Chapter 313: What Works What Doesn't

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TEXAS TAXPAYERS
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Summary

Texas has a number of attractive features to attract new investment, but our state and local tax system is NOT one of them. Texas is not a low tax state for business. Absent a personal income tax, Texas relies much more heavily on property and sales taxes—taxes than fall heavily on business.

Texas has among the highest property tax rates across the states—the single largest impediment to investing here. Texas also taxes business personal property, which is exempt in several states, and inventories, which are exempt in almost all states.

All states have some type of incentive programs to help them compete for new investment—be it tax reductions or grant programs. For Texas, with our relatively high taxes on business, it would be difficult to compete with other states without incentives—particularly those seeking to mitigate our high-rate, broad base property taxes.

Given Texas' high property taxes, the single most important incentive program is Chapter 313 of the Tax Code, which allows school districts, the single largest levier of property taxes in the state, to offer a temporary limitation on the taxable value of new investments.

Chapter 313, while the most transparent incentive program (all materials associated with a 313 agreement and subsequent reporting documents are posted on-line), is the subject of controversy. Among the common misperceptions of the program are:

- it costs the state money (when in fact, it attracts projects that would not have come to Texas otherwise, turning empty fields into taxpaying industrial projects), and
- school districts receive a subsidy from the state by offering a 313 limitation (when in fact, the state reduces aid to a school district because of its increased taxable value.

Texas, as many states, incorrectly assesses the cost/benefit of its incentive programs. It defines "cost" as the amount of the tax benefit to the taxpayer, even though many new investments pay far more in taxes than they demand in public services.

Texas' incentive programs are spread across several different state agencies and across local governments. Unlike many other states, Texas does not centrally coordinate incentive programs. Texas' incentive programs also tend to be very complex. Projects often incur additional costs in Texas to hire consultants to help them work through the state's incentive maze.

The Good and Not-So-Good About Texas

Good

- A Right-to-Work State (i.e. one may not be compelled to join a labor union as a condition of employment)
- Available land at generally reasonable cost
- A growing state with a generally ample supply of labor
- Reasonable regulatory and judicial environment
- Lack of a personal income tax
- Stable and affordable energy resources
- Centrally located to both coasts

Not-so-good

- Long term water availability is a limiting factor
- Transportation networks are strained
- While labor is in good supply, certain categories of skilled workers may be more limited
- State and local taxes, particularly property and sales taxes, are higher than average and are particularly burdensome for capital intensive industries

Tax Incidence

There are two basic types of taxpayers:

1. *Businesses*, and
2. *Individuals*.

In Texas, *individuals* incur direct taxes on many of their purchases and their real estate, but unlike most states, not on their income.

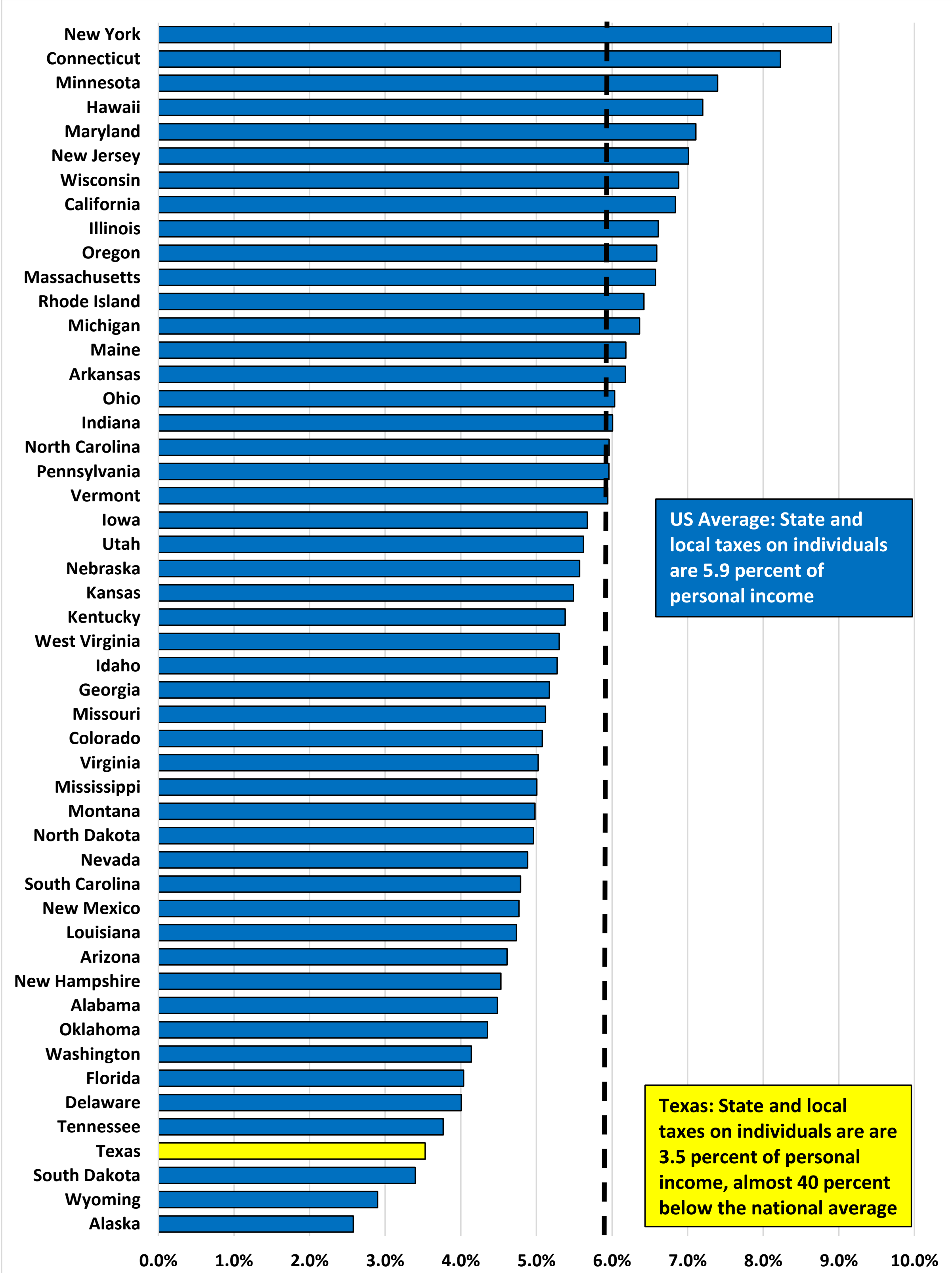
Businesses may incur taxes on their purchases (e.g. sales tax, fuels taxes), their real estate and personal assets (e.g. property tax), and be subject to special industry taxes on gross receipts (e.g. utilities, insurance). Businesses respond to taxes in one of three ways:

