LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 79TH LEGISLATIVE REGULAR SESSION

April 28, 2005

TO: Honorable Steve Ogden, Chair, Senate Committee on Finance

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.), **As Engrossed**

Estimated Two-year Net Impact to General Revenue Related Funds for HB3, As Engrossed: a positive impact of $7,510,975,000 through the biennium ending August 31, 2007, if the effective date of the bill is July 1, 2005 for sales and excise taxes; or a positive impact of $6,667,505,000 through the biennium ending August 31, 2007, if the effective date of the bill is October 1, 2005 for sales and excise taxes.

The following tables presume a July 1, 2005 effective date for sales and excise taxes.

All Funds, Six-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*
2005	$330,661,000	$352,000	$0	$0
2006	$3,295,473,000	$4,422,000	$0	$53,497,000
2007	$3,884,841,000	$4,638,000	($5,666,300,000)	$60,284,000
2008	$3,853,047,000	$4,869,000	($5,700,968,000)	$75,401,000
2009	$3,809,437,000	$5,114,000	($5,811,392,000)	$90,880,000
2010	$3,903,563,000	$5,367,000	($5,914,623,000)	$108,112,000

Fiscal Year	Probable Revenue Gain/(Loss) from *Counties/Special Districts*	Probable Revenue Gain/(Loss) from *Transit Authorities*
2005	$0	$0
2006	$6,657,000	$18,402,000
2007	$7,501,000	$20,738,000
2008	$17,246,000	$22,541,000
2009	$28,026,000	$23,996,000
2010	$40,106,000	$25,551,000

The following tables presume a September 1, 2005 effective date for sales and excise taxes.

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 *GR-D Telecommunications Infrastructure Fund* *345*	Probable Revenue Gain/(Loss) from *School Districts*
2006	$2,782,664,000	$3,686,000	$33,333,000	$0
2007	$3,884,841,000	$4,638,000	$0	($5,666,300,000)
2008	$3,853,047,000	$4,869,000	$0	($5,700,968,000)
2009	$3,809,437,000	$5,114,000	$0	($5,811,392,000)
2010	$3,903,564,000	$5,367,000	$0	($5,914,326,000)

Fiscal Year	Probable Revenue Gain/(Loss) from *Cities*	Probable Revenue Gain/(Loss) from *Counties/Special Districts*	Probable Revenue Gain/(Loss) from *Transit Authorities*
2006	$40,122,000	$4,993,000	$13,803,000
2007	$60,284,000	$7,501,000	$20,738,000
2008	$75,401,000	$17,246,000	$22,541,000
2009	$90,880,000	$28,026,000	$23,996,000
2010	$108,112,000	$40,106,000	$25,551,000

Fiscal Analysis

The bill relates to property taxes, the implementation of new taxes, the repeal of existing 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 $0.997 per $100 valuation. A new subsection would allow any school district election held before September 1, 2005 authorizing a rate cap of at least $0.997 to be sufficient authorization for a rate of $0.997 or less. Districts permitted on January 1, 2005 to have M&O tax rates higher than $1.50 would be allowed to impose a rate $0.503 less than the previously authorized rate.

The bill 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 the 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. 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.

The bill would require the disclosure of the sales price of real property to appraisal districts. The bill would require the purchaser of real property to file a signed report with the chief appraiser disclosing the sales price of the property and other sales and value related information. A disclosure report would not be required for non-market sales, such as foreclosure and bankruptcy transfers. The chief appraiser would have to provide the purchaser with a certificate stating that the report had been received. Each appraisal district would have to prepare, and make available, report forms conforming to statutory requirements. The bill would allow the chief appraiser to bring an action for injunction to compel a person to comply with the mandatory disclosure requirements. The bill would make sales price disclosure reports confidential other than: 1) to the appraisal district and collecting taxing units; 2) to the Comptroller; 3) in a judicial or administrative proceeding; or 4) for non-property specific statistical purposes. A person who knowingly disclosed confidential sales disclosure information would be subject to a Class B misdemeanor. The bill would prohibit a chief appraiser from increasing the market value of real property solely on the basis of information in a disclosure report.

The bill would make appraisal district photographs of residential improvements to real property, other than residence homesteads, confidential. Confidential photographs would be available to the Comptroller, to the state, and to local units of government. An aerial photograph of five or more separately owned buildings would not be confidential.

The bill would allow a school district containing a federal nuclear facility to continue to be considered rural, for the provisions of certain appraised value limitations, if that district was rural on January 1, 2002.

The bill would include culturally significant sites with the current optional exemption for historic sites.

The bill would require a taxing unit other than a school district or a water district to publish notice and hold a public hearing on any proposed tax rate above the lower of the rollback rate or the effective tax rate.

