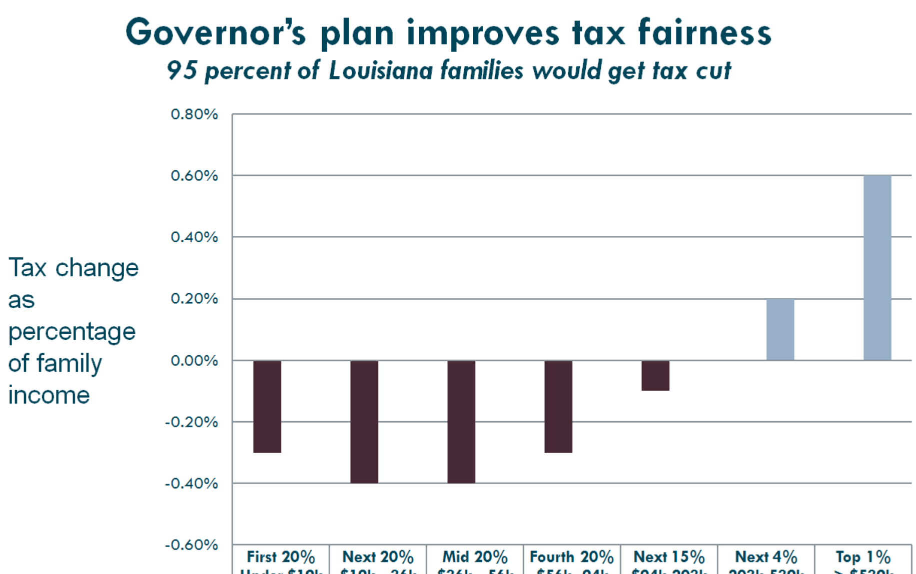
Most would get tax cut under Gov. John Bel Edwards' tax plan

Louisiana is $440 million short of the revenue needed to fund state government at current levels in next year's budget. The problem gets much worse in the 2018-19 fiscal year, when more than $1.3 billion in temporary taxes are due to expire - creating a "fiscal cliff" that would require drastic cuts to state services if left unaddressed.

To plug these holes, Gov. John Bel Edwards has proposed a package of tax reforms[i] that would overhaul the state sales tax, the personal income tax, and the taxes that corporations pay. If all elements of the plan are approved, it would raise enough revenue to plug the coming fiscal year's $440 million shortfall and avoid the 2018-19 fiscal cliff. It would generate about $411 million per year in new, recurring revenue and would provide a net tax cut to 95 percent of Louisiana families. The largest effective tax cut would go to the middle 20 percent of taxpayers - households earning between $36,000 and $56,000 per year.

The plan would also make Louisiana's tax structure more fair. But this fairness is tied to the changes proposed for the personal income tax, which have to pass both the Legislature and a vote of the people.



	First 20% Under $19k	Next 20% $19k - 36k	Mid 20% $36k - 56k	Fourth 20% $56k- 94k	Next 15% $94k-203k	Next 4% 203k-539k	Top 1% > $539k
95 percent get tax cut	-0.30%	-0.40%	-0.40%	-0.30%	-0.10%		
5 percent see tax increase						0.20%	0.60%

Source: Institute on Taxation and Economic Policy (2017)

The linchpin of the governor's plan is a new tax on corporations' gross receipts (Commercial Activity Tax, or CAT), which would generate an estimated $832 million a year. The revenue generated by this tax would be offset by loss of revenue from eliminating the temporary one-penny sales tax increase. The plan also includes an expansion of the sales tax base, and changes to personal and corporate income taxes. If the Legislature also agrees to permanently roll back tax credit programs that were reduced in 2015, the governor's plan would generate more than $600 million[ii] that could be invested in state services that have been cut deeply over the past decade such as higher education, public health and human services.

