

Remarks of Louisiana State Treasurer John Neely Kennedy to the President's Advisory Panel on Federal Tax Reform

On behalf of all my fellow citizens, I extend to you, the members and staff of the President's Advisory Panel on Federal Tax Reform, a warm welcome to Louisiana. We're proud of our state. The Lord has blessed us and, having blessed us, He blessed us again. We sit at the top of the Gulf Coast. We are located in the middle of the Gulf South. We straddle one of the mightiest rivers in the world. We have more oil and gas than most nations. We excel in agriculture, aquaculture, timber production and petrochemical manufacturing. But our greatest strength is our people. The people of Louisiana are fun-loving, God-fearing and hard-working. We are also diverse. Our heritage is French, Spanish, German, English, Acadian, African-American, Lebanese, and I could go further. Our diversity makes us stronger. But it's the harmony within that diversity that makes us successful. That's why our elementary and secondary school accountability program is a model for other states. That's why we can boast that we have five of the twelve largest ports in the United States in our state. That's why our gross state product is growing at the eighth fastest rate in the country.

I would also like to welcome you to New Orleans. New Orleans is the crown jewel of our state. It's unlike any other city in the world. I'll share with you a quick story. In a previous life I worked for a governor who had traveled to Japan on an economic development mission. He was speaking to a group of Japanese business people and decided to ask them a question. "How many of you have been to Louisiana?" he asked. Three people raised their hand. "How many of you have been to New Orleans?" he then asked. Twenty people raised their hand. We are proud of our city and proud that people want to visit us.

Also in a previous life I served as Secretary of the Louisiana Department of Revenue. That's a fancy way of saying I was the state's tax collector. I collected over \$17 billion in taxes in 3 ½ years, which means it is a minor miracle I was ever elected State Treasurer. Though I did work closely with the Internal Revenue Service, most of my experience with taxes, therefore, is at the state rather than the federal level. Nonetheless, a tax is a tax, and I have learned a few things about state taxes that might help you in formulating ways to improve the federal tax system.

Most reasonable people understand the necessity to levy taxes. I don't think they like it, but they understand it. They just want to know that everyone is paying his or her fair share. That's why the optimum tax system, in my opinion, has the broadest possible base with the lowest possible rates of taxation.

Second, the optimum tax structure should provide a reliable and predictable stream of revenue that grows with the anticipated demand for public services. Congress or the legislature should not have to change the tax laws frequently in order to counter inadequate long-term revenue growth or volatile short-term revenue swings.

Third, the optimum tax system should not strangle business. It should encourage the creation of jobs, not discourage it. American businesses compete directly with businesses in other countries, and capital, labor and products are highly mobile.

Fourth, and I mentioned this earlier, the optimum tax system should be perceived as equitable and fair. Everybody should pay a little bit. The optimum tax system doesn't soak the rich, but it also doesn't drown the middle class.

Finally, the optimum tax system should be simple. Simplicity reduces the cost of administering and complying with the tax laws and assists in maintaining confidence in the fairness of the system.

In short, the ideal tax system, in my opinion, should provide the revenues needed to pay for public services, maintain an environment that is conducive to business development, minimize the resources needed to administer and comply with the tax laws, be broad-based so as to permit low rates of taxation, and be perceived as fair.

Perhaps an insight or two about Louisiana's tax system will be of some benefit to you, particularly as to our experience with the sales and use tax. At the state level, Louisiana levies 17 taxes. We rely primarily on the sales tax, which provides 37% of our state revenue, and the individual income tax, which provides 34%. Because I know you are looking at the possibility of a national tax on consumption, such as a sales tax or a value added tax (which is just another way of collecting a sales tax), it is the state's sales tax on which I would like to offer a few thoughts.

First, the sales tax is not as simple as it looks. The Louisiana sales and use tax is an excise tax. It is a tax upon the transaction itself, not the property involved in the transaction. Louisiana levies the sales and use tax upon a broad range of transactions, including sales at retail; use, consumption and storage for user consumption within the state; leases and rentals; and the performance of statutorily enumerated services. Except for services, the sales and use tax applies only to tangible personal property, such as an automobile, as opposed to intangible personal property, such as a stock certificate. The line of demarcation is often hard to identify, however. For example, what is information? Is it tangible or intangible property? Today data is a significant commodity purchased and sold in an almost endless variety of formats. Which of

its formats will be taxable? And what is “personal property?” Personal, or movable, property can become immovable, such as when a movable is permanently attached to a building. And what is a “sale?” Should isolated or occasional sales, such as the sale of girls scout cookies, be taxed? And what is the “sale price?” Does it include a charge for installation? How do you treat a cash discount or rebate? What about freight? Is that part of the sale price?

