
Improving Texas' Competitiveness

Dale Craymer
President, Texas Taxpayers and Research Association
(512) 472-8838
dcraymer@ttara.org
www.ttara.org

Presented to the House Committees on Business and Industry and International Trade & Intergovernmental Affairs

April 26, 2016

Summary

Texas must not take growth for granted. With the downturn in oil and natural gas prices, Texas job growth is lagging the nation for the first time in 12 years. Now is the time Texas should be working to use its economic development programs most effectively.

Texas has a number of attractive features to attract new investment, but our state and local tax system is NOT one of them. Texas is not a low tax state for business. Absent a personal income tax, Texas relies much more heavily on property and sales taxes—taxes than fall heavily on business.

Texas has among the highest property tax rates across the states—the single largest impediment to investing here. Texas also taxes business personal property, which is exempt in several states, and inventories, which are exempt in almost all states.

All states have some type of incentive programs to help them compete for new investment—be it tax reductions or grant programs. For Texas, with our relatively high taxes on business, it would be difficult to compete with other states without incentives—particularly those seeking to mitigate our high-rate, broad base property taxes.

Given Texas' high property taxes, the single most important incentive program is Chapter 313 of the Tax Code, which allows school districts, the single largest levier of property taxes in the state, to offer a temporary limitation on the taxable value of new investments.

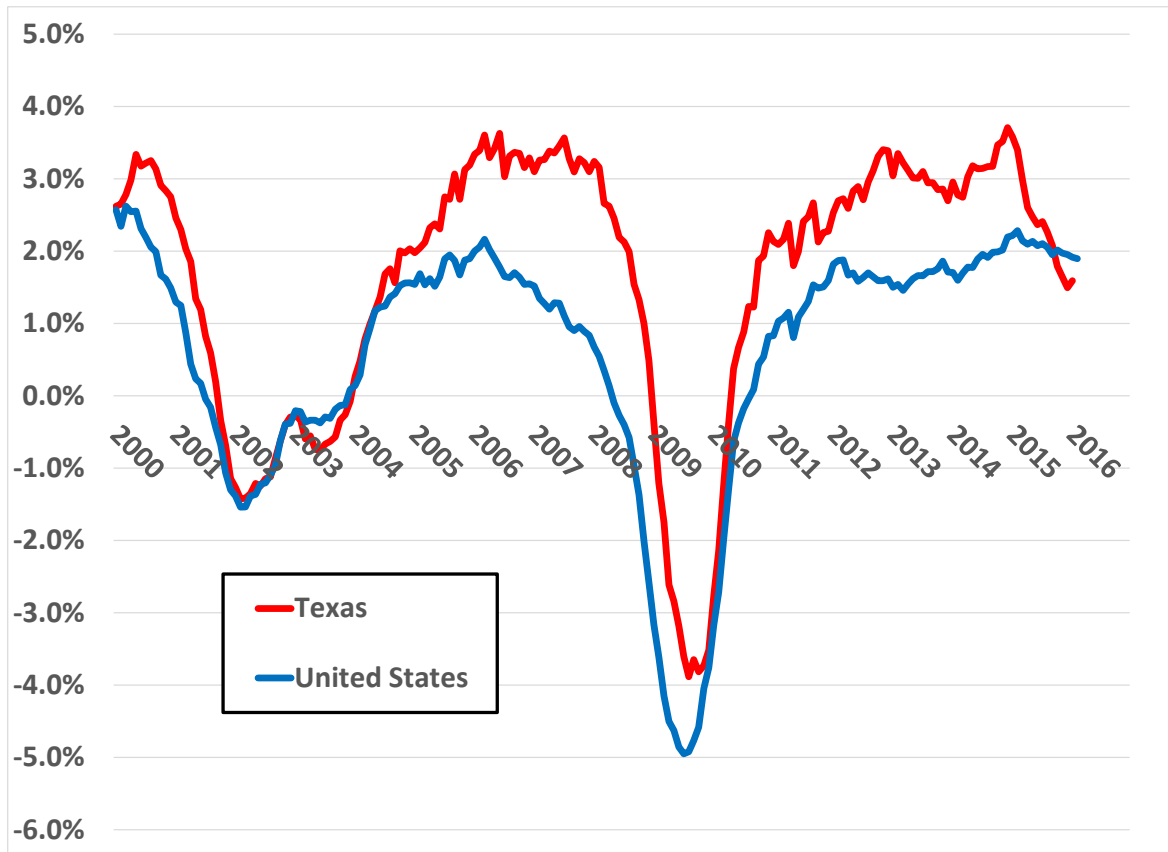
Chapter 313, while the most transparent incentive program (all materials associated with a 313 agreement and subsequent reporting documents are posted on-line), is the subject of controversy. Among the common misperceptions of the program are:

- it costs the state money (when in fact, it attracts projects that would not have come to Texas otherwise, turning empty fields into taxpaying industrial projects), and
- school districts somehow receive some benefit from the state in offering a 313 limitation (when in fact, the state reduces aid to a school district because of its increased taxable value.

Texas, as many states, incorrectly assesses the cost/benefit of its incentive programs. It defines “cost” as the amount of the tax benefit to the taxpayer, even though many new investments pay far more in taxes than they demand in public services.

Texas' incentive programs are spread across several different state agencies and across local governments. Unlike many other states, Texas does not centrally coordinate incentive programs. Texas' incentive programs also tend to be very complex. Projects often incur additional costs in Texas to hire consultants to help them work through the state's incentive maze.

Texas Job Growth Lagging the US



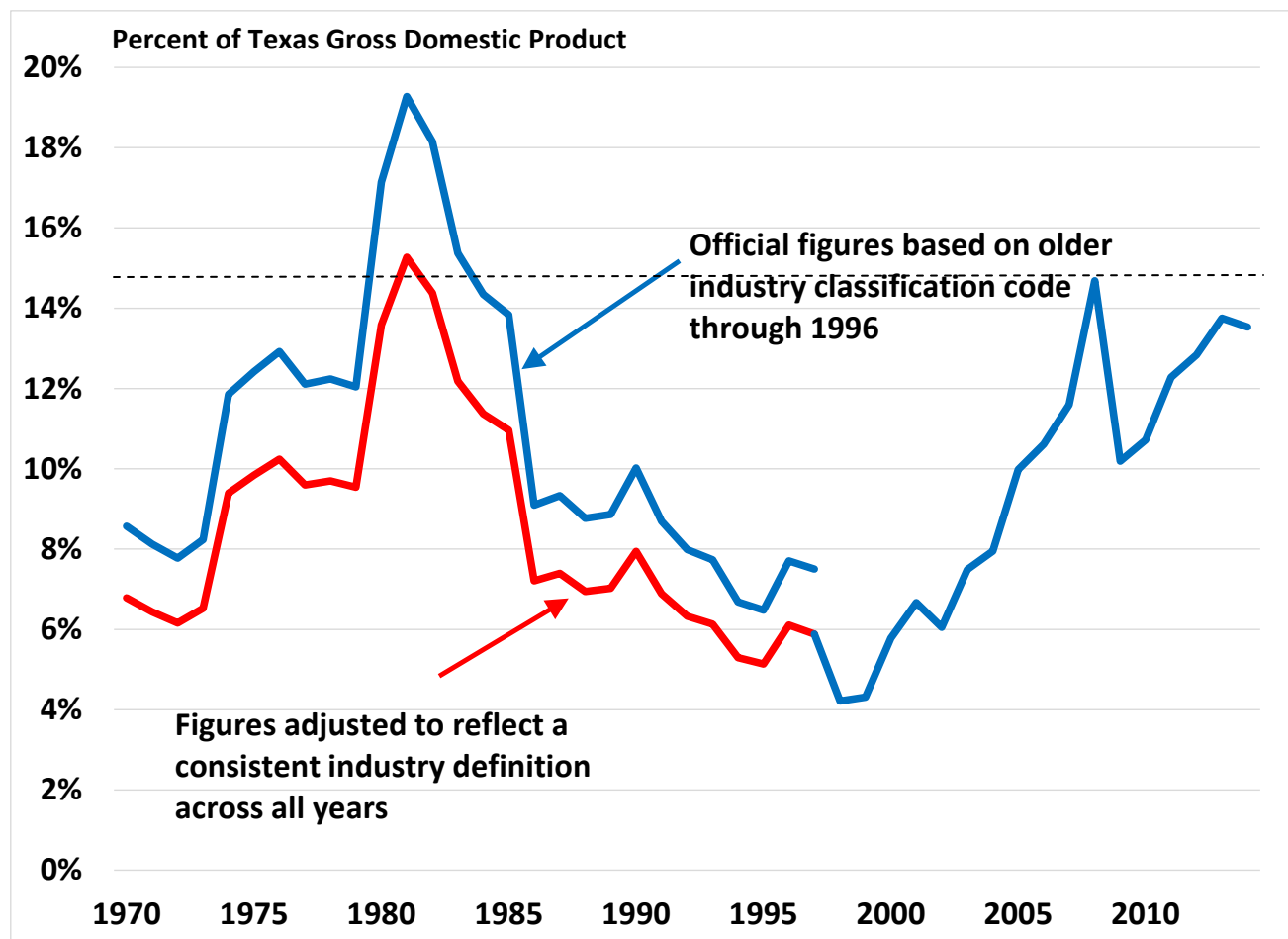
For the first time in 12 years, Texas' job growth is lagging the nation as a whole, a trend likely to continue through much of 2016.

