Reforming THE TAX SYSTEM in Louisiana

A Jobs and Opportunity Agenda for Louisiana

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Louisiana’s current tax system stands as both symptom and cause of the state’s prolonged economic stagnation. The balkanized system contains numerous targeted exemptions, all of which pick winners and losers through the tax code. These provisions encourage special interest lobbying, and add unnecessary complexity to the tax code for those who do not have lobbyists to advocate on their behalf—from middle-class families to struggling small businesses.

In addition, Louisiana residents in the past twelve months have faced two sizable tax increases. The first tax increase came indirectly—because the current system raises state taxes on Louisianans every time they receive a federal tax cut. Then, instead of mitigating that tax increase by passing an offsetting tax cut, the Legislature decided to impose another, direct tax increase, hiking state sales tax rates by nearly half a percentage point through June 2025.1

Many provisions of Louisiana’s tax code discourage jobs and economic activity. From taxes on capital and inventory that penalize manufacturing firms with large capital stock, to the numerous targeted preferences associated with both the individual and corporate income tax, the structure and complexity of the revenue code serves as a significant disincentive for companies, or individuals, looking to relocate to Louisiana.

With the state economy struggling, and tens of thousands of residents moving out of state, businesses and families need tax reform—to give them an incentive to come to, and remain in, Louisiana. A successful series of across-the-board reforms, touching all layers of the tax code—corporate and individual, and sales and income taxes—will promote growth and expand opportunity. Tax reform can spark an economic revolution in Louisiana—if only lawmakers take the initiative to act, and act boldly.

LOUISIANA’S CURRENT TAX AND ECONOMIC CLIMATE

Documents from the Louisiana Department of Revenue provide a snapshot of the state’s current tax structure.2 In the fiscal year that ended June 30, 2017, Louisiana’s general fund received $8.74 billion in state taxes:

- Sales taxes comprised $3.88 billion, or 44.4%, of the state’s total revenues. Sales tax revenues jumped by $979 million in Fiscal Year 2017, due largely to a two-year, one penny increase in the sales tax rate enacted by the Legislature.3
- Income taxes comprised 33.6% of state revenues, at $2.94 billion.
- Revenue from natural resources—both severance taxes ($376 million) and taxes on petroleum products ($640 million)—comprised 11.6% of state revenues, at $1.02 billion. While taxes on refined petroleum products have remained relatively constant over the past several years, severance taxes on extracted oil dropped precipitously as oil prices and production declined—from $721 million in oil receipts in Fiscal Year 2014 to just over one-third that amount ($257 million) in Fiscal Year 2017.4
- So-called “sin taxes” on alcohol ($78 million) and tobacco ($310 million) accounted for $388 million in revenue, or 4.4% of the state’s total.
- Receipts from businesses—the corporate franchise tax ($91 million) and

1  Act 1 of the Third Extraordinary Session of 2018.
3 Act 26 of the First Extraordinary Session of 2016.
corporate income tax ($274 million)—collectively comprised the smallest portion of state revenues, at $365 million, or 4.2% of total tax receipts.

Beyond that general picture, two themes emerge regarding the state of Louisiana’s tax and economic climate:

**Complexity:**
Data from the state Department of Revenue show the ways in which various tax preferences have distorted revenue collection. For the individual income tax, estimated exemptions represent 42.1% of total potential collections. This means that, for every dollar the state could collect in income taxes, over 40 cents of it goes toward targeted tax relief, refundable tax credits, and other provisions. The corporate income tax has an even higher exemption rate, at 86.3%. Because more than five in six dollars theoretically subject to corporate tax receive some type of targeted tax preference, corporate tax rates must remain far higher than otherwise needed to generate the same amount of revenue.

While most states compile their own list of tax preferences, the fact that the Louisiana Department of Revenue’s most recent version runs to 432 pages speaks to the complexity of the state’s tax code. If lawmakers decided to eliminate all these exemptions and credits, they could lower tax rates by roughly 40%, and yet still collect the same amount of revenue. In fact, by simplifying the tax code and making it easier for businesses to grow, lawmakers could collect even more revenue by broadening the base and lowering rates. This plan attempts to accomplish those objectives.

**Lack of Economic Growth:**
As the Pelican Institute has previously documented, the *status quo* is not working for Louisiana families and businesses. The economic statistics speak for themselves.

### Growth in Non-Farm Payrolls

- Anemic job growth, with an unemployment rate statistically higher than the national average. Louisiana’s growth in non-farm payrolls (1.0%) from October 2017 to October 2018 lagged below most of its neighbors, including Texas (3.1%), Tennessee (2.0%), Alabama (1.7%), Oklahoma (1.4%), and Mississippi (1.2%).

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6 Ibid.
9 Ibid.
A net decrease in population. From July 2017 to July 2018, Louisiana’s population declined by 10,840 individuals—one of only nine states to suffer a decline. The falling population came largely because 27,914 Americans left Louisiana and moved to other states, a continuation of trends from prior years.

The lowest growth in personal income nationwide in 2016, with incomes falling at an inflation-adjusted rate of 2.1%, compared to a nationwide growth rate of 2.4%.

The fastest growth in the nation in “transfer payments,” defined as “benefits received by persons from federal, state, and local governments and from businesses for which no current services are performed.”

