quality of life for Louisianans.

Throughout this book, we will use the *State Tax Business Climate Index* as a way to compare Louisiana's taxes to select regional competitor states and the country as a whole. The states we have chosen for comparison are Alabama, Arkansas, Florida, Georgia, Mississippi, and Texas.

CHAPTER 3:
STATE AND LOCAL SALES TAXES

Introduction

Some of Louisiana's sales tax issues are present in many other states: a shrinking tax base, limited taxation of the services sector, and a lack of taxation of e-commerce transactions. But Louisiana also faces an issue that is uncommon to nearly all other states: it allows local jurisdictions to define their own sales tax bases and to collect and audit their own sales taxes. This creates several issues for both taxpayers and the state itself—namely complexity, lack of compliance, and duplicative administration.

While reforming the state and local sales tax system is necessary to improve administration, neutrality, and simplicity, reform is also crucial if the state wants to have the ability to collect sales tax from internet retailers. Considering the continually increasing importance of the e-commerce sector and the likelihood of passing federal legislation such as the Marketplace Fairness Act or Retail Transactions Parity Act, Louisiana will need to begin bringing its tax code into compliance with national norms so that the state can collect sales tax from out-of-state sellers when that time comes.

In this chapter, we provide a general overview of the Louisiana sales tax system (both state and local) and outline some key things lawmakers should consider when discussing modernizing the state's sales tax. These include: how Louisiana sales tax rates compare regionally and nationally, the proper treatment of business inputs under the sales tax, options for base expansion to services, and requirements of states under federal remote seller legislation. We conclude the chapter by describing three reform options, along with *State Business Tax Climate Index* rankings for each.

Sales Tax: An Important Tax Tool for State and Local Governments

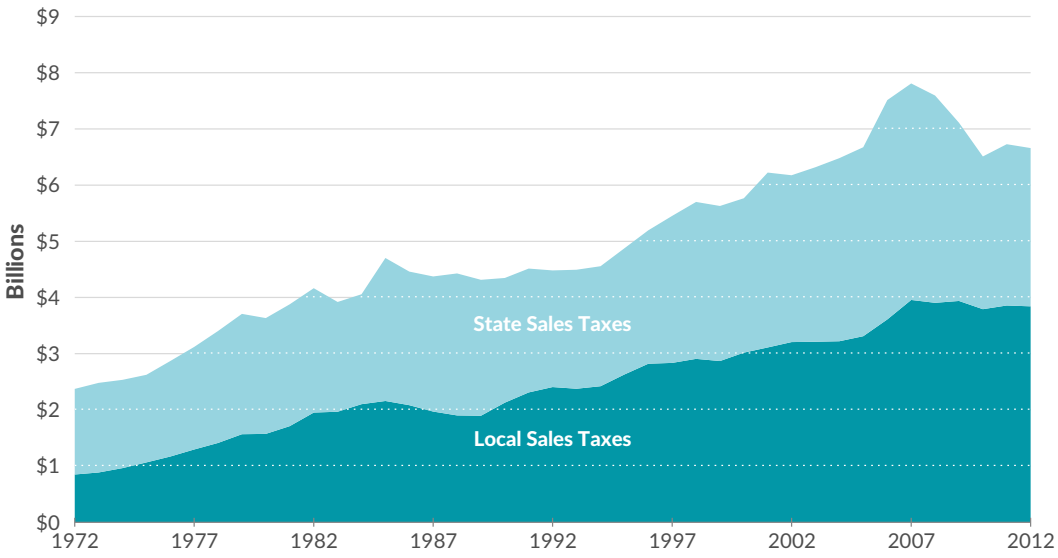
Sales taxes are one of the most important tax tools in Louisiana, accounting for 47 percent of total local tax collections and 31 percent of total state tax collections.[31]

In fiscal year 2012, Louisiana state and local governments raised $6.7 billion in sales taxes according to the U.S. Census Bureau.[32] These collections have grown in real terms over time. In 1972, Louisiana state and local governments collected $2.4 billion in sales taxes (in 2012 dollars).

The composition of those sales tax collections has changed as well. In 1972, state-level taxes made up 64 percent of the total combined collections, while 36 percent were from local-level sales taxes. In fiscal year 2012, 42 percent of those collections ($2.8 billion) came from the state-level sales tax, while the remainder (58 percent, or $3.8 billion) was derived from local option sales taxes levied by parishes, school boards, and other local entities (see Figure 3a).

Figure 3a.

Louisiana State and Local Tax Collections (1972–2012, in 2012 Dollars)



Note: Dollar amounts are adjusted for inflation based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2012 base year.
Source: Census Bureau, *State and Local Government Finances*; Bureau of Labor Statistics, *Consumer Price Indexes* (All Urban Consumers).

31 Census Bureau, *State and Local Government Finance.*
32 *Id.*

Comparing Louisiana's Sales Tax Structure to Regional and National Competitors

Louisiana has the most poorly structured sales tax in the nation according to our *State Business Tax Climate Index*,[33] putting the state at a disadvantage with its regional competitors. Louisiana's poor score is driven by two factors: the fact that the state allows localities to set their own sales tax bases, and the state's high combined state and local rate of 9.01 percent, the third highest in the country. Table 3a shows Louisiana's *State Business Tax Climate Index* sales tax component ranking, in addition to the rankings of select regional competitor states.

Table 3a.

State Business Tax Climate Index Sales Tax Component Rankings

Louisiana and Select Regional Competitors (2015)

State	Component Ranking
Louisiana	50th
Alabama	41st
Arkansas	44th
Florida	12th
Georgia	17th
Mississippi	28th
Texas	36th

Source: Tax Foundation, *2015 State Business Tax Climate Index.*

Louisiana's Sales Tax Rate: Moderate State Rate, High Local Rates

As of midyear 2015, Louisiana had the third highest average combined state and local sales tax rate in the country (at 9.01 percent), outranked by only Tennessee (which foregoes an individual income tax) and Arkansas.[34] The state has the second highest combined rate among regional competitors. See Figure 3b for how Louisiana compares regionally.

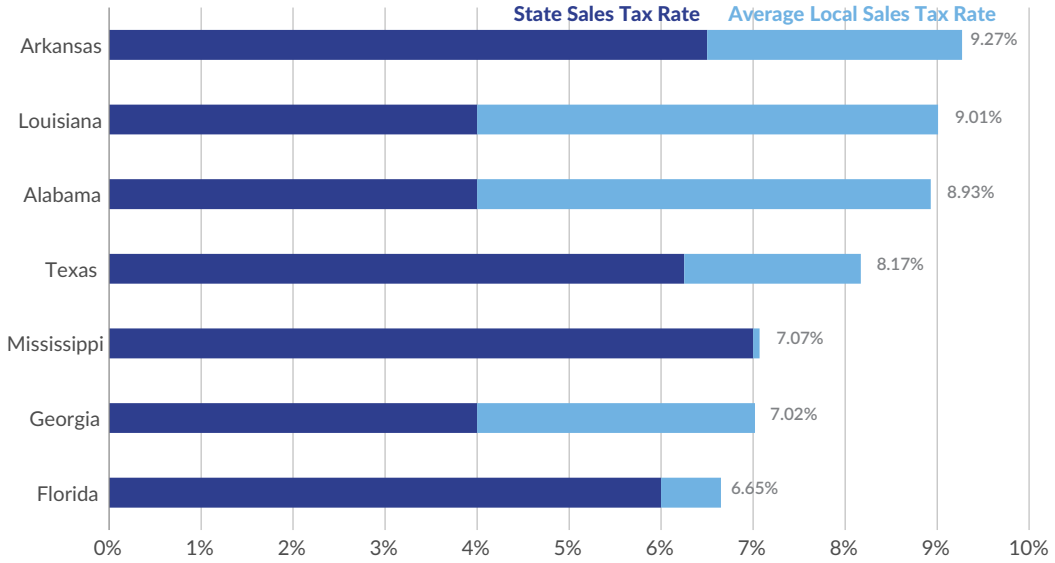
33 Scott Drenkard & Joseph Henchman, *2015 State Business Tax Climate Index*, Tax Foundation, Oct. 28, 2014.

34 Scott Drenkard & Jared Walczak, *State and Local Sales Tax Rates Midyear 2015*, Fiscal Fact No. 474, Tax Foundation, July 9, 2015.

Figure 3b.

Average Combined State-Local Sales Tax Rates

Louisiana and Select Regional Competitors (as of July 1, 2015)



Source: Tax Foundation, *State and Local Sales Tax Rates, Midyear 2015*.

Most states—Louisiana's regional competitors among them—have a two-part sales tax: a state-level rate that is levied throughout the entire state and local option sales taxes that are levied in specific jurisdictions or tax districts (such as school districts, counties or parishes, and other special local districts such as fire and water districts). When considered in isolation, the Louisiana state-level rate of 4.0 percent is relatively modest—13th lowest in the country. But when local option sales taxes are factored in, Louisiana's anomalously high local taxes contribute to one of the highest combined rates in the country. On average, Louisiana's local sales taxes are 5.01 percent (but can go as high as 7.0 percent in some areas of the state).

The average local rate of 5.01 percent includes all levels of local government, which means that actual local combined sales tax rates will differ throughout the state. For example, the combined local rate in Allen Parish ranges from 4.7 percent to 6.0 percent, depending on where in the parish a purchase is made.[35]

35 Louisiana Association of Tax Administrators, *Jurisdiction List*, Combined Local Rate, accessed Oct. 2015, http://www.laota.com/index.php?option=com_content&view=article&id=13:allen&catid=2:jurisdiction-list&Itemid=23.

Louisiana's Sales Tax Base: Narrow, Complicated, and Lacking Uniformity and Neutrality

While Louisiana's combined sales tax rates are high, an even larger problem is the sales tax base, which lacks uniformity between the state and local levels, and even between and within the localities themselves.

In many instances, the statewide base that applies a 4.0 percent rate is different from the base to which different elements of local sales taxes apply, even though only one tax payment is remitted. This poses administration and compliance issues for businesses responsible for collecting the tax, and ultimately makes the state less competitive for jobs and investment.

The State-Level Tax Base

Below is a list of the transactions on which the state-level sales tax applies, as outlined by the Louisiana Department of Revenue (local bases are discussed in a subsequent section):[36]

- Retail sales of tangible personal property
- Use, consumption, distribution, or storage for use or consumption of tangible personal property
- Lease or rental of tangible personal property
- Sales of selected services (hotel room furnishings; amusement, athletic, and recreational event admissions sales; access to amusement, entertainment, athletic, or recreational facilities; auto storage and parking; printing; laundry, dry cleaning, pressing, and dyeing; cold storage; tangible personal property repairs; and telecommunication services)
- Telecommunication and sales of prepaid phone cards and authorization numbers (taxed at a reduced rate of 3 percent)

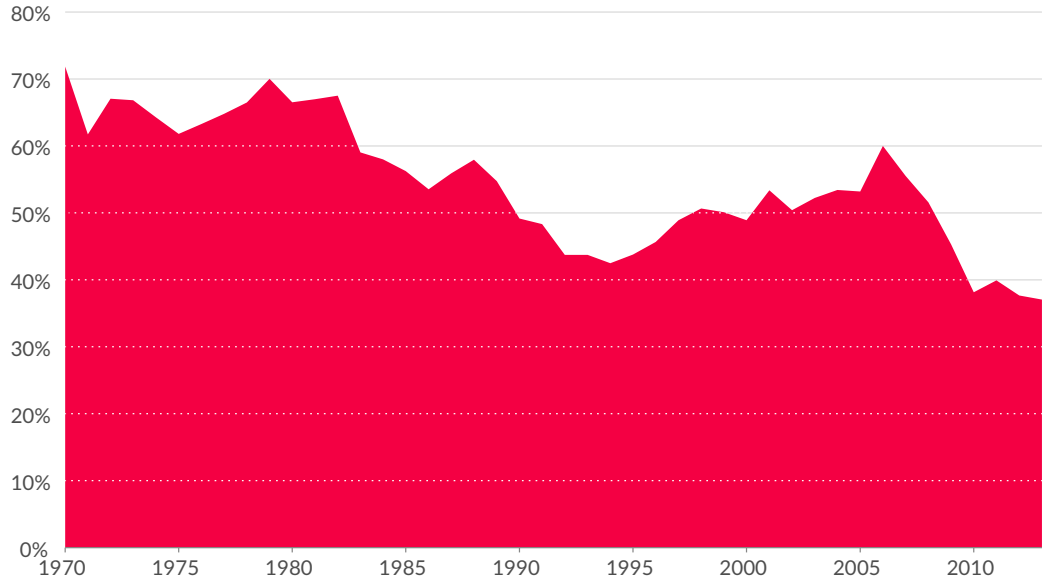
Like in most states, a main problem with the sales tax in Louisiana is its narrow base. Data indicates that since 1970, Louisiana's sales tax breadth—a measure of the broadness of the tax base—has fallen from 72 percent to just 37 percent in 2013 (see Figure 3c).

36 Louisiana Department of Revenue, *General Sales & Use Tax*, Basis of tax, accessed June 2015, http://rev.louisiana.gov/SalesTax/GeneralSalesAndUseTax.

Figure 3c.

Louisiana Sales Tax Breadth

Measured by Implicit Sales Tax Base by Personal Income (1970–2014)



Source: Professor John Mikesell, Indiana University.

Louisiana does not tax food or prescription drugs under the state sales tax, though these purchases are a sizable, stable portion of consumer spending in most states. In Louisiana, 13.7 percent of personal consumption expenditures in 2012 were on off-premise food and beverage consumption and gasoline and other energy goods.[37] As the tax base shrinks, lawmakers tend to look to rate increases for additional revenue. A better option is to broaden the tax base, which can permit rate reductions even in revenue positive scenarios.

37 Bureau of Economic Analysis, *Personal Consumption Expenditures by State, 1997-2012 (Prototype Estimates)*, Aug. 7, 2014.

Taxation of Business Inputs

When considering broadening the sales tax base, it is important to maintain proper treatment of business inputs. A perfectly structured sales tax should be imposed on all final consumer goods and services while exempting all purchases made by businesses that will be used as inputs in the production process. This is not because businesses deserve special treatment under the tax code, but because applying the sales tax to business inputs results in multiple layers of taxation embedded in the price of goods once they reach final consumers, known as "tax pyramiding." The result is higher and inequitable effective tax rates for different industries and products, which is both non-neutral and non-transparent. Unfortunately, most states do a poor job of exempting business inputs from sales taxation.

The Local Sales Tax Base

While the Louisiana state-level sales tax base does a reasonably good job of exempting business inputs, this is not the case on the local level. Certain sales tax exemptions granted by the state government (such as the exemption for the purchase of manufacturing machinery, a business input) are optional at the local level.[38] That means that when a business purchases manufacturing machinery, the transaction is exempted from the 4.0 percent state-level sales tax, but may not be exempt from the local optional sales taxes levied.

Based on a report to the Louisiana Sales Tax Streamlining and Modernization Commission, local governments within 59 of the 64 parishes in Louisiana did not adopt the optional manufacturing machinery exemption (that is, 59 parishes tax the purchase of manufacturing machinery).[39] In addition, the exemption within four of the five parishes is not parish-wide. Several other state-level exemptions are also optional at the local level. This includes the food and prescription drug exemptions present at the state level.

Table 3b outlines which parishes tax various transactions under some portion of their local sales taxes. Note that all four of the transaction types in Table 3b are exempted fully from the 4.0 percent state-level sales tax.

Allowing optional exemptions such as these creates confusion and disuniformity between state and local tax bases. Businesses collecting sales taxes should not have to determine whether or not an item is exempted from the state sales tax but not exempted from a local option sales tax. This disuniformity is especially problematic for businesses operating in multiple local jurisdictions in Louisiana.

38 Other optional local exclusions include prescription drugs, farm equipment, custom computer software, repairs to tangible personal property, digital television conversion equipment with an FCC license, parts used in fabrication, storm shutters, and capital equipment for radiation therapy treatment centers. See LSA-R.S. 47:337:10. This excludes Plaquemines parish. Any subdivision of Plaquemines can exempt anything that the state exempts from the state sales tax base, not only the optional exclusions enumerated above. See LSA-R.S. 47:305:20 and § 337.10(C).

39 *Louisiana-Wide Sales Tax Base Analysis*, Presentation to the Louisiana Sales Tax Streamlining and Modernization Commission, Oct. 7, 2015.

Table 3b.

Taxability of Select Transactions by Parish

Note: A check mark indicates transactions that are fully taxable in the parish but exempt from state sales tax.

Parish	Pharmaceuticals	Food for Home Consumption	Farm Equipment	Manufacturing Machinery & Equipment
Acadia Parish	✓	✓	✓	✓
Allen Parish	✓	✓	✓	✓
Ascension Parish	✓	✓	✓	✓
Assumption Parish	✓	✓	✓	✓
Avoyelles Parish	✓	✓	✓	✓
Beauregard Parish	✓	✓	✓	✓
Bienville Parish	✓	✓	✓	✓
Bossier Parish	✓	✓	✓	✓
Caddo Parish	✓	✓	✓	Exemption applies to Shreveport City/ Town—2.75% tax only
Calcasieu Parish	✓	Exemption applies to Calcasieu Parish Policy Jury —1% tax only	✓	Exemption applies to City of Lake Charles—2.25% tax only (limited to Brownfield area only)
Caldwell Parish	✓	✓	✓	✓
Cameron Parish	✓	✓	✓	✓
Catahoula Parish	✓	✓	✓	✓
Claiborne Parish	✓	✓	✓	✓
Concordia Parish	✓	✓	✓	✓
De Soto Parish	✓	✓	✓	✓
East Baton Rouge Parish	Exemption applies to EBR School Board—1% tax; Zachary School Board—1% tax; and 1% sewer and street levy		✓	✓
East Carroll Parish	✓	✓	✓	✓
East Feliciana Parish	✓	✓	✓	✓
Evangeline Parish	✓	✓	✓	✓
Franklin Parish	✓	✓	✓	✓
Grant Parish	✓	✓	✓	✓
Iberia Parish	✓	✓	✓	✓
Iberville Parish	✓	✓	✓	✓
Jackson Parish	✓	✓	✓	✓
Jefferson Davis Parish	✓	✓	✓	✓
Jefferson Parish	Taxable at lower rate		✓	Exemption applies throughout entire parish
Lafayette Parish	✓	✓	✓	✓
Lafourche Parish	✓	✓	✓	✓
La Salle Parish	✓	✓	✓	✓
Lincoln Parish	✓	✓	✓	✓
Livingston Parish	✓	✓	✓	✓
Madison Parish	✓	✓	✓	✓
Morehouse Parish	✓	✓	✓	✓
Natchitoches Parish	✓	✓	✓	✓
Orleans Parish	✓	✓	✓	✓
Ouachita Parish	Exemption applies to City of Monroe—1% tax only		✓	Exemption applies to City of West Monroe—2% tax only
Plaquemines Parish	✓	Taxable at lower rate (1%)	✓	✓
Pointe Coupee Parish	✓	✓	✓	✓
Rapides Parish	✓	✓	✓	✓
Red River Parish	✓	✓	✓	✓
Richland Parish	✓	✓	✓	✓
Sabine Parish	✓	✓	✓	✓
St. Bernard Parish	✓	✓	✓	✓
St. Charles Parish	✓	✓	✓	✓
St. Helena Parish	✓	✓	Exemption applies throughout entire parish	✓
St. James Parish	✓	✓	✓	Exemption applies to St James Parish Council—1% tax only
St. John The Baptist Parish	✓	✓	✓	✓
St. Landry Parish	✓	✓	✓	✓
St. Martin Parish	✓	✓	✓	✓
St. Mary Parish	✓	✓	✓	✓
St. Tammany Parish	✓	✓	✓	✓
Tangipahoa Parish	✓	✓	✓	✓
Tensas Parish	✓	✓	✓	✓
Terrebonne Parish	✓	✓	✓	✓
Union Parish	✓	✓	✓	✓
Vermilion Parish	✓	✓	✓	✓
Vernon Parish	✓	✓	✓	✓
Washington Parish	✓	✓	✓	✓
Webster Parish	✓	✓	✓	✓
West Baton Rouge Parish	Exemption applies to educational facilities district levy only (1%)		✓	✓
West Carroll Parish	✓	✓	Exemption applies to West Carrol Parish Policy Jury—3% tax only	✓
West Feliciana Parish	✓	✓	✓	✓
Winn Parish	✓	✓	✓	✓

Only six states allow localities to set their own sales tax bases (Alaska, Arizona, Colorado, Idaho, Louisiana, and New Jersey).[40] In the remaining states, the state and local sales tax bases are identical, with the base determined by the state government. Allowing local base disuniformity under the sales tax is not common and is a poor policy decision because of the confusion, compliance costs, and non-neutrality it causes.