The Dallas Federal Reserve most recently predicts Texas employment will increase by 0.7 percent in 2016—approximately 88,000 net new jobs—the lowest rate of growth since the Great Recession.

The drop in oil and natural gas prices has led to a loss of 65,000 oil and gas jobs. Given that each of these jobs is supported by up to 3 other jobs in the economy, the overall job losses to the entire economy tally near 250,000.

Texas should still add jobs in 2016, but the rate of growth will be more anemic than what the state is used to. Dallas, Austin, and the Gulf Coast will be the state's most vibrant areas. Houston, the Permian Basin, and the Eagle Ford area of South Texas will be the weakest.

Oil and Gas in the Texas Economy



The Texas economy is still heavily reliant on oil and gas, though the “official” numbers from the Bureau of Economic Analysis might, on the surface, seem to suggest otherwise. According to the BEA, oil and gas extraction accounted for almost 20 percent of Texas’ economic output in the early 1980s, and just under 14 percent in 2014. However, in 1996, the BEA adopted a new industry classification system, and shifted roughly 20 percent of what traditional was considered “oil and gas” into other industries. Adjusting for the change in definition reveals that Texas in recent years was almost as dependent on oil and gas as it was in the early 1980s.

What a \$1 Drop in the Price of Oil Does to Texas

Economic Impacts		
Value of Oil	\$1.26 billion	Based on current annualized production levels
Value of Gas	0.20 billion	Based on current annualized production levels
Rig Loss	8 rigs	Based on statistical regression analysis
Well Loss	176	Assumes 22 wells per rig on an annual basis
Investment Loss	\$1.1 billion	Based on an average of \$6.3 million cost per well
Oil & Gas Industry Jobs	1,000	Based on statistical regression analysis
Total Jobs	3,800	Based on BEA's 3.8 jobs multiplier
Direct Tax Loss		
Sales Tax	\$16.0 million	Based on \$2 million in taxable sales per rig/year
Oil Severance Tax	\$46.4 million	Based on current annualized production levels
Gas Severance Tax	\$9.4 million	Based on current annualized production levels
Franchise & Other	<u>\$5.0</u> million	
Total	\$76.9 million	
General Revenue Loss	\$35.0 million	Excludes transfers to ESF & Highways
RDF & Highways Loss	\$41.9 million	Based on current Constitutional dedications

A change in the price of oil can have a dramatic impact on the Texas economy. A one dollar drop in the price of oil results in a \$1.26 billion decline in gross industry revenue. Much of this income is literally drilled back into the Texas economy as it supports the capital investment budgets of oil and gas companies. A \$1 drop in the price of oil can result in reduced company funds for drilling, reducing the number of operating rigs and wells drilled, and the number of industry jobs.

Each oil and gas job supports 2.8 other jobs in the economy—from those manufacturing support jobs such as drilling pipe and chemicals, to those working in local communities where the workers live.

Oil and gas prices also have substantial impacts on the Texas Treasury. Oil and gas prices directly and immediately impact state severance tax revenues, though most of this revenue is dedicated for the Economic Stabilization Fund and the State Highway Fund, and the actual impact on general revenues is much less. The oil and gas industry does pay sales tax on much of its drilling equipment and supplies, however. Overall, the state treasury loses roughly \$77 million for each dollar drop in the price of oil, but only \$35 million of that impacts the general revenue fund.

