NEW TAX BURDENS ON EMPLOYERS

APRIL 2016

OUTCOMES FROM THE 2016 FIRST SPECIAL SESSION OF THE LOUISIANA LEGISLATURE

LABI Louisiana Association OF BUSINESS AND INDUSTRY

Shortly after inauguration, Gov. John Bel Edwards called the Louisiana Legislature into a special session on fiscal reform in order to address a multi-year deficit in state government. In early 2016, the Legislature voted for two dozen bills that raise more than $3.5 billion in new tax revenue from individuals and employers over the next five years. The new laws close most of the gap in the current fiscal year, although a $750 million deficit remains for Fiscal Year 2017 at the time of publication.

For the business community, the combined impact of taxes raised in the 2015 and 2016 legislative sessions is estimated as follows:

$575 million
tax increase on employers in FY16

$1.18 billion
tax increase on employers in FY17

$1.27 billion
tax increase on employers in FY18

Legislators convened in accordance with a defined call from Gov. Edwards and a short timeframe for major decisions that ultimately led to a temporary approach rather than comprehensive reforms to budgeting or tax policy. Increases and expansions of state sales taxes and corporate income and franchise taxes were the primary mechanisms enacted into law to raise more than $3.5 billion over the next five years. Officials focused on raising new revenue as quickly as possible to resolve the immediate mid-year deficit while also utilizing short-term "one-time" money and some budget reductions to close the gap in Fiscal Year 2016.

Shortly after taking office, Gov. Edwards announced his administration's "menu of options" to address the deficit with **roughly two dozen concepts that focused almost exclusively on raising new revenue.** The governor emphasized the urgency of the situation, particularly the mid-year deficit as only a few months remained in the fiscal year. The Legislature subsequently convened Feb. 14 to March 9 and passed the majority of the governor's proposals in some form or fashion.

When the Legislature met on Valentine's Day, the deficit target for the current fiscal year was an estimated $950 million from within the state's total annual budget of $24 billion and General Fund budget of $8.4 billion. This mid-year deficit was not the first of the fiscal year; state officials took steps to partially eliminate an estimated $500 million mid-year deficit in November 2015 as well. Legislative economists point to negative corporate income tax collections, flat sales tax collections, extremely low oil and gas prices, and unanticipated government expenditures as reasons that Louisiana's mid-year deficit in Fiscal Year 2016 grew to $950 million.

Fiscal Year 2016 mimicked prior years for Louisiana state government, as officials have faced recurring mid-year and annual deficits resulting from a combination of lower than anticipated tax revenue and growing costs to operate state and local government. (LABI's Budget Basics research series has considerable background information on the causes of the state deficit and can be found at www.labi.org/budget-basics.)

2016 was also not the first year that officials attempted to raise revenue to address the state's budget challenges. **In 2015, the Legislature passed more than a dozen bills that mostly affected the state's employers,** raising hundreds of millions of dollars through temporary suspensions and reductions in tax exemptions and changes to the corporate tax code.

AGAIN IN 2016, STATE OFFICIALS REPEATEDLY NOTED THAT THE NEW TAXES ARE NOT A LONG-TERM SOLUTION, BUT A "BRIDGE" TO COMPREHENSIVE FISCAL REFORM.

As such, there was a limited attempt at actual tax reform, rather the legislation was mostly intended to raise new revenue – not to fix the administrative or complicated aspects of Louisiana's tax code that rank at the bottom of most states. The bulk of the new taxes will sunset on June 30, 2018. This date matches the timeframe the Legislature imposed in the 2015 reductions in tax credits, which also mostly expire on June 30, 2018.

As a result of the legislative and executive action, the mid-year deficit was closed, and the budget is again balanced for Fiscal Year 2016 as of April 1, 2016 (see table). Furthermore, the Fiscal Year 2017 deficit was narrowed from more than $2 billion to roughly $750 million solely with new revenue.