1. Pass the cost of the tax forward to individuals in the form of higher prices,
2. Pass the tax backward to owners in the form of lower profits, and/or
3. Pass the tax backward to individuals by reducing expenses, such as payroll or relocating or shifting investment to a lower cost location.

Note about the initial incidence assignments in this analysis…

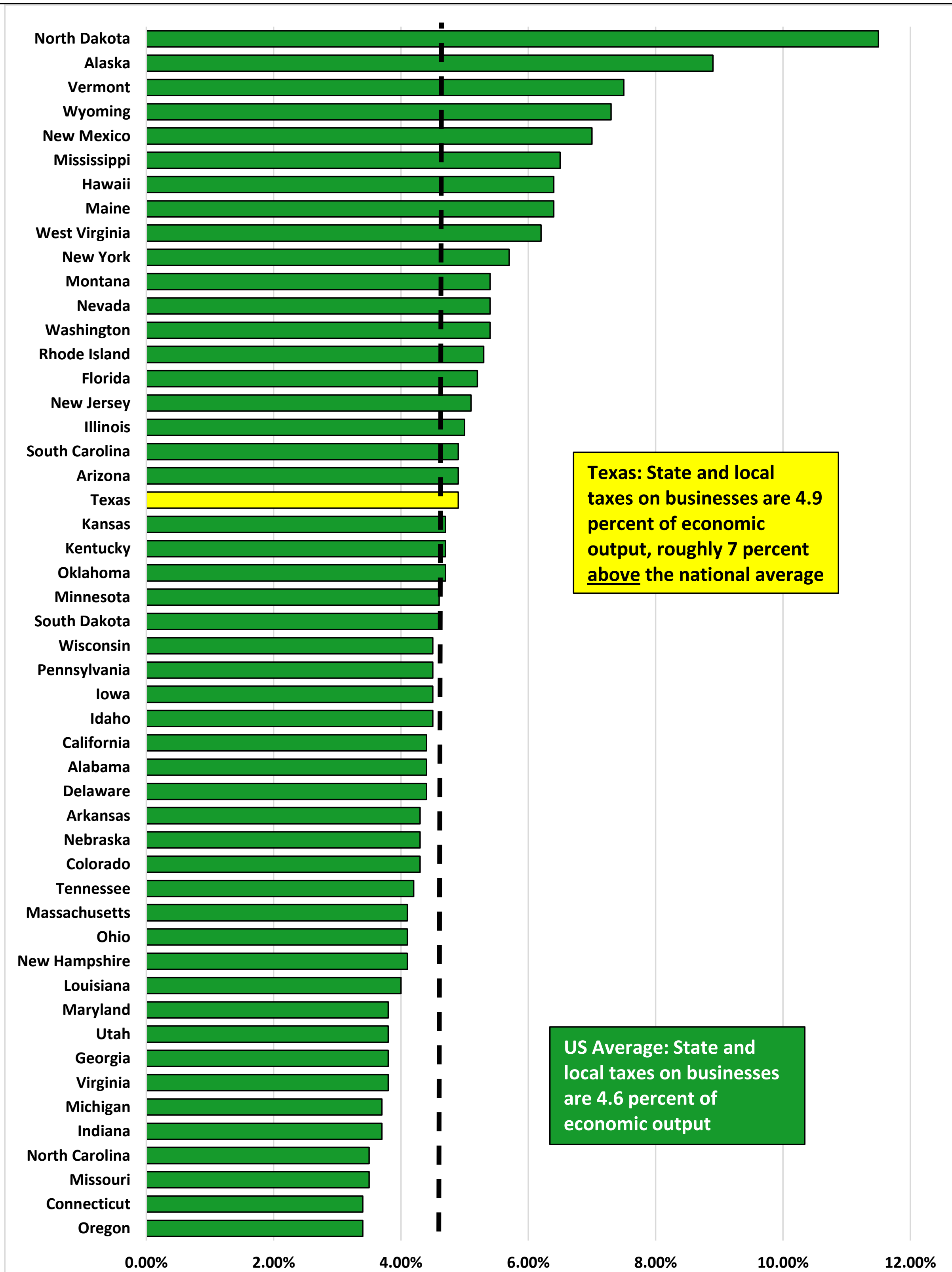
- Sales and motor vehicle sales taxes: tax due is on the sale of a taxable item and is paid by the *purchaser*. For example, while a retailer collects the tax and remits it to the state, the tax is paid by the purchaser.
- Property tax is paid by the *owner* of the property, whether an individual or a business.
- Though assessed on the refiner, motor fuels taxes are assigned to the consumer, since state law requires the tax be passed on to the consumer.
- Franchise tax is paid by the business entity.
- Severance taxes and industry gross receipts taxes are paid by the business.
- Excise taxes on consumer products (tobacco and alcohol) are predominately paid by the consumer.

Individual Tax Burden Relative to Personal Income



Source: Derived from Council on State Taxation: Total State and Local Business Taxes, 2014.

Business Taxes Relative to Economic Output



Source: Council on State Taxation: Total State and Local Business Taxes, 2014.

