# *Task Force on Structural Changes in Budget and Tax Policy*

## *Meeting Minutes*

September 28, 2016

**I. Call to Order**

The meeting of the Task Force on Structural Changes in Budget and Tax Policy convened at 9:21 a.m. on Wednesday, September 28, 2016 in the House Committee Room 6 located in the basement of the Louisiana State Capitol Building, 900 North Third Street, Baton Rouge, LA 70802.

**II. Roll Call**

a) The following Task Force Members were confirmed as present:

- Dr. James A. Richardson
- Kimberly L. Robinson
- Jason Decuir
- Sean Reilly
- V. Thomas Clark, Jr.
- Dr. James Alm
- Mayor Randy Roach
- William C. Potter
- Jay Dardenne
- Robert Travis Scott
- Barry Erwin
- Dr. Steve Sheffrin
- Louis Reine

b) Approval of Agenda:
The agenda was unanimously approved as distributed.

**III. Review of Meeting Minutes and Adopted Recommendations**

a) Discussion: Review of minutes and decisions made during previous meetings

Secretary Robinson provided a brief recap of agenda items discussed during the September 26, 2016 meeting which included the following:

- Sales Tax
- Individual Income Tax
- Corporate Income Tax
- Franchise Tax

Members reviewed and discussed the specific recommendations that were adopted for each category. The following decisions were confirmed by the Task Force:

1. Projected General fund needs for 2019 seeking 12.5 billion in additional revenue based on what the State intends to spend

2. Sales Tax

   **<u>Sheffrin Motion: Sales Tax Recommendation</u>**

   Dr. Sheffrin recommended the adoption of the proposed Adjusted Tax Base included on page three of the September 26, 2016 options spreadsheet with the following modifications:

   - Includes existing sales tax currently collected
   - Include sales tax base as defined by Act 26 with previously recognized modifications under Act 12 of the Second Extraordinary Special Session of 2016
   - Include recommendations from Sales Tax Streamlining Commission to unify the base
   - Continue to exempt items set forth in the constitution
   - Tax non-residential utilities only at the state level at the full state rate
   - Exempt Manufacturing, Machinery & Equipment from both state and local taxation
   - Tax services based on the Texas Services Model at both state and local level including
     - digital transaction
     - repairs to residential and non-residential immovable property
   - Presumably reach a rate of 4% or lower

Members confirmed that a complete list from Act 26 will be included in the final report in regards to the taxing of exemptions.

3. Manufacturing Machinery and Equipment

During a discussion of MM&E, Mayor Roach reviewed information that emphasized the burden that would be placed on many industrial parishes by excluding MM&E at the local level. Mayor Roach stressed that the general consensus among local governments is that MM&E should be discussed during the conversation on providing local governments with more ability to handle their own financial affairs. Member discussed the pro and cons of taxing MM&E at the state level versus local level.

**Roach Motion: Manufacturing, Machinery and Equipment Recommendation**

Mayor Roach recommended the local sales tax on Manufacturing, Machinery and Equipment be addressed during the discussion on providing local governments with more ability to handle their own financial affairs in order to determine if MM&E can be exempted from local taxation without a significant loss of revenue for local government.

- Second by: Mr. Reine
- Moved favorable by: Mr. Reine
- No opposition: Motion adopted

4. State and Local Sales Tax Administration

**Reine Motion: Uniform Sales Tax Collection Process Recommendation Language**

Mr. Reine made a motion to include language from the proposed state and local sales tax administration recommendation included on page four of the September 26, 2016 options spreadsheet with the following modifications:

"The state should take meaningful steps in establishing a more uniform state and local sales tax base and a uniform state and local collection and auditing system. Further, we recommend the recodification of the existing state and local sales tax statutes. ”

5. Individual Income Tax

**Sheffrin Motion: Individual Income Tax Recommendation**

Dr. Sheffrin recommended the adoption of the proposed Adjusted Income Tax Base included on page five of the September 26, 2016 options spreadsheet with the following modifications:

- Eliminating 50% Excess Itemized Deduction
- Removing recommended treatment on $35K nontaxable and then as retirement and other income rises, nontaxable income declines. Will remain subject to exclusion.
- Include proposed rates at 1.5%/3.0%/4.5% and brackets at $25k/$25k/$50k or considering a single rate
- Exemptions and deductions which need further review: School Tuition, Fees, Quality Public Education
- Change Motion Picture Credit in accordance with ROI and work towards a workable front end cap
- Remove or sunset the following:
    - Federal Tax Liability Deduction
    - Net Capital Appreciation
    - $6k retirement exclusion
    - Citizen’s property
    - Education ($25 per student)
- No change to the following:
    - SD/PE
    - Dependent
    - Military Pay
    - Disability
    - School Readiness Credit
    - LSRS/TRSL/ Others
    - Federal Retirement
    - Solar Tax Credit phase out
    - Social Security benefits
    - Net Income Taxes Paid to States
    - Child Care-based tax credit