During the 2015 legislative session, the Louisiana Sales Tax Streamlining and Modernization Commission was created to study this and other issues, to help Louisiana start on the path toward simplifying its sales tax administration.[41] Thanks to the Commission, local sales tax bases (and their differences from the state sales tax base) are being enumerated and publicly circulated for the first time.

Duplicative Collection and Administration

Yet another issue related to local sales taxes in Louisiana is that localities are permitted to administer, collect, and audit their own sales taxes. In most other states, that responsibility lies solely with the state department of revenue.

Several years ago, the Public Affairs Research Council of Louisiana (PAR Louisiana) argued:[42]

> 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.

40 Scott Drenkard & Joseph Henchman, *2015 State Business Tax Climate Index*, Tax Foundation, Oct. 28, 2014. Note that New Jersey only allows border counties to set their own sales tax bases.

41 See Louisiana State Legislature, *Sale Tax Streamlining and Modernization Commission*; and Sales Tax Institute, *Louisiana Creates Sales Tax Streamlining and Modernization Commission*, Sept. 21 2015.

42 Public Affairs Research Council of Louisiana, *Louisiana's Taxes: Problems, Solutions, and the Controversy of Reform*, p. 3, Research Brief, Apr. 2013.

Those criticisms still stand. PAR Louisiana also outlined potential solutions to this problem, which we reproduced below:[43]

> The state should simplify and centralize sales tax collections and compliance. … 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. … 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.

These observations are on target. Louisiana's current duplicative system is not only costly for the state, but costly for businesses as well. Moving toward a unified system in which companies were subject to single state-local audits is a smart policy choice.

The state of Arizona recently made changes to its sales tax system by disallowing local jurisdictions to conduct their own independent audits. As reported by Grant Thornton:[44]

> By repealing an existing statute, the legislation terminates the right of municipalities to perform separate audits on taxpayers, instead requiring that audits of taxpayers with multiple locations in Arizona be conducted by the Department. The following audit standards were also added: … all audits will include all taxing jurisdictions in Arizona regardless of which jurisdiction conducts the audit, while a locality is empowered to conduct an audit of any taxpayer that is located only in one local jurisdiction; … the Department will issue all audit assessments on behalf of the localities involved in a single notice to the taxpayer; … audit appeals will be directed to the Department; and … the Department will communicate audit conclusions to any affected localities prior to finalizing any taxpayer agreements.

Taxation of Services

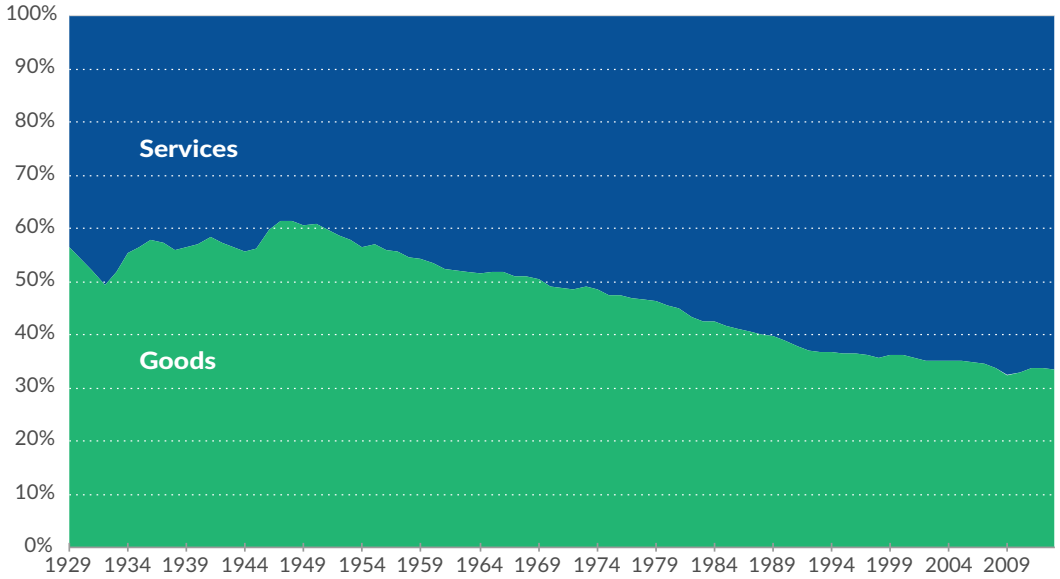
Another major contributing factor to the shrinking sales tax base over time—in Louisiana and elsewhere—is that American consumption habits have shifted over the years. We no longer spend the majority of our consumption on goods and have instead shifted toward services. Figure 3e shows national goods and services consumption shares since 1929.

43 *Id.*
44 Grant Thornton, *Arizona Enacts Transaction Privilege Tax Changes*, State & Local Tax Alert, Aug. 9, 2013.

Figure 3d.

Percent of Total U.S. Personal Consumption Expenditures

Goods and Services (1929-2013)



Source: Bureau of Economic Analysis, *National Income and Production Accounts, Personal Income and Outlays.*

Because Louisiana's sales tax base is primarily focused on the purchase of tangible personal property (that is, goods), and services are largely exempted from the tax, it is no surprise that the base has become smaller over time. To make the sales tax base more reflective of the modern economy, expansion to services is a viable option. According to the Louisiana Budget Project:[45]

> Despite the changed times, Louisiana has not modernized its sales tax to include many of the services more prevalent in today's economy. Partly for this reason, the state is unable to produce the revenue needed to keep up with the normal growth in the cost of providing education, healthcare, and other necessities.

The Federation of Tax Administrators (FTA) periodically publishes a survey of services taxable under each state's sales tax, with the most recent data compiled in 2010. The data includes both business-to-business services (which should be exempted under a well-structured sales tax, as discussed earlier) and final consumer services. Seventy-one of the transactions could be either, depending on the identity of the final purchaser.

Tables 3c, 3d, and 3e outline these service categories and note whether or not the Louisiana sales tax applies to each service type. As of 2010, Louisiana taxed 65 of the 182 services enumerated in the FTA survey under the general sales tax. Of those, at least 14 should be exempted because they are business inputs.

45 Louisiana Budget Project, *Expanding Louisiana's Sales Tax—A Little from Everyone Means a Lot for Louisiana*, Apr. 2011.

Table 3c.

Louisiana's Tax Treatment of Business Input Services

Business Input Service	Taxed in Louisiana?
Advertising, Billboards	
Advertising, Magazine	
Advertising, Newspaper	
Advertising, Radio & Television (Local)	
Advertising, Radio & Television (National)	
Advertising Agency Fees (Excluding Ad Placement)	
Armored Car Services	
Bulldozers, Draglines, & Construction Machinery Rentals (Long-Term)	✓
Bulldozers, Draglines, & Construction Machinery Rentals (Short-Term)	✓
Check & Debt Collection	
Commercial Art & Graphic Design	
Commercial Linen Supply	✓
Credit Information & Credit Bureaus	
Custom Fabrication Labor	✓
Data Processing Services	
Employment Agencies	
Financial & Tickertape Reporting	
Food Storage	
Industrial Sewer & Refuse Services	
Information Services	
Interstate Telephone & Telegraph	✓*
Intrastate Telephone & Telegraph	✓*
Labor Charges, Repairs to Commercial Fishing Vessels	✓
Labor Charges, Repairs to Interstate Vessels	
Labor Charges, Repairs to Intrastate Vessels	✓
Labor Charges, Repairs to Railroad Rolling Stock	✓
Lobbying & Consulting Services	
Mainframe Computer Access & Processing Services	
Maintenance & Janitorial Services	
Marketing	
Metal, Non-Metal, & Coal Mining Services	
Mini-Storage	
Oil Field Services	
Online Data Processing Services	
Packing & Crating	
Process Server Fees	
Public Relations & Management Consulting	
Rental of Films and Tapes by Theaters	
Rental of Hand Tools to Licensed Contractors	✓
Secretarial & Court Reporting Services	
Security Services	
Seismograph & Geophysical Services	
Sign Construction & Installation	
Software, Material Custom Programs	✓
Software, Modifications to Canned Programs	✓
Software, Professional Services Custom Programs	✓
Soil Preparation, Custom Bailing, & Other Agricultural Services	
Swimming Pool Cleaning & Maintenance	
Telemarketing Services (Contract)	
Telephone Answering Services	
Temporary Help Agencies	
Test Laboratories (Excluding Medical)	
Test Laboratories (Medical)	
Typesetting & Platemaking for Print Trades	
Utilities, Electricity (Nonresidential)	
Utilities, Natural Gas (Nonresidential)	
Utilities, Other Fuel (Including Heating Oil, Nonresidential)	
Utilities, Water (Nonresidential)	
Welding Labor (Fabrication & Repair)	✓

Note: An asterisk (*) indicates the service is subject to a lower tax rate.
Source: Federation of Tax Administrators (2010).

Table 3d.

Louisiana's Tax Treatment of Consumer Services

Consumer Services	Taxed in Louisiana?
900 Number Services	
Aircraft Rental to Individual Pilots (Long-Term)	✓
Aircraft Rental to Individual Pilots (Short-Term)	✓
Amusement Park (Admission & Rides)	✓
Bail Bond Fees	
Barber Shops & Beauty Parlors	
Billiard Parlors	✓
Bowling Alleys	✓
Circuses & Fairs (Admission & Games)	✓
Coin-Operated Video Games	
Cultural Events (Admission)	✓
Dating Services	
Debt Counseling	
Dentists	
Diaper Service	✓
Downloading, Movies & Digital Video	✓
Downloading, Music	✓
Downloading, Other Electronic Goods	✓
Electricity (Residential)	
Fishing & Hunting Guide Services	
Funeral Services	✓
Fur Storage	✓
Garment Services (Altering & Repairing)	✓
Gift & Package Wrapping Services	✓
Health Clubs & Gyms	✓
Horse Boarding & Training (Excluding Race Horses)	
Household Goods Storage	
Laundry & Dry Cleaning Services (Coin-Operated)	
Laundry & Dry Cleaning Services (Non-Coin-Operated)	✓
Local Transit (Intra-City) Buses	
Massage Services	
Natural gas (Residential)	
Nursing Services (Out of Hospital)	
Other Fuel (Including Heating Oil, Residential)	
Pari-Mutuel Racing Events	
Personal Instruction (Dance, Golf, Tennis, Etc.)	
Pet Grooming	
Physicians	
Pinball & Other Mechanical Amusements	
Private Clubs (Membership Fees)	✓
Professional Sports Events (Admission)	✓
Rental of Video Tapes for Home Viewing	✓
Residential Sewer & Refuse Services	
School & College Sports Events (Admission)	
Shoe Repair	✓
Tanning Parlors & Salons	
Tax Return Preparation	
Taxidermy	
Trailer Parks (Overnight)	
Tuxedo Rental	✓
Water (Residential)	

Source: Federation of Tax Administrators (2010).

Table 3e.

Louisiana's Tax Treatment of Other Service Types

(in which type of service, business input or consumer, depends on identity of final purchaser)

Service	Taxed in Louisiana?
Accounting & Bookkeeping	
Architects	
Attorneys	
Auto Service (Except Repairs, Including Painting & Lube)	✓
Automobile Lease (Long-Term)	✓
Automobile Rental (Short-Term)	✓
Automotive Road & Towing Services	
Automotive Rustproofing & Undercoating	✓
Automotive Storage	
Automotive Washing	
Automotive Waxing	✓
Banking Service Charges	
Cable TV Services	
Carpentry, Painting, Plumbing & Similar Trades	
Carpet & Upholstery Cleaning	✓
Cellular Telephone Services	✓*
Chartered Flights (with Pilot)	
Cold Storage	✓
Construction Contracting Labor	
Construction Service (Grading, Excavating, Etc.)	
Custom Meat Slaughtering, Cutting, & Wrapping	
Custom Processing (on Customers' Property)	✓
Direct Satellite TV	
Downloading, Books	✓
Engineers	
Exterminating	
Hotels, Motels, & Lodging Houses	✓
Installation Charges by Persons Other than Seller of Goods	
Installation Charges by Persons Selling Property	✓
Insurance Services	
Interior Design & Decorating	
Internet Service Providers, Dialup	
Internet Service Providers, DSL or Other Broadband	
Interstate Air Courier (Billed In-State)	
Intrastate Courier Service	
Intrastate Transportation of Persons	
Investment Counseling	
Labor Charges, Repairs Delivered Under Warranty	✓
Labor Charges, Repairs or Remodeling of Real Property	
Labor Charges, Repairs to Aircraft	✓
Labor Charges, Repairs to Motor Vehicles	✓
Labor Charges, Repairs to Other Tangible Property	✓
Labor Charges, Repairs to Radio, TV, and Other Electronic Equipment	✓
Land Surveying	
Landscaping Services (Including Lawn Care)	
Limousine Service (with Driver)	
Loan Broker Fees	
Marina Service (Docking, Storage, Cleaning, & Repair)	
Marine Towing Service (Including Tugboats)	
Parking Lots & Garages	✓
Photo Finishing	✓
Photocopying Services	✓
Printing	✓
Private Investigation & Detective Services	
Property Sales Agents (Real Estate or Personal)	
Real Estate Management Fees (Rental Agents)	
Real Estate Title Abstract Services	
Repair Labor (Generally)	✓
Repair Material (Generally)	✓
Service Contracts Sold at the Time of Sale of Tangible Personal Property	✓
Software, Downloaded	✓
Software, Package or Canned Program	✓

Table 3e. *Continued*

Louisiana's Tax Treatment of Other Service Types
(in which type of service, business input or consumer, depends on identity of final purchaser)

Service	Taxed in Louisiana?
Storage of Personal Property (Long-Term)	✓
Storage of Personal Property (Short-Term)	✓
Taxi Service	
Tire Recapping & Repairing	✓
Travel Agent Services	
Veterinary Services	
Water Softening & Conditioning	
Water Well Drilling	
Window Cleaning	

Note: An asterisk (*) indicates the service is subject to a lower tax rate.
Source: Federation of Tax Administrators (2010).

In a very broad, ideal sales tax, all of the services outlined in Table 3d (consumer services) would be subject to the sales tax. The services in Table 3c (business input services) would all be exempt from the sales tax. However, since sales tax breadth is not the only policy consideration facing lawmakers, certain services may be exempted for other reasons.

Taxing the services enumerated in Table 3e requires a bit of creativity in administration to ensure that when purchased by consumers these service transactions are taxed, but when purchased by businesses they are not. One option is to identify business taxpayers by using an existing business tax, like the corporate income or franchise tax. When paying this tax, a firm would be granted a business identification number registered with the Louisiana Department of Taxation. The firm would then present this number upon purchase of any goods or services used in the production process and be exempted from paying sales tax on those purchases. This is similar to how some states identify nonprofit organizations for purposes of exempting them from taxation.

It is important to note in our discussion of base expansion to services that any base changes should include changes to both the state *and* local sales tax base. If not, the system is inherently complicated and non-neutral, and such a system will not be compliant with many provisions of federal legislation allowing states to collect sales taxes on remote transactions.

Taxation of E-Commerce

Another factor contributing to dwindling sales tax bases over time is the lack of taxation of remote purchases (such as those made over the Internet). Currently, retailers are only required to collect sales taxes in states in which they have a physical presence of property or employees. This geographic limitation on the scope of state taxing power, while not new, has come under pressure due to the growing size of Internet retail and the resultant disparity in tax treatment between goods purchased online and goods purchases at brick-and-mortar stores.

Keeping the sales tax aligned with the modern economy is important for the state and brick-and-mortar retailers, just as making multistate sales tax collection as seamless and simple as possible is important for internet retailers and the national economy as a whole.

Use Taxes: A Poor Solution Due to Low Compliance

Use taxes were enacted as complements to sales taxes not long after their introduction. While the sales tax is owed for purchasing an item, the use tax is owed for using an item when sales tax has not been paid. States introduced use taxes out of concern that taxpayers would avoid sales taxes by purchasing goods in states with lower or no sales tax instead of purchasing them in state and paying the sales tax. The use tax thus creates a tax obligation for consumers who do this, and all states with a sales tax also have a use tax with the same rate as the sales tax.

However, because the use tax requires self-reporting and payment by the consumer instead of collection at point-of-sale by the retailer, use tax compliance is very low except for large purchases or business purchases susceptible to a state audit.[46] Thus, consumers do not tend to report many of their internet purchases in order to avoid paying use tax on them.

An Increased Push to Tax Internet Purchases

Americans spent about $263 billion in internet retail purchases in 2013, a growth of 15 percent over the year before and comprising about 6 percent of the $4.5 trillion in total retail sales.[47] The growth rate has been fairly steady and it is likely that internet commerce will continue to grow as a share of national retail.

While the largest driver of continued discussion of e-commerce taxation is the desire for more revenue, there is also a neutrality argument at play. There is no economically justifiable reason why the same good should be untaxed if it is purchased online versus if it were purchased in a brick-and-mortar store. Such discrepancies are non-neutral and favor online purchases at the expense of purchases made at traditional retail establishments.

However, state taxing power is generally limited to individuals and businesses within the state's borders (to prevent harm to the national economy from tax exporting). To get around this issue, some states have passed "click-through nexus" or "affiliate nexus" statutes requiring out-of-state retailers to collect sales tax under certain circumstances, leading to extended litigation and uncertainty. Examples include New York's "Amazon" Tax Law (and subsequent similar laws in other states).[48]

46 About half of the states also include a use tax payment line on their income tax form, but the collections from this method are minimal. Features of this sometimes include an exemption for purchases under a certain threshold and a lookup table where taxpayers can pay a certain amount based on their income rather than tracking all purchases throughout the year. See, *e.g.*, Nina Manzi, *Use Tax Collection on Income Tax Returns in Other States*, Minnesota House of Representatives Research Department Policy Brief, Apr. 2012.

