Review of Revenue Losses Reported in the Tax Exemption Budget

Louisiana Department of Revenue

Financial Audit Services
Issued June 30, 2016

LOUISIANA LEGISLATIVE AUDITOR
1600 NORTH THIRD STREET
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LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

June 30, 2016

The Honorable John A. Alario, Jr.,
President of the Senate
The Honorable Taylor F. Barras,
Speaker of the House of Representatives
Secretary Kimberly L. Robinson
Louisiana Department of Revenue

Dear Senator Alario, Representative Barras, and Secretary Robinson:

We performed a review of the 2015-2016 Tax Exemption Budget (TEB) prepared by the Louisiana Department of Revenue (LDR). Our objective was to determine if the 2015 revenue losses reported in the 2015-2016 TEB are adequately supported and accurately represent revenue losses sustained in fiscal year 2015. I hope this report will benefit you in your legislative and operational decision-making processes.

We would like to express our appreciation to the management and staff of LDR for their assistance during our work.

Sincerely,

Daryl G. Purpera, CPA, CFE
Legislative Auditor

EMS:BQD:EFS:aa

TEB 2015

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Louisiana Legislative Auditor
Daryl G. Purpera, CPA, CFE

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June 2016

Audit Control # 80160127

Introduction

The Louisiana Department of Revenue (LDR) is required by Louisiana Revised Statute (R.S.) 47:1517 to prepare and submit to the governor and the Legislature a Tax Exemption Budget[1] (TEB) no later than March 1 of each year. As a part of the TEB, LDR reports for each tax exemption[2] the associated revenue losses for the three previous fiscal years, as well as, the estimated revenue loss for the current fiscal year and the following year. The TEB provides the Legislature with access to data for all exemptions and is referred to frequently by legislators and other state officials. The report is also used to support budget and planning decisions and the creation of and revisions to new legislation. Errors in the preparation or content of the TEB may lead to flawed decisions that impact the future economic position of the state.

The total amount of tax exemptions reported in fiscal year 2015 was approximately $8.3 billion. Included in the reported tax exemptions are tax credits and rebates, referred to as tax incentives. LDR reported that the total revenue loss to the state related to tax incentives for 2015 was approximately $1.6 billion.

We reviewed the 2015-2016 TEB and the methodology used by LDR to extract the financial data from LDR's tax information system to address the following objective:

> **Determine if the 2015 revenue losses reported in the 2015-2016 Tax Exemption Budget are adequately supported and accurately represent the revenue losses sustained in fiscal year 2015 as a result of tax incentives.**

To evaluate the data reported within the TEB, we performed a review of the top 20 tax incentives for 2015 reported in the 2015-2016 TEB. These 20 tax incentives, which are listed in Exhibit 1, represented 97.6% of the total incentives reported and a combined loss of $1,527,837,704.

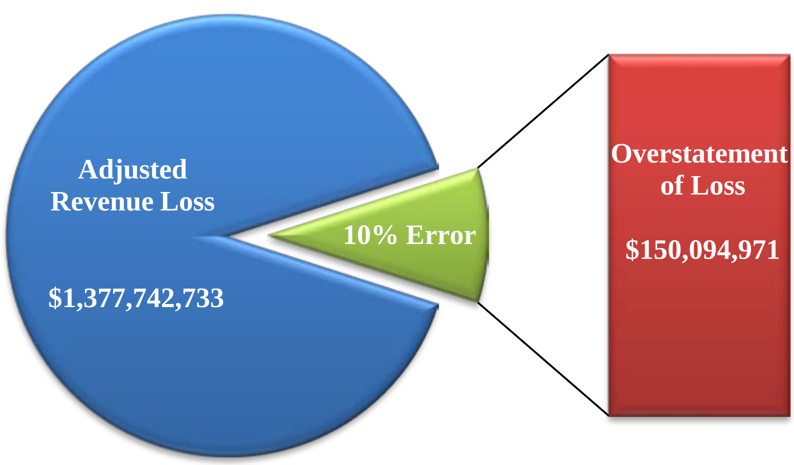
[1] http://revenue.louisiana.gov/Publications/TEB(2015-2016).pdf

[2] *Tax exemptions* means those revenue losses attributable to provisions of the state tax statutes or rules promulgated pursuant to such statutes, which allow a special exclusion, exemption, or deduction from gross income or sales or which provide a special credit, a preferential rate of tax, or a deferral of tax liability (R.S. 47:1517(E)).

