



TTARA
Webcast Update
on Tax & Fiscal Issues

February 12, 2016

Continuing Education Credits

We are pleased to offer 1 hour of continuing education credit for attorneys, accountants, and professionals in taxation with the State Bar of Texas, the Texas State Board of Public Accountancy, and the Institute for Professionals in Taxation.

Certificates of participation have been uploaded and can be found on the Gotowebinar toolbar on the right side of your screen under the “Handout” menu. You can download and place a copy in your files. If you have trouble locating the certificate, contact Ryan at ryan@ttara.org and he will send you a copy. We will enter the State Bar of Texas credit, but accountants and tax professionals need to submit their credit to those organizations.



Agenda

1. **2016 Dates of Interest**
2. **Fiscal Update**
3. **School Finance**
4. **Property Tax**
 - a. **City of Austin Appeal**
 - b. **ETC Marketing**
 - c. **Heavy Equipment Inventory**
 - d. **(Un)Truth in Taxation**
 - e. **Select Committee on Property Tax Reform & Relief**
5. **Sales Tax**
 - a. **Southwest Royalties**
 - b. **Compressors**
6. **Tax Administration**
 - a. **Procedural Rules**
7. **Franchise Tax**
 - a. **AMC Case**
 - b. **Data Report**

2016 Events & Meetings

- **Houston Luncheon in conjunction with TEI/Houston Chapter:** Tuesday, April 19, 2016 at the Westin Houston Memorial City, 945 Gessner, 11:30-1:00. Special Guest Speaker: Senator Paul Bettencourt
- **Dallas Luncheon:** Thursday, April 28, 2016 at the Westin Galleria, 13340 Dallas Pkwy from 11:30-1:00.
- **Golf Tournament:** Monday, May 23, 2016, at Falconhead Golf Club (1 p.m. start time)
- **Annual Meeting:** Thursday, October 6 and Friday October 7 at the Sheraton Austin Hotel at the Capitol.
- **Webcasts:** April 8, June 10, September 9, and November 4. (All webcasts will start at 9:30 a.m. and last no longer than an hour).

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Fiscal Update



Key Budget Numbers

All Funds Spending	\$209.4 bl.
<i>Increase over 2014-15</i>	<i>3.6 %</i>
General Revenue Spending	\$106.6 bl.
<i>Increase over 2014-15</i>	<i>12.0 %</i>
General Revenue Surplus	\$4.2 bl.
Rainy Day Fund Balance	\$10.4 bl.



Is Texas' Budget in Trouble?

Moody's, a Wall Street research and rating firm, in a January 26 report warns:

- *Texas' general revenue surplus could be eroded by the end of the fiscal year*
- *We expect Texas will make spending cuts at some point in the biennium (to remain in the black)*
- Moody's preserved the state's credit rating at Aaa stable