47 U.S. Census Bureau, *Quarterly Retail E-Commerce Sales 1st Quarter 2014*, May 15, 2014.

48 Joseph Henchman, *The Marketplace Fairness Act: A Primer*, Background Paper No. 69, Tax Foundation, July 14, 2014.

These types of laws are problematic because they're non-neutral, only applying to certain online retailers. Further, they can discourage companies from locating distribution facilities or other operations in the state and can be triggered by *de minimis* contact with a state (e.g., an Amazon affiliate being located in the state). An affiliate nexus bill was proposed in Louisiana during the most recent legislative session but was vetoed by Governor Bobby Jindal in June of 2015.[49]

Other states have worked with the Streamlined Sales Tax Project (SSTP) for greater tax uniformity. The SSTP is a joint effort by states and the business community to reduce administrative and sales tax compliance burdens. Its mission is to get states to adopt changes to their sales taxes to make them simple and uniform and then convince Congress to allow use tax collection obligations on out-of-state companies. Twenty-four states representing 33 percent of the U.S. population have ratified the Streamlined Sales and Use Tax Agreement (SSUTA).[50]

However, this effort to balance states' reserved powers with the need for simpler rules and remittance procedures has been severely hamstrung by the refusal of many large states to participate, including California, Illinois, New York, and Texas. While no state should be compelled to participate in SSTP, the Project suffers because many states believe they can assert expanded tax authority without the hard work required by SSTP, such as centralizing tax collection and auditing, reducing local sales tax complexity, adopting uniform definitions of items, and compensating vendors for administrative costs.

In an attempt to attract more member states, the SSTP Governing Board has focused increasingly on uniformity and not simplification. In many cases, the Project has enabled state sales tax complexity by permitting separate tax rates for certain goods, not addressing growing local tax jurisdiction complexity, and permitting states to retain parochial sales tax rules.[51]

In the 1990s, local collectors in Louisiana recognized the need to adopt a more uniform local sales tax code. Then-Representative Mitch Landrieu introduced a draft of what is now known as the Uniform Tax Code, but it failed due to its large size. In 2003, however, a newer version was introduced by Senator Bill Jones.[52] This Uniform Local Sales Tax Code ultimately passed, codifying the authority and parameters under which local sales taxes operate, and providing some uniformity in assessment, collections, administration, and enforcement, though in many ways, both law and practice continue to fall well short of the stated goal of uniformity.

49 Louisiana Office of the Governor, *Governor Jindal Signs Bills into Law and Issues Vetoes*, June 19, 2015.

50 Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming.

51 See, generally, George Isaacson, *A Promise Unfulfilled: How the Streamlined Sales Tax Project Failed to Meet Its Own Goals for Simplification of State Sales and Use Taxes*, 30 State Tax Notes 339, Oct. 27, 2003; Joseph Henchman, *Nearly 8,000 Sales Taxes and 2 Fur Taxes: Reasons Why the Streamlined Sales Tax Project Shouldn't Be Quick to Declare Victory*, Tax Policy Blog, Tax Foundation, July 28, 2008; Joseph Henchman, *Testimony before Maryland Legislature on the Streamlined Sales Tax Project*, Feb. 18, 2009. See also Billy Hamilton, *Happy Birthday, SSUTA!*, 66 State Tax Notes 513, Nov. 12, 2012; John Buhl, *Governing Board Gives Initial Approval to Clothing Threshold*, 50 State Tax Notes 687, Dec. 15, 2008; Eric Parker, *New Jersey Fur Tax Sparks Streamlined Governing Board Meeting Dispute*, 42 State Tax Notes 853, Dec. 25, 2006.

52 Presentation by Mark West (Ascension Parish) and Rick Mekdessie (e-Gov Systems) at a meeting of the Louisiana Sales Tax Streamlining and Modernization Commission, Oct. 7, 2015.

Furthermore, Act 73 of 2003 created a way for Louisiana to collect sales taxes electronically. Officially launched in October of 2008, the "Parish E-File System" created a central portal from which to look up rates and submit a consolidated tax return, holding taxpayers harmless if there are any mistakes in the database, and electronically transferring all collections directly into collecting jurisdictions' bank accounts. Between 2008 and the present, $9.5 billion in state and local sales taxes have been collected via this system. While all parishes participate in this system, only a handful of parishes mandate that returns be filed electronically. Taxpayers do, however, have the option to file electronically in all jurisdictions. Electronic filing is widespread—in Ascension Parish, for example, it is estimated that 73 percent of all returns are filed electronically and 81 percent of tax payments are remitted electronically.[53]

Federal Solutions

Presently, there are three options for the taxation of remote sellers being weighed federally—the Marketplace Fairness Act (MFA),[54] the Online Sales Simplification Act (OSSA),[55] and the Remote Transactions Parity Act (RTPA)[56]—all of which would authorize states to require collection of their sales taxes by out-of-state retailers.[57]

Each bill approaches the issue differently. The MFA and the RTPA are similar in that they depend on destination sourcing in exchange for states making their sales tax administration simpler, with the RTPA adding the requirement that states integrate freely-provided tax lookup software into retailer systems and sharply limiting the ability of states to audit businesses without physical presence. The OSSA uses hybrid-origin sourcing and would transform the sales tax from a tax on consumers to a tax on businesses.[58]

States are understandably interested in knowing how much revenue could be collected if they could require sales tax collection on internet commerce. Revenue estimates, however, are difficult to make with certainty because one must guess both how much internet commerce could be taxed and how much is currently untaxed (some percentage of internet sales taxes are actually presently collected because of retail physical presence, voluntary reporting of business purchases, or voluntary vendor collection by Streamlined Sales Tax Project vendors).

53 *Id.*
54 *Marketplace Fairness Act of 2015*, S. 698, 114th Congress, 2015–2016.
55 A discussion draft of the Online Sales Simplification Act of 2015 was circulated by House Judiciary Committee Chairman Bob Goodlatte, Jan. 2015.
56 *Remote Transactions Parity Act of 2015*, H.R. 2775, 114th Congress, 2015–2016.
57 Joseph Henchman, *The Marketplace Fairness Act: A Primer*, Background Paper No. 69, Tax Foundation, July 14, 2014.
58 *Id.*

In 2009, Bruce, Fox, and Luna estimated that states would lose $11 billion in 2012 if they could not collect sales tax on internet purchases, and this became the leading source of revenue estimates by virtue of being the only one.[59] Experience since then has shown that this number might not be as accurate as originally thought. For example, New York, with its law collecting tax on online sales in effect during the pendency of a legal appeal, collected $360 million through February 2012, short of the $2.5 billion estimated by the Bruce, Fox, and Luna study.[60] Economic consultant Jeff Eisenach produced scaled-down estimates of states' sales tax collection potential in 2013, pegging it at $3.9 billion nationwide.[61]

While it is true that state tax collections will increase if a federal bill is passed, states relying on the previous study's numbers risk writing excessive revenue expectations into their budget plans. States should therefore act cautiously with respect to spending anticipated new revenue when a federal bill is enacted.

Louisiana's Ability to Require Remote Sellers to Collect Sales Taxes

If legislation such as the Marketplace Fairness Act were to be enacted, Louisiana would need to do several things to become compliant with the simplification measures outlined in the legislation before it could begin requiring remote sellers to collect sales taxes. Table 3f outlines the simplification provisions contained in the Marketplace Fairness Act[62] and notes whether or not Louisiana's sales tax laws are compliant.

Table 3f.

Changes that Louisiana Must Implement under the Marketplace Fairness Act in Order to Require Out-of-State Sellers to Collect Sales Tax

Requirement	Is Louisiana Currently Compliant?
One tax authority per state. Designate one entity in each state responsible for administration, returns, and audits.	No
One audit. Provide one unified audit in each state.	No
One joint tax return. Provide one tax return that encompasses all jurisdictions in the state.	No
Uniform base. Require uniformity between state and local tax bases within the state.	No
Base database. Provide information indicating taxability of different products, including all exemptions.	In progress. While this is available at the state level, a database is currently being created outlining local sales tax bases under the Sales Tax Streamlining and Modernization Commission.
Rates database. Provide sales tax rate information and a boundary database.	Yes
Notice of rate changes. State must provide 90 days' notice of rate changes or hold seller harmless for noncompliance.	No[63]
Free software. Provide free sales tax calculation software for transactions. Software must be able to file in all states.	No
Liability waiver. Waive liability for errors made when seller relies on information provided by the state or the free software.	Yes

59 Donald Bruce, William F. Fox, & LeAnn Luna, *State and Local Government Sales Tax Revenue Losses from Electronic Commerce*, Center for Business and Economic Research, The University of Tennessee Knoxville, Apr. 13, 2009.

60 *Id.*

61 Jeffrey A. Eisenach & Robert E. Litan, *Uncollected Sales Taxes on Electronic Commerce: A Reality Check*, Empiris LLC, 2013.

62 Joseph Henchman, *What's in the Marketplace Fairness Act?*, Tax Policy Blog, Tax Foundation, Apr. 26, 2013.

63 The Louisiana Association of Tax Administrators website includes notices under each Parish's sales tax listings, which show rate changes, and there have been examples of a parish notice being directly issued. However, we were unable to determine if they are issued uniformly or how early they go out. Further, we have found no evidence that indicates that the state requires such notices or has a hold-harmless provision in the event that they are not issued. Further, there is nothing in the Uniform Tax Code requiring it.

Similarly, if Louisiana wanted to become compliant with the Streamlined Sales and Use Tax Agreement (SSUTA), numerous reforms would need to be made. Table 3g outlines what is required under the Agreement for member states,[64] in addition to whether or not Louisiana is compliant with these requirements.

Table 3g.

Changes that Louisiana Must Implement under the Streamlined Sales and Use Tax Agreement in Order to Require Out-of-State Sellers to Collect Sales Tax

Requirement	Is Louisiana Currently Compliant?
State level administration of sales and use tax collections (state and local).	No
Uniformity in the state and local tax bases.	No
Uniformity of major tax base definitions.	Yes[65]
Central, electronic registration system for all member states.	No[66]
Simplification of state and local tax rates.	No
Uniform sourcing rules for all taxable transactions.	No[67]
Simplified administration of exemptions.	No
Simplified tax returns.	No
Simplification of tax remittances.	Yes (done electronically)
Protection of consumer privacy.	Yes

Louisiana has made great strides in recent years to work toward the goals outlined in Tables 3e and 3f after the passage of the Uniform Tax Code and the move toward electronic collections and filing. The remaining roadblocks to the Marketplace Fairness Act and Streamlined Sales Tax Agreement compliance are the lack of single, statewide audits and the lack of base conformity between the state and localities and within localities. These two areas are the portion of Louisiana's sales tax that deserve the most attention because they stand in the way of increased revenues from the taxation of internet commerce.

Sales Tax Reform Solutions

Louisiana's sales tax is one of the most unique and challenging of any in the country. Business owners note how the cumbersome system is one of the chief tax elements holding the state back. However, it is also important to acknowledge how valuable the sales tax is to local government operation, and to be mindful of concerns about the impacts of possible changes.

Our sales tax solutions eliminate duplicative tax collection and administration and simplify the tax base, making Louisiana eligible for collection of tax on remote transactions when federal legislation (such as the Marketplace Fairness Act or the Remote Transactions Parity Act) is enacted. Moderate base broadening options are also included.

64 Streamlined Sales Tax Governing Board, Inc., *About Us*, accessed Oct. 6, 2015, http://www.streamlinedsalestax.org/index.php?page=About-Us.
65 While the tax base is not uniform, it is well-defined by the Uniform Tax Code.
66 A state would have no need for this until it formally joined SSTUA.
67 These refer to origin or destination sourcing rules. A state would have no need for these until it formally joined SSTUA.

We provide three different alternatives for lawmakers to consider, some more expansive than others. Unification changes are administrative and thus would be revenue neutral, apart from implementation costs, while sales tax base expansion would increase revenue. If a net increase or decrease in revenue is desired, the tax rates in each option can be dialed up or down, respectively, to achieve a tax cut or tax increase.

In each of the Sales Tax Recommendation Options (A, B, and C), we refer to sales tax base expansion to certain services. Table 3h shows three options for base broadening, where the "small" option adds a few additional consumer services to the sales tax base, and the "large" option is the broadest, adding all final consumer services to the sales tax base.

These options do not attempt to quantify the political considerations that are bound to accompany any discussion of base broadening. Portions of the existing sales tax base are also presented for reference. Providing a few base broadening options allows lawmakers to decide how broad they would like to make the sales tax base, while still accounting for other policy considerations.

Table 3h.
Sales Tax Base Expansion Options[68]

Service Type	In Current Tax Base?	Expanded Base Options (includes current base items)		
		Small	Medium	Large
Communication Services	✓	✓	✓	✓
Automobile Repair Services	✓	✓	✓	✓
Motor Vehicle Rental & Leasing	✓	✓	✓	✓
Membership Clubs (For Profit)	✓	✓	✓	✓
Amusements	✓	✓	✓	✓
Photo Processing & Video Rental Services	✓[69]	✓	✓	✓
Accommodations	✓	✓	✓	✓
Dry Cleaning, Clothing Repair, & Shoe Repair Services	✓	✓	✓	✓
Household Services (Moving, Repairs, & Cleaning)	✓[70]	✓	✓	✓
Museum, Zoo, & Recreation Activities Admissions		✓	✓	✓
Veterinary Services		✓	✓	✓
Personal Care Services		✓	✓	✓
Financial Service Charges, Fees, & Commissions			✓	✓
Investment Services			✓	✓
Trust, Fiduciary, & Custody Services			✓	✓
Legal Services			✓	✓
Accounting Services			✓	✓
Membership Clubs (Nonprofit)			✓	✓
Labor Organization Dues			✓	✓
Professional Association Dues			✓	✓
Funeral & Burial Services			✓	✓
Real Estate Services				✓
Rental Housing				✓
Household Utilities				✓
Healthcare Outpatient Services (Including Physicians and Dentists)				✓
Hospitals, Nursing Homes, & Home Healthcare				✓
Higher Education Tuition & Expenses				✓
Elementary & Secondary Education Tuition & Expenses				✓
Childcare Services, Daycare, & Nursery Schools				✓
Public & Private Transportation Services				✓
Gaming		Subject to Gaming Taxes		
Insurance		Subject to Insurance Taxes		

68 In October 2015, the Louisiana Department of Revenue estimated the sales tax base in Louisiana for various service types, found at http://house.louisiana.gov/tsmc/Agendas/2015/Oct/Services%20Tax%20Base.pdf. The state revenue impact associated with expanding the sales tax base to services can be calculated by applying the state sales tax rate to the estimated tax base for the desired service types listed in the Department of Revenue estimates.

69 It is likely that these services are taxable since the rental of tangible personal property, and the delivery of the same, is taxable.

70 Household services are generally taxable but repairs of tangible personal property are among the optional exemptions for local taxing authorizes.

Sales Tax Option A

Option A would move Louisiana from having one of the most challenging tax codes in the country to one that is streamlined and has low compliance costs. It would modestly broaden the tax base as well. Option A would:

- Unify state and local sales tax collections and audits by creating an independent, joint-run state-local sales tax authority composed of representatives from local tax collection bodies and the state department of revenue. This unified collection and audit commission would make Louisiana compliant with pending federal legislation allowing for sales tax collection on internet purchases.
- Unify state and local sales tax bases on all transactions. This would make the manufacturing machinery exemption required for all localities, removing exemptions for food and prescription drugs at both the state and local levels, and no longer allowing optional exemptions at the local level.
- Expand the sales tax base (state and local) to include select services that currently enjoy exemptions. We provide detailed options for small, medium, and large sales tax expansion in Table 3h.

If all three portions of Sales Tax Option A were implemented, Louisiana would rank as indicated below on the *State Business Tax Climate Index* (we also include the sales tax component ranking to demonstrate how the state sales tax code specifically would improve relative to other states' sales tax codes). For the *Index* ranking projections, we have assumed the state uses the "small" base expansion option outlined in Table 3h.

Resulting *Index* Rankings

	Louisiana's Current Ranking	Ranking with Full Implementation of Sales Tax Option A
Overall *Index* Ranking	35	24
Sales Tax *Index* Component Ranking	50	36

Sales Tax Option B

Option B includes some elements of Option A, but is less comprehensive. It would unify collections and audits while broadening the tax base (state and local base unification would not occur under this option). Option B would:

- Unify state and local sales tax collections and audits by creating an independent, joint-run state-local sales tax authority composed of representatives from local tax collection bodies and the state department of revenue. This unified collection and audit commission would make Louisiana compliant with pending federal legislation allowing for sales tax collection on internet purchases.
- Expand the sales tax base (state and local) to include select services that currently enjoy exemptions. We provide detailed options for small, medium, and large sales tax expansion in Table 3h.

If both portions of Sales Tax Option B were implemented, Louisiana would rank as indicated below on the State Business Tax Climate Index (we also include the sales tax component ranking to demonstrate how the state sales tax code specifically would improve relative to other states' sales tax codes). For the Index ranking projections, we have assumed the state uses the "small" base expansion option outlined in Table 3h.

While these reforms would not be reflected in the *Index*, they would substantially improve administrative and compliance burdens that retailers currently face.

Sales Tax Option C

Option C is more limited, but would still unify the state and local sales tax bases with some exceptions. In addition, it would broaden the sales tax base.

- Unify state and local sales tax bases on all transactions except for food for home consumption and prescription drugs. This would make the manufacturing machinery exemption required for all localities and no longer allow optional exemptions at the local level (with the exception of optional exemptions for food for home consumption and prescription drugs).
- Expand the sales tax base (state and local) to include select services that currently enjoy exemptions. We provide detailed options for small, medium, and large sales tax expansion in Table 3h.

While these reforms would not be reflected in the *Index*, they would substantially improve administrative and compliance burdens that retailers currently face.

CHAPTER 4: INDIVIDUAL INCOME TAX

Introduction

Louisiana's individual income tax has a graduated-rate structure, with three brackets levying different rates on different income levels. Rates rank middle-of-the-pack nationally, but are on the high side when compared to other states in the region. Several key details of the individual code warrant consideration, such as the lack of inflation indexing and the existence of large tax expenditures that significantly shrink the tax base.

Furthermore, while individual income taxes matter to individuals, it is important to remember that many businesses pay individual income taxes as well—namely, sole proprietorships and partnerships. Since these taxes impact the employers of the state, it is important to also keep them in mind when considering changes to the individual code.

In this chapter we provide a broad overview of the state's individual income tax, outline issues with the current system, and discuss three potential reform solutions. We conclude with *State Business Tax Climate Index* rankings for each proposed solution.

A Very Brief History of the Louisiana Individual Income Tax

With public budgets ravaged by the Great Depression, states increasingly turned to income taxes to generate additional revenue. Louisiana was no exception, implementing its modern income tax in 1934. The tax, adopted during the administration of Governor Oscar Allen, featured a top marginal rate of 6 percent. These rates and brackets would survive unchanged until the implementation of the Stelly Plan in 2003, which raised the threshold for the second bracket to $12,500 while lowering the third bracket's floor to $25,000, swapping higher income tax collections for the removal of food and residential utilities from the sales tax base.[71]

Later, the top tax bracket was restored to the previous $50,000 threshold, though the sales tax exemptions offered under the Stelly Plan remained in effect.[72] This partial repeal of the original Stelly Plan eliminated the provisions that raised revenue (the income tax provisions) while keeping enact the provisions that reduced revenue (the sales tax provisions). Many have attributed a portion of the state's current budget issues to the partial Stelly repeal.