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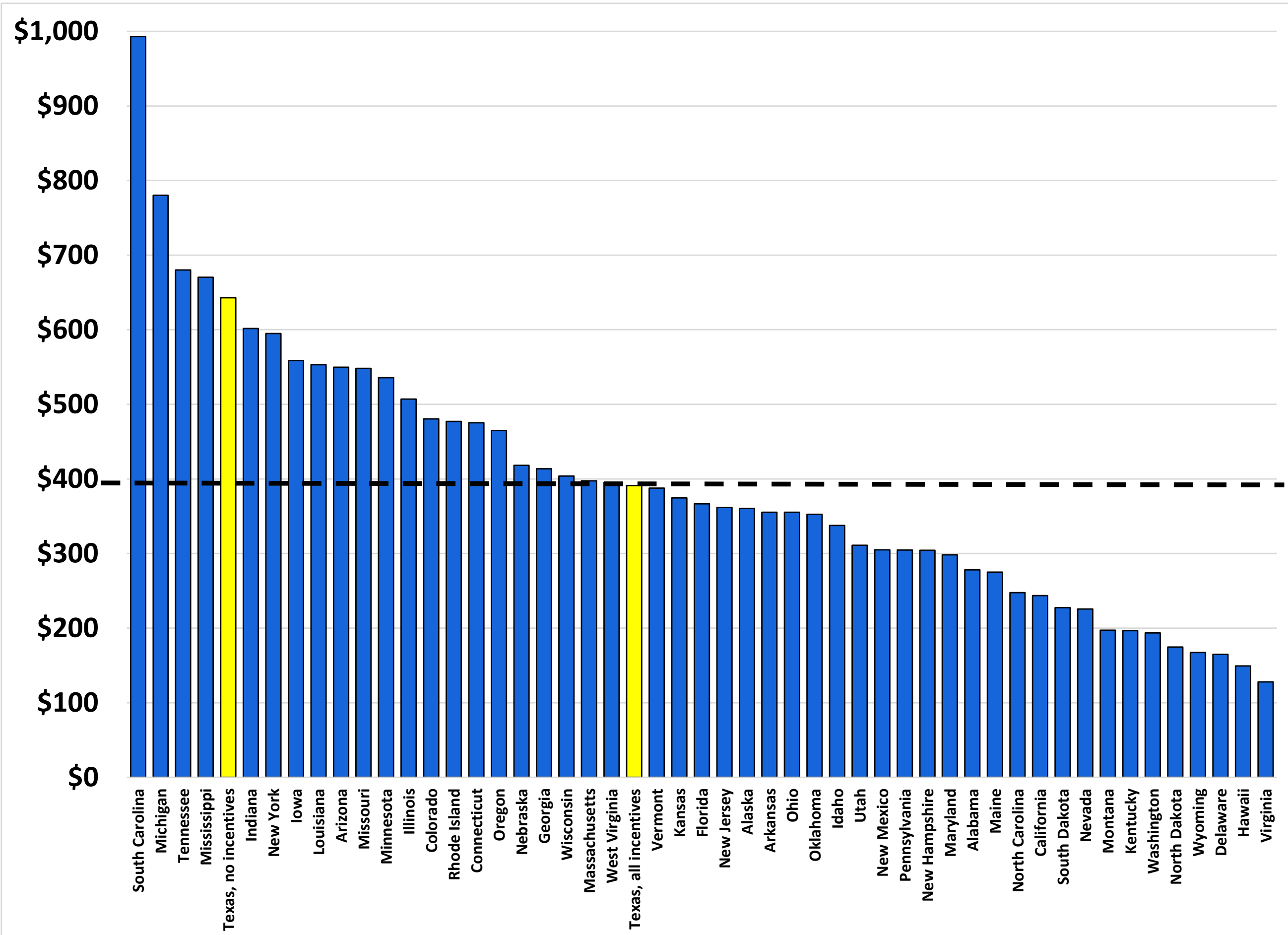
Texas' Key Taxes Compared to Other States

Tax	Current Rate and Base	Comparison
Sales Tax Rate	State Tax Rate: 6.25% Local Taxes: Generally capped at 2.0 %; average is 1.9% Average Combined Rate: 8.17%	State Rate: 13th highest Combined Rate: 12th highest
Sales Tax Base	Generally applies to all sales of tangible personal property excluding food, medicine and residential or industrial utilities; and a number of services	Texas' base is generally broader than that of other states because we tend to tax more services than other states (only 7 states tax more services)
Property Tax Rate	Residential property: average effective tax rate in 2014 was 1.85 percent of market value Industrial property: average effective tax rate in 2014 was just under 2.6% of market value	Residential property: Texas' effective tax rates rank us 15th highest nationally, 25 percent above the national average Industrial property: Texas' effective tax rates rank us 5th highest nationally, or 61 percent above the national average
Property Tax Base	Texas taxes all real estate plus any tangible personal property used for business purposes (equipment and inventory); goods in interstate commerce are exempted at local option (i.e. Freeport property)	Texas' base is generally broader than that of other states: 11 states exempt all business tangible personal property; inventories are generally exempt in all but 7 states.
Business Franchise Tax	Texas' franchise tax is unlike the net business income tax levied by most other states; Texas' effective tax rate relative to economic output was 0.33% in 2015.	Relative to economic output, Texas' franchise tax ranks 25th highest among the states, about 14 percent below the national average; 2016 rates will drop Texas to 39th place, about one third below the national average.

Selected Texas Economic Development Programs



The above chart illustrates the total property taxes on an industrial facility valued at $1 billion million over its 25 year lifespan across the various states. Texas' property tax costs are shown both with and without property tax abatements and Chapter 313 limitations. *Based on 50 State Property Tax Comparison Study by the Minnesota Center for Fiscal Excellence and the Lincoln Land Institute.*

The average state and local property taxes paid over the life of the facility nationwide is $400 million. In Texas, the facility, if it received no city/county property tax abatements or Chapter 313 school tax limitations, would pay over $640 million in property taxes—60 percent higher than the national average.