With Louisiana residents leaving the state due to a lack of jobs and economic opportunity, the state desperately needs policies that can incentivize economic growth. Tax reform can not only help to rationalize the state budget; it can revitalize a stagnant economy.

This paper presents two options for reforming Louisiana’s tax structure: One that roughly preserves the current revenue base, and another that roughly returns the tax base to its level prior to passage of the most recent tax increase. Both would rationalize and reform the tax code in ways that will generate jobs, economic opportunity, and additional revenue from growth—without raising the net tax burden faced by Louisiana businesses and families.

**Tax Reform for Individuals**

As at the federal level, tax reform starts with a simple premise: Broaden the tax base to lower rates. A successful reform to Louisiana’s tax system would operate in much the same manner, eliminating special preferences to lower rates overall. The new federal tax bill will likely create thousands of jobs throughout the country. With companies looking for places to invest, enacting state tax reform on top of the federal legislation will accelerate those gains, injecting a long-overdue spirit of growth into the Louisiana economy and making the state more attractive to prospective employers.

**Lower Rates:**

Louisiana’s tax code applies its top marginal rate of individual income tax (6%) for all taxable income in excess of $50,000 for an individual, and $100,000 for a family. To provide a fairer tax system, the Legislature should use the additional funds generated from broadening the tax base to eliminate the 6% bracket entirely, such that the state would not tax income at a rate higher than 4%.

As with the increase in the standard deduction, this change would create a flatter, simpler, and fairer tax code, one which could generate additional economic growth for the state. According to revenue modeling by the Economic Research Center at the

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Buckeye Institute (ERC), it would provide $681 million in tax relief, before taking into account the effects of economic growth.

Another option would bring a flat tax to Louisiana, by repealing the 2% tax bracket entirely, while lowering the 6% rate to 4%. Repealing the 2% rate, in lieu of any increases to the standard deduction, would provide $1.145 billion in tax relief, before considering economic growth impacts. While this option would lower the state’s revenue base, it would also generate significantly more economic growth than the revenue-neutral option, per the ERC modeling discussed in greater detail below.

Lawmakers attracted to the flat tax, but concerned about the impact on state revenues, could consider establishing revenue triggers as one way to guard against unexpected external events. If projected revenues do not materialize—perhaps because of another fluctuation in oil prices, or general economic conditions—the rate reductions would not go into effect. However, once the revenue numbers materialize, the citizens of Louisiana would benefit from a flat, and simpler, tax code.

Increase the Standard Deduction:
Under current law, individual income tax filers in Louisiana receive a combined personal exemption/standard deduction of $4,500 for an individual, and $9,000 for a family. Filers receive an additional $1,000 for each dependent, as well as for each taxpayer who is blind or over age 65.16

Increasing the standard deduction would have two primary benefits. First, it would provide broad-based tax relief to virtually all Louisiana households, regardless of income level. At a time when the Louisiana economy continues to struggle, this provision would give struggling families needed tax relief—$316 million, according to ERC modeling.

In addition, increasing the standard deduction would simplify the tax code, by reducing tax filers’ reliance on specific tax preferences. At the federal level, tax reform has cut the number of itemizers by more than half. Whereas Congress’ Joint Committee on Taxation estimates that 48.7 million taxpayers itemized deductions in 2017, only 20.4 million will do so on their federal returns in 2018, largely due to the near-doubling of the standard deduction.17

According to the revenue and economic modeling the ERC conducted for this paper, and discussed in greater detail below, raising the standard deduction from $4,500 for an individual ($9,000 for a family) to $10,260 for an individual ($20,520 for a family) would result in a revenue-neutral reform of the individual income tax code on a static basis. This increase in the standard deduction, along with the rate reductions previously discussed, would fully offset the revenue increases from repeal of various other provisions in the individual income tax code. Any additional revenue would therefore come from economic growth, rather than an increase in the overall tax burden on Louisiana households. If other models lead to slightly different revenue estimates, lawmakers can adjust the level of the standard deduction accordingly, to ensure Louisiana families do not face a net tax increase.

Increasing the standard deduction in Louisiana will have the same positive effects as

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in the federal system. Tens of thousands, if not hundreds of thousands, of taxpayers would receive the same (or greater) tax benefit from an increased standard deduction, while utilizing a simpler tax-filing process requiring less paperwork and preparation.

Eliminate Deduction for Federal Taxes Paid:
Article VII of the Louisiana Constitution provides all residents a state-level income tax deduction for federal income taxes paid.18 This constitutional provision represents the largest tax deduction provided in the Louisiana tax code. In Fiscal Year 2017, the federal income tax deduction lowered individual income tax payments by $827.6 million—larger than the next four individual income tax exemptions combined.19

However, the passage of federal tax reform legislation will result in higher taxes for Louisiana taxpayers. Beginning in 2018, the federal law will reduce most Louisianans’ federal tax obligations, limiting the value of their state-level deduction for federal taxes paid—and increasing their state tax obligations. According to the Legislative Fiscal Office, the federal law will increase state individual income tax revenue by a total of $302 million this Fiscal Year, and $271 million annually in Fiscal Years 2020-2022.20

Ironically, Louisiana stands to benefit more than most states from the federal tax law. Whereas nationwide, an average of 64.8% of tax units will see their taxes fall in 2018, more than seven in ten (70.3%) will in Louisiana—the sixth-highest total nationwide.21 And the federal tax bill will increase after-tax income in the state by 2.1% in 2018—the seventh-highest total nationwide.22 Yet even as Washington gives Louisiana residents a tax benefit with one hand, the state will take part of that benefit away with the other.

