



2004

**Special Legislative
Session Summary**

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FROM MAIN STREET TO WALL STREET

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2004 SPECIAL SESSION LEGISLATIVE SUMMARY

Prepared for our clients and friends.

Governor Blanco and the Louisiana Legislature have just completed one of the most significant tax and economic development sessions in years. Although the 3.8% temporary sales tax on business utilities was continued until July 1, 2009, aggressive economic development incentives were enacted, including the phase in of tax reductions for manufacturing, agricultural, forestry, and fishing machinery and equipment and the phase out of the corporate franchise tax on debt. Additionally, many existing incentives were extended. The following is a summary of the significant changes made by the Louisiana Legislature during the 2004 First Extraordinary Session.

3.8% Sales Tax on Business Utilities Continued Until July 1, 2009

- ✓ Act 4 continues the “temporary” sales tax on business utilities (steam, water, electricity, and natural gas) and a variety of other formerly exempt items until June 30, 2009. Currently, business utilities are taxed at a 3.8% sales tax rate. The 3.8% is comprised of a permanent 1% sales tax and a temporary 2.8% sales tax. The 2.8% sales tax will expire on July 1, 2009, if the Legislature does not take action to continue the tax. Additionally, the Legislature continued the imposition of the sales tax on a variety of formerly exempt transactions, including the purchase of raw materials used in printing, outside gate admissions to fairs and festivals, and prescription drug marketing samples. Transactions involving these items will continue to be taxed at a 4% rate until July 1, 2009. The rate will be reduced to 1% in 2009 if the Legislature does not take action to continue the 4% tax rate.

La. Acts 2004, No. 4 (1st Ex. Sess.), enacting R.S. 47:302(R) and 331(P); House Bill No. 1 by Rep. Hammett.

Sales Tax on Manufacturing/Agriculture/Forestry Machinery and Equipment Will be Reduced then Eliminated

- ✓ Act 1 will phase out the state sales tax on purchases and leases of machinery and equipment used by a variety of businesses. The new law redefines many provisions of the state sales tax law creating the opportunity to purchase business machinery and equipment with substantial reductions in sales taxes. While much of the eligible machinery and equipment must be integral to the manufacturing operations, the new law contains generous provisions reducing the sales tax on pollution control equipment even if the equipment is not integral to the manufacturing operations. The phase in of the tax reductions begins July 1, 2005. Beginning on July 1, 2011 no state sales tax will be due on covered machinery and equipment. Small reductions in the sales tax could begin earlier if the state determines that its revenues for the fiscal year beginning July 1, 2004 are larger than previously anticipated.
- ✓ Businesses assigned a North American Industrial Classification System (NAISC) code within the manufacturing sections (Sections 31 - 33) or the agricultural, forestry, fishing, and hunting section (Section 11) by the Louisiana Department of Labor are eligible for the tax reductions. NAISC code Sections 31 - 33 include virtually all types of manufacturing businesses, including businesses as diverse as those engaged in printing and the manufacture of food products, manufactured homes, asphalt and concrete products, clothing, dental equipment, and jewelry. The new law provides generous provisions for those engaged in agricultural, fishing and hunting operations (NAISC codes in section 11), including the production, processing and storing of food, fiber and timber.
- ✓ Covered machinery and equipment includes tangible personal property or other property that is eligible for depreciation for federal income tax purposes and that is used as an integral part in the manufacturing of tangible personal property for sale. La. R.S.47:301(3)(i)(ii)(aa). For agriculture, fishing and forestry purposes, covered machines and equipment includes tangible personal property or other property used as an integral part of the production, processing, and storing of food and fiber or of timber. La. R.S. 47:301(i)(ii)(aa). The following machinery and equipment is specifically covered by the new law: (i) computers and software that are an integral part of the machinery and equipment used directly in the manufacturing process; (ii) machinery and equipment necessary to control pollution at a plant facility where pollution is produced by the manufacturing operations (pollution control equipment does not have to be integral to the manufacturing