The Good and Not-So-Good About Texas

Good

- A Right-to-Work State (i.e. one may not be compelled to join a labor union as a condition of employment)
- Available land at generally reasonable cost
- A growing state with a generally ample supply of labor
- Reasonable regulatory and judicial environment
- Lack of a personal income tax
- Stable and affordable energy resources
- Centrally located to both coasts

Not-so-good

- Long term water availability is a limiting factor
- Transportation networks are strained
- While labor is in good supply, certain categories of skilled workers may be more limited
- State and local taxes, particularly property and sales taxes, are higher than average and are particularly burdensome for capital intensive industries

Tax Incidence

There are two basic types of taxpayers:

1. *Businesses*, and
2. *Individuals*.

In Texas, *individuals* incur direct taxes on many of their purchases and their real estate, but unlike most states, not on their income.

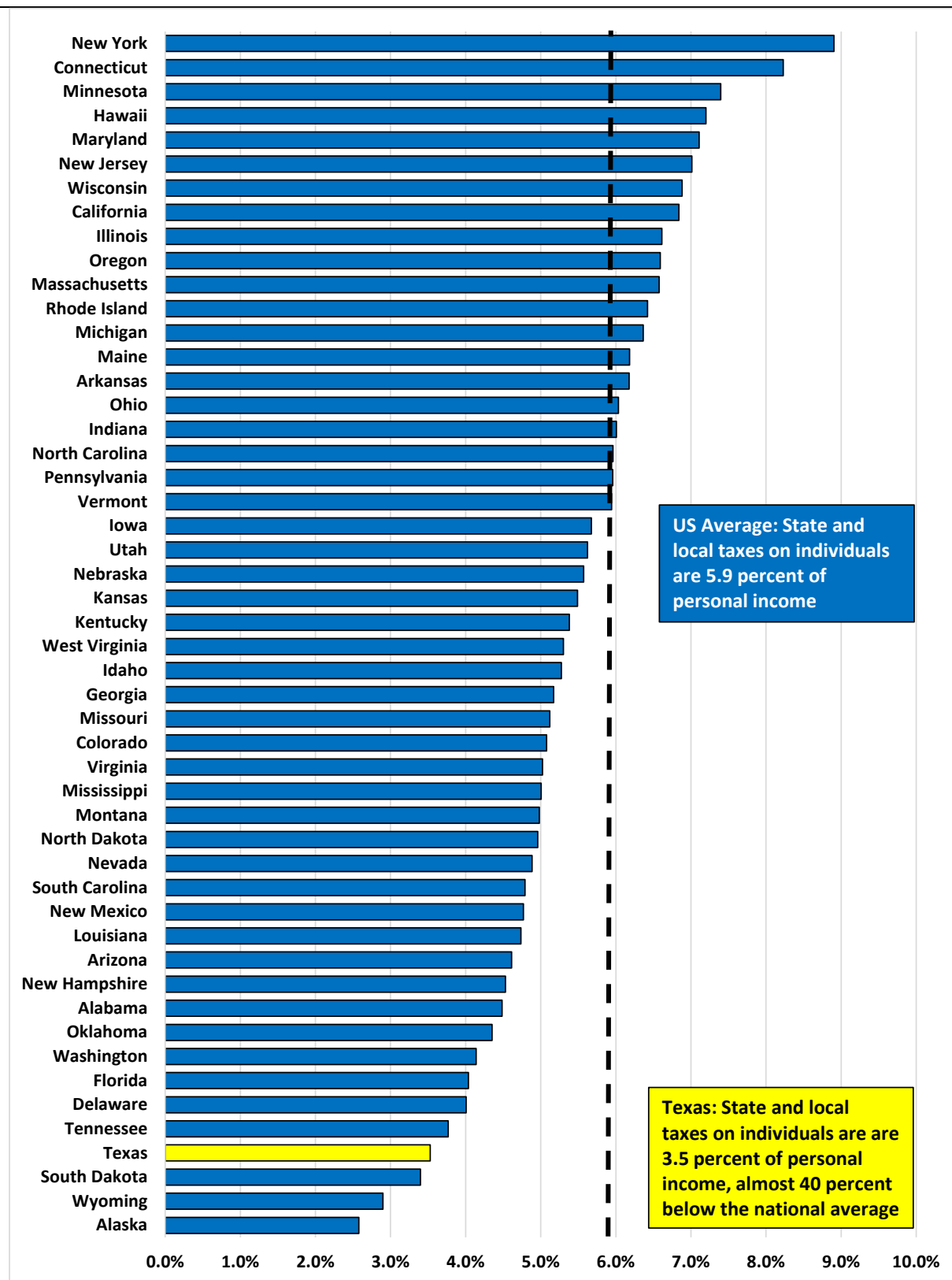
Businesses may incur taxes on their purchases (e.g. sales tax, fuels taxes), their real estate and personal assets (e.g. property tax), and be subject to special industry taxes on gross receipts (e.g. utilities, insurance). Businesses respond to taxes in one of three ways:

1. Pass the cost of the tax forward to individuals in the form of higher prices,
2. Pass the tax backward to owners in the form of lower profits, and/or
3. Pass the tax backward to individuals by reducing expenses, such as payroll or relocating or shifting investment to a lower cost location.

Note about the initial incidence assignments in this analysis...

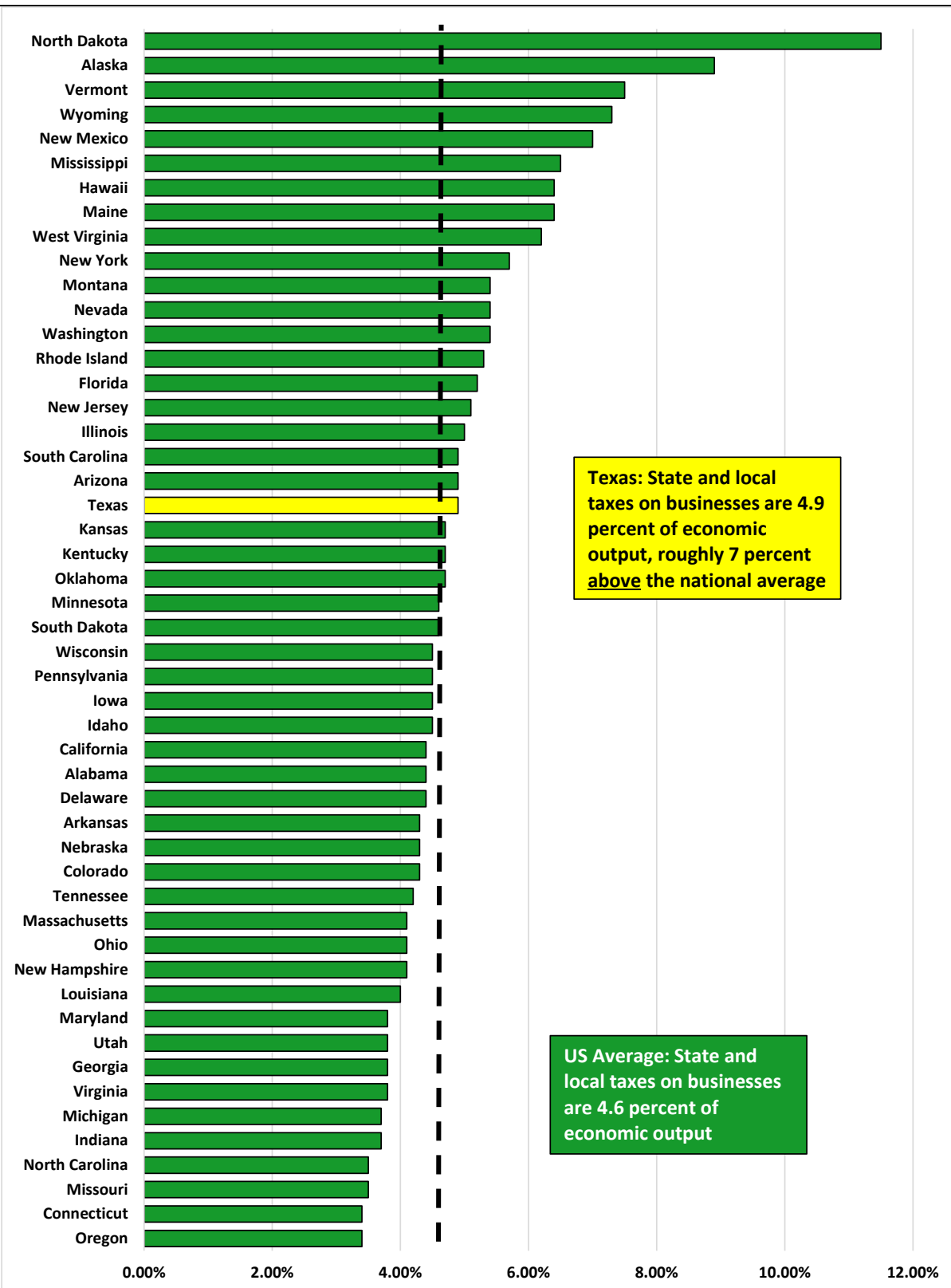
- Sales and motor vehicle sales taxes: tax due is on the sale of a taxable item and is paid by the *purchaser*. For example, while a retailer collects the tax and remits it to the state, the tax is paid by the purchaser.
- Property tax is paid by the *owner* of the property, whether an individual or a business.
- Though assessed on the refiner, motor fuels taxes are assigned to the consumer, since state law requires the tax be passed on to the consumer.
- Franchise tax is paid by the business entity.
- Severance taxes and industry gross receipts taxes are paid by the business.
- Excise taxes on consumer products (tobacco and alcohol) are predominately paid by the consumer.