Louisiana's Current Individual Income Tax System

The Louisiana individual income tax has scarcely changed since the tax's imposition in 1934. The rate structure, with three brackets taxing different income levels at 2, 4, and 6 percent, has not changed since 1934. What has changed, however, is the income levels to which these rates apply. Table 4a shows how bracket levels have been altered since the tax's inception in 1934.

Table 4a.
Individual Income Tax Rate and Bracket History

Bracket Rate	Original System (1934)	Stelly Plan (2003)	Current System (2009)
2% >	$0	$0	$0
4% >	$10,000	$12,500	$12,500
6% >	$50,000	$25,000	$50,000

The starting point for calculating individual income tax is federal adjusted gross income, to which certain modifications are made. A personal exemption of $4,500 is allowed per filer (for single or married filing separately, or $9,000 for joint filers), in addition to a $1,000 exemption per dependent. An additional $1,000 exemption is allowed for each taxpayer that is blind or aged 65 years and older.[73] The current brackets are not indexed to inflation, nor is the state's personal exemption.

71 Public Affairs Council of Louisiana, *The "Stelly Plan": A Proposed Income/Sales Tax Swap*, PAR Analysis No. 305, Sept. 2002.
72 Tax Foundation, *State Individual Income Tax Rates, 2000-2014*, Apr. 1, 2013.
73 Louisiana State Legislature, *Revised Statutes*, RS 47:294.

Inflation indexing is an important facet of a well-structured individual income tax code. When an income tax system does not adjust tax brackets for inflation, a phenomenon known as bracket creep can occur. Higher income can bump a taxpayer into the next tax bracket, even if that higher income is merely keeping pace with inflation. A lack of inflation adjustment can also push more of a taxpayer's income into the highest bracket for which they qualify. This combined with bracket creep can lead to a higher average tax rate. This is problematic because increased incomes haven't risen in real terms—only nominally (in other words, taxpayers' tax bills will increase even though their purchasing power has not). Indexing addresses this by altering each bracket level each year by the level of annual inflation.

Comparing Louisiana's Income Tax Structure to Regional and National Competitors

When compared to other state individual income tax systems, Louisiana ranks middle-of-the-pack. Table 4b shows Louisiana's *State Business Tax Climate Index* individual income tax component ranking, in addition to select regional competitor states' rankings.

Table 4b.
State Business Tax Climate Index
Individual Income Tax Component Rankings

State	Component Ranking
Louisiana	27th
Alabama	23rd
Arkansas	28th
Florida	1st
Georgia	42nd
Mississippi	21st
Texas	6th

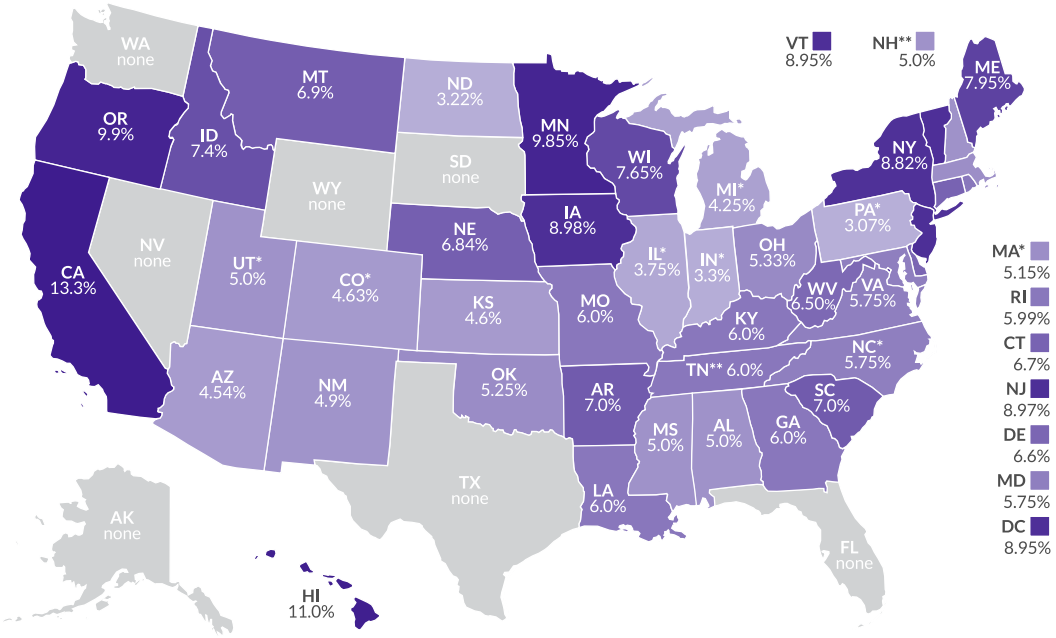
Source: Tax Foundation, *2015 State Business Tax Climate Index.*

In terms of top marginal tax rates, Louisiana has the 19th highest top marginal individual income tax rate in the country at 6 percent. This top rate is higher than all but two regional competitor states' (Arkansas's top rate is 7 percent and Georgia's is tied with Louisiana's at 6 percent). Alabama and Mississippi both have a top rate of 5 percent, which is lower than Louisiana's. Florida and Texas forgo an individual income tax altogether, though Texas' Margin Tax extends to some pass-through business income generally taxed by an individual income tax. Figure 4a shows top marginal income tax rates for all states.[74]

74 Jared Walczak, *State Individual Income Tax Rates and Brackets for 2015*, Fiscal Fact No. 462, Tax Foundation, Apr. 15, 2015.

Figure 4a.

Top State Marginal Individual Income Tax Rates in 2015 (as of April 15, 2015)



Note: Map shows top marginal rates: the maximum statutory rate in each state. It represents the statutory tax rate on the last dollar of income earned for the highest income individuals in that state. It is not an effective marginal tax rate, which would include the effects of phase-outs of various tax preferences. Local income taxes are not included.

Source: Tax Foundation, *State Individual Income Tax Rates and Brackets for 2015*, Fiscal Fact No. 462.

Top Marginal Individual Income Tax Rate

Lower Rate — Higher Rate

* State has a flat income tax

** State also only taxes interest and dividends income

Excessive taxes on income are generally less desirable than taxes on consumption because they discourage wealth creation. In a comprehensive review of international econometric tax studies, Arnold et. al. (2011) found that individual income taxes are among the most detrimental to economic growth, outstripped only by corporate income taxes. The authors found that consumption and property taxes are the least harmful.[75]

The economic literature on graduated-rate income taxes is particularly unfavorable.[76] The Arnold et. al. study concluded that reductions in top marginal rates would be beneficial to long-term growth, and Mullen and Williams (1994) found that higher marginal tax rates reduce gross state product growth. This finding even adjusts for the overall tax burden of the state, lending credence to the principle of broad bases and low rates.[77]

75 Jens Arnold, Bert Brys, Christopher Heady, Åsa Johannsson, Cyrille Schwellnus, & Laura Vartia, *Tax Policy for Economic Recovery and Growth*, The Economic Journal Vol. 121, Issue 550, Feb. 2011.

76 See, *e.g.*, William McBride, *What is the Evidence on Taxes and Growth?*, Special Report No. 207, Tax Foundation, Dec. 2012.

77 John Mullen & Martin Williams, *Marginal Tax Rates and State Economic Growth*, Regional Science and Urban Economics Vol. 24, Issue 6, 1994.

Pass-Through Businesses Pay Individual Income Taxes

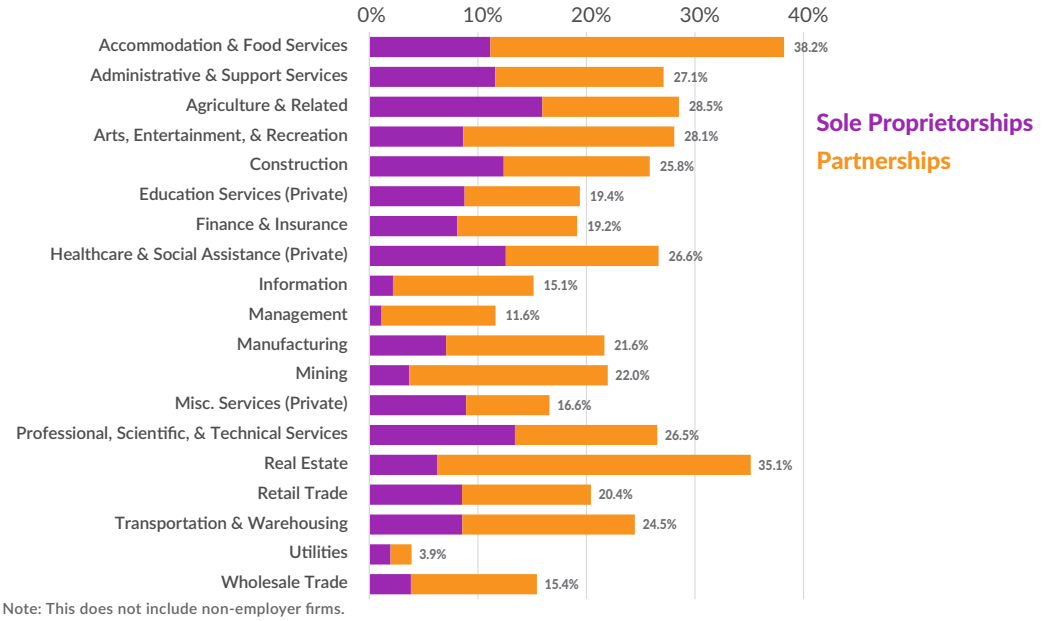
A pass-through entity is a type of business that pays the individual income tax in lieu of the corporate income tax because the earnings "pass-through" to the income tax form of the owners, rather than the business entity itself. Because partnerships, sole proprietorships, and LLCs remit their income tax payments through the individual income tax, the individual code is also a significant policy issue for many businesses.

Unlike in most states, however, in Louisiana, S corporations are liable under the corporate, rather than the individual, income tax code.[78] For sole proprietorships and partnerships (types of pass-through entities) paying through the individual income tax code, the state's rates, along with available exemptions, deductions, and credits, can be an important consideration. Figure 4a shows the share of employer firms in each sector that pay individual income taxes in Louisiana (separated by type).[79]

Figure 4b.

Louisiana Employer Businesses Subject to Individual Income Tax

Louisiana Sole Proprietorships and Partnerships by Industry (2013)



Note: This does not include non-employer firms.
Source: Census Bureau, *County Business Patterns*.

78 Scott Drenkard & Joseph Henchman, *2015 State Business Tax Climate Index*, Tax Foundation, Oct. 28, 2014.
79 Census Bureau, *County Business Patterns*, "Geographic Area Series: County Business Patterns by Legal Form of Organization," 2013.

Tax Expenditures: Deductions, Exemptions, and Credits

Louisiana's individual income tax code has 79 tax expenditures (in the form of exemptions, exclusions, deductions, credits, and rebates). Some are administrative in nature, and others reflect an effort to arrive at an accurate calculation of income (for example, exemptions or deductions to avoid double taxation). Many, however, reflect policy preferences, some of which may have lost their salience over time. There are credits to incentivize the sugarcane industry, support small-town doctors, and promote the purchase of bulletproof vests. There are credits for small businesses which employ first-time offenders, deductions for home school educational expenses, and exclusions for social security benefits. Louisiana taxpayers can even claim excess federal itemized deductions on their state income tax forms. Each tax preference reflects a policy goal, many of them laudable—but each also necessitates a higher tax rate than if these exemptions did not exist.[80]

All states provide exemptions, and some are necessary for administrative purposes. In Louisiana, however, exemptions have a projected price tag of $2.2 billion in the 2016 fiscal year,[81] which means that nearly half the individual income tax base is given away in exemptions. A better approach is to tax income at a lower rate but on a broader base, reducing the "sticker shock" of the 6 percent top marginal tax rate. Applying the tax to all adjusted gross income, with a generous personal exemption and few itemized deductions, would greatly reduce taxpayer compliance costs, eliminate distortions between types of incomes, and maintain progressivity.

A portion of Louisiana's income tax code is particularly interesting—the Pelican State offers a deduction for federal income taxes paid. Louisiana is one of only three states (along with Alabama and Iowa) that allow full deductibility of federal income taxes; another three allow a limited deduction.[82] Because federal income tax liability necessarily diverges from state liability due to variations in rate distributions and differences in the availability of exemptions, deductions, and credits, this tax deduction has distributional effects that favor higher-income Louisianans. The federal income tax deduction is worth more than twice the value of the next most generous tax expenditure.

Further, by permitting excess federal itemized deductions—the value of federal itemized deductions less the standard deduction—to be deducted from Louisiana taxable income as well, the state provides a substantial offset of federal income taxes paid even as it extends the value of federal income tax credits.

80 Louisiana Department of Revenue, *Tax Exemption Budget 2014-2015*, pp. 130-170, Mar. 2015.
81 *Id.*, p. 21.
82 Scott Drenkard & Joseph Henchman, *2015 State Business Tax Climate Index*, Tax Foundation, Oct. 28, 2014.

Together, these two tax expenditures cost the state $1.2 billion in income tax revenue.[83] A revenue neutral coupling of the deductions' elimination with an offsetting rate reduction would increase the neutrality of the tax code and reduce revenue volatility. Notably, federal deductibility is enshrined in the state constitution, and any attempt to repeal it would require both statutory and constitutional changes.[84]

Other tax expenditures, like the personal exemption and the Earned Income Tax Credit, modify the definition of taxable income to make the income tax more progressive, while other tax deductions and credits are designed to benefit certain populations (for example, exempting Social Security or pension income from taxation, or providing a child care expenses credit) or incentivize certain activity (such as credits for wind and solar energy, or rehabilitating historic structures).

A few credits are even designed to offset local taxes on tangible personal property or business inputs in an attempt to mitigate some of the damage of local inventory taxes and taxes on business inputs. While taxes on capital can be detrimental and certainly make the state less competitive, using the individual (and corporate) income tax code to offset these local taxes creates perverse incentives for localities and can lead to timing issues with tax obligations. Table 4b lists all individual income tax expenditures that are projected to be in excess of $10 million in the 2016 fiscal year.

Table 4b.

Individual Income Tax Exemptions, Credits, and Deductions in Excess of $10 Million (FY 2016, Projected)

Tax Expenditure	Value
Federal Income Tax Deduction	$845,054,000
Excess Federal Itemized Deductions	$359,785,000
Personal Exemption-Standard Deduction	$258,000,000
Retirement Benefits and Retirement Income Exclusions (Aggregate)	$232,561,000
Credit For Income Taxes Paid to Other States	$89,655,000
Earned Income Tax Credit	$49,782,000
Deduction for Net Capital Gains	$46,553,000
Dependent Exemption/Deduction	$32,360,000
Wind and Solar Energy System Credit	$30,000,000
Rehabilitation of Historic Structures Credit	$27,553,000
Elementary & Secondary School Tuition Deduction	$22,542,000
Child Care Expenses Credit	$19,392,000
Gasoline & Special Fuels Tax Exemption for Commercial Fishermen	$19,392,000
Education Credit	$17,693,000
Ad Valorem Tax Credit for Offshore Vessels	$14,951,000
School Readiness Credits (Aggregate)	$14,919,000
Inventory Tax/Ad Valorem Tax Credit	$12,047,000

Source: Louisiana Department of Revenue, *Tax Exemption Budget 2014-2015*.

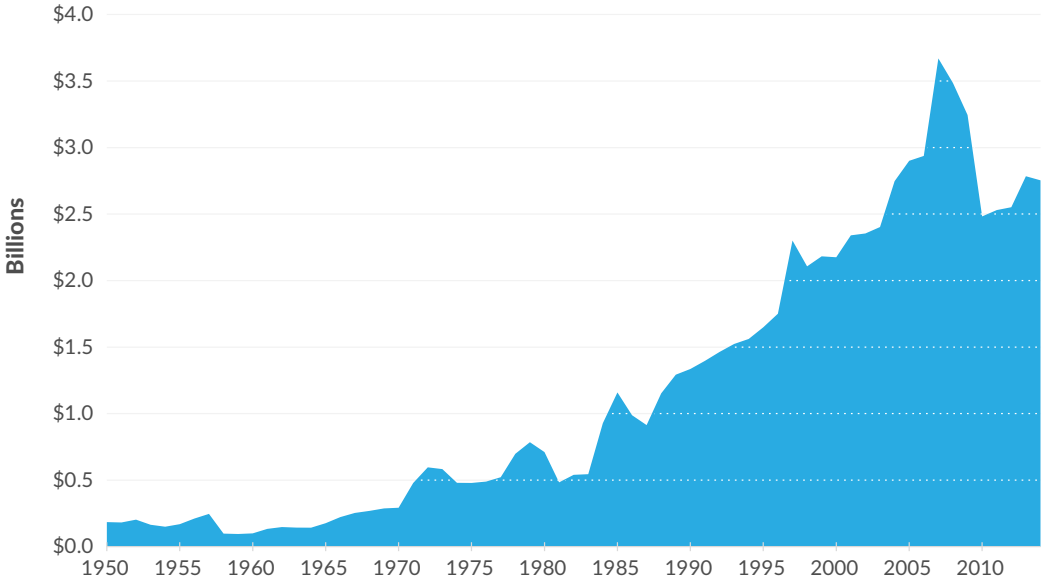
83 Louisiana Department of Revenue, *Tax Exemption Budget 2014-2015*, p. 137, Mar. 2015.
84 La. Const. art. VII §4(a).

Individual Income Tax Collections

Individual income tax collections in Louisiana have grown significantly since the 1950s, though they have seen sizable swings during that time. Figure 4c shows collections since 1950.

Figure 4c.

Louisiana Individual Income Tax Collections (1950–2014, in 2014 Dollars)



Note: Dollar amounts are adjusted for inflation based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2012 base year.
Source: Census Bureau, State and Local Government Finances; Bureau of Labor Statistics, Consumer Price Indexes (All Urban Consumers).

Beginning in 2003, the Stelly Plan, named after its patron, Representative Vic Stelly, implemented a tax swap that narrowed the sales tax base while altering income tax bracket widths to expose more income to the top marginal rate of 6 percent.[85] This was intended to increase income tax collections by swapping them for lower sales tax collections.

The Stelly Plan's partial repeal, effective calendar year 2009, coincided with the Great Recession, and the late 2000s saw individual income tax revenues recede markedly, a decline from which they have only partially recovered. At the time, the legislature's fiscal office estimated that by eliminating the income tax portions of the Stelly Plan, the state would forego $1.1 billion in revenue over five years.[86]

85 Louisiana Department of Revenue, *Information Available on Recent Tax Changes*, Jan. 21, 2003.
86 Greg Albrecht, *Fiscal Note on SB 87*, Louisiana Legislative Fiscal Office, June 13, 2008.

Individual Income Tax Reform Solutions

Our individual income tax solutions improve the tax code by broadening the tax base and reducing tax rates, making the state more competitive with its neighbors and the system more neutral and fair. We've provided three different options for lawmakers to consider.

Each of the following options are designed to be revenue neutral within themselves. If a net increase or decrease in revenue is desired, the tax rates in each option can be dialed up or down, respectively, to achieve a tax cut or tax increase.

