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Louisiana Taxation of Businesses: Two Alternative Proposals

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Louisiana should reconsider the uneven manner in which it taxes businesses. For both federal and state tax purposes, businesses are taxed differently depending on the form of business organization that the investors choose. There is no justification for the difference in taxation of the various types of business organizations, either at the state or at the federal level.[1] This article addresses only the issue of eliminating the disparity at the state level.

In two respects, corporations are taxed more heavily by the State of Louisiana than other forms of business organization. First, the income of a C corporation is taxed at a higher rate than the income of a pass-through entity, such as an S corporation, a sole proprietorship, or a business entity that is taxed as a partnership. In addition, all corporations, including S corporations, are subject to the corporate franchise tax.

This article explores two alternative proposals for providing uniformity in the manner in which Louisiana taxes businesses. Both proposals would reduce the maximum corporate income tax rate from eight percent to six percent, which is the maximum rate that applies to income flowing through to individual owners of pass-through entities. Both proposals also would eliminate the corporate franchise tax. One proposal also would eliminate the state sales tax on machinery and equipment. Both proposals focus on how businesses should be taxed as opposed to how much tax businesses should pay.

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1. Historically, corporate taxation was based on the premise that because shareholders are not personally liable for corporate debts and obligations, a corporation should be a separate, tax-bearing entity. In contrast, partnerships and sole proprietorships, which did not offer limited liability to investors, were not treated as separate entities from their owners for tax purposes. Presently, partnerships and sole proprietorships have access to limited liability, thus this has been eliminated. For federal income tax purposes and for administrative purposes, it may be appropriate to distinguish between publicly traded and non-publicly traded business organizations. Pass-through taxation of a publicly traded corporation would be difficult to administer because it would be difficult to determine whether a shareholder owned stock in the corporation at the time that each item of the corporation's income was earned. *See, e.g.*, Rebecca S. Rudnick, *Who Should Pay the Corporate Tax in a Flat Tax World?*, 39 Case W. Res. L. Rev. 965 (1988-89). Nevertheless, there is no reason for the corporate double tax or the rate differential between the federal income tax and the federal corporate tax. For a discussion of the various proposals to integrate the individual and corporate income taxes into a single comprehensive system, see Peter C. Canellos, *Corporate Tax Integration: By Design or By Default?* *in* Corporate Tax Reform: A Report of the Invitational Conference on Subchapter C 129 (Am. Bar Ass'n Section on Taxation; N.Y. State Bar Ass'n Tax Section 1988). For articles suggesting that the differences in federal income taxation of pass-through entities be eliminated, see, *e.g.*, Susan Kalinka, *The Limited Liability Company and Subchapter S: Classification Issues Revisited*, 60U. Cin. L. Rev. 1083 (1992); William J. Rands, *Passthrough Entities and Their Unprincipled Differences Under Federal Tax Law*, 49 SMU L. Rev. 15 (1995).

Reducing the maximum corporate income tax rate and eliminating the corporate franchise and the designated sales taxes would create a significant drain on state tax revenues. This article offers two alternatives for replacing the revenue that would be lost if the Louisiana Legislature decided to conform the corporate and individual tax rates and eliminate the corporate franchise tax. The first proposal suggests a value-added tax on all businesses. The second alternative suggests an additional tax on all business profits, regardless of the form of business organization adopted. Because each proposal would broaden the tax base by increasing taxes for all businesses, it would not be necessary to impose a high rate for the supplementary tax if either alternative were adopted.

The differences in business taxation arose many years ago when the three forms of business organization were the corporation, the partnership, and the sole proprietorship. Traditionally, a corporation has been considered an entity separate from its shareholders, whereas a partnership generally has been considered an aggregate of its partners, at least in jurisdictions other than Louisiana.[2] Like a partnership, a sole proprietorship has never has been treated as a separate entity. Thus, until the adoption of subchapter S, a corporation has been taxed as an entity liable for the tax on its own income.[3] In contrast, a partnership is treated as a pass-through entity for tax purposes. A partnership does not pay tax on its income.[4] Instead, each partner pays tax on the partner's distributive share of the partnership's income.[5] Similarly, the owner of a sole proprietorship pays tax on the income of the business, because the proprietorship is not regarded as an entity separate from its owner for tax purposes.[6]

Under state law, shareholders of a corporation are shielded from liability for corporate debts and obligations.[7] To ensure that shareholders enjoy limited liability for corporate debts, a corporation is required to register with the secretary of state by filing articles of incorporation.[8] Registration serves notice on all parties dealing with the corporation that its shareholders have limited liability.

2. La. Civ. Code art. 2801 provides that a partnership is a juridical person, distinct from its partners. La. Civ. Code art. 2801 was enacted in 1980. 1980 La. Acts No. 150. The comments to Article 2801 state that the treatment of a partnership as a legal entity distinct from its partners is a codification of "a well established rule of Louisiana jurisprudence." La. Civ. Code art. 2801, cmt. (e). *See, e.g.*, Trappey v. Lumbermen's Mat. Cas. Co., 229 La. 632, 637, 86 So. 2d 515, 517 (1956); Smith v. McMicken, 3 La. Ann. 319, 321-22 (1848). Under the Revised Uniform Partnership Act, a partnership also is treated as an entity separate from its partners. Rev. Unif. Partnership Act § 201 (1996). The federal taxation of a partnership as an aggregate of its partners, however, is based on the Uniform Partnership Act which, for many purposes, treats a partnership as an aggregate of its partners. *See, e.g.*, Unif. Partnership Act § 6(1) (defining the term "partnership" as an association of two or more persons to carry on as co-owners a business for profit). As explained *infra* note 18 and accompanying text, the Louisiana income taxation of business organizations tracks the federal tax rules.

3. I.R.C. § 11(2000); La. R.S. 47:287.11(A) (2001).

4. I.R.C. § 701(2000); La. R.S. 47:201 (1990).

5. I.R.C. § 702(2000); La. R.S. 47:202 (1990).

6. The items of income, deduction, and credit of a sole proprietorship are reported on the owner's individual tax return for both state and federal tax purposes.

7. *See, e.g.*, La. R.S. 12:93(A) (1994).

8. *See, e.g.*, La. R.S. 12:25(A)(1) (2001).

In contrast, all partners in a general partnership are personally liable for partnership debts.[9] Similarly, the owner of a sole proprietorship, as the direct owner of the business, is personally liable for all of the debts and obligations of the business. Because there is no limitation on the liability of partners or sole proprietors that would necessitate notice to third parties, a general partnership or a sole proprietorship may transact business without registering with the state.[10]

Traditionally, the state franchise tax has been justified as a charge due from a corporation for the privilege of exercising its corporate charter and offering investors limited liability. With the rise in popularity of limited liability entities such as partnerships in commendam, limited liability partnerships ("LLPs"), and limited liability companies ("LLCs"), the distinctions between corporations and other forms of business entities have blurred. Like corporations, partnerships in commendam, LLPs, and LLCs offer investors limited liability.[11] Like corporations, partnerships in commendam, LLPs, and LLCs are treated as entities separate from their owners.[12] Nevertheless, partnerships in commendam, LLPs, and LLCs generally are treated as partnerships for tax purposes.[13]

Equity considerations call for the equalization of the tax treatment of all businesses, regardless of the form in which the business is conducted. One of the goals of a tax structure is horizontal equity, the concept that similarly situated taxpayers should be taxed similarly.[14]

Fiscal considerations also suggest that Louisiana should reconsider its apportionment of the state business tax burden based on the different forms of business organization. The corporate income and franchise tax base has eroded significantly because taxpayers are using business organizations other than corporations. As a result, corporate tax receipts have declined. With the availability of other business entities, such as the LLC, that offer limited liability to all owners of the business, investors have no incentive to form a corporation.

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9. In Louisiana, each partner in a general partnership is liable for the partner's virile share of partnership debts. La. Civ. Code art. 2817.

10. If a Louisiana general partnership owns immovable property, it is likely that the partnership will file its contract of partnership with the secretary of state. As to third parties, immovable property of a partnership is treated as owned by the partners individually unless until the partnership agreement is filed. La. Civ. Code art. 2806.

11. La. Civ. Code art. 2844 (limited liability for partners in commendam); La. R.S. 9:3431(A) (limited liability for partners in an LLP); La. R.S.12:1320(A)(1994) (limited liability for LLC members).

12. La. Civ. Code art. 2801 (partnerships in commendam and LLPs); La. R.S. 12:1301(A)(10) (2001) ("LLC" generally defined as an entity that is an unincorporated association having two or more members); La. R.S. 12:1303 (2001) (LLC has same powers as a corporation or partnership to sue or be sued in its own name, enter into contracts); La. R.S. 12:1320(A) (1994) (limitation on the liability of LLC members).

13. An unincorporated entity, such as a partnership or LLC, however, may electto be taxed as a corporation. Treas. Reg. §§ 301.7701-1 through 301.7701-3 (West 1993).

14. *See* James A. Richardson & W. Bartley Hildreth, *Economic Principles of Taxation, in* Handbook on Taxation 21 (W. Bartley Hildreth & James A. Richardson eds. 1999) and J. Slemrod & J. Bakija, Taxing Ourselves: A Citizen's Guide to the Great Debate Over Tax Reform (1996).

Parity in the taxation of business organizations would not be a novel concept in Louisiana. At one time, there were some business taxes that applied evenly to all forms of business organization. For example, until 1981, Louisiana imposed an occupational license tax on business organizations, other than those engaged in manufacturing, banking, and sawmill operations.[15] The occupational license tax was paid by corporations, partnerships, and sole proprietorships alike. The Louisiana occupational license tax promoted horizontal equity, but it was repealed in 1981.[16]

I. CURRENT TAXATION OF LOUISIANA BUSINESSES

The current business tax structure in Louisiana is summarized in Table 1.

Table 1. Taxation of Business Organizations

Form of Business Organization	Income Taxation*	Franchise Tax**
C Corporation	Corporate income taxed at progressive rates of 4 to 8 percent. Eight-percent rate applies to taxable income in excess of $200,000. Shareholders subject to Louisiana tax jurisdiction pay tax on dividend distributions; individual shareholders pay tax at graduated rates of 2, 4, or 6 percent.	$3.00 per $1,000 of amount of issued and outstanding capital stock, surplus, undivided profits, and borrowed capital.

15. La. R.S. 47:341-47:363 (repealed 1981).

16. 1981 La. Acts No. 567, § 1. Currently, parishes and municipalities impose the occupational license tax. La. R.S. 47:341(A) (1990).

S Corporation	Corporate tax applies at the entity level, but S corporation is permitted to exclude all of its Louisiana income reported by shareholders. As a practical matter, S corporation's Louisiana income flows through to shareholders and is taxed at their individual rates, of 2, 4, or 6 percent.	Same as C corporation.
Partnership Partnership in Commendam LLP, or LLC	Income flows through to partners or members and partners and is taxed at the rate applicable to the partner or member (depending on whether the partner or member is an individual or a C corporation)	None
Sole Proprietorship	Income is taxed at progressive rates of 2, 4, and 6 percent	None

* La. Const. art. VII, § 4(A); La. R.S. 47:21-47:285, 47:290-47:299, 47:287.2-47:287.785 (2001).

** La. R.S. 47:601-617 (1990).

The corporate income and franchise taxes create arbitrary differences in the manner in which a business is taxed. As a practical matter, there is little difference between a corporation and any other form of business entity, such as an LLC, LLP, or partnership in commendam, that offers limited liability to its owners. The only significant difference is the manner in which the entity and its income are taxed.

The disparate tax treatment of business entities at the state level is, in part, the result t of Louisiana's decision to classify business organizations for state income tax purposes in the same way as they are classified for federal tax purposes.[17] Louisiana's decision to "piggyback" the federal tax laws provides administrative convenience to the Louisiana Department of Revenue (the "Revenue Department") and eases the cost of compliance for taxpayers. Because Louisiana treats business entities for state tax purposes in the same manner as they are treated for federal tax purposes, the Revenue Department can refer to a

17. *See, e.g.*, La. R.S. 47:293(6)(a),(7), 47:296(A), 47:287.11, 47:287.61, 47:287.63, 47:287.65, 47:287.67 (2001).

business entity's federal income tax return to ensure that the entity's income has been reported properly for state income tax purposes.[18] Taxpayers enjoy reduced compliance costs because they may compute their state income in the same manner in which they compute federal income.

It is not necessary for the Louisiana Legislature to repeal Louisiana's piggyback rules in order to eliminate the disparity in taxation of business organizations. This article explores two alternative methods that the Louisiana Legislature should consider for taxing business organizations in a manner that will treat similarly situated businesses similarly, at least for state tax purposes.

