

84th Legislative Session Wrap-up

The 2015 legislative session began with great suspense. Armed with a revenue estimate well above state spending levels, it was clear that taxes would be cut, but the big question was what form those cuts might take. The Governor's ante in his State of the State address set targets of roughly \$2 billion each of franchise and property tax cuts. The Senate responded with their package providing a modest across-the-board franchise tax rate cut, coupled with a quadrupling of the small business exemption and a new, indexed school property tax homestead exemption that would increase over time. The House raised the bet, laying out deeper across-the-board franchise tax cuts coupled with the first ever cut in the state sales tax rate.

In the end, they split the pot. The final package included a little bit of each — the House's franchise tax cuts, a more modest and fixed homestead exemption from the Senate, and a total very near the Governor's overall target. But while each of the major offices won a little, the true victors were the taxpayers of the state.

The final package provides a 25 percent cut in the franchise tax for most taxpayers (42 percent for smaller taxpayers opting for the alternative EZ tax calculation). The small business exemption remains at a generous \$1 million. The school property tax homestead exemption is raised to \$25,000 (a \$10,000 increase), providing about \$130 per year in savings

for most homeowners. To provide some protection against those cuts being lost to local tax hikes, jurisdictions wanting to raise taxes cannot do so absent a 60 percent or more majority vote. Finally, a number of minor taxes will be eliminated, as well as the \$200 annual occupation tax on over a dozen different professions, including accountants, attorneys, property tax professionals, and medical practitioners.

While the public's eyes were focused on the big tax bills, there were over 600 other tax and fiscal bills introduced and tracked by TTARA this session (Table 1), some significant, others not so much. The process of passing a bill is a complicated one — often described as being designed to kill bills rather than pass them. Only half of the tax and fiscal bills actually received a hearing in committee — the necessary first step in the process. Only half of those were actually passed out of committee after the hearing. Additional steps in the process offered further barriers. In the final analysis, less than one in every 8 tax and fiscal related bills passed the legislature and survived the Governor's veto pen.

In this research brief, TTARA reviews some of those key bills of interest, mostly those that will become law, and what changes they may bring for taxpayers. We also assess the prospects of resurrection for those that failed — possible fodder for the 85th Legislature convening in January of 2017.

Table 1. Tax and Fiscal Related Bills of the 84th Legislature

Process	Number of Bills	Percent of Total
Bills Introduced	668	100.0 %
Bills Granted Committee Hearing	308	46.1 %
Bills Passing Out of Committee	156	23.4 %
Bills Passing the First House	130	19.5 %
Bills Passing the Second House	83	12.4 %
Bills Sent to the Governor	80	12.0 %
Bills Becoming Law	77	11.5%

Note: Includes bills referred to the House Ways and Means, House Appropriations, and Senate Finance Committees.

Property Tax

Property tax relief was a key focus for lawmakers in 2015. Lt. Governor Patrick wasted little time after his election in working on a package to help ease the burden of Texas' biggest tax. The Lt. Governor had designs on relief for homeowners, but had also reached out to business groups. In his preliminary work, the Lt. Governor had included a phase-out of the local property tax on business inventories (Texas is one of the few states taxing inventories), but this was set aside for future study, along with Texas' overall tax on business personal property, after a high cost estimate from the Comptroller.

As inventory relief fell out of the Senate tax package, it was replaced by a modest across-the-board franchise tax cut and a four-fold increase in the small business exemption — an approach that immediately sparked concerns over tax equity and pitted businesses against one another.

The homeowner relief as originally proposed generated angst from a large swath of the business community. **SJR 1/SB 1 by Nelson (R-Flower Mound)**, set the mandatory school property tax exemption at an amount equal to 25 percent of the median value of a Texas home, a de facto split roll which would shift a higher share of the property tax to business over the years ahead.

The sting of future property tax increases was to be eased by reining in the ever-increasing property tax levies, but that proposal (**SB 182 by Bettencourt, R-Houston**) ran into a storm of protest from local officials in a day long Senate Finance Committee hearing, all claiming violation of the sanctity of “local control.” The proposal would have limited the ability of cities, counties and special districts to raise revenues from the property tax, lowering the current maximum increase of 8 percent down to 4 percent,¹ and mandating a ratification election for any level above that (similar to the current requirements for school districts). Although Senator Bettencourt offered lesser alternatives in an effort to invite compromise — such as lowering the limit to only 6 percent, or mandating an election only for rate increases above 8 percent — the votes were not there. The only idea to survive the onslaught, a 60 percent vote requirement for a taxing unit to adopt a rate that would increase property taxes, became an important part of the final tax package by adding it to **SB 1760 by Creighton (R-Conroe)**.

Nevertheless, the 84th Session demonstrated the imperative for a real policy discussion of the calculation of tax rates and

the methods by which they are adopted. Interim charges from the Speaker and Lt. Governor are expected to include a study of these issues, and the 2017 legislative session is almost certain to include a spirited debate on the property tax.

HOMESTEAD EXEMPTION

SJR 1, a proposed constitutional amendment, and **SB 1** its associated statutory enabling legislation, both authored by **Senate Finance Committee Chair Jane Nelson (R-Flower Mound)**, were the primary pieces of legislation dealing with the homestead exemption. Taken as a package, SJR 1 / SB 1 as passed:

- Raises the mandatory homestead exemption from school district taxes from \$15,000 to \$25,000;
- Reduces the tax freeze to reflect the higher exemption amount;
- Prohibits a school district, city, or county that adopted a local option exemption for the 2014 tax year from repealing or lowering the exemption until December 31, 2019;
- Prohibits a real estate transaction tax;
- Amends §11.13, Tax Code, to raise the mandatory homestead exemption from school district taxes from \$15,000 to \$25,000;
- Amends §11.26, Tax Code, to reduce the tax freeze to reflect the higher exemption amount;
- Directs assessors to prepare the tax roll and calculate the effective tax rate for the 2015 tax year as if the exemption were in effect;
- Establishes a procedure for mailing supplemental tax bills reflecting the exemption for 2015, if approved by the voters; and
- Holds school districts harmless from the increase in the homestead exemption and provides additional state aid for lost property tax revenue for debt service purposes.