If the facility received a ten year city/county property tax abatement and a ten year 313 value limitation of $40 million, the project's lifetime property tax bill would be $391 million—

Chapter 313 Forms

Application Forms	Pages
• **Form 50-296A Application for Appraised Value Limitation on Qualified Property** To be filled out by an applicant seeking an appraised value limitation and submitted to the school district. The school district submits a completed application to the Comptroller for review and approval.	9
• **Form 50-300 Application for Tax Credit on Qualified Property** (PDF) To be filled out by an agreement holder after paying property tax for the last complete tax year of the qualifying time period and submitted to school district.	4
Agreement Forms	
• **Form 50-286 Texas Economic Development Act Agreement** (PDF) To be used by the applicant and school distract as a template for a value limitation agreement. The school district submits a draft agreement to the Comptroller for review and approval. *Only applies to agreements resulting from applications determined to be complete after Jan. 1, 2014.*	29
Reporting Forms	
• **Form 50-772A Annual Eligibility Report** (PDF) To be filled out by agreement holders and submitted by an authorized representative of each company to the school district by **May 15th of every year** using information from the previous tax (calendar) year. School districts should review the submitted forms, retain the original and submit PDF scans of the completed and signed forms and any attachments to the Comptroller's office by June 15th of every year.	4
• **Form 50-773A Biennial Progress Report** (PDF) To be filled out by agreement holders and submitted by an authorized representative of each company to the school district by May 15th of each even-numbered year. The Comptroller's office requests that companies complete the spreadsheet version of this form, submitting both an unsigned electronic version and a signed hard copy version—with any attachments—to the school district. School districts should forward to the Comptroller's office by June 15th of each even-numbered year.	7
• **Form 50-287 Biennial School District Cost Data Request** (PDF) School districts are also requested to submit the Biennial School District Cost Data Request Form to the Comptroller's office by July 15th of each even-numbered year, indicating—for each project—actual and estimated property values, tax rates, payments in lieu of taxes, extraordinary educational expenses, and revenue protection payments.	1
• **Form 50-825 Job Creation Compliance Report** (PDF) To be filled out by agreement holders and submitted by an authorized representative of each company directly to the Comptroller's office annually. *Only applies to agreements resulting from applications determined to be complete after Jan. 1, 2014.*	4

ALL *limitation documents are posted on line on the Comptroller's website and are publicly available. Chapter 313 is the most transparent economic development program in the state.*

How the Limitation Works

The Texas Economic Development Act, is commonly referred to as “Chapter 313,” named for the chapter in the Tax Code in which it resides. The programs allows a school district to grant a temporary (up to 10 years) limitation on the taxable value of a new investment project. Existing property is not eligible for a limitation—only new property that does not exist at the time of the application.

A project must file an extensive application to the local school district for the limitation on forms promulgated by the Comptroller. The project must meet certain investment and job thresholds. If the school district decides to act on the application it must first forward the application to the Comptroller. If the Comptroller determines that the project:

- Qualifies as an investment eligible for the limitation under the law, and will
- Generate a greater amount in taxes than the amount of benefits it will receive, and
- That the limitation is a determining factor in the decision to invest capital, then…

…the Comptroller may issue a certificate of those findings the school district, which may then act on the application. If approved, the school district and the project must enter into a formal agreement stipulating the terms of the limitation. The Comptroller requires a standard agreement form be used.

If the school district approves the application, it may enter into an agreement with the applicant and offer the project a temporary limitation on the amount of property value that will be subject to the district’s maintenance and operations taxes for a period not to exceed ten years. A district may NOT fully abate a project’s value—some portion of value must be added to the tax rolls, even during the limitation period. This results in higher property tax collections for the district, and a corresponding reduction in the district’s state aid.

School districts typically demand the project share a portion of its tax savings, typically requiring up to 40 percent of the tax be paid to the district. These “supplemental payments” are NOT including in school funding formulas and are “free and clear” to the district.

In addition to the application and the agreement, projects and school districts must file numerous progress reports on either an annual or biennial basis.

Critics of the program often erroneously equate the amount of the temporary reduction as being a state “cost.” In fact, a project must demonstrate that absent the incentive, they will not make the investment. Consequently, there is no real cost to the state; in fact, the program makes money by attracting new investment that would not otherwise, turning empty fields into taxpaying industrial facilities.

Further, there is a misperception that somehow the state pays districts for awarding a limitation. In fact, districts granting a limitation see a reduction in state aid as a result of the additional taxable value being added to their tax base.