All businesses, regardless of the form in which they are organized, use state services in the process of producing the goods and services that they provide to their customers, either within the state or somewhere outside the state.[19] The payment of a tax for the use of state services constitutes the cost of doing business, in the same way that employee compensation, interest payments on business debts, costs of raw materials and utilities, and other business expenses are essential and necessary costs of doing business. State services provided to businesses include maintenance of roads and highways, oversight of the environment, education and training of the workforce, and provision of a court system and a legal environment that ensures that contracts will be enforced in the state. These and other services create a productive business environment within the state from which all types of business organization benefit.

In furtherance of the goal of horizontal equity, the concept that similarly situated businesses should be taxed similarly,[20] businesses should pay similar taxes, regardless of the form of business entity employed by the owners of the business. The following sections discuss in more detail the current differences in state taxation of business organizations and offer further policy reasons for eliminating the differences.

A. Income Tax

The most significant difference between the corporate income tax and the taxes paid on the income of a pass-through entity is the two-percent differential between the corporate income tax rate and the individual income tax rate. The highest rate of tax that applies to a C corporation's Louisiana net income is eight percent.[21] In contrast, the highest rate of tax that applies to the net income of a pass-through entity is six percent if the owners of the entity are individuals.[22] For this purpose, pass-through entities include S corporations and all business organizations that are

18. A corporation is required to file a Form 1120 each year with the Internal Revenue Service. An entity that is classified as a partnership for federal tax purposes files an information return, Form 1065, which lists all of the entity's items of income, gain, loss, deduction, andcredit and the manner in which each of the items is allocated to each of the partners.

19. Thomas Pogue, *Principles of Business Taxation: How and Why Should Businesses Be Taxed?*, *in* Handbook on Taxation 191 (W. Bartley Hildreth & James A. Richardson eds. 1999).

20. *See supra* note 14 and accompanying text.

21. La. R.S. 47:287.12 (1990).

22. La. R.S. 47:32(A), (B) (1990)

classified as partnerships, including partnerships in commendam, LLPs, and LLCs, that have not elected to be classified as corporations for tax purposes.[23]

Under the current Louisiana income tax rules, the income of a C corporation is potentially subject to a double tax. Corporate income is taxed first when the corporation earns the income,[24] and again when the income is distributed to shareholders as dividends.[25] In contrast, the owners of interests in a pass-through entity generally pay income tax on their individual shares of the entity's income as it is earned;[26] subsequent distributions of profits are free of tax.[27]

As a practical matter, it would be difficult for Louisiana to eliminate the double tax on corporate income without eliminating the corporate income tax. The corporate double tax is inherent in the federal tax regime[28] and the Louisiana income tax provisions adopt the federal rules with modifications in order to ease the burden of administration and taxpayer compliance in computing taxable income.[29] It is not necessary to eliminate the corporate double tax, however, because the double tax is easily avoided by closely held corporations and because Louisiana does not tax dividends distributed to persons that are not residents of Louisiana. Rather than distributing corporate profits as dividends, many corporations distribute profits to shareholders in the form of salaries. A single level of tax applies to corporate profits distributed as salaries, because, while the salaries are income to the employee-shareholder,[30] amounts paid as salaries are deductible from the corporation's income, thereby reducing the amount of corporate profits subject to income tax.[31] In addition, dividends paid by corporations transacting business in Louisiana to persons that are not subject to Louisiana income tax, such as tax-exempt entities and nonresident individuals and corporations, generally are not subject to Louisiana tax.[32]

Shareholders in closely held corporations also avoid the corporate double tax by financing their corporations, in part, with debt, rather than with equity contributions. Interest payments constitute income to the shareholders,[33] but they

23. Treas. Reg. §§ 301.7701-1 through 301.7701-3 permit an entity other than a corporation that has two or more members to elect to be classified as a corporation or a partnership for federal tax purposes. Treas. Reg. § 301.7701-3(a)(1993). An entity other than a corporation that has only one member may elect to be classified as a corporation or a disregarded entity. *Id.* If an entity is eligible to elect to be classified as a disregarded entity and makes the election, the entity will be treated, for tax purposes, as a sole proprietorship (if the sole owner is an individual) or as a branch or division of the owner (if the sole owner is a corporation). Treas. Reg. § 301.7701-2(a) (1993).

24. I.R.C. § 11 (2000); La. R.S. 47:287.11(B) (2001).

25. I.R.C. §§ 61(a)(7), 301(c) (2000). For state tax purposes, dividends generally are taxable if they are received by an individual who is a Louisiana resident. La. R.S. 47:293(6)(a), 47:296 (2001).

26. I.R.C. §§ 702, 1366(a) (2000).

27. I.R.C. §§ 731(a), 1366(b), (c) (2000).

28. I.R.C. §§ 11, 301 (2000).

29. *See, e.g.*, La. R.S. 47:287.61, 287.63, 287.65(1990), 47:293(6)(a) (2001).

30. I.R.C. § 61(a)(1) (2000).

31. *See* I.R.C. § 162(a)(1) (2000) (authorizing a deduction for reasonable salaries).

32. La. R.S. 47:121, 47:241, 47:243(A)(4) (1990).

33. I.R.C. § 61(a)(4) (2000).

are deductible by the corporation.[34] Thus, with respect to interest payments, a single level of tax applies at the shareholder level. On the other hand, payments of principal on shareholder-held debt, while not deductible by the corporation, constitute a return of capital to the shareholders, and therefore are not income to the shareholders. Thus, the corporation pays tax on corporate profits that are distributed to shareholders as payments of principal, but the distributions are not included in the income of the shareholders. In other cases, a closely held corporation may avoid the double tax by electing to be taxed as an S corporation.

While it is more difficult for widely held corporations to avoid the double tax, not much income of widely held corporations actually is subject to a double tax in Louisiana. Louisiana residents owning corporate stock must pay tax on corporate earnings that are distributed to them as dividends.[35] Dividends received by nonresident individuals and corporations, however, generally are not subject to Louisiana income tax.[36] Thus, while a portion of a widely held corporation's income may be subject to a double tax in Louisiana, much of the corporate income may be subject only to a single level of state income tax.

B. *Corporate Franchise Tax*

If a business is operated as a C corporation or an S corporation, the entity must pay the Louisiana corporate franchise tax in addition to the tax imposed on the corporation's net income.[37] The Louisiana corporate franchise tax is imposed at a rate of $3.00 for each $1,000, or major fraction thereof, of a corporation's capital stock, surplus, undivided profits, and borrowed capital.[38] In essence, the corporate franchise tax is a property tax.

The burden of the corporate franchise tax falls primarily on capital-intensive corporations such as manufacturing concerns. Partnerships and LLCs do not pay the corporate franchise tax. An LLC does not pay Louisiana corporate franchise taxes, even if the LLC is treated as a corporation for income tax purposes.[39]

Now that the economy has become more service-oriented, the burden of the corporate franchise tax falls only on a small sector of corporate taxpayers. Moreover, the corporate franchise tax is easily avoided. A corporation can convert to a partnership in commendam, a limited partnership, or an LLC under state law without

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34. I.R.C. § 162(a) (2000).

35. *See* La. R.S. 47:293(6)(a) (2001) (defining the term "tax table income" for Louisiana residents by reference to federal adjusted gross income); I.R.C. § 61(a)(7) (2000) (including dividends in income).

36. *See* La. R.S. 47:243(A)(4) (1990) (dividends received by a nonresident alien individual or a corporation generally allocable to a nonresident individual's legal domicile or a corporation's commercial domicile); § 47:287.11(B) (2001) (imposing the Louisiana corporate income tax on a corporation's Louisiana tax table income); § 47:293(7) (2001) (defining a nonresident individual's Louisiana tax table income by reference to the individual's Louisiana income).

37. La. R.S. 47:601(A) (1990).

38. *Id.*

39. Under La. R.S. 47:601, the Louisiana corporate franchise tax is imposed on "corporations." For purposes of the Louisiana corporate franchise tax, an LLC is treated as a partnership in commendam. La. R.S. 12:1368 (1994).

changing its federal and state status as a corporation for income tax purposes. If a corporation converts to an LLC and makes a federal check-the-box election to be taxed as a corporation,[40] the corporation will not recognize any gain on the conversion. However, by converting from corporate form to an LLC, the entity will escape Louisiana corporate franchise tax. In three separate rulings, the Internal Revenue Service provided guidance for tax payers desiring to convert a corporation to a limited partnership or LLC without incurring potential adverse tax consequences.[41] The private letter rulings illustrate the ease with which a taxpayer may convert a corporation to a limited partnership or LLC.[42]

Taxpayers in Louisiana can convert a corporation to a partnership or LLC by using either of two methods. On the one hand, the parties may utilize the merger statutes under Louisiana law to merge a corporation into a newly-formed LLC or partnership.[43] Alternatively, the parties may form a partnership or LLC and have the newly-formed entity acquire all of the assets of the corporation in exchange for interests in the entity. As long as the newly-formed entity makes a check-the-box election to be classified as a corporation for federal tax purposes, the transaction should qualify as a tax-free "assets-for-stock" reorganization under section 368(a)(1)(C) of the Internal Revenue Code.

Only a small number of corporations are unable to convert to LLCs. Such corporations include corporations that have nonassignable contracts and permits that would be lost if the form of the business entity were to change.

With the increase in popularity of the LLC form of business and the ease of converting a corporation to an LLC, the corporate franchise tax base is shrinking. For many taxpayers, the Louisiana corporate franchise tax is a trap for the unwary.

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40. *See* discussion of Treas. Reg. §§ 301.7701-1 through 301.7701-3 (1993), discussed *supra* note 23.

41. *See, e.g.*, Priv. Ltr. Rul. 2000-07-011 (Nov. 16, 1999); Priv. Ltr. Rul. 1999-47-034 (Aug. 26, 1999); Priv. Ltr. Rul. 1999-42-009 (July 16, 1999). If an entity that is classified as a corporation converts to an LLC or partnership in commendam that is classified as a partnership for federal tax purposes, the conversion is treated as a liquidation of the corporation. Treas. Reg. §301.7701-3(g)(1)(ii) (1999). Liquidation of a corporation may trigger gain recognition both to the shareholders and to the corporation. I.R.C. §§ 331(a), 336(a) (2000). In each of the private letter rulings, the conversion of a corporation to an entity that was classified as a corporation for federal tax purposes was intended to qualify under I.R.C. § 368(a)(1)(F) as a tax-free reorganization. While the Internal Revenue Service did not rule on the issue, the conversions should have qualified under I.R.C. § 368(a)(1)(F) because they resulted in a mere change in form of the corporation.

42. *See, e.g.*, Priv. Ltr. Rul. 2000-07-011 (Nov. 16, 1999)(conversion of corporation to limited partnership classified as a corporation did not cause the corporation at any time to be treated as an entity other than a corporation for federal tax purposes); Priv. Ltr. Rul. 1999-42-009 (July 16, 1999) (conversion of S corporation to limited partnership classified as a corporation did not cause the corporation to have more than one class of stock even though the partnership had partners with different management rights because partners had equal rightsto distributions and liquidation proceeds; ruling prevented termination of the corporation's subchapter S election that would have occurred if it had more than one class of stock); Priv. Ltr. Rul. 1999-47-034 (Aug. 26, 1999) (conversion of corporation with common and preferred stock to LLC with interests providing the formershareholders the same rights and preferences they had before the conversion did not cause adverse gift tax consequences under I.R.C. § 2701).

43. La. R.S.12:117 (2001).

Only those taxpayers that are unaware of the check-the-box rules or are unable to convert their corporations to LLCs will continue to pay the corporate franchise tax.

The Louisiana Legislature could eliminate the disparity in the application of the franchise tax and strengthen the franchise tax base by imposing the franchise tax on all businesses or on all business organizations that offer investors limited liability under state law. However, as explained above, the franchise tax imposes an unfair burden on capital-intensive businesses. Service enterprises benefit from state services to the same extent as capital-intensive businesses. Thus, there is no justification for imposing a tax in addition to the state income tax only on capital-intensive businesses.

C. Policy Considerations

Corporate taxation should not be used as a method of disguising the true cost of government to its citizens. In many respects, state government uses businesses as the tax collector, and a taxes are reflected in higher prices charged by the company, reduced prices paid to suppliers, lower compensation paid to employees, or smaller distributions of corporate profits accepted by the shareholders.[44] It is impossible to estimate how much of the increase in prices, decrease in amounts paid to suppliers, reduction in wages, or decrease in dividend distributions is due to higher taxes or other costs of doing business. Thus, the cost of state government is hidden in the price of the product or the price of inputs used to make the product, as opposed to being fully recognized in the rate of taxation.