How Officials Closed the Deficit March 2016	FY16 $950 million	FY17 $2 billion
One-time revenue	$415 million	TBD
New tax revenue	$300 million	$1.26 billion
Budget reductions	$235 million	TBD

Because officials were focused on the immediate need to generate revenue, sales taxes were the mechanism selected to raise the most dollars in the quickest timeframe. Unlike income taxes, for example, the sales tax changes could trigger immediate new dollars for the state Treasury. The Legislature took a two-fold approach, raising the existing 4 percent state sales tax by 1 percent, largely without exemptions, and eliminating more than 150 statutory exemptions on the current 4 percent.

Louisiana employers pay an estimated 47 percent of all sales taxes. The approach taken by the Legislature ensures that business will pay an even greater share going forward with new sales taxes imposed on primary business inputs such as utilities and manufacturing machinery and equipment (see table). The timeframe and rates vary widely, injecting significantly more complication into an already burdensome sales tax framework.

Problematic New Sales Taxes on Industry	
Business Utilities	5% — April 1 - June 30, 2016 4% — July 1, 2016 - June 30, 2018 1% — July 1, 2018 - March 31, 2019
Manufacturing Machinery and Equipment	2% — April 1 - June 30, 2016 1% — July 1, 2016 - June 30, 2018

Of note, no legislation was passed in 2015 or 2016 relative to individual income tax or property tax. **Nearly all legislation that has been passed either raises corporate income and franchise tax or raises sales taxes.**

AS A RESULT, ALL BUSINESSES IN EVERY INDUSTRY SECTOR AND GEOGRAPHIC REGION OF LOUISIANA WILL BE SIGNIFICANTLY AFFECTED BY THE COMBINED IMPACT OF THE TAX CHANGES IMPOSED IN 2015 AND 2016.

The following page outlines the specific legislation that passed in 2016. (LABI issued a similar publication to summarize the 2015 legislation, which is available at www.labi.org.)

Business Taxes Passed in 2015 and 2016

BILL NO. AUTHOR	SIGNIFICANT NEW TAX LAWS AFFECTING LOUISIANA EMPLOYERS	FY16	FY17	FY18
2015 LEGISLATION				
Act 103 Broadwater	Eliminates the three-year carry-back option for Net Operating Loss deductions for corporate income tax and increases the carry-forward period from 15 years to 20 years.	$29,000,000	$29,000,000	$29,000,000
Act 109 Stokes	Limits availability of tax credit for taxes paid in other states from July 1, 2015, to June 30, 2018.	$34,000,000	$34,000,000	$27,800,000
Act 123 Jackson	Reduces certain corporate income tax exclusions and deductions by 28% from July 1, 2015, to June 30, 2018 (does not affect the S-Corporations exclusion). See Act 6 of 2016 for details, impact of changes to Net Operating Loss.	$17,000,000	$17,000,000	$11,900,000
Acts 125, 29 Jackson	Reduces certain income and corporate franchise tax credits and incentives by 28% from July 1, 2015, to June 30, 2018 (does not reduce inventory tax credit).	$31,500,000	$33,500,000	$27,600,000
Acts 126, 28 Jackson	Reduces certain tax rebates by 20% from July 1, 2015, to June 30, 2018; permanently excludes retail and food service from the Enterprise Zone program.	$5,000,000	$3,100,000	$12,200,000
Act 133 Adams	Provides for carry forward rather than refunds of 25% of tax credits for inventory and natural gas storage paid as ad valorem taxes to local governments (does not apply to companies with inventory tax liabilities of $10,000 annually or less). Removes refundability of various R&D tax credits.	$129,000,000	$138,000,000	$146,000,000
HCR8 Montoucet	Suspends exemptions on business utilities for 1% of state sales and use tax from July 1, 2015, to 60 days after final adjournment of the 2016 regular legislative session.	$60,000,000	$0	$0
2016 LEGISLATION				
Act 5 Montoucet	Reduces discount for timely remittance of tobacco excise tax and stamping from 6% to 5%. Effective April 1, 2016.	$550,000	$2,200,000	$2,200,000
Act 12 James	Expands the definition of the franchise tax to extend it to capital, plants, or property owned directly or indirectly by a partnership, joint venture, or other business organization of which the domestic or foreign corporation is a related party. Applies the franchise tax to LLCs if the company is taxed as a Subchapter-C Corporation at the federal level (does not apply to LLCs that are qualified and meet the eligibility rules to be taxed as Subchapter S-Corporations). Increases the rate of the franchise tax in the initial year from $10 to $110 but requires the taxpayers already in existence to pay the actual franchise tax instead. Authorizes a holding company deduction under certain circumstances. Applicable to tax periods beginning Jan. 1, 2017.	$0	$10,340,000	$89,300,000
Act 6 Broadwater	Prohibits the amount of the Net Operating Loss deduction from exceeding 72% of Louisiana net income. Effective retroactively on Jan. 1, 2016. (Bill was passed as clarification to language in Act 123 of 2015.)	$105,000,000	$105,000,000	$105,000,000
Act 7 Cox	Reduces discounts for timely remittance of alcohol excise taxes by 25%. Effective April 1, 2016.	$94,000	$375,000	$375,000

