

# LOUISIANA'S OPPORTUNITY

Comprehensive Solutions for a Sustainable Tax and Spending Structure

Prepared by

The Task Force on Structural  
Changes in Budget and Tax Policy



**FINAL REPORT**

JANUARY 27, 2017

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The Louisiana Legislature created the Task Force on Structural Changes in Budget and Tax Policy during the First Special Session of 2016. The purpose was to look beyond recent temporary revenue fixes and recommend permanent solutions for the growing and possibly intractable imbalance between annual state revenues and spending levels. Led by Rep. John Schroder and supported by House Speaker Taylor Barras and Senate President John Alario, House Concurrent Resolution No. 11 [See [Appendix A](#)] directed the Task Force "to make recommendations of changes to the state's tax laws in an effort to modernize and enhance the efficiency and fairness of the state's tax policies for individuals and businesses, to examine the structure and design of the state budget and make recommendations for long-term budgeting reforms." The members of the Legislature and the Office of the Governor are fully aware that this imbalance between state spending and revenues collected will not solve itself.

Public meetings commenced March 18, 2016, and continued on an almost weekly basis through October 2016.<sup>1</sup> The resolution called upon the Task Force to report to the Legislature and to urge and request the Governor to support and implement initiatives for structural change. The key component would be a "specific plan for long-term tax policy that may be used to introduce legislation no later than the 2017 Regular Session of the Legislature." The Task Force in concurrence with House and Senate leaders lengthened the original September 1, 2016, report deadline to November 1, 2016. On that date, the Task Force submitted its Outlook and Recommendations to the Legislature and the Governor.

This final report, which begins with a Summary of Task Force Recommendations, is larger in scope and includes additional perspectives, background information, charts and tables offered by the Task Force for a fuller account of its work during the year. The report outlines the basic principles of a good tax and fiscal system, identifies the problems with the current system in Louisiana, and recommends a package of solutions. These recommendations are designed to be holistic in impact. As a practical matter, we have to focus on one tax at a time when assessing an entire fiscal structure, but the changes in the entire tax structure that we recommend should be examined globally in relation to one another. We strongly caution against a piecemeal approach since one tax change by itself may appear to be focusing on taxing one sector of the economy or one group of taxpayers while examining all of the proposed tax changes will allow the overall impact of the proposed tax changes on all income categories, on individuals versus businesses, and state obligations versus local activities to be fully appreciated. Equally important, once reforms are in place, the Legislature and the Governor must resist the temptation to begin carving out exceptions or diluting the impact of the new structure.

A failure to act is not an option. Most of the temporary revenue fixes implemented in 2015 and 2016, valued at well more than \$1 billion, will expire in 2018. Realistic spending cuts of this magnitude are not expected to be found. A massive budget shortfall and deeply damaging instability would ensue. Neither

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<sup>1</sup> Presentation materials, supporting documents and video archives are available on the LDR website (<http://www.revenue.louisiana.gov/LawsAndPolicies/TaskForceOnStructuralChangesBudgetTaxPolicy>).

does the Task Force see a good solution in simply extending all of the temporary revenue measures. In that scenario, the state would be doubling down on a broken and inefficient tax system, thereby inviting poor credit ratings, greater uncertainty in both the private and public sectors, and an inevitable return to the drawing board. It is the fervent desire of the Task Force to see Louisiana graduate to a more mature and stable form of taxation and spending. All of the recommendations posted here are well within our grasp if we decide to adopt them.

The Task Force has 13 members supported by the staff of the Louisiana Department of Revenue. The members of the Task Force are as follows:

- **Kimberly Robinson**, Secretary of the Louisiana Department of Revenue, Co-Chair of the Task Force. (LDR Secretary.)
- **Dr. James Richardson**, Co-Chair of the Task Force. He is the John Rhea Alumni Professor of Economics and Public Administration in the Public Administration Institute in the E. J. Ourso College of Business Administration at Louisiana State University. (principal on the Revenue Estimating Conference)
- **Dr. James Alm**, Professor and the Chair of Economics at Tulane University. (One economist or tax specialist appointed by the Speaker of the House of Representatives from a list of nominees submitted by public or private universities in the state including the Louisiana State University AgCenter and the Southern University AgCenter.)
- **Tom Clark**, a partner with the Adams and Reese law firm and Chairman of the Committee of 100. (A member appointed by the Governor.)
- **Jay Dardenne**, Commissioner of Administration. (Division of Administration Commissioner or designee.)
- **Jason DeCuir**, Principal for the tax service firm Ryan. (One member of the business community appointed by the Speaker of the House from a list of nominees submitted from Blueprint Louisiana, Committee of 100 for Economic Development, and the Louisiana Association of Business and Industry.)
- **Barry Erwin**, President of the Council for a Better Louisiana. (A member appointed by CABL.)
- **William Potter**, Senior Tax Director at Postlewaite & Netterville. (A member appointed by the Society of Louisiana Certified Public Accountants.)
- **Sean Reilly**, Chief Executive Officer for Lamar Advertising. (One member of the business community appointed by the President of the Senate from a list of nominees submitted by

Blueprint Louisiana, Committee of 100 for Economic Development, and the Louisiana Association of Business and Industry.)

- **Louis Reine**, President of the Louisiana AFL-CIO. (A member appointed by the President of the Senate from a list submitted by the Louisiana School Boards Association, the Louisiana Budget Project, and the Louisiana AFL-CIO.)
- **Randy Roach**, Mayor of Lake Charles. (A member appointed by the Speaker of the House of Representatives from a list submitted by the Louisiana Sheriffs' Association, the Louisiana Assessors' Association, the Police Jury Association of Louisiana, and the Louisiana Municipal Association.)
- **Robert Travis Scott**, President of the Public Affairs Research Council of Louisiana. (A member appointed by PAR.)
- **Dr. Steven M. Sheffrin**, Professor of Economics and the Director of the Murphy Institute at Tulane University. (One economist or tax specialist appointed by the President of the Senate from a list of nominees submitted by public or private universities in the state including the Louisiana State University AgCenter and the Southern University AgCenter.)

The Task Force would like to thank the substitutes who sat in for members at some meetings. They included: Steven Procopio, Policy Director for PAR; Scott Richard, President of the Louisiana School Boards Association; Ed Parker, Louisiana AFL-CIO; Camille Conaway, Vice President for Policy and Research at the Louisiana Association of Business and Industry; Barbara Goodson, Deputy Commissioner of Administration; Ron Gitz, CEO of the Society of Louisiana CPAs; Brandon Lagarde, a Director in the Postlethwaite & Netterville Tax Services Group; and Bryan Beam, Calcasieu Parish Administrator.

Additional and profound thanks are owed to the many individuals, government officials and interest groups that provided valuable information and testimony to the Task Force. Their input was vital to the process. Due to the engagement and support of employees of multiple state agencies, including in particular the staffs of the Division of Administration, the Department of Revenue, and the Legislative Fiscal Office, the Task Force was able to request queries and multiple analyses of fiscal data. For these efforts, the Task Force is most appreciative and forever indebted, as it would have been impossible to conduct the Task Force's work without their substantial knowledge, experience and support through this process.

The Task Force on Structural Changes in Budget and Tax Policy started with the premise that a tax structure should generate sufficient revenues to fund legitimate and necessary government expenses. In so doing, the tax structure should be fair, simple, competitive with other states, and stable over the short and long term. These qualities are best achieved with taxes that are broad-based with low rates, and that do not play favorites for or against a particular constituency. The Task Force viewed economic competitiveness and comparisons to other states as fundamentally relevant factors in its decision making, while attempting to assure that compliance with a new structure would be easy and clear. The Task Force also believes that exceptions should be minimal and for clearly established reasons that serve our state's needs.

The Task Force acknowledges that much of what the state spends each year is constitutionally and statutorily obligated before the Legislature begins the budget debate and is primarily required to meet fundamental state obligations. The Legislature is limited in its ability to alter the spending obligations and there are few clearly identifiable areas that can easily be eliminated to materially reduce overall state spending. Additionally, a substantial portion of the state budget is derived from federal matching funds that cannot be used for anything other than the designated purpose. However, there are areas that should be addressed to provide for better budgeting practices and to prevent overspending, that would mitigate the potential for mid-year deficits, allow for better long-term planning and potentially free up revenues to address long-standing accumulated state obligations.

The Task Force offers the following recommendations that should be considered as a package. Although the changes will require separate pieces of legislation, they should be considered in their entirety as a whole and not individually in isolation, because of their interactions with one another in establishing a balanced and fair tax system. With that in mind, the Task Force - after more than six months of information gathering and deliberations - makes the following recommendations:

### **Budget and spending recommendations**

1. Avoid budgeting practices that allow for spending beyond available recurring revenues.
2. Implement and adhere to improved revenue-needs forecasting, particularly with regard to the MFP, Medicaid and TOPS, that more closely predicts actual utilization. The state should strengthen current law which provides for estimating conferences in various major spending areas to provide a formal multi-year spending forecast for such things as Medicaid, the MFP, TOPS and Corrections.
3. Continue the ongoing review of state contracts to identify opportunities for consolidation, renegotiation or elimination.
4. Examine individual constitutional dedications to determine if they remain a state policy priority.
5. Conduct a holistic review of state trust funds for possible revision, elimination or merger of funds.
6. Continue to implement fiscal structures that will help protect the state budget from swings in volatile state revenue streams, such as mineral revenues and corporate taxes.

7. Implement staggered sunsets on all statutory dedications to see if they can be adjusted, eliminated or combined with others.
8. Continue payments to state pension systems on the initial Unfunded Accrued Liability under the current timeline to avoid increasing debt, while looking for ways to accelerate payments toward an earlier debt retirement.
9. Examine expected rates of return on pension investments to make proper adjustments to ensure that the retirement systems are not creating another new and costly unfunded accrued liability in the future.
10. Continue review of various tax credits, rebates, deductions, and exemptions to state taxes to determine whether they can be eliminated, curtailed or more closely regulated.

### **Sales tax recommendations**

1. Expand the sales tax base and reduce the sales tax rate from its current 5% to no more than 4%. To do so, the Task Force recommends: (1) retaining, with a few modifications, the expanded state sales tax base adopted in Act 26 of the first special session of 2016 and amended by Act 12 in the Second Special Session, which would continue the tax on such things as custom software, business utilities, and storm shutter devices; and (2) making certain services, such as those taxed in Texas, and digital transactions subject to sales tax. Some of the taxable services include cable and satellite television, repairs to nonresidential, commercial property, web hosting and security services.
2. The state should take meaningful steps to establish a more uniform sales tax base by bringing exemptions and exclusions in line on both the state and local levels.
3. State and local governments should work to create a uniform system of tax administration, collection and audit that respects and protects local revenue streams from any overlap with state revenues.
4. Give local governments the authority to increase their sales tax rates without a vote of the state Legislature, but still require a vote of the people in the area being taxed. Sales tax and property tax reform are essential if local governments are to have the tax capacity to independently provide their own funding.
5. In order to provide greater clarity and ease of compliance, the Task Force recommends a recodification of sales tax law.

### **Income tax recommendations:**

1. Eliminate the state deduction for federal income taxes paid, accompanied by appropriate state income tax rate reductions. This change would decouple Louisiana's income tax base from federal tax changes. Eliminating federal tax liability as a deduction for the income tax will break the connection between federal changes in tax policy and state income tax collections. The state should not be rewarded when the federal government decides to lower taxes nor penalized when the federal government decides to raise federal taxes. The only way to lower the individual income tax rates is to get rid of the federal tax liability exemption. It also recommends limiting the excess itemized deduction for personal income to 50%. These two deductions account for a reduction of

\$1.225 billion in income tax collections in Louisiana at the current rate structure. These exemptions provide a much larger tax break to higher income groups, both absolutely and proportionally. If the excess itemized deduction were limited to 50%, mortgage interest and charitable giving would still be deductible. This proposal, along with the state's reliance on the sales tax, will balance the overall tax structure among various income categories in terms of who is paying for state services.

2. Two options for changes to the individual income tax law – one constitutional and the other statutory. A constitutional option allows Louisiana to expand the income tax base, narrow the brackets, and lower all rates by 25%. A statutory option only allows base expansion and narrowing of the brackets.
  - a. Under the constitutional option, the Task Force recommends allowing voters to approve the elimination of the federal income tax deduction that decouples the Louisiana tax base from federal tax changes. This option would include scaling back excess itemized deductions to 50%. A new three-bracket structure would be used and rates of taxation lowered – 1.5% on the first \$25,000 (\$12,500 single), 3% on \$25,000 through \$50,000 (\$12,500 through \$25,000 single) and 4.5% above \$50,000 (above \$25,000 single). Not only would rates be lowered by 25%, but they would apply more fairly and evenly to all taxpayers because of the proposed elimination of many deductions and exemptions.
  - b. Under the statutory option, the excess itemized deduction would be fully eliminated. This would be coupled with the elimination of other deductions and exemptions proposed by the Task Force. The statutory option would use the new compressed three-bracket structure, but tax rates would remain at the current 2%, 4% and 6% levels.
3. Eliminate many income tax exemptions and credits and impose a moratorium on any new tax credits or exemptions applied to the individual income tax. The Task Force recommends keeping (1) the standard and dependent deductions, (2) the exclusion for military pay for active duty personnel, (3) the credit for taxes paid to another state, (4) the earned income tax credit (because it allows the state to enhance the progressivity of its income tax and reduce the regressive nature of the overall state tax structure), (5) the exclusions for social security and retirement income for public employees, and (6) credits related to child care and early childhood education ( in part because these programs help all families and improve educational outcomes, and in part because they leverage federal money).

#### **Corporate tax recommendations:**

1. Eliminate the deduction for federal taxes paid for the corporate income tax. A constitutional amendment included on the statewide ballot on Nov. 8, 2016, failed with 44% of voters favoring the amendment. The reform would have decoupled the Louisiana tax base from federal tax changes and would have set the corporate tax rate at a flat 6.5%. The upper bracket rate for Louisiana currently is 8%. This approach would have better aligned Louisiana with its competitor states, potentially provided for a more stable source of revenue than the current corporate income tax structure, and eliminated instability in state corporate tax collections due to actions in Washington, D.C. The Task Force believes this proposal should be considered again since it will be impossible to lower the marginal corporate tax rate, a very important ingredient in long-term tax reform, without



eliminating a major exemption such as federal tax liability. Also, at this stage, it will be combined as part of an overall tax reform package reform and hopefully will be backed by political leaders with a strong constituency of support. A convincing public education effort will be needed.

2. Direct the Department of Revenue, with the Louisiana Tax Institute, to study moving from single-entity taxation on the corporate level to a system of combined reporting with findings due by January 2019. Under combined reporting, corporations are taxed based on their apportioned share of income of their “unitary group” which includes a variety of criteria, including common ownership, common management and common lines of business. Combined reporting solves the profit-shifting incentive because related companies are part of a unitary group in which intercompany transactions are eliminated. Instead a state will apportion the entire unitary group using a combined return to determine its share of its tax base.
3. Restructure, phase out or eliminate the corporate franchise tax, provided the state identifies replacement revenue that coincides with changes in the tax. The analysis of the restructuring, elimination, or phase out, along with the identification of the replacement revenue source, is to be conducted by the Department of Revenue, with the Louisiana Tax Institute. The findings are to be presented to the Legislature by January 2019.

#### **Ad valorem tax recommendations**

1. Amend the Louisiana Constitution to provide local governmental authorities with a role in granting industrial tax exemptions and create a statutory framework to establish the extent of this role for local involvement, as well as defined policies for use of the exemption as an economic development tool that favors job growth.
2. Expand the use of payment in lieu of tax arrangements for local governments considering property tax exemptions to attract economic development. Such arrangements should require the coordinated approval of the elected officials in the impacted taxing jurisdiction.
3. Amend the Louisiana Constitution to allow for a gradual elimination of locally-imposed inventory taxes over a 10-year period accompanied by the elimination over a five-year period of the state income and franchise tax credit paid on inventory. To offset local governments’ reduction in revenues, the Task Force suggests several options, including a constitutional change to allow a roll-up in existing property tax millages, enhanced local revenues resulting from expansion of the sales tax base and changes to the industrial tax exemption, and creation of a temporary revenue sharing fund to bridge the gap as the inventory tax goes away.
4. Amend the Louisiana Constitution to limit the property tax exemption on property owned by non-profits to that used exclusively for the tax-exempt purposes of the non-profit.

#### **Economic development incentive recommendations**

1. Require the Louisiana Department of Economic Development (LED) and the Legislature to establish sunset review periods for all incentive programs and eliminate underutilized or inactive programs.
2. Require LED to continue to monitor and regularly report on the performance of all its incentive programs. The reporting must include information on the return on investment for each program

and be conducted by independent third parties in accordance with the legislatively established objectives for these programs.

3. Retain the Motion Picture Investor Tax Credit as a non-appropriated, non-refundable tax credit incentive with both discounted redemption and transferability as alternative options for use. The Legislature should implement a modified front-end cap to control the number of credits issued from inception and implement other mechanisms to encourage reasonably timely use to avoid the creation of another backlog of credits that would put a drain on the state budget. The implementation of the front-end cap should coincide with the elimination of the back-end cap.

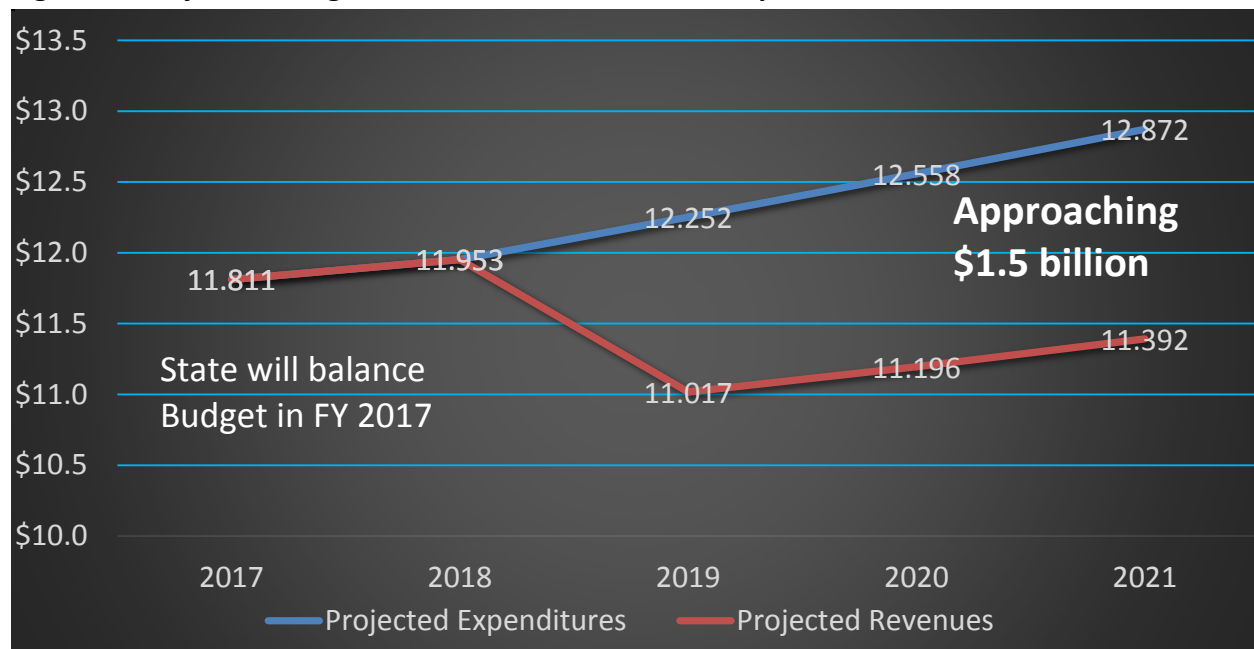
*If we want to solve our fiscal problems and not repeat mistakes of the past, we need to understand how we got to where we are*

Taxes and spending are inextricably linked. The fundamental purpose of a tax system is to provide sufficient revenues to pay for public services in line with the overall demand of the electorate and in line with the development and growth of the state. As noted in business publications such as Forbes, Bloomberg, and the Tax Foundation, a state's attractiveness to out-of-state investment depends on a stable and competitive tax structure and the delivery of public services necessary to maintain a friendly environment for companies and their employees. Factors that influence out-of-state investors also affect choices made by individuals and businesses already in the state. Louisiana cannot afford to ignore the image that is being transmitted to out-of-state investors and credit-rating agencies by an annual budget debacle, or the uncertainty it creates for individuals and businesses who have already invested in the state.