Lawmakers tend to make tax policy decisions by focusing only on the legal incidence of a tax. In other words, the taxpayer is considered to be the person who is legally responsible for paying the tax. In contrast, economists suggest that the tax legislation should be enacted after taking into account the economic incidence, or the person or persons who actually bear the burden of the tax after the market has reacted to the imposition of the tax.

If the Louisiana Legislature wants to tax businesses equitably, it should define the appropriate tax base and associated tax rates. At the same time, the Louisiana Legislature should be aware of the incidence of the tax it chooses to impose. To raise revenue from businesses, states have utilized occupational license taxes, corporate income and franchise taxes, sales taxes on business transactions, and taxes defined for specific industries such as the excise premium license tax on insurance premiums or the natural gas franchise tax.[45]

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44. There is a distinct difference between legal incidence, which is the legally imposed responsibility for paying the tax to the government, and economic incidence, which is the ultimate burden of the taxes as borne by various participants in the market, ranging from consumers to workers to stockholders to other such participants. *See* Richardson & Hildreth, *supra* note 14.

45. Forty-five states impose a corporate income tax; Forty eight states impose a corporate franchise or license tax; Fifty states impose an occupational license tax; and forty six states impose a sales tax but with varying definitions of the tax base as it pertains to business transactions. *See* Bureau

An income tax on business profits often is justified because its burden falls more heavily on taxpayers that have the ability to pay. In other words, the income tax is an excise on a taxpayer's net profits, which are determined after taking into account payment of business expenses. The state cannot automatically conclude, however, that businesses have the "ability to pay" only if they have net income.

The definition of "Louisiana taxable income," the amount on which the income tax is imposed, does not necessarily reflect the ability of a business to pay tax. The tax code contains many incentives encouraging businesses to invest in certain property or activities that reduce net taxable income below the real economic income of the business. For example, the allowance of generous depreciation deductions for businesses[46] is designed to encourage businesses to invest in equipment and other business assets. A business taking advantage of depreciation deductions may have plenty of cash flow, even though it is operating at a tax loss.

Business taxation also can be justified on the grounds that businesses should reimburse the state for benefits and services that they consume. For example, the state incurs tremendous costs in providing businesses an educated workforce, maintaining highways, and offering a legal environment in which courts will enforce contracts and ensure limited liability to owners of certain business organizations. There is no concrete or necessary relationship, however, between the public services consumed by businesses and the taxes that are paid in the form of corporate income taxes or corporate franchise taxes. In fact, such taxes are paid only if a company is a corporate entity and only if the corporation actually earns taxable income within its taxable year. The Louisiana Legislature's decision to exact lower taxes from non-corporate business organizations implies a legislative assumption that non-corporate business organizations consume fewer public services than corporations.

Under the income tax rules, businesses that do not earn a tax profit in one year are not charged for any public services that they might have consumed during the year. Therefore, businesses are charged for public services only when they have taxable income. As with the corporate franchise tax, which incorrectly suggests that corporate entities consume public services in proportion to their capital intensity, the tax on net income is not connected to the value of state benefits consumed by a business organization..

The current method of taxing business organizations also is problematic because it does not provide a predictable stream of revenue for the state. State corporate income tax revenues vary substantially from year to year. As explained earlier, the corporate franchise tax base has eroded and continues to erode because investors are using non-corporate business organizations that are not subject to state franchise taxes.

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of Governments, U.S. Department of Commerce (1998).

46. *See, e.g.*, I.R.C. § 168 (2000) (permitting accelerated depreciation allowances); I.R.C. § 179 (2000) (permitting a taxpayer to "expense" up to $24,000 of depreciable personal property acquired in taxable years beginning in 2001 and 2002); § 197 (2000) (allowing 15-year amortization of intangible such as goodwill and going concern value whose useful life is indeterminate).

For example, Louisiana corporate income and corporate franchise taxes together generated $551 million of revenue for the 1994-95 fiscal year.[47] The amount of corporate income and franchise tax revenues peaked in 1996-97 at $624 million.[48] For the 2000-2001 fiscal year, the state is expected to collect only approximately $450 million.[49]

Reliance on corporate income and franchise taxes also causes forecasting problems for the state. Louisiana's fiscal year begins in July and ends in June of the next year.[50] Corporate taxes, however, are primarily received in April and May of the fiscal year.[51] The Louisiana Legislature must prepare the state's budget for the succeeding fiscal year during the legislative session before most corporate taxes are collected for the current year. If corporate tax revenues do not meet expectations, there is almost no time left in the preceding budget current year to correct the problem.[52]

Taxation of corporations under the current corporate income and corporate franchise tax laws is inappropriate because there are many other forms of business organization that do not pay franchise taxes and whose income is taxed at a lower rate than corporate income; the corporate income tax base fluctuates radically from year to year; the corporate franchise tax base is being eroded by changes in the types of business entities now being organized under state law; and the corporate franchise tax is imposed only on capital as opposed to the entire range of inputs used in the production of goods and services.[53] The current structure of the state corporate tax does not serve the needs of the state, nor does it provide an adequate connection between public services consumed by businesses and taxes paid by the various business entities.

Horizontal equity requires that all businesses of approximately the same size that use approximately the same amount of state public services should be taxed as uniformly as possible. The current tax system, as outlined in Table 1, makes economic distinctions on the basis of the taxpayer's form of business organization, capital intensity, and profitability, and not on the basis of the taxpayer's use of public services. Similar business enterprises that use the same amount of state public services are not necessarily taxed in the same fashion. An alternative business tax proposal creating equal treatment of equals, as well as short and long-term budgetary stability for the state, should be seriously considered.

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47. Presentation to the Revenue Estimating Conference, Economic Assumptions and Revenue Forecasts for Fiscal Years 1999/2000 and 2000/2001, Office of Planning and Budgeting, Louisiana Division of Administration (May 10, 2000).

48. *Id.*

49. *Id.*

50. La. R.S. 39:53(D) (Supp. 2001).

51. Revenue collections for the past ten years suggest that almost 80 percent of all corporate taxes paid within the state's fiscal year are received in the last three months of the fiscal year.

52. Robert Keaton of the Louisiana Senate Fiscal Office, Presentation to the Louisiana State Law Institute Tax Study Committee (Feb. 3, 2000).

53. Progue, *supra* note 19, at 191.

This article proposes that the Louisiana Legislature reduce the maximum corporate income tax rate, repeal the corporate franchise tax and replace excessive corporate taxes with a tax that is applied more equitably to all businesses. The following sections discuss alternative proposals: (1) the value-added tax; and (2) an additional flat tax on net business income.

I. THE VALUE-ADDED TAX

One alternative business tax is the value-added tax, a tax applied to the amount of value added by each firm at every stage of the production of goods and services.[54] Value added is a very common tax base in Europe. Value added is defined as the difference between the value of products sold (revenues) and the cost of materials used to produce the products. Thus, value added can be computed by subtracting the cost of materials from revenues collected on the sale of goods.

On the other hand, the sum of a firm's revenues generally equals the cost of labor, cost of materials, depreciation,[55] interest, and profit. Thus, value added also may be computed by adding a firm's cost of labor, depreciation, interest, and profit (an amount equal to the business's revenues) less its cost of materials. Regardless of how value added is computed, value added represents the firm's business activity. Thus, value added more closely measures the amount of state benefits and services enjoyed by the firm than net income.

European countries generally utilize two different methods of computing the value-added tax: (1) the credit-invoice method; and (2) the subtraction method.[56] Both methods compute the value-added tax base by subtracting the cost of materials from gross revenues. Under the credit-invoice method, a business pays the value-added tax to a supplier. Later, when the business sells its goods or services and collects the value-added tax from the buyer, the business claims a credit for the value-added tax it paid the supplier and remits the balance to the government. The following example illustrates the application of the credit method of computing the value-added tax:

> **EXAMPLE #1:** Assume that a bakery purchases farm goods, such as milk, butter, eggs, flour, and sugar, from local farmers for $5,000. If the state has in effect a one-percent value-added tax, the bakery will pay the farmers $5,050 ($5,000 cost of farm products, plus $50 of value-added tax, *i.e.*, one percent of $5,000). The farmers then will keep the $5,000 for their farm products and remit the $50 of value-added tax received from the

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54. For a discussion of the value-added tax, see generally, Alan Tait, *Value-added tax, National*, in The Encyclopedia of Taxation and Tax Policy 422 (Joseph J. Cordes et al. eds. 1999).

55. A business's use of capital is represented by depreciation. Depreciation is thereduction in value of a business's assets, through wear and tear and obsolescence. Thus, depreciation roughly measures the business's consumption of capital. McGraw-Hill Dictionary of Modern Economics 130 (3d ed. 1983); P. Samuelson & W. Nordhaus, Modern Economics 902 (12th ed. 1985).

56. For a description of the two methods utilized by European countries for imposing a value-added tax, see Eric Toder, *Comments on Proposals for Fundamental Tax Reform*, 66 Tax Notes 2003, 2005 (Mar. 27, 1995).

bakery to the state tax collector. Assume that the bakery charges a wholesale distributor $8,000 for its baked goods. The wholesale distributor must pay the bakery $8,080, consisting of $8,000 purchase price, plus $80 of value-added tax. If the state utilizes a creditable value-added tax, the baker will remit to the tax collector $30 of value-added tax ($80 received from the wholesale distributor, less $50 in value-added taxes paid to the baker).

Assume that the wholesale distributor then sells the baked goods to retailers for $10,000. The retailers will pay the wholesale distributor $10,100 ($10,000 for the baked goods, plus $100 in value-added tax). The wholesale distributor will pay the tax collector $20 of the $100 of value-added tax that it collects from the retailers, claiming a credit for the $80 of value-added tax that the wholesale distributor paid to the bakery.

Assume that the retailers then sell the baked goods to consumers for $12,500. Consumers will pay $12,625 for the baked goods ($12,500, plus $125 of value-added tax). The retailers will remit to the tax collector $25 ($125 of value-added taxes received from consumers, less $100 of value-added taxes paid to the wholesale distributor).

The subtraction method value-added tax is a close variant of the credit-invoice method. Under the subtraction method, a business is liable for a value-added tax on the difference between sales to and purchases from other businesses, including purchases of buildings and equipment. Example #2 illustrates the application of a subtraction method value-added tax.

EXAMPLE #2: Assume the same facts as in Example #1. Each farmer computes its value added as the price of the farm goods to the bakery, but does not include the value-added tax. Thus, the tax on the farm goods provided to the bakery is one percent of $5,000, or $50. The bakery pays the farmers the $50 tax, and the farmers remit this amount to the government. The bakery computes its value added by subtracting the $5,000 price it paid the farmer, without regard to the $50 value-added tax, from $8,000, the price the baker charges the wholesaler. In this example, $5,000 is subtracted from $8,000, and the tax base is $3,000. The bakery then remits $30 to the government. The wholesaler may pay the bakery more than $8,000 for the bakery's products. For example, if the bakery wants to pass some or all of the $ 50 value-added tax burden it incurred to the wholesaler, it may charge the wholesaler more than $5,000 for the bakery goods. Nevertheless, the bakery calculates the value-added tax base without including the value-added tax paid by baker or the wholesaler. The wholesaler pays one percent of its contribution to the value added of this product with its contribution being computed as the difference between the selling price of the baked goods to retailers, less the cost of the baked goods to the wholesaler without including any value-added tax at any level.

The credit-invoice method and the subtraction method are different methods of administering the value-added tax. If the value-added tax is applied to all goods and

services at the same rate, a credit-invoice method value-added tax will have the same economic effect as a subtraction method value-added tax.

As the foregoing examples illustrate, the value-added tax has the potential to increase the cost of goods and services to consumers. Businesses along the chain of production may pay a value-added tax, but they receive a refund of the tax when they collect from the person to whom they sell their goods and services. The incidence of the value-added tax, however, does not necessarily fall as heavily on consumers as the foregoing examples may seem to indicate.

A business will not be profitable unless it sells a significant amount of goods and services. Prices that a business charges must be competitive. In pricing its goods and services, a business must take into account any tax a purchaser will be required to pay. To keep its prices competitive, a business may reduce the amount of compensation it pays to employees, exact lower prices from suppliers, or distribute smaller amounts to investors. Thus, the value-added tax is likely to affect a number of persons involved in the production, purchase, and sale of goods and services that are subject to the tax. The economic incidence of the value-added tax is difficult to determine, especially if the taxpayer is engaged in a business that competes in national markets or global markets, or both.

