LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 79TH LEGISLATURE 1st CALLED SESSION - 2005

July 1, 2005

TO: Honorable Jim Keffer, Chair, House Committee on Ways & Means

FROM: John S. O'Brien, Deputy Director, Legislative Budget Board

IN RE: **HB3** by Keffer, Jim (Relating to property tax relief and protection of taxpayers, taxes and fees, and other matters relating to the financing of public schools; providing civil and criminal penalties; making an appropriation.), **Committee Report 1st House, Substituted**

Estimated Two-year Net Impact to General Revenue Related Funds for HB3, Committee Report 1st House, Substituted: a positive impact of $8,236,718,000 through the biennium ending August 31, 2007, if the bill receives two-thirds vote; or a positive impact of $7,458,472,000 through the biennium ending August 31, 2007, if the bill does not receive two-thirds vote.

The following tables presume passage by two-thirds majority vote.

All Funds, Five-Year Impact:

Fiscal Year	Probable Revenue Gain/(Loss) from *GENERAL REVENUE FUND* 1	Probable Revenue Gain/(Loss) from *STATE HIGHWAY FUND* 6	Probable Revenue Gain/(Loss) from *School Districts*	Probable Revenue Gain/(Loss) from *Cities*
2006	$3,749,657,000	$3,686,000	($2,978,708,000)	$52,853,000
2007	$4,487,061,000	$4,638,000	($4,292,936,000)	$77,385,000
2008	$4,584,328,000	$4,869,000	($4,475,481,000)	$89,269,000
2009	$4,806,330,000	$5,114,000	($4,660,466,000)	$94,742,000
2010	$4,910,807,000	$5,367,000	($4,853,799,000)	$100,571,000

Fiscal Year	Probable Revenue Gain/(Loss) from *Counties/Special Districts*	Probable Revenue Gain/(Loss) from *Transit Authorities*
2006	$6,577,000	$18,181,000
2007	$12,742,000	$25,110,000
2008	$15,466,000	$28,594,000
2009	$16,366,000	$30,370,000
2010	$17,320,000	$32,264,000

The following tables presume passage by less than a two-thirds majority vote.

Fiscal Year	Probable Revenue Gain/(Loss) from *GENERAL REVENUE FUND* 1	Probable Revenue Gain/(Loss) from *STATE HIGHWAY FUND* 6	Probable Revenue Gain/(Loss) from *School Districts*	Probable Revenue Gain/(Loss) from *Cities*
2006	$2,971,411,000	$2,580,000	$0	$42,282,000
2007	$4,487,061,000	$4,638,000	($4,292,936,000)	$77,385,000
2008	$4,584,328,000	$4,869,000	($4,475,481,000)	$89,269,000
2009	$4,806,360,000	$5,114,000	($4,660,466,000)	$94,742,000
2010	$4,910,807,000	$5,367,000	($4,853,799,000)	$100,571,000

Fiscal Year	Probable Revenue Gain/(Loss) from *Counties/Special Districts*	Probable Revenue Gain/(Loss) from *Transit Authorities*
2006	$5,262,000	$14,546,000
2007	$12,742,000	$25,110,000
2008	$15,466,000	$28,594,000
2009	$16,366,000	$30,370,000
2010	$17,320,000	$32,264,000

Fiscal Analysis

The bill relates to property taxes, the implementation of new taxes, the increase in rates for existing taxes, and the expansion of tax bases.

Article 1 would reduce the ad valorem maintenance and operations (M&O) tax rate cap from $1.50 per hundred dollars of valuation to $1.23, plus $0.15 for local enrichment, per $100 valuation for the 2005 tax year, should the bill receive two-thirds majority vote, and $1.12, plus $0.15 for local enrichment, each year thereafter. A new subsection would allow any school district election held before September 1, 2005 authorizing a rate cap of at least $1.23 to be sufficient authorization for a rate of $1.23 or less, and a school district election held before January 1, 2006 authorizing a rate cap of at least $1.12 to be sufficient authorization for a rate of $1.12 or less.