2016 Incomes	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than	$19,000 –	$36,000 –	$56,000 –	$94,000 –	$203,000 –	$539,000 –
	$19,000	$36,000	$56,000	$94,000	$203,000	$539,000	or more
Average Income	$12,000	$28,000	$47,000	$71,000	$132,000	$295,000	$1,444,000
Tax Change as % of Income	–0.3%	–0.4%	–0.4%	–0.3%	–0.1%	+0.2%	+0.6%
Average Tax Change	$ (36.23)	$ (108.94)	$ (180.60)	$ (205.43)	$(197.01)	$ 644.93	$9,147.37

The various elements of the plan will move forward using different legislative vehicles; therefore, it's important to both look at the plan in its totality while also breaking it down into its component parts.

Corporate tax changes

Most notably, the plan would eliminate the corporate franchise tax over a 10-year period and institute a new commercial activity tax (CAT) for corporations and limited liability corporations. The CAT would serve as an alternative minimum tax to the corporate income tax, meaning corporations would pay whichever is the greater of the two. This will broaden the base of corporate taxation, with more corporations subject to the tax compared to the current corporate income tax.

In addition, the governor calls for elimination of the corporate deduction for federal income taxes paid coupled with reduction in the corporate income tax rates, another base broadening proposal that will bring in $66 million per year, according to the administration.

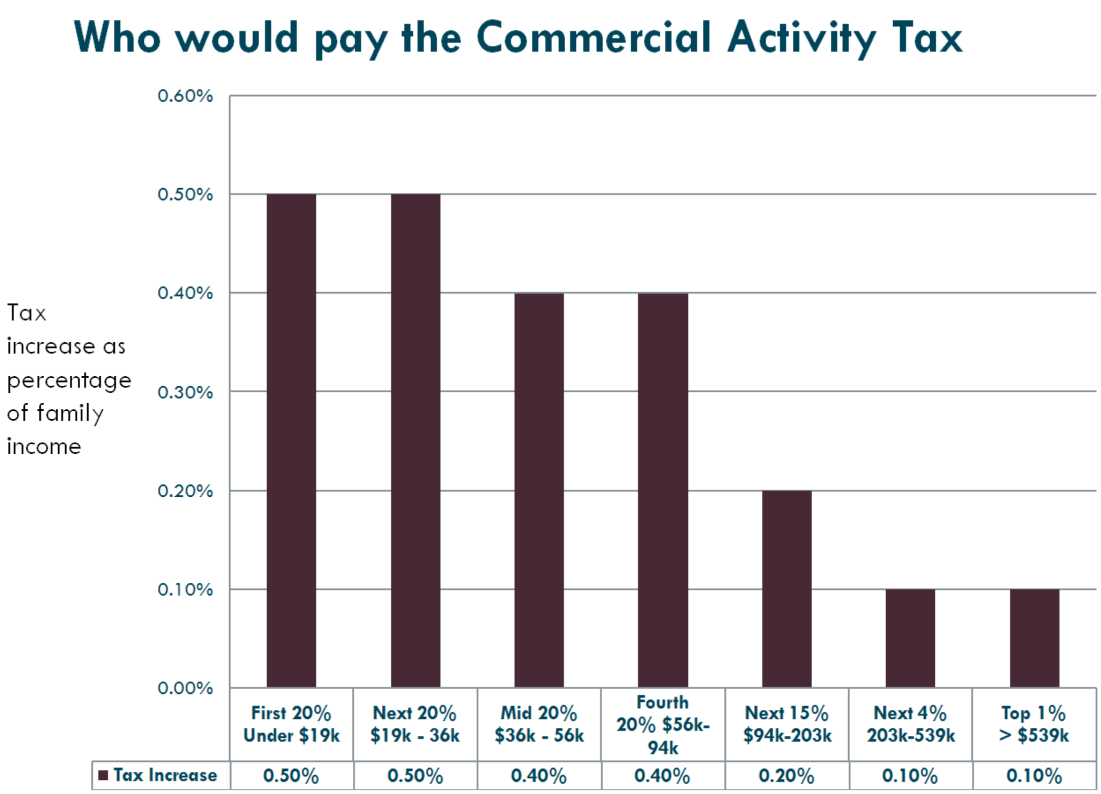
The Commercial Activity Tax (CAT)

The Commercial Activity Tax would apply to the total sales of a company and is projected to generate $832 million per year. Corporations with total sales below $1.5 million would be subject to a flat fee (Minimum Commercial Activity Tax, or MCAT) of $250 - $750 depending on the amount of their receipts, while corporations with more than $1.5 million in total receipts would pay a percent of their gross sales in taxes. The administration outlines the proposal here.

