Louisiana Budget Project
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Eliminating State Income Tax: Good for Whom?

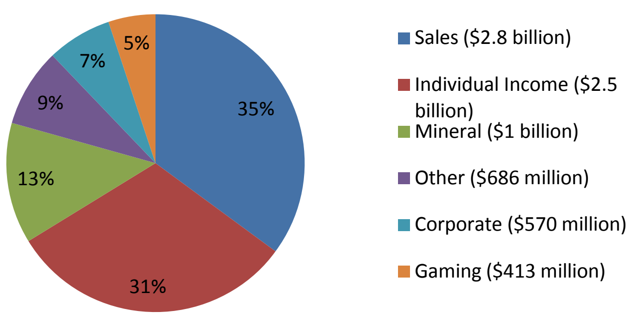
Executive Summary

Several bills introduced in the current regular legislative session would eliminate Louisiana's state income tax, without mandating any replacement revenues. Adoption of any of these measures would be detrimental to the state's future. Ending the state income tax would cause a reduction in many services provided by the state or to mitigate significant destabilization of government, other sources of tax revenue would need to increase. Without the income tax, Louisiana's overall revenue system would become more volatile and unpredictable. And low-and moderate-income Louisianans share of income owed in taxes would likely increase because the tax system would depend less on the ability to pay.

Louisiana Can't Afford to Lose Major Revenue Producer

When Louisiana legislators last year considered eliminating the state income tax in 2008, there was a budget surplus. However, this year our economy and budget have changed dramatically and a state shortfall is projected now and into the future. Against this deteriorating budget situation, Louisiana would be eliminating state government's second largest revenue source. For fiscal year 2010, the income tax will bring in more than $2.5 billion, according to Executive Budget projections (see figure 1). In Governor Jindal's proposed budget, money collected from state income taxes equals approximately 31 percent of the state general fund expenditures for fiscal year 2010.[1]

Fig 1: General Fund Revenue FY2010



Source: Executive Budget FY 2010

Not Having State Income Taxes Hurts Economic Outlook

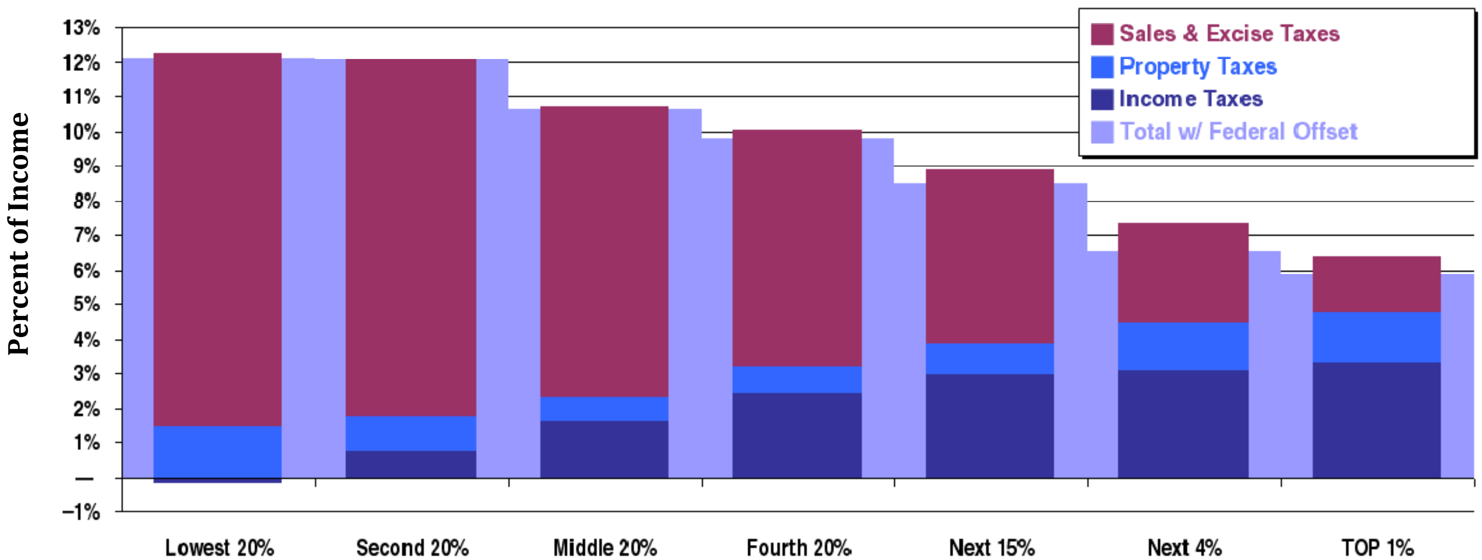
Having an extensive, diverse source of revenues is vital to maintaining stability in a state's tax system. The narrower that system is, the more vulnerable it is to changes in the economic situation. Specifically, states that have no income tax and in turn rely heavily on sales tax have seen more rapidly declining revenue as consumer spending drops in this weakened economy, compared to states that also have an income tax.