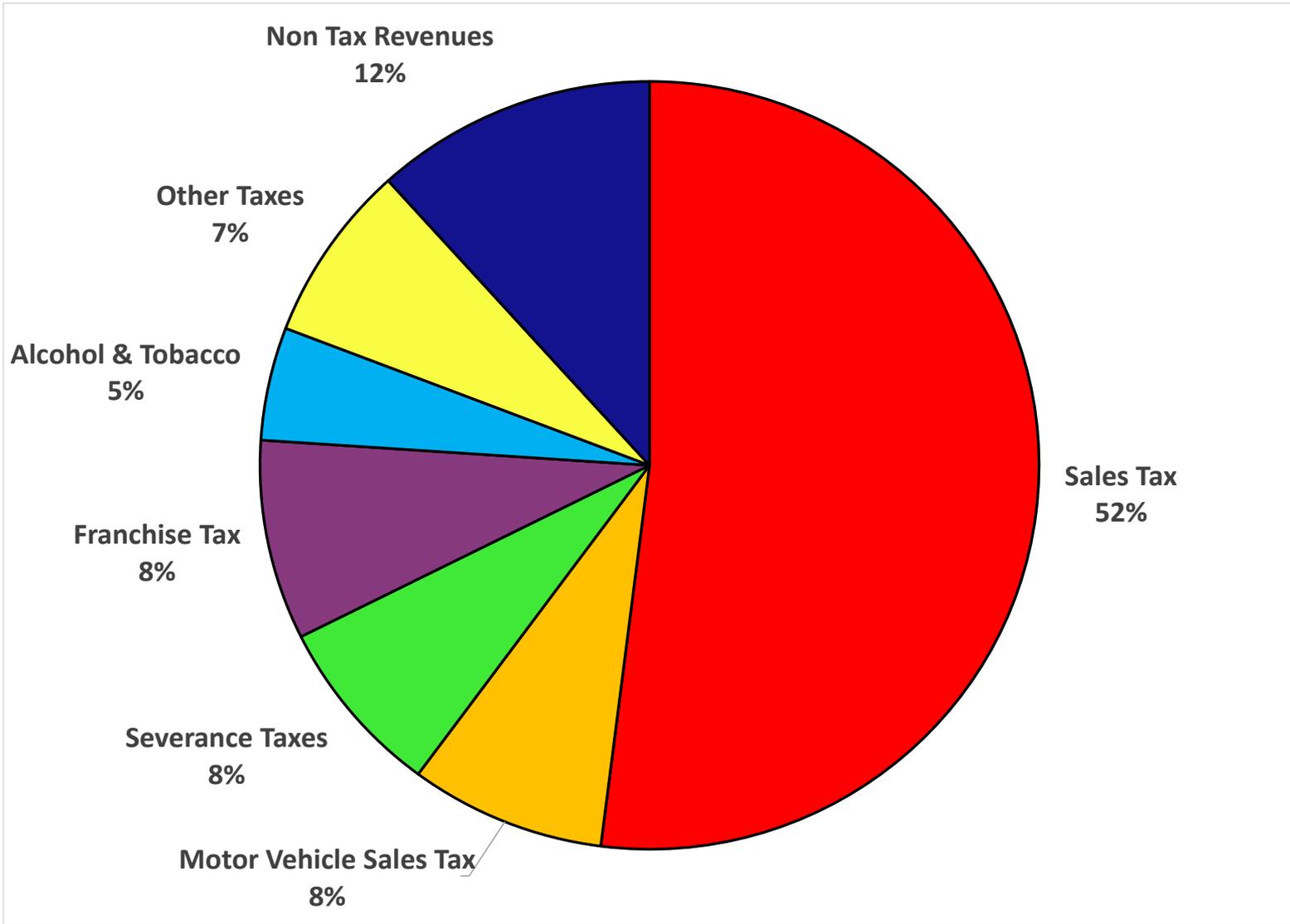
Comptroller Hegar Responds

- Moody's analysis is *"an oversimplified, back-of-the-envelope calculation based on unfounded assumptions."*
- *Moody's should know better*
- *The current budget works even with oil prices at recent lows*