Individual Income Tax Option A

Option A would retain the current three-bracket structure, but reduce tax rates. It also includes base broadening components and resembles the income tax structure recommended by Dr. Jim Richardson of Louisiana State University and Dr. Steven M. Sheffrin and Dr. James Alm of Tulane University. Option A would:

- Retain the existing three-bracket structure, with rates reduced to 1 percent, 3 percent, and 4.5 percent.
- Eliminate the deduction for federal taxes paid.
- Retain the current Earned Income Tax Credit of 3.5 percent of the federal credit.
- Eliminate excess itemized deductions.
- Retain the existing personal exemption but adjust the tax brackets and personal exemption for inflation.

If all five portions of Individual Income Tax Option A were implemented, Louisiana would rank as indicated below on the *State Business Tax Climate Index* (we also include the individual income tax component ranking to demonstrate how the state's individual income tax code specifically would improve relative to other states' individual income tax codes).

Resulting *Index* Rankings

	Louisiana's Current Ranking	Ranking with Full Implementation of Individual Income Tax Option A
Overall *Index* Ranking	35	31
Individual Income Tax *Index* Component Ranking	27	19

Individual Income Tax Option B

Option B converts the progressive income tax into a single, flat rate on all income levels, while providing additional relief to low-income taxpayers. Option B would:

- Move from three brackets to a single, flat-rate tax of 4 percent on all income levels.
- Eliminate the deduction for federal taxes paid.
- Increase the personal exemption to $10,000 per filer and index it to inflation (maximum of $20,000 per family).
- Increase the Earned Income Tax Credit from 3.5 percent of the federal credit to 10 percent of the federal credit, nearly tripling benefits for low-income households.
- Retain current itemized deductions.

If all five portions of Individual Income Tax Option B were implemented, Louisiana would rank as indicated below on the *State Business Tax Climate Index* (we also include the individual income tax component ranking to demonstrate how the state's individual income tax code specifically would improve relative to other states' individual income tax codes).

Resulting *Index* Rankings

	Louisiana's Current Ranking	Ranking with Full Implementation of Individual Income Tax Option B
Overall *Index* Ranking	35	21
Individual Income Tax *Index* Component Ranking	27	14

Individual Income Tax Option C

Option C is the most broad-based option of the three, retaining the single rate structure of Option B, but eliminating more preferences to bring the overall rate lower. Option C would:

- Move from three brackets to a single, flat-rate tax of 3.5 percent on all income levels.
- Eliminate the deduction for federal taxes paid.
- Increase the personal exemption to $10,000 per filer and index it to inflation (maximum of $20,000 per family).
- Increase the Earned Income Tax Credit from 3.5 percent of the federal credit to 10 percent of the federal credit, nearly tripling benefits for low-income households.
- Eliminate excess itemized deductions.

If all five portions of Individual Income Tax Option C were implemented, Louisiana would rank as indicated below on the *State Business Tax Climate Index* (we also include the individual income tax component ranking to demonstrate how the state individual income tax code specifically would improve relative to other states' individual income tax codes).

Resulting *State Business Tax Climate Index* Rankings

	Louisiana's Current Ranking	Ranking with Full Implementation of Individual Income Tax Option C
Overall *Index* Ranking	35	21
Individual Income Tax *Index* Component Ranking	27	12

CHAPTER 5: CORPORATE INCOME TAXES

Introduction

Louisiana's corporate income tax is a graduated-rate tax with five brackets and a top rate of 8 percent. This rate is comparatively high both regionally and nationally. On top of a high rate, Louisiana's corporate income tax system suffers from a narrow tax base—a problem that exacerbates the upward pressure on tax rates.

In this chapter, we provide a broad overview of Louisiana's corporate income tax, outline issues to consider regarding the current system, and provide three options for reform. Accompanying these solutions are projected *State Business Tax Climate Index* rankings for each recommended reform solution.

Overview of Louisiana Corporate Income Taxation

Louisiana's corporate income tax is a five-bracket graduated tax with a top rate of 8 percent of corporate net income. This top rate is the highest in the southern United States and tied for 13th highest nationwide. The rate is driven in part by the state's deduction for federal corporate income taxes paid, which reduces liability for many but not all businesses and subjects state revenue collections to the vicissitudes of the federal tax code. This deduction also applies to the individual income tax (Chapter 4), and is discussed in Chapter 3 as well. Further, Louisiana's corporate tax code is one that provides substantial incentives for select businesses rather than lower rates across the board.

Louisiana's corporate income tax rates and brackets are shown in Table 5a. The income tax rates and brackets are constitutionally prohibited from rising above current levels.[87]

Table 5a.

Louisiana Corporate Income Tax Rates (2015)

Rate		Corporate Income Level
4%	>	$0
5%	>	$25,000
6%	>	$50,000
7%	>	$100,000
8%	>	$200,000

Among bordering states, Arkansas imposes a top marginal corporate income tax rate of 6.5 percent, Mississippi imposes a 5.0 percent top rate, and Texas forgoes a corporate income tax in favor of a gross receipts tax, the Texas Margin Tax. Arkansas' 6.5 percent top marginal rate is tied with those of Alabama and Tennessee for the second highest in the south, behind Louisiana's highest-in-the-region 8.0 percent top marginal rate. Nearby Georgia imposes a top marginal rate of 6.0 percent, while Florida's top rate is 5.5 percent.[88]

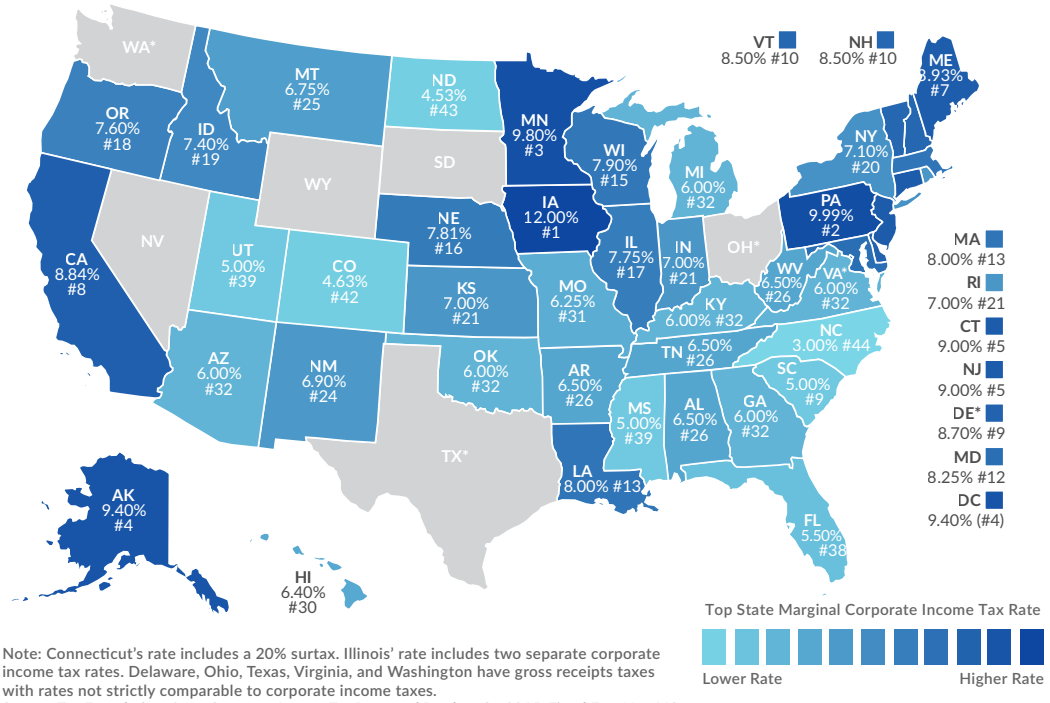
Figure 5a shows top marginal corporate income tax rates for all 50 states and Washington, DC.

87 La. Const. art. VII §4(a).

88 Jared Walczak, *State Corporate Income Tax Rates and Brackets for 2015*, Fiscal Fact No. 463, Tax Foundation, Apr. 2015.

Figure 5a.

Top State Marginal Corporate Income Tax Rates (as of April 2015)



Note: Connecticut's rate includes a 20% surtax. Illinois' rate includes two separate corporate income tax rates. Delaware, Ohio, Texas, Virginia, and Washington have gross receipts taxes with rates not strictly comparable to corporate income taxes.
Source: Tax Foundation, *State Corporate Income Tax Rates and Brackets for 2015*, Fiscal Fact No. 463.

Louisiana has a graduated-rate corporate income tax—something that has little justifiable rationale. Single-rate systems are consistent with the sound tax principles of simplicity and neutrality. In contrast to the individual income tax, there is no meaningful "ability to pay" concept in corporate taxation. Jeffery Kwall, law professor at Loyola University Chicago School of Law, notes:

> graduated corporate rates are inequitable—that is, the size of a corporation bears no necessary relation to the income levels of the owners. Indeed, low-income corporations may be owned by individuals with high incomes, and high-income corporations may be owned by individuals with low incomes.[89]

A single-rate system minimizes the incentive for firms to engage in expensive, counterproductive tax planning to mitigate the damage of higher marginal tax rates that some states levy as taxable income rises.

Since 2008, 14 states and the District of Columbia have cut corporate income taxes, and Michigan shifted from a gross receipts tax to a traditional corporate income tax.[90] In Louisiana, by contrast, the corporate income tax has changed very little over the years. Authorized by the state constitution in 1921 and first levied in 1934 as a tax of 4 percent on corporate net income exceeding $3,000, the Louisiana corporate income tax has only changed

89 Jeffrey L. Kwall, *The Repeal of Graduated Corporate Tax Rates*, p. 1395, Tax Notes, June 27, 2011.
90 See, *e.g.*, Joseph Henchman, *Trend #3: Corporate Tax Reductions, Top 10 State Tax Trends in Recession and Recovery, 2008 to 2012*, Fiscal Fact No. 311, Tax Foundation, June 13, 2012; *Facts & Figures: How Does Your State Compare?*, Tax Foundation, multiple years.

once substantially, in 1977, when the state adopted its current graduated rate and bracket structure, maxing out at 8 percent on net income in excess of $200,000.[91]

Reductions in corporate rates elsewhere reflect a trend toward decreased reliance on a highly volatile tax imposed on a declining amount of taxable income, and, in some instances, an effort to simplify the tax structure by broadening the base and lowering the rate. Corporate income tax revenue is in decline across the country as more businesses choose to structure as S Corps and LLCs, single sales factor apportionment schemes become more common, and states give away more of their tax base in special credits and deductions. Corporate income taxes tend to be complex and impose substantial administrative burdens for both payers and the government, and this complexity has not abated as the tax base has eroded. Finally, revenue volatility necessarily follows from the nature of the tax, since in periods of economic distress, many companies may post losses and thus lack exposure to a corporate income tax.

Comparing Louisiana's Corporate Taxes Regionally and Nationally

When compared to other states' corporate income tax systems, Louisiana's ranks middle-of-the-pack, both regionally and nationally, with the 23rd best corporate income tax system in the country. On our *State Business Tax Climate Index*, Florida, Georgia, and Mississippi scored better than Louisiana on the corporate income tax component ranking, while Alabama, Arkansas, and Texas scored worse. Table 5b shows Louisiana's *State Business Tax Climate Index* corporate income tax component ranking, in addition to select competitor states' rankings.

Table 5b.

State Business Tax Climate Index Corporate Income Tax Component Rankings

Louisiana and Select Regional Competitors (2015)

State	Component Ranking
Louisiana	23rd
Alabama	27th
Arkansas	40th
Florida	5th
Georgia	8th
Mississippi	11th
Texas	39th

Source: Tax Foundation, *2015 State Business Tax Climate Index.*

91 Louisiana Department of Revenue, *Tax Exemption Budget 2014-2015*, p. 91., Mar. 2015.

Corporate Income Tax Collections

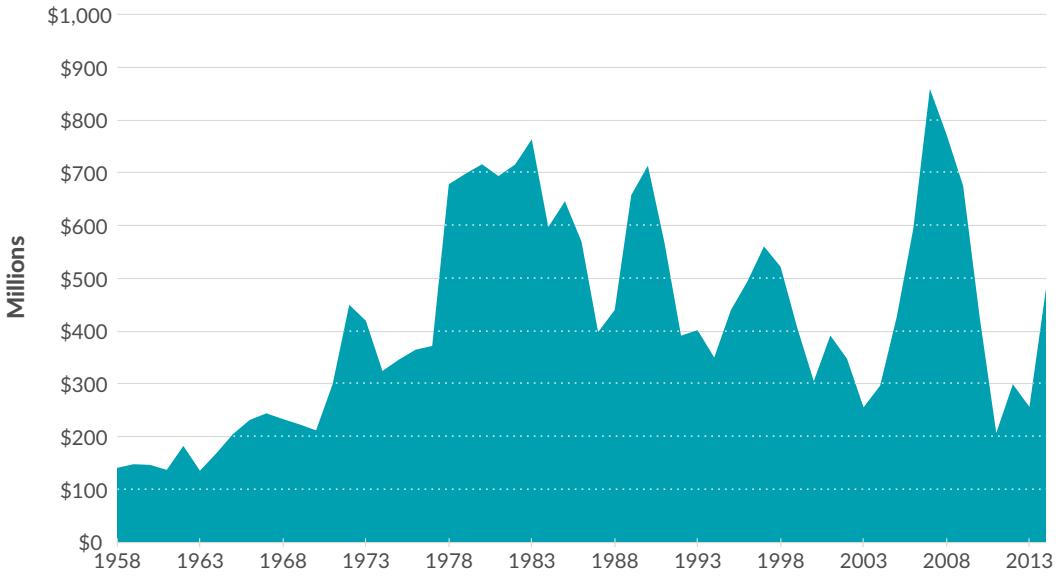
Corporate income taxes are among the most volatile sources of state revenue, since many companies may generate little or no net income during economic downturns. While practically all revenue streams are cyclical, with collections lower during periods of economic distress, corporate income taxes experience particularly deep troughs. Property values may decline during a recession, but they are rarely wiped out, limiting how low property tax collections can go. Similarly, consumption patterns may decline, leading to lower sales tax revenues than when the economy is booming, but sales can only drop so far. Many companies' net income, by contrast, can bottom out or even go into negative territory. As such, collections tend to be highly cyclical, spiking sharply in good years and collapsing in bad ones.

In Louisiana's case, the destruction wrought by Hurricanes Katrina and Rita is an important part of the story—though what would otherwise have been steep declines in corporate revenue was more than offset by large influxes of federal cash, both directly to the government and to taxpaying businesses. However, as federal assistance began to wane and the Great Recession took its toll, the state's artificially inflated corporate income tax revenue crashed to levels not seen in a decade, declining by more than two-thirds. Figure 5b shows the state's inflation-adjusted corporate income tax collections over time.[92]

Other than the mid-2000s surge, the only sustained increase in corporate income tax collections is associated with a 1977 tax hike. As of the 2013 fiscal year, corporate income tax revenue only accounted for 4 percent of state and local tax collections, and its relative share of revenue can be expected to continue to decline over time.

Figure 5b.

Louisiana Corporate Income Tax Collections (1958–2014, in 2014 Dollars)



Source: Tax Foundation, State and Local Sales Tax Rates, Midyear 2015.

92 Census Bureau, *State and Local Government Finances*, 2013.

Corporate Income Tax Expenditures: Deductions, Exemptions, and Credits

In fiscal year 2016, Louisiana's corporate income tax expenditures are estimated to total $803.9 million.[93] Credits and deductions are projected to be worth more than $1 million in the 2016 fiscal year are enumerated in Table 5c.

Table 5c.

Corporate Income Tax Expenditures Projected to Exceed $1 Million in FY 2016

Tax Expenditure	Value
Subchapter S Corporation Excludable Percentage Exemption	$545,611,000
Inventory Tax/Ad Valorem Tax Credit	$458,918,000
Motion Picture Investor Tax Credit*	$250,378,776
Federal Income Tax Deduction	$208,145,000
Enterprise Zones Tax Credit*	$47,162,129
Louisiana Quality Jobs Program*	$41,307,231
Ad Valorem Tax Credit for Offshore Vessels	$31,854,000
Insurance Company Premium Tax	$26,517,000
Wind and Solar Energy System Credit	$25,000,000
Credit for Ad Valorem Tax Paid by Certain Telephone Companies	$24,000,000
Research & Development Tax Credit*	$17,920,948
Digital Interactive Media and Software Tax Credit*	$12,618,072
Credit for Rehabilitation of Historic Structures	$10,913,000
Industrial Tax Equalization Program*	$10,399,417
Louisiana Motion Picture Incentive Program*	$7,302,363
Ad Valorem Tax on Natural Gas	$4,367,000
Credit for the LA Citizens Property Insurance Corporation Assessments	$3,800,000
Conversion of Vehicles to Alternative Fuel	$3,394,000
Musical and Theatrical Productions Tax Credit	$3,701,603
Purchase of Qualified New Recycling Equipment	$2,927,000
School Readiness Child Care Provider Credit	$2,424,000

Note: The asterisk (*) indicates that no FY 2016 estimates are available for these credits. Actual FY 2014 figures were used instead.
Source: Louisiana Department of Revenue, Tax Exemption Budget 2014-2015.

These figures are for corporations required to file a return, and thus do not capture the many exemptions within the tax code which relieve certain corporations of all tax liability. For a variety of policy reasons, lawmakers have exempted, among other things, credit unions, electric cooperatives, state banks, out-of-state lenders, nonprofit organizations, and Louisiana Community Development Financial Institutions from the corporate income tax. Because no returns are required from these institutions, no estimates of revenue forgone due to these policy determinations are available.

93 Louisiana Department of Revenue, *Tax Exemption Budget 2014-2015*, pp. 91-122. Tax expenditures for which estimates are available total a projected $803,936,000. Estimates are not available for many expenditures. However, these remaining expenditures are *de minimus*, and may sum to as little as a few thousand dollars.

The largest tax expenditure deals with S corporations. In most states, S corporations join other pass-through corporations in filing under the individual, rather than the corporate, income tax. Because Louisiana taxes them under the corporate income tax, it is necessary to take extra steps to arrive at taxable income, limiting imposition to income at either the corporate or shareholder level. This is a very large tax expenditure on paper, the result of the state's unique decision to tax S corporations through the corporate income tax code.

The next largest tax expenditure is the inventory tax swap, by which corporations are obligated to remit an *ad valorem* tax on inventory to their local parish which is then reclaimed as a refundable tax credit on other state tax filings. For business payers, this creates unnecessary compliance burdens and, while full reimbursement can be anticipated, imposes short-term tax costs as well. For state government, it is, in effect, aid to local government distributed on the basis of inventory and inventory tax rates, at an estimated cost of $458.9 million in fiscal year 2016. The inventory tax and associated credit are discussed in more detail in Chapter 6.