The CAT has the advantage of expanding the base of economic activity subject to taxation and eliminate tax avoidance schemes that some corporations use to erode the base of the corporate income tax. Given the broad base, the CAT could also be a relatively stable source of revenue - in sharp contrast to the current corporate income tax, which tends to fluctuate. However, there is a degree of risk in year one. If the CAT does not raise the amount of projected revenue, the state could be faced with further structural tax and budget problems. This is an important consideration when determining when the CAT will kick in and when the one penny sales tax increase will roll off.

Like any tax on sales, the CAT is regressive, meaning that it hits low and moderate-income people the hardest since they spend most of their income just to make ends meet (corporations will pass on a portion of the CAT to consumers). And since the tax is levied at multiple stages of production, it creates a phenomenon known as tax pyramiding, where the tax is levied on itself and the effective rate is higher than the actual rate.

The CAT would be paid by Louisianans at all income levels, with the average middle-income households paying an estimated $198 per year (the lowest-earning households would pay about $66 per year, while the richest 1 percent would see their taxes go up by $988 per year. Here is how the CAT affects households as a percentage of their total income:



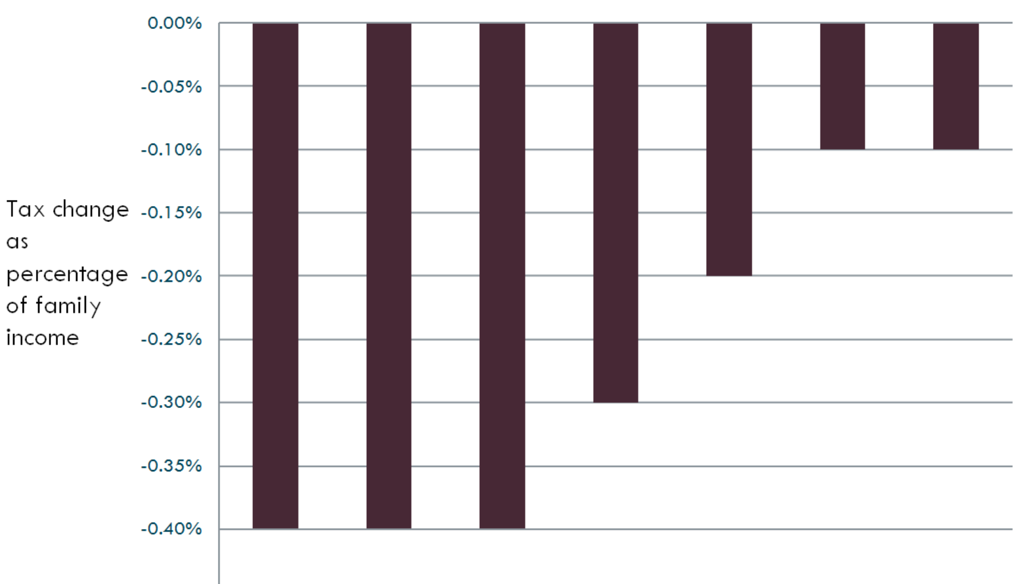
Source: Institute on Taxation and Economic Policy (2017)

Sales tax changes

The governor's plan calls for allowing the temporary one-cent sales tax to expire in 2018 - a change that would reduce state revenues by $808 million a year. But the governor proposes to make up some of this revenue with other changes to the sales tax that could be used to address the $440 million shortfall for the 2018 fiscal year.

The governor's plan calls for eliminating exemptions to the permanent 4 percent state sales tax, which would raise an estimated $107 million per year. Expanding the base of the permanent sales tax to services that are taxed in Texas would bring in an additional $216 million per year. And because the sales-tax changes can be implemented quickly, the revenue gains could help alleviate the shortfall in next year's budget and allow the state to reinvest in priorities such as TOPS scholarships, K-12 education and safety-net hospitals that are not fully funded next year.

