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Louisiana joins other states proposing unpopular gross receipts tax

By: Michael Joe , Reporter April 13, 2017 0

As the state Legislature convenes to focus on Louisiana's chronic fiscal woes, Gov. John Bel Edwards is calling for a tax structure overhaul that includes lower rates but a broader base to raise more revenue.

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Most state tax reform experts would agree: That sounds like sound tax policy.

But the key piece and largest revenue raiser in Edwards' tax overhaul proposal, a new business tax on a percentage of gross receipts, is decidedly more controversial.

Edwards wants legislators to consider what he is calling a commercial activity tax to bring in revenue from tens of thousands of businesses that pay no corporate income tax each year. Whether these businesses did not make a profit or benefitted from various economic incentives such as tax credits, deductions and exemptions to lower their taxable income, the vast majority would be subject to the new gross receipts tax on business transactions.

Under Edwards' proposal, businesses with more than $1.5 million in gross receipts would pay a rate of .35 percent, and businesses with gross receipts between $150,000 and $1.5 million would pay a flat minimum tax of $250 to $750. The tax would effectively act as an alternative minimum tax to the corporate income tax – businesses would pay whichever is higher.

Aside from the question of whether Louisiana businesses should contribute more to state revenues, as Edwards would like, the merits of a gross receipts tax as a method of corporate taxation on businesses of all types will be debated by the Legislature as it seeks revenue to replace the expiration of $1.3 billion worth of tax provisions next year.

Five states have statewide gross receipt taxes, including Ohio, Washington and most recently Nevada. And four states currently facing budget shortfalls – Louisiana, Oklahoma, West Virginia and Oregon – are now considering proposals for a gross receipts tax, according to the Tax Foundation.

But many other states over the years have thought about but decided against it, and three other states that adopted a broad-based gross receipts tax in the 2000s repealed the tax within four years – New Jersey, Kentucky and Michigan have returned to the traditional approach of taxing corporate income.

Then, as now, the allure of a gross receipts tax is its stability and simplicity, taxing all business transactions with few or no deductions. Because it taxes revenues, not profits, a gross receipts tax would provide a consistent and broader base of corporate contributions to state revenues at a fairly low rate compared to income taxes, most economists and tax experts agree.

"Gross receipts tax is one of those taxes that when you look at it, on its face it should make sense. But then in application, it just doesn't," said Cara Griffith, editor-in-chief of Tax Analysts and an expert on local and state taxation. "And I think that's why states look at it when they need money, and then once they start to implement it, it ends up being repealed because in terms of tax policy it's just not good tax policy."

The main concern with a gross receipts tax is that it implements a layer of taxation at each stage of production by taxing business purchases of supplies, raw materials and equipment, which results in what is called "pyramiding," raising the price of goods and services along the way to the ultimate consumer.

"When you ultimately purchase the product, you also have to take into account that you are now paying more for their commercial activity taxes," said Jaye Calhoun, a tax attorney at Kean Miller. "Even though it's being talked about as an alternative to a tax on business, it could very easily be considered an addition to a tax on transactions. It's almost like you have a very high effective sales tax rate that would go into place."

In theory, pyramiding would also affect businesses' decisions, encouraging them to provide goods and services in-house or purchase goods and services from out-of-state firms that are not subject to the gross receipts tax. But how big of a problem pyramiding would be is hard to know.

Another concern among business groups is that the tax would hurt emerging businesses not yet making a profit and disproportionally impact certain businesses and industries, such as grocers and other retailers that have high revenues but low profit margins.

"There are a number of industries in New Orleans like those in the tourism industry – restaurants and hotels – they may be low margin. And if they are, that's a concern for them," said James Richardson, an LSU economist who led a tax reform task force that in January recommended many of the proposals in the governor's tax overhaul outline, but did not mention a gross receipts tax.

On Monday, the Edwards administration said its gross receipts proposal will include different formulas for low-margin businesses that have a lot of sales to alleviate concerns. "This is why Nevada has different rates for different industries," Richardson said.

Nevada, which passed a gross receipts tax in 2015, has 26 different categories for businesses and tax rates ranging from .331 percent to .051 percent. And Washington has a similar categorical structure in its version of the tax. But the tradeoff is that it is no longer easy to administer and for businesses to understand.

