Business is Paying More than Its "Fair Share" in Louisiana

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Louisiana's business climate faces well-documented, perennial challenges: an unfriendly legal environment, an under-skilled workforce, and an unnecessarily complex tax system, among others. Louisiana's business tax climate is currently ranked #44 in the nation as a result of this complicated framework as well as the imposition of numerous taxes on businesses that other states do not impose. The inventory tax, high state and local sales taxes on business inputs such as utilities and manufacturing machinery and equipment (MM&E), and an expanding franchise tax top the list of uncompetitive taxes imposed on Louisiana businesses.

Louisiana business taxes are estimated at **$10.1 billion annually for state and local government.** In fact, **Louisiana ranked #1 in the nation for the annual increase in state and local business taxes** from 2016 to 2017 – largely as a result of action by elected officials to increase collections of corporate income and franchise tax, raise the sales tax rate, and expand the business inputs to which sales tax applies. An executive order in 2016 also significantly limited the Industrial Tax Exemption Program (ITEP), resulting in no financial benefit to the state but requiring increased property tax payments to local government.

The Council On State Taxation (COST) reports that business taxes grew two percent on average across the U.S. while **increasing an estimated 12.5 percent in Louisiana**. For a closer comparison, Texas grew state and local business taxes by 3.3 percent, while Mississippi and Arkansas reduced by 0.6 percent and 0.9 percent respectively.

National data confirms the sizeable increase in business taxes projected by the Louisiana Legislative Fiscal Office in each of the more than 30 bills passed by the Legislature raising business taxes from 2015 to 2018. (See attached spreadsheet.) In just three years, **the totality of this legislation required an additional $3.2 billion from Louisiana businesses** for the operations of state and local government. While some of these changes were temporary, more than 20 bills made permanent changes to Louisiana tax policy to drive up tax revenue from employers. Unfortunately, **most of the new tax policy has only served to further complicate and burden Louisiana businesses, as state rankings for tax competitiveness fall even further**.

COST data indicates **Louisiana businesses pay 40 percent of all state taxes and 58 percent of all local taxes** for a total of just under half of all taxes collected in Louisiana (49%). Of note, **Louisiana businesses fund state and local government <u>at or above</u> the national average,** where businesses pay 38 percent of state taxes, 52 percent of local taxes, and a total of 44 percent of all state/local taxes in the United States.

In addition to the three major categories of property, sales, and income tax examined in detail below, large categories of business taxes in Louisiana include **severance tax, excise taxes, and business and occupational licenses,** totaling hundreds of millions of dollars annually for state and local government.

A CLOSER LOOK AT BUSINESS SALES TAXES

In recent years, **business paid an estimated 47 percent of all sales taxes collected in the state.** Businesses in Louisiana pay sales taxes on everything from office equipment to certain cleaning services to some software. A Louisiana manufacturer, for example, pays sales taxes on processing chemicals, gaskets and cables, filters and timing belts, security equipment, uniforms, office supplies, trailer and forklift rentals, cranes and tank rentals, vehicle repairs, and more.

Sales taxes make up 37 percent of all taxes paid by business in the state, when on average nationally, sales taxes make up only 21 percent of the business tax burden. Louisiana businesses paid an estimated $3.7 billion in sales taxes to state and local government in 2017.

Louisiana is one of only three states to receive an F in a national sales tax scorecard. Including Louisiana, only two states in the country imposed a sales tax on manufacturing raw materials in 2018, only nine states taxed manufacturing machinery and equipment, and just 12 states taxed manufacturing utilities. Before and after the temporary sales taxes enacted in 2016, businesses in Louisiana are subject to the **highest local sales tax in the nation on manufacturing machinery.** LSU economists predict an increased MM&E sales tax in Louisiana would lead to a **potential loss of $19 billion in planned projects** and the immediate reduction in maintenance and turnarounds, resulting in $6.9 billion in lost earnings for workers and **$414 million in foregone state taxes.**

To quote the Tax Foundation: "[Not taxing business inputs] is not because businesses deserve special treatment under the tax code, but because **applying the sales tax to business inputs results in multiple layers of taxation** embedded in the price of goods once they reach final consumers, known as 'tax pyramiding.' The result is higher and inequitable effective tax rates for different industries and products."

