LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 79TH LEGISLATIVE REGULAR SESSION
Revision 1

March 8, 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.), **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 $11,770,175,000 through the biennium ending August 31, 2007, if the effective date of the bill is July 1, 2005; or a positive impact of $10,943,424,000 through the biennium ending August 31, 2007, if the effective date of the bill is September 1, 2005.

The following tables presume a July 1, 2005 effective date.

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 *FOUNDATION SCHOOL FUND* 193	Probable Revenue Gain/(Loss) from *School Districts*
2005	$328,242,000	$352,000	$0	$0
2006	$5,696,781,000	$4,422,000	$0	$0
2007	$5,762,289,000	$4,638,000	($17,137,000)	($5,630,700,000)
2008	$5,914,617,000	$4,869,000	($15,516,000)	($5,702,000,000)
2009	$6,211,576,000	$5,114,000	($13,759,000)	($5,815,200,000)
2010	$6,458,234,000	$5,367,000	($14,772,000)	($5,921,400,000)

Fiscal Year	Probable Revenue Gain/(Loss) from *Cities*	Probable Revenue Gain/(Loss) from *Counties/Special Districts*	Probable Revenue Gain/(Loss) from *Transit Authorities*
2005	$0	$0	$0
2006	$57,729,000	$7,184,000	$19,858,000
2007	$64,590,000	$8,037,000	$22,219,000
2008	$79,783,000	$17,791,000	$24,048,000
2009	$95,328,000	$28,580,000	$25,526,000
2010	$112,652,000	$40,668,000	$27,103,000

The following tables presume a September 1, 2005 effective date.

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 *FOUNDATION SCHOOL FUND* 193	Probable Revenue Gain/(Loss) from *GR-D Telecommunications Infrastructure 345*
2006	$5,198,272,000	$3,686,000	$0	$33,333,000
2007	$5,762,289,000	$4,638,000	($17,137,000)	$0
2008	$5,914,617,000	$4,869,000	($15,516,000)	$0
2009	$6,211,576,000	$5,114,000	($13,759,000)	$0
2010	$6,458,234,000	$5,367,000	($14,772,000)	$0

Fiscal Year	Probable Revenue Gain/(Loss) from *School Districts*	Probable Revenue Gain/(Loss) from *Cities*	Probable Revenue Gain/(Loss) from *Counties/Special Districts*	Probable Revenue Gain/(Loss) from *Transit Authorities*
2006	$0	$43,297,000	$5,387,000	$14,895,000
2007	($5,630,700,000)	$64,590,000	$8,037,000	$22,219,000
2008	($5,702,000,000)	$79,783,000	$17,791,000	$24,048,000
2009	($5,815,200,000)	$95,328,000	$28,580,000	$25,526,000
2010	($5,921,400,000)	$112,652,000	$40,668,000	$27,103,000

Fiscal Analysis

This 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 $1.00 per $100 valuation. A new subsection would allow any school district election held before September 1, 2005 authorizing a rate cap of at least $1.00 to be sufficient authorization for a rate of $1.00 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 $0.50 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 rollback 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 that conformed 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, the state and local units of government. An aerial photograph of five or more separately owned buildings would not be confidential.

The bill would specify that the governing body of a taxing unit other than a school district that adopted a tax rate higher than the effective tax rate would have to meet certain public hearing and notice requirements.

Article 1 sections 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, these sections would take effect on the 91st day after the last day of the legislative session. Other Article sections would take effect January 1, 2006.

Article 2 would create the Reformed Franchise Tax, repeal the existing franchise tax, and amend Chapter 111 of the Tax Code by adding a subchapter entitled, "Forfeiture of Right to Transact Business in This State."

The Reformed Franchise Tax would impose a tax on a taxable business based on wages paid by a business. A taxable business would be defined as an employer subject to tax under the unemployment compensation provisions of the Labor Code. Wages would be defined as under Subchapter F, Chapter 201, Labor Code. The bill would specify conditions under which payment for services provided outside the state would be subject to the tax. The tax base would be the total amount of wages paid an employee during a calendar year that is equal to or less than $90,000. The tax rate would be 1.15 percent of the base amount. A taxable business would remit the tax due to the Workforce Commission in the same manner and at the same time as contributions assessed under the unemployment compensation provisions of the Labor Code. Government entities and charitable organizations exempt from federal income tax under Internal Revenue Code Section 501(c)(3) would be exempt from the tax.

A taxable business subject to insurance premium taxes would receive a credit against premium taxes for taxes paid under the Reformed Franchise Tax. A taxable business participating in the Medicare or Medicaid program, except providers of durable medical equipment and pharmaceuticals, would receive a credit against the Reformed Franchise Tax for an amount equal to 40 percent of the total payments received under the Medicare or Medicaid programs. The credit would be limited to the amount of tax due. A taxable business with unused credits under the current franchise tax could apply credits that had not expired by December 31, 2005 to certain liability under the Reformed Franchise Tax. Revenue from the Reformed Franchise Tax would be deposited to the General Revenue Fund.