Comptroller Price Forecast

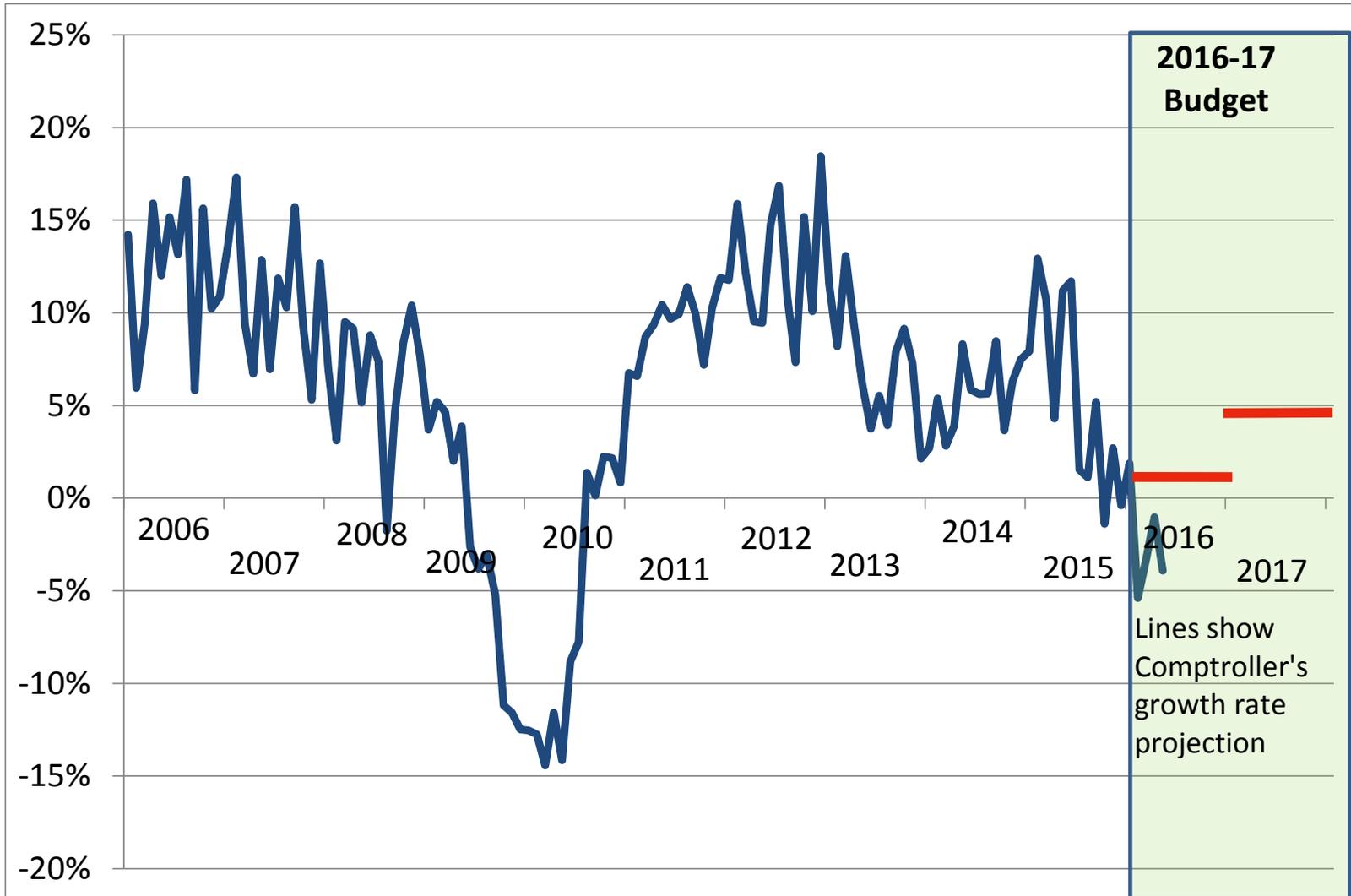
	2016	2017	Wednesday Spot Price
Price of Oil (\$ bl)	\$ 49.48	\$ 56.52	\$27.97
Price of Natural Gas (\$ M Btu)	\$ 2.91	\$ 3.05	\$2.17