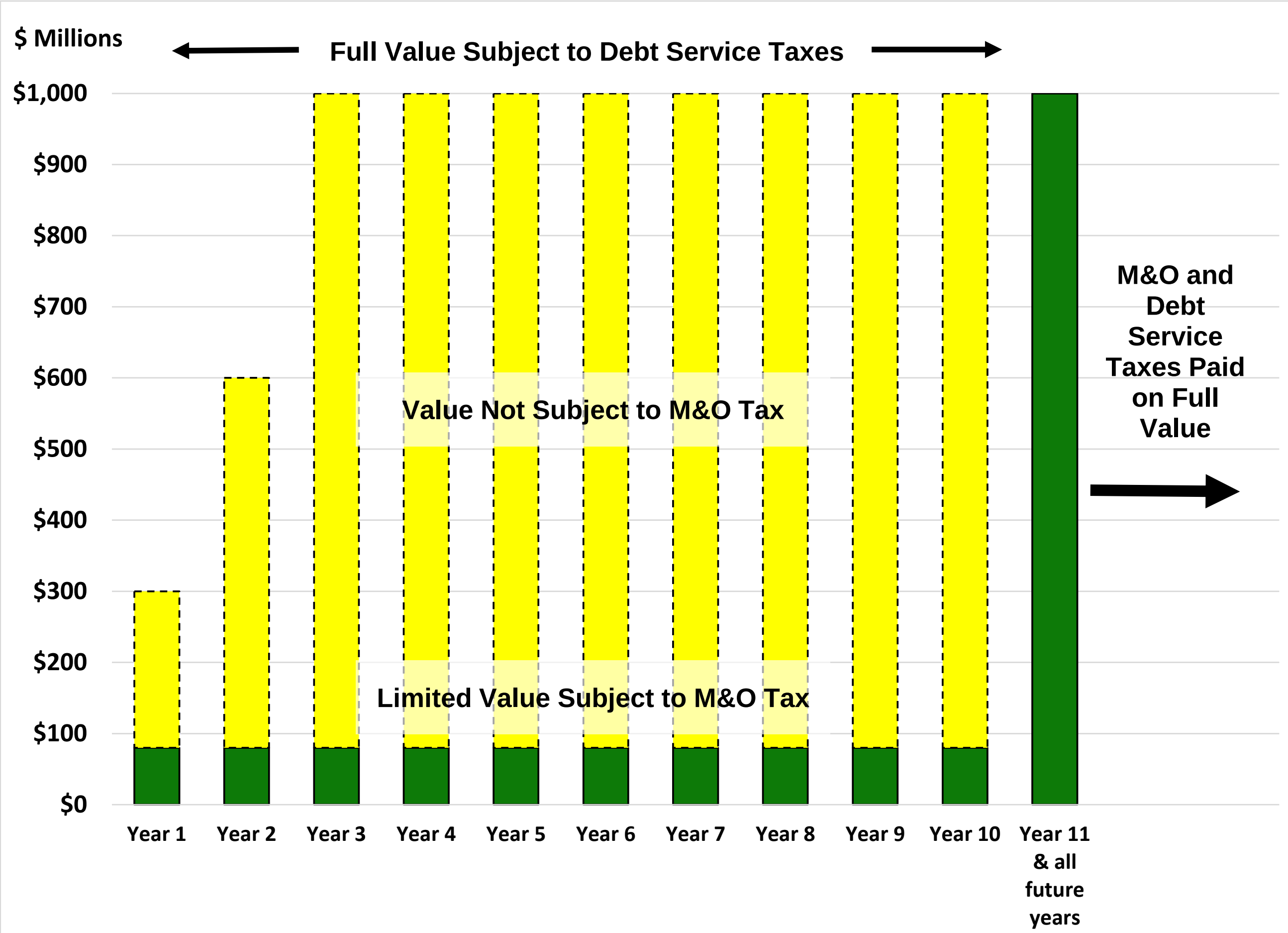
The Big Two Tests

Regardless of what the school district wants, each agreement must be approved by the Comptroller before it can take effect. The Comptroller may not approve the limitation unless:

1. The project demonstrates that it will generate more in state and local tax revenue than the amount of the tax savings from the limitation, AND
2. That the limitation was a determining factor in the applicant's decision to invest.

See Tax Code 313.026

How the Limitation Works



The above example demonstrates how a Chapter 313 limitation works on a $1 billion project with an $80 million, 10 year limitation granted by the school district.

In this example, the project receives a temporary ten year limitation on the amount of taxable value in the amount of $80 million. The limitation applies only to new property put in place; existing taxable property may not be removed from the tax rolls.

During the first two years, the project is under construction, and while it has not reached its operational value of $1 billion, the value of “construction in place” is still limited to $80 million, as it is through year ten of the project (as shown by the green portion of the bar). The limitation remains in effect once the project becomes operational, temporarily exemption $920 million in value from the tax rolls (shown in yellow).

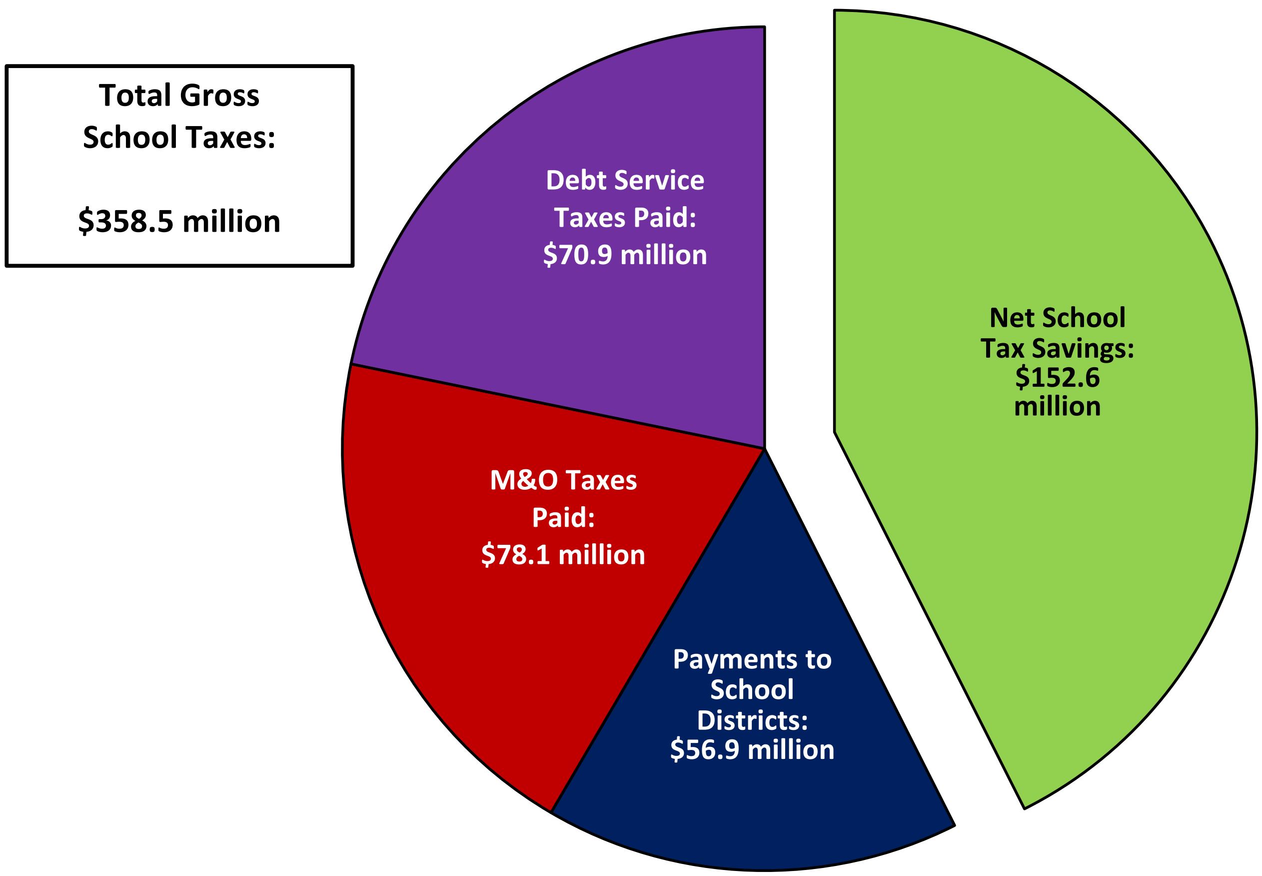
After ten years, the limitation expires (it may not be renewed), and the project is fully taxable.