Policy-makers have several valid reasons to support the elimination of this tax exemption through constitutional reform:23

- It would allow for a significant reduction in tax rates, particularly given the exemption’s size.
- It would help to harmonize Louisiana’s tax code with the rest of the country, as only two other states—Iowa and Alabama—allow a full deduction for federal taxes paid.24
- It would prevent a recurrence of the scenario set to transpire this year, whereby Washington allows citizens to keep some of their hard-earned money through tax relief—only to have the state capture some of the excess.

Eliminate Excess Itemized Deductions:
As part of a tax plan that passed in 2007, the Legislature re-established a provision allowing filers to deduct all of their itemized deductions in excess of the federal

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20 Louisiana Legislative Fiscal Office, “State Revenue Outlook for Revenue Estimating Conference,” April 12, 2018, http://lfo.louisiana.gov/files/revenue/RevOutlook_Apr_2018_REC.pdf, p. 4. As noted below, the $302 million figure includes the added revenue coming from both the state deduction for federal income taxes paid and the state allowance for itemized deductions in excess of the federal standard deduction.
23 In conjunction with the reforms proposed in this series of policy papers, the Pelican Institute has called for a constitutional convention focused on fiscal responsibility, to consider budget-related changes to the state’s foundational document. For more information, see https://pelicaninstitute.org/constitutional-reform/.
standard deduction.\textsuperscript{25} This provision reduced taxes by a total of $382.6 million in Fiscal Year 2017.\textsuperscript{26} However, that tax reduction will decline beginning in calendar year 2018, because the near-doubling of the federal standard deduction will reduce the extent to which taxpayers will claim excess itemized deductions on their Louisiana tax returns.\textsuperscript{27}

Several reasons suggest the elimination of this tax preference. First, a comparatively small number of households benefit from the current preference for excess itemized deductions. Only about one-quarter of Louisiana filers itemized deductions on their federal tax returns in recent years—and that number will decline, likely significantly, due to the passage of federal tax reform.\textsuperscript{28} Second, the excess itemized federal deductions taken on a Louisiana tax return can include taxes paid to the state of Louisiana—an inherently illogical position.\textsuperscript{29}

As part of its overall tax reform efforts, the Legislature should eliminate the deduction for excess itemized deductions. As with the federal law that increased the standard deduction, eliminating this preference will allow for a broader tax base and lower rates overall.

**Eliminate Other Tax Preferences:**

Eliminating the deduction for federal income taxes paid and excess itemized deductions will raise an estimated $950 million in revenue from the individual income tax. However, eliminating additional, smaller tax preferences elsewhere in the tax code should allow the Legislature to raise an additional $200-250 million in revenue, or nearly $1.2 billion in total—money that lawmakers can then use to lower rates.

**Potential Amount ($) Raised from Eliminating Deductions**

- **Federal Income Taxes Paid Deduction** - $950 million
- **Other Smaller Tax Preferences** - $200-250 million

For instance, in Fiscal Year 2017 the state lowered individual income taxes by nearly $57 million due to a credit provided to individuals who rehabilitate historic structures—a credit that has grown more costly over time.\textsuperscript{30} While the Legislature recently took steps to reduce and phase out the credit, it should instead work to repeal it entirely.\textsuperscript{31} The state’s difficult fiscal situation and the need to simplify the tax code both speak to the need to repeal this credit—and others like it.

While non-refundable tax credits, like the historic rehabilitation credit, provide a dollar-for-dollar reduction in their tax obligations, they do not allow households to receive payments over and above their income tax liability. Conversely, refundable tax credits—like the credit for the installation of solar energy systems, which the

\textsuperscript{25} Department of Revenue, “Tax Exemption Budget,” Individual Income Tax Deductions, p. 160.
\textsuperscript{26} Ibid. Top Individual Income Tax Exemptions 2016-17, p. 12.
\textsuperscript{27} Legislative Fiscal Office, “Outlook for Revenue Estimating Conference,” p. 4. Some of REC’s recorded $302 million revenue gain to the state from tax reform comes from the interaction of the near-doubling of the federal standard deduction with the Louisiana provision allowing for excess itemized deductions. However, for simplicity’s sake, and because REC did not delineate the relative weight of these two factors in arriving at its new revenue estimate in April 2018, this paper attributes all the revenue gains due to tax reform to the provision in the Louisiana Constitution allowing a deduction for federal income taxes paid.
\textsuperscript{28} Task Force on Structural Changes, “Louisiana’s Opportunity,” p. 47.
\textsuperscript{29} Ibid. p. 35.
\textsuperscript{30} Department of Revenue, “Tax Exemption Budget,” Individual Income Tax, p. 12.
\textsuperscript{31} Act 403 of the Regular Session of 2017.
Legislature has begun phasing out—allow taxpayers to receive payments from the state over and above any income tax obligations. Whereas non-refundable credits represent actual tax cuts—allowing individuals to keep more of their own money, albeit for engaging in specific government-favored activities—most budget analysts consider the refundable portion of tax credits not reductions in revenue but increases in spending.