Exhibit 1 Top 20 Tax Incentives Based on the 2015-2016 TEB	
Inventory Tax/Ad Valorem Tax	Research and Development Tax Credit
Motion Picture Investor Tax Credit	Insurance Company Premium Tax
Net Income Taxes Paid to Other States	Ad Valorem Tax Paid by Certain Telephone Companies
Solar Energy System	Vendor's Compensation
Ad Valorem Tax Credit for Offshore Vessels	Certain Child Care Expenses
Louisiana Quality Jobs Program	Education Credit
Rehabilitation of Historic Structures	Musical and Theatrical Productions Tax Credit
Earned Income Tax Credit	Digital Interactive Media and Software Tax Credit
Enterprise Zones	School Readiness Child Care Directors and Staff
LA Citizens Property Insurance Corporation Assessment	Conversion of Vehicles to Alternative Fuel
Source: Prepared by LLA using the 2015-2016 TEB prepared by LDR.	

LDR was unable to provide adequate supporting documentation for the losses reported in the 2015-2016 TEB. Based on query language provided by LDR and analysis of system data for reasonableness, we found that of the $1.5 billion in losses reported for the top 20 incentives, $150,094,971 represented credits included in the reported losses of prior years. Therefore, the 2015 revenue loss reported for tax incentives was overstated by more than $150 million, or 10%, as shown in Exhibit 2. Since the TEB is relied upon by legislators and others to formulate budget estimates, propose legislative change, and plan for the future economic impact of our state's tax incentive programs, errors in the TEB could result in decisions that could negatively impact the economic outlook of the state.

Exhibit 2
Top 20 Tax Incentives: Overstatement of Related 2015 Loss



Source: Prepared by auditors using the 2015-2016 TEB and data from the tax information system.

Objective: Determine if the 2015 revenue losses reported in the 2015-2016 Tax Exemption Budget are adequately supported and accurately represent revenue losses sustained in fiscal year 2015 as a result of tax incentives.

We reviewed the methodology LDR used to extract the revenue losses related to tax incentives, specifically the incentives with the 20 highest reported losses for 2015. Overall, we found that LDR did not have adequate support for the losses reported in the TEB, and the losses reported for 2015 were overstated by more than $150 million. These issues are discussed in detail below.

LDR was unable to provide adequate supporting documentation for the losses reported in the 2015-2016 TEB.

We requested supporting documentation from LDR for the 2015 revenue losses reported in the 2015-2016 TEB; however, the department did not maintain detailed support for the losses and was unable to produce support for the amounts reported. LDR provided query language that was used to prepare the TEB; however, given the adjustments and activity that occur on a daily basis in the tax information system, the original queries used by the department will not generate the same results months later. Therefore, failure to maintain detailed support for the amounts reported in the TEB limits the ability of the department or others to provide assurance regarding the consistency of the reported data from year to year as well as the accuracy and completeness of the data at the time it was reported.

> **Recommendation:** Because legislators base significant decisions on the information provided by LDR, and because errors may lead to negative or unintended effects on the financial position of the state, LDR should review and improve the procedures followed in the preparation of the TEB. LDR should ensure that adequate documentation is maintained supporting the amount of revenue losses reported in the TEB and should perform an adequate review of the documentation before finalizing the TEB.
>
> **Summary of Management's Response:** LDR responded that the department has begun a complete review and overhaul of the TEB preparation process, including the implementation of a single repository for all documentation supporting the revenue losses reported in the TEB and adequate review of all documentation prior to finalizing the TEB.

The losses reported for the top 20 tax incentives in the 2015-2016 TEB were overstated by more than $150 million.