Acts 8, 30, 31 Leger	Establishes a flat 6.5% corporate income tax rate rather than the current five-tiered rate and bracket structure and would be applicable to tax years beginning Jan. 1, 2017, **if voters approve a Constitutional Amendment in November 2016** to eliminate the corporate income tax deduction for federal income taxes paid.	$0	"small amount" but unclear	$3,300,000
Act 15 White Act 26* Jackson	Caps vendor's compensation to $1,500 per month per dealer with one or more business locations in the state. Limits vendor's compensation to the original 4% state sales tax only. Effective April 1, 2016.	$3,700,000	$14,600,000	$14,600,000
Act 16 Leger	Requires corporations to add-back otherwise deductible interest expenses and costs, intangible expenses and costs, and management fees directly or indirectly paid, accrued, incurred to, or in connection with one or more direct or indirect transactions with one or more related members (such adjustments are not required if a corporation shows the item was already taxed or if the principal purpose of the transaction was not taken to avoid Louisiana income tax). Applicable to tax periods beginning 1 January 2016.	$0	"relatively small additional receipts"	"larger gain in receipts"
Act 25* Morris	Removes more than 150 exclusions and exemptions from 4% state sales tax from April 1 to July 1, 2016 (including 4% on business utilities). Removes more than 150 exclusions and exemptions from 2% state sales tax from 2 July 2016 to July 1, 2018 (but 3% on business utilities and 1% on MM&E). Removes 1% of the business utilities exemption from July 2, 2018 to April 1, 2019. Repeals $25 per cash register reprogramming credit. Largely maintains agricultural sales tax exemptions.	$59,900,000	$238,500,000	$238,500,000
Act 25 Morris	Increases the annual license tax for health maintenance organizations with enrollment greater than 55,000 individuals to be $600 for every $10,000 of gross annual premiums collected. Effective if and when approved by the Centers for Medicare and Medicaid Services.	$0	$136,600,000	$136,600,000
Act 26* Jackson	Imposes new 1% state sales and use tax from April 1, 2016, to June 30, 2018. Limits more than 125 exclusions and exemptions to the existing 4% tax, including business utilities (which will be subject to the new tax) and MM&E (which will be subject to the new tax but only from April 1, 2016 to 30 June 2016).	$100,700,000	$413,900,000	$413,900,000
Act 18 Barras	Prohibits new advance notifications for the Enterprise Zone program after July 1, 2017. Modifies the Enterprise Zone credit for which notifications are filed after April 1, 2016, to prohibit credits for hotel and employment services jobs; caps sales tax rebate and investment tax credit at $100,000 per net new job among other changes.	$0	$0	$2,000,000
Act 10 Anders	Reduces the amount of the insurance premium tax credit for insurers who invest a portion of their assets in La. financial institutions by 5% for tax years 2016 and 2017 for most payers. Removes certain Certificates of Deposit and Cash on Deposit from eligibility for the credit.	$0	$8,300,000	$8,600,000
Act 24 Ivey	Requires the Net Operating Loss from the most recent taxable year to be applied first (rather than in order of the year of the loss). Effective Jan. 1, 2017.	"depends" on size of losses	"depends" on size of losses	"depends" on size of losses
Act 23 Morrell	Changes the order for utilization tax credits to require that refundable credits be the second priority after non-refundable credits with no carry-forward position (excludes inventory tax credit from the re-ordering). Requires that transferrable credits only be claimed if acquired on or before the due date of the return. Applicable to tax periods beginning Jan. 1, 2016.	$0	$0	$0
ESTIMATED NEW TAX REVENUE FROM LOUISIANA BUSINESS:		$575,444,000	$1,184,415,000	$1,268,875,000

*Fiscal impact estimates are from the legislative fiscal notes but quantify the business share only, not the total revenue generated for the state.