At the time the Task Force on Structural Changes in Budget and Tax Policy was formed, a prevalent view among government leaders and policy analysts was that past management of the state budget and the underlying fiscal structure were flawed and needed fundamental change. State spending levels had chronically outpaced recurring state revenues, and as of early 2016 the forecasted gap for the next budget year was approaching \$2 billion. The situation posed a threat to the state's ability to provide basic public services and to maintain financial stability. The nation's credit rating firms took notice. Moody's warned in 2015 about Louisiana's "growing structural budget imbalance." Fitch criticized the state's November 2015 budget adjustments as "largely stop-gap measures" that "will not address the state's persistent budget challenges." The rating firms indicated they were looking for Louisiana leaders to form a consensus to bring recurring revenues and expenses into a more stable alignment. After 13 years of credit rating improvements, Louisiana was on the verge of a costly downgrade.

Temporary revenue-raising measures were fashioned to address the emergencies in 2015 and 2016. The Legislature raised more than \$725 million in 2015 with a variety of tax changes, from increases in the tobacco tax to trimming the value of tax credits. But these adjustments were not enough to allow the state to get through fiscal 2016 without further revenue increases. In February 2016 the state sales tax was increased from 4% to 5%, and many exemptions and tax credits were further modified, suspended or reduced. Many of these revenue measures are scheduled to expire on June 30, 2018. If no further action is taken, the state's annual revenue stream will rise in the next two years and then fall by approximately \$1.2 billion. Combined with expected spending levels, the budget gap for fiscal 2019 is currently estimated at \$1.5 billion and projected to approach \$1.5 billion by 2020 as depicted in Figure 1.

**Figure 1. Projected Budget Outlook Based on Current Expenditures and Tax Structure**



Meanwhile -- and perhaps a more worrisome signal about the state's financial condition -- state cash balances have been severely depleted and recent revenue collections have failed to meet expectations, leading the state to borrow short-term to maintain cash flow and pay state expenses in a timely manner. Adding to the stress, a budget deficit of \$313 million was determined for the fiscal year that ended June 30, 2016, and for fiscal year 2017 it is anticipated that the state will be facing another budget deficit of over \$300 million.

Clearly, the state has lived well beyond its means as defined by the revenues produced by its tax structure even if it has not lived beyond its means as defined by the consensus needs of the state. The Legislature has too often determined the state budget by a policy of spending as much recurring revenue as is collected plus any additional windfalls that can be found. The budget seems to have been based on how much money we have, not on what we need to spend to meet the obligations of the state. The goal of establishing a real and reliable balance between spending by the state and tax revenues received by the state is the greatest challenge facing the Legislature and the Administration.

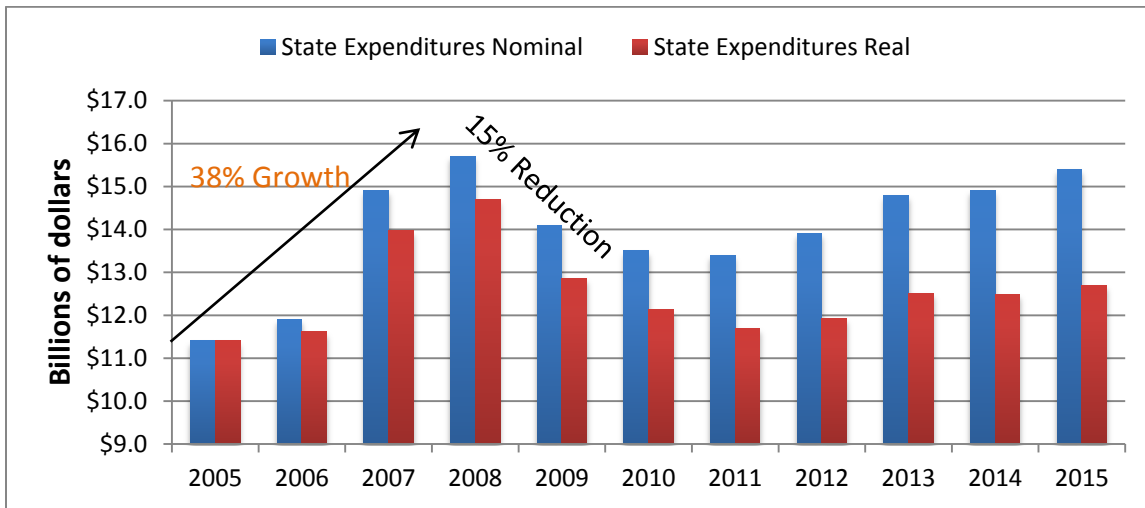
**It did not happen overnight**

Government tax and spending policies in Louisiana, as in other states, are a combination of old and new tax laws and spending priorities, short-term remedies, and changing circumstances. The fiscal structure of the state becomes acceptable to the state's residents and therefore changes in it become difficult. Also, the state survives from year to year. Sometimes, decisions that work in the short-term do not

work in the long-term. Sometimes decisions made many years ago need to be re-assessed given the dynamics of the state’s economy and national tax policy.

In Louisiana the fiscal situation has been volatile since the 2005 hurricanes as illustrated in Figure 2. The state’s finances were riding high in the post-Katrina years as a result of increased tax revenues from all major revenue sources, residential and business recovery spending, federal aid, and insurance coverage. Louisiana’s taxes, licenses and fees reached a peak in 2008 of over \$12 billion and all spending (including fees and self-generated funds), less federal money, reached almost \$16 billion, a record that would stand for the next eight years. Tax cuts under Governor Blanco in 2007 and Governor Jindal in 2008 for individuals and businesses were a significant savings for taxpayers but also amounted to about a \$1 billion difference in annual state revenue.

**Figure 2. Louisiana’s Budget Pattern: FY 2005-FY 2015**



The federal bailout of the states during the national recession of 2007-2008 eventually phased out, removing a temporary prop. The cost of tax credit programs grew substantially. Corporate income tax revenue that soared above \$1 billion in the post-Katrina years has fallen to a fraction of that amount. Oil and gas tax revenues have declined by \$1.4 billion since 2008, and, recently, the dip in oil and gas prices has led to private sector layoffs and lower business profits. In 2015, oil and gas revenues accounted for just over 10% of total taxes, licenses, and fees; however, in fiscal 2017, oil and gas revenues are projected to account only for about 4% of those revenues. This illustrates the dramatic shift in the revenues available to support state spending.

**Budget challenges grew worse**

Inadvisable budget practices added to the imbalance over time. Trust fund depletions, debt defeasance maneuvers, and four tax amnesty periods are examples of ways the state borrowed from the future and spent money from sources that were not available in subsequent years. The previous administration and

the Legislature also passed budgets that chronically underfunded the real expenses of Medicaid, TOPS college scholarships, and the state's K-12 funding program. As a result, mid-year budget shortfalls became a regular occurrence.

The federal matching rate for Medicaid money in Louisiana was revised downward after Hurricane Katrina due to rising per-capita income, a major reason the program's annual cost in state money grew by nearly a billion dollars.<sup>2</sup> Even before Medicaid expansion for low-income adults was launched this year in Louisiana, Medicaid expenses and enrollments had steadily increased.<sup>3</sup> Meanwhile, the state's annual expenses for the public pensions and the government employee Group Benefits health insurance program increased. The annual payment schedule for unfunded accrued liabilities (UAL) in the state pension systems required less than \$600 million in 2006 but has grown to more than \$1.6 billion since that time.

Starting in 2009, thousands of state employee positions were eliminated or moved into the private sector, notably during the privatizations of the state-run Charity hospitals. This change in the Charity hospital system reduced the number of state employees, but it did not necessarily reduce state expenditures associated with providing health care for the indigent. This was a major structural change in how Louisiana handled healthcare for indigents and the fiscal impacts are still being assessed. Meanwhile, several state agencies sustained significant cuts in state general fund spending, including the Department of Children and Family Services. Higher education coped with cuts in direct state support by raising tuition, fees, and enrollments. Essentially, the state was balancing its budget partially on the backs of college students and their parents.

### Credits and exemptions flourished

Tax exemptions and deductions have been around for ages with some going back to the 1930s. Some have been created by statute and others have been put in the Louisiana Constitution by a vote of the people. Tax credits became more frequent and significant in defining tax policy starting in the 1980s and 1990s. Deductions are a reduction in a taxpayer's taxable income. Tax credits are a direct reduction in a taxpayer's tax liability. If the tax credit is larger than the tax liability, the state may in some cases provide a refund to the taxpayer. The tax credit can also be mobile in the sense that some tax credits may be transferred to other parties with a significant tax liability. Table 1 provides a sense of the change in exemptions, deductions, and credits over the years. Many tax exemptions, deductions, and credits really took off after 2008.

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<sup>2</sup> The Federal Medical Assistance Percentages (FMAP) provided Louisiana with about 70% of its Medicaid costs, but this match was lowered to about 62% based on the formula used to compute the federal assistance per state. This formula compares the state's average per capita income to the national average. The lower rate became fully effective in 2011.

<sup>3</sup> Medicaid Expansion will reduce the cost of Medicaid for Louisiana, at least initially. There is still a debate about the long-term financial implications of Medicaid Expansion and some of this discussion depends on assumptions about federal policy.

As an example, the state's horizontal drilling exemption was originally passed in 1994 when horizontal drilling was truly an infant industry. It was not used extensively in Louisiana until 2008 with the expansion of hydraulic fracturing, or “fracking,” in northwest Louisiana’s Haynesville Shale. From 2008 through 2015 the horizontal drilling exemption represented a cumulative tax break of more than \$1 billion. It could be argued that this exemption encouraged the drilling and production; however, it is also likely that the high price of natural gas, peaking at over \$9 per thousand cubic feet, was a more important factor in encouraging the exploration, drilling, and production.

**Table 1. Exemptions, Deductions, and Credits for Selected Years (in millions of dollars)**

	<b>General Sales Tax (not including sales tax on motor vehicles)</b>	<b>Individual Income Tax</b>	<b>Corporate Income and Franchise Tax</b>	<b>Severance Tax</b>	<b>Sales, Income, CIFT, and Severance</b>
<b>FY 2000</b>					
<b>Collections</b>	\$2,119.0	\$1,582.0	\$491.0	\$406.0	\$4,598.0
<b>Est. Exemptions,</b>	\$378.0	\$927.7	\$427.8	\$69.0	\$1,802.5
<b>% Exemptions to Collections</b>	17.8%	58.6%	87.1%	17.0%	39.2%
<b>FY 2005</b>					
<b>Collections</b>	\$2,152.0	\$2,190.0	\$416.0	\$514.0	\$5,272.0
<b>Est. Exemptions,</b>	\$1,876.7	\$939.8	\$540.8	\$87.9	\$3,445.2
<b>% Exemptions to Collections</b>	87.2%	42.9%	129.8%	17.1%	65.3%
<b>FY 2008</b>					
<b>Collections</b>	\$2,802.0	\$3,116.0	\$1,005.0	\$898.0	\$7,821.0
<b>Est. Exemptions,</b>	\$1,441.6	\$1,292.7	\$1,094.8	\$117.6	\$3,946.7
<b>% Exemptions to Collections</b>	51.4%	41.4%	108.9%	13.1%	50.5%
<b>FY 2015</b>					
<b>Collections</b>	\$2,658.0	\$2,786.0	\$623.0	\$826.0	\$6,893.0
<b>Est. Exemptions,</b>	\$3,148.2	\$2,138.7	\$1,695.2	\$328.2	\$7,310.3
<b>% Exemptions to Collections</b>	118.4%	76.8%	272.1%	39.7%	106.1%

As another example, the inventory tax credit was first introduced in the 1990s. This credit essentially made the state responsible for any inventory taxes paid by companies to local governments. From 2005 to 2015, the assessed value of inventories rose from \$2.045 billion to \$4.389 billion, or an increase of 115%. This compares to a 62% increase in the assessment of real estate; a 74% increase in personal property not including inventories; and 71% in public service properties. The Task Force found that

inventory assessments in Louisiana have grown at a much higher rate than inventory assessments in other states that allow that form of property tax but do not have a similar credit.

Both of these economic development incentives did not materially affect the state's fiscal ledger until after 2008, when they grew to become major contributors to the state's inability to reclaim revenues lost during the economic downturn. The state's motion picture production tax credit also grew substantially during this time.

Here's another way of looking at the impact. The state general sales tax, the individual income tax, the severance tax, and the corporate income and franchise taxes together represent almost two-thirds of the overall state revenue base. In fiscal 2000, exemptions, deductions, and credits represented about 39% of the actual collections of those taxes. This percentage grew to 65% in fiscal 2005, just over 50% in fiscal 2008, and over 100% in fiscal 2015. That means the value of all exemptions, deductions and credits in fiscal 2015 was larger than the total collections of all those taxes. The tax base has been eroded by special provisions.

These tax advantages all had their own specific purposes. A national trend was under way to use the tax system in multiple ways to address certain problems or opportunities. As we stated earlier, the tax structure's primary purpose is to provide sufficient revenues to fund state government. But with the use of the tax system to provide an economic spark to the economy, the purpose of the tax system became more complicated and more difficult to assess if it was truly serving the multiple purposes we had asked it to do.

We know now that the growth of the exemptions, deductions, and credits have affected the ability of the tax structure to provide sufficient revenues to support state services as deemed necessary by the Legislature and the Office of the Governor. These breaks have become part of the tax structure and part of what individuals and businesses expect. Taxpayers are accustomed to making use of these special tax provisions and they are used to advance certain public policies. But the question now, given the imbalance between state expenditures and projected tax receipts, is whether we choose to sustain or increase high rates on taxes or eliminate some of the exemptions, deductions, and credits.

### **Overcoming our past**

Eventually, the Legislature increased taxes, first in 2015 and then again in 2016. But these measures have not resolved the fiscal and structural problems and were not meant to be long-term solutions. The Legislature chose temporary solutions with the full knowledge that in 2017 the state will have to agree on a long-term plan, along with a transition to the long-term plan.

The challenge before us is to find a way to balance the budget realistically, fully, and durably for the future. The Task Force sees three broad approaches to achieve this goal:

1. Providing a general framework to address major expenditure issues;



2. Revising the revenue structure so that it generates the necessary revenues and provides fairness and competitiveness; and,
3. Outlining the importance of state versus local responsibilities both from a tax perspective and as an expenditure issue.

The focus is on a long-term framework that is durable for the next 10 to 20 years. In establishing such a framework, we are cognizant that the transition from the current imbalance to the long-term framework requires attention and suggestions.

### *O*ur chronic budget shortfalls and biggest inflationary costs must be addressed with long-term treatments and better fiscal discipline

Comprehensive state spending must be addressed as part of the solution for long-term fiscal sustainability. In Figure 2 we showed all state spending, including all dedications and fees and self-generated funds. A surge in state spending came in 2007 and 2008, but state spending fell in 2009 and has been, on average, relatively stable over the last seven years with very modest increases, though there may have been changes in priorities within the budgets.

Federal dollars in the state budget began a decline in 2010 but rebounded with a substantial increase in fiscal years 2016 and 2017. Our total state budget increased accordingly. Federal funds cannot be utilized for anything other than the identified purpose, which in most cases are roads, hospitals and healthcare. Among the 50 states, Louisiana ranks No. 2 in the use of federal funds as a percentage of its annual budget, which is primarily a statement on our high level of poverty. Mississippi is ranked first.

The Task Force recognizes that the issue of state spending involves the amount of money the state spends on various government programs and the structure of priorities that are built into the state's dedications and spending mandates. Most of what the state spends each year is obligated even before the Legislature begins the annual budget debate. The state's flexibility is tied by commitments and dedications made years ago. Some, if not many, of these dedications may stand the test of scrutiny year after year, but dedications do inhibit extra examination of each spending program.

We will make it clear from the beginning that any major change in the delivery of public services or even in the downsizing of public services will not generate major savings in the short-run. This is not to say that structural changes in the public services offered by the state or in the way in which the state delivers them should not be examined, evaluated, and altered. Rather, we want to warn everyone that they should not expect an immediate reduction in expenditures from structural changes in public programs. This has been amply noted by the major change in the delivery of healthcare to persons in Louisiana that did not have access to healthcare. Closing state healthcare institutions and replacing them with private hospitals via cooperative endeavor agreements may and hopefully will save money and improve services in the long-run; in the short-run, it was not promoted as a method of balancing the budget. As a general rule, elimination of structural elements of a system is rarely, if ever, achieved with an immediate overall savings if a transition is to be successful.

#### **Fiscal management recommendations**

The Task Force offers these recommendations on state spending, viewed especially as long-range treatments and cures:

As an absolute guideline, the state must avoid budgeting practices that allow spending beyond the available recurring revenues. Also, the state should not create short-term spending or revenue-raising gains in exchange for greater long-term costs. These practices and budget gimmicks in recent years have had a profound and damaging impact on state fiscal stability, our state's credit and fiscal ratings, and ultimately resulted in an inefficient allocation and expenditure of resources.

Furthermore, the appropriations process must be based on the most realistic forecasts of budget expenditures. In recent years, grossly inadequate targets for the real utilization of MFP school funding, Medicaid, and TOPS have been used to give the appearance of a balanced budget during the appropriations process, but have ultimately led to mid-year budget shortfalls as actual utilization has materialized. Louisiana has experienced mid-year budget cuts in each of the last eight years, sometimes more than once per year. To reduce the potential for this reoccurring, the Task Force recommends establishing a formal multi-year spending forecast, a tool that some other states have found useful. Also, the Task Force recommends that all estimates of spending be carefully and correctly projected. Good budgeting requires reliable information being built into the budget process.

More efficient spending can possibly be addressed through the continued elimination, streamlining, consolidation or appropriate outsourcing of government services as an ongoing endeavor. The Commission on Streamlining Government issued a report in 2010 with 238 specific recommendations, many of which have been adopted and implemented. In 2014 the state commissioned a study by Alvarez and Marsal, *Government Efficiencies: Management Support*, which outlined different ways of cutting state expenditures. More recently, the Legislature passed House Concurrent Resolution 25 to compel state agencies to demonstrate efforts to become more efficient.

The Task Force was not charged with conducting a detailed study of the proposed efficiencies and streamlining, but members were provided with and reviewed the HCR 25 reports submitted by each agency. Some of the reports contain detailed and worthwhile initiatives even though they might not lead to transformative changes in state spending levels. In particular, the Task Force wants to commend the Board of Regents' report for a thorough review and listing of alternatives to encourage efficiencies and enhance the overall higher education structure. The Task Force has placed in [Appendix B](#) information about processes used to evaluate spending programs in the state.

### **Contracts management**

Additionally, the Task Force notes that the Division of Administration, pursuant to Governor John Bel Edwards Executive Order JBE 16-05, and the Legislature have undertaken a comprehensive review of all state contracts to determine whether there might be cost savings. Although not quantified, this effort has resulted in the cancellation of some state contracts; however, more significantly, this effort has revealed that many of the largest contracts are directly tied to the provision of vital public services. As such, these contracts cannot and should not be cancelled because these services were deemed to be provided more efficiently to the state through a contracted relationship. They could

yield either greater controls over costs or potentially savings in the long run. The Edwards Administration is continuing this process and implementing changes in state contracting wherever available as detailed further in the main report.

The Task Force recommends a continual analysis of state contracts with the idea of eliminating those that are non-essential or reducing those that can be reduced. Some key facts may help to manage our expectations: The top 50 contracts in the state currently represent 72% of the contract spending, including the five multi-year, core Medicaid managed care pacts with private insurance companies. Each of these contracts has an estimated value of \$2 billion or more. Forty-three of the 50 top contracts are for three or more years. Many contracts represent a move toward privatization, and many involve work that state employees do not have expertise to perform or that would necessitate an expanded government workforce if a private firm was not hired. Privatization is a method of reducing government employment but maintaining certain services that can only be provided through public support. Contracts are necessary if privatization is to be accomplished.