The impact of the homestead exemption was the focus of much discussion. Senators, and the Lt. Governor, felt very strongly that lawmakers had to address the rising property tax burden on homeowners. House leaders were more skepti-

¹Under current law, cities, counties, and special districts begin their tax rate adoption process by calculating their effective tax rate — essentially the tax rate that, when applied to the current year property values, would raise the same amount of property tax revenue generated in the previous year (with any new values excluded). If they adopt a tax rate that raises 8 percent or more revenue than what the effective tax rate would raise, local voters may organize a petition calling for an election in which voters may “rollback” the tax rate so that it produces no more than an 8 percent increase in revenue.

cal. The legislature had provided property tax “relief” several times in the past, only to see it gobbled up by local tax increases. It was not so much that the House opposed increasing the homestead exemption, they just did not want to build unrealistic expectations with voters. With SJR 1/SB 1 in place, the average homeowner will likely still see their property taxes increase by several hundred dollars in 2015. The \$10,000 increase in the homestead exemption will ease the sting of those rising taxes, but very few homeowners will actually see their total property tax bill go down.

In addition to raising the mandatory exemption, more narrowly targeted homestead exemption changes passed, including:

HJR 75/HB 992 by D. Bonnen (R-Angleton) authorizes the legislature to extend the 100 percent homestead exemption of the surviving spouse of a deceased, totally disabled veteran to the surviving spouse of an otherwise eligible totally disabled veteran who died before the exemption went into effect.

HB 1022 by Moody (D-El Paso) amends §11.13, Tax Code to expand the definition of a “residence homestead” to include a life estate held by the surviving spouse of the property owner.

SB 833 by Campbell (R-New Braunfels) amends §11.13, Tax Code to allow an owner of a residential homestead to continue a homestead exemption if the owner’s temporary absence is caused by military service inside the United States.

This session also saw a serious attempt to modify the local option homestead exemption for taxing units other than school districts. A proposal to recraft the local homestead exemption for cities, counties, and special districts failed in the waning hours of the legislative session, having sparked concerns from the business community.

Under current law, a taxing unit may adopt a proportional local option homestead exemption up to 20 percent of the value of the homestead (with a minimum guaranteed exemption of \$5,000). Motivated by the City of Austin’s desire for an alternative to the current percentage-based exemption, **SJR 20 and SB 279 by Watson (D-Austin)** as introduced would have allowed taxing jurisdictions to adopt a fixed dollar homestead exemption instead. While advertised as a “local-option” bill, in fact the legislation automatically imposed a \$5,000 homestead exemption in all cities, counties and special districts that did not currently offer an optional percentage exemption. A taxing unit could opt out, but would specifically have to vote to rescind the automatic exemption. As passed by the Senate, the exemption was uncapped — if a district wanted to offer a higher exemption, there would be no limit. Nor would districts have to cut spending to pay for the exemption. They could simply raise their tax rate with the increase not subject to the current rollback limit so that one group of taxpayers would have to pay for the relief of others.

In addition, taxing units that previously adopted a percentage exemption (capped at 20 percent) could rescind it and adopt a dollar amount exemption (uncapped) instead, provided that a property owner could elect to retain the higher percentage exemption previously adopted by the taxing unit expressed as a dollar amount. This provision would have given constitutional sanction to differential homestead exemptions based on the date of adoption, opening the way to a classified system.

Finally, the Senate would have prohibited a taxing unit that adopted an exemption for the 2014 tax year from repealing or reducing the amount of the exemption for years, except that the governing body could rescind a percentage exemption adopted in 2014 in lieu of the dollar amount exemption if the dollar amount of the exemption was greater than \$5,000. This provision survived as a five-year lock in SJR 1, but the impact should be minimal because it is limited to percentage exemptions already in place.

When the bill got to the House Ways & Means Committee, Senator Watson and Rep. Eddie Rodriguez, the House sponsor, agreed to add a cap on the exemption amount tied to 20 percent of the value of an average homestead in the taxing unit. The House also removed some of the other objectionable language, such as the automatic imposition of a \$5,000 exemption with an opt-out provision. The proposals cleared committee late in the session, but died on the last House Calendar before they could be considered. Nevertheless, the idea is likely to return as the appetite for more homeowner property tax relief becomes evident next session.

OTHER EXEMPTIONS/SPECIAL VALUATIONS

With so much attention focused on the homestead exemption, very few other exemptions had much of a chance, especially if they cost any money. The few ideas that did survive include:

HB 994 by Anchia (D-Dallas) amends §11.311, Tax Code to exempt tangible personal property used in the collection, compression, processing, and delivery of landfill gas and requiring the exempt property to be appraised as TPP, regardless of whether affixed to or incorporated into the realty (this proposal makes permanent a temporary one-year exemption for landfill gas processing plants adopted in 2013).

HB 275 by Ashby (R-Lufkin) defines eggs as a farm product for purposes of the property tax exemption.

HB 1905 by Springer (R-Muenster) exempts from property taxes real property that is leased to a person for use as a school for educational purposes, if the owner passes the tax reduction through to the lessee in the form of a reduction in the rent (pending passage of a constitutional change, which did not get through the Legislature this time) and amends §11.231, Tax Code to allow local economic development corporations (Type A and B corporations formed under the Economic Development Act of 1979) to claim a property tax

exemption as a “nonprofit community business organization.”

SB 1985 by Uresti (D-San Antonio) amends §23.175, Tax Code to make adjustments to the valuation methodology for a real property interest in oil and gas in place. The bill provides that if, as of February 1 of the current calendar year, the most recent edition of the United States Energy Information Agency’s Annual Energy Outlook was published before December 1 of the preceding calendar year, the chief appraiser shall use the projected and preceding calendar year spot price of West Texas Intermediate crude oil or natural gas at the Henry Hub, as stated in the Short-Term Energy Outlook report published in January of the current year by the USEIA in the price adjustment factor calculation.