General Revenues, 2015



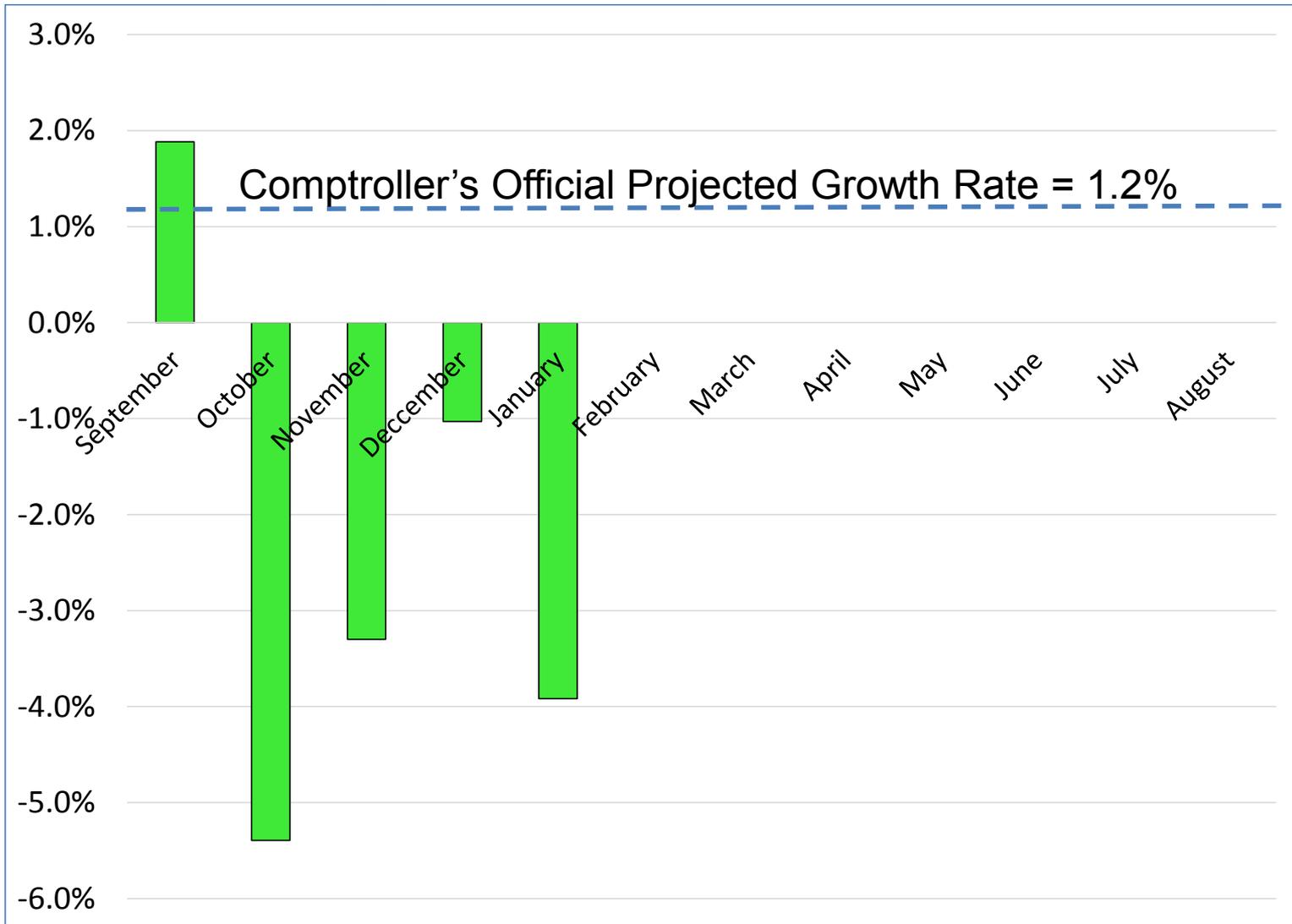
Sales Tax Revenues

Growth Compared to the Same Month in the Previous Year



Sales Tax in 2016

Growth Compared to Same Month in the Previous Year



Official Revenue Estimate, 2016

	CRE Est (\$ bl)	Cert Est Growth	YTD	Track
General Sales Tax	\$ 29.1	1.2 %	(2.5 %)	↓
Motor Vehicle Sales Tax	\$ 4.8	5.9 %	0.9 %	↓
Franchise Tax	\$ 3.5	(24.2 %)	(54.9 %)	↓
Oil and Natural Gas Tax	\$ 2.7	(34.7 %)	(48.1 %)	↓
Alcohol & Tobacco Tax	\$ 2.5	(3.4 %)	(4.7 %)	↓
Other Taxes	\$ 4.2	2.0 %	(7.7 %)	↓
Non Tax Revenue	<u>\$ 6.3</u>	(2.3 %)	(2.3 %)	-
Total General Revenues	\$53.3	(3.8 %)	(6.2 %)	↓

State Finances Remain Sound

- If current trends continue, Texas' general revenue surplus would be reduced in half by the end of 2016, with 2017 yet to come
- Texas will still have close to \$10 billion in the Rainy Day Fund as a cushion
- Texas appears able to weather the downturn in oil and natural gas, but if the US goes into recession, all bets are off

Looking Ahead to 2018-19

- A portion of general revenues (\$4 to \$5 billion) will be newly-dedicated for highways
- Court cases could pressure the budget:
 - School finance
 - Various tax cases
- More tax cuts will be a challenge, but will still be a top priority for many



School Finance



School Finance Lawsuit

Timeline

Initially Filed	October 11, 2011
Ruling from the Bench Unconstitutional	February 4, 2013
Re-hearing due to Changes	January 21, 2014
Formal Ruling Unconstitutional	August 28, 2014
Appealed to TX Supreme Court	September 26, 2014
Supreme Court Oral Arguments	September 1, 2015
Supreme Court Ruling	After March 1 Primary?



School Finance Lawsuit

Possible Rulings

- **Unconstitutional on all claims.** School finance system violates all constitutional provisions put forth by the plaintiffs. **Would include an injunction.**
- **Constitutional Ruling on all claims.** The school finance system does not violate the Constitution.
- **Mixed Ruling – Part constitutional and part unconstitutional.** School finance system violates one or more constitutional provisions but not all. **Would include an injunction.**

School Finance Lawsuit

Other Possible Actions

- **Dismiss the case.** School finance lawsuits are never-ending. Changes should be made by the Legislature. The **remedy sought** by the Plaintiffs — an injunction prohibiting the state from sending revenue to school districts — would do **further harm** to school districts.
 - Suggested by Attorney General and Governor
 - Nebraska and Oklahoma Supreme Courts did this
- **Remand the case back to district court.** Case is **not ripe** because the data examined by the District Court did not incorporate changes made by the Legislature in 2013 and 2015.
 - Suggested by Attorney General and Governor



Three-Judge Court SB 455 by Creighton-84th Regular

Supreme Court Advisory Committee (46 members; 5 ex officio members; mainly attorneys and judges) has drafted rules to implement SB 455.