Part B of Article 1 would establish the distribution of increases in available state revenue for school district property tax reduction. The Comptroller, before each regular session, would determine the increase, if any, in available state revenue, comparing certain preceding and current state revenue estimates required by Section 49a(a) of the Texas Constitution. The Comptroller would certify to the Legislature the amount of any increase and the school district M&O taxes levied for the second year of the current fiscal biennium. The Comptroller would distribute to school districts 15 percent of any increase in available state revenue for the reduction of school district tax rates. Further, the bill would establish the School Property Tax Relief Fund as an account in the General Revenue Fund. For each of five fiscal years beginning September 1, 2006, the Comptroller would be required to deposit to the credit of the account the amount, if any, by which actual revenue collections from the provisions of this Act exceed the estimated amount of revenue of this Act as estimated on or before the effective date of the Act. The revenue would be distributed in equal amounts in each fiscal year of the biennium based on the taxable value in each school district, as determined by the Comptroller's property value study. The bill would provide additional state aid to school districts as compensation for losses in state funding caused by the proposed tax rate reductions. The bill would require school districts receiving additional state aid for property tax relief to reduce their rollback tax rates commensurate with the additional aid.

Part C of Article 1 would conform personal property rendition penalty provisions to provide that a tax lien attaches to the property against which the penalty is imposed, effective January 1, 2006. The bill would allow the chief appraiser or the chief appraiser's authorized representative, for purposes of rendition verification, to request a property owner's IRS schedules and forms that relate to acquisition and cost of fixed assets, including ledgers and depreciation schedules. A property owner would have

21 days to deliver the requested documents, which would be confidential in the same manner as the owner's rendition statement. A representative's compensation could not exceed 20 percent of the value of any tax penalties and interest on unreported or underreported assets verified by the representative. No later than July 31 of each year, a chief appraiser would have to report to the Commissioner of Education any increased value for each school district, for adjustment of school funding amounts to those districts.

The bill would also add language creating a licensing classification for "Asset Verification Agents." These provisions would take effect April 1, 2006.

Article 2 would amend Chapter 171 of the Tax Code to change the definition of "doing business in this state" and to require corporations to add-back certain payments made to related entities. The definition of "doing business in this state" would expand to include a foreign corporation that holds a controlling interest in a partnership as a limited partner in a limited partnership that is doing business in this state. A limited partner would hold a controlling interest in a limited partnership if any related party owned a controlling interest, directly or indirectly, in the partnership.

If a corporate partner asserted that the tax imposed was unconstitutional, the article would provide that the tax be imposed on the partnership to the extent the partnership was owned, directly or indirectly, by a corporation.

A corporation would have to include in its gross receipts the share of partnership receipts from partnerships owned directly or indirectly by the corporation as though the corporation directly earned the receipts. A corporation owning an interest in an upper-tier partnership would be considered to be a partner in both the upper-tier partnership and each lower-tier partnership. A corporation would have to include in its net taxable earned surplus the corporation's share of a partnership's items of income or loss, without regard to whether the partnership was taxed as a corporation for federal income tax purposes. In the event the change in the definition of "doing business in this state" was found unconstitutional, the franchise tax would apply to partnerships to the extent they were owned by corporations.

Corporations would have to add-back to reportable federal taxable income certain payments made to related entities. The article would specify certain safe harbors for the add-back of royalty, interest payments, and management fees; and it would grant the Comptroller authority to adjust items and income and deductions among related parties if such adjustment were necessary to reflect an arm's length standard.

This article would take effect November 1, 2005, and it would apply to reports originally due on or after that date. For corporations that would become subject to the tax because of this bill, income or losses occurring before January 1, 2005 could not be considered for the earned surplus component. An entity that would become subject to the tax because of this bill and that would be subject to the tax on January 1, 2006, but for which January 1, 2006, was not the beginning date, would file an annual report due May 15, 2006.