As indicated above, the wisdom of taxing business tangible personal property (TPP) and inventories under the property tax likewise entered the tax relief discussion, if only briefly. It is worth noting, nevertheless, that several members of the Legislature introduced proposals to alter the tax treatment of TPP for the better, including the following bills that **did not** pass:

HJR 102/HB 2136 by Button (R-Garland), adding §11.35, Tax Code, to exempt from school district property taxes the appraised value of a person’s inventory held for resale.

HJR 139/HB 3776 by Workman, phasing out the school district property tax on inventory by 10 percent per year through 2024; the total exemption would have been effective January 1, 2025.

SJR 29/SB 516 by Bettencourt/HJR 20/HJR 25/HB 1675 by Bohac, extending the Freeport exemption period from 175 to 365 days.

SJR 35/SB 758 by Bettencourt (R-Houston)/HJR 140/HB 3826 by Elkins (R-Houston), adding Article VIII, §1-t, Texas Constitution, to authorize the legislature to exempt from property taxes by one or more political subdivisions tangible personal property used by the owner of the property to manufacture, process, or fabricate tangible personal property for ultimate sale.

SJR 50/SB 1379 by Lucio (D-Brownsville), exempting from property taxes structures used to store implements of husbandry used in the production of farm and ranch products.

SJR 56/SB 1693 by Bettencourt (R-Houston), authorizing the legislature to exempt inventory from ad valorem taxation by one or more taxing units.

This session also saw several bills attempting to address the 2011 changes in the dealers’ heavy equipment inventory statute that have produced widespread litigation across the state over the appropriate situs of heavy equipment (especially natural gas compressors) and the constitutionality of the statute’s valuation methodology. These bills ranged from a nar-

row proposal to exclude natural gas compressors from the definition of “heavy equipment” [**HB 2117 by Rep. Tracy King (D-Batesville)** or **SB 1860 by Zaffirini (D-Laredo)**] to a broader reform of the statute. For example, **HB 2591 by Phillips (R-Sherman)/SB 1285 by Hall (R-Canton)** proposed to remove leases and rentals of a dealer’s heavy equipment inventory from the special valuation methodology for such equipment and apply the statute only to an inventory held for retail sale (including for lease or rental with a purchase option). None of these bills passed, however, and the cases now in litigation will march onward to judicial decision.

PROPERTY TAX ADMINISTRATION

There were fewer changes in property tax administration than in prior sessions. Nevertheless, some positive pro-property owner bills of a mainly technical nature did survive the process.

Most of these improvements are contained in **SB 1760 by Senator Creighton (R-Conroe)**, which surprisingly became an important vehicle late in the session for the overall budget deal between the House and Senate, but was supported by TTARA at each step in the legislative process. In its final version, the bill:

- Allows a lessee who is designated as the property owner’s agent, subject to the owner’s approval, to designate a property tax agent (a technical change requested by TTARA);
- Allows electronic signatures on property tax forms;
- Requires the Comptroller to publish annually a statewide list of local tax rates (excluding school districts);
- Provides that a taxpayer does not have to apply for a refund resulting from a late homestead exemption application or from a correction in the tax roll, allowing the refund to be processed automatically;
- Requires 60 percent of the governing body of a taxing unit to adopt a tax rate greater than the effective rate (i.e., the rate that when applied to the current year tax base generates the same amount of tax revenue as the prior year);
- Requires the notice of a public hearing at which a tax rate increasing the total amount of revenue will be adopted to include a statement of how the governing body plans to use the additional revenue;
- Requires the notice of a school district ratification election to state the purpose of the proposed rate increase;
- Allows a court, if an appraisal district employee testifies as to value, to give preference to the testimony of an appraisal district employee authorized to perform an ap-

praisal of real estate under §1103.201, Occupations Code (this section effective 1/1/20);

- Raises the interest rate on a refund resulting from a judicial appeal to 9.5%;
- Requires local governments proposing to adopt higher tax rates to state the purpose for the additional revenue;
- Extends the time a taxing unit must file a tax rate notice from September 1 to October 1 or the 30 days after the unit receives the certified roll.

SB 1760 reverses (and then some) legislation passed in 2011 that reduced the amount of interest on a property tax refund from 8 percent to the prime rate plus two percent. The filed version of SB 1760 would have equalized *all* interest rates, including those charged on delinquent tax collections, so the final outcome represents a trade-off of sorts.

While SB 1760 became the primary vehicle for administrative changes, it was not the only bill that passed. Others include:

SB 46 by Zaffirini (D-Laredo) makes confidential a photograph taken by an appraisal district for property tax appraisal purposes showing the interior of an improvement to property. The bill further requires disclosure of the photograph to a person with an ownership interest in the property on the date the photograph was taken, allows discovery of a photograph in a protest or appeal if it is relevant, and protects the confidentiality of the photograph in the possession of the person to whom it is disclosed. A House floor amendment allows a photograph to be used to ascertain the location of equipment used to transmit oil and gas for purposes of taxation if that equipment is located on January 1 in the appraisal district that appraises property for the equipment for the preceding 365 consecutive days. This odd provision doesn't appear to have any effect because a chief appraiser may already establish situs by various evidentiary means, including photographs.

SB 593 by Watson (D-Austin) adds 42.227, Tax Code, to allow a property owner or appraisal district to request settlement discussions, including through an informal settlement conference or other alternative dispute resolution procedure. The bill requires the request to be in writing delivered prior to trial. The court, upon motion, must enter an order directing the settlement discussions proceed in the form specified by the court. Each party must attend the settlement discussions, which must be held on or before the 120th day after the written request is delivered, and negotiate in good faith. If the appraisal district cannot attend settlement discussions on or before the 120th day, the deadline for designating experts is changed to 60 days prior to trial for the party seeking affirmative relief, and 30 days before trial for all other experts. Finally, the bill prohibits an appraisal district from requesting or requiring a property owner to waive any rights as a condition to attending settlement discussions. This latter provision

addresses concerns, especially in Harris County, that a Central Appraisal District (CAD) may refuse to settle values with taxpayers who wouldn't agree to waive appeal rights.