Rules apply to **school finance** and redistricting cases:

- Filed on or after the effective date of the rules
- Pending in district court, or
- **Filed before effective date of rules, but are remanded back to district court.**



Three-Judge Court

SB 455 by Creighton-84th Regular

- Authorizes the **Attorney General to petition** the Chief Justice of the Texas Supreme Court to appoint a **special three-member District Court** to hear **school finance and redistricting cases**.
- The Chief Justice must then appoint **three judges** to hear the case.
 - the judge to which the case was assigned
 - a district judge from a county other than the county in which the case was filed
 - an appeals court justice from a jurisdiction other than the jurisdiction in which the case was filed
- Judges **must have been elected** to that office; cannot be serving an appointed term



Three-Judge Court

SB 455 by Creighton-84th Regular

- If current case is **remanded** back to district court, the **Attorney General almost certainly would petition for a three-judge court** under SB 455.
- If Supreme Court issues a ruling that the school finance system is unconstitutional, the **injunction deadline** will determine whether or not a **special session** is necessary.
 - Deadline before June 1, 2017 ~ Special Session



Property Tax



City of Austin vs. Travis Central Appraisal District, et. al

- City of Austin filed suit on August 24 against TCAD challenging the certified appraised values of commercial real property (Category F1) and vacant land (Category C1)
- Trial court granted summary judgment to TCAD and intervening property owners on jurisdictional grounds
- The city attorney requested a new trial, enabling the City to file an appeal with the Third District Court of Appeals
- The City filed its appeal with the Third Court on January 26
- No timetable yet for consideration



ETC Marketing, Ltd. v. Harris County Appraisal District

- In October TTARA filed an amicus brief with the Texas Supreme Court in support of ETC's petition for review
- The case involves the application of the *Complete Auto test* for determining whether state taxation imposes an impermissible burden on interstate commerce
- SCOTX has requested briefing on the merits; Petitioner's brief is due on February 22, Response brief on March 14
- SCOTX will then decide whether to grant petition and schedule oral argument



Heavy Equipment Inventory

- On February 10, Loving Central Appraisal District filed a petition for review in the Texas Supreme Court in its case against EXLP Leasing and EES Leasing
- LCAD is appealing the El Paso Court of Appeals' ruling upholding the constitutionality of the heavy equipment statute
- LCAD argues that one month's rent is not a reasonable estimate of market value
- EXLP/EES have 30 days to respond



Untruth in Taxation: County Energy Transportation Reinvestment Zones

- Authorized by Legislature in 2013 (§§221.1071-1072, **Transportation Code**)
- Law allows a county to establish a tax increment zone to pay for transportation infrastructure projects *inside the zone*
- In December a number of TTARA members notified TTARA of potential irregularities in the establishment of CETRZs in Dimmit, LaSalle, Reeves, and possibly other counties
- Irregularities resulted in grossly inflated calculations of value increments, allowing counties to exclude excessive value from ETR calculation and evade rollback limits



County Energy Transportation Reinvestment Zones *Continued*

- The consultants retained by the counties only counted those properties within the zone that *increased* in value
- Property owners never entered into agreement with county as required by statute
- The consultants failed to notice that the database identifiers for some properties changed from 2013 to 2015, producing erroneous increments
- The boundaries of the zones are not clear, and open records requests for copies of the orders creating the zones and the zone boundaries have not been successful to date
- Some properties included in a CETRZ are not physically located within the zone, while in other instances the same property has been assigned to multiple CETRZs
- The county's ETR calculations, which exclude the increment value, cannot be verified



Senate Select Committee on Property Tax Reform

- Chaired by Sen. Paul Bettencourt (R-Houston), the committee held first public hearing in San Antonio on January 27
- Approximately 50 witnesses, including TTARA, presented testimony
- Bulk of public testimony concerned increases in local government tax levies, lack of transparency in the rate-setting process, and the inadequacy of current rollback procedures to control property taxes



Senate Select Committee on Property Tax Reform *Continued*

- Second public hearing held in Harlingen yesterday
- Similar focus as in San Antonio:
 - Rise in local tax levies
 - Attacks on equal and uniform provisions
 - Appraisal district / review board treatment of taxpayers