Taken together, the proposed sales tax changes would reduce state revenues by $485 million. Louisiana households at every income level would get a tax cut, ranging from $49 per year in a low-income household making $12,000 per year to $1,144 in the richest 1 percent. Here is how the sales tax changes break down as a percentage of household income:



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Tax Decrease	-0.40%	-0.40%	-0.40%	-0.30%	-0.20%	-0.10%	-0.10%

Source: Institute on Taxation and Economic Policy (2017)

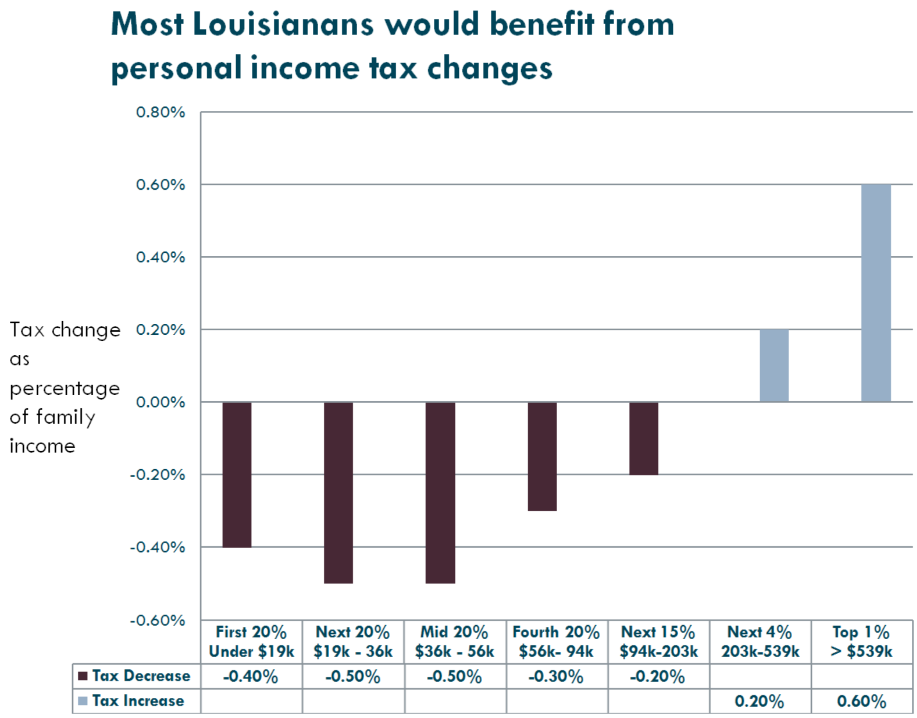
Personal income tax changes

The personal income tax portion of the proposal calls for eliminating the tax deduction for federal taxes paid, and lowering the rates across-the-board by 1 percentage point. These changes would reduce state revenues by $92 million per year, and provide a net tax cut to 95 percent of Louisiana families.

Louisiana is one of only three states (Iowa and Alabama are the others) that allow full deductibility of federal taxes on state returns. This tax break costs the state more than $1 billion per year in lost revenue, and the vast majority of the benefits (83 percent) flow to the wealthiest 20 percent of Louisiana taxpayers (the deductibility of corporate income taxes costs the state an additional $165 million).[iii]

The combination of eliminating the federal deduction and lowering rates would produce a tax cut for 95 percent of Louisiana households, ranging from an average of $54 per year for low-income households earning $12,000 per year to an average of $243 per year for households in the fourth income quintile, those earning between $56,000 and $94,000 per year. The richest 5 percent of households would see a net tax increase, despite paying a lower rate.