The Motion Picture Investment Tax Credit proves quite costly. Louisiana was the first state to offer film incentives, and the state's program remains among the largest and most expensive, costing the state an estimated $250.4 million in forgone corporate tax revenue in fiscal year 2014. Credits are transferable, so they are often applied against the tax liability of firms other than the studios which received them, and frequently years after their issuance. This can make it difficult for the state to budget for the tax expenditure.[94]

While Louisiana's film incentives undeniably attract film production to the state, they do so at a considerable expense. In Massachusetts, the Department of Revenue found that the state spent more on film credits than the industry actually spent in the state, that Massachusetts recouped only 11 cents on the dollar in tax revenue, and that the average new job cost the state nearly $119,000 in tax credits. In Michigan, the Senate Fiscal Agency found a taxpayer cost of $193,000 per direct hire, and concluded that the average job ran its course in 23 days. Maryland's best case scenario estimate involved recouping 6 cents on the dollar. Film incentives are not an investment in job creation; they are an expense which is increasingly hard to justify in an era of budgetary restraint.[95]

Louisiana is one of three states (along with Alabama and Iowa) that allow full deductibility of federal income taxes, both corporate and individual; another three states allow a limited deduction.[96] Because federal income tax liability necessarily diverges from state liability due to variations in rate distributions and differences in the availability of exemptions, deductions, and credits, this tax deduction has distributional effects which favor companies with greater exposure to corporate income taxes, and subjects state revenue collections to the effects of changes in the federal tax code. A revenue neutral coupling of the deduction's elimination with an offsetting rate reduction would increase the neutrality of the tax code and

94 *Id., Annual Tax Collection Report 2012-2013.*

95 See, *e.g.,* I. Harry David and Mark Robyn, *Movie Production Incentives in the Last Frontier,* Special Report No. 199, Tax Foundation, Apr. 2012; Jared Walczak, *Testimony on Film Tax Incentives before the Florida Senate Appropriations Committee,* Tax Foundation, Apr. 21, 2015.

96 Scott Drenkard & Joseph Henchman, *2015 State Business Tax Climate Index*, Tax Foundation, Oct. 28, 2014.

reduce revenue volatility. Notably, federal deductibility is enshrined in the state constitution, and any attempt to repeal it would require both statutory and constitutional changes.[97]

The state also leans heavily on business incentives to reduce corporate tax liability well below the amount indicated by statutorily-established tax rates. An Enterprise Zone Tax Credit is available to businesses which create jobs in areas of low income or high unemployment. The Louisiana Quality Jobs Program provides an incentive worth 5 to 6 percent of the payroll costs of qualifying new jobs, alongside credits for qualifying capital investments. A research and development tax credit can offset up to 40 percent of qualified research expenses in Louisiana.[98]

Louisiana's incentives are broader than those of many competitor states, helping to offset high tax rates for a fairly wide range of firms. In many cases, however, companies must navigate an application process to be approved for such credits, and of course, some companies fail to qualify.

Incentives can be effective, but they are not efficient. By lowering tax costs for targeted industries or rewarding particular business activities, they can yield higher employment or greater investment in those sectors. Unfortunately, the cost of these incentives must be borne by other, un-incentivized businesses which bear a correspondingly higher tax burden. Ultimately, incentives involve picking winners and losers, and seek to guide the economy in keeping with policymakers' (often competing) visions. A well-structured tax code with a broader base—eliminating many of the incentives—and a lower rate would do far more to encourage job creation and economic growth.

Structural Elements

Net Operating Loss Carrybacks and Carryforwards

The corporate income tax is designed to tax only the profits of a corporation. However, a yearly profit snapshot may not fully capture a corporation's true profitability. For example, a corporation in a highly cyclical industry may look very profitable during boom years but lose substantial amounts during bust years. When examined over the entire business cycle, the corporation may actually have an average profit margin.

Although corporate income tax liability is determined on an annualized basis, business cycles do not follow the calendar. This can be problematic for corporations with cyclical income, enjoying high profitability one year and losses the next. To mitigate this reality, states (along with the federal government) allow corporations to deduct losses from previous years and future years to offset current taxes owed. These net operating loss (NOL) "carrybacks" and "carryforwards" smooth out tax obligations over time, ensuring that industries with cyclical income are not set at a competitive disadvantage against industries with more consistent and stable revenue streams.

97 La. Const. art. VII §4(a).
98 Louisiana Department of Revenue, *Tax Exemption Budget 2014-2015*, p. 353.

The deduction for net operating losses helps ensure that, over time, the corporate income tax is a tax on average profitability. Without the NOL deduction, corporations in cyclical industries pay much higher taxes than those in stable industries, even assuming identical average profits over time.

There are two important variables of a state's NOL provisions: the number of years allowed for carrybacks and carryforwards, and caps on the amount of carrybacks and carryforwards. The maximum that any state allows for carrybacks is three years, with no cap (that is, an unlimited dollar amount allowed). Among the states that allow carrybacks, the most common timespan is two years with no cap. The maximum carryforward given in any state is twenty years, again with no cap (most states allow either 15 or 20 years, though 20 is more desirable).

The longer the overall time span, the higher the probability that the corporate income tax is being levied on the corporation's average profitability.

Currently, Louisiana allows no carrybacks and a 20-year carryforward period with no cap, policies that were enacted in the 2014 legislative session. Previously, Louisiana allowed three-year carrybacks (no cap) and 15-year carryforwards (also uncapped).[99]

Thirty-five states and the District of Columbia allow businesses to carry forward previous losses to offset current tax obligations for up to 20 years. Twenty-one states permit net operating loss carrybacks.

Table 5d shows the treatment of net operating losses in Louisiana and select regional competitor states.

Table 5d.

Treatment of Net Operating Losses

Louisiana and Select Regional Competitors (2015)

State	Carryback (Years)	Carryback Cap	Carryforward (Years)	Carryforward Cap
Louisiana	0	$0	20	Unlimited
Alabama	0	$0	15	Unlimited
Arkansas	0	$0	5	Unlimited
Florida	0	$0	20	Unlimited
Georgia	2	Unlimited	20	Unlimited
Mississippi	2	Unlimited	20	Unlimited
Texas	not applicable (no CIT)			

Source: Tax Foundation, *2015 State Business Tax Climate Index.*

99 KPMG, *SALT Alert! 2015-14: Louisiana: Budget Agreement Includes Tax Increase Affecting Certain Returns Filed On or After July 1, 2015*, House Bill 218, 2015.

Apportionment

When businesses operate in more than one state, income must be apportioned among those states for tax purposes. The legal term for whether a state has the power to tax is *nexus*—which typically requires a business to have some physical presence, either property or employees, in a state—and the determination of the amount of that business's income subject to a given state's corporate income tax is known as *apportionment*. States apportion business profits based on some combination of the percentage of company property, payroll, and sales located within their borders.

Louisiana adopts an evenly-weighted three-factor apportionment formula for most businesses, meaning that property, payroll, and sales are taken into account equally in determining income apportionment. If, hypothetically, a business owned all of its property in Louisiana, and two-thirds of its employees were located in the state, but all of its sales took place out of state, then about 55.5 percent of its net income would be subject to Louisiana's corporate income tax. Table 5e shows standard apportionment formulas for Louisiana and select states in the region.

However, the state allows manufacturing firms—which are disproportionately likely to have the bulk of their sales take place out of state—to use single sales factor apportionment, meaning that only sales are taken into account when apportioning income for tax purpose. A firm with all of its property, but only ten percent of its sales, in Louisiana, would only pay Louisiana corporate income taxes on ten percent of its profits. Certain other businesses are also subject to unique apportionment formulas. Service enterprises, for instance, face a two-factor formula based on payroll and sales, since property is a less significant input for such operations.[100]

Other Considerations

Because each state has a different apportionment method, sometimes certain income goes untaxed. Throwback rules, which exist in 25 states and the District of Columbia, throw back this so-called "nowhere income" into the taxable base. In many cases, multiple states claim the right to tax the same income, introducing added complexity to the tax code. Louisiana beneficially forgoes the imposition of a throwback rule.[101]

100 La. Rev. Stat. Ann. § 47:287.95.
101 Scott Drenkard & Joseph Henchman, *2015 State Business Tax Climate Index*, Tax Foundation, Oct. 28, 2014.

At least for now, Louisiana also uses separate accounting rather than combined reporting, meaning that out-of-state subsidiaries of Louisiana-based corporations do not have their profits or losses combined with those of the parent company in determining taxable income. Combined reporting can produce an increased likelihood that corporations will have more than 100 percent of their income considered part of the tax base across multiple states. Should Louisiana move to combined reporting, it would increase collections somewhat inasmuch as these subsidiaries are profitable, though subsidiaries posting a net loss in other states would decrease the parent company's Louisiana tax liability. Table 5e shows throwback rules for Louisiana and select states in the region.

Table 5e.

Standard Apportionment Formulas and Throwback Rules

Louisiana and Select Regional Competitors (2015)

State	Standard Apportionment Formula	Throwback Rule
Louisiana	Three Factor	No
Alabama	Double-Weighted Sales	Yes
Arkansas	Double-Weighted Sales	Yes
Florida	Double-Weighted Sales	No
Georgia	Single Sales Factor	No
Mississippi	Single Sales Factor	Yes
Texas	One-Factor Gross Receipts	No

Source: Tax Foundation, *2015 State Business Tax Climate Index;* Federation of Tax Administrators, *State Apportionment of Corporate Income, 2015.*

Corporate Income Tax Reform Solutions

Our corporate income tax solutions would make Louisiana more competitive by bringing its rate from the highest in the region to the lowest among neighboring states that levy a corporate income tax. It also includes base-broadening elements and helps mitigate tax uncertainty for businesses.

This option is designed to be revenue neutral. If a net increase or decrease in revenue is desired, the tax rate can be dialed up or down, respectively, to achieve a tax cut or tax increase.

- Flatten tax brackets into a single rate of 5 percent.
- Eliminate the deduction for federal taxes paid.
- Increase net operating loss carrybacks from zero to three years.

If all three portions of the corporate income tax reform recommendations were implemented, Louisiana would rank as indicated below on the *State Business Tax Climate Index* and the corporate income tax subcomponent of the *Index*.

Resulting *State Business Tax Climate Index* Rankings

	Louisiana's Current Ranking	Ranking with Full Implementation of Corporate Income Tax Reform Recommendations
Overall Index Ranking	35	24
Corporate Income Tax Index Component Ranking	23	4

CHAPTER 6:
PROPERTY AND RELATED TAXES

Introduction

While Louisiana has low property tax burdens, there are several poorly structured components of the property tax code that warrant consideration. In terms of local ad valorem taxes, Louisiana has several base-narrowing exemptions, such as a high homestead exemption and costly industrial exemptions. The state also levies a capital stock tax and localities levy inventory taxes which are then rebated back to businesses by the state in a convoluted system with very little accountability. All of these limit the competitiveness of Louisiana's tax code.

On the positive side, Louisiana doesn't have a real estate transfer tax, an estate tax, an inheritance tax, a gift tax, or a generation-skipping transfer tax. Furthermore, the state has low property tax collections per capita and low real estate taxes as a percentage of personal income.

In this chapter, we provide an overview of the property tax system in Louisiana and then provide four ideas for improvement, including *State Business Tax Climate Index* rankings for each suggested solution.

A General Overview of the Louisiana Property Tax

In the 2013 fiscal year, property taxes made up 46 percent of local tax collections in Louisiana—the second largest source of local tax collections (just after sales taxes at 47 percent of total collections).[102]

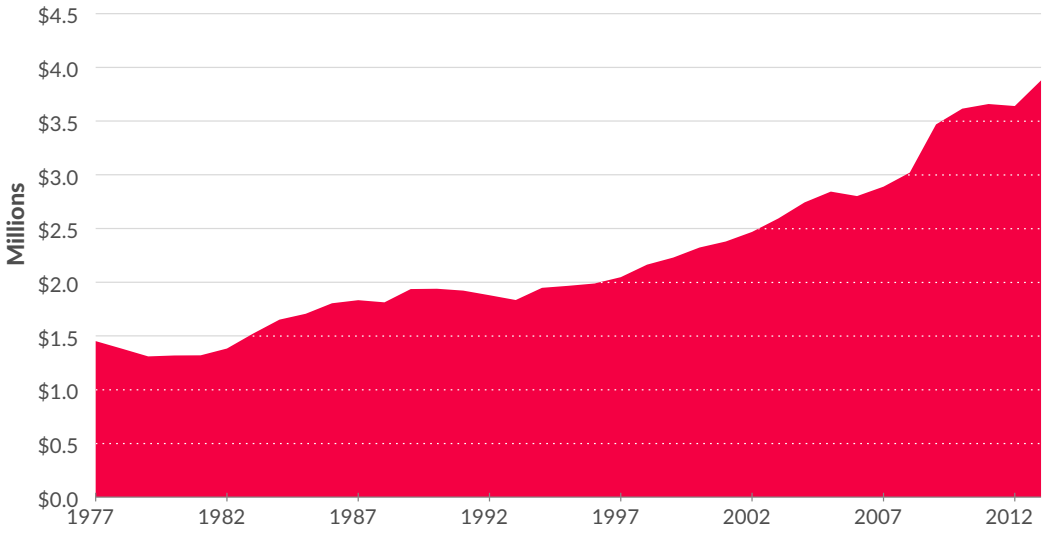
In Louisiana, both real and personal property are subject to property tax. Real property is property that is immovable—such as land and improvements to land (buildings). Personal property is property that is movable, or "not attached" (sometimes referred to as tangible property). Things such as furniture and inventories qualify as personal property. In Louisiana, both commercial and residential real property is taxable, though only commercial personal property is taxed (not residential personal property).

Property Tax Collections

Local property tax collections in Louisiana have grown from $1.45 million (adjusted for inflation) in 1977 to $3.88 million in 2013.[103] Figure 6a shows property tax collections over time.

Figure 6a.

Louisiana Local Government Property Tax Collections (1977–2013, in 2013 Dollars)



Note: Dollar amounts are adjusted for inflation based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2013 base year.
Source: Census Bureau, *State and Local Government Finances*; Bureau of Labor Statistics, Consumer Price Indexes (All Urban Consumers).

102 Census Bureau, *State and Local Government Finances*, 2013, http://www.census.gov/govs/local/.
103 *Id.*

Compared to most other states, Louisiana has very low property taxes on average. Per capita state and local property tax collections in Louisiana are the eighth lowest the nation (at $793 per person in FY 2012).[104] Similarly, property taxes paid as a percentage of owner-occupied housing value in Louisiana are the third lowest in the nation (at 0.51 percent of housing value).[105]

Comparing Louisiana's Property Tax Structure to Regional and National Competitors

When compared to other states' property tax systems, Louisiana ranks middle-of-the-pack, both regionally and nationally. On our *State Business Tax Climate Index*, Alabama and Arkansas scored better on the property tax component ranking, while Georgia, Mississippi, and Texas scored worse. Table 6a shows Louisiana's *State Business Tax Climate Index* property tax component ranking, in addition to select competitor states' rankings.

Table 6a.

State Business Tax Climate Index Property Tax Component Rankings

Louisiana and Select Regional Competitors (2015)

State	Component Ranking
Louisiana	24th
Alabama	10th
Arkansas	19th
Florida	16th
Georgia	30th
Mississippi	33rd
Texas	36th

Source: Tax Foundation, *2015 State Business Tax Climate Index.*

Corporation Franchise Tax

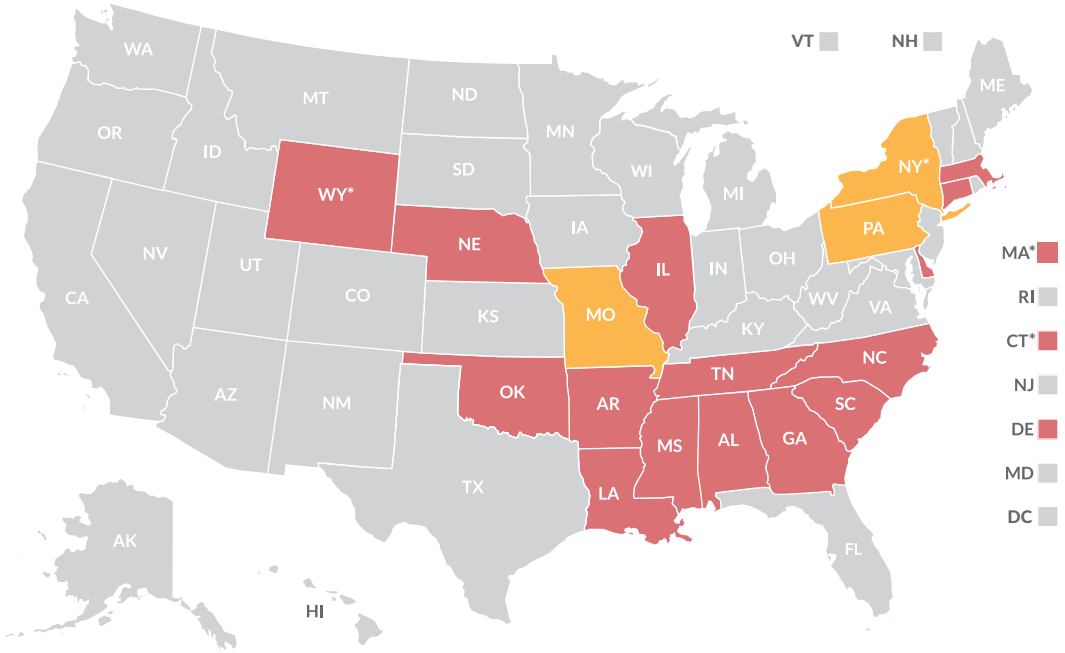
Louisiana ranks 24th due to several structural factors that hold the state back despite low collections. First, Louisiana is one of only 18 states that levies a capital stock tax (sometimes called a franchise tax), an economically damaging tax imposed at a low rate but directly on business capital. These taxes discourage capital formation and are a deterrent to economic growth and development.

The Louisiana capital stock tax—formally known as the Corporation Franchise Tax—has no limit on the maximum amount a firm can pay.[106] The tax has a graduated rate, levied at 0.15 percent on capital up to $300,000 and 0.3 percent on capital above $300,000.[107] Louisiana's top rate is the second highest among states levying these types of taxes. Figure 6b shows all states levying capital stock taxes in 2015.

104 Tax Foundation, *Facts & Figures 2015: How Does Your State Compare?* Table 32, Mar. 10, 2015.
105 *Id.*
106 *Id.*
107 Louisiana Department of Revenue, *Corporation Income & Franchise Taxes*, accessed Oct. 9, 2015, http://revenue.louisiana.gov/CorporationIncomeAndFranchiseTaxes.

Figure 6b.

States with and without Capital Stock Taxes (as of January 1, 2015)



Notes: Missouri, New York, and Pennsylvania are in the process of phasing out their capital stock taxes. Rhode Island and West Virginia just finished phasing out their capital stock taxes. (*) indicates that taxpayers pay the greater of corporate income tax or capital stock tax liability. See Table 33 of Tax Foundation, Facts & Figures 2015 for more information.

Source: Tax Foundation, *Facts & Figures 2015: How Does Your State Compare?*

- State Has a Capital Stock Tax
- State Is Phasing Out a Capital Stock Tax
- State Does Not Have a Capital Stock Tax

First imposed in 1932, Louisiana's franchise tax is levied on the greater of the assessed value of all real and personal property in the state or the amount of issued and outstanding capital stock, surplus, and undivided profits attributable to Louisiana. It is reported on the same form with the state's corporate income tax.[108] Based on net worth, the tax fails to take profitability or cash flow into account, meaning that a company that posts losses would still pay the franchise tax.

Because of their detrimental economic effects, states are increasingly moving away from capital stock taxes. Kansas eliminated its capital stock tax in 2011, and Rhode Island and West Virginia completed phase-outs in 2015. Missouri, New York, and Pennsylvania are in the process of phasing out their franchise taxes as well.

108 Louisiana Department of Revenue and Louisiana Economic Development, *Primer on State Tax Structure in Louisiana*, Oct. 8, 2012.