### **A review of the Constitution**

Much of state spending is determined in the Constitution by dedicated trust funds. Of the nearly 50 constitutional funds, about half make a significant impact on state spending or major government programs. Approximately three-fourths of these funds were created or substantially revised since the enactment of the Constitution of 1974. That is a rate of nearly one new fund per year. Constitutional provisions also serve to detour or restrict certain sources of revenue and to mandate various types of spending or savings. The long-term piecemeal approach of locking up state resources and obligating expenditures in the Constitution has raised anxiety that the state's fiscal structure lacks the flexibility to deal effectively with its most pressing financial problems. Certainly, the bulk of the fund management placed in the Constitution continues to align with current Legislative priorities. Still, in some cases, what was a budget priority in years past might not be seen as so vital today, and some new best practices may have come to light to better inform our state's policy. However, while the number of trust funds locked up in the Constitution is a matter for concern that should be avoided in the future; the vast majority of dedicated revenues in the Constitution are contained within funds dedicated to education and transportation, both of which are vital needs of the state.

The Task Force did not have the responsibility of reviewing individual constitutional funds and making specific recommendations for changes; however, the members recognize the dimensions of the problem and are prepared to suggest next steps. The Task Force recommends a new holistic review mainly of Article VII and Article VI Part II of the Louisiana Constitution, and related statutes, with the purpose of identifying consensus on changes that would improve the state fiscal structure, including potential revisions, elimination or mergers of funds. This initiative could take one of several forms, including a special legislative committee or a constitutional convention limited in scope to Article VII and not on the entire document.

## **Stabilizing the budget**

Additionally, the Constitution has been used to control the volatile revenue streams from oil and gas taxes, particularly through the Budget Stabilization Fund, or Rainy Day Fund. Voters passed a constitutional amendment on the Nov. 8 ballot that will further control large surges in mineral and corporate income revenue. These types of controls can serve to stabilize revenue and government operational budgets over the long run and may also contribute to stronger credit ratings for the state. This type of mechanism should be included in any review or convention dealing with constitutional changes. The goal would be to ensure the mechanism is simple, well protected and flexible enough to be practical while still serving the purpose of stability.

## **Dedications management**

Statutory dedications also present a challenge and perhaps some opportunities. Numbering about 500, they reduce the ability of state policy makers to set priorities through the appropriations process. Many receive little scrutiny. However, eliminating statutory dedications does not necessarily create substantial new revenue or solve spending problems, especially if the dedications are adding value to the state or are already offsetting general fund expenses. Eliminating dedications may not create more revenue, but it might allow for funding to be more optimally spent on key policy areas.

The Task Force recommends staggered sunsets on all non-constitutional dedications by specific dates, with genuinely skeptical reviews to determine if they can be adjusted, eliminated or combined with others.

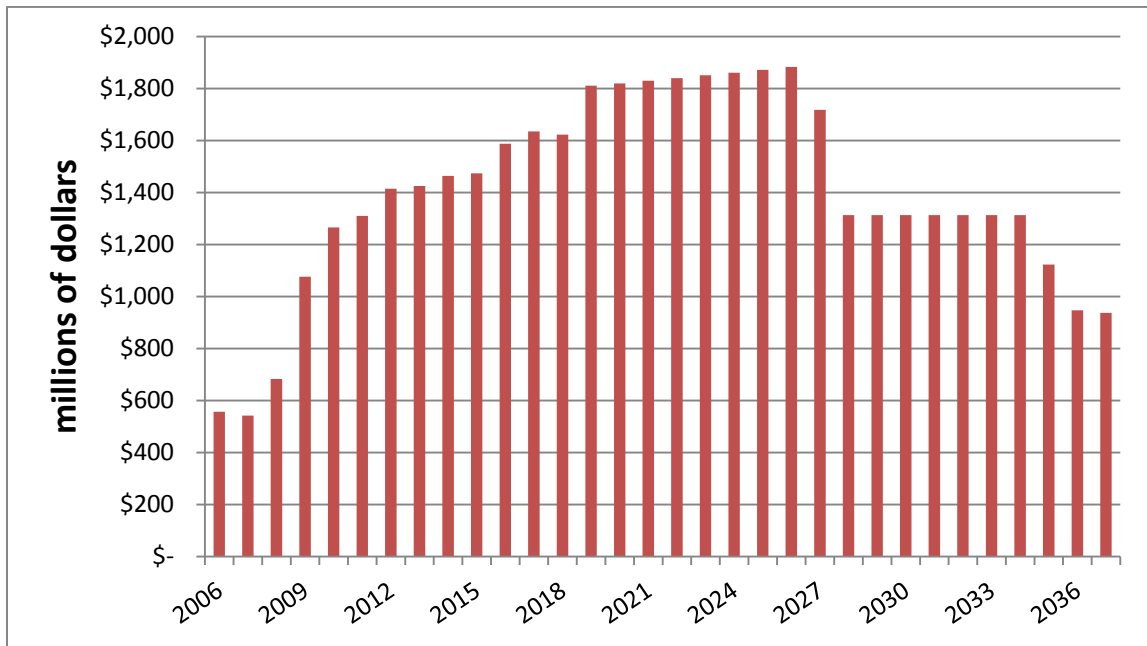
## **Pension pressure on the budget**

Among the state's most significant spending problems is the unfunded accrued liability (UAL) of the state pension systems. The UAL is a more than \$20 billion debt created by past decisions that places a serious stress on the state budget. It arises from historically inadequate funding of the state pension system, which is a constitutionally established benefit to current and former state employees that takes the place of both a pension plan and Social Security for those who participate. Each year the state makes payments toward this UAL according to a long-term schedule as noted in Figure 3, which for the two largest systems required less than \$600 million in 2006 but has grown to more than \$1.6 billion annually since then. A portion of the UAL is targeted to be paid off no later than 2029, due to a constitutional amendment mandating this that was passed in 1988.

The money for UAL payments is drawn from funds appropriated or received by state agencies, colleges and school districts, which are obligated to fund the cost of maintaining this pension program. The UAL pension costs have soared to keep up with the escalating schedule, where now these agencies, colleges and school districts must pay the equivalent of more than 20% (for teachers) or 30% (for rank and file state workers) of each employee's salary in order to make their UAL contributions. These payments reduce the funding available for policy priorities, squeezing already cash-strapped agencies. Testimony

and materials provided to the Task Force reveal that the structure of the program has undergone substantial legislative modification over the past decade. Now, the primary problem associated with our pension program is the need to pay down the existing UAL and ensuring that we avoid the creation of new UALs. This goal must be pursued through the utilization of sound projections and transparency into the costs associated with reducing this state obligation.

**Figure 3. Past and Future UAL Payments**



This report does not make recommendations regarding a restructuring of the pensions or a potential change toward a defined contribution system. Such an evaluation was beyond the scope of the Task Force's work. The Task Force neither called for such changes nor ruled them out. However, the Task Force recognizes that state leaders need to continue evaluating those structures and looking for ways to anticipate and control state costs in the long run. Some of the potential long-term proposals, such as moving from a defined benefit to a defined contribution plan for new employees, would likely cost the state more in the short term compared with the current rate of normal costs. The Task Force questioned whether the current contribution level toward the pension normal costs is adequate to prevent further build-ups of UAL.

**Alleviate long-term pension costs**

As for future direction, the Task Force recommends that the state continue making its UAL payments without stretching the debt further over time for the purpose of short-term gain. Also, as the pension systems have demonstrated with their analysis, extra contributions toward the Initial UAL debt would show a strong return on investment for the state and could hasten the day when the Initial UAL can be retired, freeing substantial amounts of money for the state operating budget. If additional funding is

found, it can be put to good use by paying down the UAL. For example, the actuary for LASERS and TRSL has estimated that an additional \$100 million per year dedicated to the UAL could create a net savings of either \$427 million over 11 years or \$698 million over 9 years depending on how much short term relief was given to the agencies.

The Task Force also would like to draw attention to the Legislative Auditor's recommendations for the pension systems and for the need to establish the most accurate possible rate of expected return for the pension investments. A lower expected rate of return would cost the state more in the short term but, if warranted, would make a sounder financial plan for the long term by limiting further the possibility of creating new UALs.

### **Credits and exemption cost management**

Tax credits, rebates, deductions and exemptions have the same effect as spending on the state's budget, because they reduce the revenues that would otherwise flow to the state for use in the state general fund. As such, while these mechanisms may and do, in some cases, serve a useful purpose, the number and value of these measures have grown remarkably and have placed an undeniable strain on the state budget by limiting receipts in many cases and actually requiring a direct payment from the state to the party claiming the rebate.

Between 1990 and 2013, the Legislature added 34 credits and various exemptions to the corporate and franchise tax structure and 61 new measures affecting the individual income tax, 30 new sales tax exemptions, and 63 sales tax exclusions. Among those affecting taxes on sales, individual and corporate income, franchise and severance, the total value of these breaks between 2008 and 2015 grew 85% to \$7.3 billion and exceeded actual collections of the taxes themselves. This report addresses many of these programs and in many cases recommends elimination, revision, curtailment or increased oversight and regulation.

We caution the Legislature that in the absence of express provisions in the enabling legislation, these special tax provisions are essentially unconstrained and the growth of the exemption, deduction, or credit is not controlled by the State Legislature. Most significantly, resources utilized to satisfy a tax exemption, deduction, or credit will take precedence over the allocation of resources as described in HB 1 – the state operating budget.

### **Higher education challenges**

Higher education in Louisiana faces daunting challenges unlike anything seen in recent memory. State funding for colleges and universities has declined significantly over the last eight years, while the burden on students and families through tuition and fees has increased by nearly 100%. Louisiana ranks last among Southern Regional Education Board states in state funding for higher education, and 49<sup>th</sup> nationwide in the total funding per full-time student.

At the same time, our higher education system is the most critical component in delivering Louisiana's workforce of the future. Forty-six percent of Louisiana job openings last year required a post-secondary credential and the demand for skilled workers continues to grow, yet Louisiana ranks 48<sup>th</sup> in educational attainment. This is a disparity that must be addressed.

State public universities have implemented numerous efficiencies over the last eight years and their efforts have been recognized by the U.S. Chamber of Commerce, which ranked Louisiana's system of higher education the 4<sup>th</sup> most efficient in the South and the 16<sup>th</sup> most efficient nationwide.

Still, there is a clear need to ensure that postsecondary education in Louisiana is sustainable for the future and an appropriate review of the entire enterprise must be ongoing.

To that end the task force recommends that the Board of Regents and the management boards as applicable:

- Continue to conduct reviews and recommend changes on the role, scope and mission of each public postsecondary institution in the state of Louisiana.
- Submit recommendations to the Legislature and implement changes within the higher education systems based on opportunities for operational and administrative mergers or consolidations within or across institutions to optimize state resources.
- Make recommendations for consolidating programs based on statewide and regional reviews of low-completer programs, graduate programs and targeted undergraduate programs with consideration for 1) their ability to meet student and state needs and priorities; 2) their sustainability given current and anticipated fiscal constraints taking into account programs that are self-sustaining or low cost; and, 3) other factors as set out in the report.
- Develop policies to reduce unnecessary duplication of academic programs.

Concurrent with these recommendations, the task force believes that the Legislature should continue to look at ways to provide more flexibility to institutions to enable them to manage their operations more effectively and recommends that higher education officials be given greater autonomy with regard to self-generated revenues.

Just as the state's tax structure plays a major role in Louisiana's economic competitiveness with other states, so, too, does a high-quality system of postsecondary education which is responsible for developing the highly-skilled workforce Louisiana needs for the future. Given that, the task force also recommends that the Legislature continue to look for ways to provide a more equal balance between state and student support for higher education and take the necessary steps to ensure that our colleges and universities are able to provide both high-quality services and access to all citizens.

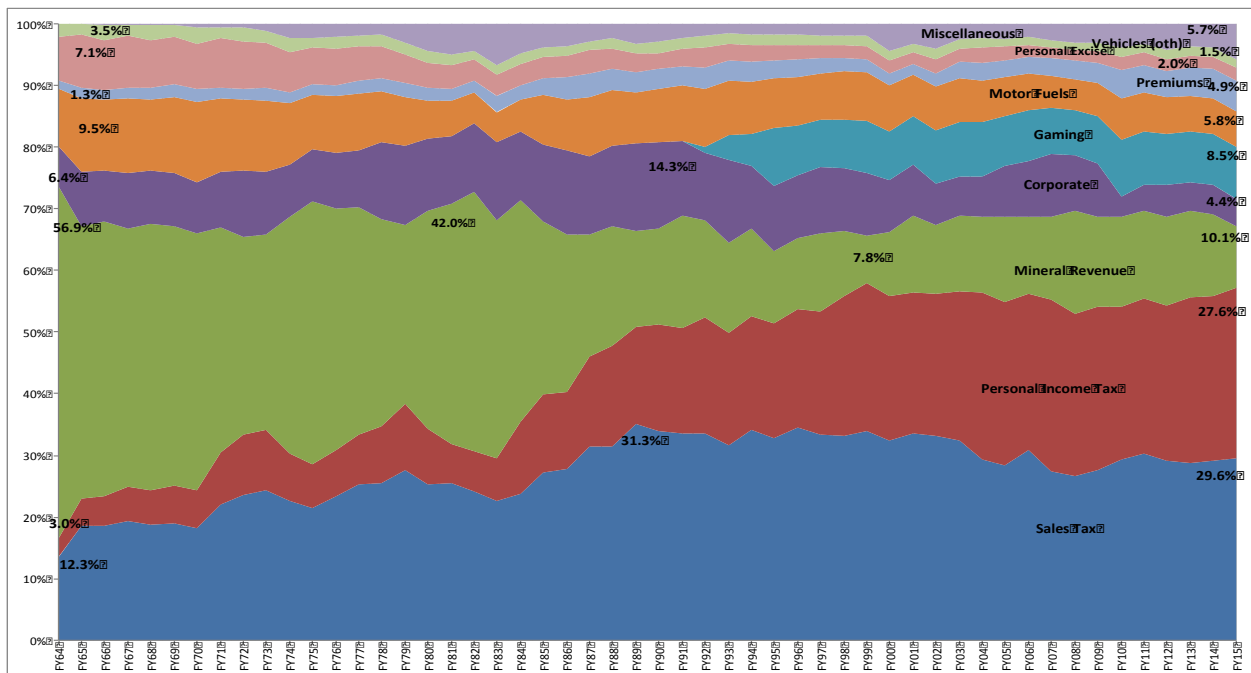


*L*et’s understand what’s wrong so that we can make it right

The tax system underlying Louisiana's budget has contributed to our fiscal problems. This chapter looks closely at that system and identifies its merits and faults, as viewed by the Task Force on Structural Changes in Budget and Tax Policy. In brief, Louisiana's tax and revenue system is the product of a long and incremental evolution, with layers of adjustments, special advantages, and compromises added over the years. As a result, what we have today is not a comprehensively integrated or simple state tax code but an ad hoc tax system that has failed to adapt strategically to the changing circumstances facing all state and local governments in the United States.

We have high tax rates for certain taxes and moderate rates for others, numerous exemptions and deductions, a variety of tax credits, unclear and complicated definitions, unbalanced priorities, and a difficult time trying to forecast what it all means. The projection of how much revenue the tax structure might provide for the state is becoming increasingly difficult to forecast because of the frequent changes in the tax code. Figure 4 illustrates the sources of tax collections from the 1960s through 2015. This chapter provides the highlights of how we got to the current system of state taxation and reviews the most important shortcomings.

**Figure 4. Distribution of Tax Sources from 1964 to 2015**



Source: Louisiana Legislative Fiscal Office

## Evolution and adaption

In the 1960s and 1970s oil and gas dominated the revenues of the state. Oil and gas contributed well over 40% of the state's budget in fiscal 1981. The oil bust of the 1980s, however, devastated the economy and the state budget, leading to a re-evaluation of the government's reliance on energy revenue. To deal with a \$1 billion shortfall in 1984, the state legislature raised the sales tax rate from 3% to 4%, increased the corporate franchise tax, increased taxes on tobacco and gasoline, and increased several other taxes. Oil and gas severance and royalty payments still make a significant direct contribution to the state's finances but are no longer a major portion even though the industries related to oil and gas remain a base of the economy.

Lotteries, casinos and video poker spread across Louisiana in the 1990s, with these forms of activities being the substitute for tax increases in the 1990s. Gambling taxes now form the fourth largest source of state revenue, with more net collections than the corporate income and franchise taxes combined. Gambling revenues have also been relatively stable over time. Meanwhile, net state revenue from corporate income and franchise taxes has been volatile and has been compromised by a variety of credits, rebates, and exemptions, some of them intended to act as economic development incentives but with an uncertain impact on actual development.

The excise tax on motor fuel that finances the Transportation Trust Fund has been imposed at the same tax rate -- 20 cents per gallon -- since 1990 while fuel usage in the past decade has been flat until only very recently. Cars have become much more fuel-efficient over the last 25 years, so the productivity of the tax compared to miles of travel has diminished. The result is that dedicated revenue for roads and other transportation needs has not kept pace with the inflationary costs of projects and maintenance. Also, dedicated road funds have been diverted to pay for state operating costs. Fees from licenses, titles, and other driving-related revenue sources have been increased substantially in recent years to support general fund spending, leaving few alternatives for higher user fees to help pay for roads. The fuel taxes debate is both a revenue and a spending issue. A separate task force is addressing the issue of transportation and infrastructure improvements and will be examining different methods of financing. The Task Force on Structural Change in Budget and Tax Policy decided to leave possible changes in the gasoline and special fuels taxes to the Task Force on Transportation Infrastructure Investment. We note that the sales tax on gasoline is constitutionally prohibited at this time. Presently, gasoline and special fuels taxes make up about 6% of total state revenues.

The sales tax and the individual income tax are by far the two largest sources of state revenue, making up almost 60% of all taxes, licenses, and fees collected in fiscal 2015. The sales tax base has been compromised by nearly 200 exemptions added over time that the government estimates at a \$2.8 billion cost in revenue. The state sales tax rate in 2016 was increased from 4% to 5%, creating a combined state and local average sales tax rate of 10%, the highest in the nation. The Legislature also suspended or reduced many exemptions temporarily, adding to the complexity of the sales tax and the ability to project the amount of tax revenue the changes might bring. The individual income tax is also diluted by

exemptions, deductions, and credits. These choices were made over a long period of time and were done with knowledge of the consequences, at least in the short term. In other words, legislatures and governors made choices that they considered to be in the best interest of the state at the time.

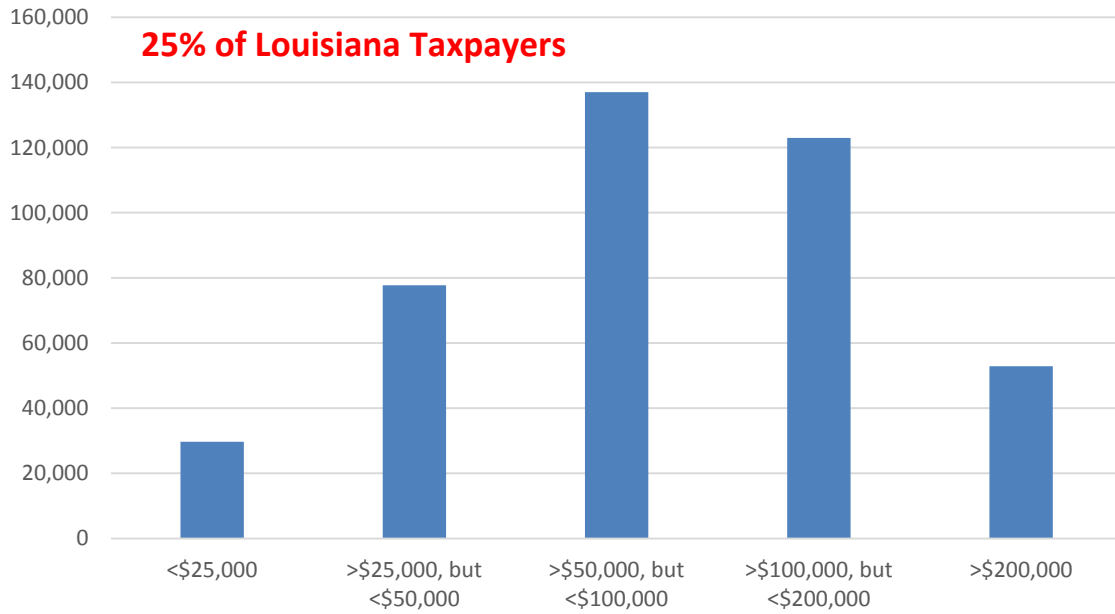
### **To Stelly and back again**

In a constitutional amendment vote in 2002, the people of the state made a fundamental change in the sales and individual income tax structure. This change was called the Stelly Plan, named after state Rep. Vic Stelly. The Stelly Plan created major constitutional exemptions on state sales taxes. Particularly important were the exemptions on food for home consumption, prescription drugs, and residential utilities. The plan raised income taxes on middle to upper level filers by eliminating excess itemized deductions as an exemption in a taxpayer's Louisiana taxable income. The Stelly Plan also reduced the brackets in which the income tax rates of 2%, 4%, and 6% applied. Eliminating excess itemized deductions as an exemption affected about 25% of the state's taxpayers. It created a more progressive tax system with the expectation of producing stronger and steadier revenue growth over time.

