

BILL ANALYSIS

H.B. 3461
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Ways & Means
Committee Report (Unamended)

BACKGROUND AND PURPOSE

In lieu of granting a bad-debt deduction or credit to automobile dealers who finance motor vehicle sales (i.e. “tote the note”), in 1993 the Texas legislature adopted an approach that allows dealers who obtain a special seller-finance permits to pay sales tax on a cash basis, meaning when payments are actually received from a purchaser/debtor. This deferral of sales tax allowed small dealers to pay taxes on a cash basis rather than accelerating taxes on the value of the entire note, particularly because it was small automobile dealers utilizing these in-house financing transactions.

However, to limit the benefits of deferred sales tax only to small, in-house financing dealers, the legislation included a “due-on-sale” provision that accelerated the payment of sales tax on the *entire* purchase price if the installment contract is sold, assigned, or otherwise transferred to a *third party*.

Because the State Comptroller now had direct access to sales and tax data through the monthly sales tax statements and remittances from dealers, this process has proven to be very successful for the State and for small automobile dealers around the state.

Around the same time, Congress amended the IRS Code to require that installment sellers, including automobile dealers, accrue into income the face value of installment contracts in the year in which the transaction was entered into. This reversed the typical cash reporting system used by dealers who offered in-house financing.

As a result, around the country automobile dealers began creating related finance corporations (RFC’s) with common ownership to the dealership. Under IRS regulations, because the RFC was under common ownership to the dealership who sold the vehicle, an automobile dealer could sell an installment contract to the RFC at a discounted price. This, in turn, lowered the federal income tax liability on the contract by the automobile dealer. The RFC’s service the contract and report income as payments were collected. With the lowered tax basis on the contract, small automobile dealers were able to take advantage of lower pre-payment of federal income taxes which freed up much needed capital for expansion and growth.

However, because of the “due-on-sale” clause in the deferred sales tax provision under State law, Texas dealers faced the loss of deferred sales tax if an RFC were used. Thus, Texas automobile dealers were faced with the choice of the lesser of two evils. As a result, most Texas automobile dealers chose to pay the higher income tax.

HB 3461 would allow dealers to use RFCs and continue to defer sales tax if the RFC has common ownership of at least 80 percent with the dealership.

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

ANALYSIS

SECTION 1 adds Sec. 152.047(g-1), Tax Code, which exempts transactions from Subsection (g) if the dealer sells the purchaser’s account to a person in which at least 80 percent of the ownership is identical to the ownership of the dealer or if the dealer retains custody and control of the account.

SECTION 2 insures that the Act does not affect taxes imposed before the effective date of the Act.

SECTION 3 states this Act takes effect July 1, 2007, or, if the Act does not receive the necessary vote, the Act takes effect September 1, 2007.

EFFECTIVE DATE

This Act takes effect July 1, 2007, if it receives a vote of two-thirds of all the members elected to each house, as provided by Section 39, Article III, Texas Constitution. If the Act does not receive the necessary vote, the Act takes effect September 1, 2007.