All told, the Department of Revenue estimates that in Fiscal Year 2017, the state of Louisiana paid out $142.8 million in refundable tax credits on individual income tax returns—government spending to individuals over and above any tax obligations. The Department also estimates that the state lowered taxes by an additional $144.9 million in non-refundable credits during the same period.

When looking for places to trim individual income tax expenditures, the Legislature should closely examine both refundable and non-refundable tax credits to help broaden the tax base—or, in the case of refundable credits, reduce spending—and lower rates. Reducing or eliminating credits like the historic preservation and solar credits, along with eliminating jobs incentive programs (discussed further below) that have an impact on the individual income tax, will go a long way towards reducing individual income tax exemptions and preferences by a total of nearly $1.2 billion.

**CORPORATE TAX REFORM**

At present, Louisiana’s corporate tax code epitomizes a system of perverse incentives. Because lobbyists have managed to establish a complex system of targeted tax preferences, the state must maintain a high corporate income tax rate to generate revenue. With the economy stagnant, the Legislature should revitalize the business environment by creating a level, pro-growth playing field for all businesses, large and small, by ridding the tax code of its many programs that pick winners and losers.

**Repeal the Corporate Income Tax:**

Several factors make a compelling case for repealing Louisiana’s corporate income tax entirely. First, the tax raises a comparatively small amount of revenue. In Fiscal Year 2017, only $274 million, or about 3.1%, of the state’s general revenue income came from the corporate income tax.

Second, as noted above, the corporate tax contains far more exemptions and preferences than it generates in revenue. While the state collected $274 million in corporate income taxes in Fiscal Year 2017, the corporate income tax base comprised just

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32 Ibid.; Department of Revenue, “Tax Exemption Budget,” p. 188.
34 Ibid.
under $2 billion.\textsuperscript{36} In some years, payments to corporations via refundable tax credits exceeded income tax payments from corporations to the state.\textsuperscript{37} All the targeted tax preferences to favored companies mean that the corporate income tax must maintain high rates to generate its income. While many companies pay no corporate tax at all, some must shoulder a comparatively high tax burden, one which hinders their ability to grow.

Third, Louisiana's current corporate tax structure varies compared to most other states. The corporate code operates on a "separate entity" basis, whereby each corporation calculates its obligations separately. This structure allows corporations to pass intangible income like royalties from state to state in ways that shift profits to avoid taxation.\textsuperscript{38} While the Legislature has made reforms in recent years, the flaws inherent in "separate entity" taxation speak to the way in which the corporate tax code picks winners and losers. All this complexity raises compliance costs, particularly for small enterprises, in a way that could discourage new business formation.

Finally, the Legislative Fiscal Office notes that "corporate tax receipts have always been the riskiest of all the taxes that finance the state general fund budget."\textsuperscript{39} Moreover, myriad changes to corporate tax laws in recent years have made predicting corporate tax receipts even more difficult to predict. The Fiscal Office adds that with "the fact that one-half to two-thirds of corporate tax is routinely collected in the last quarter of the fiscal year, it is essentially impossible to forecast corporate tax collections, even near the end of the fiscal year."\textsuperscript{40}

Ideally, the Legislature would repeal Louisiana's corporate income tax. With the amount of revenue it raises small and difficult to predict from year-to-year, the tax barely generates enough net revenue to justify its compliance costs. Moreover, the top marginal tax rate of 8%, high relative to Louisiana's neighbors, discourages those businesses who do end up paying corporate taxes.\textsuperscript{41}

If the Legislature cannot repeal the corporate income tax outright, it should dramatically lower the rate by broadening the tax base. Eliminating the corporate income tax deduction for federal taxes paid (discussed above regarding the individual income tax) as well as targeted tax preferences to certain corporations would more than double the corporate tax base. This base-broadening should bring the comparatively high corporate tax rate of 8% down to approximately 3.28%.

Since 1980, countries around the globe have lowered their corporate tax rates, recognizing the benefits such reforms could have on economic growth. The average corporate income tax rate has fallen from 38.68% in 1980 to 23.03% this year.\textsuperscript{42} Moreover, some countries have eliminated corporate income taxes entirely.\textsuperscript{43} With Louisiana's economy lagging behind the national average, reducing—or better yet, eliminating—the corporate income tax would provide the state with a needed boost of economic growth.

\textsuperscript{36} Department of Revenue, "Tax Exemption Budget," Analysis of Tax Collections vs. Exemptions, p. 9.
\textsuperscript{38} Task Force on Structural Changes, "Louisiana's Opportunity," pp. 50-51.
\textsuperscript{40} Ibid.
\textsuperscript{43} Ibid.
Repeal the Franchise Tax:
Louisiana has collected a franchise tax on corporations since 1932, originally assessed in exchange for the privilege of doing business in the state. Because the tax is assessed on corporations’ capital stock, plant, and personal property in addition to any surplus or undivided profits, it applies to profitable and unprofitable businesses alike—placing a greater strain on new, capital-intensive, and/or narrow-margin firms.