SB 849 by Bettencourt (R-Houston) raises the appraised value of property eligible for binding arbitration from \$1 million to \$3 million and establishes a fee schedule for an application for binding arbitration and for the arbitrator's fee, based on the appraised value of the subject property. The purpose of this bill is to encourage greater utilization of binding arbitration by making it more affordable for taxpayers.

SB 1394 by Hancock (R-North Richland Hills) requires the chief appraiser and property owner to exchange material stored on a portable device prior to a hearing on a protest and provides that if the chief appraiser uses AV equipment at the hearing, the appraisal office shall provide AV equipment of the same general type, kind, and character for the property owner's use.

SB 1420 by Hancock (R-North Richland Hills) requires the appraisal notice to identify an exemption or partial exemption approved for the property in the preceding year that was canceled or reduced for the current year.

SB 1468 by Watson (D-Austin) makes an exception to the ex-parte communication rule for a communication between a property owner or the owner's agent or a property tax consultant and the taxpayer liaison officer regarding a ground for removal of a member of the Appraisal Review Board (ARB).

HB 3532 by Herrero (D-Robstown) allows disclosure of a driver's license number, personal identification certificate number, or social security account number provided in an application for a property tax exemption filed with the chief appraiser to an agent of the appraisal district who performs appraisal services for the district.

HB 3756 by Otto (R-Dayton) requires the Comptroller to make available at the time he releases the property value study to appraisal districts the comparable sales and appraisals used in developing the automated valuation models and the study. The bill also requires the Comptroller to perform the study using appraisals and automated valuation models, in addition to comparable sales.

The legislature passed, but the Governor vetoed **HB 2282 by Guillen (D-Rio Grande City)**. This bill would have required the chief appraiser and ARB to review a property owner's evidence offered by affidavit prior to the hearing, but it also contained a local provision allowing a property owner in Atascosa County to bring an appeal of an ARB order before a justice of the peace if the amount of taxes due on the disputed value is less than \$10,000.

As in the past, this session we saw two proposals for the election of appraisal officials, although none received a hearing. **SB 1536 by Burton (R-Colleyville)** would have increased the number of CAD board members from 5 to 6, pro-

vided for the election of 3 directors at the general election, and allowed the CAD board to be increased to an even number not more than 14, with one-half elected members. **SB 1807 by Bettencourt (R-Houston)** would also have expanded the CAD board from 5 to 7, with two elected members. Additionally, the bill required the taxpayer liaison officer to serve as a nonvoting member of the CAD board, required an appointed member of the CAD board to be an elected official from a taxing unit, and transferred authority for the election of the chair and secretary of the ARB from the CAD board to the ARB.

Finally, Sen. Bettencourt and Rep. Elkins filed legislation this session to transfer the Property Tax Assistance Division from the Comptroller to a separate agency. Though the bill did not pass, it is likely to be the focus of an interim legislative study.

EQUAL AND UNIFORM

In the past few years the valuation of selected commercial properties has drawn increased scrutiny. Critics have used selected anecdotes as constituting proof that commercial properties are routinely and systemically undervalued, creating a massive tax shift onto residential property. The issue was reviewed in a TTARA research brief last year: *Appraising the Appraisals: Local Values and Property Taxes*. The Texas Constitution provides that taxation should be equal and uniform. Using this authority, property owners can challenge their appraisal, using values of comparable properties to demonstrate that their property is taxed unequally. Critics contend that unequal taxation is justified because relying on appraisals of comparable properties creates a “race to the bottom.”

These contentions, focused primarily in Harris, Bexar, and Travis Counties, prompted the Legislative Budget Board (LBB) staff to conduct a “study” of commercial appraisals, making a number of flawed recommendations as a part of their biennial Government Effectiveness and Efficiency Review. The recommendations were arrived at in secret and without any input from the taxpayer community, or from the Comptroller (who has the statutory responsibility of assuring that there is no systemic undervaluation in any category of property).

Legislators, primarily but not exclusively from Harris and Travis Counties, filed several bills to implement the LBB recommendations. Though these bills differed in some respects, they generally contained a combination of the following provisions that would have:

- Allowed the appraisal district to defeat a protest on the basis of unequal appraisal if the district establishes that the appraisal ratio of the property is equal to or less than the median level of appraisal of a reasonable number of comparable properties in the appraisal district;

- Limited equal and uniform appeals to residential homesteads and properties valued at \$1 million or less;
- Required a person making a determination of a comparable property to use the characteristics listed in §23.013 (d), Tax Code, and to calculate the median level of appraisal of comparable properties as shown in the appraisal records submitted by the chief appraiser to the ARB;
- Required the Comptroller to establish standards for the development and calibration of adjustments for industrial, petrochemical refining and processing, utility properties and other unique properties;
- Amended §42.26, Tax Code, to permit equal and uniform appeals only on the ground that the appraisal ratio of the property exceeds by at least 10 percent the median level of appraisal of comparable properties in the appraisal district;
- Required the same standards for comparable properties and calculating the median level of appraisal as in §41.43, Tax Code, as amended; and
- Allowed appraisal districts to recover attorney’s fees up to \$15,000.

TTARA and other taxpayer groups united in opposition to these bills on the basis that they gutted the equal and uniform standard altogether (not to mention that they were of dubious constitutionality to begin with). However, a compromise bill addressing the lack of statutory standards for the selection of comparable properties in an equal and uniform appeal moved forward and has been signed by the Governor, with TTARA’s support. **HB 2083 by Rep. Darby (R-San Angelo) and Sen. Hancock (R-North Richland Hills)** amends §23.01, Tax Code, to base the selection of comparable properties and the application of appropriate adjustments on the application of generally accepted appraisal methods and techniques. The bill adds that adjustments must likewise be based on recognized methods and techniques necessary to produce a credible opinion. The bill further entitles property owners who represent themselves to offer an opinion of and present argument and evidence related to the value or the inequality of appraisal of the owner’s property.