Article 3 would amend sales and use taxes. The state sales and use tax rate would increase from 6.25 percent to 7.25 percent. Further, certain computer goods and services, motor vehicle repair services, and bottled water would be taxable under the sales tax. The timely filer discount for sales tax payers would be repealed. These provisions would take effect October 1, 2005, assuming that the bill received the requisite two-thirds majority votes in both houses of the Legislature. Otherwise, they would take effect January 1, 2006.

The motor vehicle sales tax rate, the motor vehicle rental tax rate on rentals of more than 30 days and the boat and boat motor sales and use tax rate would increase from 6.25 percent to 7.35 percent. These provisions would take effect October 1, 2005 if the bill received a vote of two-thirds of the members elected to each house. If the bill did not receive the necessary votes for immediate effect, these provisions would take effect January 1, 2006.

The bill would establish a presumptive value for determining the proper amount of motor vehicle sales tax due on certain motor vehicle sales transactions. The presumptive value would be the average retail value of a motor vehicle for motor vehicle sales tax computation purposes. The Texas Department of Transportation (TxDOT) would determine the presumptive value of a motor vehicle based on a nationally recognized motor vehicle industry reporting service. If the amount paid for a motor vehicle in a sales transaction were greater than or equal to the presumptive value, a tax assessor-collector would compute and collect the motor vehicle sales tax due on the amount paid. If, however, the amount paid for a motor vehicle in a sales transaction were less than the presumptive value, the tax assessor-collector would compute and collect the motor vehicle sales tax due on the presumptive value, unless the purchaser could establish a retail value. The bill would allow a purchaser to establish a retail value by obtaining an appraisal certified by an adjuster licensed under Chapter 4101 of the Insurance Code or by a motor vehicle dealer operating under Subchapter B, Chapter 503 of the Transportation Code. Appraisals would have to be on a form prescribed by the Comptroller, and they would have to be obtained no later than the 20th day after purchase. Dealers could charge a fee, set by the Comptroller, for providing the certified appraisal; and the tax assessor-collector would retain a copy of each certified appraisal for a period prescribed by the Comptroller. TxDOT would maintain information on the standard presumptive values of motor vehicles as part of its registration and title system; TxDOT would update the information at least quarterly each calendar year. Standard presumptive value would not apply to even exchange transactions or gift transactions. The provisions relating to standard presumptive value and its use by tax assessor-collectors would take effect November 1, 2005.

Article 4 would raise the tax rates for cigarettes, cigars, and other tobacco products. The bill would raise the cigarette tax rate by $50.00 per 1,000 cigarettes weighing three pounds or less per thousand ($1.00 per pack of 20 cigarettes), to a new rate of $70.50 per 1,000 cigarettes ($1.41 per pack). Cigarette tax revenue generated by the rate increase would be allocated to the General Revenue Fund. The bill would raise the tax rates for all of the tobacco products included in Chapter 155 of the Tax Code. The tax on small cigars (weighing three pounds or less per thousand) would increase from $0.01 per 10 cigars to $.0125 per 10 cigars; the tax on each of the three categories of large cigars ($7.50, $11.00, and $15.00 per thousand) would increase by 25 percent (to $9.375, $13.75, and $18.75 per thousand, respectively); and the tax on tobacco products other than cigarettes and cigars (i.e., snuff; chewing and pipe tobacco) would increase from 35.213 percent to 40 percent of the manufacturer's list price. Cigar and tobacco products tax revenue generated by the rate increases would be allocated to the General Revenue Fund. These provisions would take effect September 1, 2005 if the bill received a vote of two-thirds of the members elected to each house. If the bill did not receive the necessary votes for immediate effect, these provisions would take effect November 1, 2005.