The final report of the state’s Task Force on Changes in Budget and Tax Policy provided numerous valid reasons for eliminating the 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.”
- Fewer than one third of states (16) have a franchise or capital stock tax, and two states are phasing theirs out. Five states have eliminated their franchise taxes in recent years.
- Once Mississippi phases out its levy, Louisiana will be one of only seven states with an unlimited franchise tax.
- Louisiana has the second-highest franchise tax rate in the nation; only Connecticut has a higher rate, but companies based there can choose to pay corporate income taxes in lieu of the franchise tax.44

Comparatively speaking, the franchise tax generates little revenue for the state. As noted above, Louisiana saw $91 million in revenue from the tax in Fiscal Year 2017.45 While the Legislature in 2016 expanded the reach of the franchise tax—applying it to certain limited liability companies that file Subchapter C federal income tax returns—this move does not appear to have generated significant new revenue, and will only cause added complexity for small business owners.46

The complexity and burdens created by the franchise tax do not warrant the comparatively minimal revenue gain the tax generates. Moreover, economic theory indicates that removing a tax on capital, such as the franchise tax, will unleash that capital in ways that trigger economic growth—growth that can generate additional revenue. As a matter of tax policy, lawmakers should repeal the franchise tax, and any credits linked to the tax, at the first opportunity. As a matter of economic policy, they may find that doing so will generate sufficient growth to overcome much of the revenue loss from its repeal.

Inventory Tax:
Currently, local parishes impose a tax on business inventories as part of their property tax assessments. Since 1992, state government has provided a refundable tax credit to offset the cost of these inventory tax assessments.47

However, the inventory tax credit has led to an inflationary spiral for the state. Because

46 Act 12 of the First Extraordinary Session of 2016. The Task Force on Structural Changes, citing a Legislative Fiscal Office note, wrote in January 2017 that the change could generate an estimated $90 million in revenue in Fiscal Year 2018. However, the most recent Revenue Estimating Conference forecast estimates a combined $383 million in corporation franchise and income tax revenue for Fiscal Year 2018—only slightly increased from the $365 million the Department of Revenue reported in combined franchise and income tax revenue for Fiscal Year 2017. See Legislative Fiscal Office, “Outlook for Revenue Estimating Conference,” pp. 4-5.
the refundable credit effectively subsidizes parishes’ inventory tax assessments, businesses have less incentive to scrutinize inventory property assessments. As a result, inventory assessments more than doubled from 2005 through 2015, growing at a far greater rate than assessments on other forms of property. Many would argue that the inventory tax credit has encouraged parishes to inflate their inventory assessments.48

The above-average increases in inventory tax assessments resulted in higher inventory tax credit payments. By Fiscal Year 2015, the inventory tax credit, including refundable tax credit payments, cost the state a total of $570.4 million.49 That entire sum of more than a half-billion dollars represents a de facto subsidy from state government to parishes, funneled through businesses by means of the inventory tax credit.

Beginning in 2015, the Legislature acted to curb the cost of the refundable inventory tax credits to the state. Effective in Fiscal Year 2016, businesses whose inventory taxes paid exceed their income tax liability can receive a refundable credit of 75 percent of their inventory taxes paid, up to a maximum refundable credit of $750,000.50 That limitation on the refundable credit has reduced the cost of the credit somewhat; payouts in the current fiscal year will cost an estimated $325.3 million, or less than 60% of the total four years ago.51

Despite the reduction in the inventory tax credit’s cost in recent years, it remains a sizable draw on the state budget. Moreover, the credit’s structure still gives parishes an in-built incentive to inflate their inventory assessments, to maximize the amount of indirect revenue they can obtain from the state via the business community.

As discussed in a separate paper on reforming local government, lawmakers should move away from both the parish-based inventory tax, and the refundable tax credits used to help businesses offset their cost.52 The Legislature should make this transition away from such aid as part of more fundamental reforms to the relationship between state government and local governing entities.

Repeal Jobs “Incentive” Programs:
In exchange for undertaking certain economic activities, businesses receive numerous preferences in the tax code—a series of rebates, deductions, non-refundable credits, and refundable credits called tax incentives and exemption contracts. In Fiscal Year 2017, these exemptions totaled $393.2 million—a number roughly one-third higher than the total revenue generated by the corporate income tax.53

Growth in Non-Farm Payrolls

Louisiana’s Motion Picture Investor Tax Credit comprises the largest exemption contract, totaling over half ($205.8 million) of the $393.2 million spent in Fiscal Year 2017.\(^{54}\) Other similar incentives include the Louisiana Quality Jobs Program ($99.3 million), Enterprise Zones ($41.1 million), Industrial Tax Equalization Program ($14.5 million), a tax credit for digital media and software ($9.9 million), and a tax credit for musical and theatrical productions ($6.1 million).\(^{55}\)

These programs all operate under one fundamentally flawed premise—that the Legislature, or officials within Louisiana Economic Development, can determine what will bolster the economy and create jobs better than individuals and businesses. Rather than providing benefits to some firms based upon whether a project meets criteria laid out by government bureaucrats, or whether a firm can hire lobbyists to clamor lawmakers to give them special incentives, the Legislature should instead work to help all Louisiana businesses, by creating a pro-growth environment where they can thrive. Repealing these targeted tax preferences, and using the proceeds to lower tax rates, will do just that.