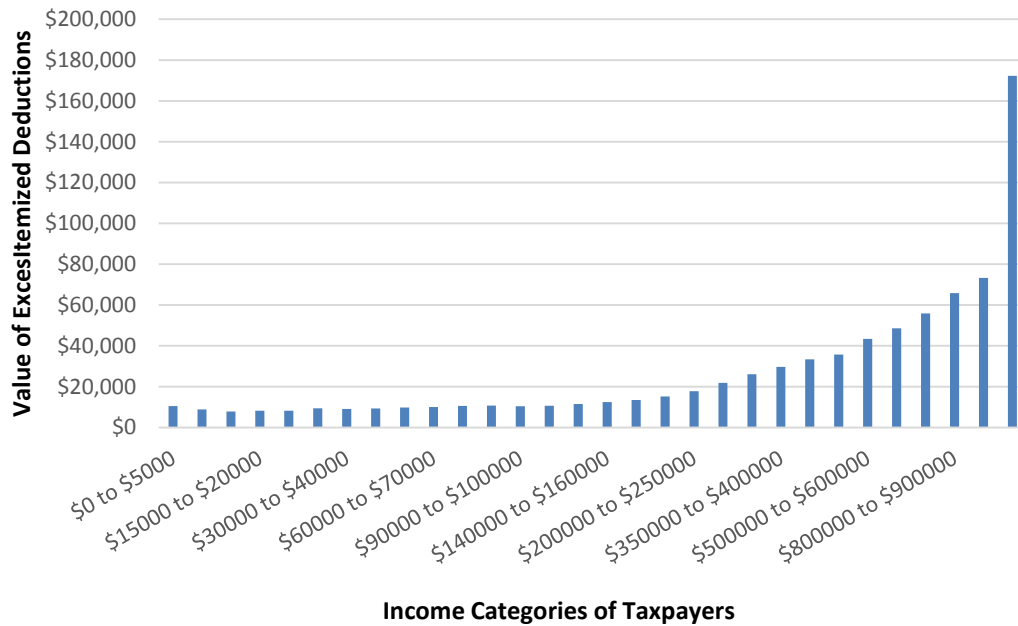
After Hurricanes Katrina and Rita, income tax receipts increased substantially, but not solely because of Stelly. Federal tax reductions in 2001 and 2003 had the effect of automatically increasing state income tax collections. That's because in Louisiana, federal taxes are an exemption that can be deducted from taxable income on the state income tax form. On top of the federal changes and the Stelly Plan, the Louisiana economy grew sharply because of the hurricane recovery efforts. Income tax collections, along with sales tax collections, corporate income and franchise taxes, and mineral revenues all spiked. The abundance of revenue, as noted in Figure 2, allowed the state to grant additional credits and deductions to promote long-term growth and key elements of the Stelly plan were peeled away in the form of individual income tax cuts. In fact, the two elements of the Stelly Plan pertaining to individual income taxes were changed in 2007 during the Blanco Administration and in 2008 by the Jindal Administration. Taxpayers got a break on their income taxes and the state received less income tax revenue. Meanwhile, the reduction in sales tax collections that was an integral part of the Stelly Plan was not changed in 2007 or 2008. Whereas the income tax changes could be made in statutes, the Stelly Plan sales tax reductions were protected in the Constitution.

To explain the impact of the Stelly Plan ups and downs on Louisiana taxpayers, we are providing Figures 5 and 6 regarding the number of taxpayers in Louisiana who itemize on their federal tax returns and the size of the excess itemized deductions claimed on their state returns in 2014. Just over 420,000 Louisiana taxpayers itemize on their federal tax returns out of 1.8 million taxpayers. The largest number of taxpayers who itemize is in the income categories of \$50,000 to \$100,000 and \$100,000 to \$200,000. The average value of the excess itemized deduction ranges from just over \$9,000 in the \$50,000 to \$60,000 income range to almost \$13,500 for taxpayers in the \$180,000 to \$200,000 income range.

**Figure 5. Number of LA Taxpayers Filing Schedule A with Federal Tax Returns**



**Figure 6. Dollar Value of Excess Itemized Deductions in 2014 as Claimed on Louisiana Tax Return**



## How we got to here

Since 2002, several other major tax changes were made. One was the elimination of the state sales tax rate on manufacturing machinery and equipment, with this process being enacted over a period of time to avoid a sudden impact on the state budget. Similarly, the corporate franchise tax on debt was gradually eliminated as well. And the tax on industrial utilities was gradually reduced prior to 2016. All of these tax changes were aimed at economic development. As illustrated previously in Figure 2, the ability of the state to spend or to provide additional tax advantages grew by over 38% from 2005 to 2008. From 2008 through 2014, the emphasis was on avoiding tax increases and providing additional tax advantages through exemptions, deductions, or credits.

In 2015 and 2016, the state made significant increases in tobacco, beer, liquor and wine, and excise license taxes, as well as limiting multiple tax credits and offsets, with particular attention to the inventory ad valorem tax credit. Additionally, in 2016 the state raised the sales tax rate from 4% to 5% and expanded the sales tax base in Act 26 of the First Extraordinary Legislative Session; several changes were made to tax credits associated with the individual income tax; and an adjustment was made to the horizontal drilling exemption associated with the severance tax on oil and natural gas. The changes in 2015 were estimated to yield \$750 million in additional revenue in fiscal 2016. The changes in 2016 were estimated to increase state revenue by approximately \$1.5 billion for fiscal 2017 and fiscal 2018.

The state is projected to collect \$11.811 billion in state taxes, licenses and fees in fiscal 2017 while at the same time the state is expected to allow \$7.71 billion of exemptions, deductions, and credits. The amount of these breaks is equal to 65% of state tax collections. In theory and assuming no changes in the behavior of taxpayers, if there were not any exemptions, deductions or credits, the state would receive approximately \$20 billion in state revenues, licenses and fees.

Many of the tax changes made in 2015 and 2016, including the new 5% sales tax rate, were temporary in nature and will expire on June 30, 2018. Therefore, the state faces a fiscal shortfall of over \$1.5 billion in fiscal 2019, which means there is an absolute necessity to amend the tax structure to fund the programs that the state believes are in the best interest of the state or to make appropriate reductions in state expenditures.

## An analysis of the current revenue structure

The Task Force has carefully reviewed Louisiana's tax system and will pinpoint a number of problems. We highlight the sales tax and the individual income tax since these two taxes account for more than 60% of the total state revenues. Additionally, these are the broad base taxes that have been diminished by a number of exemptions, deductions, and credits. The overall state tax program is summarized in Table 2.

**Table 2. State Taxes, 2017**

<b>Sources of Revenues, Fiscal 2017 (in thousands)</b>			
	Projected	% of Taxes, Licenses, and Fees	Comments
<b>Sales Tax, General and Motor Vehicles</b>	\$4,298.1	35.7%	Over 60%. Must find most efficient and equitable way of using Sales and Income. Cannot avoid making fundamental choices.
<b>Individual Income Tax</b>	\$3,088.3	27.7%	
<b>Corporate Income and Franchise</b>	\$510.4	4.2%	Changes made. Must allow implementation.
<b>Severance/Minerals</b>	\$464.6	3.9%	Issue not taxation, but appropriate use of these revenues. Might look at separately
<b>Tobacco, Beer, Liquor and Wine</b>	\$381.3	3.1%	Increased in 2015 and 2016.
<b>Gasoline/Special Fuels</b>	\$624.1	5.2%	Not to balance budget, but for infrastructure
<b>Gaming</b>	\$906.6	7.5%	Maintain as is due to competitive alternatives
<b>Excise License</b>	\$858.6	7.1%	Increased in 2016; these taxes need to be examined separately
<b>Others</b>	\$900.1	7.5%	Variety of taxes
<b>Total</b>	\$12,032.1	100.0%	Based on June 30, 2016 estimates
<b>Estimated Exemptions, Deductions, and Credits</b>	\$7,707.6	64.1% of total estimated taxes, licenses and fees	Sales, individual income, CIFT, and Severance make up 94% of these exemptions

The table points out several items: (1) sales and individual income tax collections dominate the revenue estimates; (2) the corporate income and franchise tax and mineral revenues together make up only about 9% of total revenues and both of these revenues are subject to fluctuations; (3) some of the other taxes have been increased already; (4) the gasoline and special fuels tax is now focused on transportation and any new revenue would likely emphasize special infrastructure projects; (5) exemptions, deductions, and credits account for over \$7.7 billion, or about 64% of taxes, licenses, and fees collected; and (6) the sales, income, corporate income and franchise, and severance taxes

accounted for 94% of the exemptions, deductions, and credits, or from a different perspective, exemptions, deductions, and credits associated with the sales tax, individual income tax, corporate income and franchise tax, and severance taxes represented 86% of the taxes collected from these sources of revenues.

### **Sales tax dependency**

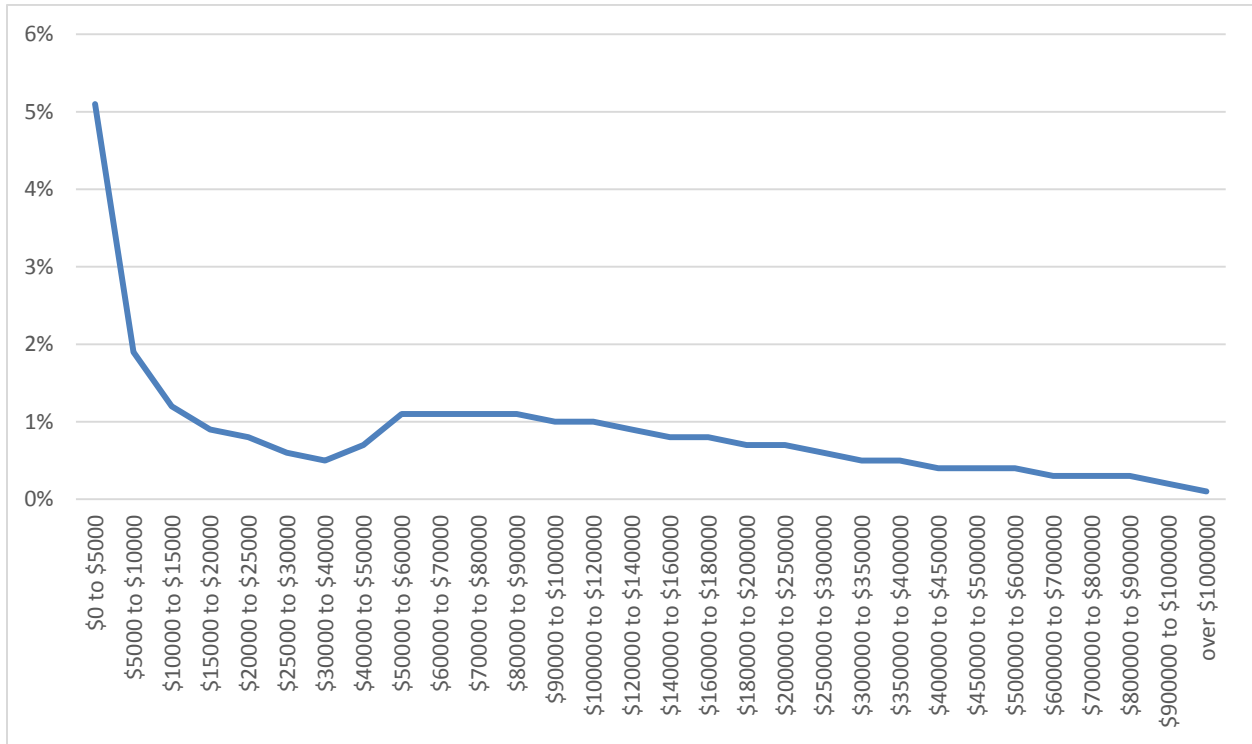
The state is dependent upon the sales tax, both general and for motor vehicle sales. Until recently, the sales tax and the individual income tax brought in about the same proportion of revenue for the state, but that situation has changed. The sales tax in fiscal 2017 accounts for about 36% of all state sources of revenue. The next largest source is the individual income tax, at about 26%. Louisiana's sales tax system provides more than a third of the state's revenue despite having features that can be described as bad tax policy. It features ultra-high rates especially when local sales tax rates are included, an extraordinary number of exemptions and exclusions, a difference in sales tax bases between the state and local governments, multiple sales tax collectors and auditors, and multiple sales tax rates within a parish. Both the state and local governments make above average use of the sales tax compared with the practice in other states.

The list of concerns about the Louisiana sales tax system are given below:

-At 10% or more, Louisiana has the highest average combined local and state sales tax rate in the nation. Tourist states such as Florida and Nevada, which do not have an income tax, have combined sales tax rates of 6.66% and 7.98% respectively in 2016, according to the Tax Foundation. Tennessee, which has no income tax on salaries and wages, has a state and local sales tax rate of 9.45%. Arkansas has a rate of 9.3% and Alabama is at 8.97%. The Louisiana sales tax rate can have a deterrent effect on business investment in the state since some of these taxes are paid by businesses.

-A high sales tax rate will affect most directly the lower income families in the state as noted in Figure 7. Income in the lowest income groups may be misrepresented by various public assistance programs that enhances a person's ability to purchase items but do not show up as income. But even from around \$20,000 in income, the average family spends about 1% of their income on sales tax while at the higher income scales the average family's spending on sales tax collections approaches 0.1% of a family's income.

**Figure 7. Sales Tax Expenditures as % of Average Income**



-An analysis by the Institute on Taxation and Economic Policy estimated that a 3% sales tax rate on families in the lower 20% of income earners in Louisiana with food, prescription drugs, and residential utilities in the tax base would result in slightly less taxes or just about the same amount of taxes as a 5% rate on all items excepting food, prescription drugs, and residential utilities. Lower-income families purchase more than just food, prescriptions, and utilities.

**Sales tax collection shortcomings**

-Although actual collections are up due to high rates, the underlying base for sales taxes has been a weakening source of revenue growth for the state and for some parishes. There are several likely reasons for this. Louisiana exempts many basic items from the state portion of the tax such as food, prescription drugs, and residential utilities and these items would add stability to any sales tax base. Additionally, the modern marketplace offers consumers a growing wealth of goods and services that may not come with a sales tax. Internet sales growth is undermining state and local sales tax collections; we do not have an exact number but we know that Internet sales are growing relative to other sales.

-Sales tax exemptions are more numerous and costly than in other states, and many of them have not been reviewed to ascertain if they were still serving their purpose. A large collection of exemptions is grouped under the category “other exemptions” with a value estimated at \$800 million to \$900 million, or nearly 30% of total exemptions. We do not know precisely how much some of them are costing the state or what is being accomplished by having these items exempted from paying the sales tax.



-Parishes, municipalities, school boards, and some sheriffs are heavily dependent on the sales tax compared to the situation in the great majority of states where local governments tend to be reliant on more stable property taxes.

-The overall high tax rate reduces the flexibility of local governments to generate revenue if necessary, so conditions tend to force local governments to seek assistance from the state.

-Local sales tax revenues tend to be more volatile than property taxes collections. This reliance on sales taxes creates volatility in revenues thereby generating more uncertain local government budgets. This volatility can cause local governments to expand services and then have to cut back due to the short-term nature of the revenue growth.

### **A lack of uniformity**

-The state and local governments do not apply the sales tax to the same items as the state or possibly to each other, creating a lack of conformity in the state-local sales tax base that is unusual compared to other states and that also hinders the goal of streamlining the state's sales tax system.

-Lack of state-local uniformity and a highly decentralized collection and auditing system complicates reform efforts and could penalize Louisiana if Congress passes legislation that would help Louisiana state and local governments collect sales tax revenue from Internet and shipped sales. Louisiana is only one of two states that currently have decentralized collection and auditing.

-State sales tax policy affecting business -- such as for business utilities and manufacturing machinery -- was reduced for economic development purposes and then has been increased, leaving the private sector unsure of the state's long-term tax policy. In addition, the state was not taxing manufacturing machinery equipment but most local governments do tax it, creating another mismatch between the state and locals.

-The tax code is outdated with regard to sales that once were taxed as tangible personal property but now are not taxed, particularly digital age purchases of software, data, music, and videos. Taxation of these items does not necessarily constitute bad tax policy, but a lack of clear modern definitions and intent is a problem. This is an issue in many states given the dynamics of the market.

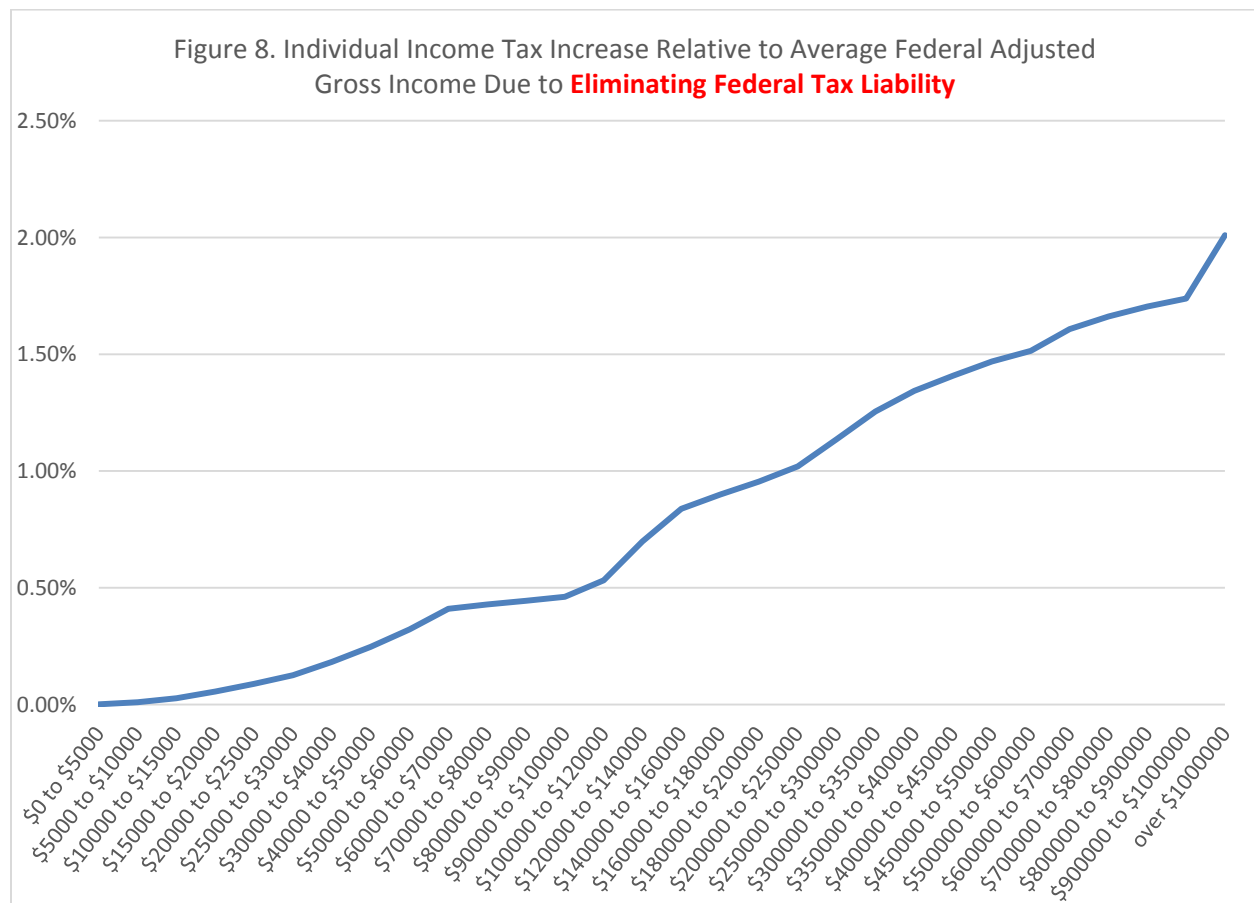
-Sales tax law needs a recodification to ease compliance, clarify definitions, better distinguish exclusions from exemptions, and reflect the transactional realities of the 21st century.