Inventory Tax

Louisiana also has a tax on business inventory levied by local governments. While the tax liability paid to local governments by businesses is reimbursed by the state via a complicated credit, there are still administrative and compliance costs necessary because the tax exists in the first place. Rather than utilize this wasteful credit system, a better option would be to repeal the tax altogether. Only 12 other states besides Louisiana have inventory taxes (though three are Louisiana's neighbors—Arkansas, Mississippi, and Texas).[109]

While the inventory tax itself is poor policy, the administration of Louisiana's inventory tax is most troubling. In 2014, *The Advocate* released a series of articles investigating various Louisiana tax credits. We have reproduced the discussion of the inventory tax credit below, as the analysis and conclusions still stand today:

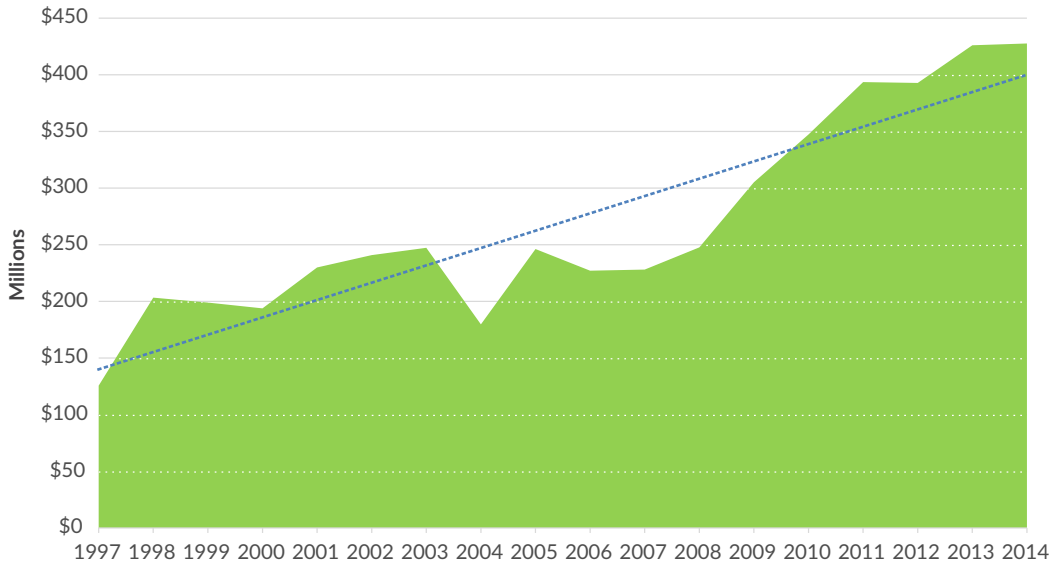
> Every year, the oil refiner Motiva Enterprises writes a check for $6.6 million to St. James Parish. A couple of months later, the state of Louisiana sends the company a full refund. The messy system was created a generation ago in order to wipe away an obscure property tax that is assessed by parish governments against 'business inventory' held by companies in Louisiana.
>
> … Louisiana arrived at the rebate system in a roundabout way. … In the late 1980s, lawmakers began talking about getting rid of the tax or scaling it back. It was widely viewed as a tax that put Louisiana at a disadvantage compared with other states, most of which had by then abolished the tax. … [T]he Legislature on its own passed a plan to phase out the tax for all businesses, in increments of 20 percent a year. Because they couldn't get rid of the tax without a constitutional amendment …, the plan called for businesses to go on paying the tax locally and then to get a refund from the state.
>
> That system put the state in the awkward position of having no say or control over the size of the bill it gets each year. And it could give local assessors an incentive to overappraise [*sic*] inventory—or assess property as inventory rather than in another category, such as movable property—knowing companies don't really mind paying it because of the refund.
>
> … If there's no hard evidence that businesses are taking advantage of the refund system, there's also little being done to ensure they're not—and the growth in inventory being taxed has far outpaced Louisiana's economic expansion.
>
> The state only makes a cursory effort to determine if the tax is being uniformly assessed around the state, or that businesses are not counting items as inventory that actually belong in a different category, one that does not qualify for a refund.[110]

109 Scott Drenkard & Joseph Henchman, *2015 State Business Tax Climate Index*, Tax Foundation, Oct. 28, 2014.
110 Gordon Russell, *Giving Away Louisiana: Inventory tax refund*, The Advocate, Dec. 4, 2014.

The current system is one that has little accountability, resulting in a tax expenditure that's value has skyrocketed in recent years; Figure 6c shows the value of the inventory tax credit over time, which has more than tripled in size since 1997.

Figure 6c.

Value of Inventory Tax Credit (1997–2014, in 2014 Dollars)



Note: Dollar amounts are adjusted for inflation based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2014 base year.
Source: Louisiana Department of Revenue, multiple editions of annual *Tax Expenditure Budget*; Bureau of Labor Statistics, *Consumer Price Indexes* (All Urban Consumers).

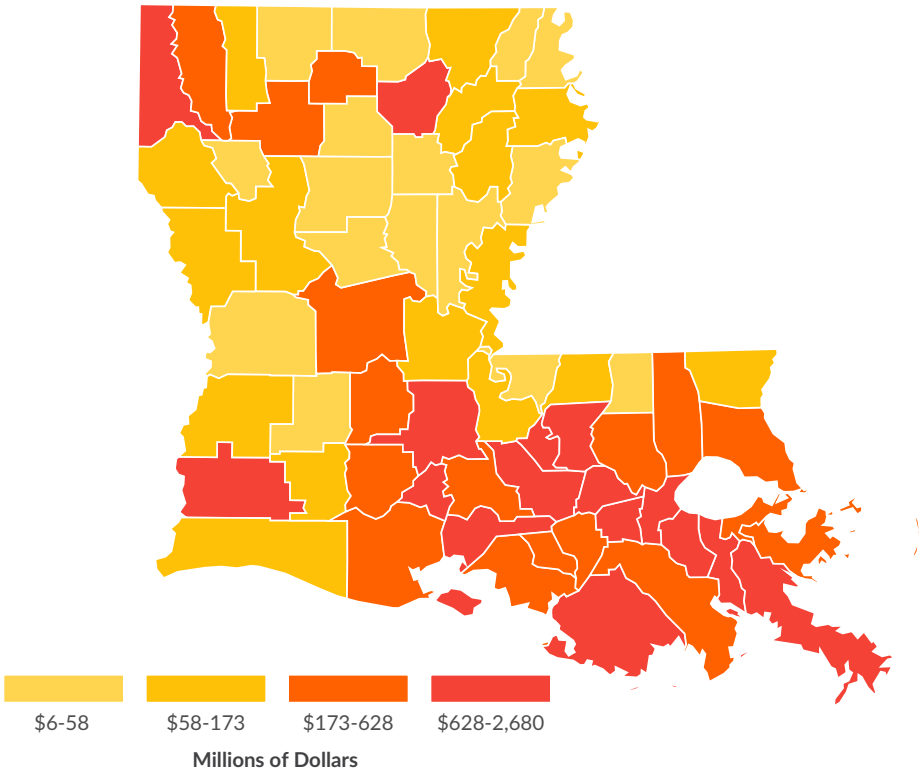
While inventory taxes are poor tax policy, it cannot be ignored that revenues from the tax make up a sizable portion of many local government entities (for example, *The Advocate* reported that in 2014, "in industry-heavy St. James Parish, it accounts for nearly half of the property tax base and about 17 percent of all tax collections").[111]

Based on the most recent report of the Louisiana Tax Commission, the parishes with the largest inventory fair market assessed value (in order of decreasing magnitude) were East Baton Rouge, Jefferson, St. Charles, Calcasieu, Lafayette, St. James, St. John, Ascension, Caddo, and Plaquemines. These are the parishes that would be most negatively impacted if the inventory tax were repealed. Figure 6d shows a map of Louisiana counties based on the amount of inventory fair market value.[112]

111 *Id.*
112 Louisiana Tax Commission, *Annual Report 2014*, p. 25.

Figure 6d.

Inventory Fair Market Assessed Value by Parish (2014)



Source: Louisiana Tax Commission, *Annual Report 2014.*

Property Tax Exemptions and Credits

All property—real and personal, tangible and intangible—is subject to tax in Louisiana unless constitutionally exempted. These exemptions can be understood as consisting of two broad categories: a homestead exemption for owner-occupied residential property and types of property wholly exempted. Special assessment levels are also available for certain property owners.

The Homestead Exemption

A homestead exemption exempts a portion of a taxpayer's residence from property taxation, meaning that the property tax is levied on a lesser taxable value that it would have been without the exemption.

Established by Article VII, Section 20 of the Louisiana Constitution, the state's homestead exemption exempts the first $7,500 of assessed value from taxation. According to the Louisiana Tax Commission,

> In order to qualify for homestead exemption, one must own and occupy the house as his/her primary residence. Regardless of how many houses are owned, no one is entitled to more than one homestead exemption, which is a maximum of $7,500 of assessed value, except in those parishes whereby voters approved that the next $7,500 of the assessed valuation on property receiving the homestead which is owned and occupied by a veteran with a service connected disability rating of 100% by the U.S. Department of Veterans Affairs shall be exempt from ad valorem taxation.[113]

Because the level of assessment on residential property—both land and improvements—is set at 10 percent, for practical purposes the homestead exemption is often spoken of as a $75,000 exemption subtracted from fair market value rather than as a $7,500 exemption subtracted from assessed value. The result is, of course, the same.

Based on the most recent data, Louisiana's homestead exemption is one of the highest in the nation. The only state exceeding it is South Carolina's School Property Tax Exemption for Homeowners at $100,000.[114] The existence of such a large exemption significantly limits the local property tax base.

Exempt Property

Many types of property are wholly exempt from property taxation for policy purposes. For instance, personal property used in the home is exempt, ensuring that individuals are not liable for tax on their home furnishings or appliances. Most financial instruments are exempt, as are some (but not all) categories of business personal property, most property held by nonprofits or governmental entities, and other forms of property deemed worthy of advantageous treatment.

The list of exempt property includes: public lands; property owned by non-profit organizations exempt from federal and state income taxes; medical equipment leased to qualifying small rural hospitals; property leased to nonprofit corporations for the purpose of housing homeless persons; property of labor organizations; cash, stocks, and bonds (except bank stocks); life insurance policy loans, mortgage-secured obligations, and similar debt instruments; personal property used in a home; agricultural equipment and agricultural products while owned by the producer; property used for the Mardi Gras carnival or civic activities; oceangoing vessels engaged in international trade, commercial vessels used for gathering seafood for human consumption, and gasoline-powered boats; materials, fuels, and energy sources used by public utilities to generate electricity; goods, commodities, and

113 Louisiana Tax Commission, *Frequently Asked Questions*, Louisiana Department of Revenue, accessed Oct. 9, 2015, http://www.latax.state.la.us/Menu_FAQ/FAQ.aspx#faq6.

114 Lincoln Institute of Land Policy & George Washington Institute of Public Policy, *Significant Features of the Property Tax*, Summary Table on Exemptions and Credits in 2012, accessed Oct. 2015, http://www.lincolninst.edu/subcenters/significant-features-property-tax/Report_Residential_Property_Tax_Relief_Programs.aspx.

personal property imported or in transit through the state; motor vehicles; coal or lignite stockpiled for use in industrial or manufacturing concerns; and enhancements of certain structures in downtown, historic, or economic development districts.

The state constitution also authorizes the State Board of Commerce and Industry, with the approval of the governor, to enter into contracts exempting new manufacturing equipment or additions to existing manufacturing establishments from the property tax (this is called the "Industrial Tax Exemption," which is discussed in detail in the following section). Goods held in inventory are eligible for tax exemptions at the parish level, though due to a tax shift policy adopted by the state (discussed in the previous section of this chapter), parishes have little incentive to offer such exemptions.

Industrial Tax Exemption

Louisiana's Industrial Tax Exemption Program is a state-run program that was enacted in order to "stimulate industrial expansion by offering to manufacturers certain tax benefits at the most critical stage of any business endeavor."[115] While decided and administered by the state government, the program exempts participating businesses from *local* property taxes for a period of five or ten years.

According to the Lincoln Institute of Land Policy,

> The Industrial Tax Exemption Law (10-Year Tax Exemption Program) provides that any manufacturing establishment entering Louisiana or any manufacturing establishment expanding its existing Louisiana facility [known as "capital additions"], is eligible to receive exemption from state, parish and local property taxes for a period up to 10 years (the exemption is for an initial term of no more than 5 calendar years and may be renewed for an additional 5 years). The exemption includes all buildings, machinery, and equipment that are used as part of the manufacturing process. Improvements to the industrial land are eligible to be tax exempt, but not the land itself. The exempt property must be located on the plant site at all times and must be used in conjunction with the manufacturing operation.[116]

The Lincoln Institute estimates that tax savings as a result of the Industrial Exemption result in "approximately one percent per year of the value of the assessment." They provide the following instructive example: "the tax exemption on a $20 million facility would amount to approximately $200,000 a year, or approximately $2 million over the ten-year life of the exemption."[117]

While beneficial to the firms that claim it, this program has eroded the tax base of many local governments in Louisiana. Also, while the local government coffers are most affected by the Industrial Exemption, the state government decides whether or not projects will be

115 Lincoln Institute of Land Policy, *Ten Year Tax Exemption Program*, summary of Louisiana's Industrial Tax Exemption Program, June 14, 2006.
116 *Id.*
117 *Id.*

approved for the first five-year exemption, and also whether or not firms receive the second five-year period under the exemption.

Property Tax Reform Solutions

Our property tax solutions broaden the local property tax base and eliminate distortionary and economically damaging taxes.

- Repeal the inventory tax and inventory tax credit.
- Permanently limit the total annual value of the industrial tax exemption program to 80 percent.
- Allow localities to approve or reject any extensions of the industrial tax exemption program (that is, the second five-year exemption period).

If all three portions of the Property Tax Reform Recommendations were implemented, Louisiana would rank as indicated below on the *State Business Tax Climate Index* overall and on the property tax subcomponent.

Resulting *State Business Tax Climate Index* Rankings

	Louisiana's Current Ranking	Ranking with Full Implementation of Property Tax Reform Recommendations
Overall *Index* Ranking	35	33
Property Tax *Index* Component Ranking	24	12

CHAPTER 7: TRANSPORTATION INFRASTRUCTURE AND THE RAINY DAY FUND

Introduction

In this final chapter, we provide solutions that would address lackluster transportation infrastructure and prevent budgetary distress brought on by revenue volatility.

Addressing Lackluster Transportation Infrastructure

In 1989, to address a $2.9 billion highway and bridge maintenance backlog over the next ten years, the gasoline tax in Louisiana underwent major changes. Voters approved creation of the Transportation Trust Fund and dedicating the 16 cent per gallon gasoline tax to the fund. Voters also approved an additional 4 cent per gallon gasoline tax to fund the Transportation Infrastructure Model for Economic Development (TIMED) program.[118] The TIMED program was created to address new construction and infrastructure improvements. Together, these two taxes combine for a total gasoline tax of 20 cents per gallon that is still in place today.[119]

Louisiana first adopted a tax on motor fuels in 1921, taxing gasoline at a 1 cent per gallon rate. When adjusted for inflation, the tax was at its highest from 1936 to 1939, with a state tax rate in today's dollars of $1.19 per gallon. When adjusted for inflation, the gasoline tax rate of 20 cents per gallon in 1990 was worth 36 cents per gallon in today's dollars. Without indexing the gas tax rate to inflation, the 20 cents per gallon tax rate is now worth just over half of what it was worth 25 years ago. (See table 7a.)

Table 7a.

Louisiana Gasoline Excise Tax Rates, Nominal and Real (Selected Years)

Year	Tax Rate (Cents per Gallon)	Tax Rate expressed in 2015 values (Cents per Gallon)
1921	1¢	13 ¢
1924	2 ¢	27 ¢
1928	4 ¢	55 ¢
1930	5 ¢	70 ¢
1936	7 ¢	119¢
1948	9 ¢	88 ¢
1952	7 ¢	62 ¢
1968	8 ¢	54 ¢
1984	16 ¢	36 ¢
1990	20 ¢	36 ¢
Average (1921-2015):		49.6 ¢
Average (1952-2015):		36.9 ¢

Source: Louisiana Department of Revenue; Bureau of Labor Statistics, *Consumer Price Indexes* (2015).

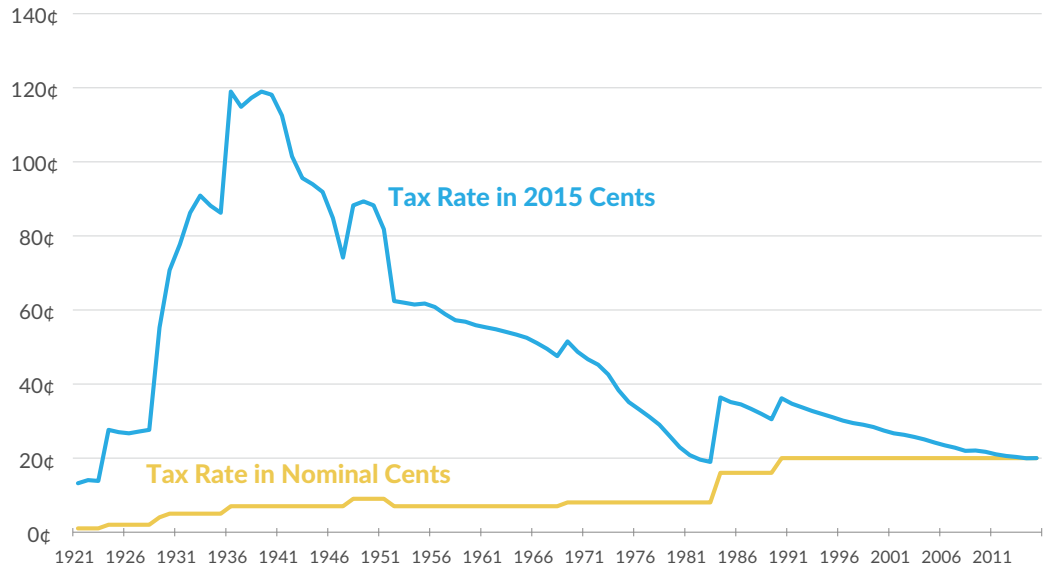
118 *Transportation Funding Task Force Final Report*, Mar. 2015, http://www.louisianagoodroads.org/pdf/TaskForceReport_part1.pdf.

119 Louisiana also has a 0.008 cent per gallon motor fuel delivery fee and a 0.00125 cent per gallon petroleum products fee, resulting in a combined state motor fuels tax rate of 20.00925 cents per gallon. American Petroleum Institute, *State Motor Fuel Taxes: Notes Summary*, Oct. 1, 2015.

Figure 7a.

Louisiana Gasoline Excise Tax Rate

Nominal Value and Real Value (1921–2015)



Source: Louisiana Department of Revenue; Bureau of Labor Statistics, *Consumer Price Indexes*.