HB 2083 should address concerns regarding the applicability of appropriate appraisal standards to equal and uniform appeals. Nevertheless, we expect the political issue to continue to fester. The real problem is that Texas is seeing spectacular growth and immense pressure on both residential and commercial values. The fact that litigation over commercial property is concentrated in some counties probably says more about a particular CAD’s approach to negotiating values than it does to the accuracy of the values themselves. And as long as the Texas Constitution requires *taxes* to be equal and uniform, property owners, no matter what type of property they own, should be able to enforce that requirement.

CHAPTER 313

Chapter 313 of the Tax Code is the state's most important economic development program. It allows school districts to offer a temporary limitation on the taxable value of new investment property. Despite substantial reforms in 2013, in which applicants are now required to demonstrate that the incentive was a determining factor in the investment, and demonstrate that the taxes from the project will outweigh the amount of the incentive, the program still has its critics. Originally designed to attract capital investment and high-paying jobs, critics complain that the program is not creating a substantial number of jobs. Others complain about high amounts of "supplemental" payments commonly required by school districts — revenue that is not included as a part of the school finance system.

The program requires projects to apply for a limitation to the school district in which they are to be located; however, the statute does not make specific provision for projects that cross multiple school district boundaries. **HB 2826 by Murphy (R-Houston)** would have addressed this problem by providing that if a project is located in up to three contiguous districts, the project is considered to be located in the district with the highest taxable value for purposes of determining the minimum qualified investment and minimum value limitation. The bill prorated the value limitation in each district in proportion to the amount of qualified investment in each district and requires the Comptroller to determine eligibility of the whole project based on the project's eligibility if it were located in one district.

HB 2826 was also amended on the Senate floor to direct the Comptroller to verify the new qualifying jobs data in a random sample of 313 agreements using information from the Workforce Commission, the appraisal district, and other sources the Comptroller considers reliable. This provision was lifted from **SB 829 by Sen. Lois Kolkhorst (R-Brenham)** and **HB 3637 by Chris Turner (D-Arlington)**, and stemmed from a recommendation by the State Auditor.

HB 2826 passed the legislature with little controversy, but fell to Governor Abbott's veto pen, the subject of a scathing, off-the-mark, assessment in his veto proclamation:

"Chapter 313 of the Tax Code allows for certain businesses to negotiate with school districts for lower appraisal valuations and, as a result, lower school property taxes. While the program may sometimes have a positive impact on local economic development, serious concerns exist about its oversight, its transparency, and its value to the taxpayers. According to a 2013 report by the Comptroller's Office, Chapter 313 cost the taxpayers \$341,363 for every new job created by the program. The Comptroller estimates that House Bill 2826 will ultimately cost State taxpayers \$100 million per biennium. I cannot support expansion of an incentive program that has not been proven to deliver the value taxpayers deserve."

As a fiscally conservative state, Texas leaders are traditionally skeptical about the use of economic incentives. Former Governor Perry initially considered vetoing the legislation creating Chapter 313 (legislation which TTARA strongly supported), but allowed it to become law without his signature. Eventually he became a proponent of the program, discovering its importance in attracting new investment to the state. TTARA will continue to work with both supporters and opponents of the program to ensure that it operates efficiently and effectively, and is assessed objectively.

All other Chapter 313 proposals died in the legislature, including bills to exclude wind projects from eligibility, raise the amount of school district pilot payments, and extend eligibility to large data center projects and large-scale electric energy storage facilities. Legislation requiring a clawback of foregone revenue if the value of the property declines to a certain threshold during the life of the agreement likewise failed.

TRUTH IN TAXATION/ROLLBACK

As discussed above, the session began with some hopes for significant reform of the truth in taxation and rollback procedures. The lead proposal, **SB 182 by Sen. Paul Bettencourt (R-Houston)**, had the backing of Lt. Governor Dan Patrick, but could not muster enough support in Senate Finance to advance. Sen. Bettencourt tried other approaches as well, including **SB 766**, which modified the effective tax rate calculation to lower the base, and **SB 1692**, a revenue cap

Don't forget the TTARA Annual Meeting!

**October 29-30, 2015
Sheraton Austin at the Capitol
701 East 11th Street
Austin, Texas 78701**

pegged at population growth plus the rate of inflation. On the House side, Rep. Gary Elkins introduced companions to the Bettencourt bills, and freshman **Rep. Dennis Paul (R-Webster)** filed **HB 1965**, which lowered the rollback limitation from the current 8 percent increase to one equal to the rate of inflation plus one percent. Increases above that required taxing units to hold an automatic ratification election. A version of HB 1965 did get out of House Ways & Means late in the session, but died in Calendars. The only truth in taxation measure to pass both Houses was **HB 1953 by Chairman Dennis Bonnen (R-Angleton)**, which extends the September 1 deadline for a city or county to provide notice of a proposed tax rate to the later of September 1 or the 30th day after the date the certified appraisal roll is received by the taxing unit. Two bills requiring local governments to publish additional information regarding proposed and existing bonded indebtedness, **HB 114 and HB 1378 by Rep. Dan Flynn (R-Van)**, also made it to the Governor's desk.

Given this session's intensive focus on rising property taxes, it is anticipated that the legislature's interim work will include revisiting the effective and rollback tax rate calculations. It will almost certainly return as a major issue next session.

APPRAISAL CAPS

Similarly to truth in taxation, a number of proposals to lower the 10 percent appraisal cap for homesteads and/or to expand the cap to additional categories of property failed to move. This inaction may be partly attributed to the shift in attention to the homestead exemption in SJR 1/SB 1, and partly to the spillover effect from the vehement local government opposition to changes in the effective and rollback rates. Nevertheless, appraisal caps are certain to reappear on the agenda next time, as legislators continue to grapple with voter ire over the property tax.

Franchise Tax

In 2006 lawmakers revised the state's profits-based franchise tax to better reflect the economy of the state and to eliminate rampant tax planning opportunities of the old tax. The resulting "margin" tax reforms accomplished those goals, but the new tax has been characterized by complexity and confusion, while containing elements of a gross receipts tax that result in some degree of double-taxation (albeit at a much lower rate than traditional corporate income taxes).