-Finally, sales taxes are extremely sensitive to major disasters such as the recent flooding in the Baton Rouge, Tangipahoa and the Lafayette areas and in north Louisiana from Caddo Parish to Ouachita Parish. Sales tax receipts will increase substantially but these increases do not say anything about the long-term robustness of the economy.

## Individual income tax challenges

Louisiana's individual income tax carries an upper bracket tax rate of 6% that is effective at taxable income of more than \$50,000 for single filers and \$100,000 for joint filers. The 6% rate is less than the top marginal rate in Arkansas and South Carolina, even with the top marginal tax rate for Georgia and Kentucky, and higher than the top marginal tax rate in Alabama, Mississippi, and North Carolina. Texas and Florida have no individual income tax.

Louisiana's income tax allows a deduction for federal taxes paid. This deduction ties the fortunes of Louisiana taxpayers and the state's revenue picture to the perturbations of the federal tax code and hinders the adoption of lower rates that would apply to all taxpayers. Only two other states -- Alabama and Iowa -- allow this deduction in its entirety. This exemption costs the state approximately \$900 million in the most recent year; tax rates must be higher in order to offset the loss of this revenue. As can be seen in Figure 8, the value of this exemption is especially important to families earning more than \$200,000 per year given the current tax rates and brackets. This is predictable since the federal income tax is progressive. The average savings for a family earning about \$45,000 because of this exemption is about \$100 while a family earning about \$190,000 will save about \$1,800. The family earning \$190,000 has an income about 4 times as high as the family earning \$45,000, but the tax savings are about 18 times higher. The Louisiana income tax should not be used to mitigate the progressivity of the federal income tax.



Louisiana's income tax allows a deduction for itemized deductions taken on the federal tax form that are in excess of the federal standard deduction. These so-called "excess itemized deductions" can be viewed either positively or negatively as a matter of tax policy, but they clearly hinder the goals of achieving lower rates and a broader base. In particular, the excess itemized deductions include taxes paid to the state of Louisiana, a provision that is illogical and works against lower rates. This exemption only applies to about 25% of the individuals filing Louisiana tax returns.

Over time, the individual income tax form has become more difficult for taxpayers to navigate, partly because of the many credits and deductions. Despite these complications, the individual income tax is one of the easier taxes to administrate. From the perspective of the taxpayer and the tax collector, compliance is relatively manageable.

### **Corporate income tax perspectives**

The corporate income tax was refined in the special sessions in 2016. Certain provisions were added regarding apportionment, market-based sourcing, and add-backs with the focus of more clearly defining the tax base for the benefit of both the corporation and the state. The Legislature should be commended on making some fundamental decisions regarding the determination of the tax base for corporate income taxes. It is now the responsibility of the Louisiana Department of Revenue to administer these changes.

Despite these improvements, the current system contains a number of exemptions, credits, and rebates along with temporary restraints on those programs. The inventory ad valorem tax exemption is the most costly, with an estimate of close to \$450 million in fiscal 2015. Corporations also have the federal tax deduction amounting to about \$200 million per year in foregone revenues from the state's perspective. The temporary restraints on these credits make revenue forecasting extremely difficult. As an example, in 2015 the Legislature implemented a reduction of the inventory tax credit of 72% of its value for those credits that were provided through a refund. The projection of the gain by the state due to this tax change is still being examined.

Some of the exemptions, such as the Subchapter S Corp exemption, constitute a necessary adjustment to avoid double taxation because the money is merely being moved directly from the corporation to an individual. Also, the net operating loss provision is normal compared with other states and federal tax policy; it is justifiable because companies experience fluctuations in earnings.

Louisiana's upper tax rate on corporate income of 8% is relatively high compared with other states in the south and central regions of the country. Even though the net tax paid by corporations is more competitive with other states, the higher absolute rate creates at least the perception of a barrier to economic development. In November 2016, voters statewide rejected a constitutional amendment that would have eliminated the federal tax deduction and also would have triggered a corporate flat tax rate of 6.5%, a rate that is more competitive. This amendment would have connected lower rates with a

broader tax base and would have delinked federal tax obligations from Louisiana's corporate income tax system. The Task Force supported this constitutional amendment enthusiastically and believe that we should propose a similar amendment for the citizens of the state to examine one more time.

Various exemptions and credits contribute to volatility in corporate income tax collections, and create disparate tax burdens on different businesses. In most years, net taxes paid to the state are far less than the total tax liabilities, an indication of the opportunity for lower rates for all businesses if tax breaks were removed. As noted in Table 1, corporate exemptions, deductions, and credits for the income tax and the corporate franchise tax amounted to almost \$1.7 billion in fiscal 2015 while corporate collections for these two taxes amounted to less than \$700 million.

### **The corporate franchise tax perspectives**

The franchise tax is a tax on wealth and investment that represents the equity of a corporation. Investment supported by long-term debt is not subject to the corporate franchise tax. It is widely recognized as a complex and antiquated type of taxation that discourages investment, inhibits economic development, provides a disincentive to corporate headquarters operations and causes costly compliance and auditing problems. The franchise tax is exceptionally complex to administer by the government and to calculate for businesses. Audits and lawsuits are more common with the franchise tax than with other tax types.

This tax is paid whether or not the business entity is profitable. Business startups and narrow-margin businesses in particular are adversely impacted. However, some businesses that are able to avoid corporate income taxes through exemptions and financial losses could be paying some of their share of the state tax burden due to the existence of the franchise tax.

Actual collections of the tax are low. The total tax liability for Louisiana's franchise tax in fiscal 2014 was \$460.1 million; however, after credits and prepayments, the net amount collected in state revenue was only \$157.1 million. Similarly, net collections in fiscal 2013 were only \$84.7 million. A law passed in the First Extraordinary Session of 2016 will extend the tax to a broader class of businesses, possibly adding \$90 million in state revenue for fiscal 2018, according to the Legislative Fiscal Office. This new law will assess a franchise tax on Limited Liability Companies that choose to be taxed as Subchapter "C" corporations for federal tax purposes.

Louisiana has always desired to attract corporate headquarters, but the state has difficulty doing so due to this tax. This tax is levied on the sum of all corporate stock, paid-in capital, and retained earnings. In other words, any corporation that is heavily capitalized, which is the most desirable kind to attract, would be less likely to locate in Louisiana due to this annual assessment.

Louisiana's franchise tax separates it from other states. In particular:

-Louisiana is one of a diminishing number of states with a franchise tax. Sixteen states have a franchise or a capital stock tax, of which two -- including Mississippi -- are phasing theirs out. Five other states have eliminated their franchise taxes in the past five years.

-Louisiana's rate is high. Only Connecticut has a higher franchise tax rate than Louisiana, and a company in Connecticut can choose to pay either the franchise or income tax liability, whichever is greater.

-Louisiana is one of only eight states with an unlimited franchise tax, including Mississippi which is phasing out the tax.

### **Oil and gas tax remedies**

The current oil and gas tax rates have been part of the state's tax structure since the 1970s and in the future should be reassessed. However, in this sustained era of low energy prices, increases in the rate structure are not likely to have a substantial effect on revenue collections and could be damaging to the industry and counter-productive for the state. The horizontal drilling exemption, which was created in the 1990s to spur an expensive new technology and expanded exploration, was modified in 2015 after the technology had matured. The new law would scale down the exemption if oil and gas prices rise in the future.

This modification should also be reassessed to make sure that it is still a necessary tax advantage. This is the time to re-examine it because once it is being heavily utilized again, the state would not be advised to suddenly change the rules for market participants. Any change in this tax exemption should be made within the guidelines of an overview of the entire oil and gas tax structure. However, the state's current definitions and methods of calculating the sales point for purposes of taxation on the value of oil are being contested and perhaps should be clarified.

Oil and gas revenues, both from severance taxes and from royalties and other payments from state-owned lands, tend to be volatile over time. Prices will rise and then decline dramatically. The state should be careful in how these dollars are incorporated into the budget for use as recurring revenues. The state's Budget Stabilization Fund, also known as the Rainy Day Fund, has played a role in tapering the surge of oil and gas revenues that sometime occurs by steering portions of that money into the fund instead of into the state operating budget. Voters statewide passed Constitutional Amendment 5 on the ballot in November 2016 that adds another layer of volatility control. The amendment's newly created Revenue Stabilization Trust Fund provides a mechanism to steer additional oil and gas and corporate income revenue surges toward special spending priorities, including state pension debts and infrastructure. The Task Force supported passage of Amendment 5.

### **Tobacco and alcohol options limited**

In 2016, excise taxes on tobacco products, beer, wine, and liquor were increased substantially. These changes followed recommendations by the Louisiana Tax Study presented to the Legislature in 2015.

The new revenue was contributed to state general operating costs rather than as an offsetting method to lower rates on other types of taxes. Tobacco taxes were increased in 2015 also. As a result, the state already has tapped these sources of income probably to a near-maximum tolerable level, and the revenue is ingrained in the state spending budget.

### **The gamble on gaming**

During the 1990s the state created a diverse gambling industry that provided new revenue for the state. Gambling, or gaming, is the fourth largest source of state revenue. Tax rates are relatively high compared to other states for the many forms of legalized gambling in Louisiana, including casinos, race tracks, racinos, video poker, and the lotteries. Local governments also receive revenue from gaming. The gaming industry is not a major growth sector because it is driven primarily by population and the number of casino sites is limited by law. The state benefits from out-of-state visitors coming to Louisiana to gamble; however, the state constrains casinos from pursuing some competitive measures that might increase tourism and taxable revenue. There are always technical issues relating to any state-industry relationship, but the state cannot expect the gaming industry to provide a large amount of net new dollars for support of public services or for offsetting other sources of taxation.

### **Property taxes, Louisiana style**

Property taxes are collected by local governments. The state does not levy a property tax, though the state has the constitutional authority to impose a statewide property tax of no more than 5.75 mills. Still, property taxes are an important issue in state fiscal policy because they provide revenue to local governments and help determine the degree of local dependence on the state. Property tax exemptions for homeowners and businesses are relatively high in Louisiana, resulting in an over-reliance by local governments on sales taxes, state support and shared tax revenue. The exemptions shift the property tax burden to a smaller group of taxpayers.

An exception is the ad valorem tax on inventories, a type of business property tax that local governments collect in full. The inventory tax is considered a form of property tax that is protected in the state Constitution. It is a common form of tax among the Southern states but is used by few states outside the region. The state accepted the burden of the inventory tax in the 1990s by creating a refundable tax credit for businesses that could be applied against state individual income taxes or corporate income and franchise taxes based on 100% of the ad valorem tax on inventories that they paid to local government. This was a second-best solution: the local governments could not give up the revenues from the ad valorem tax on inventories and the state felt that this tax was a deterrent to economic development.

Other features of the property tax in Louisiana include:

- Louisiana has a significant homestead exemption of \$7,500 of assessed value plus a variety of special exemptions. Many homeowners of lesser value houses carry little responsibility for

supporting their local government and schools. This exemption is a major reason that school systems in Louisiana are less reliant on property taxes than schools systems generally in other states. However, the real value of the homestead exemption in Louisiana has declined since it was last changed in 1982. Rising home values have increased the property tax base for local governments and the exemption has become less of a factor.

- For many years, the industrial tax exemption provided manufacturing expansions and upgrades with complete relief from property taxes for five years plus another five-year renewable term. The industrial tax exemption was granted by the state even though local governments are the recipients of property taxes. The Constitution provides the governor and a State Board of Commerce and Industry with the authority to grant the exemptions. Governor John Bel Edwards and his newly appointed board have made significant changes to the program, as outlined in a set of newly proposed rules. Local government agencies are now involved in the decision-making process. Machinery replacements, miscellaneous capital additions and environmental equipment are no longer eligible. The renewable term, if granted, would be up to an 80% exemption over another three years.
- Nonprofits are exempt from property taxes. Certain municipalities are greatly affected, which has raised questions about the appropriate application of property taxes to nonprofits.
- The more property that is taken off the rolls for taxation, the greater the burden on other property which is taxed, such as commercial establishments and people who rent houses or apartments. Or, other taxes must be used to pay for local public services or local governments must ask for more state support.

**W**e will need a combination of new, old and bold ideas based on sound principles to create a better tax structure

The Task Force on Structural Changes in Budget and Tax Policy started with the premise that a tax structure should generate sufficient revenues to fund legitimate and necessary government expenses and, in doing so, should be fair, simple, competitive with other states, and stable over the short and long term. These qualities are best achieved with taxes that are broad-based with low rates and that do not play favorites for or against a particular constituency. However, the Task Force viewed economic competitiveness and comparisons to other states as fundamentally relevant factors in its decision making, while attempting to assure that compliance with a new structure would be easy and clear. The Task Force also believes that exceptions should be minimal and for clearly established good reasons that serve our state's needs.

Fairness is an important value to be considered: Does a tax system in its entirety treat fairly taxpayers of different income levels and other characteristics, and does a tax system treat fairly businesses and individuals? Simplicity is essential: In our pursuit of multiple goals, have we made the tax system unnecessarily complex to administer and for taxpayers to follow? Balance and variety in revenue sources also need to be weighed: What type of balance between tax types is the healthiest for long-term growth and stability?

Additional factors may enter into consideration that play upon people's differing value systems. Some tax systems are more likely than others to result in stronger annual revenue growth, which some might view negatively as an impetus for unnecessary government expansion. Others might view such growth positively. For example, an income tax that levies rates according to income brackets might bring more revenue growth over time than a flat tax. The Task Force has attempted to account for these factors in its analysis.

In accordance with its basic principles, the Task Force makes recommendations in this chapter that are designed to be holistic in impact. The Task Force focused on the sales tax, individual income tax, corporate income tax, and property tax, as well as the various exemptions, exclusions, deductions, and credits that impact the revenues derived from these taxes. *As a practical matter, we have to focus on one tax at a time when assessing an entire fiscal structure, but the changes in the entire tax structure that we recommend should be examined globally in relation to one another. We strongly caution against a piecemeal approach.*



**Revenue targets and balances**

As an illustration of the challenges in establishing a sound revenue structure, consider the circumstances presented in Table 3. Here we establish an estimate of the dollars that will need to be generated given the decisions made by the Legislature in the last several sessions. We are building this tax scenario around an assumption that the state will require \$12.5 billion in fiscal 2019, according to the pattern set by the Legislature. If this number is too low or too high, we can adjust the taxes required to cover the budget gap.

**Table 3. Estimated Revenues for Fiscal 2019 in line with Expenditures Based on Current Spending Priorities Based on Long-term Tax Structure**

<b>Taxes</b>	<b>Projected 2017</b>	<b>Projected 2019 with current expiration</b>	<b>Estimated 2019 with Tax Changes</b>
<b>Sales Tax, General and Motor Vehicles</b>	\$4,298.1	\$3,176.4	\$3,935.0
<b>Individual Income Tax</b>	\$3,088.3	\$3,222.1	\$3,935.0
<b>Corporate Income and Franchise</b>	\$510.4	\$361.4	\$586.4
<b>Severance/Minerals</b>	\$464.6	\$558.7	\$558.7
<b>Tobacco, Beer, Liquor and Wine</b>	\$381.3	\$382.7	\$382.7
<b>Gasoline/Special Fuels</b>	\$624.1	\$642.5	\$642.5*
<b>Gaming</b>	\$906.6	\$888.5	\$888.5
<b>Excise License</b>	\$858.6	\$656.0	\$656.0
<b>Others</b>	\$900.1	\$916.0	\$916.0
<b>Total</b>	\$12,032.1	\$10,804.3	\$12,500.8**

\*We have not made any assumptions about proposed infrastructure spending

\*\*Assuming that the level of expenditures is consistent with the expenditures in 2017.

As an example, in Table 3 we have made the following changes in the tax structure: (1) increase revenue by about \$225 million from changes in corporate income and franchise taxes; (2) set a balanced target of \$3.9 billion each from the sales tax and the income tax; and, (3) correct the projections for all the other revenue sources for 2019. These are the taxes that we suggested remain the same in Table 2. The Task Force is not proposing to raise taxes; it is merely proposing to cover the projected spending as determined by the state Legislature over the last several sessions. This chart shows the give and take at play in achieving that goal.

The Task Force recommends that the individual income tax and the sales tax be structured to provide approximately the same amount of revenue to support the state’s budget as this allows the state to keep the rates for both the sales tax and the income tax as low as our identified revenue requirements

allow. This also provides fair treatment across income brackets, because lower income households pay a larger share of their income in sales taxes and higher income households pay a larger share of their income in income taxes. Both taxes grow with the economy; however, the individual income tax has a slightly higher elasticity than the sales tax.

### **The “Maximum Options”**

The Task Force studied examples of tax structures in which the broadest base with the fewest exemptions could be combined with the lowest possible rates while still maintaining revenue levels similar to the projected outlook for 2019. This exercise is important because it presents what are probably the “maximum options” to the state for tax reform. Although the Task Force’s final recommendations took a different form than the maximum options, the scenario demonstrates the opportunity cost in the form of lower tax rates that the state forfeits by allowing special exceptions, credits, and exemptions.

For the sake of simplicity, we will use 2019 as a starting point, while keeping in mind that actual recommendations will need to be forecast over a period of years into the future. The current state sales tax is 5% and is expected to produce about \$4.3 billion in revenue in the 2017 fiscal year, not accounting for the variable of flood recovery. Suppose that the state broadened the base and applied the full sales tax to many purchases that have been exempt or partially exempt. This base expansion could include food for home consumption, prescription drugs and residential utilities, all of which have been protected in the Constitution since 2002. It would also include the items changed in Act 26 of the First Special Session, which amended certain exemptions. It would also include manufacturing machinery and equipment and industrial utilities. Further, a limited group of services could be taxed, such as the sales tax on personal and data services that Texas applies to its sales tax base.

What would these actions allow? Under this scenario, a 5% sales tax rate would theoretically increase annual revenue up to \$6.3 billion. Or, the state sales tax rate could be lowered to approximately 3.4% and still generate the same \$4.3 billion level currently expected. The state sales tax rate could be reduced even further if a decision were made to reduce the overall amount of revenue collected by the sales tax and make the state less dependent on it. If the state wanted to collect about \$3.76 billion from the sales tax, then it could lower its rate to 3.0%. In Table 3, we suggest the sales tax should generate about \$3.9 billion, which is the same that we propose the income tax generate. This would require a sales tax rate of about 3.15%.

A further broadening of the base could be achieved by eliminating a longer list of more minor tax exemptions. For example, a guideline for this list might be the exemption tables prepared by Rep. Julie Stokes and discussed by the sales tax streamlining commission. (Not all exemptions or exclusions on the books should be considered in this exercise. For example, the state should not apply sales tax to raw agricultural products; to do so would be wildly non-competitive for Louisiana farmers. So, we cannot assume that all sales tax exemptions could be eliminated in the name of lower rates.) A greatly simplified state sales tax could achieve a rate approaching a low of 3%, and this likely represents the

maximum option for this tax type. It is also important to recognize that an expanded *state* government sales tax base would increase all *local* government sales tax collections if local governments followed the example of the state.

A similar exercise can be applied to the individual income tax, which is also expected to generate approximately \$3.9 billion in 2019. An elimination of all deductions, exclusions and credits would theoretically generate revenue up to \$5.1 billion. With this broader base, the tax rates could be lowered dramatically and still bring in \$3.9 billion. For example, one scenario might show a revenue neutral outlook with a flat tax rate of approximately 3% that would generate the \$3.9 billion but also including a zero tax on the first \$10,000 of income for single filers and a zero tax for the first \$20,000 for joint filers. This approximate figure of 3% likely represents the maximum option that could be achieved with a tax reform unless a lower amount of income tax revenue was deemed acceptable.

Although these maximum options are instructive, the Task Force proposed a set of recommendations that head in the same direction but without the burden of all the highly controversial constitutional amendments and other likely insurmountable obstacles. Our income tax proposal is close to the maximum option, while the sales tax proposal stops short of endorsing a constitutional amendment to allow sales taxes on food, drugs and home utilities.