If income taxes were eliminated, the two major sources of revenues in Louisiana would be the state sales tax and taxes on minerals, specifically oil. As shown over the past few years, changes in energy prices make an oil tax subject to wide swings up and down, further reducing the stability of the state's revenue system.

Taxes Not Based on Ability to Pay

Figure 2: Louisiana State and Local Taxes in 2006:

Shares of Family Income for Non-Elderly Taxpayers



Source: Institute on Taxation and Economic Policy, "Fair and Sustainable Tax Reform: Options for Louisiana" (June 2008).

Already, the tax structure in Louisiana is one in which the wealthiest households pay a smaller share of their income in overall taxes than do low- and moderate-income households. As shown in Figure 2, in 2006 the last year for which information is available, the poorest fifth of non-elderly taxpayers paid 12 .1 percent of their income in state and local taxes, while the wealthiest one percent of non-elderly taxpayers paid only 5.9 percent.

This inequality in all likelihood grew worse due to repeal of the Stelly Plan last year. Approved by voters as a constitutional amendment, Stelly when it took effect in 2002 eliminated sales taxes on food, drugs and household utilities. The difference was made up by increasing state income taxes. Tax brackets were changed to raise the rates paid by higher-income households, while giving a small break to lower-income households. But in 2008 the two highest income brackets were reduced to the level they were prior to the implementation of Stelly. The sales tax exemptions remained, and the net effect will be a substantial loss of revenue for the state, estimated by the Louisiana Legislative Fiscal office to average $271 million annually..

Senate Bill 336 (authored by Senator Lydia Jackson and Senator Sharon Weston Broome) has been introduced during the current regular legislative session; the bill will delay for one year the repeal of the Stelly plan currently scheduled to be applicable for tax year 2009. Governor Jindal has stated that he will not back a proposal that will delay a planned tax cut for middle- and upper- income families. The Louisiana Budget Project supports Senate Bill 336, and believes delaying the reduction in revenues is prudent due to the fact that it will mitigate some of the drastic budget cuts currently proposed for next year.

Proposals for Eliminating Income Tax

Five bills have been introduced in the current regular legislative session to eliminate Louisiana's income tax. House Bills 284 (authored by Representative Cameron Henry) and 611 (authored by Representative Hunter Greene) and Senate Bills 6, 232 and 233 (all authored by Senator Nicholas Gautreaux) all would phase out the state tax on the income of individuals, estates, and trusts over a 10-year period by 10 percent per year. This will cost the state revenue loss starting at $267 million in fiscal year 2010 and reaching $4.6 billion when the phase-out is complete in 2020, according to the Louisiana Legislative Fiscal Office.

Senate Bills 6 and 233 also include a refund of a low-income child credit for those with incomes of $25,000 or less. Senate Bills 232 and 233 have a clause that would suspend the income tax phase-out if the commissioner of administration determines that a decrease in revenues, estimated in a final official forecast prior to the beginning of such fiscal year, would result in a budget deficit. However, after the 10- year time period established in the bill, the commissioner would not have further authority to modify this permanent reduction.

Conclusion

The long-term consequences of eliminating the state income tax would be detrimental to Louisiana's future. Unless other taxes were increased to make up the difference, the major revenue loss would result in the reduction of key state services, as well as produce a volatile and unpredictable tax base that would threaten the state's economic performance. The ensuing reliance by the state on other taxes would mean the share of their income that low-and moderate-income Louisianans would owe in taxes would likely increase because the system would be less based on the ability to pay.

About the Louisiana Budget Project

Louisiana Association of Nonprofit Organizations formed the Louisiana Budget Project (LBP) in 2006 to increase public awareness of, information on and input into the state budget preparation process. The LBP monitors and reports on state government spending and how it affects Louisiana's low- to moderate-income families.

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References

[1] http://www.doa.louisiana.gov/opb/pub/FY10/FY10ExecutiveBudget.pdf