A third method of imposing a value-added tax is the addition method. Under an addition method value-added tax, a business adds up all of the payments made to the owners of the business and to the providers of the labor and capital used to bring about the added value of the materials or services initially purchased.[57] Example #3 illustrates the application of an addition method value-added tax.

> **EXAMPLE #3**: Assume the same facts as in Example #1. In computing its value-added tax base, the bakery will add up its costs in producing the baked goods, including the amount of salaries paid to workers and the depreciation on equipment. The bakery will pay the value-added tax on this amount. Thus, for example, if the bakery incurs $3,000 of expenses in producing the baked goods, the bakery will pay a value-added tax computed as one percent of $3,000, or $30. The price that the bakery charges the wholesaler for its baked goods may or may not include a mark-up that reflects the value-added tax that the bakery paid to the state. The wholesaler will also add the cost of its inputs, including for example, the amount of salaries paid to workers and depreciation on the warehouse, to determine the value-added tax base.

For those who are familiar with the income tax, it may seem inappropriate to require taxpayers to pay tax on the cost of producing goods and services, items that usually are deducted from gross income to determine the net income that is subject to an income tax. The tax base for the value-added tax, however, is value added, rather than net income.

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57. The addition method value-added tax has been adopted by Michigan and New Hampshire. Mich. Comp. Laws Ann. §§ 208.1 -208.145 (1998 and Supp. 2000); N.H. Rev. Stat. Ann. §§ 77-E:1-E:14 (Lexis Supp. 2000); *see* discussion *infra* notes 64-85 and accompanying text.

Unlike the income tax, the value-added tax is a tax on business activity.[58] A business generally consumes state services in proportion to the amount of business activity it conducts in the state. Thus, a value-added tax more appropriately measures the proportionate amount of state services that a business consumes than the income tax. The more state services a business consumes, the more it should be required to pay the state for those services.

As Example #3 illustrates, it is difficult to estimate precisely the full impact of a value-added tax. Like the incidence of the income tax, the incidence of an addition method value-added tax may fall upon suppliers, workers, consumers, and/or business owners. Therefore, if the Louisiana Legislature decides to adopt a new tax like the value-added tax, it should impose the tax initially at a low rate and on an experimental basis to avoid creating distortions in the state's economy.

The value-added tax has not been popular in the United States. While bills that would replace the federal income tax with a value-added tax have been introduced in Congress,[59] none have been passed.

A number of critics of the value-added tax have objected to the tax on the grounds that it increases the cost of goods and services.[60] Because low-income taxpayers spend most of their income purchasing necessary goods and services such as food, clothing, shelter, and utilities, many have argued that the value-added tax is regressive. In contrast, an income tax that applies at graduated rates to increasing increments of income imposes a heavier tax burden on taxpayers with larger amounts of disposable income who are better able to pay.

As explained earlier, however, the incidence of the value-added tax is difficult to determine. While the tax applies to the price that a business charges for its goods and services, the price that the seller establishes will take into account the fact that the purchaser must pay a tax on the amount that is charged. Therefore, the seller may be required to request a lower price for its goods and services than it would request in the absence of the value-added tax.

One of the problems with the bills that have been introduced in Congress is that the bills would *replace* the federal income tax with a value-added tax. While the value-added tax is a tax on business activity,[61] it may be easier to pass the incidence of a value-added tax to the consumer than an income tax because the consumer's bill will show the amount of value-added tax due and, therefore, the consumer can blame Congress, rather than the retailer, for the high cost of goods and services.

Replacing the federal income tax with a value-added tax also would result in double taxation of retirees. Retirees who paid income tax on amounts that were invested in savings would be taxed again on the same income when they spent their savings on consumption.[62]

58. William Oakland & James A. Richardson, *A Layman's Guide to the Value-added tax*, in Louisiana's Fiscal Alternatives 182 (James A. Richardson ed. 1988).

59. Freedom and Fairness Restoration Act of 1995, H.R. 2060, 104th Congress.

60. *See, e.g.*, Jane G. Gravelle, *The Flat Tax and other Proposals: Who Will Bear the Tax Burden?*, 69 Tax Notes 1517 (1995).

61. Oakland & Richardson, *supra* note 58.

62. Sheldon D. Pollack, *Consumption Taxes, Flat Taxes, Capital Gains, and Other Tax Fantasies*, 66 Tax Notes 577, 582 (Jan. 23, 1995); Lee A. Sheppard, *Consumption Tax Debunking at Tax*

Moreover, if the federal government replaced the federal income tax with a value-added tax, it could create significant fiscal problems for states. States rely heavily on consumption taxes, such as sales taxes, as an important source of revenue. A federal value-added tax, when added to state sales taxes, would likely make the overall tax structure, both at the federal and state level, more regressive.

Furthermore, the elimination of the federal income tax could cause difficulties for states trying to enforce their own income taxes. States like Louisiana "piggyback" the federal income tax rules in applying state income taxes.[63] If the federal government were to replace the federal income tax with a value-added tax, states would either have to lose income tax revenues or else adopt their own rules for taxing income. If states enacted their own rules for taxing income in the absence of a federal income tax, state revenue departments would not be able to rely on federal income tax audits to verify state income tax returns. Thus, replacing the federal income tax with a value-added tax would create a serious financial burden for states.

Many of the concerns that have prevented the federal government from enacting a value-added tax do not exist at the state level. Unlike the federal government, the states traditionally have imposed consumption taxes like the sales tax. Moreover, it is not necessary to impose a value-added tax in lieu of the state income tax. Indeed, this article proposes a low-rate value-added tax to supplement the income tax on businesses.

Currently, Michigan and New Hampshire are the only states that have in effect a value-added tax. Both states utilize addition method value-added taxes. While the Michigan statutes refer to the value-added tax as a "single business tax" and New Hampshire's value-added tax is labeled a "business enterprise tax,"[64] this article sometimes will refer to each tax as a "value-added tax."

New Hampshire's Business Enterprise Tax was enacted in 1993.[65] The New Hampshire tax imposes a tax at a rate of 0.5 percent tax on the taxable enterprise value tax base of every business enterprise.[66] For this purpose, the term "business enterprise" generally is defined as any profit or nonprofit enterprise or organization, whether corporation, partnership, LLC, proprietorship, association, trust, business trust, real estate trust or other form of organization engaged in or carrying on any business activity within New Hampshire.[67] A business is exempt from the tax if it has $100,000 or less in gross receipts or if its business enterprise tax base is $50,000 or less.[68] The statute allows only a few other exemptions from

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Foundation Conference, 69 Tax Notes 1071, 1072 (Nov. 27, 1995).

63. *See, e.g.*, La. R.S. 47:293(1), (2), (3), (6)(a), (7); 47:287.61, 47:287.63; 47:287.65 (1990 and Supp. 2000).

64. N.H. Rev. Stat. Ann. § 77-E (Lexis Supp. 2000).

65. For a discussion of New Hampshire's Business Enterprise Tax, see V. Hummel Berghaus, IV, & William F.J. Ardinger, *The Policy and Structure of the Business Enterprise Tax*, 34 N.H.B.J. 5 (1993); Ebel et al., *supra* note 54, at 424; N.H. Rev. Stat. Ann. ch. 77-E, N.H. Code Admin. R. Ann. Rev. ch. 2400.

66. N.H. Rev. Stat. Ann. § 77-E:2 (Lexis Supp. 2000).

67. N.H. Rev. Stat. Ann. § 77-E:1(III) (Lexis Supp. 2000).

68. N.H. Rev. Stat. Ann. § 77-E:5(I) (Lexis Supp. 2000).

Unlike the New Hampshire tax, the Michigan tax has been highly unpopular. Currently, Michigan is in the process of phasing out its Single Business Tax; the tax will completely expire after 23 years, beginning in January 1999.[69]

Michigan's value-added tax has generated controversy for a number of reasons. Businesses object to paying the Single Business Tax in years when they are not making a profit.[70] The Single Business Tax, with its many complications, has provoked litigation.[71] The tax has increased in complexity over the last 25 years as legislators have provided relief to certain taxpayers. Since 1975, there have been 17 major changes in the Single Business Tax.[72] Many consider the current rules unfair. Some have observed that what once was a broad-based tax paid by all businesses is now a narrow-based tax paid by fewer taxpayers.[73]

In recent years, Michigan has experienced a surplus in state revenues. The surplus has provided the state an opportunity to initiate the repeal of the tax. The repeal is incremental. As explained above, the tax will be phased out over a 23-year period. The length of the phase-out period allows the Michigan Legislature an opportunity to resurrect the tax and reform it, if necessary, to meet the state's future fiscal needs. Indeed, the statute provides that the scheduled phase out will be deferred if the Countercyclical Budget and Economic Stabilization Fund (Michigan's rainy day fund) falls below $250 million at the end of any fiscal year.[74] Thus, if the Michigan economy slows and budget reserves must be utilized, the phase-out of the Single Business Tax will discontinue, to be resumed only if and when the reserves reach $250 million.

The repeal of the Michigan Single Business Tax does not necessarily indicate that a value-added tax is problematic *per se*. New Hampshire's experience has been positive. The New Hampshire experience suggests that a value-added tax will not create so much controversy if it is a simple tax, imposed at a low rate, and does not provide the state's sole source of business revenue.

In fact, the repeal of the Michigan Single Business Tax suggests that the tax has been successful. It was enacted at a time when the state was facing falling revenues because of a slump in the state's economy that had been largely dependent on automobile manufacturers. Michigan now has a booming economy that includes growth outside the automobile industry. *Site Selection Magazine*, a publication concerning economic development, has ranked Michigan as the best state to locate a business and the second-best state for manufacturing.[75] Some have

69. 1999 Mich. Pub. Act 115; H.R. 4745, 90th Leg. Res. Sess. (Mich. 1999).

70. David Brunori, *The Long Fadeout of Michigan's SBT*, 17 State Tax Notes 965 (Oct. 11, 1999); Kenyon, *supra* note 75, at 1608.

71. Kenyon, *supra* note 75, at 1609.

72. Robin C. Capehart, *Proposing a State VAT: The Political Experience in West Virginia*, 2000 State Tax Today 79-23 (Apr. 24, 2000).

73. *Id.*

74. Mich. Comp. Laws. Ann. § 208.31(1)(c)(5) (West Supp. 2000). For an explanation of the phase-out, see David S. Turzewski & Marjorie Bilyeu Gell, *The Phase out of SBT: What Will It Mean for Taxpayers?*, 17 State Tax Notes 22 (July 5, 1999).

75. Jack Lyne, *Michigan Nips California for 1998 SS Governor's Cup as Records Shatter*, Site Selection Magazine Online (March 1999) http://conway.com/>sshighlites/0399/p182/.

opined that Michigan's Single Business Tax helped stabilize state revenues, and has helped produce such a large surplus that legislators now can consider eliminating the state's business taxes entirely.[76]

The Louisiana Legislature briefly considered the value-added tax during its 2000 Regular Session.[77] House Bill 235, that would have implemented a single business tax in Louisiana, was introduced in and passed by the Louisiana House Ways and Means Committee, but was not placed on the calendar on the House floor.[78] Opposition to House Bill 235 arose for a number of reasons. Concern was expressed that the legislature and those who would be affected by a value-added tax did not have sufficient time to consider the bill and its effect on businesses and the state economy before the end of the legislative session. House Bill 235 would have imposed a value-added tax at a rate of 1.85 percent and was expected to raise $1.8 billion of revenue in the first year of its implementation. Legislators were uncomfortable with the uncertain economic effects of an unfamiliar tax that would generate such a large amount of revenue.

As explained above, a value-added tax has never been imposed in Louisiana or any state other than Michigan and New Hampshire. Because the value-added tax provides a different way of taxing businesses, any bill that would impose a value-added tax in Louisiana should be carefully drafted by a committee, presented to taxpayers in a number of information sessions, and considered by the Louisiana Legislature only after much deliberation and discussion. The concerns of industry, tax specialists, and the Louisiana Department of Revenue should be carefully considered before a value-added tax bill is enacted. Initially, the Louisiana Legislature should impose a value-added tax at a very low rate. The tax should be applied at a low initial rate so that the projected effect on the economy, on state revenues, and on taxpayers can better be predicted if the legislature decides to rely more heavily on a value-added tax in the future.

Despite the limited use of the value-added tax in the United States at the federal and state level, the tax is an attractive substitute for the various types of business taxes that are now imposed at the state and federal level.[79] The value-added tax, with appropriate adjustments to other business taxes, is an excellent method for taxing businesses in a manner consistent with their use of public services; for providing budget stability for state government that use business taxes to reimburse the state the public services that it provides to businesses; and for maintaining a competitive tax environment for the state's long-term economic development and growth.