Although the department was unable to provide adequate supporting documentation for the revenue losses reported in the TEB, our analysis of the data in the tax information system produced results that were reasonably close to the amounts reported in the TEB. Using this data, our analysis revealed that LDR reported losses related to amended returns when those losses had been included in the TEBs for the year(s) of the previous filings. When the changes made to the returns did not affect the credits claimed originally, the result was duplicate reporting leading to an overstatement of losses in the TEB.

In our review of the 20 tax incentives with the highest revenue losses for 2015, we found a combined $150,094,971 of losses erroneously reported in the 2015-2016 TEB. Because the department also uses this data to project future losses, projected losses would also be overstated.

Exhibit 3
Top 20 Tax Incentives - 2015 Revenue Loss

Tax Incentive	2015 Loss per TEB	Overstatement of Loss	Adjusted Loss
Inventory Tax/Ad Valorem Tax	$551,659,608	$91,980,094	$459,679,514
Motion Picture Investor Tax Credit	212,850,572	13,471,962	199,378,610
Solar Energy System	80,677,750	8,922,293	71,755,457
Research and Development Tax Credit	45,265,674	8,271,321	36,994,353
Net Income Taxes Paid to Other States	108,739,220	6,548,782	102,190,438
Insurance Company Premium Tax	41,492,489	4,723,679	36,768,810
Rehabilitation of Historic Structures	69,480,754	4,352,943	65,127,811
Ad Valorem Tax Paid by Certain Telephone Companies	26,216,232	3,958,580	22,257,652
Enterprise Zones	46,910,067	2,263,660	44,646,407
Digital Interactive Media and Software Tax Credit	13,106,817	2,238,986	10,867,831
LA Citizens Property Insurance Corporation Assessment	45,467,890	934,757	44,533,133
Musical and Theatrical Productions Tax Credit	13,439,537	667,141	12,772,396
Conversion of Vehicles to Alternative Fuel	7,145,110	536,345	6,608,765
Ad Valorem Tax Credit for Offshore Vessels	76,529,496	467,544	76,061,952
Education Credit	16,619,051	458,491	16,160,560
School Readiness Child Care Directors and Staff	8,198,222	112,678	8,085,544
Certain Child Care Expenses	17,777,817	88,348	17,689,469
Earned Income Tax Credit	47,514,338	85,030	47,429,308
Vendor’s Compensation	25,882,917	12,337	25,870,580
Louisiana Quality Jobs Program	72,864,143	0	72,864,143
Totals	**$1,527,837,704**	**$150,094,971**	**$1,377,742,733**

Source: Prepared by auditors using the 2015-2016 TEB and data from the tax information system.

Recommendation: LDR should reevaluate the methodology employed to prepare the TEB to ensure the proper treatment of amended returns and to prevent the overstatement of revenue losses for tax incentives previously reported in the initial filing of the returns. Since the TEB is relied upon by a number of committees and groups to formulate budget estimates and plan for the future economic impact of our state’s tax incentive programs, users of the TEB should be informed of the errors and adjustments should be made to existing projections, as necessary.

Summary of Management's Response: LDR responded that the tax information system is not currently configured to differentiate between an original and amended return, so the department conducts a manual review for amended returns to adjust the TEB amounts, as necessary. LDR has requested assistance from the Office of Technology Services "to determine the most accurate method to generate the information to reflect the correct effect of tax credits." The department has also contacted the programmer for the tax information system to update the amended return process, which will begin in early 2017. "The duplicate reporting issue will be addressed in time for preparation of the 2016-2017 TEB. Updates to the 2015-2016 TEB will be provided to all users to ensure duplicate credits are correctly reported."