"You go from having a tax that should be broad base and low rates, which is general good tax policy – but then you add varying rates and this and that," Griffith said. "Now, it's no longer simple and it's hard to be transparent when you have these if-thens. That's when it kind of falls apart and you end up getting back to the income tax."

But Richardson noted that there is no such thing as the perfect business tax. Business resources are mobile, and while the state wants to attract them, there are a variety of businesses. "Anything you do, you have to ask what will be the impact. You are looking at all these things," Richardson said. "Every business tax has some type of deficiency."

The tax has already faced skepticism from influential business groups, GOP lawmakers who would rather cut spending and some Democrats – even before details of the proposal have been announced. The Edwards administration plans to release a detailed plan this week.

The state has struggled to meet its commitments in recent years due to a confluence of factors, including low energy prices, the long-range effect of tax cuts in 2007 and 2008 and the slow recovery from the recession, forcing difficult cuts to K-12 and higher education, mental health and addiction programs, hospitals, transportation projects and other public investments.

The fiscal situation has led to temporary and targeted tax increases in recent sessions. Revenue raisers have included a one-cent sales tax increase in 2016 and reductions to corporate income tax expenditures adopted in 2015, such a dividend income tax deduction for corporate taxpayers, a job creation credit and a credit that reimburses companies for local property taxes paid on inventories.

But those temporary fixes and others that amount to $1.3 billion, or about 15 percent of the state-funded portion of the budget, will expire in 2018. More immediately, the state faces a $440 million gap in the governor's proposed budget for next fiscal year beginning in July.

Edwards says his tax reform plan would provide those funds and stabilize the state budget for the future by building a broader tax base to include more businesses, goods and services while also lowering rates. The gross receipts tax could raise up to $900 million in revenues each year.

An overhaul outline released last month also calls for the corporate franchise tax to be phased out over 10 years, and a lowering of corporate and individual income tax rates contingent upon approval of a constitutional amendment by voters to end state deductions for businesses and households for federal income taxes paid. An uphill battle, voters already rejected an effort in November to end the corporate deduction.

Yet Edwards is hoping the public will be moved this time by a lowering of income taxes for 90 percent of households under his plan, though those with incomes above $140,000 would likely see a tax increase – on balance decreasing revenue by $46 million. Corporate income taxes would see an overall increase by eliminating the federal deduction despite the lower income tax rate, raising $66 million in revenue.

The plan would also make permanent the 2015 reductions in tax expenditures and allow other expenditures to expire, raising $192 million; expand sales and use taxes to include more services, raising $200 million; and remove exemptions from sales taxes, raising $180 million.

Edwards would let the "fifth penny" that was added to the sales tax last year, which gave the state the highest combined local and state tax rate in the nation, expire next year.

Though his proposal for a gross receipts tax was unexpected, Richardson says there is some consensus among lawmakers on both sides that businesses should contribute more to fund state services. But he said that Edwards does not seem to think he has many options.

"I think his purpose is, he is trying to find an answer to the problem, or to the riddle. He says that every time he brings up changes to the income tax to raise money, he can't count the votes. So he said, 'Where do I go?'" Richardson said.

Edwards has pointed to Ohio as a model of a successful gross receipts tax, which was adopted in 2005 as part of a broader tax overhaul for economic development. Like his proposal, Ohio exempts nonprofits and certain public utilities, financial institutions and insurance companies from the tax.

But Calhoun notes that Ohio's tax, which levies a .26 percent rate on businesses with gross receipts over $1 million, relies less heavily on corporate taxes in general. "The problem in Louisiana is we certainly do not have the property tax base as Ohio has, or the other sources of revenues," she said.

Griffith of Tax Analysts said the tax in Ohio is arguably working, but that "if you talk to Ohio practitioners about how much they hate it, and to the businesses that hate it, from their perspective it probably isn't."

Regardless of whether a gross receipts tax is good tax policy, that doesn't necessarily mean a gross receipts tax couldn't work in Louisiana – if taxpayers and lawmakers can learn to live with the complexity that would come with making the tax more palatable.

"There comes a point, too, where a certain amount of time has passed and you keep it around and people get accustomed to it and it becomes the normal," Griffith said.

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