The Inventory Tax Credit and Local Ad Valorem Taxes

Our Task Force recommends proposals that are consistent with the fundamental goals of:

- sustaining and advancing Louisiana's business climate;
- improving the state fiscal position by reining in the inventory tax credit, which has grown substantially over time;
- increasing local governmental control of the property tax; and
- reducing reliance on the local ad valorem personal property tax as it applies to inventories.

To accomplish these goals, we propose significant modifications to the industrial tax exemption, the local personal property tax as it applies to inventories, and the state inventory tax credit.

First, with respect to the industrial tax exemption, we believe that in the long run local governments must have a voice in whether to grant tax exemptions for industrial property. While Governor John Bel Edwards has initiated an executive order and an administrative process to include local governments in decision making, this needs to be a permanent part of the fiscal landscape. The Tax Foundation recommended that there be only an 80 percent exemption, but we believe that industrial property tax decisions can be left collectively to the state and local governments and the business partners. The State Board of Commerce and Industry is rewriting the rules in a way that is anticipated to disqualify certain categories of non-job-producing industrial investments from the exemption program. This governor is advocating the rule changes and is granting local governments a seat at the negotiating table for broader expansions with more significant economic development impacts. But a future governor could quickly reverse that policy under the current Constitution. Overall, we believe that additional scrutiny will reduce some of the losses to the property tax base that local governments have experienced. The potential for greater local revenue also offers opportunities for tradeoffs and reforms in other areas of taxation. As a consequence, we recommend:

> ***A constitutional amendment should be introduced that would require local governmental approval for enactment of a specific industrial tax exemption.***

The Governor and the State Board of Commerce and Industry would continue to be involved in the collective decision making process, as is appropriate. The amendment should make explicit that tax exemptions can be full or partial, and can also be for a length of time less or more than the current ten years. Either the amendment or companion statutes would need to clarify what levels of local government would participate in this process.

Second, the Task Force recognizes that the personal property tax on inventories is, in some parishes, an important revenue source. Nonetheless, we believe that reducing the reliance on this revenue source is necessary to help reduce fiscal stress at the state level—which inevitably causes local fiscal stress. We also believe that a reduced reliance on this particular form of revenue would be a healthy diversification for the relatively small number of parishes that depend heavily on the inventory tax. And further, Louisiana's business competitiveness would be improved. To accomplish this goal, we suggest that the ad valorem tax system be changed to recognize a new class of property—"inventory property." This property would be classified at a 10% rate—the same rate that applies to land and residential improvements and which is less than the 15% rate currently applied to personal property, including inventories. This change would reduce, but not eliminate, the reliance of local governments on property taxation of inventories. We would envision this change being phased-in over time. Local governments could maintain their revenue from the property tax by increasing millages, which would have the effect of shifting the tax burden to other types of property in their parish. The Task Force has recommended increasing sales taxes on services (following the Texas model), which would bring additional revenues to local governments. Some state and local sales tax exemptions might also be eliminated following the recommendations of the sales tax streamlining task force. As a consequence, we recommend:

> ***A constitutional amendment and supporting statutory legislation should be introduced to create a new class of property -- "inventory property" -- that would be classified at the same rate as land and residential property and that (after voter approval) would be phased-in over time.***

The Legislature could consider additional revenue sources that local governments could generate.

Third, with less local taxation of inventories, there will be less demand for the inventory tax credit that is taken against personal income tax returns and corporate/franchise tax returns. The Legislature should reduce the credit at least proportionately in line with the reduction in local inventory taxation. If the classification percentage falls from 15% to 10%, then the inventory tax credit should be reduced to 66%. The Legislature, however, may wish to start from the reduced current level of the inventory tax credit, before making these percentage reductions. For reasons of sound tax policy, we recommend that the credit be fully refundable. As a consequence, we recommend:

> ***The Legislature should reduce the inventory tax credit from its current level as local governments reduce reliance on the personal property tax on inventories.***

Together the latter two proposals relating to inventory would create a mechanism to curb the growth of the inventory tax credit. Local governments would have an incentive not to classify property as inventory in order to obtain a higher classification, whereas businesses would prefer personal property to be classified as inventory in order to gain the credit.

Overall, we would expect any decreases in local revenues from the new classification rate for inventories to be made up through a combination of additional property taxes through reform of the industrial tax exemption, additional sales tax revenue from services, and higher millage rates. The state budget position would improve through reduced usage of the inventory tax credit.