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Economic Competitiveness in Louisiana: The Inventory Tax Credit

Louisiana's local inventory tax is assessed on tangible personal property used in a business. This includes goods awaiting sale, commodities that are in the course of production, and raw materials and supplies. Examples of taxable items include retail or wholesale merchandise, commodities from farms, repair parts, and manufacturing by-products, among others.

For decades, Louisiana has maintained an ad valorem tax on inventory held by manufacturers, distributors, and retailers that is assessed and collected by local government**. In 1991, the Louisiana Legislature authorized a five-year phase-in of a state refund of the local inventory tax paid by such businesses, which was a major step to make the state more competitive for business investment and jobs.** This complicated approach was enacted rather than an outright repeal of the local tax because the politics of the time prevented the more direct approach of repeal. Instead, the state chose to essentially subsidize local governments, allowing them to keep the revenue, which totaled an estimated $452 million in 2014.

The state inventory tax credit had an immediate positive economic impact and was credited for bringing a number of new warehousing facilities into the state along with the jobs they created. Today, employers across Louisiana receive a tax credit against their state corporate income and franchise tax liability for the amount they paid to local government. Any amount beyond their state tax liability is refunded to employers up to the amount they actually paid to local government. **More than 10,000 businesses – from large, multi-national corporations to neighborhood grocery stores – pay inventory taxes to local government and claim the refund from the state,** generating about 11 percent of all local property tax collected in Louisiana. The manufacturing industry is the largest sector of the economy that pays the inventory tax, representing nearly one-third of inventory tax credit recipients.

The vast majority of states do not have inventory taxes. In fact, the Tax Foundation estimates only 13 states levy an inventory tax and at least five of these states offer exemptions against the tax. In general, across the country, states are reducing or eliminating taxes on tangible personal property due to their many disadvantages**. From 2000 to 2009, Louisiana saw a 41 percent increase in tangible personal property collections per capita, while the US average actually dropped by 15 percent**. Inventory taxes are avoided because:

- By definition, inventory taxes dis-incentivize investment, expansion, capital accumulation, and growth. That can put neighboring states without the tax at an advantage particularly in attracting distribution centers.
- The inventory tax applies to mobile property that can quickly respond to a change in tax laws and regulations, creating "strong incentives for companies to locate inventory in states where they can avoid these harmful taxes" (Tax Foundation).
- Researchers estimate that a tax increase on personal property, such as the inventory tax, of one percentage point reduces annual employment growth by 2.44 percentage points. Businesses that retain inventories require warehousemen, forklift operators, clerks and staff to maintain

and keep track of those inventories. If employers are forced to shift their inventories elsewhere, the number of these jobs will necessarily decline.

- The negative effect of property taxes, such as the inventory tax, is particularly severe because it is owed by employers regardless of profits in any given year.

- This form of taxation is also cumbersome and requires detailed and regular reporting from employers on goods awaiting sale, commodities in the course of production, and raw materials and supplies as often as monthly.

- Local governments should oppose any change in the current state inventory tax credit, as they would see an erosion of their revenues when companies losing the credit choose to shift inventories to locations where such a tax does not exist. Companies can and will warehouse their inventory in states that do not have an inventory tax. They can later ship that inventory in when it is required.

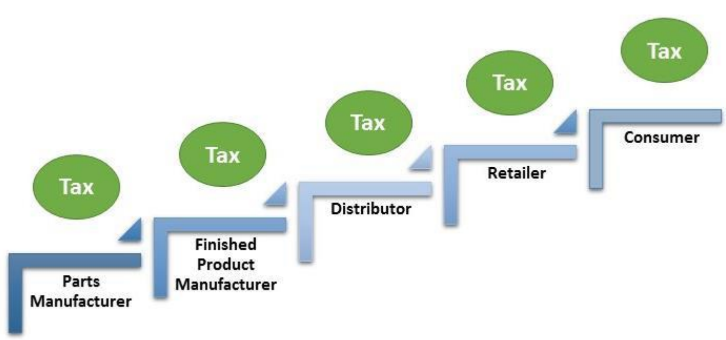
- Inventory taxes are a business expense that will likely be passed on to consumers, raising costs for everyone, not just employers. The effect of inventory taxation is such that consumers can end up paying the inventory tax amount four times over. Here's how:

(1) A parts manufacturer stores raw materials to be used in building a final product. Company A must declare those raw materials as inventory for each month they are held, along with any parts in stock, and accordingly pay the local inventory tax.

(2) Company A then sells the parts to a finished product manufacturer. Company B pays inventory tax on the parts it holds for use in building the finished product along with any of that finished product or good it holds for distribution.

(3) Later, as the good is turned over to a distributor that stores it in a warehouse, the product is taxed anew as inventory for Company C.

(4) Finally, when it is sold to a retailer for sale to consumers, while sitting on that retailer's shelf awaiting purchase, the good is once again taxed as inventory on Company D. So, the parts manufacturer, the finished goods manufacturer, the distributer, and the retailer all pay the inventory tax and each time add it to the cost of the product before the consumer buys it and pays sales tax on top of that.



The Invisible Costs of the Louisiana Inventory Tax Chain

Refunding the inventory tax was seen as a major step to make Louisiana more competitive when it was enacted, and it is still a factor in national rankings of business-friendly states. Today, **Louisiana ranks #35 on the 2015 State Business Tax Climate Index** and #24 on the property tax component – before the Legislature acts on changes to the tax code under discussion for the 2015 legislative session. Due to the generous homestead exemption in Louisiana, employers already tend to bear the burden of property taxes more than individuals; in fact, Louisiana ranks #9 in one study of the degrees that homeowner property taxes are subsidized by industrial and commercial property owners.

In sum, should the state choose to repeal or reduce the state tax credit to industry but leave the local inventory tax in place, **the net result will be an increase in taxes from Louisiana employers to state/local government of $377 million.**