Louisiana Personal Income Taxes: Are There Unintended Consequences

And, If So, What Can We Do About Them?

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Excerpts from the 30-page report, relative to the Capital Gains issue:

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State tax collections will grow if the economy grows, so it is vital that the tax system does not impede the growth of the economy. Hence, it is important for a state's tax structure to be competitive in terms of attracting individuals and businesses to the state and insuring that individuals and businesses do not leave the state merely for tax reasons. States have a higher burden of concern about competitive tax policy than the national government because labor, knowledge, technology, and capital are mobile resources that can settle in Jacksonville, Florida as easily as Covington, Louisiana or Beaumont, Texas as easily as New Orleans, Louisiana. The new economy is based on businesses and individuals being able to locate in any number of places. Hence, tax policy becomes a more significant dimension of the decision making process.

Taxes are necessary to fund public services. Taxes can also distort private decision making and, many times in these cases, the state does not collect as much as it anticipated because private individuals and businesses simply re-locate, decline to invest in the state, or choose to make a smaller investment in the state. States have an obligation to monitor its tax laws to minimize the unintended consequences of its tax laws and regulations. For example, states must monitor to ensure that they will not unintentionally lose tax revenues by forcing individuals and businesses to relocate or not to locate in the state or create a business tax environment that may threaten the long-term growth of the state's economy.

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Investment income is a mobile income source. Taxpayers earn the income from a variety of sources, many of which are not Louisiana based. Taxpayers can easily relocate in order to avoid a burdensome income tax assessment. Similarly, certain persons may choose not to settle in Louisiana due to the prospective income tax on major investment income. There is anecdotal evidence to substantiate such concerns. We cannot quantify precisely the number of such persons who have determined that it is better to make certain transactions as a resident of Florida or Texas than as a resident of Louisiana because of the personal income tax; it is reasonable, however, to accept the fact that the incentive to relocate is present.

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Louisiana has the complicating problem of a relatively poor set of public services; hence, it cannot portray its tax structure as being non-competitive in order to pay for the excellent public services. Louisiana has to find a tax system that does not create any relocation or reduces any in-migration. The tax system cannot discourage mobile resources from locating within the state or staying within the state. Yet, the state also has to find a way to pay for public services.

The personal income tax structure is the focus in one sense, but in this study, the focus has been on the taxation of investment income within the personal income tax structure. Activities associated with investment income, defined in this case as interest earnings, dividends, and capital gains, tend to be highly mobile with the exception of certain businesses constrained by industrial location. Yet, even a person owing a Louisiana business can sell it and perhaps benefit as a resident in another state when the sale is completed. In this simple example, the person has a reason to consider relocating to another state because of the tax structure. In this example the business does not move; just the person or family who formerly owned the business. The state loses productive citizens.