Effective January 1, 2006, the bill would repeal Tax Code Chapter 171. Provisions relating to audits, deficiencies, redeterminations, and refunds would continue to apply until barred by limitations. The bill would not affect the ability of the Comptroller's Office, the Secretary of State, or the Attorney General to take action against a corporation for activities that took place before the repeal. The rights of a corporation to contest a forfeiture, revocation, lawsuit, or appointment of a receiver would not be affected by repealer provisions. A corporation subject to the franchise tax on December 31, 2005 would be subject to a transitional tax . The transitional tax would be equal to the tax the corporation would have paid in 2006 if the franchise tax had not been repealed.

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 this 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, and motor vehicle wash and detail services would be added to the list of taxable services under the sales tax. In addition, the sales tax exemption for water would be amended to exclude water sold in a sealed container, and the sales tax exemption for newspapers would be repealed. The bill would provide a prior contract exemption for the services being added to the sales tax base until October 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 6.25 percent to 7.35 percent. Further, the bill would establish a presumptive value for determining the proper amount of motor vehicle sales tax due on certain motor vehicle sales transactions, with that value to be determined by the Texas Department of Transportation (TxDOT) based on a nationally recognized motor vehicle industry reporting service. If the amount paid 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 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 established a retail value. Standard presumptive value would not apply to even exchange transactions or gift transactions. The presumption value provisions would take effect October 1, 2005. The other 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. Revenue from all parts of this article would be deposited to the credit of the General Revenue Fund.

The bill would impose a tax on discretionary food and drink items. The tax rate would be 3 percent of the sales price of soft drinks and snack food. The tax would not apply to food or 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 this tax 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 $50.00 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 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 generated by the rate increases would be allocated to General Revenue Fund.

The bill would implement a fee on cigarettes and cigarette tobacco products manufactured by companies that did not sign the tobacco settlement agreement with Texas, otherwise known as Non-Participating Manufacturers (NPM). The fee, two cents for each cigarette and each 0.09 ounce of tobacco used in roll-your-own cigarettes, would be levied on NPMs; the fee would be increased annually by the Comptroller's Office by the higher of 3 percent or the annual change in the U.S. consumer price index for urban consumers. Cigarette distributors operating in Texas would file monthly reports with the Comptroller's Office with specific information on their sales of NPM products. Based on the distributor reports, each month the Comptroller's Office would compute the fee amounts due from each NPM and notify them of their assessment by mail. NPMs would have to certify each month to the Attorney General's Office that they were in full compliance with this subchapter. NPMs seeking to enter the Texas market after this bill took effect would have to prepay an estimated fee amount for their first month of sales.

Article 5 would continue the Telecommunications Infrastructure Fund (TIF) until September 1, 2011, and it would repeal the revenue limit for the TIF assessment. Certificated telecommunications utilities could 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.

Unless otherwise noted, the bill would take effect July 1, 2005, providing it receives two-thirds vote in both chambers. Otherwise the bill 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 and the administrative requirements of this bill are not reflected in the tables.

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 $0.50. For each school district with an M&O rate above $1.00, but at or below $1.50, the M&O rate was reduced to $1.00. No change was made to the tax rates of school districts with M&O rates less than $1.00.

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. For this reason, the bill would have no fiscal impact, unless the language were revised to make the rate reduction mandatory, or unless a court determined that the language did require rate reduction.

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 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 rollback tax rate reduction, the fiscal impact of reducing the rollback rate factors for taxing units other than school districts 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 for the Reformed Franchise Tax was based on employment and wage data published by the Texas Workforce Commission, information from the Internal Revenue Service, and Comptroller's Office economic forecasts and tax records. The provisions relating to tax enforcement would have no fiscal impact on the state or units of local government.

Article 3. The fiscal implications of raising the sales tax rate to 7.25 percent were estimated using current state sales and use tax revenue projections. The fiscal impact was adjusted for both a July 1, 2005 and October 1, 2005 effective date. 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, newspapers, billboard advertising services, motor vehicle repair services, and motor vehicle wash or detail services, data on Texas sales were gathered from the U. S. Census Bureau and Comptroller tax files. Sales were multiplied by the increased state sales tax rate, adjusted for potential prior contracts, adjusted for the effective dates, and extrapolated through fiscal 2010.

The fiscal implications of raising the motor vehicle sales and motor vehicle rental tax rates to 7.35 percent were estimated using current motor vehicle sales and motor vehicle rental tax revenue projections. The new tax rate was applied to estimates of annual gross sales subject to the motor vehicle sales tax and adjusted for behavioral effects. Long-term motor vehicle rentals represent approximately 5 percent of all rental tax revenue collected. The new rate was applied to estimates of adjusted gross rental tax and adjusted for behavioral effects.

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 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. The fiscal impact estimate of the NPM fee was based on cigarette manufacturer reports, for NPMs and other companies, sent to the Comptroller’s Office each month detailing their shipments to Texas distributors. The experiences of other states that have implemented a comparable fee or tax, notably Michigan, were considered, and the estimate was adjusted accordingly.

Article 5. Estimates of the fiscal impacts on the Telecommunications Infrastructure Fund were based on the Comptroller's 2006-07 Biennial Revenue Estimate.

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: 302 Office of the Attorney General, 304 Comptroller of Public Accounts, 307 Secretary of State, 320 Texas Workforce Commission, 601 Department of Transportation, 701 Central Education Agency

LBB Staff: JOB, SD, WP