Although numerous tax increases passed on employers in 2016, LABI worked with other stakeholders to stop even more harmful legislation that would further damage the state's fragile economy. The arena has now shifted from the Legislature to the administration, as the Department of Revenue attempts to interpret and enforce the complex new laws now on the books in Louisiana.

Although substantial new taxes were raised on employers, there were several especially harmful bills initially filed that LABI and the business community effectively opposed. In particular, Gov. Edwards sought to suspend retroactively all state tax credits for ad valorem taxes paid to local government on inventory in 2016. The legislation, House Bills 46 and 47 by Rep. Ted James, also would have permanently reduced the inventory tax credit to 80 percent. The bills failed to pass on the House floor 30-68. Sen. J.P. Morrell filed similar legislation but it never faced a vote on the Senate floor.

LABI ALSO CLOSELY TRACKED SEVERAL BILLS OF CONCERN TO THE BUSINESS COMMUNITY THAT WERE AMENDED OR FAILED TO PASS:

- House Bill 54 by Rep. Chris Broadwater was initially filed to **require advanced payment of sales taxes,** although it was amended several times in the legislative process. The bill passed the House 80-18 but ran out of time on the Senate floor.

- House Bills 22, 23 and 24 by Rep. Katrina Jackson were initially filed to remove the July 2018 **sunset dates from the 20 percent and 28 percent reductions to all tax credits** that passed the Legislature in 2015. The bills were successfully amended to allow the reductions to expire when the new sales taxes will sunset (also July 2018). House Bill 22 (House vote 55-26, Senate vote 26-12) and House Bill 23 (House vote 54-27, Senate vote 23-15) were enacted as amended, but House Bill 23 ran out of time in conference committee.

- House Bill 99 by Rep. Julie Stokes would have established **market-based sourcing** in Louisiana and changed **the apportionment formula for corporate income tax** to a single ratio calculation for individual industry sectors. It passed the House 85-6 and the Senate 39-0 but ran out of time for concurrence.

LABI AND OUR MEMBER COMPANIES ARE NOW FOCUSED ON UNDERSTANDING AND EXECUTING THE NEW TAX LAWS.

The Louisiana Department of Revenue began to issue guidance in the days preceding the April 1, 2016, effective date of most of the new tax legislation. The sales tax laws are complex to a record-breaking extent.

Already ranking No. 50 for sales taxes by the Tax Foundation, experts reported to media that they have "never seen anything like" this newest convoluted construct that employers and individuals are asked to follow in Louisiana.

The Department of Revenue is regularly updating guidance in response to questions and issues that arise, including a detailed spreadsheet of sales tax exemptions, timelines and rates available online.

As officials contemplate another special session, and there is a window for long-term reforms, LABI urges a comprehensive approach to:

1. **Address the overly complicated and burdensome tax code,**
2. **Contain ever-increasing costs in expensive state and local programs, and**
3. **Fix the broken budget itself.**

At the time of publication, the Fiscal Year 2016 budget is in balance. The Fiscal Year 2017 shortfall is estimated at $750 million, with $1.3 billion of the initial $2 billion gap closed with new revenue. Further budget reductions or one-time sources of income have not yet been offered for Fiscal Year 2017.

Because the 2015 and 2016 tax increases will expire in the summer of 2018, the state faces a looming cliff. Getting the long-term solution right is critical as the Louisiana economy struggles through a recession. A predictable and stable tax climate and the state budget is in the best interest of both the public and the private sector.

The special session created the **Task Force on Structural Budget and Tax Policy** composed of state and local government, economists and academics, and representatives of civic groups, the business community and unions. The task force has begun to meet weekly and is required to offer comprehensive budget and tax reform recommendations by September 2016. House Speaker Taylor Barras appointed Jason DeCuir, chair of the LABI Taxation and Finance Council, serves as a member of the task force.