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76. Capehart, *supra* note 81.

77. HB 235, Reg. Sess. (La. 2000).

78. One of the authors was present at the Louisiana Ways and Means Committee when the Louisiana Business Activity Tax passed. The bill then was not considered for a debate by the full House.

79. "The United States has debated the possibility of adopting a VAT on numerous occasions. It has been seen as a way to reduce the budget deficit, finance Social Security, replace the corporate and personal income tax, and finance a health scheme or defense." Tait, *supra* note 54, at 423-24.

A. "Value Added": One Method of Computing the Amount

Table 2. Value added Transactions for Making Bakery Products

Transactions	Market Value as Product Leaves this Stage of Production	Value Added By this Activity*
Production of Raw Materials by Farm Community	$5,000	$5,000
Processing of Raw Materials Into Bakery Products	$8,000	$3,000
Wholesale Distributor	$10,000	$2,000
Retail of Bakery Products	$12,500	$2,500
Total Value Added		$12,500

* Value added is market value as product leaves each stage of production, less market value as product left the previous stage of production.

Value added as computed in Table 2 can be identified in the following calculation for the retail establishments in the foregoing example:

Market Value of Product or Service	$12,500
less initial cost of Product or Service to retailer	$10,000
equals value added by retailers	$ 2,500.

The first step in computing the value added by a company is to determine the market value of the product as it leaves the company. From that amount, the company subtracts the market value of the product as it entered the company. The difference is the value added by the company. The value added by the company represents the company's contribution to the creation of the product.

Example #4 illustrates the computation of value added in the case of a business involved in the manufacture or production of goods. The concept applies in the same way to other businesses, including businesses providing professional services, financial services, health care, and other services. For example, assume that a law firm provides 40 hours of professional services with a market value of $10,000. In computing the value added by the firm, the

taxpayer would subtract the market value of any raw materials that are purchased by the firm in order to provide the service, including paper, pens, legal forms, and other materials that have been created by other firms. The difference is the value added created by the law firm.

B. *Alternative Method of Computing Value added*

Another method of computing value added is based on inputs. Under the inputs method, each company adds up the cost of the resources or inputs used by the company in creating the value added. The inputs method is illustrated by the following example:

> **EXAMPLE #5**: Assume the same facts as in Example #4. A bakery purchases farm products from local farmers for $5,000 and sells breads and other baked goods for $8,000. The market value of the products as they leave the bakery is $8,000. The cost of the raw materials to the bakery is $5,000. The value added at this stage of the production process is $3,000. The value added also represents amounts the company paid its workers as compensation for their services, interest the company paid loans, rental payments for machinery that the company used in the production of the products, payments for any other resources that the company used in producing the bakery products, depreciation on property owned by the company and used in producing the bakery products, and profits paid to investors. In other words, another method of computing value added is to add up the dollars paid to the various inputs used in creating the value added, including the depreciation expense and the profits accruing to the owners of the company.

The inputs method of computing value added is used by Michigan. Michigan defines its value-added tax base is as follows:[80]

Federal Adjusted Business Gross Income (representing profits)
plus Depreciation Expense (representing use of capital)
plus Interest Paid (representing payments on capital)
plus Wages and Salaries, including bonuses, commissions, and all fringe benefits (representing payments to workers)[81]

80. What is the Single Business Tax, Michigan Department ofTreasury, Form No. 3280 (Sept. 1999).

81. Effective in 1995 Michigan excluded FICA, unemployment insurance, and workman's compensation contributions in defining total compensation for tax purposes under the Single Business Tax. Mich. Comp. Laws Ann. § 208.4(3) (West 1998 and Supp. 2000).

plus Royalties and Lease Payments (representing payments to various owners of resources used un production of goods and services)
less Royalties, Interest, and Dividends Reported on Federal Income Tax Returns
plus Taxes Based on Income (representing payments for public services)
less Cost of Capital Assets Acquired in the State During the Taxable Year

As the foregoing formula illustrates, Michigan includes all payments for inputs in computing the value-added tax base. Such payments include remuneration to workers, lenders, and providers of facilities and land, as well as profits distributed to investors in the company for their organizational contributions and risk taking. In addition, Michigan adds depreciation expense to its definition of the value added base because the depreciation expense represents the utilization of the company's capital in producing its goods and services. Under the Michigan statute, capital expenditures are deducted from value added.

In many respects, the computation of value added under the inputs method is the inverse of the computation of net income. The costs of the inputs that are included in value added are the expenses that are deducted from gross income in computing net income. Similarly, capital expenditures are deducted from value added but are not deductible from gross income.[82] If a taxpayer incurs a capital expenditure to acquire depreciable property, the taxpayer deducts the expenditure as depreciation or amortization deductions over the recovery period of the property in computing taxable income.[83]

C. Items Not Included in the Value-added tax Base

Value added does not include the assets of a firm. For example, the deposits and loan portfolio of a bank are not included in the value-added tax base. Value added also does not include premiums collected by an insurance company or the value of the policies held by an insurance company. Value added cannot be determined by examining the balance sheet of a firm. The typical income statement of a firm does not provide an estimate of value added without additional computations. However, the information contained in the income statement allows for the computation of value added.

Value added is a flow concept—that is, value added changes during the year. Value added is not a stock concept—that is, value added cannot be measured at a point in time.

82. *See generally* I.R.C. § 263 (2000).
83. *See generally* I.R.C. §§ 167, 168, 197 (2000).

D. *Taxes to be Replaced*

As explained above, the Louisiana Legislature could enact a value-added tax to replace the revenues that would be lost from equalizing the burden of state taxes on all businesses, regardless of the form in which a business is operated. Enacting such a value-added tax would generate sufficient revenue to allow the legislature to repeal the corporate franchise tax and adjust the corporate income tax rates to conform to the individual income tax rates.

As explained earlier, horizontal equity demands that the corporate income tax rate structure be consistent with the individual income tax rate structure. Thus, corporate income should be taxed according to the following rate schedule: two percent on the first $20,000 of net corporate income, four percent on the next $80,000 of net corporate income, and six percent on any net corporate income above $100,000.[84] Presently, the corporate rate schedule is four percent on the first $25,000 of net corporate income, five percent on the next $25,000, six percent on the next $50,000, seven percent on the next $100,000, and eight percent on net corporate income above $200,000.[85] It is projected that harmonizing the corporate and individual income tax rates would cost the state from $60 to $90 million.[86]

The corporate franchise tax should be eliminated. As explained earlier, the Louisiana corporate franchise tax falls most heavily on capital intensive industries. The tax also applies only to corporate entities, and not to any other business entities such as LLCs, partnerships, or sole proprietorships. Moreover, the Louisiana corporate franchise tax is imposed at a much higher rate than franchise taxes imposed in most other states.[87] Most states exact the corporate franchise tax as a license fee for the privilege of transacting business in the state, and not as a major source of revenue.[88] It is projected that eliminating the corporate franchise tax would cost the state from $250 to $275 million.[89]

In equalizing the taxation of businesses, the legislature also should consider whether to apply the value-added tax to banking corporations and insurance corporations in lieu of the state taxes that such corporations currently pay. Under the current rules, banks pay an ad valorem tax on stockholder equity in lieu of a corporate franchise tax.[90] Insurance corporations pay an excise

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84. *See generally* La. R.S. 47:21-285, 47:290-299 (1990 and Supp. 2001).

85. *See generally* La. R.S. 47:287.2-287.785 (1990 and Supp. 2001)

86. Projection made by James A. Richardson, co-author of this article, based on information from Louisiana Department of Revenue.

87. Census of Governments, U.S. Department of Commerce, 1997. In 1997, the average corporate franchise tax in the United States was $25 per capita, while in Louisiana the tax was almost $70 per capita. *Id.*

88. The franchise tax is listed as a corporate license for U.S. Census of Government purposes. *Id.*

89. Projection made by James A. Richardson, co-author of this article.

90. La. R.S. 47:606.2 (1990).

premium tax in lieu of corporate franchise taxes.[91] An insurance company also may claim a credit against income taxes for the excise premium tax it pays.[92]

Because banking corporations and insurance corporations do not pay corporate franchise taxes, eliminating the franchise tax will not reduce the amount of tax such corporations currently pay. Banks, however, would benefit by a reduction in the corporate income tax rate. The ad valorem tax on shareholder equity paid by banking corporations and the excise premium tax paid by insurance corporations may have the same economic and revenue impact as the franchise tax that they replace.[93]

If a value-added tax is enacted, the legislature also should adjust appropriately the state sales tax on machinery and equipment. The purpose of any tax reform is to make the business tax environment competitive, thereby attracting businesses to the state. Imposing a state sales tax on machinery and equipment is inconsistent with taxing policy in other states.[94] The sales tax operates in a manner similar to the value-added tax, exacting an excise on the amount charged for goods at each stage of the production. Unlike the value-added tax, however, the sales tax has a cascading effect, *i.e.*, the sales tax applies to each item purchased by a business, but the business cannot offset the sales tax that it collects when it sells its goods. While the cascading effect of the sales tax is offset somewhat because a business may deduct the sales tax it pays in computing net income, the reduction of taxable income that results from the sales tax deduction does not generate a dollar-for-dollar credit against state income taxes. The sales tax also differs from the value-added tax in that most services are exempt from sales taxes, whereas all services generally are included in the value-added tax base. Thus, producers of goods bear a much heavier sales tax burden than service providers.

Replacing all state sales taxes with a value-added tax would help equalize the treatment of all businesses because the service sector would bear a similar burden as capital-intensive businesses under a value-added tax. However, if the Louisiana Legislature eliminated all state sales taxes, it would have to impose a value-added

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91. La. R.S. 47:608.10 (1990). Article VII, Sections 4, 20, and 21 of the Louisiana Constitution authorize all property tax exemptions. Stocks and bonds are specifically exempted, except for bank stock. The excise license tax (on insurance policies) for state and local governments is permitted by La. R.S. 22:2, 1061-1076, 1079, 1265, and 1661-1662.

92. La. R.S. 47:227 (1990).

93. While the current taxation of banks and insurance companies differs from that of other businesses, banks and insurance companies should be subject to the value-added tax. However, a special analysis for such companies may be necessary. For example, interest earned by a bank or insurance company generally is considered business income, whereas the same income earned by another type of enterprise may be considered investment income. Michigan provides special rules for computing the Single Business Tax that is imposed on financial organizations and insurance companies. Mich. Comp. Laws Ann. §§ 208.21-208.22f (Lexis 1998). Similarly, the New Hampshire Business Enterprise Tax exempts from the value-added tax base interest paid to depositors of a mutual bank or credit union and certain amounts that are paid, credited or set aside in connection with reserves by insurers to fulfill policy and contractual responsibilities. N. H. Rev. Stat. Ann. § 77-E:1(VI)(e), (XI) (Supp. 2000).

94. *See* comments by Louisiana Law Institute Tax Study Committee to Louisiana Legislature, Spring 2000.

tax at a rate of 2.5 percent to replace only lost sales tax revenues. Because there is no way to determine the effect of a value-added tax on industries, consumers, and the state economy, it is not advisable to impose a value-added tax at a high rate at this time. If the legislature enacts a value-added tax statute imposing a low rate of tax, information can be gathered that will help project the effect of a higher rate that might apply in the future.

Nevertheless, some sales taxes paid by businesses should be eliminated if a value-added tax is adopted in Louisiana. Selective elimination of sales taxes would have a significant impact on different industries. For example, the legislature should eliminate the sales tax on machinery and equipment.[95]

The sales tax on machinery and equipment should be eliminated because machinery and equipment constitute the same capital that will eventually be depreciated and subsequently computed as part of value added. On the other hand, the sales tax on materials purchased by businesses applies to items that would not be included in the value-added tax base.

Moreover, eliminating both the sales tax on machinery and equipment and the sales tax on materials would reduce state revenues by $600 million. The elimination of the sales tax on machinery and equipment is projected to cost the state approximately $315 million.[96] If the value-added tax is to be imposed at a low rate, Louisiana cannot afford to eliminate too many taxes without a substantial loss in state revenues.

The projected loss of revenues by Louisiana as a result of changing the corporate income tax structure, eliminating the corporate franchise tax, and eliminating the sales tax on machinery and equipment is expected to range from $625 million to $680 million. The proposal advocated by this article is not intended either to raise or to reduce state revenues. The Louisiana Legislature should enact a value-added tax because it provides an alternative tax base that is more efficient and equitable. Hence, the value-added tax should raise about $625 million to $680 million in order to keep the proposal revenue-neutral.