Under the revised franchise, or "margin tax," a business, on a combined basis, calculates its tax liability starting with its total revenues. From that, it may deduct one of the following: 1) cost of goods sold (using a special state definition), 2) compensation (including certain overhead), or 3) 30 percent of total revenues. The result is apportioned to Texas based on the company's percentage of total sales in Texas. The apportioned tax base is subject to a one percent tax rate, or one half percent for wholesalers and retailers (these rates were temporarily reduced in 2014 and 2015). Businesses with less than \$10 million may opt for a simpler "EZ" calculation and pay a tax equal to 0.575 percent of their Texas sales.

Only a handful of bills amending the franchise tax passed in 2015, though not for lack of trying. Almost 100 bills were introduced that would have made various changes to the tax — second in number only to the 105 bills introduced in 2009. The high number of bills reflects legislative dissatisfaction with the tax, but the fact that fewer than 10 bills actually passed suggests a bit of legislative schizophrenia about the tax — uncertain whether to "fix" the tax or to simply repeal it. By comparison, in the five legislative sessions prior to the

enactment of the "margin" tax reforms, an average of 28 franchise tax bills were filed each session.

HB 32 by D. Bonnen (R-Angleton) cuts the basic rates of the franchise tax by 25 percent (to 0.75 percent and 0.375 percent, respectively) and the alternative "EZ" rate available to small businesses by 42 percent to 0.331 percent (while also extending it to businesses with up to \$20 million in total revenue).

HB 2896 by Tan Parker (R-Flower Mound) clarifies that certain broadcaster receipts be apportioned based on the legal domicile of the payor — consistent with the state's policy of sourcing intangible revenue. **HB 3230 by Justin Rodriguez (D-Victoria)** expands the types of costs eligible for the tax credit for the rehabilitation of historic structures under Subchapter S. **SB 1049 by Campbell (R-New Braunfels)** offers a temporary, five year franchise tax exemption as well as an exemption from certain business filing fees for newly-started businesses entirely owned by veterans.

Two other franchise tax bills deal with reporting requirements. **SB 1364 by Kolkhorst (R-Brenham)** requires taxpayers to file their "no tax due" reports electronically. **HB 2891 by Otto (R-Dayton)** eliminates certain reporting requirements and filing fees on professional associations and partnerships to the Secretary of State, instead including the information in the entity's public information report filed with the Comptroller — eliminating roughly \$2.4 million annually in fees.

A number of bills attempting to “fix” certain aspects of the tax failed this session as the legislature was more focused on trying to kill the tax. At least 14 bills filed in 2015 would have repealed the tax. The House-passed version of HB 32 actually included a provision that would have phased out the tax, though a similar provision failed in the Senate. Other bills that failed passage this session would have addressed problem areas with the tax involving timber production costs, manufacturing under federal contracts, credit card fees, hospital operating costs, independent contractors, zoo and aquarium costs, sales of locomotives, among others.

A controversial proposal to increase the small business exemption to \$4 million from the current \$1 million, **SB 8 by Schwertner (R-Georgetown)**, passed the Senate, but died in the House. This bill would have exempted all but 55,000 of the 117,000 businesses currently paying tax (out of over 1 million total liability-protected businesses), and was strongly opposed by TTARA and a number of other business groups.

Several new tax credits failed passage, most notably **SB 4 by Larry Taylor (R-Friendswood)**, which would have allowed a franchise or insurance premiums tax credit for contributions made to qualified “educational assistance organizations” providing scholarships for disadvantaged students to attend private schools (termed “vouchers” by some). Other tax credits for new hires, internships, and certain new businesses also failed to work their way through the legislative process.

A number of bills to better conform the state franchise tax to federal income tax definitions also failed to pass.

The interim will bring further study of the franchise tax. HB 32 includes a curiously-worded provision requiring the Comptroller to report back to the legislature by September 30, 2016 on the “effects of economic growth on future state revenues,” and identify “growth allocation options to promote efficiency and sustainability in meeting the revenue needs of this state, including revenues... upon repeal of the franchise tax.” In effect, the Comptroller may report on revenue alternatives to the franchise tax and the effect they would have on the Texas economy, though the language gives him great latitude in just how proscriptive to be. Legislative committees may also study the tax, though formal interim committee charges are not expected until fall.

For now, the franchise tax is something of an enigma to citizen legislators. It remains unpopular with many segments of the business community, but many view it as a “known evil.” Replacing the tax is something of a double-edged political sword—taxpayers may enjoy not having to pay a tax based on margin, but they may appreciate even less what replaces it. For now, the most likely outcome is further reductions of the rate—an approach that benefits all existing taxpayers without arbitrarily picking winners and losers.

Sales Tax

Outside of the brouhaha over whether to cut the sales tax rate in **HB 31 by Dennis Bonnen (R-Angleton)**, it was a fairly calm session of relatively routine sales tax bills.

The aforementioned sales tax cut, HB 31, was a bit of a curve ball in the tax debate. Though it had a low bill number (a sign of support from House Speaker Joe Straus), it was actually something of a late session surprise. Chairman Bonnen has a long track record of supporting property tax cuts, but had developed a substantial degree of skepticism over the ability of the state to cut a locally imposed tax and make those cuts stick. Though the sales tax is not as despised as the property tax, Chairman Bonnen assessed that it would be a much more efficient mechanism of providing actual tax relief. HB 31 would have cut the state sales tax rate by five percent—from 6.25 percent to 5.95 percent—what would have been the first rate cut in the history of the tax. The proposal quickly gained steam and passed the House without a single “no” vote (and with support from TTARA and a number of other business associations). However, the sales tax bill arrived in the Senate about the same time appraisal no-

tices arrived in the mailboxes of Texas property owners. Substantial appraisal increases renewed interest in targeting the property tax. HB 31 died in the Senate without a hearing.

But the sales tax debate was not simply limited to rate cuts. As we did last session, TTARA successfully opposed two bad ideas—1) giving local governments their own authority to conduct sales tax audits and 2) busting the two percent aggregate cap on local sales taxes.