- Earned Income Tax Credit
- Historic Tax Credit (2021 sunset)

Dr. Richardson provide additional projection information from the fiscal office based on the difference in revenue generated by bracket and rate changes, removing solar from calculations, and inventory tax credit decisions will apply to individual income. +

6. Corporate Income and Franchise Tax

During a recap of recent changes that the State Legislature and Governor Edwards made to CIFT during the last two extraordinary sessions, Dr. Richardson recommended that the Task Force encourage public support of the amendment that will remove federal deductions and lower the top rate from 8% to 6.5%.

a. **Dardenne Motion: Support of the Constitutional Amendment on the Fall 2016 ballot**

Commissioner Dardenne recommended that the Task Force strongly support the passing of the constitutional amendment on Corporate Income Tax on the fall 2016 ballot.

Members agreed that the inventory tax credit will be discussed with the inventory tax, homestead exemption, ad valorem tax on offshore vessels and the industrial tax exemption at a later date.

b. **Sheffrin Motion: Combined Reporting Study**

Dr. Sheffrin proposed that the Louisiana Department of Revenue, with involvement from the Tax Institute, conduct a study of combined reporting to be completed within two years and make recommendations to the legislature based on the findings by 2019.

c. **Sheffrin Motion: CIFT Recommendation Chart**

Dr. Sheffrin moved to adopt the following recommendations from the chart included on page six of the of the September 26, 2016 options spreadsheet:

- Maintain Subchapter S Corporation
- Eliminate Federal Income Tax Deduction
- School Readiness: Keep with connection to federal support
- Donation to School Organizations: keep sight of possible cost
- Focus on ROI:
    - Motion Picture Credit
    - Enterprise Zone
    - Louisiana Quality Jobs
    - Other LED recommendations on incentive programs

Net Louisiana Operating Loss, Ad Valorem, and Property Tax will be addressed at the following meeting.

The minutes were approved as amended.

**IV. Agenda Topics**

a) Discussion: Net Operating Loss

Members discussed NOL policy and procedures in comparison to other states. Best budgetary practices were identified and options to improve current policy and profitability were discussed. Options in regards to a cap, removal of the carry back and carry forward options were also discussed. The need to establish more predictability for the incentive programs was also identified.

**<u>Potter Motion: Net Operating Loss Recommendation</u>**

Mr. Potter recommended the phase out of the Net Operating Loss cap of 72% to allow 100% of Net Operating Loss to be deducted with a carry forward for a 20 year period.

- Second by: Mr. Decuir
- Moved favorable by: Dr. Sheffrin
- Opposition: No opposition, motion adopted

**<u>Reine Substitute Motion: Interest and Dividend Income Study</u>**

Mr. Reine recommended that the Louisiana Department of Revenue, with involvement from the Tax Institute, conduct a study of interest and dividend income. The study is to be completed within two years and recommendations should be made to the legislature based on the findings by 2019.

- Second by: Mr. Scott
- Moved favorable by: Mr. Reine
- Opposition: No opposition, motion adopted

b) Discussion: Franchise Tax

Members discussed the Louisiana Tax Study which was presented to Louisiana Legislature in March of 2015 as well as the Committee 100 study, both containing language recommending phasing out the franchise tax. Dr. Sheffrin emphasized that the Tax Study report was made prior to recent legislative changes made to franchise tax structure. During the discussion, the complexities in administering the tax were identified. The effects that removing the tax would have on the $12.5B goal were identified. The existence of the tax in regards to creating policy that is both good and fair was also discussed in detail. Replacement revenue options were also discussed.

**Decuir Motion: Franchise Tax Recommendation and Study**

Mr. Decuir recommended the following language: "The Task Force recommends restructuring, phasing out or eliminating the Corporate Franchise Tax provided the replacement revenue source to coincide with that restructure, phase out or elimination is identified. The determination of the appropriate restructure, elimination or phase out would be through a study conducted by the Louisiana Department of Revenue, with involvement from the Tax Institute. The appropriate term of the phase out will also be determined by the study. The study is to be completed within two years and recommendations should be made to the legislature based on the findings by 2019."

- Second by: Mr. Clark
- Moved favorable by: Mr. Reilly
- Opposition: No opposition, motion adopted

Immediately following the adoption of the franchise tax recommendation and study motion, the members approved the removal of the previously adopted Sheffrin Motion for the Single Sales Factor Study.

c) Local Commentary: Dino Paternostro, LegisLink

Mr. Paternostro briefly provided a follow up to previous commentary he provided to the Task Force in support of the capital gains exclusion. Based on this information, Mr. Paternostro urged the Task Force to maintain the capital gains law, as originally passed in 2009 (Act 457) and revised in 2016 (Act 11). Points emphasized by Mr. Paternostro during his commentary included the following:

- The cap gains exclusion was driven by the economic development community, as a wealth/business retention strategy—important to philanthropy, local assets, and community reinvestment.