D. Effect of Implementing a Value-added tax in Louisiana With Adjustments for other Business Taxes

The following table lists the amount of value added by the top 15 contributors to value added, from the largest contributor to value added in Louisiana to the lowest such contributor, excluding the government sector.[97] The information contained in the table provides a useful economic backdrop in identifying the industries that generate value added in Louisiana.

95. *See* James A. Richardson & David W. Hughes, State of Louisiana, A Report on Alternative Tax Impacts 4 (2000).

96. *Id.* at 19-20.

97. *Id.* at 2.

Table 3. Value added by Louisiana Industries

Industry	Percent of Value added
Oil and Gas	13.2%
Financial Services	10.9%
Transportation-Utilities	9.6%
Retail Trade	7.9%
Chemicals, Plastics	6.7%
General Services (repair, recreation, etc.)	6.3%
Medical Services	6.1%
Wholesale Trade	5.3%
Construction	4.9%
Refining	2.4%
Business Services (accounting, engineering, etc.)	2.1%
Fabricated Metals	1.5%
Food Processing	1.5%
Legal Services	1.4%
Paper Products	1.3%

The fact that production of oil and gas tops the list of industries that create value added in Louisiana is not surprising. The state is endowed with abundant oil and gas reserves, even after many years of development and production from the onshore fields. Financial services ranks second. Financial services include banking, real estate, and insurance services. Transportation, including road transportation, water transportation, and utilities, are third. Total value added in the Louisiana economy equaled about $111.2 billion, including government agencies, and $971 million, excluding government agencies, in 1999.[98]

Based on the foregoing numbers, a 1.0 percent value-added tax will generate about $1.0 billion in tax revenues. Thus, a 0.75 percent value-added tax should offset the revenue loss resulting from the reduction in the corporate income tax, the

98. *Id.* at 14, 16.

elimination of the corporate franchise tax, and the elimination of the sales tax on business purchases of machinery and equipment.[99]

Table 4. Effect of Imposing 0.75% Value-added tax, Reducing Corporate Income Tax, and Eliminating Corporate Franchise Tax and Sales Tax on Machinery and Equipment (in millions of dollars)

Industry Group	Value added Taxes Paid	Net Taxes After Other Business Tax Reductions
Agriculture	$7.8	($0.3)
Forestry, Fishing	$3.2	$0.5
Mining Other than Oil and Gas	$1.8	($2.7)
Oil and Gas	$110.0	$62.6
Construction	$40.5	$4.9
Food Processing	$12.4	$1.6
Apparel	$2.4	$1.3
Lumber	$5.4	$2.4
Wood Products	$0.2	($0.3)
Paper	$10.6	($0.6)
Printing	$3.9	($2.7)
Chemicals, Plastics	$55.8	($13.0)
Refining	$20.4	($34.1)
Leather	$0.01	($0.1)

99. *Id.* at 20. The net tax impact is based on the estimated taxes to be paid under the value-added tax less the corporate taxes and sales taxes paid by each of these industries under the current tax system. The value-added tax estimates are based on economic information developed by the U.S. Department of Commerce on a state by state and industry by industry basis. Actual tax data for the value-added tax do not exist so all of the estimates are based on general economic information. On the other hand, the estimates of reductions in corporate taxes paid are based on aggregate information by industry derived from the Louisiana Department of Revenue. These are actual tax collections by industry adjusted by the proposed tax changes. The sales tax estimates are based on purchases of machinery and equipment as developed by the U.S. Bureau of the Census by industry and the appropriate state sales tax rate. These estimates are based on the best information available.

Glass, Clay, Concrete	$1.8	($0.8)
Metal Foundries	$1.2	($1.2)
Fabricated Metals	$12.7	$2.1
Electrical Equipment	$2.5	($0.7)
Transportation Equipment	$8.4	$2.3
Electronic Equipment	$0.5	($2.5)
Other Manufacturing	$0.7	($19.8)
Transportation-Utilities	$79.8	($79.1)
Wholesale Trade	$44.4	$6.4
Retail Trade	$66.0	($1.1)
Financial Services	$90.7	$57.5
General Services	$52.3	($4.7)
Medical Services	$50.8	$33.9
Legal Services	$12.0	$8.5
Educational Services	$5.6	$4.0
Social Services	$7.5	$4.9
Business Services	$17.1	$8.5
Total	$728.5	$37.7

Table 4 illustrates the likely effect of reducing corporate income taxes, eliminating the corporate franchise tax, and eliminating the sales tax on business purchases of machinery and equipment and the imposition of a value-added tax in Louisiana. For example, it is estimated that the agricultural industry would pay $7.8 million in value-added taxes, but after subtracting corporate taxes and sales taxes on machinery and equipment, which will be repealed, the net tax impact on the agricultural industry would be a slight reduction in business taxes of about $266,000. It also is projected that the oil and gas industry would experience a net increase in taxes of approximately

$62 million, while the petrochemical industry, including chemical plants and refineries, would enjoy a net reduction in business taxes of about $47 million.

In general, the substitution of a value-added tax in exchange for a reduction in the corporate income tax and elimination of the corporate franchise tax and the sales tax on machinery and equipment would shift the business tax burden from the manufacturing sector and the transportation and utilities sector to the service sector, the oil and gas sector, and the trade sector of the economy. The shift is appropriate because the service, oil and gas, and trade sectors enjoy the same benefits that the state provides all sectors of the economy but do not shoulder their share of the burden of paying for those benefits under the current state tax law. One of the greatest benefits that the service sector enjoys is the state's provision of an educated workforce.

The current business tax structure was created during a time when manufacturing was the dominant force in the economy and the service industry had not yet experienced its dramatic growth. As explained earlier, Louisiana business taxes are imposed primarily on capital. Thus, capital intensive industries such as manufacturers bear the majority of current business taxes. The value-added tax is based on all inputs, not just capital. Thus, if a value-added tax is implemented in Louisiana, all industries will share the tax burden.

E. Considerations in to be Taken Into Account in Implementing a Value-Added tax

The real challenge in drafting value-added tax legislation, as in drafting any tax legislation, is to create a law–and the accompanying regulations–that is as consistent with the economic definition of value added as possible. While the concept of value added is relatively simple, the details of a value-added tax law may be complex.[100]

No tax is free of complications, especially in a complex economy. In considering any business tax, the Louisiana Legislature should take into account the effect of taxes imposed by various levels of government, such as parish sales taxes, and the myriad of products and services that are produced in other states that may not be subject to Louisiana tax. In addition, the legislature must make fundamental decisions about what should be included and what should be excluded from the tax base. The value-added tax is no exception. The following sections present the considerations and choices that complicate the decision as to whether to adopt a value-added tax in Louisiana and the nature of such a tax.

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100. There is considerable controversy regarding these details and the administrative costs of levying a value-added tax. Tait indicates, "The VAT is not a cheap tax to administer." Tait, *supra* note 54, at 423. A wide range of administrative costs are presented in Edith Brashares, *Replacing the Federal Income Tax*, *in* Handbook on Taxation, *supra* note 14, at 556-57. As a practical matter, an addition method value-added tax should not present any additional administrative issues as compared to a net income tax on corporations or other business enterprises. A company must generate the same information to calculate a profit tax as it does to compute a value-added tax.

1. Destination or Origination[101]

If Louisiana adopts a value-added tax, the legislature must decide whether Louisiana should use the destination or origination principle in applying the tax. Under the destination principle, a state taxes items sold and consumed in the state, including exports from other states, but excludes items produced in the state and sold elsewhere. Taxation by destination places the cost of government upon consumers of goods and services sold in the state, regardless of where the products are produced. A destination tax can ultimately be paid by households or by businesses. A sales tax employs the destination principle.

If the legislature chooses to utilize the origination principle, the state will tax items produced in the state, regardless of where such items ultimately are sold, and exclude items produced in other states but sold in Louisiana. Taxation by origination places the tax burden on the business activity used in producing the goods or services, regardless of where the product or service is sold and/or consumed.

From a purely economic perspective, there is no preference for taxation under the destination or under the origination principle. Taxation based on origination is justifiable because businesses use public services in the process of producing goods and services. Businesses should pay for public services regardless of where the goods are sold. As explained above, any tax that a business pays in exchange for services constitutes one of the costs incurred in producing the goods and services and should be incorporated into the price of the goods or shifted to other participants in the production process. A value-added tax based on the origination principle is similar to a broad based income tax because the tax is based on what Louisiana produces, not what its citizens consume.

The destination principle is justifiable because all public services ultimately are consumed by individuals. Thus, individuals should pay for the public services they consume, regardless of where the goods and services are produced. As in the case of all business taxes, it is difficult to determine the incidence of a value-added tax based on this destination principle. The manner in which the burden of such a tax is distributed among the various participants in the production and consumption process is not ascertainable. The final consumer will incur some of the tax burden, but not necessarily all of it. The amount of the burden of a destination-based value-added tax on the consumer depends on the market conditions under which the various products and services are produced. A value-added tax based on the destination principle is similar to a broad based sales tax because the tax is based on what Louisiana citizens consume, not what they produce.

Whether a state should adopt a value-added tax based on the destination principle or on the origination principle depends on administrative feasibility and the other components of the state's tax structure. For example, a state with a high sales tax rate would want to avoid levying the value-added tax based on the

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101. *See* George Carlson, *Destination Principle and Origin Principle*, The Encyclopedia of Taxation and Tax Policy 77, 267 (Joseph J. Cordes et al. eds. 1999).

destination principle because such a tax would compound the sales tax burden. On the other hand, a state with a high income tax rate would want to avoid levying the value-added tax based on the origination principle because it would compound the income tax burden.

If a state wants to formulate a balanced tax structure, the value-added tax must be incorporated into the entire tax structure. Because Louisiana imposes a high sales tax and a relatively low income tax, a value-added tax based on origination would be more compatible with a balanced tax structure in Louisiana than a value-added tax based on destination. Moreover, a value-added tax based on origination appears to be easier to administer than a value-added tax based on destination. Firms already provide most of the information required for a value-added tax based on the origination principle to the state when they file income tax returns.

Constitutional constraints also should be considered in deciding whether to adopt an origination or a destination-based value-added tax. If Louisiana adopts a value-added tax based on destination, it may not be able to enforce the tax with respect to goods provided by nonresident individuals and firms. The Commerce Clause of the United States Constitution[102] and the Due Process Clause of the Fourteenth Amendment[103] prohibit a state from imposing tax on the income, property, or activities of a firm that are attributable to a state other than the state seeking to impose the tax.[104]

The United States Supreme Court has held that a state may not impose a sales tax on goods sold by a nonresident unless the nonresident has certain minimum contacts with the state. In *Quill Corp. v. North Dakota*,[105] the Court held that the Commerce Clause of the Constitution prohibits a state from imposing a sales tax on a mail order business that has no physical presence in the state. A destination-based value-added tax resembles a sales tax in application. *Quill* may limit the state's ability to impose such a tax on the consumption of certain items in the state. Because of the constitutional limitations that are likely to apply in the case of a destination-based value-added tax, it may be necessary to impose a higher rate of tax under a destination-based value-added tax than under an origination- based tax. On the other hand, an origination-based value-added tax is likely to pass constitutional muster.[106]

2. Exemptions

In enacting a value-added tax, the legislature also should consider whether it wants to exempt certain items. For example, utilization of capital, as measured by depreciation expense, economically contributes to the production of goods or

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102. U.S. Const. art. I, § 8, cl. 3.

103. U.S. Const. amend. XIV, § 1.

104. *See, e.g.*, Mobil Oil Co. v. Commissioner of Taxes, 445 U.S. 425, 100 S. Ct. 1223 (1980); Standard Oil Co. v. Peck, 342 U.S. 382, 72 S. Ct. 309 (1952); Ott v. Mississippi Valley Barge Line Co., 336 U.S. 169, 69 S. Ct. 432 (1949).

105. 504 U.S. 298, 112 S. Ct. 1904 (1992).

106. In *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358, 111 S. Ct. 818 (1991), the Supreme Court held that Michigan's Single Business Tax, an origination-based value-added tax, is constitutional.

services and therefore is included in value added. While the economic definition of value added includes depreciation, the legislature may desire to exclude the depreciation expense from the value-added tax base to encourage capital investment in Louisiana. Alternatively, the legislature could encourage capital investment by including depreciation expenses in the value-added tax base, but allowing capital expenditures to be deducted from the value-added tax base whenever such expenditures are actually incurred. If capital expenditures are deducted from the value-added tax base, tax revenues will be recovered when the capital expenditures are ultimately depreciated.