Most of the exemption contracts ($330.9 million of the $393.2 million) deliver benefits through the corporate income tax code—benefits that would disappear if the Legislature repeals the corporate income tax entirely. However, smaller portions of exemption contracts funnel through the individual income tax ($17 million) and sales tax ($41.3 million).\(^{56}\) The Legislature should use the proceeds from the repeal of these targeted benefits to lower rates across-the-board.

**ESTIMATING THE ECONOMIC EFFECTS OF TAX REFORM**

To estimate the anticipated effects of the tax reform plans outlined above, the Pelican Institute engaged the services of The Buckeye Institute’s Economic Research Center to model two sets of proposals.\(^{57}\) The first presupposes a broadly revenue-neutral reform package, while the second uses the opportunity to enact a more pro-growth agenda, by largely repealing the fiscal effects of the tax increase lawmakers passed a few months ago.\(^{58}\)

The first scenario analyzed by the ERC assumes the changes referenced above, including: 1) reducing the rate for the top individual income tax bracket from 6 percent to 4 percent; 2) increasing the standard deduction for individual income taxes; 3) repealing the corporate franchise tax; 4) repealing the corporate inventory tax; 5) eliminating the deduction for federal income taxes paid; 6) eliminating the deduction for excess itemized deductions; and 7) eliminating additional deductions and credits for individual income taxes.

The below table summarizes the various effects of these changes, along with the interactions among them. For instance, the above narrative referred to broadening the individual income tax base by repealing $1.2-1.25 billion in tax preferences—when measured against current law, one with a top marginal rate of 6%. The analysis below

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\(^{54}\) Ibid. Beginning in Fiscal Year 2016, the Legislature capped spending on the motion picture credit at $180 million annually; see Act 134 of the Regular Session of 2015 and Act 309 of the Regular Session of 2017.

\(^{55}\) Ibid., Tax Incentives and Exemption Contracts 2016-17, p. 14.

\(^{56}\) Ibid.

\(^{57}\) Even though Act 1 of the Third Extraordinary Session of 2018 specifies that the 0.45% increase in sales tax revenue shall expire on July 1, 2025, the Buckeye model held the current revenue baseline constant, so as not to confuse the economic effects of these tax reform proposals with the effects of the expiration of the tax increase.

does consider the elimination of the 6% tax bracket in the proposal, reducing the value of those tax preferences from $1.2-1.25 billion to $996 million. However, this statistically modeled analysis does not take into account the effects of economic growth on tax revenues.

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<tr>
<th>Tax Change</th>
<th>Revenue Gain/(Loss) (in millions of 2019$)</th>
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<tbody>
<tr>
<td>Eliminate Franchise Tax</td>
<td>(105)</td>
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<tr>
<td>Eliminate Corporate Income Tax</td>
<td>(315)</td>
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<tr>
<td>Decrease Top Individual Income Bracket (from 6% to 4%)</td>
<td>(681)</td>
</tr>
<tr>
<td>Eliminate Individual Federal Tax Deduction (with top rate at 4% and with new federal tax code)</td>
<td>447</td>
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<tr>
<td>Eliminate Individual Excess Itemized Deductions (with top rate at 4%)</td>
<td>318</td>
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<tr>
<td>Eliminate Misc. Individual Exemptions (with top rate at 4%)</td>
<td>231</td>
</tr>
<tr>
<td>Increase Standard Deduction by $5,760 for singles and $11,520 for married couples (with top rate at 4%)</td>
<td>(316)</td>
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<tr>
<td><strong>TOTAL</strong></td>
<td><strong>(421)</strong></td>
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<td><strong>With Revenue Neutral Corporate Tax Reform:</strong></td>
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<td><strong>TOTAL</strong></td>
<td><strong>(106)</strong></td>
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*Based on Louisiana Department of Revenue (LDR) Collections from 2017 and Projections for 2019

Source: Economic Research Center at The Buckeye Institute

This first scenario assumes a revenue-neutral corporate tax reform. Unfortunately, the Louisiana Department of Revenue, despite requests from both Pelican and ERC researchers, provided only incomplete information about the incidence of corporate income taxes in Louisiana. Additional information and data would have provided more clarity on the specific characteristics (e.g., small vs. large) of firms that utilize credits to reduce their corporate tax liability, and those that pay corporate income taxes.59

In the absence of specific data from LDR about the actual incidence of corporate income taxation in Louisiana, researchers from the ERC assumed that the highest net corporate income group receives disproportionately more credits than their liability. That is, the highest group has about 98% of tax liability but receives 99% of the credits, while the lower corporate income groups pay proportionally more of their liability, since they are not receiving as many credits. This assumption for taxation patterns in Louisiana echoes similar patterns at the federal level.

While the first scenario assumes the enactment of corporate tax reform on a revenue-neutral basis dynamically, the corporate tax changes will result in a very small revenue increase on a static basis. This dynamic occurs because of interactions from

59 Prior press reports have focused on the high incidence of corporate tax usage among large Louisiana firms;
the changes occurring: 1) a repeal of tax exemption contracts and other tax incentive programs, 2) repeal of the deduction for federal income taxes paid, and 3) a reduction in the corporate tax rate from 8% to 3.28%. While the reduction in the corporate tax rate leads to a sizable tax reduction for smaller businesses, larger firms suffer a tax increase resulting from the loss of relevant credits. However, larger firms’ effective tax rates increase only slightly.