### **Sales tax rate and base recommendations**

As a predicate to our recommendations, we note that the Louisiana Tax Study, presented to the Legislature in 2015, called for the creation of a sales tax commission to make recommendations for a uniform sales tax collection process, rates and auditing. The Legislature did so with the creation of the Louisiana Sales Tax Streamlining and Modernization Commission, whose work has been underway for over a year working directly with all stakeholders to identify a way to move to a common sales tax base between state and local governments and to simplify collections. This Task Force is fully supportive of those efforts. To provide this Commission with specific recommendations, the Task Force advises as follows:

The Task Force recommends expanding the sales tax base and reducing the sales tax rate from its current 5% to no more than 4% and preferably less as the revenues derived from a tax base expansion and eliminations of exemptions are quantified. To do so, the Task Force recommends:

- (1) Retaining, with a few modifications, the expanded state sales tax base adopted in Act 26 of the first special session of 2016 and amended by Act 12 in the Second Special Session, which would continue the tax on such things as custom software, business utilities, and storm shutter devices.
- (2) Making certain services, such as those taxed in Texas, and digital transactions subject to sales tax. Some of the taxable services include cable and satellite television, repairs to nonresidential, commercial property, web hosting and security services.
- (3) Include non-residential utilities as part of the tax base

- (4) Including manufacturing machinery and equipment as part of the state sales tax base but establish rebates in order to be competitive with other states. We make this suggestion regarding MME in order to maintain a common sales tax base with locals.

We also suggest that, with the exception of non-residential utilities, any expansion of the state sales tax base also apply to the local sales tax base as well. It would be our suggestion that locals use any revenue enhancements to offset other reductions in local taxes or to lower the sales tax rate as appropriate. We cannot provide specific information regarding the allocations among each governmental subdivision in each parish.

The Task Force recommends allowing local governments the ability to increase their sales tax rates without a vote of the state Legislature, but still requiring a vote of the people in the area being taxed. Sales tax and property tax reform are essential if local governments are to have the tax capacity to independently provide their own funding.

The purpose of a low state sales tax rate is to keep Louisiana competitive with other states, while allowing local governments the ability to fund local programs from locally derived revenue. This change also reduces local government's need to seek state assistance. While some of the state sales tax exemptions relieve some of the tax burden on lower income households, the sales tax is regressive with respect to individuals and families. As we broaden the base, the allocation falls on businesses and higher income individuals to a greater extent than lower income individuals.

Additionally, the Task Force recommends that local and state government create a uniform sales tax base in a reasonable balanced, but expeditious manner. A common sales tax base is integral to improving the impression of Louisiana's sales tax policy as indicated in national comparisons which currently view our system as complex, inconsistent and more challenging to comply with than other states. Additionally, a uniform sales tax base will be helpful in allowing local governments to receive the benefit of sales taxes associated with online sales. While there are arguments in favor and against Internet sales taxes, the shift to online purchasing from vendors such as Amazon is occurring at a rapid pace and our state and local governments are not receiving the sales taxes for these transactions. The state passed a law in the extraordinary session in 2016 having Amazon and other online entities to report the names of Louisiana citizens who purchase online from them. Amazon has indicated that it will remit the sales taxes collected on the purchase of its goods. Notably, these are not new taxes, as a "use" tax already applies to these transactions; however, the state and local governments do not receive these revenues as the law intends.

In [Appendix C](#), The Public Affairs Research Council of Louisiana (PAR) provides a set of guidelines to help navigate the complex web of sales tax exemptions in Louisiana.

## **Sales tax administration recommendations**

The state and local sales tax administration system should be made simpler for business and taxpayers. The Task Force recommends that state and local governments establish a uniform sales tax administration and collection system. Louisiana must streamline and standardize the sales tax collection system in terms of definitions, exemptions, exclusions, and auditing standards for the state and all local political subdivisions. These recommendations are based on making sales tax administration simpler for business tax compliance as well as minimizing the cost of administering and collecting the sales tax and making our sales tax collection system conform to the best practices followed by other states. The Task Force also recommends a recodification of the sales tax laws into a simpler, easier to follow format.

The ultimate goal and most effective way to achieve tax streamlining is to pass a constitutional amendment allowing a single, uniform state/local collection and auditing system that would align Louisiana's practices with those used by other states that utilize state and local sales tax. If a constitutional amendment is not pursued, then alternative systems that would be effective in streamlining collections should be developed and implemented. This system could include newly created oversight bodies that take advantage of existing and developing technology and maintain the confidence of the local bodies whose budgets are dependent upon certainty of the revenue which flows from this source.

In making these recommendations, the Task Force does not imply that there is a single way to achieve this policy change or that any change can be accomplished in a short time frame; however, the Task Force does contend that improvements in the administration of the sales tax collections will benefit the state's economy and its competitiveness. To achieve this objective, the cooperation of state and the local governments is absolutely imperative in achieving this essential reform.

## **Additional sales tax reforms**

The state should impose a moratorium on any new or resurrected sales tax exemptions. Any remaining exemptions should have a sunset established for re-evaluation over a five-year period. All of the exemptions could not be evaluated in one year. We would need to establish a time path for the exemptions to first state exactly what the exemption is trying to accomplish; identify the cost to the state of this exemption; and compare the accomplishments of the exemption to the cost to the state. We recognize that every exemption is not alike in terms of its purpose.

Sales tax law needs a comprehensive recodification to ease compliance, clarify definitions, better distinguish exclusions from exemptions, and reflect the transactional realities of the 21st century. Clarifications are also needed on what is defined as tangible personal property and software services, among other developments of the digital age. A lack of clear modern definitions is a problem and should be addressed. This is a problem that exists in every state that uses the sales tax to pay for public services.

## Individual income tax recommendations

By design, the individual income tax is progressive and thereby offsets some of the regressive nature of the sales tax. It is also a growth tax offsetting the fact that a number of other state revenue sources do not automatically grow with the economy. In terms of administration and compliance, the individual income tax is more cost effective than the sales tax or corporate taxes. The Task Force income tax proposals are consistent with best practices utilized by competitor states in defining the income tax base and in establishing rates that are within ranges used by these states. These proposals create an individual income tax system that is simpler, more transparent and more competitive than our current system.

The Task Force recommends two options for changes to the individual income tax law. Option 1 will require a constitutional amendment approved by the people, while the Option 2 may be accomplished by legislative action. These options are presented in Table 4. A constitutional option allows Louisiana to expand the income tax base, narrow the brackets, and lower all rates by 25%. A statutory option only allows base expansion and narrowing of the brackets.

<b>Table 4. Individual Income Tax Recommendations</b>		
<b>Tax Characteristics</b>	<b>Constitutional</b>	<b>Statutory</b>
	Lower Rates; adjust brackets; and expand tax base	Adjust brackets; expand tax base
<b>Rates and Brackets (single filer in parenthesis)</b>	1.5% on first \$25,000 (\$12,500 single)  3.0% on \$25,000 through \$50,000 (\$12,500 through \$25,000 single)  4.5% above \$50,000 (above \$25,000 single)	2.0% on first \$25,000 (\$12,500 single)  4% on \$25,000 through \$50,000 (\$12,500 through \$25,000 single)  6% above \$50,000 (above \$25,000 single)
<b>Eliminate exclusions and deductions</b>	Federal Tax Liability  50% of Excess Itemized Deductions  \$6,000 Retirement exclusion	Excess Itemized Deductions  \$6,000 Retirement exclusion
<b>12/31/2019 Sunset Exemptions and Deductions—re-evaluate so changes, if necessary, can be made.</b>	Net Capital Appreciation \$25 Education Credit Quality Public Education Home-Schooled Children	Net Capital Appreciation \$25 Education Credit  Quality Public Education Home-Schooled Children

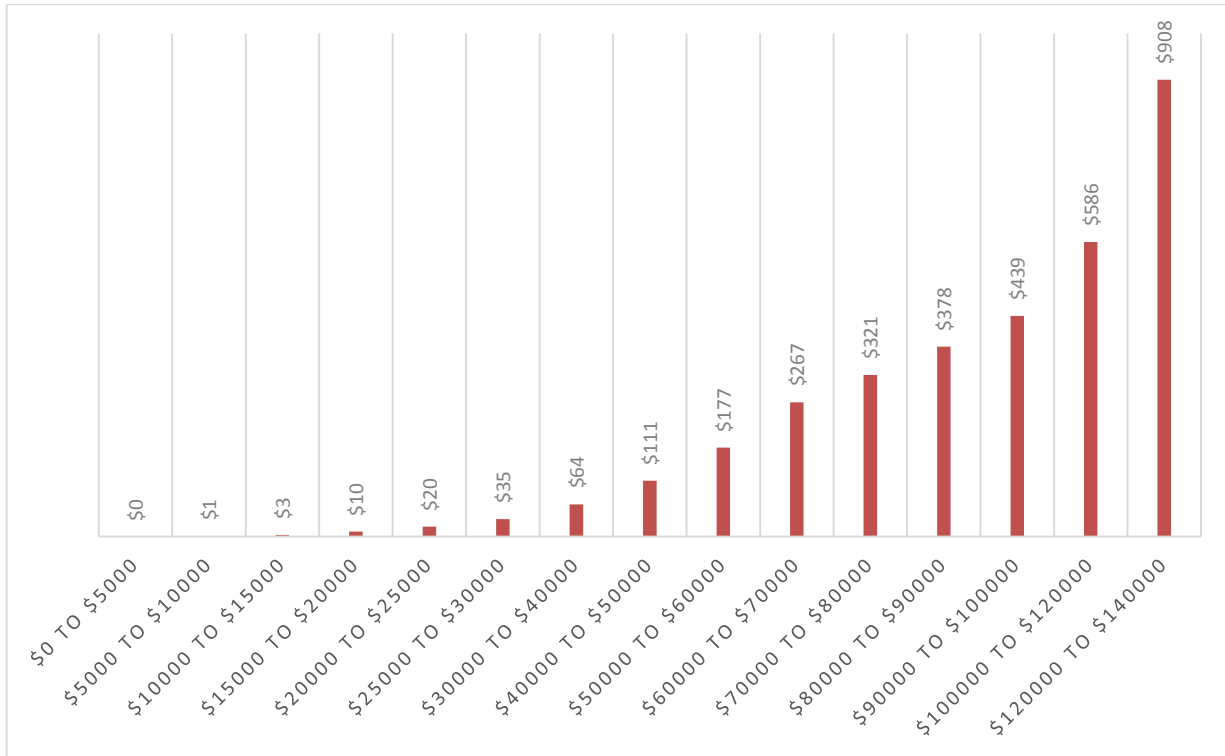
<b>Enhanced Oversight by Legislature with specific expectations about accomplishments of special tax advantages</b>	Recreation Volunteer Volunteer Firefighter IRC Section 280C Expense	Recreation Volunteer Volunteer Firefighter IRC Section 280C Expense
<b>Eliminate Tax Credits</b>	Citizens Property Tax Credit	Citizens Property Tax Credit
<b>Allow to Expire in 2018</b>	Solar Credit	Solar Credit
<b>Re-evaluate in 2021</b>	Historic Tax Credit	Historic Tax Credit
<b>LED's Programs—will examine as group</b>	See discussion at p. 53-54	See discussion at p. 53-54
<b>Property Tax Credits—to be examined in property tax</b>	See discussion at p. 58	See discussion at p. 58

- Under the constitutional option, the Task Force recommends allowing voters to approve the elimination of the federal income tax deduction that decouples the Louisiana tax base from federal tax changes. This option would include scaling back excess itemized deductions to 50%. A new three-bracket structure would be used and rates of taxation lowered – 1.5% on the first \$25,000 (\$12,500 single), 3% on \$25,000 through \$50,000 (\$12,500 through \$25,000 single) and 4.5% above \$50,000 (above \$25,000 single). The marginal tax rates would be lowered by 25%, but they would apply more fairly and evenly to all taxpayers because of the proposed elimination of many deductions and exemptions.

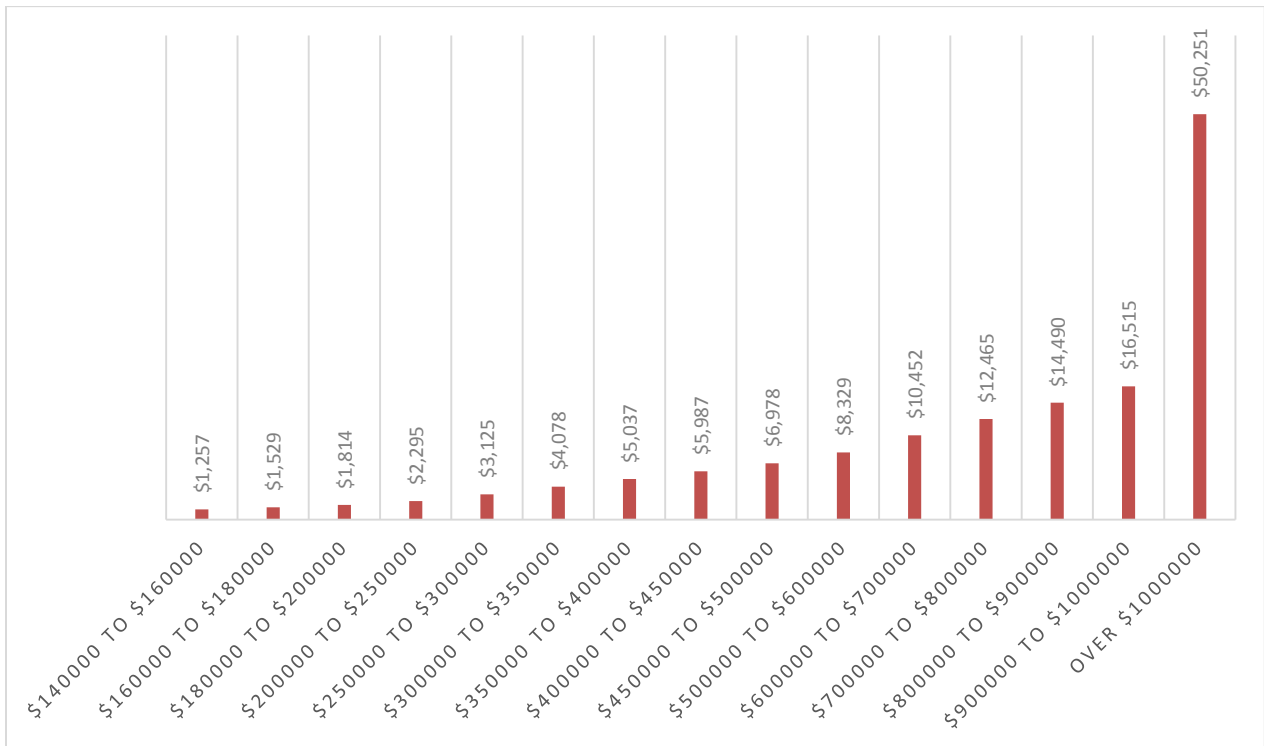
- Under the statutory option, the excess itemized deduction would be fully eliminated. This would be coupled with the elimination of other deductions and exemptions proposed by the Task Force. The statutory option would use the new compressed three-bracket structure, but tax rates would remain at the current 2%, 4% and 6% levels. Approximately 420,000 Louisiana taxpayers itemize on their federal tax returns. This represents roughly 25% of all taxpayers in the state. The purpose of doing away with this particular tax advantage that applies to a portion of the taxpayer is to lower the rates overall.

Figures 9 and 10 provide information regarding the impact of eliminating the deduction for federal taxes and not changing the rate structure. As can be seen, the elimination of the federal tax liability will cost the family earning between \$40,000 and \$50,000 about \$111 on average. It would cost the family earning between \$100,000 and \$120,000 about \$586. For the family earning between \$900,000 and \$1,000,000 this change would cost about \$16,515. But these estimates are assuming that the current rates of 2%, 4% and 6% remain in place. The idea behind eliminating the federal deductibility would be to lower rates.

**Figure 9. Tax Increase Due to Eliminating Federal Tax Liability up to \$140,000**



**Figure 10. Tax Increase Due to Eliminating Federal Tax Liability From \$140,000 and Higher**





## **Additional income tax changes**

Additionally, the Task Force includes in Table 4 recommendations regarding tax breaks.

The Task Force recommends the elimination of many income tax exemptions and credits and the imposition of a moratorium on any new tax credits or exemptions applied to the individual income tax. The Task Force recommends keeping (1) the standard and dependent deductions, (2) the exclusion for military pay for active duty personnel, (3) the credit for taxes paid to another state, (4) the earned income tax credit (because it allows the state to enhance the progressivity of its income tax and reduce the regressive nature of the overall state tax structure), (5) the exclusions for social security and retirement income for public employees, and (6) credits related to child care and early childhood education, in part because these programs help all families and improve educational outcomes, and in part because they leverage federal money.

The historic rehabilitation tax credits should be preserved because this program was recently revised and reduced by consensus in the Legislature and is due for re-evaluation in 2021, but this credit should definitely be evaluated in 2021. Also, the program involves many stakeholders with legal and financial obligations over a long period of time and therefore could not be eliminated immediately. It affects individual and corporate income tax revenues.

## **Corporate income tax recommendations**

The Task Force had recommended the elimination of the deduction for federal taxes paid for the corporate income tax as a constitutional amendment included on the statewide ballot on November 8, 2016. Only 44% of voters were in favor of the amendment and this measure failed to pass. The reform would have decoupled the Louisiana tax base from federal tax changes and would have set the corporate tax rate at a flat 6.5%. The upper bracket rate for Louisiana currently is 8%. This approach would have better aligned Louisiana with its competitor states, potentially provided for a more stable source of revenue than the current corporate income tax structure, and eliminated instability in state corporate tax collections due to actions in Washington, D.C.

The Task Force believes this is a fundamental change that will allow the state to compete across the country with lower corporate tax rates. We agree that any tax change is automatically subject to concern, but the only way to reduce the top corporate tax rate is to scale back some of the exemptions with the federal deductibility being the one exemption that is not commonly allowed in other states. Other states can have lower rates because they do not include the exemption of federal tax liability. We appreciate that a convincing public education effort will be needed.

With respect to exclusions, deductions, and credits applicable to corporate income and franchise taxes, the Task Force makes the recommendations set forth in Table 5. However, it should be noted that several exemptions and credits are really not corporate income tax issues, but instead pertain to other areas of the state's tax structure. Key examples of this are the inventory ad valorem tax credit and the economic incentives utilized by Louisiana Economic Development.

<b>Table 5. Corporate Tax Exemptions, Deductions, and Credits</b>			
<b>Subchapter S</b>	<u>Maintain</u>	<b>Inventory Tax</b>	Property Tax Issues; not really corporate income tax issues Recommend that these be discussed separately
<b>Net Operating Loss</b>	<u>Maintain</u> and remove 72% cap	<b>Offshore Vessels</b>	
<b>School Readiness Credit</b>	<u>Maintain</u>	<b>Other Telephone Companies</b>	
<b>Federal Tax Deduction</b>	<u>Eliminate</u>	<b>Natural Gas</b>	LED Issues Recommend that these be discussed separately
<b>Donations to School Tuition—can also be individual income tax deduction</b>	<u>Expanded Legislative Oversight</u>	<b>Motion Picture Credit and other associated credits</b>	
<b>Interest and Dividend Income</b>	Study by LDR and Tax Institute due by 2019	<b>Enterprise Zone</b>	
		<b>Quality Jobs</b>	
		<b>Other LED Programs</b>	

The Task Force recommends that all temporary changes enacted during the 2015 and 2016 Legislative Sessions be allowed to sunset in 2018 in favor of the implementation of the permanent adjustments that are being recommended herein.

**New models for corporate income tax reform**

During the legislative sessions in 2016, several important steps were taken to reform the corporate income tax for Louisiana. These reforms were precipitated by the Louisiana Tax Study in 2015 and the Tax Foundation report from the Committee of 100, as well as other prior reports and our ongoing discussions of tax reform. While there were important accomplishments, additional items should be on the reform agenda.

The U.S. Supreme Court has long ruled that a state can tax a multistate business as long as the income from the business is “fairly apportioned.” However, within this broad framework states differ in the precise methods of taxing corporations. Louisiana calculates its corporate tax on a “separate entity” basis, in which the tax for each corporation is calculated separately, regardless of its corporate affiliations or whether they are part of a consolidated return for federal tax purposes. Separate entity taxation poses difficult challenges for a state with respect to intangible income, such as royalties and interest. For example, corporations could pay royalties and interest to a related corporation in another state where it is not taxed and thereby reduce reported corporate income in Louisiana. Effectively, corporate profits are shifted from one state to another.