Also, the Senate Revenue and Fiscal Affairs Committee has embarked on a line-by-line review of all tax exemptions. Similarly, the House Ways and Means Committee is soliciting written feedback on all tax exemptions.

LABI urges the task force, the Legislature, and the governor and his administration to consider comprehensive and long-term reforms that will truly address the reasons the state faces a perennial deficit.

1. Officials should **only raise revenue in a way that recognizes a competitive economy is critical to the success of the state and our citizens** – and take the opportunity to correct fundamental flaws in an overly complex and burdensome tax code.

2. Officials should also **seek to operate the most efficient and effective state government possible,** reforming high-cost programs and improving outcomes for taxpayers.

3. Finally, officials must **fix the budget structure itself,** allowing for real prioritization of state resources for the first time in decades. With such a substantial increase in state taxes (see below), there is simply no excuse that higher education and healthcare remain the only areas of the budget that are regularly scrutinized for reductions while billions in funding continue on auto-pilot.

LOUISIANA TAXES, LICENSES AND FEES (REC 3/2016)			
FY15	FY16	FY17	FY18
$10.47 billion	$10.69 billion	$11.66 billion	$11.91 billion

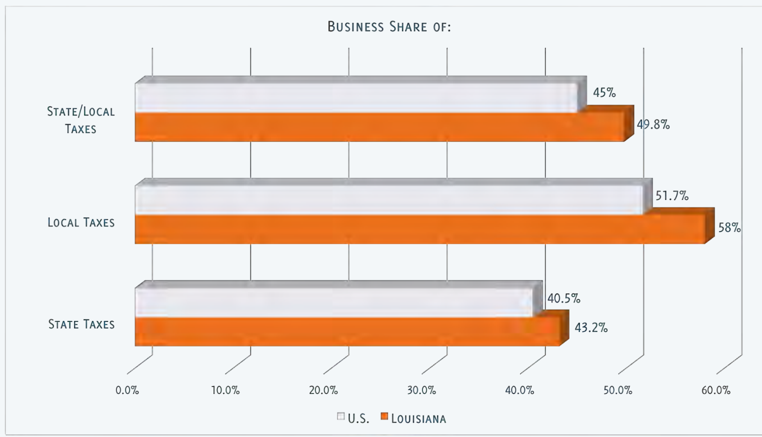
Louisiana's Business Climate: Myths versus Facts

MYTH No. 1: Louisiana has a very favorable and overly generous tax climate for business.

FACT: The Council on State Taxation reports that Louisiana businesses pay a larger share of state (43%) and local (58%) taxes than the U.S. average.

Furthermore, **the Tax Foundation ranks Louisiana's business tax climate at No. 35 overall and dead-last specifically for sales tax** due to high rates, a weak base structure, and administrative complexity. This ranking came out before the 2015 and 2016 tax changes, which arguably made the business climate even worse, especially on sales taxes.

In 2016, the Tax Foundation ranked Louisiana's corporate income tax rates, structure, brackets, base and credits at No. 38.



MYTH NO. 2: Corporate tax exemptions and credits are the primary reason for the state budget deficit.

FACT: The entire tax exemption budget is $8.3 Billion in Fiscal Year 2016. Corporate exemptions account for $2.3 billion (28%) of that total. The bulk of tax exemptions benefits individual taxpayers through income tax deductions and credits and sales tax exemptions. All categories of exemptions have grown in recent years and represent merely one challenge in a complicated state budget.

Unfortunately, corporate exemptions became necessary in Louisiana to overcome a high corporate income tax rates in the country as well as the imposition of the franchise tax on top of that, which less than 20 states impose. **Of the $2.3 billion in corporate tax exemptions, the vast majority mirror the federal tax code or are standard in the overwhelming majority of states; furthermore, the Legislature has voted to reduce or reform nearly every corporate tax credit in 2015 and 2016.**

The largest corporate tax exemption is $647 million for an accounting mechanism whereby **Subchapter-S Corporations** file taxes as individuals subject to the individual income tax rather than the corporate income tax; this represent $0 in actual credits.