- Within the broader context of unearned income, this law addresses a narrow issue with a narrow solution applied only to sale of privately held businesses (not investment stocks, dividends, royalties, interest, raw land, etc.)

- The law is working as intended to keep business owners in our state, rather than setting up in TX or FL before "cashing out" on sale of their company or retirement**.**\

- The cap gains exclusion is equitable, available to business owners of any size in any sector of our state economy.

- These same owners have paid annual taxes during their years of operations, including income tax, sales tax, property tax, etc.

- Reducing the marginal income tax rate for personal income tax should not be connected with capital gains treatment for sale of business – a one time/infrequent event.

- Bills to repeal the Cap Gains law were defeated by a broad coalition in the 2015 and 2016 Sessions, establishing legislative precedent.

- As a practical matter, repealing the Cap Gains law will not realize significant savings, as major business owners will simply exit for other states again, leaving small businesses to pick up the tab.

- The law was tightened and potential abuses addressed by the 2016 revised statute, including a five year holding period and tiered benefit based on longevity, which will also yield savings long term.

d) Discussion: Ad Valorem

**<u>Sheffrin Proposal: Ad Valorem Grand Proposal</u>**

Dr. Sheffrin presented a proposal with three components that encompass the Industrial Tax Exemption, Local Inventory Tax, and the Inventory Tax Credit. The proposal aims to improve the state fiscal position by reigning in the growing inventory credit, increasing local control of property tax resources, and reducing local reliance on the taxation of inventories.

It accomplishes these goals by:

(1) Requiring local approval of any property tax exemption and shortening the total period to 8 years (5 initial years, plus a 3 year renewal). It also explicitly allows for partial exemption;

(2) Introducing a new category of property "inventory property" which would be classified at a 11.25% rate of fair market value, reduced from the 15% rate now used for "other property." This change would be phased-in over five years. It would have the effect of reducing property tax revenues for localities unless millages were increased, which would then reallocate the property tax burden across different taxpayers. [Note: Land is now classified at 10 percent.

(3) Reducing the Inventory Tax Credit to 75 percent. The credit would be fully refundable. This reduction is the same percentage as the reduction in the classification rate for inventories. [Note: This change would give an incentive for taxpayers to try to classify personal property as inventory, while local governments would have the opposite incentive.

To implement these changes, we would need to:

A) Amend the state constitution for the ITE (Article 7 Section.21 F) to read (new language in bold): Notwithstanding any contrary provision of this Section, the State Board of Commerce and Industry or its successor, with the approval of the governor and the local governing authority, may enter into contracts for the full or partial exemption from ad valorem taxes of a new manufacturing establishment or an addition to an existing manufacturing establishment, on such terms and conditions as the board, with the approval of the governor and the local governing authority, deems in the best interest of the state. The exemption shall be for an initial term of no more than five calendar years, and may be renewed for an additional three years

B) Amend the state constitution as follows for classification of property taxes (changes in bold (Article VII, Section 18B)): Classification. The classifications of property subject to ad valorem taxation and the percentage of fair market value applicable to each classification for the purpose of determining assessed valuation are as follows:

| Classifications Percentages | |
|---|---|
| 1. Land | 10% |
| 2. Improvements for residential purposes | 10% |
| 3. Electric cooperative properties, excluding land | 15% |
| 4. Public service properties; excluding land | 25% |
| 5 Inventories | 11.25% |
| 6 Other property | 15% |

C) Enact legislation to reduce the inventory tax credit to 75% and make it fully refundable.

**<u>Sheffrin proposed principles instituting in the law that locals have the authority at the discretion of the Governor:</u>**

a. Increase local involvement in industrial tax exemption
b. Find mechanisms to reduce the reliance of local government on the inventory tax through suggestions such as changing classification while im
c. plementing a reduction on the inventory tax credit at the state level

Members discussed possible ways of completely moving away from the inventory tax credit and credit. The localities reliance on the inventory tax was identified when discussing complications faced in completely removing the tax. Based on discussion of the proposal and suggestions from members, a revised version of the proposal was requested to be presented during the next meeting.

e) Discussion: Exemptions and PILOTS

Members discussed tax exemptions and the effect they have on local revenue and a recommendation from Mayor Landrieu addressing the issue. The eligibility requirements for non-profit exemptions and PILOTS were also discussed in detail.

**Potter Motion: Non-profit property exemption proposal**

Mr. Potter suggested the following language "The Task Force recommends the requirement that property owned by a non-profit be exclusively used for the purpose on which its exemption is based."

- Second by: Dr. Sheffrin
- Moved favorable by: Dr. Sheffrin
- Abstained from voting: Mr. Reine
- Opposition: No opposition, motion adopted

## V. New Business

a) Review of HCR reports for recommendations

b) Extension of deadline submission of report to November 1, 2016

c) Tentative meeting date:
   - First week of October

## IV. Adjournment

The meeting was adjourned at 3:16 p.m.

Minutes submitted by: Marisha Patterson