HCR11

Summary of the Recommendations of the HCR11 Task Force

The **Task Force on Structural Changes in Budget and Tax Policy** was created by House Concurrent Resolution 11 in the first special session in March 2016, authored by Rep. John Schroder (R-Covington). The 13-member body included members of the Governor's cabinet, local elected officials, economists from academia, representatives of the business community and labor unions, and good government groups. The Task Force was given a broad mission to study and recommend changes to the state's tax laws and the structure and design of the state budget.

Beginning in March, the HCR11 Task Force began holding regular meetings, convening hundreds of hours from the spring to the fall. The final report and recommendations were submitted to the Legislature on November 1, 2016. While the report makes a handful of recommendations related to the state budget, the overwhelming majority of the time and focus of the Task Force was to overhaul the state tax code. Of note, no changes were suggested for excise taxes (tobacco, liquor, beer, wine), gaming taxes or fees, severance or mineral taxes, or gasoline.

On state **SPENDING**, the Task Force made generalized recommendations such as avoiding budget practices that allow spending beyond the available recurring revenue, continuing to identify opportunities to eliminate, streamline, consolidate, or outsource government services, and consideration for reducing some commitment to local government if they are empowered to raise additional local revenue. The Task Force also suggested staggered sunset dates on non-constitutional dedications, the potential merger or elimination of certain state funds, and stabilizing the budget from surges in mineral or corporate income tax revenue.

On the **SALES TAX**, the Task Force recommended reducing the temporarily high rate back to four percent, authorizing local rate increases by local vote, eliminating certain exemptions, aligning the state and local government base, and expanding that base to include some services and digital products. The following elements affect the business community in particular:

- A uniform system of tax administration, collection, and auditing;
- A state sales tax on non-residential utilities;
- A state sales tax on manufacturing machinery and equipment (MM&E) with a newly created rebate; and
- The permanent repeal of various exemptions that were temporarily removed in the 2016 sessions, including pollution control devices, repairs of drilling rigs, and purchases of consumables by paper and wood manufacturers, among others.

On **PROPERTY TAX**, the Task Force recommended maintaining the homestead exemption at the current level and suggested a number of changes that affect the business community in particular:

- A permanent role for local government going forward in granting the industrial tax exemption, if approved by voters in a Constitutional Amendment, and a statutory 80 percent cap on renewals of the exemption, which would also be limited to three years;
- A phase-out of the inventory tax over ten years with a simultaneous five-year phase-out of the inventory tax credit, if approved by voters in a Constitutional Amendment that may also allow for a roll-up of existing millages to offset the revenue reduction to local government;
- A phase-out of the ad valorem tax credit for natural gas over five years;
- Review and maintenance of the ad valorem tax credit for offshore vessels and for telephone company property; and
- Expanded use by local governments of payment in lieu of tax arrangements ("PILOT").

On **CORPORATE INCOME AND FRANCHISE TAX**, the Task Force acknowledged that a number of changes have been made in 2015 and 2016 that are now in the implementation phase, such as changes to the credit for taxes paid in other states, a new apportionment formula, and an add-back law that is now in the rule-making process. As a result, several studies were suggested with 2019 deadlines, including a possible move to combined reporting and the exemption for interest and dividend income. Other major suggestions include:

- Support for the Constitutional Amendment to eliminate federal deductibility and move to a flat tax, although voters subsequently rejected the change on the November 8 ballot by a vote of 56 percent to 44 percent;
- Restoration of the full carry-forward of the Net Operating Loss deduction;
- A study to restructure, phase-out, or eliminate the franchise tax with alternatives to replace this revenue source; and
- Sunsets in 2021 and 2022 on Louisiana Economic Development tax credit and rebate incentives, enhanced monitoring and reporting by independent third parties, and specific recommendations for higher wage requirements in the Quality Jobs program, restructuring of the R&D credit, and a front-end cap with non-refundability for motion picture tax credits.

On **INDIVIDUAL INCOME TAX**, the Task Force recommended expanding the income tax base by eliminating most exemptions, compressing the tax brackets, and potentially lowering the rate by 25 percent if the plan is approved by voters in a Constitutional Amendment. The following elements affect the business community in particular:

- Elimination of the deduction for federal taxes paid and the exclusion for private-sector retirement income;
- December 2019 sunset for most exemptions and credits, including net capital appreciation; and
- The same recommendations on Louisiana Economic Development incentive programs as outlined under corporate income and franchise tax above as it relates to individual income tax, as well as the elimination of “underutilized or inactive” programs.

The objective of the HCR11 Task Force plan is commendable: a revenue system that is fair, simple, competitive with other states, and stable over the long run. In large part, the recommendations meet these principles by seeking lower rates and a broader base, which LABI has long supported for a transparent and competitive tax system.

However, the Task Force fell short on its stated objective of economic competitiveness. The 10-year phase-out of the inventory tax and a gradual move toward unified sales tax collection represent substantial improvements for economic development. However, the progress is in part offset by the proposed taxation of business utilities, potentially at the state and local level, and the imposition of a state manufacturing machinery and equipment tax with a rebate likely subject to annual debate for reductions or elimination. The vast majority of states do not have an inventory tax, nor do they tax manufacturing utilities or equipment, and all but two already have centralized collections.

The HCR11 Task Force plan is intended to meet an assumed $12.5 billion target for taxes, licenses, and fees that the state will need to generate in Fiscal Year 2019 to meet the spending patterns set by the Legislature. Based on current five-year projections, the spending rate in state government will continue to grow between three and four percent annually. It is unclear if the recommendations of the Task Force will grow at that rate, or at the historic rates more akin to the growth in the economy between one and two percent maximum in recent years. The tax code is only half of the budgetary challenge; spending realities must be confronted in a holistic and rigorous way, as well.

Getting the long-term solution right is absolutely critical as the Louisiana economy struggles through a recession. A predictable and stable tax climate and state budget is in the best interest of both the public and the private sector. In 2017, comprehensive tax reform with lower rates and a broader base that acknowledges the necessity for job growth should be accompanied by comprehensive budget reform with fewer dedications, scrutinized spending, and better prioritization of limited dollars.