Article 5 would require the Office of Attorney General (OAG) to provide legal services for the collection of uncollected and delinquent obligations. The article would allow OAG to contract with private debt collectors, and it would allow the collectors to charge and retain an amount equal to 30 percent of the total obligation for services rendered. This article would take effect September 1, 2005, assuming that the bill received the requisite two-thirds majority votes in both houses of the Legislature. Otherwise, it would take effect on the 91st day after the last day of the legislative session.

Unless otherwise noted, this bill would take effect September 1, 2005, assuming that it received the requisite two-thirds majority votes in both houses of the Legislature. Otherwise, it would take effect November 1, 2005.

Methodology

The estimates in the tables above reflect only revenue changes to the state and affected local governments. The fiscal impact to state public education funding from the decrease in property taxes and the administrative requirements of this bill are not reflected in the tables. Further, the estimates in the tables do not reflect dynamic tax impacts as identified by the Comptroller.

Article 1. Regarding property tax rate reduction, for each school district with an M&O rate above $1.12 ($1.23 for tax year 2005), but at or below $1.50, the M&O rate was reduced to $1.12. No change was made to the tax rates of school districts with M&O rates less than $1.12. A statewide school district M&O levy was calculated at the new rates, trended over the projection period, and subtracted from the statewide M&O levy as calculated and trended under current law. The difference would be the loss to school districts under the bill. Cities, counties and special districts would be unaffected. No estimate is provided for Part B of Article 1.

Part C of Article 1 would give appraisal districts greater legal authority and improved information in the property rendition process. The fiscal note assumes a partial gain to taxing units in fiscal 2007, with full gains accruing in fiscal 2008. School district gains would be offset by reduced state funding after a one-year lag, resulting in savings to the state.

Article 2. The estimated fiscal impact is based on the Comptroller's franchise tax and sales tax records, on information from tax records from the Internal Revenue Service, and on the experience of other states with tax provisions similar to those in HB 3.

Article 3. The fiscal implications of raising the sales tax rate to 7.25 percent and repealing the timely filer discount were estimated using current state sales and use tax revenue projections. The fiscal impact was adjusted for the two potential effective dates. The revenue gains for the State Highway Fund 6 reflect the increased sales tax revenue attributable to motor lubricants. To estimate the implications of taxing bottled water, certain computer services and motor vehicle repair services, data on sales were gathered from industry sources, the U.S. Census Bureau, and Comptroller tax files. Sales were adjusted for Texas, multiplied by the increased state sales tax rate, adjusted for the two potential effective, and extrapolated through fiscal 2010.

The fiscal implications of raising the motor vehicle sales tax and motor vehicle rental tax rates to 7.35 percent were estimated using current motor vehicle sales and motor vehicle rental tax revenue projections. Long-term rental taxes represent approximately five percent of all rental tax revenue collected. The new rates were applied to estimates of adjusted gross rental tax and adjusted for behavioral effects and effective dates. The presumptive value provisions would apply primarily to sales of motor vehicles between individuals, often referred to as "casual" or "private" sales. The estimate assumes an average value of a used vehicle in Texas to be approximately $7,300. The fiscal implications of raising the boat tax rate were estimated using current boat tax revenue projections. The fiscal impact was adjusted for the two effective dates.

Article 4. The proposed cigarette, cigar and other tobacco tax rate increases were estimated using current revenue projections for these taxes, adjusted for declines in taxable consumption in Texas, as well as tax avoidance effects and collection lags.

Article 5. The Comptroller's office indicates the revenue gain from enhanced delinquent collection abilities would be approximately $13 million per year once fully implemented.

Not reflected in the above tables are expected administrative costs to the Comptroller of $3.4 million in fiscal 2006, $2.4 million in fiscal 2007 and $1.9 million per year thereafter, and an increase in 43 FTEs necessary to implement the provisions of the bill.

Local Government Impact

The impacts to local governments are shown in the above tables.

Source Agencies: 304 Comptroller of Public Accounts

LBB Staff: JOB, SD, WP