The Limitation's Impact on a School District's Finances

Element of School Finance		No Project	Project w/ Limit in Effect	Diff to No Project	Project w/ Limitation Expired	Diff. to No Project
Maintenance and Operations						
A	Number of Students			0		0
		20,000	20,000		20,000	
B	Basic Allotment	$5,140.0	$5,140.0	$0.0	$5,140.0	$0.0
C	Guaranteed Aid (A*B; $ml)	$102.8	$102.8	$0.0	$102.8	$0.0
D	Property Tax Wealth ($ml)	$4,000.0	$4,000.0	$0.0	$4,000.0	$0.0
E	Project Taxable Value ($ ml)	$0.0	$80.0	$80.0	$1,000.0	$1,000.0
F	Total District Property Wealth (D+E; $ml)	$4,000.0	$4,080.0	$80.0	$5,000.0	$1,000.0
G	M&O Tax Rate (per $100 of value)	$1.000	$1.000	$0.000	$1.000	$0.000
H	Local Tax Revenues (F*G; $ml)	$40.0	$40.8	$0.8	$50.0	$10.0
I	State Aid (C-H; $ml)	$62.8	$62.0	($0.8)	$52.8	($10.0)
Debt Service						
J	Tax Base for Debt Service ($ ml)	$4,000.0	$5,000.0	$1,000.0	$5,000.0	$1,000.0
K	Debt Service Payments ($ml)	$20.0	$20.0	$0.0	$20.0	$0.0
L	State Share ($ml)	$8.6	$5.7	($2.9)	$5.7	($2.9)
M	Local Share ($ml)	$11.4	$14.3	$2.9	$14.3	$2.9
N	Debt Tax Rate (L/F; per $100 of value)	$0.286	$0.286	$0.000	$0.286	$0.000
Total School Finance Impacts						
O	Local Property Taxes (H+M)	$51.4	$55.1	$3.7	$64.3	$12.9
P	State Aid (I+L)	$71.4	$67.7	($3.7)	$58.5	($12.9)
Q	Supplemental Payments (A*$100; $ml)	$0.0	$2.0	$2.0	see note	see note
R	Total School District Revenue (C+K)	$122.8	$124.8	$2.0	$122.8	$0.0
Taxes on an "Average" Home						
S	Basic Homestead (example)	$200,000	$200,000	$0	$200,000	$0
T	Homestead Exemption	$25,000	$25,000	$0	$25,000	$0
U	Taxable Value	$175,000	$175,000	$0	$175,000	$0
V	Total Tax Rate (G+M)	$1.286	$1.286	$0.000	$1.286	$0.000
X	School Taxes on $200,000 home	$2,250	$2,250	$0	$2,250	$0

The above chart illustrates the impact on the school finances of a school district offering a temporary $80 million limitation on a $1 billion project. Because of the project, the state reduces aid to the district by $3.7 million during the limitation period and by $12.9 million once the limitation expires.

How Much Does the Taxpayer Really Save?