Article 1 provisions concerning the confidentiality of certain appraisal records and the procedures for adoption of tax rates would take effect immediately upon enactment, assuming that the bill received the requisite two-thirds majority votes in both houses of the Legislature. Otherwise, the those sections would take effect on the 91st day after the last day of the legislative session. The other provisions would take effect January 1, 2006.

Article 2 would create the Reformed Franchise Tax, amend the current franchise tax, and add a subchapter titled "Forfeiture of Right to Transact Business in this State." Together, the Reformed Franchise Tax and the amendments to the existing franchise tax would create a tax system under which taxpayers would be able to choose to pay either of the taxes.

The Reformed Franchise Tax (RFT) would be based on wages paid to an employee by an employer during a calendar quarter, to which a tax of 1.15 percent would be applied. Any business that pays or is required to pay the unemployment insurance tax would be subject to the tax. With some exceptions, a business subject to the tax could elect to pay the RFT or the franchise tax. The election could not be changed for three years. An exception would include a business with no employees in the state; such a business may not elect to pay the RFT.

A business in the business of leasing employees would have to pay the RFT and could not elect to pay the franchise tax. However, an employee leasing business that reported and paid the franchise tax for a report year ending before January 1, 2005 could elect to pay the franchise tax. A corporation with no employees in the state during calendar 2004, but subsequently with employees in the state, could elect to pay the RFT. However, a minimum tax equal to the amount of franchise tax paid in the previous report year would be required through the end of calendar 2008. Government entities and charitable organizations exempt from federal income tax under Section 501(c)(3) would be exempt from the RFT. A business with Texas gross receipts less than $150,000 during a calendar year would be exempt from the tax.

A taxable business would remit the tax due to the Texas Workforce Commission in the same manner and at the same time as contributions assessed under the unemployment compensation provisions of the Labor Code.

Certain health care providers would receive credits against the tax imposed under the RFT based on their participation in the Medicare or Medicaid programs, or, in the case of physicians, the Children's Health Insurance Program. To receive the credit, the provider would have to receive at least 15 percent of the business's revenue from the programs. The credit would be equal to 40 percent of the payments received from the programs and would be limited to the amount of tax liability.

The bill would amend the existing franchise tax by including in the definition of "corporation" a sole proprietorship with at least one employee, a partnership owned solely by natural persons with at least one employee, all businesses that operate in a manner that provides liability limitations to owners, and a partnership or joint venture owned in part by another form of business that has a least one employee.

The bill would exclude from the definition of corporation ten types of entities, including, among others, a trust, a sole proprietorship with no employees, and a partnership with no employees. The bill would expand the definition of doing business in Texas to include a corporation that is a limited partner in a limited partnership doing business in Texas. The bill would provide an election for corporations to pay the franchise tax or the RFT. The election could not be changed for three years.

The bill would provide that a corporation would add back payments made to related entities for certain types of expenses to the extent they exceed an arm's length rate.

The bill would repeal provisions in the franchise tax related to the exemption of insurance companies from the franchise tax. The Comptroller would be directed to adopt rules to avoid double taxation with the taxes imposed under the RFT and the franchise tax.

The bill would add a subchapter to Chapter 111 relating to forfeiture of the right to transact business in this state. The new subchapter would preserve the powers that the Comptroller's Office has under the existing Chapter 171 regarding forfeiture of corporate privileges and the right to transact business in Texas. The new subchapter would extend the same procedures to other entities that would be subject to the subchapter under a tax imposed by Title 2 of the Tax Code. Article 2 would take effect January 1, 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, billboard advertising services, motor vehicle repair services, motor vehicle wash or detail services, and elective cosmetic procedures would be added to the list of taxable services under the sales tax. Motor vehicle parking at certain health care facilities and diapers would be exempted from the sales tax. In addition, the exemption for water would be amended to exclude water sold in a sealed container. The timely filer discount for sales tax payers would be reduced from 0.5 percent to 0.33 percent. The bill would provide a prior contract exemption for the services added to the sales tax base until July 1, 2007. These provisions would take effect July 1, 2005, assuming that the bill received the requisite two-thirds majority votes in both houses of the Legislature. Otherwise, they would take effect October 1, 2005.

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 6.26 percent to 7.35 percent. These provisions would take effect July 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 September 1, 2005.

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 October 1, 2005.

The bill would impose a tax on discretionary food and drink items. The tax rate would be three percent of the sales price of soft drinks and snack food. The tax would not apply to food or to a beverage sold by a restaurant or other business for consumption on the premises of the business. This provision would take effect July 1, 2005, assuming that it received the requisite two-thirds majority votes in both houses of the Legislature. Otherwise, it would take effect September 1, 2005. All revenues received under the new chapter would be deposited to the credit of the General Revenue Fund.

