

LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 84TH LEGISLATIVE REGULAR SESSION

May 11, 2015

TO: Honorable Jane Nelson, Chair, Senate Committee on Finance

FROM: Ursula Parks, Director, Legislative Budget Board

IN RE: HB32 by Bonnen, Dennis (Relating to the computation and rates of the franchise tax; decreasing tax rates; amending provisions subject to a criminal penalty.), **As Engrossed**

Estimated Two-year Net Impact to General Revenue Related Funds for HB32, As Engrossed: a negative impact of (\$160,000) through the biennium ending August 31, 2017.

Additionally, the bill will have a direct impact of a revenue loss to the Property Tax Relief Fund of (\$2,559,867,000) for the 2016-17 biennium. Any loss to the Property Tax Relief Fund must be made up with an equal amount of General Revenue to fund the Foundation School Program.

All Funds, Five-Year Impact:

Fiscal Year	Probable Revenue (Loss) from <i>Property Tax Relief Fund</i> 304	Probable Revenue (Loss) from <i>General Revenue Fund</i> 1	Probable (Cost) from <i>General Revenue Fund</i> 1
2016	(\$1,268,483,000)	\$0	(\$160,000)
2017	(\$1,291,384,000)	\$0	\$0
2018	(\$1,896,859,000)	(\$104,015,000)	\$0
2019	(\$1,922,661,000)	(\$115,460,000)	\$0
2020	(\$1,947,059,000)	(\$119,771,000)	\$0

The above table assumes that the franchise tax rates are further reduced in fiscal year 2018 because the *2018-19 Certification Revenue Estimate* projects that state tax revenues not dedicated by the Constitution exceeded the Article VIII limit on appropriations of state tax revenues not dedicated by the Constitution. The table below assumes no further franchise tax rate reductions.

Fiscal Year	Probable Revenue (Loss) from <i>Property Tax Relief Fund</i> 304	Probable (Cost) from <i>General Revenue Fund</i> 1
2016	(\$1,268,483,000)	(\$160,000)
2017	(\$1,291,384,000)	\$0
2018	(\$1,286,313,000)	\$0
2019	(\$1,310,256,000)	\$0
2020	(\$1,328,712,000)	\$0

Fiscal Analysis

The bill would amend Chapter 171 of the Tax Code, regarding the franchise tax, to permanently change tax rates applicable in determining franchise tax liability and the amount of total revenue at or below which a taxable entity may elect to use the EZ computation to determine tax liability. The bill would set a tax rate of 0.75 percent for taxable entities not primarily engaged in retail or wholesale trade; the rate under current law is 1.0 percent. The bill would set a rate of 0.375 percent for taxable entities primarily engaged in retail or wholesale trade; the rate under current law is 0.5 percent. The bill would set a tax rate of 0.331 percent for taxable entities electing the EZ computation; the rate under current law is 0.575 percent. The bill would provide that a taxable entity could elect the EZ computation if its total revenue were no more than \$20 million; under current law the amount is no more than \$10 million.

The bill would provide for adjustment of the tax rates for calculating franchise tax under certain circumstances. Beginning in 2018, on January 1st of each even-numbered year for which the Comptroller's most recent certification estimate projects state tax collections not dedicated by the constitution to exceed the limit on appropriations for the current biennium as provided by the constitution, the tax rates for calculating franchise tax liability would be reduced from the rates in effect on December 31st of the previous year. The amount of the rate reduction would be: 0.15 for the rate applicable to taxable entities not primarily engaged in retail or wholesale trade; 0.075 for taxable entities primarily engaged in retail and wholesale trade; and 0.0662 for taxable entities electing the EZ calculation. If the rates of the franchise tax are reduced to zero, a taxable entity would not owe any tax and would not be required to file a report that would otherwise be due. The Comptroller would make the determination regarding the rate reduction and may adopt rules related to the determination. The Comptroller would publish the rates determined in the Texas Register and on the Comptroller's website not later than January 15th of each year.

The bill would provide for lowering the tax rates used in determining franchise tax liability if the Comptroller makes a transfer of any unencumbered balance of positive general revenues from a preceding biennium to the Economic Stabilization Fund (ESF). The Comptroller would identify an amount of money equal to 25 percent of those unencumbered general revenues that are not transferred to the ESF. The Comptroller would estimate the amount of franchise revenue for the current biennium that would be received at current franchise tax rates. The Comptroller would subtract from that estimated amount the amount of money identified from the unencumbered general revenues. If the result were greater than zero, the Comptroller would determine rates for the franchise tax that if applied beginning January 1st of the current state biennium would generate the amount of revenue resulting from the subtraction. The Comptroller would reduce franchise tax rates proportionally and, not later than December 15th of each odd-numbered year, adopt the rates, publish the reduced rates in the Texas Register and provide any other notice the Comptroller considers appropriate. The rates would apply to reports due on or after January 1st of the year following the adoption of the adjusted rates.

The bill would provide that in the state fiscal year in which the subtraction results in an amount equal to zero or less, Chapter 171 of the Tax Code would expire. Not later than December 15th of that year the Comptroller would publish notice in the Texas Register that entities previously subject to the tax are no longer required to file a report or pay the tax. The bill would provide that action taken by the Comptroller would be final and could not be appealed. The Comptroller would adopt rules to implement this provision.

The bill would provide that the expiration of Chapter 171 of the Tax Code would not affect audits, deficiencies, redeterminations, and refunds of any tax due or collected until barred by limitations. The bill would provide that the expiration of Chapter 171 would not affect the status of an entity that has been subject to Comptroller action prior to the expiration or bar action against an entity for actions that took place before the chapter expired or the rights of an entity to contest actions.

The bill would provide that the Comptroller would study and report on the impact of the bill on the rate of the franchise tax and what further reductions in the rate may be made following a review of exemptions and credits from the franchise tax. The Comptroller would provide the report to the Legislature not later than December 31, 2016.

The bill would take effect January 1, 2016 and apply to reports due on or after that date.

Methodology

The estimated fiscal impact is based on the Comptroller's franchise tax return databases and the *2016-17 Biennial Revenue Estimate*. Estimates are shown for both the case of a 2018 rate reduction based on estimated revenue exceeding the spending limit and the case of no reduction in 2018.

In some circumstances, the bill would require the Comptroller to set franchise tax rates at an amount that would result in less revenue collected over the biennium than was appropriated. Reductions in franchise tax rates would be triggered any time the Comptroller determines, in an even-numbered year starting in 2018, that tax revenues not dedicated by the constitution exceed the limit on appropriations. Such rate reductions could result in revenue for the biennium insufficient to cover the appropriations for that biennium.

The administrative cost estimate reflects the funds that would be necessary to hire contract staff to conduct a study on the impact of the franchise tax rate reduction as well as to conduct a review of what further reductions in the rate of that tax may be made following a review of existing exemptions and credits from the franchise tax.

Local Government Impact

No fiscal implication to units of local government is anticipated.

Source Agencies: 304 Comptroller of Public Accounts

LBB Staff: UP, KK, SD