Individual Tax Burden Relative to Personal Income



Source: Derived from Council on State Taxation: Total State and Local Business Taxes, 2014.

Business Taxes Relative to Economic Output

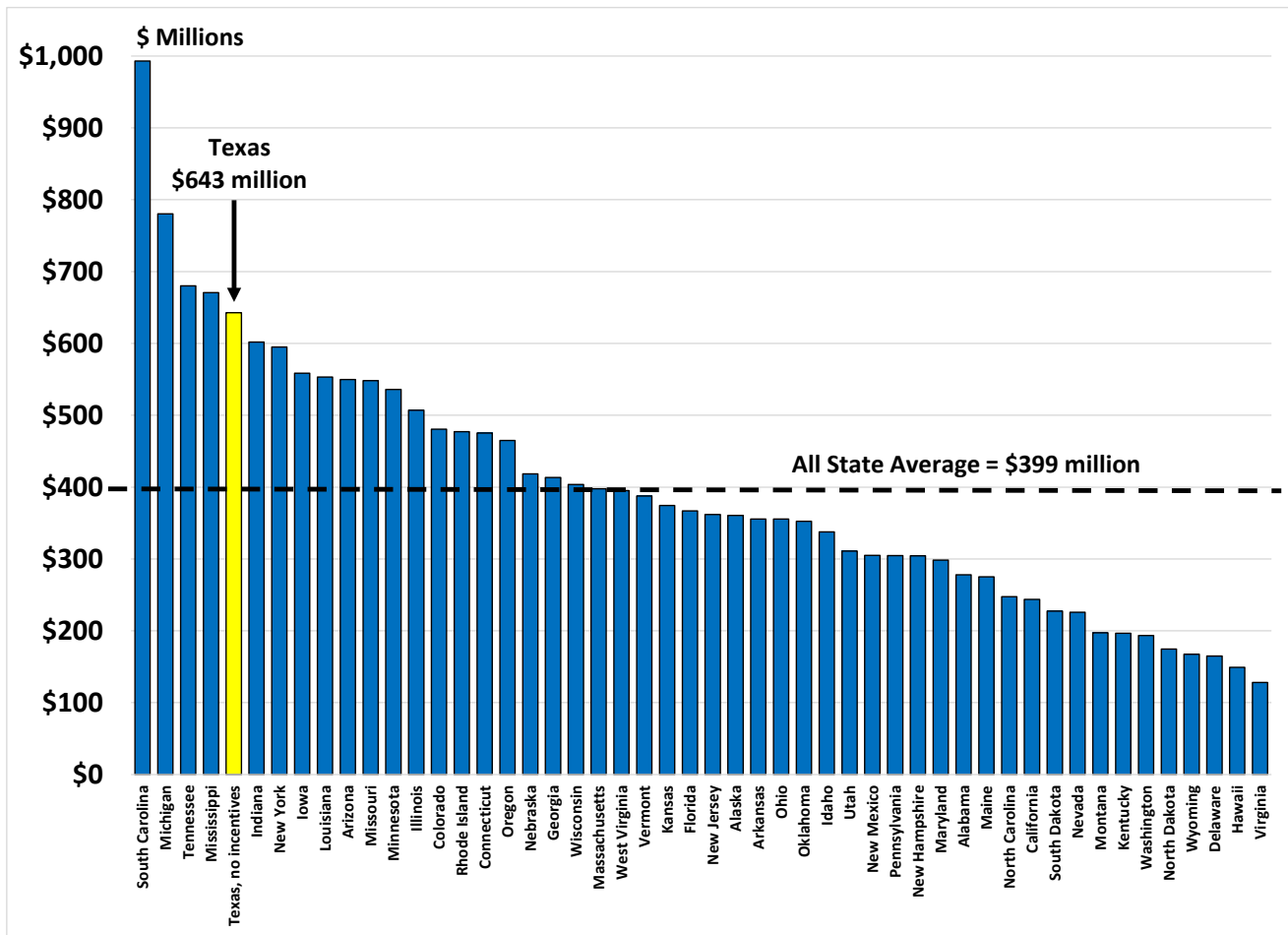


Source: Council on State Taxation: Total State and Local Business Taxes, 2014.

Texas' Key Taxes Compared to Other States

Tax	Current Rate and Base	Comparison
Sales Tax Rate	State Tax Rate: 6.25% Local Taxes: Generally capped at 2.0 %; average is 1.9% Average Combined Rate: 8.17%	State Rate: 13th highest Combined Rate: 12th highest
Sales Tax Base	Generally applies to all sales of tangible personal property excluding food, medicine and residential or industrial utilities; and a number of services	Texas' base is generally broader than that of other states because we tend to tax more services than other states (only 7 states tax more services)
Property Tax Rate	<u>Residential property</u>: average effective tax rate in 2014 was 1.85 percent of market value <u>Industrial property</u>: average effective tax rate in 2014 was just under 2.6% of market value	<u>Residential property</u>: Texas' effective tax rates rank us 15th highest nationally, 25 percent above the national average <u>Industrial property</u>: Texas' effective tax rates rank us 5th highest nationally, or 61 percent above the national average
Property Tax Base	Texas taxes all real estate plus any tangible personal property used for business purposes (equipment and inventory); goods in interstate commerce are exempted at local option (i.e. Freeport property)	Texas' base is generally broader than that of other states: 11 states exempt all business tangible personal property; inventories are generally exempt in all but 7 states.