These assumptions lead to the results in the below tables, which offer a dynamic analysis of the proposal’s effects on the economy and growth, and the subsequent effects on the state’s revenue base:

### BASELINE

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>Employment</th>
<th>Tax Revenue</th>
<th>Consumption</th>
<th>Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>217,616</td>
<td>2,026,638</td>
<td>9,071</td>
<td>133,972</td>
<td>46,900</td>
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<tr>
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</tr>
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<td>10,260</td>
<td>151,520</td>
<td>53,043</td>
</tr>
<tr>
<td>2026</td>
<td>251,221</td>
<td>2,149,644</td>
<td>10,472</td>
<td>154,661</td>
<td>54,142</td>
</tr>
</tbody>
</table>

### DIFFERENCE FROM BASELINE

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>Employment</th>
<th>Tax Revenue</th>
<th>Consumption</th>
<th>Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>(18)</td>
<td>500</td>
<td>(58)</td>
<td>16</td>
<td>585</td>
</tr>
<tr>
<td>2020</td>
<td>108</td>
<td>2,200</td>
<td>(58)</td>
<td>17</td>
<td>239</td>
</tr>
<tr>
<td>2021</td>
<td>149</td>
<td>2,500</td>
<td>(59)</td>
<td>18</td>
<td>151</td>
</tr>
<tr>
<td>2022</td>
<td>167</td>
<td>2,600</td>
<td>(60)</td>
<td>18</td>
<td>125</td>
</tr>
<tr>
<td>2023</td>
<td>179</td>
<td>2,600</td>
<td>(61)</td>
<td>19</td>
<td>116</td>
</tr>
<tr>
<td>2024</td>
<td>187</td>
<td>2,700</td>
<td>(63)</td>
<td>19</td>
<td>113</td>
</tr>
<tr>
<td>2025</td>
<td>194</td>
<td>2,700</td>
<td>(64)</td>
<td>20</td>
<td>112</td>
</tr>
<tr>
<td>2026</td>
<td>200</td>
<td>2,700</td>
<td>(65)</td>
<td>21</td>
<td>112</td>
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Note: GDP, tax revenues, consumption and investment in millions of 2009$. Employment in units of full-time equivalent non-farm jobs and rounded to the nearest hundred.

Source: Economic Research Center at The Buckeye Institute

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see for instance Melinda Deslatte, “Loopholes Allow Many Louisiana Companies to Skip Taxes, Says Revenue Chief.” Associated Press April 8, 2015. https://www.nola.com/politics/index.ssf/2015/04/louisiana_companies_tax_loopho. html. While both Pelican and ERC researchers requested the 2015 LDR report referenced in this article, the Department of Revenue did not provide it.
As a whole, this scenario would generate almost $50 million of tax revenue from economic growth—the difference between the $106 million revenue loss on a static basis and the $58 revenue loss after accounting for economic growth. The economic growth from revenue-neutral corporate tax reform and revenue-neutral individual tax reform will finance approximately half the cost of repealing the corporate franchise tax, making the package broadly revenue-neutral.

The second, more pro-growth plan would make three changes to the above scenario. For corporate taxes, it would repeal the income tax entirely. For individual taxes, it would repeal the existing 2% income tax bracket instead of increasing the standard deduction. However, because the 2% tax bracket applies to the first $12,500 of income for an individual ($25,000 for a family), repealing it would still effectively increase the state’s standard deduction. Moreover, combined with the first scenario’s repeal of the 6% tax bracket this change would convert the existing tax structure to a 4% across-the-board flat tax, by lowering the 6% bracket to 4% and lowering the 2% bracket to 0%.

Before considering the effects of economic growth, this scenario leads to the following results on a static basis:

<table>
<thead>
<tr>
<th>Tax Change</th>
<th>Revenue Gain/(Loss) (in millions of 2019$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eliminate Franchise Tax</td>
<td>(105)</td>
</tr>
<tr>
<td>Eliminate Corporate Income Tax2</td>
<td>(315)</td>
</tr>
<tr>
<td>Decrease Top Individual Income Bracket (from 6% to 4%) and Eliminate Bottom Bracket</td>
<td>(1,145)</td>
</tr>
<tr>
<td>Eliminate Individual Federal Tax Deduction (with top rate at 4%, 0% bottom bracket rate, and with new federal tax code)</td>
<td>440</td>
</tr>
<tr>
<td>Eliminate Individual Excessive Itemized Deductions (with top rate at 4% and 0% bottom bracket rate)</td>
<td>314</td>
</tr>
<tr>
<td>Eliminate Misc. Individual Exemptions (with top rate at 4% and 0% bottom bracket rate)</td>
<td>227</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>(584)</strong></td>
</tr>
<tr>
<td>With Corporate Tax Revenue Neutral Reform: TOTAL</td>
<td>(269)</td>
</tr>
</tbody>
</table>

*Based on Louisiana Department of Revenue (LDR) Collections from 2017 and Projections for 2019