- operations); and (iii) machinery and equipment used to test or measure raw materials, the property undergoing manufacturing or the finished product, when such testing or measurement is a necessary part of the manufacturing process. La. R.S. 47:301(i)(ii)(aa)(I).
- ✓ Covered machinery and equipment does not include (i) a building or its structural components, unless the building or structural component is so closely related to the machinery and equipment that it houses or supports that the building or structural component can be expected to be replaced when the machinery and equipment are replaced; (ii) heating, ventilation, and air-conditioning systems, unless their installation is necessary to meet the requirements of the manufacturing process, even though the system may provide incidental comfort to employees or serve, to an insubstantial degree, non-production activities; (iii) tangible personal property used to transport raw materials or manufactured goods prior to the beginning of the manufacturing process or after the manufacturing process is complete, and (iv) tangible personal property used to store raw materials or manufactured goods prior to the beginning of the manufacturing process or after the manufacturing process is complete. La. R.S. 47:301(3)(i)(ii)(aa)(II).
 - ✓ In order to receive the benefit of the tax reductions, eligible machinery and equipment must be used “by a manufacturer in a plant facility predominately and directly in the actual manufacturing for agricultural purposes or the actual manufacturing process of an item of tangible personal property, which is for ultimate sale to another and not for internal use, at one or more fixed locations within Louisiana.” La. R.S. 47:301(3)(i)(i). Although these requirements could be read restrictively, the Act was designed to provide broad tax relief not only to traditional manufacturers but also to logging and fishing operations that have a temporary presence at locations within the state. Businesses that are not clearly covered by the provisions of the new law should consider aggressively testing the limits of the law to their machinery and equipment purchases and leases.
 - ✓ The tax reductions are computed by reducing the tax base (“cost price”, “sales price”, or gross proceeds from the lease or rental) of eligible machinery and equipment that is subject to tax. Effective July 1, 2005 the tax base of covered property will be reduced by 14% before the tax is computed. Additional reductions are phased in as of July 1st of each year through 2010 and the tax base of covered machinery and equipment becomes fully non-taxable as of July 1, 2011. La. R.S. 47:301(3)(i)(i) (phased reduction in “cost price” for use tax); La. R.S. 47:301(13)(k)(i) (phased reduction in “sales price” for sales tax);

La. R.S. 47:301(28)(a) (phased reduction of lease tax). If state revenues are higher than originally anticipated, a modest reduction in the sales tax could begin this year and the phase in could be accelerated.

- ✓ Eligible companies must be assigned a covered NAISC code by the Louisiana Department of Labor and apply for and obtain an exclusion certificate from the Louisiana Department of Revenue before they will be entitled to the benefits of the new law. La. R.S. 47:301(3)(i)(iii); La. R.S. 47:301(13)(k)(iii); La. R.S. 47:301(28)(c). The department will also issue regulations that will implement the law. La. R.S. 47:301(3)(i)(iv); La. R.S. 47:301(13)(k)(iv); La. R.S. 47:301(28)(d). The department regulations may attempt to reduce some of the benefits identified in this article.
- ✓ Local sales taxes will also be reduced in those areas of the state where the local governing authorities enact provisions similar to the tax reductions discussed above. Local governments have the discretion to adopt selective portions of the tax reduction provisions of the new law. La. R.S. 47:337.10(I).
- ✓ Even if your principal business is not engaged in manufacturing, there may be opportunities for tax reductions under the new law. All businesses should consider placing the manufacturing elements of their operations in separate entities. For example, a restaurant chain that uses a central kitchen to prepare some of the food items served at the retail restaurants could drop the central kitchen operations into a new limited liability company that is engaged solely in the manufacture of food products for sale to the individual restaurants. Similarly, a retail company that uses expensive printing and photocopying machines should consider putting that portion of their operations into a limited liability company that sells printing and copying to the main retail business. Such changes in your operations could have other tax consequences; therefore, it is critical that an overall plan be developed with a tax advisor prior to making such changes.

La. Acts 2004, No. 1 (1st Ex. Sess.), enacting R.S. 47:301(3)(i), (13)(k), and (28) and 337.10(I) and amending R.S. 47:301(3)(i)(i), (13)(k)(i), and (28)(a); House Bill No. 2 by Rep. Hammett.

Corporation Franchise Tax on Debt Phased Out

- ✓ Act 2 phases out the tax on borrowed capital. The Louisiana corporation franchise tax, originally enacted in 1935, is imposed upon a corporation's capital stock, surplus and borrowed capital (debt with a term in excess of one

year or which is not paid within one year). The rate is \$1.50 per \$1,000 of taxable capital on the first \$300,000 of taxable capital and \$3.00 per \$1,000 of taxable capital in excess of \$300,000. Under Act 2, the term “taxable capital” is redefined as “the amount of a corporation’s issued and outstanding capital stock, surplus, undivided profits, and that portion of borrowed capital” subject to tax under the phase out provisions of the act. La. R.S. 47:602(A). The phase out starts with taxable years beginning after December 31, 2005. La. R.S. 47:603(A)(2). Borrowed capital is phased out of the taxable base as follows:

| <u>Fiscal Year Beginning</u> | <u>Percentage of borrowed capital included in taxable capital</u> |
|------------------------------|---|
| January 1, 2006 | 86% |
| January 1, 2007 | 72% |
| January 1, 2008 | 58% |
| January 1, 2009 | 44% |
| January 1, 2010 | 30% |
| January 1, 2011 | 16% |
| January 1, 2012 and after | 0% |

- ✓ The new law contains special rules for related party debt. Under those rules, if a corporation’s total debt to all related parties exceeds the capital stock, surplus, and undivided profits of the corporation, then the amount of the excess is included in the capital stock, surplus and undivided profits of the corporation. La. R.S. 47:605.1. Thus, a corporation cannot unduly reduce its tax liability by increasing its capitalization by borrowing from related entities. For purposes of these special rules “debt” does not include (i) trade debt that is less than one hundred eighty days old; or (ii) deposit liabilities to related parties La. R.S. 47:605.1(B). Additionally, debt between related parties cannot be reduced by receivables for purposes of the application of the special rules. La. R.S. 47:605.1(B).

