

## **BILL ANALYSIS**

C.S.H.B. 3  
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Ways & Means  
Committee Report (Substituted)

### **BACKGROUND AND PURPOSE**

Texans pay more in property taxes than for any other state or local tax. In tax year 2003, 3,702 local taxing units levied almost \$29 billion in property taxes, of which school districts accounted for more than 60 percent, according to the Comptroller of Public Accounts. From 1985 to 2003, the school district property tax levy increased by approximately 260 percent. Currently, Texas ranks 45th among the states in terms of homeownership levels. The high property tax burden impairs Texans' ability to own their own homes. C.S.H.B. 3 raises state revenue to fund a significant property tax reduction for Texas taxpayers.

### **RULEMAKING AUTHORITY**

It is the committee's opinion that rulemaking authority is expressly granted to the Texas Commission on Licensing and Regulation in SECTION 1C.10 and to the Comptroller of Public Accounts in SECTIONS 2A.03, 2B.07, 2B.10, 2C.01, and 3B.07.

### **ANALYSIS**

#### **LIMITATION ON SCHOOL DISTRICT TAX RATE**

The bill decreases the cap on the school district maintenance and operations (M&O) tax rate from \$1.50 to \$1.12 beginning with the 2006 tax year. For the 2005 tax year, the rate is \$1.23. The bill also permits an enrichment tax rate of \$0.15 on the \$100 valuation of taxable property in the district, as authorized by an election under Chapter 42, Education Code.

The change in the tax rate for the 2005 tax year bill takes effect only if both H.B. No. 2, Acts of the 79th Legislature, 1st Called Session, 2005, and H.B. No. 3, Acts of the 79th Legislature, 1st Called Session, 2005, receive a vote of two-thirds of all the members elected to each house. If either does not receive a vote of two-thirds, the change in tax rate made by the bill applies beginning with the 2006 tax year.

The bill provides that a school district election held before January 1, 2005, authorizing a rate equal to or greater than \$1.23, is sufficient to authorize a rate of \$1.23 for the 2005 tax year, and a school district election held before January 1, 2006, authorizing a rate equal to or greater than \$1.12, is sufficient to authorize the maximum rate.

#### **BUY-DOWN OF SCHOOL DISTRICT TAXES**

Part B of Article 1 of the bill amends Chapter 403, Government Code, by adding Subchapters O and P. Subchapter O requires the comptroller, in advance of a regular session of the legislature, to certify the amount of any increase in available state revenue for the succeeding state fiscal biennium, requires the comptroller to distribute to school districts for tax rate reduction a portion of that increase in addition to an amount equal to the amount of available state revenue distributed in the preceding state fiscal biennium for school district tax rate reduction, specifies how the money is to be apportioned among school districts, and requires that the money received be applied to reducing the rollback tax rate of the school district.

Subchapter P requires the comptroller to estimate for the next five state fiscal years the amount of the increase in state revenue that is attributable to changes in law made by H.B. No. 3, to deposit to the school property tax relief fund for distribution to school districts the amount by which the actual amount of the increase in state revenue that is attributable to H.B. No. 3 for

each of those state fiscal years exceeds the amount estimated by the comptroller, and to distribute the money deposited in the fund to school districts for maintenance tax rate reduction. The bill specifies how the money is to be apportioned among school districts and requires that the money received be applied to reducing the rollback tax rate of the school district.

The bill adds Section 42.2518, Education Code, which provides that for any school year a school district is entitled to additional state aid to the extent that an increase in the guaranteed level of state and local funds per weighted student per cent of tax effort under Section 42.302, Education Code, applicable to that school year does not compensate the district for a reduction in district ad valorem tax revenue caused by ad valorem tax rate reduction under Subchapter O or P, Chapter 403, Government Code.

The bill amends Section 26.08, Tax Code, to require that state funds for property tax rate relief that will be distributed to a school district under Subchapters O and P, Chapter 403, Government Code, be taken into account when determining the school district's rollback tax rate.

The bill appropriates to the comptroller for the state fiscal biennium beginning September 1, 2005, the money in the school property tax relief fund to be used to reduce school district maintenance tax rates.

#### RENDITION OF PROPERTY FOR AD VALOREM TAXATION AND REGULATION OF ASSET VERIFICATION AGENTS

Part C of Article 1 of the bill amends Sections 22.28 and 22.29, Tax Code, which authorize penalties in connection with rendition of property for ad valorem tax purposes, to provide that a lien in the amount of the penalty imposed attaches to the property against which the penalty is imposed, as if it were a tax, and a delinquent penalty accrues penalties and interest in the same manner as a delinquent tax.