APPENDIX A: MANAGEMENT'S RESPONSE

State of Louisiana
Department of Revenue

John Bel Edwards
Governor

Kimberly Lewis Robinson
Secretary

June 27, 2016

Mr. Daryl Purpera
Louisiana Legislative Auditor
1600 N. 3rd Street
Baton Rouge, LA 70804

Re: Financial Audit – Tax Exemption Budget (TEB) – Louisiana Department of Revenue (LDR)

Dear Mr. Purpera,

The following serves as the official response from the Louisiana Department of Revenue (LDR) to the Louisiana Legislative Auditor (LLA) regarding the aforementioned audit of the Tax Exemption Budget:

1. **LDR should reevaluate the methodology employed to prepare the TEB to ensure the proper treatment of amended returns and to prevent the overstatement of revenue losses for tax incentives previously reported in the initial returns. Since the TEB is relied upon by a number of committees and groups to formulate budget estimates and plan for the future economic impact of our state's tax incentive programs, users of the TEB should be informed of the errors and adjustments to existing projections, as necessary:**

LDR acknowledges the Delta software system is not currently configured to differentiate between an original and amended return. The system captures the original return information in the fiscal year the return is filed. If an amended return is filed, the system also captures the amended return information in the fiscal year it is filed. In order to eliminate duplications, a manual review is conducted for amended returns and the numbers for the TEB are adjusted based on the manual review. The duplicate credits are removed from the TEB. These duplicates include credits on amended returns when the credit was previously reported on the original filed return, credits that were incorrectly reported, and credits that were incorrectly taken.

Prior to the publication of the 2015-2016 TEB, LDR discussed alternative methods of reporting credits in order to eliminate duplicate reporting. The manual review process was again utilized to address the issue. Since the publication of the 2015-2016 TEB, the LDR has continued discussions on alternative reporting methods and enlisted the support of the Office of Technology Services to determine the most accurate method to generate the information to reflect the correct effect of tax credits. We have also initiated conversations with Fast Enterprises, the Delta System programmers, to update the amended return process. This update will begin in early 2017, after all new year tax processing changes are completed. Until the updates are complete, service packs, which include updated components and functionality for the Delta System, have been scheduled for September 19, 2016. These service packs will assist with identifying amended returns and define specific criteria to create a more accurate report for the TEB. The duplicate reporting issue will be addressed in time for preparation of the 2016-2017 TEB. Updates to the 2015-2016 TEB will be provided to all users to ensure duplicate credits are correctly reported.

2. **LDR should ensure that adequate documentation is maintained supporting the amount of revenue losses reported in the TEB, and ensure an adequate review of that documentation before finalizing the TEB.**

LDR has begun a complete review and overhaul of the TEB preparation process. This overhaul includes implementation of a single repository for all documentation supporting the revenue losses reported in the TEB. This single repository will include all LDR documentation, as well as documentation from external agencies responsible for administering an incentive program. The updated TEB preparation process will include a tiered review of all reported revenue losses and supporting documentation, with both a program specific review and a tax specific review. The new process for preparing the TEB will ensure an adequate review of all documentation prior to finalizing the TEB.

I would like to thank the LLA staff for the professionalism, courtesy, and efficiency displayed during the course of this audit.

Please do not hesitate to contact me if you have any questions or require additional information.

Sincerely,

Kimberly Lewis Robinson
Secretary

APPENDIX B: SCOPE AND METHODOLOGY

We conducted procedures to provide information to the Legislature on the tax incentive data reported in the 2015-2016 Tax Exemption Budget (TEB) by the Louisiana Department of Revenue (LDR). Our objective was to determine if the 2015 revenue losses reported in the 2015-2016 TEB are adequately supported and accurately represent the revenue losses sustained in fiscal year 2015 as a result of tax incentives.

To accomplish our objective, we performed the following steps:

- Reviewed requirements of Louisiana Revised Statute 47:1517
- Obtained the 2014-2015 and 2015-2016 TEBs
- Reviewed the fiscal year 2015-2016 TEB to determine the 20 incentives with the highest reported revenue losses.
- Discussed the methodology employed by LDR for reporting revenue losses for individual tax incentives with LDR management.
- Attempted to reproduce queries and calculations used by LDR personnel to calculate the revenue losses reported in the 2015 TEB for the top 20 tax incentives.
- Generated new queries and reviewed taxpayer accounts as a part of our review of the validity of the amounts reported as revenue losses relating to the highest 20 tax incentives in the 2015-2016 TEB.