Business Franchise Tax	Texas' franchise tax is unlike the net business income tax levied by most other states; Texas' effective tax rate relative to economic output was 0.33% in 2015.	Relative to economic output, Texas' franchise tax ranks 25 th highest among the states, about 14 percent below the national average; 2016 rates will drop Texas to 39 th place, about one third below the national average.

Comparative Property Taxes on a \$1 Billion Industrial Plant



The above chart illustrates the total property taxes on an industrial facility valued at \$1 billion million over its 25 year lifespan across the various states. Texas' property tax costs are shown both with and without property tax abatements and Chapter 313 limitations. *Based on 50 State Property Tax Comparison Study by the Minnesota Center for Fiscal Excellence and the Lincoln Land Institute.*

The average state and local property taxes paid over the life of the facility nationwide is roughly \$400 million. In Texas, the facility, if it received no city/county property tax abatements or Chapter 313 school tax limitations, would pay over \$640 million in property taxes—60 percent higher than the national average.

If the facility received a ten year city/county property tax abatement and a ten year 313 value limitation of \$40 million, the project's lifetime property tax bill would be over \$400 million—roughly equal to the average of other states, excluding any incentives those states might offer.

Selected Texas Economic Development Programs

Office of the Governor & Texas Economic Development Bank

- Texas Enterprise Fund (Government Code, Chapter 481.078)
- Texas Enterprise Project Designation
- Governor's University Research Initiative
- Defense Economic Adjustment Assistance Grants (Government Code 2310.403)
- Texas Moving Image Industry Incentive Program (Government Code, Chapter 485)
- Events Trust Fund (V.A.C.S., Article 5190.14)
- Major Events Reimbursement Program (V.A.C.S., Article 5190.14)

Office of the Comptroller

- **School Tax Limitations (Tax Code, Chapter 313)**
- **Enterprise Zone Sales Tax Refunds**