Article 4 would raise the tax rates for cigarettes, cigars, and other tobacco products. The bill would raise the cigarette tax rate by $50.60 per 1,000 cigarettes weighing three pounds or less per thousand ($1.01 per pack of 20 cigarettes), to a new rate of $71.10 per 1,000 cigarettes ($1.42 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 $0.0344 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 244 percent (to $25.80, $37.84, and $51.60 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.

Article 5 of the bill would continue telecommunications infrastructure assessment until September 1, 2011, and it would repeal portions of the statute imposing a ceiling on the assessment. Revenue received from extension of the assessment would be deposited to the General Revenue Fund. Certificated telecommunications utilities would be allowed to recover the assessment from their customers once the balance in the fund from assessment deposits exceeded $1.5 billion. The Comptroller's Office would publish in the Texas Register the date that assessment deposits totaled $1.5 billion. Utilities would annually file with the Public Utility Commission confidential affidavits attesting to the assessment amounts paid and the assessment amounts recovered from customers. This article would take effect September 1, 2005.

Unless otherwise noted, this bill would take effect July 1, 2005, assuming that it received the requisite two-thirds majority votes in both houses of the Legislature. Otherwise, it would take effect September 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 contained in House Bill 2, as Engrossed 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 tax rate above $1.50, the M&O tax rate was reduced by $0.503. For each school district with an M&O rate above $0.997, but at or below $1.50, the M&O rate was reduced to $0.997. No change was made to the tax rates of school districts with M&O rates less than $0.997.

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.

Note: The Comptroller indicates that the reduction in school district M&O rates proposed in this article would not be mandatory. Instead, the bill would reduce the maximum rate allowed in an electoral proposition to authorize an operations tax levy. School districts could choose not to submit a proposition to authorize the reduced tax rate, because they already have voter authorization at their current M&O rate.

Regarding sales price disclosure, the amount of property value gain was based on a survey of large appraisal districts. The median percent increase in property value was applied to the state total property value to estimate the statewide property value gain. The disclosure requirement would begin on January 1, 2006, the first affected tax year would be 2007, and the first effect on taxing units would be in fiscal 2008. Also, the state only requires reappraisal once every third year, so the full effect of the bill would not be realized until fiscal 2010. In this estimate, the gain was implemented in increments of one-third per year. Values and tax rates were trended through the projection period. A factor of 70 percent was applied to the statewide value gain to estimate the amount of gain inside cities. No information was available to estimate special district gains. The appropriate county, city, and school district tax rates were applied to the value gains to project their respective revenue gains.

Regarding the rollback tax rate reduction, the fiscal impact of requiring a taxing unit other than a school district or water district to publish notice and to hold a public hearing on any proposed tax rate above the lower of the rollback rate or the effective tax rate would depend on future actions by taxing units relative to the adoption of property tax rates. No estimate is provided here.

Article 2. The estimate is based on Comptroller's tax files and on employment and wage information from the Texas Workforce Commission.

Article 3. The fiscal implications of raising the sales tax rate to 7.25 percent and lowering the timely filer discount to 0.33 percent were estimated using current state sales and use tax revenue projections. The fiscal impact was adjusted for potential effective dates of July 1, 2005 and October 1, 2005. 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, billboard advertising services, motor vehicle repair services, motor vehicle wash or detail services, and elective cosmetic procedures, and to estimate the implications of exempting diapers and parking services at certain health care facilities, 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 potential prior contracts and potential effective dates of July 1, 2005 and October 1, 2005, 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. These changes would take effect July 1, 2005 or September 1, 2005.

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. This change would take effect October 1, 2005.

The fiscal implications of raising the boat tax rate were estimated using current boat tax revenue projections. The fiscal impact was adjusted the two effective dates.

The fiscal implications of imposing a tax on discretionary food and drink items were estimated using data on the sale of soft drinks and snack food were gathered from industry sources. Revenues were adjusted to reflect Texas sales, adjusted for restaurant and other sales for consumption on premises, multiplied by the tax rate of three percent, adjusted for potential effective dates of July 1, 2005 and September 1, 2005, and extrapolated through fiscal 2010.

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. Estimates of the fiscal impacts of extending the telecommunications infrastructure assessment were based on the Comptroller's 2006-07 Biennial Revenue Estimate and data from assessment returns paid by telecommunications utilities.

The Secretary of State, Office of Attorney General, Texas Workforce Commission, and the Texas Department of Transportation all report administrative costs associated with implementing various provisions of the bill. These costs as reported total approximately $20 million per fiscal year, and are not included in the tables above. The largest share of administrative costs would be incurred by the Texas Workforce Commission to implement the revised franchise tax.

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