To help preserve the tax base in Louisiana, the first major reform was the enactment of a new add-back statute in 2016. Add-back statutes disallow deductions for intangible payments if they are not taxed in

other states. This is a useful tool for the Department of Revenue to preserve the tax base, and it also provides clarity to taxpayers.

The second major reform involved changes to the methods that Louisiana uses to apportion the income of corporations that operate both within and outside Louisiana. Prior to the changes made this year, there were a number of different methods, depending on the industry of the business. Manufacturing and merchandising businesses apportioned income using a single sales factor—that is, the ratio of sales made into Louisiana over total sales. Other businesses were typically required to use a three-factor method, taking an average of the factors for sales, payroll, and property. In the Second Special Session of 2016, the Legislature extended the single sales factor to all industries except for oil and gas, which now has a four-factor formula. The move to a near universal single-sales factor is beneficial to the state, as it removes any disincentives to employ capital and labor within the state.

The same legislation also changed the way that corporate income is calculated for sales of services. Prior to this legislation, sales for companies providing services were allocated to the state that had the highest fraction of the cost of performing the service. If, for example, a credit card company processed credit cards in South Dakota but circulated cards in Louisiana, the sales would be credited to South Dakota. The new legislation moved to a concept of “market sourcing” in which the sales would be allocated to the state where the market for the services was located. In this example, the sales would be credited to Louisiana. With a single sales factor the ratio of Louisiana sales to total sales would be used to apportion the income of the credit card company. Market sourcing will mean that Louisiana should secure its fair share of income from multistate service companies.

Despite these positive reforms, important items remain on the corporate reform agenda. One would be to move from single-entity taxation, as we currently have, to a system of combined reporting. Under combined reporting, corporations are taxed based on their apportioned share of income of their “unitary group”. Corporations are combined into a unitary group under a variety of criteria, including common ownership, common management, and common lines of business. Combined reporting solves the profit-shifting problem from intangibles because related companies are part of a unitary group in which intercompany transactions are eliminated. A state will apportion the entire unitary group using a combined return to determine its share of its tax base.

The Task Force recommends directing the Department of Revenue, with the Louisiana Tax Institute, to study moving from single-entity taxation on the corporate level to a system of combined reporting with findings due by January 2019. Combined reporting is widely viewed as a more aggressive and reliable approach than add-back statutes for countering profit-shifting. A separate state study of combined reporting is underway, and this analysis could serve as a guideline for how and whether the state should move to combined reporting for the corporate income tax. Combined reporting is now used in roughly one-half of states, but not typically in the South; although Texas uses combined reporting for its margin tax.

## Franchise tax recommendation

Because the corporate franchise tax as it is utilized in Louisiana differs substantially from how it is used in other states, the Task Force recommends restructuring, phasing out or eliminating the tax provided the state identifies replacement revenue to coincide with those changes. The determination of the appropriate restructure, elimination or phase out would be through a study conducted by the Louisiana Department of Revenue and the Louisiana Tax Institute. The appropriate timeframe for any phase out or elimination will also be determined by the study. The study of the franchise tax and the combined reporting evaluation are to be completed within two years and recommendations based on the findings are to be made to the Legislature by 2019.

## LED development incentives

The Task Force recommends that the Louisiana Department of Economic Development (LED) establish sunsets and review periods for all of its programs, other than as set forth herein. This has been recommended by national organizations such as the Pew Charitable Trusts as a way to ensure fiscal responsibility and effectiveness of incentive programs. While most of LED's programs already have established sunsets, the department will have to file legislation during the 2017 and 2018 legislative sessions to extend them. Examples include the Quality Jobs (QJ), Enterprise Zone (EZ), Angel Investor (Angel), and Research and Development (R&D) incentive programs.

The Task Force recommends that LED continue to monitor and regularly report on the performance of all of its programs. The reporting must include information on the return on investment for each program in terms of the fiscal impact, the economic impact and other metrics relevant to program performance. Rigorous studies are required to examine tax incentives. We suggest that these studies must follow three general guidelines.

First, the studies should be conducted by independent parties without a vested interest in the specific conclusions of the studies. This means that the economic development agencies or the business lobbying groups should not conduct these studies. Instead, the studies should be contracted out to disinterested parties with strong track records in conducting similar studies using best practices from other states' studies.

Second, the studies should recognize that using taxpayer funds for tax incentives means that these same taxpayer funds cannot be used for other government programs. An implication of this guideline is that the studies should be prudent in conclusions that rely upon the "multiplier" effects of the amount of an incentive in assessing the fiscal impact of the tax incentive. Tax incentives are one form of government spending, and generally any government spending generates multiplier effects. A dollar spent by state government on, say, school construction will generate additional economic activity through a multiplier effect, just like a dollar given by state government to businesses using a tax incentive will generate additional economic activity via a multiplier effect. Assessing the viability and benefit of an incentive program primarily based on its multiplier effects can overestimate the economic impact of the incentive

program relative to other spending programs. A further implication of this guideline is that the studies should make symmetric use of multiplier effects in assessing the fiscal impact of any program.

Third, the studies should recognize that many businesses may expand or re-locate without the tax incentives. This means that the studies should not use a “but for” methodology that assumes all new activity is generated by tax credits. Instead, the analysis should assess the programs relative to the legislatively identified objectives with recommendations for how the programs can be modified to achieve these objectives.

### **Recommendations on specific programs**

The Task Force recommends that LED revisit the wage requirement (\$14.50/hour) of the QJ Program. The wage required for program eligibility should be adjusted periodically to keep pace with the growth of the economy.

It is recommended that LED restructure the R&D program from a 40% tax credit to a 30% credit, and designate a specified subset of the program’s participation to only those companies that receive a federal Small Business Innovation and Research (SBIR) grant.,

The EZ Program underwent significant reform in the First Extraordinary Session of 2016. The program has been capped and the jobs credit has been redesigned to reward the hiring of economically disadvantaged Louisiana citizens. These changes will result in an estimated \$26 million in savings by fiscal year 2020. No further changes are recommended for the EZ program. The Task Force recommends that the program’s performance be continuously monitored as the reforms begin to show results.

It is recommended that LED establish program sunsets of July 1, 2021, on all of its tax credit incentives and July 1, 2022, on all of its tax rebate incentives. It is recommended that LED identify to the Legislature all underutilized or inactive programs so that they may be eliminated.

### **Motion picture tax credits**

The Motion Picture Investor Tax Credit Program underwent fairly substantial reform in the 2015 Legislative session, which introduced new tools for LED, and for the inspector general to further inhibit the potential for fraud and abuse. However, a back-end cap of \$180 million per year was established along with a one-year suspension of the buyback option. Both of these measures had the unintended consequence of destabilizing the industry to the extent that the investments made through the development of the industry over the last decade were at risk.

LED has been tasked with developing further recommendations for reform for introduction during the 2017 Legislative session. The department has a strategic plan under development to accomplish this goal. The desired result is a program that achieves sustainability and predictability, an improved return for the state, and a positive statewide economic impact.

The Task Force recommends that the motion picture credit be retained as a non-appropriated, non-refundable tax credit incentive with both discounted redemption and transferability as alternative options for use. The back-end cap established during 2015 should be eliminated in its entirety and replaced with a legislatively enacted front-end cap to mitigate the state's exposure to tax credits going forward. The state should implement a modification to the initial certification process to allow for a project to count against the cap only after it commences active production. This will allow the state to have control over the number of credits issued from inception. Coupled with other mechanisms that would target specific types of production and potentially encourage reasonably timely utilization of credits, the potential for another backlog of credits that would materially impact the state budget may be avoided.

The current review of the program by LED at the direction of Governor John Bel Edwards, which includes outreach to the industry, is supported and it is recommended that the outreach to the industry be incorporated into the future development of the program. One mechanism to achieve this would be to reinstitute the Film Commission to provide for a structured means of incorporating industry insight on a regular basis.

The biennial review of the program should be revised to include a report that specifically addresses the progress of the program with respect to each objective identified by the Legislature, especially with regard to building a stronger, more self-sustaining Louisiana motion-picture industry, as well as newly identified benefits of the program with a focus on accomplishing an acceptable return on investment.

**W**e must address the close relationships of state and local spending and revenue and their impacts on all citizens and levels of government

### What is the relationship, and why does it matter?

The financial relationship between local governments and the state is one of the most controversial issues in policy and tax discussions in Louisiana. The state's large obligations to local governments -- combined with limits on local property taxes and other collections -- have contributed to a long-running debate as to whether parishes and municipalities are structurally and overly dependent on state resources. State spending on local government tops \$500 million annually not counting the MFP or other education-related expenses; payments to sheriffs for housing state prisoners; or the inventory tax rebate [See [Appendix D](#)]. A recurring theme in the Task Force hearings was the question of whether the current structure is contributing too great a strain on state finances and just how that strain might be alleviated without jeopardizing appropriate parish and city services. Local government representatives offered substantial data and perspectives on this issue. Finding the potential solutions proved to be challenging and complicated.

State support to local governments comes in many forms, including direct state subsidies, annual appropriations to public schools, road money, the provision and financing of charity and rural hospitals and the main responsibility for community colleges. The state provides annual subsidies for salaries of law local law enforcement and firefighting personnel. The state also shares certain forms of tax revenue with local governments. State hotel occupancy taxes are dedicated to local causes throughout the parishes. Local governments also can benefit from business expansions, which often are rewarded with state incentives and credits.

In addition to this state support, local governments depend on a combination of their own sales taxes, property taxes, fees on business and specific charges for utilities and other public services. Local governments in Louisiana are less dependent on property taxes and more dependent upon sales taxes compared either to national or southeastern regional averages. For example, Louisiana relies on property taxes for 14.8% of its total state and local revenue, compared with an average of 30.1% among all states nationally, according to the Tax Foundation. The local sales tax rate in Louisiana is typically about 5%. Combined with the current state sales tax rate of 5%, Louisiana has the highest sales tax rate in the nation.

Homeowners in Louisiana enjoy the largest homestead exemption in the nation while manufacturers until recently have enjoyed a 10-year total exemption on property taxes for qualified expansions. Many people believe this sweeping property tax protection contributes to the state's fiscal problems, causing locals to be too dependent on the state for financial and public service support. A comparison is often

made with neighboring Texas, where local governments collect a much higher property tax than in Louisiana and also tend to be more self-sufficient with regard to schools, community colleges, health care, law enforcement, infrastructure, and local project funding.

Although Louisiana property tax collections are relatively low compared to other states, Louisiana local sales tax collections are relatively high. Purchasing trends and fluctuations in the Louisiana economy, especially in the oil patch, are causing cutbacks in many parishes affected by lower sales tax revenue, whereas the less-emphasized property tax base is more stable and more resilient in good times or bad. Local government spending tends to boom and bust with the sales tax cycles. Property taxes tend to be a more stable form of revenue.

Local governments in Louisiana do have a few fiscal advantages over most of their peers in other states. They can collect a property tax on business inventory and a sales tax on new manufacturing machinery and equipment. Also, in lieu of paying a corporate tax to the state, banks in Louisiana are assessed a tax that is distributed to local governments. The state shares various kinds of revenue with local governments, such as taxes on video draw poker, a fire insurance fund, the severance tax, tax-increment financing deals, and a host of dedications of state hotel taxes that are routed to local projects and organizations. Local governments do not pay state sales tax on their purchases. Also, there are many state-dedicated funds that spill over into local interests. For example, the state diverts personal income taxes paid by visiting professional athletes performing in New Orleans into revenue for the Superdome and local sports development.

### **Specific obligations**

The biggest ticket item in state support is for local schools, most notably in the form of the Minimum Foundation Program (MFP) at a cost in 2016 of \$3.67 billion. This amount makes up a large proportion of K-12 school costs, which is not unusual compared to other states. Most states distribute money to school districts according to a formula that helps maintain sufficient funding levels in poorer counties. By comparison with other states, Louisiana is about average in its payment obligations to local schools. What is unusual in Louisiana is that the proportion of school funding that comes from local property taxes is well below the national average.

The Revenue Sharing Fund was established in the state Constitution as a partial recompense for the homestead exemption. It guarantees that every year \$90 million will be distributed directly from the state general fund to local governments through a formula based on population and homesteads. The money is allocated in a separate bill each year and is spent strictly on local programs and projects, such as law enforcement, general operations, stoplights, playgrounds, and sewers. This direct charge to the general fund for local projects is among the very highest spending priorities for the state. It cannot be interrupted by the Legislature or the Governor without violating the Constitution.

The Constitution also protects annual state funding for supplemental pay for police, deputy sheriffs, and firefighters, at a cost of over \$125 million. The annual supplemental pay has been defended as a state



priority because law enforcement and emergency response efforts often overlap jurisdictions and involve collaboration with state agencies. The Constitution also requires state financing of the Parish Transportation Program. Less protected, but historically prolific, are local construction projects financed by the state through the capital outlay process.

Most of these activities and financial arrangements are shielded from the state budget process in one form or another. With few exceptions, they are on automatic pilot and have strong support in the Legislature. The local-state relationship is structured into the spending system, the dedications system, and the tax system, but it is also part of the culture of direct state provision of major public services on the local level.

### **Outlook for state and local relations**

The first step in dealing with the state and local relationship is to create a fiscal structure for local governments that will allow them an opportunity to financially handle more of their responsibilities. Sales tax reform and property tax reform are essential if local governments are to have the capacity to raise sufficient revenues to provide for themselves and not have to depend on the state.

The state should allow local governments to increase their sales taxes without a vote of the Legislature. Instead, a vote of the people in the area would be the requirement to determine whether the area will be subject to a new tax rate. The state also should consider reducing some of its commitment to local government as locals are given more authority to raise revenues and those revenues are collected.

### **Property Tax Reform**

The property tax is a local tax. The state has the constitutional authority to levy an ad valorem tax of 5.75 mills but has not passed a law to do so. Several major exemptions apply to the property tax and the state constitution establishes an assessment process. Land and residential improvements are assessed at 10% of fair market value; industrial and commercial property at 15%; and public service property at 25%. Farm and timber property are taxed on use value as opposed to fair market value.

The homestead exemption was increased to \$7,500 as of 1982 and has not been increased since that time. Over the last 36 years the relative value of the homestead exemption has diminished due to rising home prices and property taxes paid by residential property owners. In 1990 and in 2015 homesteads made up just about half of all property taxpayers. In 1990 the Louisiana Tax Commission noted that 83% of all owner-occupied homesteads were tax-free because the assessed value of their homes did not exceed \$7,500, while in 2015 only 38% of the homesteads were tax-free. The appropriate policy is to maintain the present homestead exemption.

## **The inventory tax**

Local governments include business inventories as part of their property tax assessments. Since the 1990s the state has offered a tax credit to offset the inventory taxes that businesses pay to the local governments. As inventory assessments grew over the years, the state's cost of supporting the tax credit grew also. Total inventory tax collections among all local governments statewide reached \$463.1 million in the 2015 report by the Louisiana Tax Commission. That figure fell by 10% to \$416.8 million for the commission's most recent 2016 report. (The report tracks previous year data; for example, the 2016 report reflects properties held in 2015.) This decline coincided with a fall in prices for oil and gas commodities, which are stored as inventory in large volumes in Louisiana. The Legislature trimmed the credit in 2015 and has taken other steps to reduce the state's liability with the credit program.

The Task Force recommends a constitutional amendment to allow for a gradual elimination of the assessment of ad valorem taxes on inventory over a 10-year period accompanied by an elimination of the state income and franchise tax credit for ad valorem taxes paid on inventory over a five-year time period. The constitutional amendment for the elimination of the ad valorem tax on inventory should include a provision to allow for a roll-up of existing millage to offset the revenue reduction. In lieu of the millage roll-up to offset the revenue reduction, the Legislature should consider enhanced sources of local revenue from changes to the local tax base including but not limited to changes to the industrial tax exemption or expansion of the sales tax base. Another alternative to offset the revenue reduction would be the creation of a temporary revenue sharing fund. The offsets to address any revenue reductions should consider the impact of the inventory tax elimination on each local governmental subdivision currently collecting the tax.

The Task Force recommends the elimination of the ad valorem tax credit for natural gas over a five-year period. The Task Force recommends that the tax credits associated with offshore vessels and other telephone company property be maintained presently, but that special committees, such as the SCR 6 Task Force, examine other methods of dealing with these unique ad valorem situations. The present method of the state picking up the tab needs to be reassessed.

## **The industrial tax exemption**

Governor Edwards, along with newly appointed members of the Board of Commerce and Industry, has revised the industrial tax exemption program. This incentive has provided a break on local property taxes for up to 10 years for qualified manufacturing expansions. The Governor is empowered by the Constitution to oversee the program and set the rules. The incentive is not authorized or controlled by statutes. The Governor's new program is designed to exclude some types of manufacturing improvements, require more accountability and jobs creation, and give local parish officials the ability to weigh in on the deals. The Board of Commerce and Industry has rewritten the guidelines for the process and qualifications. The new set of rules is on track to be implemented through the state's Administrative Procedures Act.

Taken in isolation, Louisiana's industrial tax exemption program has been a tax break that is unusual among states that typically compete with Louisiana for manufacturing operations. Not only is it monetarily generous, but it has been granted exclusively by the state board and the Governor, with no involvement from local officials. However, industrial incentive packages cannot be viewed in isolation. Nearly all local governments in Louisiana have opted to maintain a local sales tax on the purchase of manufacturing machinery and equipment. Such a tax is something local governments in most other states do not collect, particularly at the relatively high local tax rate of 5%. Also, local governments in Louisiana collect a tax on business inventory, which affects many manufacturing plants. Few states have an inventory tax, and some that do also have an inventory tax break provision for manufacturers.

The Industrial Tax Exemption has increased in value since the market price of industrial expansion has risen. This exemption has an economic development value, but the plants and facilities also require public services. This is an exemption controlled by the state though the dollars given up are local revenues. The Task Force recommends that local governments have a role in granting the industrial tax exemption. As such, the Legislature should adopt a resolution amending the industrial tax exemption in the Constitution to allow for local governmental approval of the exemption and creating a statutory framework for the exemption that ensures local governments are included in the approval process and establishing policies for use of the exemption as an economic development tool that favors job growth. Further, the following guidelines could be included in the statutory framework: the industrial exemption can be up to 100% of the value of the investment for the first five years and then up to 80% for the next three years.

### **Other property tax issues**

The Task Force further recommends expanded use of payment in lieu of tax (“PILOT”) arrangements for local governments considering ad valorem tax exemptions to attract economic development and that the Legislature consider legislation deemed appropriate to expanding this opportunity. Any such use of PILOT arrangements should require a resolution of the elected officials in the taxing jurisdiction in addition to any appointed board, such as an industrial development board.

The Task Force recommends a constitutional amendment limiting the ad valorem tax exemption for property owned by non-profits to property exclusively used for the tax exempt purposes of the non-profit. This recommendation would still allow for a complete exemption of property owned by religious entities and an apportioned treatment of non-profit owned property that is not exclusively used for the tax exempt purpose of the organization. Other states have implemented an apportionment model to allow for a partial exemption of the property.

### **State and Local Relations**

There is no simple, one-policy option that will improve the fiscal connection between the state and local governments in Louisiana. There are over 300 municipalities in the state; 64 parishes and sheriffs; 70 school boards; and numerous special districts. All of these local governments have different ways of

funding local services; some use mainly local sales taxes while others are more dependent on the property tax. We also have considerable economic inequality among the parishes. Improving the ability of locals to fund services for themselves is an important first step, but certainly not the only step to be considered. A careful examination of all spending programs related to local government is also a necessary step. Finally, we have to connect the revenue options and the spending requirements at the local level.

***F**iscal Stability is an essential ingredient for long-term growth and prosperity in the state.*

Louisiana has gone through a decade of budget instability with individual and business taxpayers unsure about their tax obligations and public service providers unable to make long-term commitments due to uncertainty about funding. . Economic development and growth do not prosper in such an atmosphere. An essential ingredient in the long-term development of the state is a stable and predictable fiscal structure. The Task Force carefully and thoughtfully suggested changes for the spending of dollars by the state government, changes in the way the state pays for these public services, major changes in the administration of several taxes with specific focus on the state and local sales tax collections, and changes in the state and local relationship.

None of these suggestions will be easy to implement. A state is typically reluctant to consider major changes in its spending priorities and tax structure. But the state has reached a stage that it cannot keep doing what it has done for the past 40 or so years. It must plan for the next 40 years and be very realistic about what this plan must include.