TTARA Testimony Before Bettencourt Committee

- Property taxes account for 47% of state and local taxes, more than any other tax
- Property tax is the largest tax paid by business
- All states tax real estate owned by individuals and businesses
- In contrast to Texas, 39 states exempt personal property owned by individuals and 44 exempt retail inventories generally



TTARA Testimony Before Bettencourt Committee *Continued*

- Texas ranks among the highest tax states on industrial property
- Residential property pays a considerably lower effective tax rate than business property, attributable largely to homestead exemptions
- Residential property as a percentage of the total tax base is growing slowly as the Texas economy shifts from capital-intensive, goods-producing businesses (with high property taxes) to labor-intensive businesses (with far less taxable property)

TTARA Takeaways

- Texas' high property taxes are detrimental to all taxpayers, not just homeowners; all tax cuts or protections should apply to all taxpayers on an equal basis
- The constitutional market value standard must be preserved to ensure equality and uniformity of taxation
- Arbitrary value restrictions distort the tax base and offer no real or lasting relief; taxing units merely offset the loss in value by higher tax rates, shifting the burden to other property owners



TTARA Takeaways *Continued*

- Property taxes continue to increase because taxing units adopt rates that consistently increase their tax collections, even if the rate appears to be the same as the prior year
- Voters have few effective tools to restrain property tax increases and there is no independent oversight of local government tax rate setting procedures
- The problem with the property tax is not the appraisal process, which is one of the most independent and professional in the nation—the problem is the amount of taxes levied



Sales Tax



Southwest Royalties Inc. v. Hegar **(S.Ct. Case #14-0743)**

Issue: Does downhole equipment used to extract oil and gas qualify for a manufacturing exemption? Does such equipment, especially the pipe, directly make or cause a chemical or physical change?

- District Court ruled against taxpayer – April 2012
- Court of Appeals affirmed with ruling that statute is ambiguous and ties go to the Comptroller – August 2014
- Appeal to Supreme Court – December 2014
- Oral argument – March 8

O&G Compressor Taxability

- September 30, 2015 – Comptroller issued guidance and lifted hold on pending audits (STAR 201509491L)
- Fog has not entirely lifted
 - Documentation required to support exemption
 - Status of compressors at wellhead that separate water from gas
 - Continuing audit holds
- Working with Comptroller to further clarify agency policy



Tax Administration

Rules Revision Project

- Comptroller has begun process of reworking practice and procedures rules (§§1.1 – 1.42)
- TTARA participating in advisory group
- Rules prioritized for review
- First rules to be drafted for advisory group review:
 - §1.8 – Resolution prior to Issuance of a position letter
 - §1.28 – Comptroller’s decision
 - §1.29 – Motion for rehearing
 - §1.41 – Ex parte communications
 - New rule on settlement procedures



Franchise Tax

AMC v. Hegar

Texas Court of Appeals, 3rd District (No. 03-14-00397-CV)

Travis County District Court

- Court ruled that film presentation met the “perceptible to the senses” test of selling tangible personal property, but also relied on language in statute specific to film
- Comptroller warned that court’s decision for the taxpayer could substantially expand the cost of goods sold deduction to services providers, costing Texas as much as \$6 billion in refunds and \$1.5 billion in annual prospective losses



AMC v. Hegar

Appellate Timeline

April 30, 2015: 3rd Court of Appeals ruling in favor of the taxpayer is issued

June 5, 2015: State files motion requesting a rehearing, contending that the court has substantially expanded the definition of “tangible personal property”

December 30, 2015: Taxpayer files response to state’s motion for rehearing, arguing the court’s decision was not as broad as the state contends

January 19, 2016: State files reply to taxpayer’s response

Court has not yet ruled on rehearing

Franchise Tax Data Available

www.ttara.org

- *TTARA has published on its website franchise tax data at the detailed industry level (over 50 categories) that enables you to compare your company's franchise tax snapshot with your industry peers*
- *You must login, then look under:
Documents/Document Categories/Franchise Tax*

Franchise Tax Data Available

www.ttara.org

Number of Entities	1,175,948
Entities Owing Tax	124,108
Gross Receipts Everywhere	\$49,978 bl
Gross Margin	\$5,969 bl
Margin based on COGS	\$3,198 bl
Texas apportioned margin	\$620 bl
Margin Tax Due, after credits	5 bl



Thanks for Joining Us!

If you have any questions or comments, please feel free to contact TTARA staff.

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