Report Highlights

Financial Risks to the State Associated with the Inventory Tax Credit

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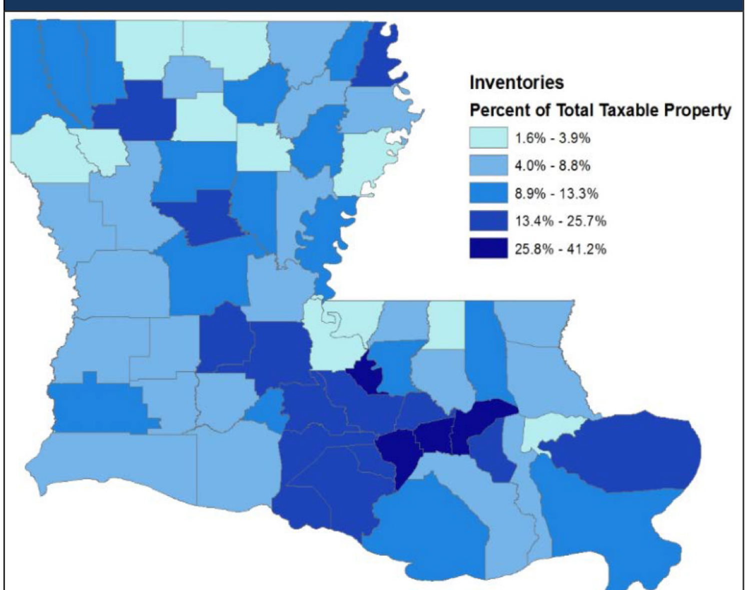
Why We Conducted This Audit

Louisiana's inventory tax credit has increased 50% over an eight-year period, from $271 million in tax year 2007 to a projected $405 million in tax year 2014. Because of this growth, we conducted this audit to evaluate the financial risks to the state associated with the inventory tax credit and to provide recommendations to help mitigate those risks.

What We Found

Local governments in Louisiana tax "real property," such as land and buildings, and "personal property," which includes business inventories. Inventory taxes can make up a large percentage of total property assessments in some parishes, as shown in the exhibit at right. The state then reimburses these taxes levied on inventories in the form of a tax credit to companies.

Inventory Assessments as a Percentage of Total Property Assessments by Parish, Tax Year 2015



Our analysis shows that approximately $157 million has been or will be claimed[1] in potential excess tax credits for tax years 2007 through 2014. In addition, the tax credit increased 50% (approximately $135 million) from tax years 2007–2014. We identified several financial risks to the state related to how the inventory tax credit is structured and administered.

- From tax years 2007 through 2013, at least $229.5 million was claimed by companies with a primary business activity outside of manufacturing, distributing, or retailing. Amending the inventory tax credit law to specify that only companies with a primary business activity of manufacturing, distributing, or retailing are eligible for the inventory tax credit would reduce the cost of the credit. However, this would not affect local governments' ability to levy the tax.

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[1] Companies may continue to file amended returns for three years following any given tax year. Therefore, using past data and actual assessed inventories, we projected the credits that will ultimately be claimed for tax years 2012 through 2014.

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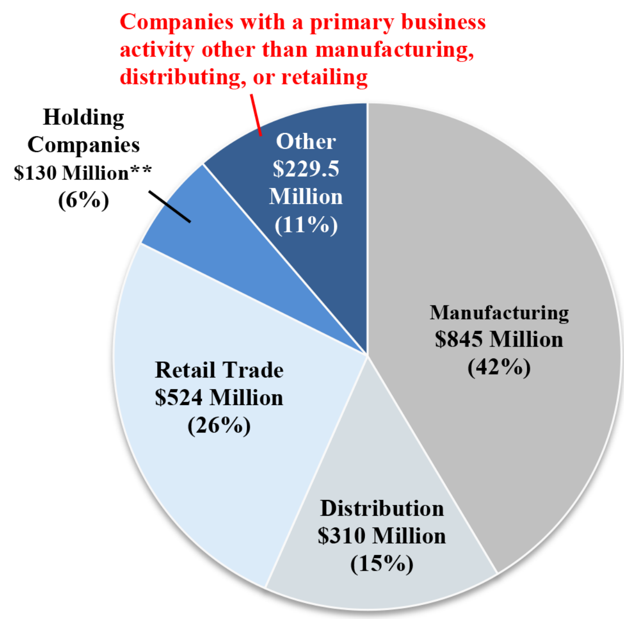
What We Found (Cont.)

- Inventory tax credit amounts are based on local assessments, which are calculated using self-reported information. However, the lack of oversight by local tax assessors and the Louisiana Tax Commission (LTC) in ensuring the accuracy of the assessments increases the risk that the state is granting more in credits than it should. Specifically, local assessors do not verify the self-reported inventory amounts claimed by companies, and LTC does not sufficiently verify the inventory reported by companies to local assessors. LTC conducts six to seven personal property audits annually, which during calendar year 2015 represented three (0.03%) of the approximately 11,000 companies that claimed the inventory tax credit.

- LTC does not require that companies provide support for their inventory amounts, which may increase the risk that governing authorities (local tax assessors, LTC, and LDR) will not identify the misclassification of non-eligible property as inventory.

- Because the definition of "eligible inventory" changed as of January 1, 2016, the Louisiana Department of Revenue (LDR) needs to develop a process to identify and exclude ineligible inventory from receiving the credit. Not developing a process to address this change could increase the risk that the state will grant more in credits than allowed.

Inventory Tax Credits by Primary Business Activity
At least $2 Billion Total*
Tax Years 2007 through 2013



*Because the $2 billion does not include claims that can still be filed with LDR for tax years 2012 and 2013, this amount may potentially be higher.
**Holding companies were included separately because, according to LDR, they are primarily parent companies claiming tax credits for inventory taxes paid by their subsidiary companies, and the primary business activities of those subsidiary companies are not captured by LDR. Therefore, we could not further classify the holding companies by the industries of their subsidiary companies.

Matters for Legislative Consideration to Help Mitigate Risk to the State

1. Consider more clearly defining the eligibility criteria companies need to meet to receive the credit. Amending the law to limit the eligibility to companies whose primary business activity is manufacturing, distributing, or retailing, as was done for the manufacturers' sales tax exemption and the quality jobs tax credit, would reduce the cost of the credit to the state. However, it would not affect local governments' ability to levy the tax.
2. Consider amending the law to specify which NAICS codes are eligible to receive the inventory tax credit.
3. Consider clarifying LTC's responsibilities in regard to verifying the inventory taxes assessed, such as how often to audit local inventory assessments.
4. Consider amending Louisiana Revised Statute 47:2327 to allow LDR access to the LAT-5 form for use during its Inventory Tax Credit reviews.