In addition, the bill adds Section 22.31, Tax Code. That section requires a property owner, on request of the chief appraiser or an authorized representative of the chief appraiser retained or employed by the appraisal district, to deliver or make available certain information to be used by the chief appraiser or authorized representative in verifying the location and valuation of certain property, contains provisions regarding protecting the confidentiality of the information, requires an authorized representative to hold a certificate of registration as an asset verification agent under Chapter 1152, Occupations Code, contains provisions regarding contracts with authorized representatives, requires a chief appraiser to report to the commissioner of education on the increased value added as a result of rendition verification for each school district participating in the appraisal district, and requires the commissioner to adjust distributions to the school district based on the reported value increases.

The bill amends Chapter 1152, Occupations Code, to prohibit a person from performing services as an asset verification agent for compensation under the person holds a certificate of registration issued under that chapter. The changes to Chapter 1152 also set out various provisions relating to the oversight and conduct of asset verification agents. Section 1C.10 of the bill requires the Texas Commission of Licensing and Regulation to adopt rules pertaining to the regulation of asset verification agents.

#### FRANCHISE TAX

Article 2 relates to changes in the application and administration of the franchise tax, currently imposed under Chapter 171, Tax Code. It is divided into four parts as follows:

- PART A. CORPORATE OWNERSHIP IN PARTNERSHIPS
- PART B. APPLICATION TO PARTNERSHIPS
- PART C. ADD-BACK OF CERTAIN PAYMENTS
- PART D. TRANSITIONAL PROVISIONS

#### PART A. CORPORATE OWNERSHIP IN PARTNERSHIPS

Part A of Article 2 amends the franchise tax in Chapter 171, Tax Code, to extend the application of the tax to certain corporate ownership interests in partnerships. It does not, however, extend

the application of Chapter 171, Tax Code, to entities other than corporations as currently defined by that chapter. It adds definitions of "partner" and "partnership" to the law.

Part A provides, in new Section 171.001, Tax Code, the circumstances under which a foreign corporation, through holding certain partnership interests or through holding a beneficial interest in a trust, will be considered as doing business in this state for the purposes of the franchise tax. However, a foreign corporation is not doing business in this state solely because the corporation holds an interest in a real estate investment trust, certain publicly traded partnerships, a regulated investment company, a real estate mortgage investment conduit, certain passive investment partnerships, and certain entities used solely for a finance, securitization, or monetization purpose.

If a corporate partner asserts that the tax imposed as a result of the application of new Section 171.001, Tax Code, violates the United States Constitution or federal law, the franchise tax is imposed on the partnership doing business in Texas and provides the manner in which the franchise tax liability of the partnership is calculated.

In determining how a corporation's earned surplus is apportioned, the corporation shall count the gross receipts of each partnership and joint venture in which the corporation directly or indirectly owns an interest. Part A also provides that in computing net taxable earned surplus, the corporation shall include the corporation's share of a partnership's items of income or loss, without regard to whether the partnership is taxed as a corporation for federal income tax purposes.

Part A takes effect November 1, 2005, and applies to reports originally due on or after that date.

#### PART B. APPLICATION TO PARTNERSHIPS

Part B of Article 2 takes effect only if a court enters a final judgment that the application of new Section 171.001, Tax Code, added by Part A of Article 2, violates the United States Constitution.

Part B extends the application of Chapter 171, Tax Code, to each partnership that does business in Texas and that is owned directly or indirectly by a corporation, to the extent the partnership is not owned by a natural person. The definition of "corporation" is amended to reflect this extension of the tax.

Part B provides that the reportable federal taxable income of a partnership is the partnership's income as an entity, to the extent that the partnership is now owned by a natural person and as determined by rules adopted by the comptroller.

The comptroller's enforcement powers are enhanced by the ability to secure a lien on a person's interest in a partnership doing business in this state whose activities cause the person to be subject to the franchise tax. Additionally, the comptroller may, in the same circumstances in which corporate privileges are forfeited, seek the forfeiture of the right of a partnership to transact business in Texas.

Part B also repeals several provisions of the tax code.

Part B has transitional provisions for partnerships first becoming subject to the franchise tax, and the comptroller is required to adopt rules to establish applicable reporting periods.

#### PART C. ADD-BACK OF CERTAIN PAYMENTS

Part C of Article 2 takes effect regardless of whether Part A or Part B is in effect.

Addressing the so-called "Geoffrey's" loophole, Part C adds new Sections 171.1001 and 171.1101, Tax Code, that require a corporation, in determining its net taxable earned surplus, to add back to reportable federal taxable income any royalty payment, interest payment, or management fee payment made to a related entity. Certain "safe harbors"--circumstances in which a corporation does not have to make these required add-backs--are provided in new Section 171.1102, Tax Code.