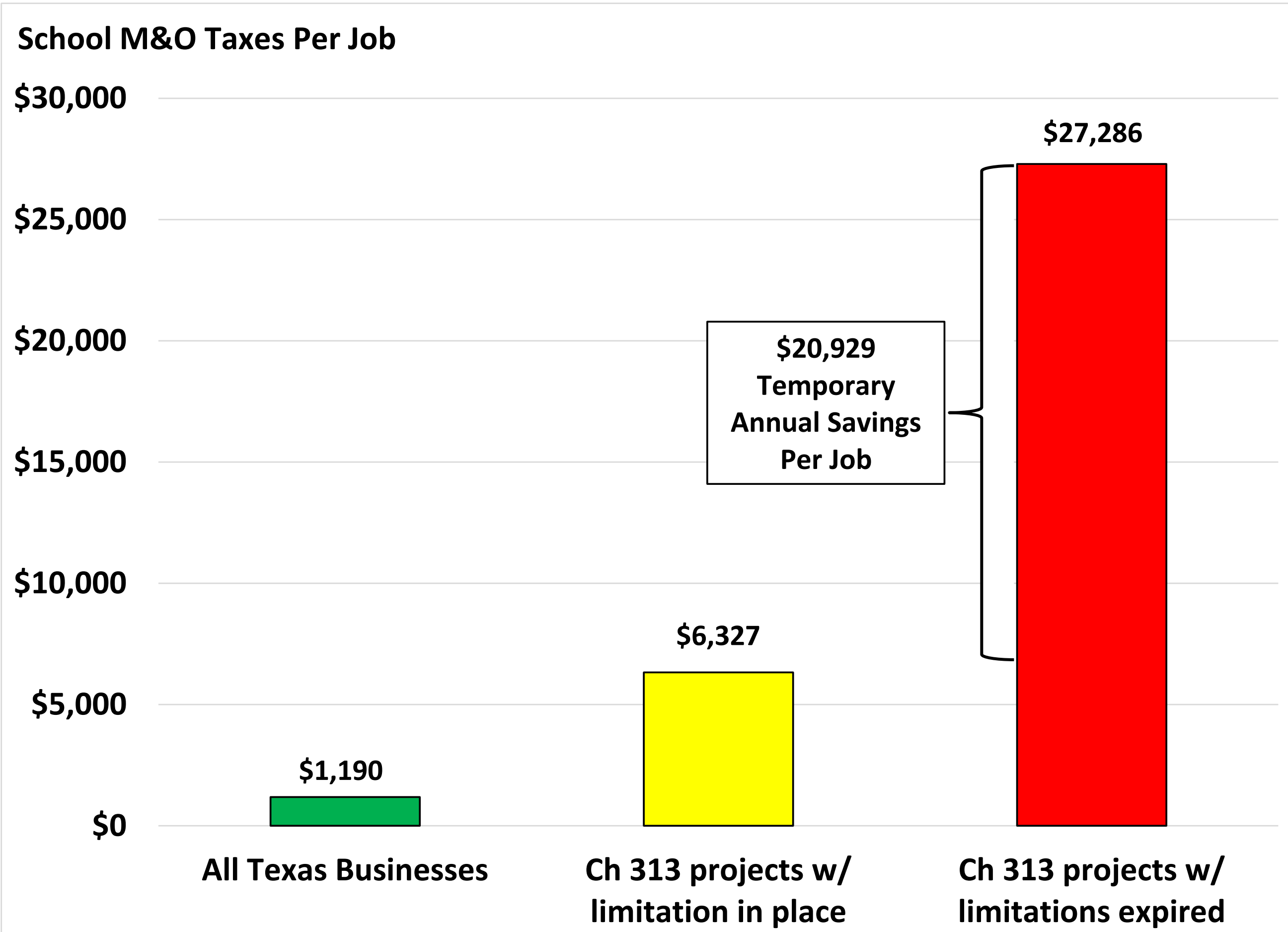
In 2013, had all projects with existing Chapter 313 agreements been on the rolls at full value they would have paid a total of $358.5 million in school taxes. Because of Chapter 313 limitations, they saved $152.6 million—less than 42 percent of their school tax bill.

Chapter 313 projects with limitations in effect paid:

- $78.1 million in school M&O taxes as a result of the limited value on the tax rolls
- $70.9 million in debt service taxes to schools (Chapter 313 value limitations do not apply to debt taxes), and
- $56.9 million in supplemental payments to school districts required by the limitation agreement.

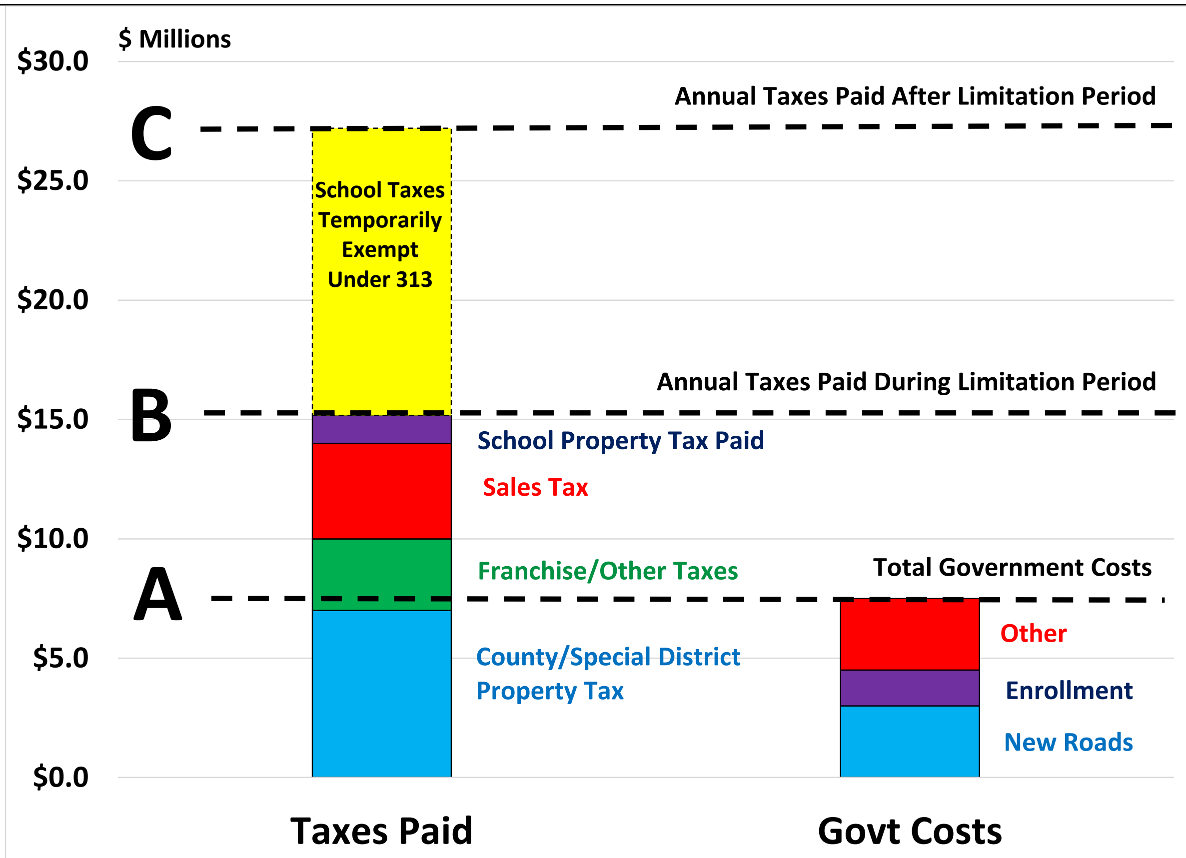
School M&O Taxes Paid:

1. Average Texas Jobs
2. Ch 313 Jobs with Limitation
3. Ch 313 Jobs after Limitation



Based on 2013 data, the limitation saved Chapter 313 employers $20,929 in school taxes per job they created. Critics of Chapter 313 translate this into a state "cost per job." There is no cost to the state since the project must demonstrate the limitation is a determining factor in the decision to invest, but even then the figure illustrates just how high a barrier the property tax is to investing in Texas. Without the limitation, projects face a school M&O tax bill of $27,286 for each job they create. During the limitation period, the limitation drops that to $6,327 per job in taxes the company will pay—a burden that is more than five times the amount of school taxes business pay for each job in the Texas economy.