A tax system founded substantially on a sales tax also has to address the question of whether to tax services. Louisiana taxes some services, such as the furnishing of sleeping rooms, certain admissions to places of amusement, parking, printing and cleaning services, but not most services. This is a critical issue because our nation’s economy is becoming more and more service-based. Other issues that have to be addressed as to the sales tax include which, if any, exemptions and exclusions will escape the sales tax and how those exemptions and exclusions will affect the elasticity of the tax. For example, Louisiana has a sales tax elasticity of about .75, which means that our sales tax grows at only three-quarters of the rate of growth in the state’s personal income. There are numerous reasons for this, one of which is the number of state exemptions and exclusions. Also, will the sales tax apply to government? What about quasi-public entities such as colleges and universities? How do you handle returned goods? What will be the record keeping requirements? If business collects the sales tax for you, what will be the compensation for doing so? These and many other issues make it clear that the sales tax is not as simple as it might first appear.

Second, any tax system founded substantially on a sales tax must address the question of whether to tax transactions consummated over the internet. In Louisiana, there is a use tax on internet purchases, but most people don’t pay it and it is almost impossible to enforce. The numbers are substantial. The National Governors Association projects state revenue losses to be

more than \$35 billion this year from online purchases. That figure will go to \$45.2 billion in 2006 and around \$55 billion in 2011. Louisiana is expected to have losses of \$1 billion in 2006 and \$1.2 billion in 2011. Only 1.9% of total retail sales nationwide were made online this year, so the revenue losses have the potential to grow substantially over the next 25 to 50 years.

The third point I'd like to make is to encourage you to think of the impact of federal tax reform on the states. It seems to me that, at the end of the day, you have only two basic choices at the federal level: a tax on consumption or a tax on income. If you choose a tax on consumption, such as a sales tax or a value added tax, please be mindful of the fact that almost every other state, such as Louisiana, already relies substantially on a sales tax. As I said, Louisiana levies a state sales tax of 4 cents, which is below the national average. However, at the local government level, maximum sales tax rates are as high as 6.25%, for a combined rate of 10.25%. Thus, Louisiana has one of the highest combined state and local sales tax rates in the country. Adding a sales tax at the federal level on top of this will impact both business and consumers in ways I know you will consider carefully.

If you choose to tax income, please be mindful of the fact that most states rely on the federal government and the Internal Revenue Service for help in administering their own income tax and ensuring compliance, 36 states and the District of Columbia use the federal computation of taxable income as a starting point. States will face increased enforcement costs and/or lost revenue if they do not change their rules to adapt their systems to the federal system. This will be true if you retain a tax on income but change that tax from its current form, or if you reject a tax on income in favor of a national tax on consumption. Additionally, all states rely on tax-exempt bonds to raise capital. Please be mindful of how the changes you recommend will

impact investors' appetite for tax-exempt bonds, which will affect local government as well as state government.

Two final points. First, in my opinion, the federal earned income tax credit, which rewards hard work and family, has done more than any other federal program to lift people out of poverty. In the 2003 tax year, 512,351 Louisiana citizens received \$1.09 billion in earned income tax credits. I urge you to keep the EITC or substitute something better, if such a program exists.

Second, and finally, one of the reasons I believe Louisiana's tax system works reasonably well is because we hold government to the same standard government holds taxpayers. We do so through Louisiana's unclaimed property program. Since 1973, the State of Louisiana has returned over \$110 million in unclaimed property to Louisiana citizens. Our unclaimed property program is very aggressive and very visible and, I believe, contributes to Louisiana taxpayers' sense of fairness and equity. With respect, I cannot say the same for the United States government. For example, the United States Department of Treasury is holding \$12 billion in matured unredeemed savings bonds that belong to American taxpayers with no meaningful outreach program in place to try to return that money. That's just one example. I suggest that if you couple changes to the federal tax system with a federal unclaimed property program, similar to the unclaimed property programs that are so successful at the state level, you will find that most taxpayers in America will be more likely to embrace any changes you recommend.

And with that, I conclude. Thank you for your time and attention. I'm honored to have been asked to make this presentation.