This part of the proposal is critical for making Louisiana's overall tax structure more equitable. Without eliminating the deduction for federal income taxes paid - which if passed by the Legislature would also require a vote of the people - the overall tax package would not improve Louisiana's regressive tax system. Here's how the tax cut would be felt by different income groups:



Institute on Taxation and Economic Policy (2017)

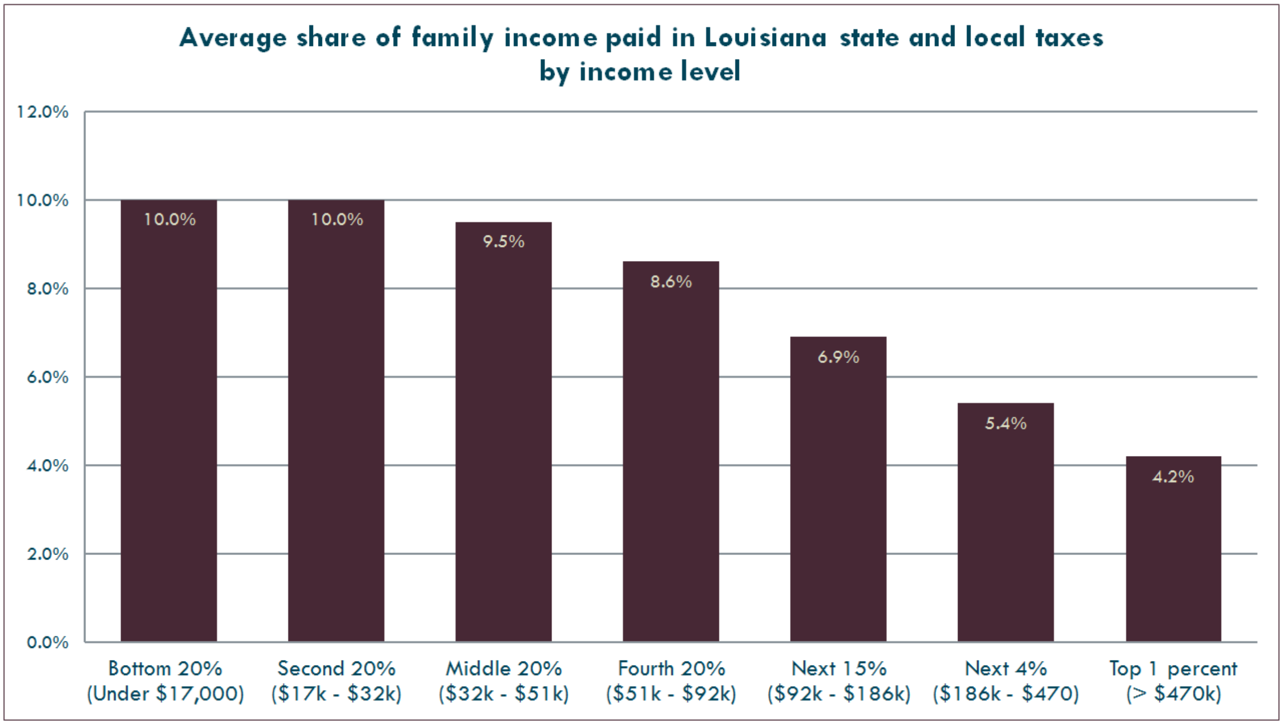
Tax expenditure changes

Finally, the governor proposes making temporary reductions to corporate tax incentive programs permanent, which will raise an estimated $192 million. These tax credit rollbacks were passed in 2015 and mainly affect corporations.

Conclusion

Louisiana's current tax structure is not sufficient to fund the state's basic needs, let alone make necessary investments in education, public health and other critical priorities. It also is fundamentally unfair, as it requires low and moderate-income households to pay a higher effective tax rate (see chart below) than the very wealthiest. And because it relies on temporary revenues that are expiring in 2018, it is highly unstable.

The governor's tax plan is not perfect. But if all the elements are taken together, it would take a step toward making Louisiana's broken tax system more fair and adequate.



Source: Institute on Taxation and Economic Policy (2015)

Louisiana Budget Project

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[i] Based on package released March 29, 2017.

[ii] Unless otherwise noted, distributional and revenue projections based on analysis provided by the Institute on Taxation and Economic Policy (2017).

[iii] Louisiana Department of Revenue, Tax Exemption Budget, 2017