Other expenditures could be excluded from the value-added tax base to encourage other forms of investment. For example, the legislature could exclude wages and other forms of compensation to encourage businesses to hire more employees and independent contractors, thereby adding jobs to the state economy. However, if the legislature begins excluding items from the value-added tax base to encourage economic activities, the tax is likely to create economic inefficiency because firms will take the tax consequences into account before making business and investment decisions. It would be more efficient and useful to allow the economy to operate in the context of a neutral tax system, rather than to create a targeted tax system. In a tax-neutral environment, business decisions are based only on economic considerations, instead of state-engineered tax incentives.

The legislature also might consider exempting certain industries, such as health care providers, from the value-added tax to stem the rising cost of certain goods and services. Such exemptions would be consistent with current state sales tax law designed to reduce certain consumer costs or to foster certain industries.[107]

However, if the legislature allows exemptions from the value-added tax base it may be necessary for the legislature to impose a higher rate of tax than would be required if the value-added tax base included all economic value added. Otherwise, the legislature could not raise a sufficient amount of revenue to replace the revenues that would be lost by repealing the corporate franchise tax and reducing the corporate income tax rate, at least for the short-term. It is possible that in the long-term certain exemptions may generate sufficient economic activity to provide additional revenues.[108] However, such long-term projections are very fragile.

Moreover, state governments are typically faced with balancing a budget within a short-term horizon. The policy makers will have to decide if such incentives are more valuable than merely having a neutral tax structure which incorporates a very broad tax base and a low tax rate.

107. Title 47 is replete with exemptions and exclusions. *See, e.g.*, La. R.S. 47:302.1, 47:305, 47:305.1-47:305.49 (1990).

108. Certain tax exemptions may encourage additional economic activity, whereas other tax exemptions, such as current sales tax exemptions for health care services, are based on equity considerations.

3. Taxing the Service Sector

Over the last twenty years, the service sector has been, by far, the fastest growing sector of the Louisiana economy in terms of employment. The service sector includes businesses providing professional services such as legal, accounting, engineering, business and management consulting, and educational and social services; medical services, including medical care provided by physicians, hospital care, and nursing home care; recreational services, including hotels, casinos, theaters, and other recreational outlets; and repair services.

In 1980, approximately 250,000 persons were employed in the service sector, comprising approximately 15 percent of the total employment in the state. Presently, there are approximately 550,000 persons employed in the service sector, comprising more than 25 percent of all persons employed in the state.[109] The foregoing figures do not include the financial sector which presently employs over 80,000 persons in Louisiana.[110] The financial sector includes banking and depositary services, insurance services, real estate services.

Taxing the service sector, however, provides one of the special challenges in administering a value-added tax. For example, application of a value-added tax is fairly simple with respect to a local law office that provides legal services only to local clients. All of the value added that is attributable to the legal fees is located in the state. The value added by the local law office can be computed by measuring the profits earned, the wages paid, the interest paid on any outstanding loans, depreciation expenses, and any direct taxes paid.

A value-added tax would not create any competitive disadvantage for any of the local law firms providing services to and for local clients. All local firms would be subject to the same tax. However, a value-added tax could create a competitive disadvantage for Louisiana law firms that have offices in other states, that do legal work for clients or companies headquartered in other states or other countries, and that compete with law firms in other states for business within Louisiana. Many of the same problems are also encountered by businesses that produce goods, but in the case of a business producing services, it may be more difficult to identify where the service was performed.

The application of the value-added tax to businesses that provide goods would not present as much of a competitive disadvantage because the net taxes paid by producers of goods would not increase significantly, or would be reduced if Louisiana adopted a value-added tax, whereas the total tax burden on the service sector would increase. Since services are not taxed so heavily in other states, the increase in the state tax liability of service providers might create competitive disadvantages. On the other hand, if the state excluded the service sector from the value-added tax base, the state would have to impose a heavier tax burden on manufacturers and merchants to ensure revenue stability, thereby violating principles of horizontal equity.

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109. Loren C. Scott et al., Louisiana Economic Outlook: 2001 and 2002 (2000).

110. *Id.*

4. Gradual Implementation of a Value-added tax in Louisiana

Implementation of a value-added tax in Louisiana would create a major change in the business tax structure of the state. Companies that do not pay corporate income or franchise taxes, such as sole proprietorships, partnerships, and LLCs, would be subject to the value-added tax.[111] Businesses would calculate their taxes using a new and different tax base. The value-added tax also would require changes in the administration of the tax by the Louisiana Department of Revenue.

It would be very difficult to accurately predict business tax revenues if the state radically revised the business tax structure in one year. Any major restructuring of the taxes will cause the revenue estimates to be very fragile until there is a history of revenues that actually are collected. Furthermore, the Louisiana Department of Revenue will need time to promulgate the rules and regulations that will apply to the value-added tax. Such a major tax change as the implementation of a value-added tax would best be accomplished by a gradual revision of the tax structure. An attractive method of phasing in the tax over time would be to impose a value-added tax at a low rate for a three-year period, but to allow businesses to claim value-added taxes as a credit against other business taxes paid. This method would provide hard data with which to analyze the impact of the tax on various industries and to provide reliable estimates of expected value-added tax revenues. For example, if Louisiana adopted a value-added tax at a rate of 0.25 percent, economists would have hard data on which they could rely to predict the impact of the tax on various industries and the actual tax collections that can be expected. In addition, the application of a low rate of tax for the first few years in which the tax is implemented would provide sufficient time for the state revenue department to establish rules and regulations for the effective administration of the tax. After the state has had sufficient time to study the effect of a 0.25-percent value-added tax, it could implement a 0.75 percent tax for another three-year period. If the state allowed a credit against other businesses taxes for value-added taxes paid, the value-added tax would be imposed only after the Louisiana Legislature had time to examine the results of the experiment. In that case, no new taxes would be imposed and no current taxes would be repealed or reduced until there was sufficient data to assess the burden and economic implications of the value-added tax.

The Louisiana Legislature should gradually implement the tax rather than radically change the business tax structure and the tax base. If the value-added tax were gradually introduced in Louisiana, the new tax would not disrupt the economy in any unexpected way. Gradual implementation of the tax also would provide the Louisiana Department of Revenue an opportunity to administer the tax in an appropriate fashion.

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111. Exemptions for small businesses are typically included in the legislation. For example, in Michigan, tax credits are permitted for businesses with adjusted business income of less than $475,000, gross receipts below $10 million, and adjusted business income to any business owner below $115,000. *See* Form No. 3280 from the Michigan Department of Treasury.

III. BUSINESS PROFITS TAX

As explained above, the value-added tax has not received much political support in the United States. Some of the resistance to the value-added tax results from the uncertain impact a new tax would have on the economy in general and on specific industries in particular. As explained in the foregoing section, a gradual implementation of the tax would alleviate those concerns.

Because the value-added tax may increase the cost of goods and services, it could place a heavy burden on low-income taxpayers who consume most of their income for necessities such as food, clothing, shelter, and utilities. As explained above, however, the real incidence of the value-added tax is difficult to determine. Nevertheless, because the effect of the value-added tax has not been tested in any of the United States other than Michigan and New Hampshire, there is much uncertainty concerning the effect that such a tax would have both on consumers and on businesses. It may be difficult to gain sufficient political support for value-added tax legislation in Louisiana.

In lieu of enacting a value-added tax, the Louisiana Legislature could provide horizontal equity in the Louisiana tax law by repealing the corporate franchise tax, reducing the maximum corporate income tax rate from eight to six percent, and enacting a business profits tax. The business profits tax would apply to the net profits of a business (*i.e.*, taxable income), regardless of the form in which the business is conducted. For example, a pass-through entity, such as a partnership or LLC might pay a flat two-percent tax on all of its net profits, in addition to the tax paid by members or partners on their distributive shares of the entity's income. Likewise, a C corporation would pay a flat two-percent tax on its net profits in addition to the income tax that the corporation is required to pay at graduated rates. The exact rate that would be required to offset the loss of revenue from the repeal of the corporate franchise tax and the reduction of the corporate tax rate must be determined. At this time, there is insufficient data to determine the necessary business profits tax rate.

Admittedly, a business profits tax would not achieve some of the goals that would be achieved if Louisiana adopted a value-added tax. Unlike the value-added tax, the business profits tax would apply only to taxable income. As explained above, taxable income does not necessarily reflect real economic income or the ability of a business to pay tax. Moreover, because a business would pay the business profits tax only in years in which it had taxable income, enactment of a business profits tax would cause the state to forego reimbursement for services and benefits provided by the state to a business in years in which the business operated at a tax loss.

While the economic incidence of either a business profits tax or a value-added tax is likely to be defrayed by businesses, taxpayers and legislators tend to evaluate a tax proposal by focusing on the legal incidence, as opposed to the economic incidence, of a tax. Many perceive that a value-added tax would be paid by the consumer and therefore would make Louisiana businesses less competitive by

increasing the cost of their goods and services. In contrast, the incidence of the income tax is considered to fall on a business's net profits, reducing the amounts that are available to be distributed to investors. While no business wants to diminish the amount of distributable profits, taxpayers may find a business profits tax more palatable, or at least less objectionable, than a value-added tax.

Implementation of a business profits tax should impose fewer administrative burdens on the Revenue Department and smaller compliance costs for taxpayers than a value-added tax. Because a business profits tax is based on familiar tax principles that are already in place, the business profits tax may be more acceptable than a value-added tax that would have an unpredictable impact on businesses, on the economy, and on tax revenues. While the proposal advanced by this article to implement the value-added tax on a gradual and experimental basis should alleviate any concerns about the uncertainties under a value-added tax, the legislature could more quickly achieve horizontal equity in the taxation of business organizations by adopting a business profits tax.

Like the value-added tax, the business profits tax would apply equally to all businesses, regardless of the form of business organization in which the business is operated. The business profits tax also would apply equally to capital intensive industries and to the service sector of the economy. Thus, such a tax would provide horizontal equity in the taxation of business organizations in Louisiana.

The business profits tax would permit the state to eliminate the corporate franchise tax and to tax business income at the same rate. However, a business profits tax would not constitute a major tax reform that would result in long-term economic development. It is unlikely that a business profits tax would encourage business growth in the state.

In contrast, a value-added tax may encourage economic development in Louisiana. Unlike the income tax, the value-added tax applies evenly to all forms of business activity. Businesses that are subject to a value-added tax may make decisions based on economic considerations rather than on tax incentives. Thus, the value-added tax promotes economic efficiency. The Michigan experience supports economists' assessment of the value-added tax.

It also is likely that enactment of a business profits tax, coupled with a repeal of the corporate franchise tax, would increase the volatility of the state's revenue collections because all of its business tax collections would be based on profits. Profits are cyclical by nature; reliance on profits as the business tax base would result in cyclical state tax collections.

The most significant disadvantage of a business profits tax, however, is the ease with which closely held firms could avoid it. Amounts paid to employees as salaries reduce the amount of a business's profits that are subject to income tax.[112] If the legislature enacted a business profits that would apply in addition to the general income tax, small firms would have incentive to pay employee-owners large salaries that would reduce the amount of income subject to the surtax.

112. I.R.C. § 162(a)(1) (2000).

The New Hampshire experience is instructive. Before it enacted its Business Enterprise Tax, New Hampshire's only business tax was its Business Profits Tax.[113] The Business Enterprise Tax was enacted, in part, because of the growing public perception that the Business Profits Tax operated unfairly by effectively exempting certain closely held businesses.[114] In 1988, only 21 percent of the business organizations that filed Business Profits Tax returns paid any tax.[115]

It would seem that administration of a business profits tax would be easy. Because the business profits tax would supplement rather than replace the income tax, the business profits tax base would be the same as the base that is used in computing the income tax. Unlike implementation of a value-added tax, implementation of a business profits tax would not require taxpayers or employees of the Louisiana Department of Revenue to learn new rules and apply a different set of numbers in computing business taxes.