The Louisiana gas tax rate is one of the lowest in America, although not extremely low compared to Louisiana's neighbors (Figure 7b). Only nine states impose lower taxes and fees on the purchase of motor fuels: Texas (20 cents), Arizona (19 cents), New Mexico (18.88 cents), Mississippi (18.78 cents), Missouri (17.3 cents), Oklahoma (17 cents), South Carolina (16.75 cents), New Jersey (14.5 cents), and Alaska (11.3 cents).[120]

Of these states, three (New Jersey, Oklahoma, and Texas) generate significant transportation revenue from toll road facilities and other user fees.[121] For every dollar that Texas spends on road maintenance and construction, 11 percent comes from tolls and user fees, while 47 percent comes from gasoline and license taxes, and 41 percent comes from federal and state general revenues. In contrast, Louisiana's spending on road maintenance and construction primarily comes from general revenue sources (72 percent), followed by gasoline and license taxes (26 percent) and toll revenue and user fees (2 percent).[122] In addition to the transportation revenue Louisiana collects, the state also relies on about 52 percent of its highway and bridge budget from the Federal Highway Trust Fund, which is close to the national average.

120 Tax Foundation, *Facts & Figures 2015: How Does Your State Compare?*, Table 22, Mar. 10, 2015.

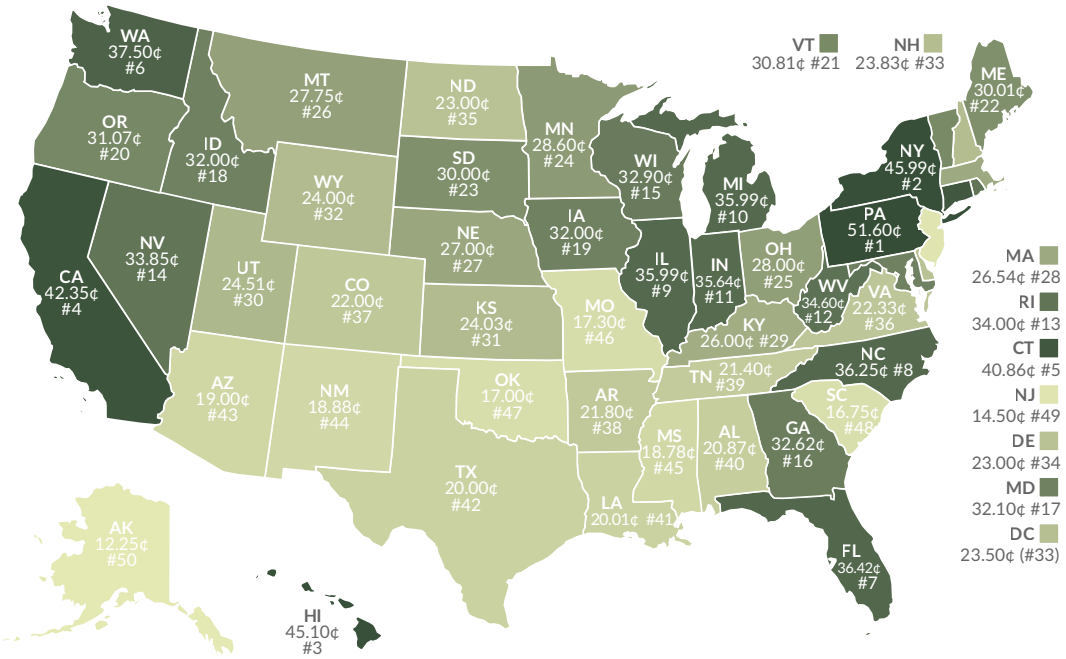
121 See Joseph Henchman, *Gasoline Taxes & User Fees Pay for Only Half of State & Local Road Spending*, Fiscal Fact No. 410, Tax Foundation, Jan. 2014.

122 Calculations are for road construction and maintenance costs only. For the total DOTD budget, Louisiana collects $50 million in self-generated user fees (3%), $645 million in fuel tax and license and registration fees (36%), $117 million in TIMED fuel tax proceeds and TTF balances (7%), $63 million in bonds (4%), and $894 million in federal funds and interagency transfers (51%).

Figure 7b.

State Gasoline Tax Rates

Total State Taxes and Fees on Gasoline, as of July 2015 (Cents per Gallon)



Note: These rates do not include the 18.40 cent/gallon federal excise tax on gas. The American Petroleum Institute (API) has developed a methodology for determining the average tax rate on a gallon of fuel. Rates may include any of the following: excise taxes, environmental fees, storage tank taxes, other fees or taxes, and general sales taxes. Data as of July 2015. Published July, 22 2015.

Source: American Petroleum Institute.

In the 2014–2015 fiscal year, the Louisiana Department of Transportation & Development (DOTD) will spend a total of $1.77 billion, which includes $753 million on road construction, $580 million on road operations, $46 million to parishes for local transportation, and $176 million in debt service.

In 2013, the DOTD calculated its backlog of highway needs at $12.3 billion, and a 2015 update estimated a $37.4 billion 30-year gap between identified revenue ($18.5 billion) and needed transportation infrastructure spending ($55.9 billion).[123] These include all costs associated with maintaining the existing system in a state of good repair, modernizing the system to current standards of safety and reliability, and expanding capacity with better traffic management and new infrastructure. The DOTD study gave no recommendation but evaluated the pros and cons of various funding options:

Expanded toll road facilities. The elevated LA 1 Highway Fourchon to Leeville toll bridge and approaches were developed and are operated by the Louisiana Transportation Authority (LTA) using this method. Tolls of $2.50 per car, paid in advance using an electronic transponder or by using an in-lane machine, repay loans and other debt issued to construct the bridge and the first phase of approach improvements.[124] Future phases of approaches will be funded by DOTD funds. The LTA is authorized to pursue other public-private

123 Louisiana Department of Transportation & Development, *Statewide Transportation Plan (2015)*, http://wwwsp.dotd.la.gov/Inside_LaDOTD/Divisions/Multimodal/Transportation_Plan/2015_Statewide_Transportation_Plan/Forms/AllItems.aspx.

124 Federal Highway Administration, *LA 1 Improvements*, http://www.fhwa.dot.gov/ipd/project_profiles/la_laone.aspx.

partnerships, leveraging state funds with user fees and investment financing to stretch public dollars. Options include complete privatization or sale, concessions (long-term lease), design-build-finance-operate-maintain (constructed by private sector and then transferred back to public sector), or operation-management contracts (publicly owned but privately operated). While minimizing the cost and risk for taxpayers, toll facilities usually involve borrowing in advance rather than pay-as-you-go financing, and setting toll rates can be difficult. Many states have toll bridge and toll road facilities, which can include new toll roads or bridges, new toll lanes within existing roads, or converting existing high-occupancy vehicle (HOV) into high-occupancy toll (HOT) lanes.[125]

Index the gasoline tax for inflation. This change makes the existing tax more sustainable over time. Three states (Florida, Maryland, and New Hampshire) index their gasoline tax for the consumer price index, four states (Kentucky, North Carolina, Virginia, and West Virginia) and the District of Columbia adjust their gasoline tax for the wholesale price of gasoline, and one state (Nebraska) adjusts gasoline tax rates based on state transportation funding needs.

Replace the gasoline tax with a sales tax increase. A 1 percent sales tax would generate approximately $675 million per year, more than the $587.6 million generated from the 20-cent gasoline tax. While a sales tax would not be eroded by inflation, it would shift the responsibility of paying for transportation infrastructure away from users and instead to the general fund. For example, trucks who drive across Louisiana would pay nothing for transportation infrastructure, while people who do not drive but purchase goods would pay higher sales taxes. Virginia is the only state to have adopted this model.[126]

Convert the gasoline tax to an ad valorem (percentage of value) tax. This would express the gasoline tax in terms of a percent of the sales price rather than a fixed number of cents per gallon. The DOTD estimated that a 7 percent gasoline tax would be revenue neutral. This tax would automatically change as prices change, resulting in increased taxes when fuel prices increase. The reverse also happens; North Carolina recently suspended a share of the tax dependent on the price of gasoline because recent price falls meant the state would see a significant revenue drop.

Implement a distanced-based vehicle miles traveled (VMT) fee. Oregon is currently operating a 5,000-person pilot program where volunteer participants will be assessed a 1.5 cent per mile fee and be credited for any gasoline tax paid. Charging based on distance, or variably depending on type of road and type of vehicle, preserves revenue against changes in fuel prices or increased vehicle fuel economy. However, a number of technical, administrative, and institutional challenges must be overcome, as well as public concerns about data privacy from tracking travel.

125 See, *e.g.*, Zachary Bartsch, *Lessons from the Indiana Toll Road*, Tax Policy Blog, Tax Foundation, Jun. 26, 2013.
126 See, *e.g.*, Joseph Henchman, *Virginia Legislators Approve Increases in Sales Tax, Car Tax, Regional Taxes*, Tax Policy Blog, Tax Foundation, Feb. 25, 2013.

Allow local option transportation taxes. This solution devolves responsibility for finding funding to local governments for local projects. Thirty-five states (including Louisiana) allow local option sales taxes for transportation, 16 states allow local property taxes for transportation purposes, 15 states (including Louisiana, in Jefferson Parish only) allow local vehicle taxes, nine states allow local income or payroll taxes for specific purposes, and nine states allow local gasoline taxes.

Establish a special district for particular projects and/or for a metropolitan area. The statewide TIMED program is an example of voters agreeing to fund a specific list of transportation improvements with an additional tax. If a particular project is likely to be embraced by voters in a metropolitan area, a local district could be established with voter approval to tax themselves to fund the project. The DOTD estimated that a Baton Rouge district, for instance, could generate $20 million a year with a 0.25 cent sales tax. A downside is that any conflicts between jurisdictions (especially between urban and rural areas) could hamstring approval.

Increase car and truck registration fees. The DOTD estimated a $1 increase in vehicle registration fees could generate $4 million annually. Car and truck drivers generally oppose such increases.

Increase fines. Higher fines, or surcharges on traffic violators, may encounter less initial resistance but an effort in Texas resulted in a high non-payment rate due to the fine being set at a level higher than needed to punish or deter illegal driving behavior. The DOTD estimated a Texas-style program could generate between $25 million and $40 million annually in Louisiana.

General revenue transfers. While not mentioned in the DOTD report, using state funds derived from general revenue sources for transportation can avoid more politically problematic methods of raising money from users. State Treasurer John Kennedy estimated that the state could cancel less important capital projects and redirect as much as $240 million a year for highway projects.[127] Some key legislators contend the possible amount is much lower. Regardless, the state budget itself faces pressures, meaning there are unlikely to be surplus funds of any size to transfer out of the general fund.

127 Will Sentell, *Current, former DOTD chiefs disagree on La. highway conditions*, The Advocate, Sep. 30, 2014.

In 2014, the state of Louisiana convened a panel to recommend options for additional transportation funding. The Transportation Funding Task Force issued its final report in March 2015, recommending that legislators explore a number of options:[128]

- Continue to explore public-private partnerships to help deliver projects, but acknowledge that significant public funding will still be required due to low traffic count projections in some areas.
- Replace 16 cents of the gasoline tax with an 8 percent fuel tax. This would generate a net additional $210 million per year, or an extra $58 per year per Louisiana resident.
- Provide tax credits for private investment in transportation projects. This would not reduce actual state transportation expenses, but instead pay for them by reducing state tax collections instead of by appropriations.
- Allow local option gasoline taxes and subject motor fuels to state and local sales taxes. This would require a constitutional amendment.
- Issue additional bonds. Louisiana is below its borrowing capacity at a time of preferential interest rates. A revenue source would still need to be identified to pay off the bonds.
- More closely examine the issue of funding the state police with transportation revenues.
- Dedicate one-time revenue, such as a portion of excess mineral revenues, to transportation infrastructure projects. Currently, up to $850 million in mineral revenues can be used in the state budget, with excess amounts distributed to local parishes or deposited in trust funds including the state rainy day fund. Until 2017, the cap is suspended and all mineral revenues are supporting the state budget. The return of some amount of "excess" mineral revenues, such as from an increase in oil and gas prices, would be required for this solution to be viable. However, using the funds for transportation conflicts with saving them in a rainy day fund.
- Dedicate motor vehicle sales tax to transportation purposes. Currently motor vehicle sales tax revenues are general fund revenues, and a law will dedicate them to transportation once revenues exceed the 2008–2009 revenue level. This "trigger" has yet to happen, and legislators have proposed making this transfer happen anyway. Such a change would reduce general fund revenue by the same amount as it increases transportation revenue.
- Impose a special tax on fuel efficient vehicles to pay for their use of roads.
- Index the gasoline tax for inflation.
- Increase the efficiency of state and local planning agencies to expedite transportation projects once funding is identified.

While not specifically mentioned in either the DOTD study or the legislative task force report, raising the Louisiana gasoline tax to the post-1952 average rate of 36.9 cents per gallon would generate an additional $470 million per year. The last two gasoline tax increases, in 1984 and 1990, brought the tax up to the 2015 equivalent of 36 cents per gallon. One option could be to phase it in over a series of years, such as 4 cents per gallon

128 Transportation Funding Task Force, Final Report, Mar. 2015, *available at* http://www.louisianagoodroads.org/pdf/TaskForceReport_part1.pdf.

per year for four years, coupled with a defined list of projects the money will be used to complete.

Those who use the roads should primarily pay directly for it through tolls, fuel taxes, and related fees. Funding by users is most equitable, connects wear-and-tear to user payments, and reduces pressure on the state budget as a whole.

Transportation Funding Reform Solutions

- Increase the excise tax on gasoline and diesel fuel.
- Index the gasoline and diesel excise tax to inflation to keep up with transportation demands.
- Consider further tolling of vital roads and bridges to help pay for repairs and enhancements.

Preventing Budgetary Distress Brought on by Revenue Volatility

Most states have created budget stabilization, or "rainy day," funds to draw upon when economic conditions create a severe or sudden drop in tax revenues. However, these cash reserves were for the most part inadequate in coping with the recent economic downturn. In fiscal year 2006, Louisiana had 32 days of general fund spending available in its rainy day fund, higher than the 17 days held by the average state but below the 47 to 65 days recommended by fiscal experts. States have only begun rebuilding their year-end balances, and are expected to close fiscal year 2016 with an average of 26 days of expenses in reserve.[129]

At a minimum, most states are constitutionally required to deposit some portion of year-end surpluses into their rainy day funds during good years. Some examples:

- **Louisiana** must deposit 25 percent of any non-recurring revenue, plus mineral revenue above a base threshold of $950 million.
- **Idaho** must deposit any revenue in excess of 4 percent growth over the previous year's revenues, up to 1 percent of revenues.
- **Utah** must dedicate 25 percent of year-end surpluses to the fund.
- **Virginia**'s deposits are based on a formula related to the growth in tax revenues over several years.
- **Washington** must contribute 1 percent of state general fund revenues to the fund each year, irrespective of economic conditions, until the fund reaches a level of 10 percent of general revenues.

129 National Association of State Budget Officers, *Spring 2015 Fiscal Survey of the States*, Jun. 2015. Year-end balances include ending cash balances as well as rainy day funds. Many states label rainy day funds differently, with budget stabilization fund a common term.

The size of rainy day funds is typically benchmarked against annual appropriations or general revenues. There is no uniformity as to how much states are required to keep in their funds. The smallest funds are capped at 2 percent while the highest pre-set cap is 15 percent; seven states have no cap on their funds. Louisiana caps its rainy day fund at 4 percent of total state revenue receipts for the one previous fiscal year.

To prevent the politicization and misuse of rainy day funds, many states have established tough legislative rules to authorize use of the funds or economic triggers that must be met before lawmakers can access the funds. According to the National Conference of State Legislatures (NCSL), 16 states require a legislative supermajority (three-fourths, two-thirds, or three-fifths) to withdraw from their funds.[130] Other states permit drawing on the fund only after an economic trigger, such as a drop in personal income or an increase in unemployment. Implementing such restrictions on the use of rainy day funds would also be worthwhile in Louisiana, to prevent use of the funds when unnecessary.

While there is currently no consensus on how large a state rainy day fund should aim to be, bonding agencies and state budget officials generally target 5 percent as the appropriate amount. If the fund is too large, there are opportunity costs with the funds being tied up in reserve, as well as a worry that it would reduce incentives for careful expenditure planning.[131]

Recent scholarly research has studied past recessions to develop rainy day fund rules of thumb based on the average revenue shortfalls during an economic downturn. Wagner and Elder, for example, found that "the typical state can expect a revenue shortfall equal to 13 to 18 percent of revenue during a normal downturn," enough to fund between 47 to 65 days of spending.[132] To achieve this during a typical period of economic expansion, states would need to save between 2.4 percent and 2.8 percent of each year's revenues during good economic times.

Admittedly, developing a rule of thumb is difficult, as state revenue systems vary in reliance on different types of taxes. States with highly progressive income-based tax systems or heavy reliance on one-time revenue tend to experience more volatility and should therefore have larger reserves to weather economic downturns.[133] States that rely more on consumption taxes, which tend to be more stable, need not have as much in reserves to smooth over revenue declines.

Other good rules of thumb developed by organizations across the political spectrum include loosening caps on the size of rainy day funds and on the ability to deposit revenues in good times, so they can be built up to adequate levels.[134] Additionally, rainy day funds should not be used in good economic times (the "Atkins Rule," named for former Indiana Budget

130 Daniel G. Thatcher, "State Budget Stabilization Funds," *National Conference of State Legislatures Report (2008)*, National Conference of State Legislators, 2008.

131 See, *e.g.*, Gary C. Cornia & Ray D. Nelson, *Rainy Day Funds and Value at Risk*, 29 State Tax Notes 563, Aug. 25, 2003.

132 Gary A. Wagner & Erick M. Elder, *Revenue Cycles and the Distribution of Shortfalls in U.S. States: Implications for an 'Optimal' Rainy Day Fund*, 60 Nat'l Tax Journal 740, Dec. 2007.

133 See, *e.g.*, Pew Charitable Trusts, *Studying Volatility to Inform Rainy Day Fund Policy*, Sep. 2014.

134 See, *e.g.*, Elizabeth McNichol, *2013 Is a Good Year to Repair (if Not Replenish) State Rainy Day Funds*, Center on Budget & Policy Priorities, Jan. 2013; Joseph Henchman, *Insufficient Rainy Day Funds*, Fiscal Fact No. 306, Tax Foundation, Jun. 2012; National Association of State Budget Officers, *State Budgeting and Lessons Learned From the Economic Downturn*, Summer 2013. See also Todd Haggerty & Jonathan Griffin, *A Drop in the Bucket*, National Conference of State Legislatures, Apr. 2014.

Director Chris Atkins), and drawdowns should be intended over a period of years primarily to prevent short-term shocks to spending priorities.

Having a well-funded rainy day fund may not obviate the need for making difficult programmatic cuts during an economic downturn, but it can cushion the fiscal system in the short-term. Well-designed rainy day funds should have set rules for depositing and withdrawing the funds, a targeted amount to save that takes into account the state's historical revenue volatility, and good transparency to ensure that citizens are informed about how the fund operates and is used.

Rainy Day Fund Solution

- Devote 2 percent of revenues to a rainy day fund each year to protect against tax increases during economic downturns.

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Louisiana has reached a fiscal reform crossroads. While the most recent legislative session shows that short-term budget fixes are not tenable, the exercise pushed many to ask the right questions. How can the tax and fiscal system be updated to reflect a changing economy? Why, in the midst of economic expansion, are tax collections failing to meet the state's needs?

This book is meant to help Louisiana achieve the goal of true fiscal reform—reform that benefits all taxpayers by addressing the many long-term hurdles the state budget has faced, finally bypassing the need for temporary fixes. It's meant to start the conversation about what Louisiana does well, but also what it could do better—by recognizing strengths, diagnosing challenges, and prescribing real, workable solutions.

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