Source: Economic Research Center at The Buckeye Institute

Although this scenario leads to a larger revenue loss on a static basis, it also results in much greater investment, economic growth, and revenue growth than the revenue-neutral reform option, as the dynamic analysis reveals.
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</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>(54)</td>
<td>700</td>
<td>(425)</td>
<td>209</td>
<td>3,205</td>
</tr>
<tr>
<td>2020</td>
<td>715</td>
<td>3,500</td>
<td>(419)</td>
<td>215</td>
<td>1,195</td>
</tr>
<tr>
<td>2021</td>
<td>934</td>
<td>4,100</td>
<td>(424)</td>
<td>221</td>
<td>743</td>
</tr>
<tr>
<td>2022</td>
<td>1,027</td>
<td>4,200</td>
<td>(431)</td>
<td>227</td>
<td>620</td>
</tr>
<tr>
<td>2023</td>
<td>1,084</td>
<td>4,300</td>
<td>(439)</td>
<td>233</td>
<td>581</td>
</tr>
<tr>
<td>2024</td>
<td>1,126</td>
<td>4,300</td>
<td>(448)</td>
<td>239</td>
<td>568</td>
</tr>
<tr>
<td>2025</td>
<td>1,162</td>
<td>4,400</td>
<td>(457)</td>
<td>246</td>
<td>566</td>
</tr>
<tr>
<td>2026</td>
<td>1,195</td>
<td>4,400</td>
<td>(466)</td>
<td>252</td>
<td>569</td>
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Note: GDP, tax revenues, consumption and investment in millions of 2009$. Employment in units of full-time equivalent non-farm jobs and rounded to the nearest hundred.

Whereas the first scenario generates just under $50 million in revenue from economic growth, the second scenario leads to more than three times that amount—roughly $160 million, or the difference between the $584 million revenue loss on a static basis and the $420 million revenue loss after accounting for economic growth.

Comparing the two scenarios also reveals how an outright repeal of the corporate income tax, along with creation of a flat individual income tax, would spark additional investment and growth. While these two changes generate a revenue loss of roughly $500 million compared to a revenue-neutral reform, it yields a substantial increase in investment—an up-front increase of roughly $5 billion, followed by $450 million per year in greater investment thereafter. Likewise, GDP output grows by nearly $1 billion more annually under the pro-growth scenario compared to revenue-neutral reform, as the additional investment increases economic growth.

These scenarios offer two approaches to reforming the current tax structure—one that roughly maintains the current revenue baseline, and another that lowers the
revenue baseline to approximate that prior to the Legislature’s recent tax increase—in a way that will promote greater economic growth. In both cases, the proposals would increase employment, GDP, and capital investment, while generating additional revenue from that higher growth. The results demonstrate how streamlining Louisiana’s current tax structure would provide a significant boost to the state’s economy.

**THE PATH TO A BETTER FUTURE**

After completing tax reform legislation along the lines described above, the Louisiana Legislature should take steps to preserve their gains. Any reform designed to simplify the tax code will have positive effects for only as long as lawmakers eschew the addition of new targeted tax incentives.

The Task Force on Changes in Budget and Tax Policy called for “a moratorium on any new tax credits or exemptions applied to the individual income tax,” along with a “moratorium on any new or resurrected sales tax exemptions.” 60 The Legislature should do just that, imposing a five-year moratorium on the enactment of any new exemptions to the tax code. That period will allow for the changes outlined above to “bed in,” and give stakeholders and officials in the Department of Revenue and elsewhere time to evaluate the impact of the changes on growth—both economic growth and revenue growth. After completing these types of policy assessments, lawmakers can determine where and how to continue reforming the tax code.

Enactment of the type of comprehensive tax reform outlined above would represent no small feat, particularly given that some of these reforms require changes to the state’s foundational governing document. Thus far, the special interests that advocate for the status quo have succeeded in giving Louisiana a tax code that places undue burdens on small business and families alike.

However, the combination of the state’s poor fiscal condition and a lingering economic malaise speak to the need for action. Tax reform will not single-handedly improve Louisiana’s economy—only businesses themselves, and not government, can turn the economy around. But without tax reform, the economy will continue to stagnate, jobs—and residents—will continue to melt away, and the state’s fiscal situation will continue to worsen.

Tax reform presents Louisiana with a choice—the choice to embrace reform, and the choice to embrace economic growth. After years of stagnation, it’s a choice Louisiana must take.

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1. In Fiscal Year 2017, the corporate income tax actually raised $605 million. However, $331 million of that $605 million was paid back out to corporations in the form of refundable credits, meaning the corporate income tax raised a net of $274 million in revenue. For simplicity’s sake, and because the plan proposes repealing all refundable credits paid to corporations, the ERC model shows the net cost of repealing the corporate income tax after repealing the refundable credits. See Department of Revenue, “Tax Exemption Budget,” and compare p. 20, which shows a corporate income tax revenue loss of $1.39 billion in Fiscal Year 2017, with p. 9, which shows estimated corporate income tax exemptions of $1.72 billion. The difference, of $330.9 million, comes from the impact of exemption contracts (i.e., refundable credits) on the corporate income tax, as outlined on p. 14 of the exemption budget.

2. See Footnote 59 above.