LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 78TH LEGISLATIVE REGULAR SESSION

April 9, 2003

TO: Honorable Ron Wilson, Chair, House Committee on Ways & Means

FROM: John Keel, Director, Legislative Budget Board

IN RE: **HB3146** by Wilson (Relating to franchise tax reform.), **As Introduced**

Estimated Two-year Net Impact to General Revenue Related Funds for HB3146, As Introduced: a positive impact of $402,378,186 through the biennium ending August 31, 2005.

The bill would make no appropriation but could provide the legal basis for an appropriation of funds to implement the provisions of the bill.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2004	$164,585,044
2005	$237,793,142
2006	$260,244,993
2007	$267,647,993
2008	$276,180,993

All Funds, Five-Year Impact:

Fiscal Year	Probable Revenue Gain/(Loss) from *GENERAL REVENUE FUND* 1	Probable Savings/(Cost) from *GENERAL REVENUE FUND* 1
2004	$165,895,000	($1,309,956)
2005	$239,115,000	($1,321,858)
2006	$261,418,000	($1,173,007)
2007	$268,821,000	($1,173,007)
2008	$277,354,000	($1,173,007)

Fiscal Year	Change in Number of State Employees from FY 2003
2004	24.6
2005	25.0
2006	25.5
2007	25.5
2008	25.5

Fiscal Analysis

The bill would amend various sections of Chapter 171 of the Tax Code, extending a franchise tax liability to certain entities that currently are not subject to the tax and to alter the calculation of net taxable capital and net taxable earned surplus.

The bill would amend the definition of "corporation" to include every corporation, limited liability company, limited partnership, business trust, real estate investment trust, savings and loan association, banking corporation, and any other entity for which any of the owners had limited liability. The bill would amend the definitions of "charter," "officer and director," and "shareholder" to encompass the new entities that would become subject to the tax under the provisions of the bill.

The bill would add a new Section 171.101(d) to specify the calculation of net taxable capital for a partnership or unincorporated association other than a limited liability company or a savings and loan association. The steps in the calculation would be similar to those for a corporation or a limited liability company with one exception. That exception would be the inclusion of a step that would require multiplying capital by the percentage of the entity's ownership interests directly owned by persons other than natural persons. This step would be performed before apportioning the capital tax base to this state.

The bill would amend Section 171.110(a), relating to the calculation of net taxable earned surplus. The bill would add a new Section 171.110(a)(2) to require a partnership or an unincorporated association, excluding limited liability companies and savings and loan associations, to subtract from earned surplus the distributive share of reportable taxable income or loss that would be reportable to natural persons. The bill would add a new Section 171.110(a)(3) to require the addition to earned surplus the amount of expense accrued or paid to a related entity if that related entity were not subject to the franchise tax.

The bill would add a new Section 171.110(a)(4) to require the subtraction from earned surplus the amount of a corporation's share of income, loss, or deduction from a limited liability company, limited partnership, or S corporation to the extent the income, loss, or deduction was included in the net taxable earned surplus of the limited liability company, limited partnership, or S corporation or would have been included if the entity were doing business in this state. The existing Sections 171.110(a)(2)-(4) would be appropriately renumbered.

The bill would add a new Section 171.110(e) to state that reportable federal taxable income would be determined before adjustment for distributions to owners and would include all income taxable to the entity or the owners for federal income tax purposes. The existing Sections 171.110(e)-(j) would be appropriately re-labeled.

This bill would take effect September 1, 2003, and would apply to reports originally due on or after that date.

For entities that would become subject to the tax because of the bill, income or losses occurring before January 1, 2003 could not be considered for the earned surplus component. For an entity in existence on January 1, 2003 that would have been subject to franchise tax if this bill had been effective on January 1, 2003, the first report due would be either a final report or an annual report due May 15, 2004. For entities that would have become subject to tax after January 1, 2003 if this bill had been effective January 1, 2003, the first report due would be an initial or final report, if applicable.

Methodology

This fiscal note is based on analyses provided by the Office of the Secretary of State and the Office of the Comptroller.

Comptroller staff estimated the fiscal impact of this bill based on IRS data relating to partnerships and on data from the Comptroller's franchise and sales tax files.

Secretary of State and Comptroller staff provided personnel and cost estimates for the additional processing and auditing activities that would result from extending the Texas franchise tax to business entities presently not subject to the tax.

Local Government Impact

No fiscal implication to units of local government is anticipated.

Source Agencies: 304 Comptroller of Public Accounts, 307 Secretary of State
LBB Staff: JK, JO, SD, WP, CT