The Correct Way to Evaluate Incentives

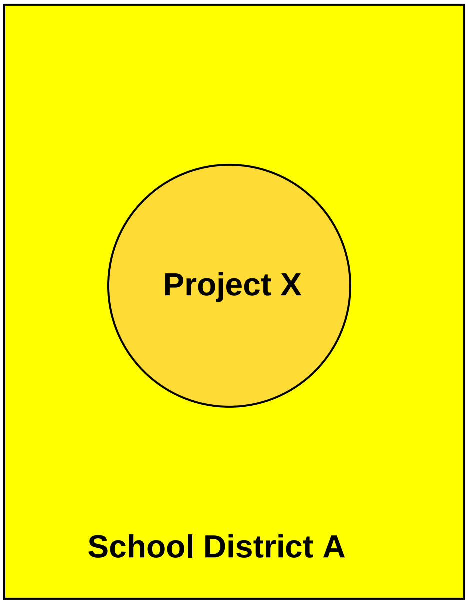


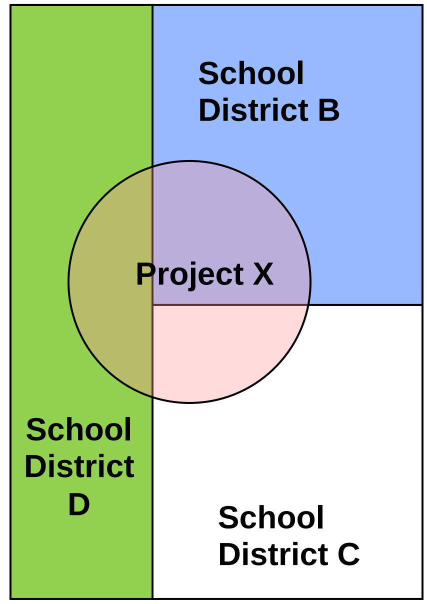
Texas evaluates the "cost" of incentives all wrong. Current state analysis equates the "cost" of a project as the amount of tax benefits a project receives (the amount between lines B and C in the above chart).

This completely ignores the amount of new taxes a billion dollar project brings to the state. In the above example, a project comes to Texas, and is granted a $40 million school tax value limitation, that for the first ten years of the project will save them $12 million annually in school taxes (the yellow portion under "Taxes Paid"). The project, however, will still pay some school property taxes (shown in purple, because Chapter 313 requires a portion of the project's value must be subject to tax). The project will also pay city/county property taxes, as well as sales taxes, franchise taxes, bringing their annual tax bill during the limitation period to $15.2 million.

The state and local governments make a "profit" from the project, while they must build some new roads and classrooms to handle the new population, as well as hire additional some new teachers to handle the increase in enrollment, their costs total $7.5 million annually, well below the $15.2 million in taxes the project pays (the difference between C and B, above). Further, when the limitation expires, the project will pay $27.2 million in taxes, far above the direct costs incurred by the state and local communities to support the project.

HB 2826 and the Problem It (Would Have) Solved





The Comptroller interprets Chapter 313 to mean “one school district” = “one project.” This does not create a problem if a project is contemplating a location wholly contained in a single school district. However, if the project is contemplating building on a parcel that spans across multiple school district lines, the project must qualify as a single project in each school district—based on the investment in that school district rather than that of the entire project. Instead of, for example, a single limitation of $80 million, the project might involve 3 separate limitations each totaling $80 million, for a total of $240 million of value subject to tax. This greatly minimizes the benefit of the program to the prospective project.

In 2015 House Bill 2826 would have addressed the multiple district issue by allowing the project to qualify in each school district based on the project as a whole, with each district making its own decision about the limitation. A single limitation amount would be based on the district with the greatest wealth, which would then be apportioned across the districts.

The Governor vetoed the bill, expressing concerns about the program, rather than the bill itself.

Recommendations

1. **Simplify**. Texas should **simplify** the application and reporting process, focusing on *quality* of information, not *quantify* of information.

2. **Consolidate**. Texas should **consolidate** application and reporting requirements, providing a single point of contact to process applications and assist applicants through the process.

3. **Evaluate**. Texas should establish a standardized matrix of factors to be used to objectively **evaluate** a project that seeks incentives, focusing on the potential value and returns to the state. That matrix should include:

    - economic benefits,
    - fiscal benefits, and
    - intangible benefits.

    The evaluation should also recognize potential costs of a project—not the value of the incentives, but the potential cost associated with any project-related demands for additional public services

A Rational Matrix for Evaluating Incentives and Projects

Projects seeking incentives should provide some type of benefit to the state, be it:

- economic,
- fiscal, or
- intangible.

In evaluating those incentives, the state should look not just to the **operational** period of the project, but also the impact of **construction**. Further, the state should consider the **ancillary** (indirect and induced) economic impacts of the project. In evaluating the “cost” of a project, the state should look at the cost of providing public services to the project and the population it attracts.

Factors for Evaluation	Benefits		Costs	
	Direct Project	Ancillary Activity	Direct Project	Ancillary Activity
1. Economic Factors				
Investment				
Business Activity (Output)				
Jobs				
Wages and Income				
2. Fiscal Factors				
Tax and Other Revenues				
Public Service Costs				
Grants and Financing				
3. Intangible Factors				
Prestige				
Publicity				
Lifestyle Considerations				
Diversification/ Infrastructure/ Other Issues				