La. Acts 2004, No. 2 (1st Ex. Sess.), amending R.S. 47:601(A)(introductory paragraph), 602(A), (B), and (E)(1), 603(A), and 606(A)(introductory paragraph) and (C), and enacting R.S. 47:602(G) and 605.1, and repealing R.S. 47:601(D) and 603; House Bill No. 3 by Rep Hammett.

Other Constructions Permanently attached to the Ground to be Treated as Immovable Property for State Sales Tax Purposes

- ✓ Act 6 treats other constructions permanently attached to the ground as

immovable property for state sales tax purposes. A similar change was made in 2003 for sales taxes levied by political subdivisions. Restrictions in the Louisiana Constitution prevented the Legislature from making the change for both state and local sales taxes in 2003. Act 6 conforms to the 2003 change and corrects a problem in which identical property could be treated as tangible personal property or as immovable property depending upon who owns the underlying ground. Other constructions are constructions, other than buildings, such as permanent tanks, permanent pieces of machinery that are not component parts of a building, large permanent signs, and similar structures. Prior to the recent changes, these structures were classified as corporeal movables (tangible personal property) if they were owned by someone other than the landowner. The structures were immovable (real estate) if they were owned by the landowner. La. Civ. Code art. 464, comment (d). These structures retain their historic classification under the Louisiana Civil Code for all purposes other than the application of the sales tax law.

La. Acts 2004, No. 6 (1st Ex. Sess.), amending La. R.S. 47:301(16)(1); House Bill No. 9 by Rep. Hammett.

Sales Tax Exemption on Residential Heating Fuel

- ✓ Act 8 creates a state and local sales tax exemption for purchases by a consumer of any fuel or gas, including butane and propane, for residential use.

La. Acts 2004, No. 8 (1st Ex. Sess.), enacting R.S. 47:301(10)(x); House Bill No. 15 by Rep. Strain.

Tax Exemption/Credit Sunset Provisions Extended

- ✓ **Quality Jobs Act** - Act 13, the Quality Jobs Act, which provides payroll and sales tax rebates for qualified businesses, has been extended to include applications filed before January 1, 2008. La. R.S. 47:2461(B).

La. Acts 2004, No. 13 (1st Ex. Sess.) amending La. R.S. 51:2461(B); Senate Bill No. 14 by Sen. Mount.

- ✓ **Credits for Historic Structures** - Act 12 extends the availability of the income and franchise tax credits for costs associated with the rehabilitation of historic structures through taxable years ending prior to January 1, 2008.

La. Acts 2004, No. 12 (1st Ex. Sess.) amending Section 3 of Act No. 60 of the 2002 Regular Session of the Legislature; Senate Bill No. 9 by Sen. Mount.

- ✓ **Sales Tax Exemption for Interstate Trucks** - Act 10 makes the sales tax exemption in La. R.S. 47:305.50 for the purchase of trucks, trailers and buses used more than 80% of the time in interstate commerce permanent.

La. Acts 2004, No. 10 (1st Ex. Sess.), amending R.S. 47:305.50(A)(1)(a); House Bill No. 35 by Rep. Montgomery.

- ✓ **Tax Credits for Motion Picture Investors** - Act 7 reenacts the provisions of La. R.S. 47:6007 providing for motion picture investor tax credits and makes the program permanent. As a result of the change, motion picture investor tax credits are freely transferable as provided in La. R.S. 47:6007 and there is no sunset date on the availability of the motion picture investor tax credit program.

La. Acts 2004, No. 7 (1st Ex. Sess.), amending R.S. 47:6007; House Bill No. 10 by Rep. Hammett.

- ✓ **Sales Tax Exemption for Steel Works** - Act 5 extends the availability of the sales tax exemption for the purchase of utilities by certain steel mills provided for in La. R.S. 47:305.51 until June 30, 2007. The exemption is only available to those companies with a 3312 SIC code and which have more than 125 full-time employees.

La. Acts 2004, No. 5 (1st Ex. Sess.), enacting R.S. 47:302(R), 321(I), and 331(P); House Bill No. 8 by Rep. Faucheux.

- ✓ **Tax Free Shopping Program** - Act 14 extends the availability of the Tax Free Shopping Program, which allows visitors to the state to receive a refund of sales taxes paid on purchases, through July 1, 2007.

La. Acts 2004, No. 14 (1st Ex. Sess.), Senate Bill No. 15 by Sen. Mount.

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