Furthermore, Louisiana is one of only two states that continue to allow **local jurisdictions to collect and audit sales taxes,** and the state has an estimated 370 separate sales tax jurisdictions. In the aftermath of the *Wayfair* decision by the U.S. Supreme Court, it remains to be seen if local governing bodies will move toward centralized collections in order to collect revenue from online sales – and if that same reform will be extended to brick-and-mortar businesses.

A CLOSER LOOK AT BUSINESS PROPERTY TAXES

Similarly, despite political rhetoric that tax incentives have negated all business property tax, **32 percent of taxes paid by business in Louisiana is for property tax,** which is slightly lower than most of the nation (39%). **Louisiana businesses paid an estimated $3.2 billion in property taxes** in 2017.

The Louisiana Tax Commission estimates business pays the majority of property taxes collected in the state. Even without agricultural and timber lands utilized in commerce, Louisiana businesses actually pay property tax at a rate 50 percent higher than individuals. Unlike homeowners, the inventory, machinery, equipment, and even office furniture of business is also taxed.

Louisiana is one of only 10 states with a statewide inventory tax assessed on tangible personal property used in a business. Examples of taxable items include retail or wholesale merchandise, commodities from farms, repair parts, and manufacturing by-products, among others. In 1991, in a major step to make the state more competitive for business investment and jobs, the Louisiana Legislature authorized a state refund of the local inventory tax paid by such businesses, which has since been diminished to 75 percent with limited refundability. In essence, the state has chosen to subsidize local governments, allowing them to keep the revenue from this uncompetitive tax estimated at roughly $500 million annually.

The hottest topic in business property taxes is the Industrial Tax Exemption Program (ITEP). In June 2016, Governor John Bel Edwards initiated seismic changes with an Executive Order to the temporary local property tax exemption for new and growing manufacturers. The newest version of the rules limit the amount of the exemption and the work that qualifies for the exemption, while authorizing local government to create their own policies to approve or reject the abatement in addition to the state. **A patchwork of policies and authorities has led to widespread confusion among employers and local government alike.** (See LABI's February 2019 policy brief on ITEP.)

Despite these major changes, critics continue to spread misinformation and insist that more taxes should be collected from Louisiana employers. Parishes with high levels of ITEP tend to have higher property tax collections per capita, higher sales tax per capita, and higher wages than other areas of the state. **Thirty-nine states offer incentives to manufacturers that are similar to the new version of Louisiana's ITEP with similar exemption periods and percentages.** In fact, 26 states offer a version of ITEP to other industries, not only manufacturers.

A CLOSER LOOK AT CORPORATE INCOME TAX

The focus of much attention in recent legislative sessions is the **corporate income tax,** which totaled $478 million in the Fiscal Year 2018 when combined with the **franchise tax.** It should be noted that corporate income tax is a volatile revenue source in every state and makes up just 3.7 percent of all state and local tax revenue; it currently makes up one percent of tax revenue in Louisiana.

A major reason that corporate income tax collections appear low nationwide is because the vast majority of American businesses – sole proprietorships, LLCs, and other partnerships – pay income taxes as individuals, **passing business income through to their individual income taxes** and not through the corporate tax. In fact, the Tax Foundation reports that U.S. pass-through businesses now make up 92% of all businesses, accounting for more than half of business income in the country, and employ more than half the private-sector workforce. The tax revenue from these enterprises is collected and reported as individual income tax.

Corporate tax exemptions are frequently blamed for Louisiana's current budget crisis. Exemptions have been necessary in Louisiana to overcome poor tax policy and **a high corporate income tax rate** as well as the imposition of the franchise tax on top of that, which only 14 states impose.