The second largest corporate tax exemption is $536 million for the **inventory tax credit,** which reimburses businesses for taxes paid to the local government in a complicated system that ultimately utilizes the private sector as a middle man for a state subsidy to local government; businesses receive $0 beyond what they pay.

The third largest corporate tax exemption is $487 million for **Net Operating Losses** in a statute that closely mirrors the federal tax code and is intended to avoid penalizing certain industries that are cyclical, allowing companies to more accurately reflect profits and losses over time. (It was reduced in 2015 and 2016.)

The fourth largest corporate tax exemption is $215 million to allow corporate taxpayers to **deduct federal income taxes** when paying state taxes – the same deduction allowed for individual taxpayers. (The Legislature voted in 2016 to repeal this corporate deduction, which is subject to a popular vote on the November 2016 statewide ballot.) That leaves roughly $400 million in corporate tax exemptions for programs such as motion picture, quality jobs, and solar energy – which have all either been capped, temporarily reduced or are scheduled to sunset.

MYTH NO. 3: The sales tax increase passed by the Legislature affects only individuals, and corporations do not have to pay.

FACT: Businesses pay nearly half of the sales tax in Louisiana, including on the new tax increase. Business utilities and manufacturing machinery and equipment will be taxed under this plan, even as individual necessities such as groceries, utilities and drugs are not.

Businesses in Louisiana pay sales taxes on everything from office equipment to 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.

Only nine states in the country impose a sales tax on manufacturing machinery and only 14 states tax manufacturing utilities. To quote the Tax Foundation: "This 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.

MYTH NO. 4: The Legislature has not hit business hard enough and more must be done.

FACT: The combined effect of the 2015 and 2016 legislative sessions will increase business taxes by an estimated $575 million in this fiscal year and $1.2 billion next year and even more in 2018. All state taxes, licenses and fees in Louisiana from individuals and corporations annually total $10.5 billion this year; the 2015 and 2016 changes on corporate taxes are real and substantial sums.

While it's a disturbing fact that Louisiana corporate income tax collections are down at the mid-point of the fiscal year, legislative staff have consistently testified that they expect the impact of the 2015 legislation to take effect in the spring of 2016. We are not there yet. Legislative economists predict corporate collections will be more than $350 million by the end of June.

In 2015 and 2016, all corporate tax credits have been reduced by nearly one-quarter or nearly one-third. All sales tax exemptions that benefit the business climate have been cut or eliminated. The franchise tax has been increased and expanded to more businesses. The deductibility of corporate income taxes paid to the federal government is on the ballot this fall.

Louisiana businesses have been squarely targeted, and tax revenue for the state from Louisiana's entrepreneurs, sole proprietorships, LLCs, and small and large corporations will unquestionably increase. The only outstanding question is by how much and what damage will be sustained in the economy as a result.

MYTH NO. 5: Business is not "at the table" and refuses to offer solutions.

FACT: Over the past year, LABI and the business community has been actively working to provide solutions to the challenges facing state government. A three-part research series created by LABI, Budget Basics, contains two dozen recommendations for how the state can solve the deficit in a comprehensive manner by addressing spending, revenue, and the structure of the budget itself.

Unfortunately, the session mostly focused on revenue generation with only a handful of items in the governor's call applying to other means to resolve the problem. Recognizing the significant challenges facing the state and the critical services that should receive funding, LABI made a deliberate choice to withdraw opposition from numerous pieces of legislation that are now raising taxes on the employers of this state, including the signature item in Gov. Edwards' legislative agenda – a 1 percent sales tax increase.

Louisiana's businesses are doing our part to help solve the problem, and in fact, we are one of the only groups at the table with solutions. Local government, for example – the recipient of billions of state tax dollars annually – is largely absent from the conversation.

Furthermore, no bills have gained traction in the special or regular session to un-dedicate statutorily protected funding for niche programs, transform expensive government programs, or address the fact that spending needs will grow every year for the next five years and that legislators must take steps to allow for prioritized spending.

The state's employers stand ready and willing to assist with the current financial crisis. We will share the burden to get through these challenging times because we care about this state, our employees, and the quality of life of our citizens. At the same time, we will not shy away from opposing taxes that will undeniably have a tremendous impact on the state's economy and the jobs of thousands of people across Louisiana.