Cities continue to have issues with the process by which the Comptroller allocates sales tax receipts across local taxing entities. **HB 1871 by Greg Bonnen (R-Friendswood)** was filed to make the process more palatable. It would have imposed significant additional reporting responsibilities on the Comptroller and allowed cities to file a redetermination petition to contest the Comptroller’s local tax allocations. Also included in the filed version was an unacceptable provision requiring the Comptroller to authorize “a city employee or designated agent” to have all the investigative and audit authority of the Comptroller. When TTARA objected to the

local audit provision, Rep. Bonnen graciously removed it from the substitute bill that was heard in House Ways and Means. The modified bill passed the House and was heard in Senate Finance where it was sponsored by Sen. Larry Taylor but it failed to be reported out of committee. The bill's fiscal note, in which the Comptroller estimated an administrative cost of \$16.6 million to pay for a new division within the agency to handle redeterminations, may have had something to do with the bill's ultimate demise.

This session's cap-buster bill, **SB 1158 by Hall (R-Canton)**, would have allowed Hopkins County to ask voter permission to levy a one-half percent sales tax above the 2% limit to finance jail construction bonds. Voters had already approved a seven-cent property tax increase to pay for a \$16 million bond package. But, after doing so, voters apparently experienced a case of buyers' remorse and county officials, in response, wanted to hold another election to allow voters to choose between the sales or the property tax increase. TTARA presented the only oral testimony against the bill when it was heard in Senate Finance where it remained at session's end.

SALES TAX HOLIDAYS

Two new sales tax holidays were created by bills authored by Senate President Pro Tempore Juan "Chuy" Hinojosa. **SB 904 by Hinojosa (D-McAllen)** allows tax-free purchases of "emergency preparation supplies" during the last weekend in April. Exempt items include: portable generators costing less than \$3,000; window protection devices and rescue ladders priced under \$300; and a list of thirteen items selling for less than \$75, including batteries, fuel containers, ice chests, tarpaulins, portable radios, fire extinguishers, smoke detectors, hatchets, first aid kits and nonelectric can openers.

In conjunction with the current Memorial Day weekend holiday for purchases of energy-efficient products, **SB 1356 by Hinojosa** also provides for tax-free purchases during the same period of certain water-efficient products used on residential property for water conservation or retention, water table recharge, or water evaporation limitation. Listed exempt items include: mulch, rain barrels, soaker hoses, sprinkler system moisture controls, permeable ground covers, and "WaterSense" products certified by the U.S. Environmental Protection Agency.

LARGE DATA CENTER INCENTIVE

With the passage of HB 1223 last session, a new §151.359, Tax Code, made up to a fifteen-year state, but not local, tax exemption available for the purchase of essential tangible personal property by new data centers that meet certain requirements, including among others: a 100,000 square foot facility with a single occupant, twenty new jobs paying a minimum of 120 percent of the average county wage, and a five-year capital investment of \$200 million for a 10-year exemption which increased to fifteen years for a \$250 mil-

lion plus investment. However, its effectiveness in attracting very large data center projects was deemed to be limited.

Thus, **HB 2712 by Geren (R-Fort Worth)** was passed up the ante to enhance the opportunity for Texas to become a leader in the growth of this segment of the technology industry. The new §151.3595, Tax Code, provides a 20-year state and local sales tax exemption for the purchase of a long list of items necessary and essential to operating a "qualifying" large data center, including for example: electricity; electrical, cooling, mechanical and plumbing systems; mainframe computers or servers; software; and data storage devices. To qualify, certain specified qualifications must be met, including a certification of eligibility from the Comptroller. Principal requirements include: a five-year capital investment of \$500 million; a new or refurbished facility of at least 250,000 square feet that may include multiple buildings; and creation of at least 40 new full-time jobs paying at least 120 percent of the average county wage.

OTHER EXEMPTIONS

Customarily, a number of proposed exemptions are introduced for consideration each session. This session was no exception and tax-free purchases of a wide range of items from college textbooks to guns and ammo were proposed. In the end, only four were enacted. In response to a change in Comptroller policy to the contrary, **HB 2507 by Kacal (R-College Station)** clarifies that the current exemption for purchases of digital transmission equipment required to comply with federal regulations applies to radio as well as television broadcast stations. **HB 1841 by G. Bonnen (R-Friendswood)** removes services performed by public insurance adjusters from the definition of taxable insurance services. **SB 140 by Perry (R-Lubbock)** exempts telecom services used to navigate machinery and equipment used on a farm or ranch to produce agricultural products or to build and maintain roads or water facilities. Lastly, the vending machine sales of nonprofit organizations operating independent life skills programs for individuals with special needs are exempted by **HB 2313 by Bohac (R-Houston)**.

SALES TAX ADMINISTRATION

The hope is that passage of **SB 1396 by West (D-Dallas)** will resolve many of the difficulties attendant to the taxation of aircraft that have been a continuing vexation for both the Comptroller and taxpayers. The bill was the outcome of discussions between the Comptroller and some affected taxpayers and is intended, in general, to ensure tax is only paid once, eliminate the double taxation of aircraft leases, conform to federal regulations, and close loopholes for aircraft purchased out-of-state for in-state use. A new Tax Code Chapter 163 entitled "*Sales and Use Taxation of Aircraft*" is created. It preserves all current exemptions and includes new provisions to: treat the transfer of operational control as defined by federal regulations as a lease or rental; establish joint tax liability for a purchaser and an affiliated entity that uses aircraft in-state; make transfers between affiliated enti-

ties tax-free; and impose no tax liability for aircraft operated under fractional ownership programs.