Louisiana's franchise tax was increased and expanded to even more companies in 2016 and must be paid regardless of profitability; the **franchise tax rate itself is the second highest in the nation.**

While all Louisiana exemptions experienced a period of significant growth over the past decade, recent years are very different. New Louisiana Department of Revenue data shows that, while individual income tax exemptions continue to grow, corporate exemptions are down significantly after changes by the Legislature and administration went into effect. Since 2015, **all corporate income tax exemptions are down 25 percent.**

Specifically, the inventory tax credit is down 45 percent; the Net Operating Loss deduction is down 49 percent; and the exemption for the sales tax on business utilities has dropped by a whopping 86 percent, among others.

Corporate exemptions have <u>not</u> and do <u>not</u> make up the majority of tax exemptions. In 2017, Louisiana granted $2.4 billion in sales tax exemptions, $2.1 billion for individual income tax exemptions, and $1.7 billion in corporate exemptions – where there is much more to the story.

Of the $1.7 billion in corporate tax exemptions in 2017, **more than half a billion dollars stems from the Sub-Chapter S Corporation exemption.** This category of businesses report income on their personal income taxes and not on corporate income taxes; this is an accounting exemption that must exist to avoid double taxation. That brings the total down to $1.2 billion in corporate exemptions.

Another major corporate tax credit is **the $293 million credit for the partial reimbursement of inventory taxes paid to local government** – a tax that penalizes investment and growth and is only collected in 10 states. In effect, businesses loan funds to local government and are later reimbursed by the state. When this credit is removed, the total exemptions for corporate income and franchise tax drops to $900 million.

The third largest corporate tax credit is for **Net Operating Losses (NOLs) at $247 million,** which accounts for cycles of business profits and losses in an attempt to smooth out income tax payments over time. NOLs are part of the tax code in every state that levies income tax; the federal government defines NOLs as an accounting practice and historically does not even consider it in the annual federal tax expenditure report. That drops the total exemptions for corporate income and franchise tax to $650 million.

Another major corporate exemption is **the deduction for federal income taxes paid, which was $203 million for businesses** but $828 million for individuals. In 2016, Louisiana voters rejected the repeal of this deduction for businesses, which would have also triggered a lower rate for corporate income taxes. Without this tax deduction, corporate income tax credits would total $450 million. (Half of the remaining balance is for the film tax credit at $205 million.)

Without just these four categories of tax deductions – which are present in nearly every state that levies income taxes – corporate tax credits are roughly $450 million total in 2017. Again, compare this to individual income tax credits, which total $2.1 billion, or to all of the taxes, licenses, and fees collected by the state, which totaled more than $12 billion in 2018.

In 2017, Governor John Bel Edwards publicly stated that 129,000 of 149,000 corporate tax filers annually paid no taxes to the state. In fact, the Department of Revenue data shows that 48,000 of these filers paid taxes as S-Corporations on their personal income tax returns. Additionally, the governor's annual snapshot ignored the state and federal NOL deduction, whereby companies nationwide weather economic downturns. Not only is Louisiana in a recession, but both hurricanes and major flooding events have impacted the profitability of tens of thousands of businesses in recent years. Finally, the share of Louisiana corporate filers with $0 taxes is consistent with national percentages, and nearly all of the 149,000 filers were still subject to the franchise tax even when they had no profits.

The full picture shows that Louisiana businesses are paying more than their "fair share." In an overly complex tax code, corporations are being treated much the same as individuals when it comes to exemptions, while **paying above the national average share of state and local taxes overall.**

Sources:

2019 State Business Tax Climate Index. The Tax Foundation
Tax Exemption Budget 2017-2018. Louisiana Department of Revenue
Total State and Local Business Taxes, November 2018. Council on State Taxation
The Best and Worst of State Sales Tax Systems, April 2018. Council on State Taxation
Fiscal notes from the Louisiana Legislative Fiscal Office from 2015 to 2018