The Task Force provides a guideline for making such changes and we might note that many of the fundamental suggestions in the state sales tax and the state individual income tax are consistent with suggestions by the Tax Foundation. We appreciate that many of these changes have to be phased in, but we should not delay initiating the changes. We are, in a sense, pushed against the wall since there is a definite fiscal cliff coming in fiscal 2019. The state has to make decisions in the upcoming legislative session in 2017 or in a special session prior to fiscal 2019. And, the state definitely should not merely renew temporary taxes for another two years.

The ultimate goal is to build a tax structure that will produce the revenues for the state services that the people believe are essential for a productive state. This is an achievable goal, but it will require decisive action by the state's citizens and political leaders.

**House Concurrent Resolution 11**

A CONCURRENT RESOLUTION To create the Task Force on Structural Changes in Budget and Tax Policy to continue the budget and tax reform evaluations begun during the 2016 First Extraordinary Session, to make recommendations of changes to the state's tax laws in an effort to modernize and enhance the efficiency and fairness of the state's tax policies for individuals and businesses, to examine the structure and design of the state budget and make recommendations for long-term budgeting changes, and to report to the legislature by September 1, 2016, and to urge and request the governor to support and implement initiatives for structural change introduced in upcoming sessions of the legislature intended to bring about long-term improvements to the programs and services of state government as well as cost savings through more efficient and effective state operations.

WHEREAS, the citizens of the state of Louisiana expect and deserve a stable, transparent, and effective government that meets the needs of citizens through high-quality programs and efficient services; and

WHEREAS, the state government of Louisiana has faced deficits annually since Fiscal Year 2008-2009; and

WHEREAS, the structure of the state budget continues to limit the ability of the legislature and the governor to prioritize critical statewide services, and the brunt of annual and mid-year deficits continue to fall on higher education and healthcare; and

WHEREAS, the state government of Louisiana is facing a \$960 million projected budget deficit in Fiscal Year 2015-2016 and a \$2.1 billion projected budget deficit in Fiscal Year 2016-2017; and

WHEREAS, the state general fund expenditures of state government are projected to continue to grow in the five-year continuation baseline projection and state revenues are not projected to meet those expenditures; and

WHEREAS, solving the budget deficits in the coming years and setting the state on a path of continued fiscal responsibility requires a thorough review of all areas of state operations and spending; and

WHEREAS, there are numerous areas within state government in which reforming the current policies and practices will produce savings or additional revenues for the state; and

WHEREAS, in 2015, the legislature commissioned a tax study to provide the legislature with alternatives for a tax structure with predictable and stable revenues, that promotes competitiveness, and is fair and simple; and

WHEREAS, the legislature began deliberating the long-term recommendations included in the tax study during the interim and 2016 First Extraordinary Session of the Legislature; and

WHEREAS, tax policy initiated in the 2016 First Extraordinary Session of the Legislature brings short-term relief for the projected budget deficits; and

WHEREAS, the short-term relief serves to bridge the time needed for the legislature and stakeholders to

continue to work on better budgeting practices and tax policy that can be introduced no later than the 2017 Regular Session of the Legislature providing long-term structural relief from recurring budget deficits; and

WHEREAS, the governor is the chief executive officer of the state and in that position is responsible for overseeing the operations of the executive branch of government; and

WHEREAS, the legislature has the authority to make and change the laws of the state and to establish a more stable, fair, and simple tax code and to enact policies that will improve the efficiency and effectiveness of state government in order to stabilize the budget for future years; and

WHEREAS, it will take cooperative action on the part of the governor and legislature to ensure that such policies are achieved that can bring about long-term structural improvements to the tax code and the operations of state government; and

WHEREAS, the executive branch, led by the governor, and the legislative branch must coordinate on structural changes to avoid the need for unnecessary additional revenues or potentially harmful cuts to required state services.

THEREFORE, BE IT RESOLVED that the Louisiana Legislature does hereby create the Task Force on Structural Changes in Budget and Tax Policy to continue the budget and tax reform evaluations begun during the 2016 First Extraordinary Session of the Legislature, to make recommendations of changes to the state's tax laws in an effort to modernize and enhance the efficiency and fairness of the state's tax policies for individuals and businesses, to examine the structure and design of the state budget and make recommendations for long-term budgeting reforms, to report to the legislature by September 1, 2016, and to urge and request the governor to support and implement initiatives for structural change introduced in the upcoming sessions of the legislature intended to bring about long-term improvements to the programs and services of state government as well as cost savings through more efficient and effective state operations.

BE IT FURTHER RESOLVED that the Task Force on Structural Changes in Budget and Tax Policy is directed to consider all options and alternatives available.

BE IT FURTHER RESOLVED that the Task Force on Structural Changes in Budget and Tax Policy shall begin meeting during the first week of the 2016 Regular Session of the Legislature, and shall report to the legislature no later than September 1, 2016.

BE IT FURTHER RESOLVED that such report shall contain a specific plan for long-term tax policy that may be used to introduce legislation no later than the 2017 Regular Session of the Legislature.

BE IT FURTHER RESOLVED that the Task Force on Structural Changes in Budget and Tax Policy shall evaluate and recommend changes to state budget practices including but not limited to:

(1) Best-practice budgeting methods such as budgeting for outcomes, zero-based budgeting and performance-based budgeting practices used in other states.

(2) Cost-benefit analysis of dedicated sources of funding that require state general fund to be used for particular functions.

(3) A means to review all state spending, regardless of revenue source, to ensure taxpayer dollars and user fees are used appropriately and effectively.

(4) The appropriate balance and requirements on the use of state tax dollars for services and operations of local government.

(5) Best-practice mechanisms to estimate expenditures and forecast revenues.

(6) Improved tools to display the details of state and local spending to the public.

BE IT FURTHER RESOLVED that the Task Force on Structural Changes in Budget

and Tax Policy shall evaluate and recommend changes to tax policy including but not limited to:

(1) Personal Income Tax

(2) Corporate Income Tax

(3) Property Tax

(4) Sales Tax

(5) Severance Tax

(6) Tax Expenditures, including deductions, credits, exemptions, and rebates

BE IT FURTHER RESOLVED that the Task Force for Structural Changes in Budget

and Tax Policy shall be composed of the following members:

(1) The principal on the Revenue Estimating Conference that is a faculty member with revenue forecasting expertise from a public or private university in the state.

(2) The secretary of the Department of Revenue, or her designee.

(3) A member appointed by the Society of Louisiana Certified Public Accountants.

(4) A member appointed by the Governor.

(5) The commissioner of administration, or his designee.

(6) One economist or tax specialist appointed by the Speaker of the House of Representatives from a list of nominees submitted by public or private universities in the state including the Louisiana State University AgCenter and the Southern University AgCenter.

(7) One economist or tax specialist appointed by the President of the Senate from a list of nominees submitted by public or private universities in the state including the Louisiana State University AgCenter and the Southern University AgCenter.



(8) One member of the business community appointed by the Speaker of the House from a list of nominees submitted from Blueprint Louisiana, Committee of 100 for Economic Development, and the Louisiana Association of Business and Industry.

(9) One member of the business community appointed by the President of the Senate from a list of nominees submitted from Blueprint Louisiana, Committee of 100 for Economic Development, and the Louisiana Association of Business and Industry.

(10) A member appointed by the Public Affairs Research Council of Louisiana.

(11) A member appointed by the Council for a Better Louisiana.

(12) A member appointed by the Speaker of the House of Representatives from a list submitted by the Louisiana Sheriffs' Association, the Louisiana Assessors' Association, the Police Jury Association of Louisiana, and the Louisiana Municipal Association.

(13) A member appointed by the President of the Senate from a list submitted by the Louisiana School Boards Association, the Louisiana Budget Project, and the Louisiana AFL-CIO.

BE IT FURTHER RESOLVED that the chair of the Task Force on Structural Changes in Budget and Tax Policy shall be elected by a favorable majority of the members of the task force.

BE IT FURTHER RESOLVED that the Task Force on Structural Changes in Budget and Tax Policy, for the purposes of conducting its meetings and accomplishing its goals, shall be staffed by staff of the Department of Revenue.

BE IT FURTHER RESOLVED that the governor is urged and requested to support initiatives introduced in the upcoming sessions of the legislature intended to bring about long-term improvements in the programs and services of state government as well as cost savings through more efficient and effective state operations.

BE IT FURTHER RESOLVED that the governor is urged and requested to implement as soon as possible any such initiatives passed by the legislature.

BE IT FURTHER RESOLVED that the long-term structural change that may be introduced by the legislature, with support requested of the governor, include but is not limited to the following:

(1) Amend the expenditure limit to ensure government does not grow beyond the revenues from short-term tax policies as the long-term tax policy is considered.

(2) Give the governor and legislature more authority to use dedications when a deficit is projected to cure the budget imbalance.

(3) Continued collaboration between the executive and legislative branches to improve the capital outlay process.

(4) Institute measures to ensure that agencies are continuing to work towards the most efficient and effective operations possible, including but not limited to an examination of departmental structures, processes, civil service procedures, procurement, and the use of

technology.

(5) Create a comprehensive plan to improve health outcomes and control costs in the Department of Health and Hospitals, including but not limited to efficiencies and oversight in the administration of programs, enrollment, and enrollee cost sharing, with a focus on the Medicaid program.

(6) Higher Education reforms to better prepare Louisiana's students for today's workforce and ensure that the state has the most efficient and effective structure to accomplish that goal.

(7) Pension system improvements that will lower Louisiana's unfunded accrued liability and create a more modern system that benefits workers and taxpayers.

(8) Smart-on-crime legislation to save costs while improving public safety that focuses on rehabilitation, re-entry, and workforce training, especially for nonviolent offenders.

(9) A review of state boards and commissions to eliminate duplication of functions and services, streamlining operations, and reducing red tape for businesses and citizens alike.

(10) Measures to ensure the efficiency and effectiveness of all tax expenditures, including reporting and appropriating.

(11) Continue efforts to evaluate contracts in terms of transparency, cost, duplication of work, and effectiveness.

BE IT FURTHER RESOLVED that a suitable copy of this Resolution be transmitted to the governor.

SPEAKER OF THE HOUSE OF REPRESENTATIVES

PRESIDENT OF THE SENATE

### Additional perspectives on state budget management

Over the years, Louisiana has adopted what are considered sound tools and best practices for fiscal planning. Among the tools in place are multi-year revenue projections, fiscal notes, consensus revenue forecasting, a non-partisan professional legislative fiscal office, a Rainy Day Fund and regular revenue and spending status reports. There are still things that can be done, however.

While Louisiana has a Rainy Day Fund – the Budget Stabilization Fund – it could be strengthened, revised – looking at requirements for replenishing, accessing, contributing to the fund as well as current caps on its use. (See Pew Charitable Trust extensive 50-state study.) A healthy fund is looked upon favorably by Moody’s and Standard & Poor’s. They give top scores to states with savings equal to or greater than 10% and 8%, respectively of annual revenue or spending. The Government Finance Officers Association recommends even higher balances of up to two months’ worth of operating revenue or expenditures. Capturing unexpected growth for a rainy day is a smart strategy for states regardless of how dramatically revenue fluctuates over the course of the business cycle. The Rainy Day Fund should keep pace with inflation and the state’s economic growth. Virginia, for example, deposits 50% of above-average revenue growth into the fund thus stopping the state from using all of the above-trend revenue – largely one-time - to fund program expansions.

Another potential area to look into is multi-year projections of state governmental service costs just like the state does in the area of revenue projections. It is a best practice used by other states to give officials and the public an idea of what the cost of state programs may be in future years. With both revenue estimates and service projections, states can better monitor whether revenues and service requirements are keeping up and whether adjustments need to be made. Under current state law, consensus estimating conferences exist to project multi-year spending requirements in specific areas of state government as well as to project economic and demographic trends data. Conferences include those for education, criminal justice, health and social services (with a subcommittee on Medicaid), transportation and Group Benefits. But information has not been forthcoming. The conferences have not been used as intended with few people knowing they even exist. Unlike the Revenue Estimating Conference, there is no requirement that the conferences’ projections be used in formulating the budget. Better use of the conferences to project spending would help put into focus what’s projected to happen between revenues and program requirements and make it more evident to legislators and the public what is going on and what is driving costs.

The state needs better oversight of its various tax expenditures such as tax credits, deductions, and exemptions that reduce state revenue. In many ways, they function as spending through the tax code. States can regularly publish tax expenditure reports (La. does) which lists each tax break and its cost. And states can enact sunset provisions so that tax breaks expire in a specified number of years unless policymakers choose to extend them. The last Tax Exemption Budget published by the Department of

Revenue showed 192 exemptions cost the state nearly \$3 billion in sales taxes last year while the treasury collected \$2.6 billion. That's an example of legislatively created tax breaks that have lessened available revenue to provide state government services. Louisiana has the potential for sufficient revenues to fund services but, instead, large sums of money are taken out of the equation for exemptions, exclusions, deductions, credits. A cost-benefit analysis is needed.

The use of one-time, or non-recurring, money to fund ongoing state expenses has exacerbated Louisiana's budget woes and provided a false picture of the state's financial health. It is one of the budget areas in which the state must clean up its act. The use of one-time dollars escalated in recent years plugging budget holes and disguising how insufficient recurring revenues were in the ability to keep existing services funded. The non-recurring dollars used in the FY 16 budget hit a high of \$826 million. That meant \$826 million in recurring revenues would have to be found in order to keep existing services maintained in the FY 2016-17. That's the situation that existed when the Edwards administration took office. In its first budget, the administration ended the practice of relying on one-time funds for recurring needs – a step the task force recognized as a best practice that needs to be continued. The administration has committed to avoid budget practices that allow spending beyond available recurring revenues recognized by the Revenue Estimating Conference.

With so much of the state budget dedicated either by the Louisiana Constitution or by statute, it's time to look at those earmarks to determine if they are still warranted or at the least can be adjusted to provide more budget flexibility within the dedicated purpose. A review of dedicated funds should be done to determine if the uses outlined in law could be expanded yet still fulfill the purpose of the dedication.

Through Executive Order JBE '16-05 and House Concurrent Resolution 2 of the First Special Session of 2016, the Edwards administration has launched a review of all state contracts, meeting with some success in eliminating, consolidating and renegotiating pacts. There should be a continued analysis of state contracts with the idea of eliminating those that are non-essential and reducing costs of others where possible. The top 50 contracts represent 72% of the contract spending, including the billion dollar public-private partnerships to manage LSU hospitals and Medicaid managed care pacts with five insurance companies. Forty-three of the 50 top contracts are for three or more years. The contracts represent a move toward privatization and many involve work that (a) state employees do not have expertise to perform and-or (b) necessitate an expanded workforce. Savings can be accomplished but not to the extent some think. The commissioner of administration has indicated that the annual budget process is the most effective and appropriate mechanism through which to right-size the state's contracting, and has committed to undertaking this review during budget meetings with departments. The Administration recognizes that there will be some contracts that should be eliminated. Others do provide critical services which must be continued but may be suitable for right-sizing through efficiencies.

### Guidelines for sales tax exemptions

The Public Affairs Research Council of Louisiana (PAR) is providing this set of guidelines to help navigate the complex web of sales tax exemptions in Louisiana.

The full sum of Louisiana's approximately 200 sales tax exemptions was valued at about \$2.8 billion before the temporary tax changes of 2016. Taxes should be broad based at low rates. Exemptions work against that principle. PAR recommends sorting through the exemptions to identify those that should be cut and to produce at least some modest savings to the state and a cleaner list of exemptions. A good way to proceed is to establish categories and guidelines that would make this task consistent and fair.

Other studies have assisted this process. The Revenue Study Commission of 2012-13 held hearings on sales tax exemptions. Although no action followed, the Commission did encounter an assortment of exemptions that did not appear to have a vocal constituency. More recently, Rep. Julie Stokes and the Sales Tax Streamlining Commission are making an effort to sort through the sales tax exemptions and are working with spreadsheets to categorize exemptions and work toward realistic solutions.

Their first priority is to identify those exemptions that, for one reason or another, are not considered taxable. For example, services are not generally taxable in Louisiana, but some services might be listed as an exemption from sales tax all the same. To cut such an exemption legally, the Legislature might have to expand the sales tax base or change the definition of what is taxable. Furthermore, many exemptions are designated as "exclusions." Some exclusions may fit well into the category of those things that are not taxable. But Stokes has found that many "exclusions" could and should be eliminated.

The streamlining commission is also taking into consideration whether both state and local governments exempt a particular item. Eventually, the current decentralized state and local sales tax collection system could be streamlined more easily if a more common sales tax base were established.

Five exemptions account for half the total value of sales tax exemptions. These include the constitutionally protected sales of "food for home consumption", prescription drugs, and residential utilities. These items are not taxed by the state, creating \$926 million in exemptions as measured under the 4% sales tax as of 2015, according to the most recent Tax Exemption Budget from the Department of Revenue. Gasoline and diesel fuel are levied as an excise tax rather than a sales tax, but the state nevertheless counts that as a sales tax exemption valued at about \$313 million. Tax-free purchases by state and local governments provide an exemption worth more than \$200 million.

A large collection of exemptions is grouped under the category "other exemptions" with a staggering \$800 million value in the most recent Tax Exemption Budget, or nearly 30% of total exemptions. Here is

where the hardest work has to be done. Among the variety of exemptions in this category, no one knows precisely how much each one is costing the state because businesses reporting one or more of these exemptions have not been required to identify which particular exemptions are being taken on the tax form. Recently, the Department of Revenue has revised its business sales tax forms and its process in an effort to collect better information on such “other exemptions.”

In some cases, such as for tax-free purchases by non-profits, there may be practical reasons for the difficulties in collecting information at the retail level. Tracking of every exemption in the “other” category may not be necessary, and consideration should be given as to whether tracking requirements might impose an overly complicated reporting system for retailers. Still, the lack of information is a problem for those who want to weed out unnecessary exemptions.

Tax reformers should make the following considerations in deciding which sales tax exemptions should be kept or disposed.

Generally, PAR would allow sales tax exemptions to remain if:

- The exemption protects the U.S. Constitution’s “commerce clause.”
- The exemption covers something that likely is not taxable even if the exemption were removed. This might include exemptions put into law as the result of a legal clarification or a court decision regarding what is considered taxable, among other possible reasons. (If the Legislature wants to tax these things, then a new law may be needed to expand the tax base or to change a particular definition.)
- The exemption protects a business or individual from an onerous form of double taxation.
- The exemption presents a clear and compelling issue of economic and business competitiveness for the state, or the lack of an exemption would clearly shut down or drive a type of business or industry out of the state, resulting in no tax collection anyway. Agricultural raw products, for example, would fit into the category of exemptions that help preserve Louisiana’s competitiveness.
- The exemption prevents tax pyramiding, such as taxation at each level of manufacturing or processing. However, the Task Force would define tax pyramiding narrowly.

Some people want sales tax exemptions based on personal and political values or on evaluations of the household economic impact. In the interest of preserving low rates and a broad tax base, these exemptions are not advisable even though their popularity is understandable. These would include exemptions that foster progressive tax policies and exemptions for charitable causes, such as Habitat for Humanity’s purchases.

### **Additional Perspectives on State and Local Relations, Specific Obligations**

We can attempt to put price tags on the state's support for local government. For example, this year the Minimum Foundation Program allocation is \$3.67 billion, or about 65% of public school costs, according to the Department of Education. Additionally, we could count more than \$525 million in annual subsidies and revenue sharing arrangements, including: \$90 million each year for the Revenue Sharing Fund; \$124 million in supplemental pay for firefighters, sheriff deputies, police officers and constables; \$60 million for the Parish Transportation Fund and the Highway Fund No. 2; about \$100 million spent on average each year for local capital outlay projects; \$131 million in video poker revenue sharing, severance and royalty taxes and state hotel sales taxes; and \$23 million for senior centers related funding. (For context, Louisiana spends about \$510 million a year in state money on prisons. The state support for the budgets of social services, environmental quality, the workforce agency, veterans and culture and tourism all combined is \$484 million.)

The price tag would grow much larger if we included the direct and indirect benefits of state support for charity and rural hospitals, the community and technical colleges, the department of transportation's state road work that primarily benefits locals, sheriffs whose departments benefit financially from housing inmates, insurance taxes dedicated to local pension costs, and the inventory tax credit. And a yet larger price tag would include money from among the many other state fund dedications that benefit local jurisdictions. The point here is that many of these programs may indeed be worthwhile, but the reality is that the locals' reliance on the state is enormous and is valued at many billions of dollars.