It is likely, however, that a business profits tax would increase taxpayer controversies. As explained above, closely held firms would have incentive to characterize a large portion of their profits as salaries paid to employee-owners. There may be countervailing tax considerations, however, that will reduce the incentive for business owners to avoid a business profits tax by characterizing distributions as salaries. Salaries paid to employees (including employee-shareholders) are subject to social security taxes under the Federal Insurance Contributions Act (FICA").[116] Compensation for services provided by owners of interests in partnerships and LLCs is subject to self-employment tax.[117]

The self-employment tax and the FICA tax each are comprised of two elements: (1) old-age, survivors, and disability insurance ("OASDI"); and (2) hospital insurance ("HI").[118] A self-employed taxpayer, such as a sole proprietor, an LLC member, or a partner, is responsible for payment of the self-employment tax on the taxpayer's self-employment income.[119] The OASDI component of the self-employment tax is computed at a rate of 12.4 percent,[120] and the HI component of the self-employment tax is computed at a rate of 2.9 percent of the individual's self-employment income.[121]

Responsibility for the FICA tax is divided between the employer and the employee. The employer and the employee each must paid the OASDI component of the FICA tax, computed at a rate of 6.2 percent of the employee's wages (or a combined rate of 12.4 percent).[122] The employer and employee each must pay the HI component of the tax, computed at a rate of 1.45 percent of the employee's wages (or a combined rate of 2.9 percent).[123]

113. N.H. Rev. Stat. Ann. § 77-A (1991).
114. Berghaus & Ardinger, *supra* note 65, at 6.
115. *Id.*
116. I.R.C. § 3101 (2000).
117. I.R.C. § 1401 (2000).
118. I.R.C. § § 1401, 3101, 3111 (2000).
119. I.R.C. § 1401 (2000).
120. I.R.C. § 1401(a) (2000).
121. I.R.C. § 1401(b) (2000).
122. I.R.C. § § 3101(a), 3111(a) (2000).
123. I.R.C. § § 3101(b), 3111(b).

There is a ceiling on the total amount of an individual's wages and self-employment income that are subject to the OASDI component of the self-employment and FICA taxes. For self-employment income and wages earned in 2002, the total amount of an individual's self-employment income and wages subject to the OASDI component of the tax is limited to $84,900.[124] There is no ceiling on the amount of wages and earnings from self-employment that are subject to hospital insurance tax of 2.9 percent.[125]

Because the self-employment tax and FICA tax are imposed at a much higher rate than would apply under a business profits tax, business owners may be less likely to recharacterize business profits as salaries, at least for federal income tax purposes. It is difficult for taxpayers to take inconsistent positions by characterizing the same income as business profits for federal tax purposes and as salaries for state income tax purposes. The Louisiana Revenue Department has access to the federal income tax returns filed by Louisiana business entities;[126] therefore, the Department can ascertain whether such taxpayers have reported items of income and deduction consistently for federal and state income tax purposes.

The incentive to treat business profits as salaries is greater for LLC owners and general partners than for limited partners and shareholders in S corporations. A general partner is required to pay both federal income tax and self-employment tax on the partner's distributive share of the partnership's business income, regardless of whether the amount is distributed to the partner and regardless of whether the amount designated as a share of partnership income or a salary.[127] A limited

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124. *See*, I.R.C. § § 1402(b)(1), 3121(a)(1) (2000) (limiting self-employment income and wages subject to the OASDI component of the tax to the contribution and benefit base as determined under § 230 of the Social Security Act); Social Security Administration, Cost-of-Living Increase and Other Determinations for 2002, 66 Fed. Reg. 54047 (Oct. 25, 2001).

125. I.R.C. § § 1401(b), 3101(b) (2000).

126. I.R.C. § 6103(d)(1) (2000) authorizes the Service to disclose federal tax return information to "any State agency, body, or commission, or its legal representative, which is charged under the laws of such State with responsibility for the administration of State tax laws for the purpose of . . . the administration of such laws. . . ."

127. For federal income tax purposes, a partner or LLC member pays tax on his or her share of partnership profits, regardless of whether the profits are distributed to the partner or member. I.R.C. § 702 (2000). If profits are paid to a partner or LLC member as a salary, the deductible salary payment will reduce the partner's share of partnership income under I.R.C. § 162(a)(1), but will be taxed to the partner as a salary under I.R.C. § 61(a)(1). Technically, a partner cannot receive salary from a partnership for income tax purposes unless the partner provides services in a capacity other than as a partner. I.R.C. § 707(a) (2000); Treas. Reg. § 1.707-1(a) (1983). In general, a partner's services are provided in a partner-capacity if the nature of the partner's services are related to the partnership's business and the partner provides the services pursuant to the partnership agreement. *See, e.g.* Pratt v. Commissioner, 64 T.C. 203, *aff'd in part, rev'd in part* 550 F.2d 1023 (5th Cir. 1977). A partner who is paid for services rendered in a capacity as a partner may receive either a guaranteed payment, if the amount of the payment is determined without regard to partnership income, or a distributive share of partnership income, which is computed by reference to partnership income (usually as a percentage thereof). I.R.C. §§ 704(b), 707(c) (2000); Treas. Reg. § 1.707-1(c) (1983). If a partner receives a guaranteed payment for services, the partner must report the payment as ordinary income, and the partnership may claim a deduction for the guaranteed payment unless the payment for the partner's services is a capital expenditure. I.R.C. §§ 61(a)(1); 162(a) (2000). A service provider who receives

partner, however, only pays self-employment tax on guaranteed payments from the partnership for services.[128] While the status of an LLC member as a general or a limited partner for purposes of the self-employment tax is uncertain,[129] it is likely that an LLC member who, like a general partner, participates in the management of the partnership's business will be treated as a general partner for purposes of the self-employment tax.[130] Because the characterization of such income is irrelevant for federal income tax purposes, general partners and managing members of an LLC could avoid business profits taxes, without incurring a greater federal tax liability, if they can characterize amounts they receive from the partnership or LLC as salary payments rather than as a distributive share of the entity's income.

For federal tax purposes, employee-shareholders of an S corporation generally prefer to characterize as salaries the smallest amount of their shares of the S corporation's income as possible. In general, an S corporation shareholder's net earnings from self-employment does not include the S corporation's income that flows through to the shareholder.[131]

The issue of whether an amount distributed to an employee-owner of a corporation is a salary payment or is a distribution of corporate profits is relevant for federal tax purposes. While salary payments are deductible by a C corporation,[132] the corporation may not deduct dividends. Thus, like Louisiana taxpayers that would be subject to a business profits tax, C corporations seek to

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a guaranteed payment may reduce the partner's distributive share of partnership by the amount, if any, of the deduction that is allocated to the service provider. *See* I.R.C. § 702(a) (2000) (partner includes in income and takes into account partner's distributive share of the partnership's items of income, gain, loss, deduction, and credit). When the partnership makes a special allocation of partnership income to a partner as compensation for services rendered in a capacity as a partner, the character of the income to the partner is determined by reference to the character of the income in the hands of the partnership. I.R.C. § 702(b)(2000). The special allocation to the service provider reduces the amount of partnership income that may be allocated to the other partners. In the case of a general partner or a managing member of an LLC, the characterization of income as a share of partnership profits or , a guaranteed payment, salary often is irrelevant for self-employment tax purposes. *See* I.R.C. § 1402(a), (a)(13) (2000) (general partner's distributive share of partnership's business income and guaranteed payments included in net earnings from self-employment).

128. I.R.C. § 1402(a)(13) (2000).

129. In 1994, and again in 1997, the Internal Revenue Service issued proposed regulations that would establish tests for determining whether a member of an LLC would be treated as a general partner or a limited partner for self-employment tax purposes. Prop. Treas. Reg. § 1.1402-2(a)-18, 59 Fed. Reg. 67253 (Dec. 29, 1994); Prop. Treas. Reg. § 1.1402-2(a) - 2(d), (g), (h), (i), 62 Fed. Reg. 1702 (Jan. 13, 1997). Because the proposed regulations were controversial, Congress placed a moratorium until July 1, 1998, on the issuance of temporary or final regulations with respect to the definition of a limited partner for self-employment tax purposes. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, §935, 1997 U.S.C.C.A.N. (111 Stat. 882). To date, no rulings or temporary, final, or newly-proposed regulations have been issued concerning the status of a member of an LLC for self-employment tax purposes.

130. For a discussion of the issue concerning the status of an LLC member as a general or a limited partner for self-employment tax purposes, see Susan Kalinka, Louisiana Limited Liability Companies and Partnerships: A Guide to Business and Tax Planning § 6.2 (2d ed. 1998).

131. *See, e.g.*, Rev. Rul. 59-221, 1959-1 C.B. 225; I.R.S. Pub. No. 589, Tax Information on S Corporations 11 (for use in preparing 1994 returns).

132. I.R.C. § 162(a)(1) (2000).

characterize a large portion of amounts paid to shareholders as salaries rather than as distributions of profits. For federal income tax purposes, a salary payment is deductible only if the amount of the payment is reasonable.[133] Determining whether a purported salary is reasonable requires an inquiry into all of the facts and circumstances and is a hotly litigated issue.

The enactment of a business profits tax in Louisiana is likely to generate controversies between taxpayers and the Revenue Department concerning the reasonableness of an employee-owner's salary.[134] While the Revenue Department may rely on federal income tax audits of C corporations and S corporations, it will not have that advantage in determining whether a purported salary paid to a partner or to member of an LLC is reasonable. Now that so many businesses in Louisiana are operated as LLCs, it is not certain whether a business profits tax would generate more controversy than revenue in Louisiana.

IV. CONCLUSION

The Louisiana Legislature should reconsider the manner in which the state taxes businesses. Currently, the heaviest burden of state business taxation falls upon capital-intensive corporations. Not only is the income of a C corporation subject to a higher rate of Louisiana income tax than the rate that applies to the business income that flows through to individual owners of a pass-through entity, but all corporations are subject to the Louisiana corporate franchise tax.

Horizontal equity requires that similarly-situated businesses be taxed similarly. Thus, for example, a corporation that produces widgets should be subject to the same types and rates of state tax as an LLC that produces the same types of widgets in the same quantity, using the same methods.

As a practical matter, the legislature should reconsider its reliance on corporate taxes because the corporate tax base has eroded and continues to erode. Taxpayers easily can avoid the current corporate taxes by forming LLCs and other limited

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133. I.R.C. § 162(a)(2) (2000).

134. The only form of business entity that is likely to refrain from paying employee-owners high salaries in order to avoid a business profits tax isthe S corporation. S corporation shareholders often attempt to characterize corporate distributions as dividends, rather than salary payments. Distributions from an S corporation generally are tax-free to a shareholder to the extent that the shareholder has paid tax on the income. An S corporation generally does not pay tax on its income. I.R.C. § 1363(a) (2000). Instead, each shareholder pays tax on a pro rata share of the corporation's income. I.R.C. § 1366(a)(1) (2000). The income that passes through to an S corporation shareholder generally increases the basis of the shareholder's stock. I.R.C. § 1367(a)(1) (2000). Distributions from an S corporation generally are tax-free to the shareholder to the extent of the shareholder's stock basis. I.R.C. § 1368(b)(1), (c)(1) (2000). In contrast, an S corporation shareholder's salary income is subject to both the federal income tax and to social security taxes. I.R.C. §§ 61(a)(1), 3101-3128 (2000). Salarypayments also may be subject to federal and/or unemployment taxes. I.R.C. §§ 3301-3311 (2000). The social security tax applies to compensation payments at a rate of 15.3 percent. I.R.C. §§ 3101(a), (b)(6), 3111(a), (b)(6) (2000). Thus, if an S corporation receives payments designated as distributions, rather than as salary, federal tax savings can be achieved. If Louisiana adopts a business profits tax, it is likely that S corporations will not try to disguise dividend payments as salaries because it will be cheaper to pay the business profits tax than the social security tax.

liability entities that do not pay corporate income or franchise taxes. C corporation shareholders have devised ways to reduce corporate income taxes by causing their corporations to pay large salaries to employee-shareholders and by financing their corporations with debt instead of equity contributions. Many closely held corporations have avoided the higher corporate income tax rates by making subchapter S elections. A corporation easily can avoid the corporate franchise tax by converting to an LLC or a partnership in commendam. Thus, state revenues are declining because Louisiana depends so heavily on corporate tax revenues.

Regardless of whether a business is organized as a corporation or other form of business entity, the business derives benefits from the state for which it should pay tax. Businesses tax receipts are necessary to reimburse the state for expenditures that it incurs in providing benefits to business. The value-added tax suggested by this article would ensure that the state receive repayment for the services it provides to businesses and would provide an equitable method for taxing businesses. The business profits tax, as proposed, would provide horizontal equity with respect to the taxation of businesses, but also would create a more cyclical tax base for state governments. The most compelling conclusion of this article is that the Louisiana Legislature should carefully and thoroughly reconsider the state's business tax structure in its entirety. The current tax structure imposes an inequitable burden on a few capital intensive industries. Such a tax structure cannot possibly provide the revenue growth necessary to compensate the state for the utilization of state services by businesses. The state can provide tax relief for a small group of taxpayers without meaningful reform. However, the state cannot provide a tax structure for long-term growth and development without meaningful business tax reform.