Another provision that has proven to be troublesome to administer is the taxation of so-called “snack items” and a section of **HB 1905 by Springer (R-Muenster)** makes certain changes to help clarify the situation. The definition of snack items in §151.314(b-1), Tax Code, is amended to exclude pine nuts and to include pork rinds, corn nuts, sunflower and pumpkin seeds, ice cream, sherbet, frozen yogurt, ice and juice pops, sorbet and other frozen fruit items with less than 50 percent fruit juice by volume. Consideration of whether or not a package specifies the number of servings it contains is removed from the determination of whether it is a taxable individual-sized portion. A new provision specifies that when a grocery or convenience store contains a type of location like a restaurant, café or deli where taxable prepared food is sold, the store is considered a like place of business in relation to items sold at that location.

SB 755 by V. Taylor (R-Plano) allows software purchases by an Internet hosting provider to be treated as sales for resale if a license to use the program is, in turn, sold to an unrelated user and a right to use the program under that license is not retained. **SB 853 by Kolkhorst (R-Brenham)** provides that an electronically-filed sales tax permit application does not have to be signed to be valid. **HB 2358 by Lucio III (D-Brownsville)** concerning the tax liability of businesses and employees who enter the state to provide disaster or emergency assistance includes a provision stating that such responders are not considered “retailers” for sales tax purposes. Tax Code §151.310(c-1) which allows volunteer firefighter and emergency services organizations to annually hold ten tax-free sales or auctions lasting not more than three days was scheduled to expire September 1st of this year but **SB 31 by Zaffirini (D-Laredo)** now makes it permanent.

Other Taxes/Tax Administration

While property, sales, and franchise taxes account for the lion’s share of taxes paid in the state, there are dozens of others as well as issues of tax administration that affect taxpayers in the state.

TAXES REPEALED

In keeping with this session’s tax-cutting theme, new Comptroller Glenn Hegar assessed the operations of his office and recommended that several smaller taxes may be more trouble to taxpayers than they are worth to the state, and recommended that they be eliminated. The Comptroller’s package eliminates eight specific taxes:

- Sulphur production (Chapter 203, Tax Code) – repealed in **SB 757 by Perry (R-Lubbock)**
- Crude oil regulation (§81.111, Natural Resources Code) – repealed in **SB 757 by Perry (R-Lubbock)**
- Controlled substances (Chapter 159, Tax Code) - repealed in **HB 1905 by Springer (R-Muenster)**
- Alcoholic beverages served on planes and trains (§34.04 & §48.04, Tax Code) - repealed in **HB 1905 by Springer (R-Muenster)**
- Liquefied gas (Chapter 162, Subchapter D, Tax Code) - repealed in **HB 1905 by Springer (R-Muenster)**
- Bingo gross rentals (§2001.501, Occupations Code) - repealed in **HB 1905 by Springer (R-Muenster)**

- Fireworks (Chapter 161, Tax Code) – repealed in **SB 761 by Creighton (R-Conroe)**
- Inheritance (Chapter 211, Tax Code) – repealed in **SB 752 by Bettencourt (R-Houston)**

HB 7 by Darby (R-San Angelo) took tax elimination even further. While this bill initially aimed at reducing the use of ending balances in general revenue-dedicated accounts to certify the general appropriations act, it garnered an amendment that eliminated the \$200 a year additional licensing fee collected from a variety of professionals, including: doctors, dentists, optometrists, chiropractors, psychologists, veterinarians, accountants, engineers, architects, landscape architects, interior designers, land surveyors, real estate brokers, property tax consultants, attorneys, and securities brokers. These taxes had been put in place in 1991, partly in lieu of extending the sales tax to those professions.

PERIODIC REVIEW/SUNSET OF TAX EXEMPTIONS

While a number of bills were filed to require periodic review of tax incentives and preferences and/or to sunset them, the only bill to go forward ended up being much more limited. **HB 1261 by Rep. Susan King (R-Abilene)** directs the Comptroller’s biennial exemptions and exclusions report to use, in the absence of actual data, available statistical data to estimate the impact of an exemption, discount, exclusion, special valuation, special accounting treatment, special rate, or special method of reporting relating to a tax.

Texas Taxpayers and Research Association
400 West 15th Street, Suite 400
Austin, Texas 78701

TTARA has long been skeptical of arbitrary external review mechanisms, though we are supportive of an objective assessment process. TTARA directly opposed attempts to automatically “sunset” exemptions — a process that would inject tremendous uncertainty into business planning.

TAXPAYER RIGHTS

A key tax administration bill that TTARA supported, but eventually died by fiscal note was **HB 3111 by Button (R-Garland)**. This bill would have equalized the rate of interest on tax refunds and tax deficiencies. Under current law, taxpayers entitled to a refund are paid interest at the rate equal to that earned on money in the State Treasury (about

0.4 percent); if, however, money is owed to the state, they must pay at a rate equal to the prime rate plus one percent (about 4.25 percent). Interest should be a measure of the time value of money, and not an additional penalty on taxpayers. The Comptroller estimated the potential future cost to the state from HB 3111 would exceed \$300 million annually. Though the bill passed out of the Ways and Means Committee, and was set on the House calendar for consideration, it died when time ran out at session end. A bill making more far reaching changes to level the playing field between the state and taxpayers, **SB 1291 by Van Taylor (R-Plano)**, dubbed the Texas Fairness and Equal Treatment in Taxation Act, died in the Senate Finance Committee.

Stay Tuned for an Active Tax Interim

With the passage of some significant tax legislation in 2015, the Comptroller’s Office will be busy working on implementation with input from TTARA, taxpayers, and their representatives. That will add to an already heavy workload for an agency that is catching up on a number of hold-over issues: rules on legislation from previous sessions, the application of the sales tax manufacturing/processing exemption (particularly to natural gas field compressors), and streamlining tax administration procedures, to name a few. Several lawsuits also loom on the horizon that could substantially impact state taxes, including *Southwest Royalties* (relating to the sales tax exemption for manufacturing/processing as it applies to oil and gas activity), *AMC* (American Multi-Cinema, and the tax definition of tangible personal property), and of course, the latest incarnation of a challenge to the state’s school finance system. Within a few months, legislative interim committee charges will be issued, inviting substantial activity on property, franchise, and sales taxes. It promises to be a very busy interim, and TTARA will be there to keep you informed and to weigh in on those issues most critical to taxpayers.