The comptroller in new Section 171.1103, Tax Code, is empowered to distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among two or more organizations, trades, or businesses, under certain circumstances. In performing this function, the comptroller is required to apply the administrative and judicial interpretations of Section 482, Internal Revenue Code.

#### PART D. TRANSITIONAL PROVISIONS

Part D of Article 2 provides transitional provisions relating to a corporation coming under the franchise tax for the first time.

Except as otherwise provided in Parts A, B, and C, Article 2 takes effect November 1, 2005, and applies to reports originally due on or after that date.

#### SALES TAX

The bill increases the state sales and use tax rate from 6 1/4 percent to 7.25 percent. The tax is imposed on custom computer programs, motor vehicle repair services, and bottled water. The bill repeals the law providing for a discount for retailers for timely remittance of tax receipts and makes conforming amendments.

The bill exempts from the taxes imposed by Chapter 151, Tax Code, the receipts from the sales, use, storage, rental, or other consumption in this state of services that became subject to the taxes because of the terms of the bill and that are the subject of a written contract or bid entered into on or before August 1, 2005. This exemption expires September 1, 2007.

The bill includes transitional provisions relating to the tax and provides that the tax provisions, other than the provision increasing the tax rate, take effect September 1, 2005, or, if the Act does not receive the necessary vote, on November 1, 2005. The provision increasing the tax rate takes effect October 1, 2005, or, if the Act does not receive the necessary vote, on January 1, 2006.

#### MOTOR VEHICLES

The tax on sales, rentals, and use of motor vehicles is increased from 6 1/4 percent to 7.35 percent.

The bill requires the county tax assessor-collector to compute the amount of the tax due on the sale of a motor vehicle. If the amount paid for a motor vehicle is equal to or greater than the standard presumptive value of the vehicle, the tax is on the amount paid. If the amount is less than the standard presumptive value, the tax is on the standard presumptive value, unless the purchaser establishes the retail value. The bill requires the Department of Transportation to maintain information on the standard presumptive values of motor vehicles. The bill also requires the Department of Transportation, by November 1, 2005, to establish standard presumptive values, modify the department's registration and title system to include that information, and make that information available through the system to all county tax assessor-collectors.

The bill includes transitional provisions relating to the motor vehicle provisions and provides that Section 152.0412, Tax Code, takes effect November 1, 2005, and that the remaining provisions relating to motor vehicles take effect September 1, 2005, or, if the Act does not receive the necessary vote, take effect on the first day of the first month that begins on or after the 91st day after the last day of the legislative session.

#### BOATS AND BOAT MOTORS

The bill increases the tax on the sale and use of boats and boat motors from 6 1/4 percent to 7.35 percent.

The bill includes transitional provisions relating to the boat and boat motor provisions and provides that the provisions relating to boats and boat motors take effect September 1, 2005, or, if the Act does not receive the necessary vote, take effect on November 1, 2005.

#### **TOBACCO PRODUCTS**

The bill increases the tax on cigarettes from \$20.50 per thousand on cigarettes weighing three pounds or less per thousand to \$70.50 per thousand on cigarettes weighing three pounds or less per thousand. The bill increases the taxes on cigars in each of the four classes of cigar. The bill increases the tax on tobacco products other than cigars from 35.213 percent to 40 percent of the manufacturer's list price.

The bill provides that the provisions relating to tobacco products take effect September 1, 2005, or, if the Act does not receive the necessary vote, on November 1, 2005.

#### **COLLECTION OF DELINQUENT OBLIGATION TO STATE**

The bill requires state agencies to report to the attorney general any uncollected and delinquent obligations on or after the 120th day after the date the obligation becomes delinquent. The bill authorizes the attorney general to provide legal services for collection of the obligation, directly contract with one or more persons to collect the obligation, or authorize the state agency to contract with one or more persons to collect the obligation. The bill prescribes guidelines in relation to those contracts and the contracting parties, including the compensation allowed under the contracts, the powers and duties of the person with whom attorney general or agency contracts, the sharing of information, and liability issues.

#### **EFFECTIVE DATE**

The bill takes effect September 1, 2005, or, if the Act does not receive the necessary vote, the bill takes effect November 1, 2005, except as otherwise provided by the bill.

#### **COMPARISON OF ORIGINAL TO SUBSTITUTE**

The substitute differs from the original bill in the following ways:

- Different limitation of school district tax rate.
- Includes language regarding rendition of property for ad valorem taxation and regulation of asset verification agents.
- Different language used to close the loopholes in the franchise tax, and takes away choice of tax computations as found in original bill.
- Increase on the tax of tobacco products other than cigars is 40%.
- Includes language regarding collection of delinquent obligations to the state.