Texas Workforce Commission

- **Skills Development Fund (Labor Code Chapter 303)**
- Skills for Small Business Program (Labor Code Chapter 303)

Texas Department of Agriculture

- Rural Economic Development and Incentive Program (Agriculture Code (12.0271)
- Texas Rural Investment Fund Program (Agriculture Code 12.046)
- Texas Agricultural Finance Authority (Agriculture Code, Chapter 58)
- Agricultural Loan Guarantee Program (Agriculture Code, Chapter 58)
- Texas Capital Fund (Government Code 487.351)

Local Governments

- County Assistance Districts (Tax Code, Chapter 387)
- City Economic Development Sales Tax (Local Government Code, Chapters 501-505)
- City or County Enterprise Zones (Government Code Chapter 2303)
- City and County Property Tax Abatements (Tax Code, Chapter 312)
- School Property Tax Limitation (Tax Code, Chapter 313)
- City and County Tax Increment Financing (Tax Code, Chapter 311)

Chapter 313 Forms

Application Forms	Pages
• Form 50-296A Application for Appraised Value Limitation on Qualified Property To be filled out by an applicant seeking an appraised value limitation and submitted to the school district. The school district submits a completed application to the Comptroller for review and approval.	9
• Form 50-300 Application for Tax Credit on Qualified Property (PDF) To be filled out by an agreement holder after paying property tax for the last complete tax year of the qualifying time period and submitted to school district.	4
Agreement Forms	
• Form 50-286 Texas Economic Development Act Agreement (PDF) To be used by the applicant and school district as a template for a value limitation agreement. The school district submits a draft agreement to the Comptroller for review and approval. <i>Only applies to agreements resulting from applications determined to be complete after Jan. 1, 2014.</i>	29
Reporting Forms	
• Form 50-772A Annual Eligibility Report (PDF) To be filled out by agreement holders and submitted by an authorized representative of each company to the school district by May 15th of every year using information from the previous tax (calendar) year. School districts should review the submitted forms, retain the original and submit PDF scans of the completed and signed forms and any attachments to the Comptroller's office by June 15th of every year.	4
• Form 50-773A Biennial Progress Report (PDF) To be filled out by agreement holders and submitted by an authorized representative of each company to the school district by May 15th of each even-numbered year. The Comptroller's office requests that companies complete the spreadsheet version of this form, submitting both an unsigned electronic version and a signed hard copy version—with any attachments—to the school district. School districts should forward to the Comptroller's office by June 15th of each even-numbered year.	7
• Form 50-287 Biennial School District Cost Data Request (PDF) School districts are also requested to submit the Biennial School District Cost Data Request Form to the Comptroller's office by July 15th of each even-numbered year, indicating—for each project—actual and estimated property values, tax rates, payments in lieu of taxes, extraordinary educational expenses, and revenue protection payments.	1
• Form 50-825 Job Creation Compliance Report (PDF) To be filled out by agreement holders and submitted by an authorized representative of each company directly to the Comptroller's office annually. <i>Only applies to agreements resulting from applications determined to be complete after Jan. 1, 2014.</i>	4

Texas Enterprise Fund Forms

Nominating Forms	
• Nominating Ordinance or Order or Resolution City must make take formal action to nominate a project as an "enterprise project," and provide documentation to the Office of the Govenor, Economic Development Bank. .	5
• Corporate Resolution Board of Directors must adopt a resolution approving the Enterprise Project Application to be submitted to the Office of the Governor, Economic Development Bank.	1
Application Forms	
• Texas Enterprise Project Application To be filled out by applicant and submitted to the Office of the Governor, Economic Development Bank with application fee ranging from \$750 to \$2,250. Application MUST be filed in a three-ring binder with supporting materials.	31
• Form JCF-01 Application for Program Benefits To be filled out by a designated enterprise project to receive certification that the applicant has met the criteria making it eligible for file for benefits. The application is to be filed with the Office of the Governor, Enterprise Zone Program and must be accompanied with a non-refundable check for \$500. Required back-up documents include: - o Verification of Zone Resident Status - o Verification of Economically Disadvantaged status - o Qualified Business Recertification forms - o Documentation of "Contribution to Community" - o Copy of Power of Attorney (if required) - o Spreadsheet of qualified jobs	5
Benefits Forms	
• Enterprise or Defense Readjustment Project Claim for Refund of State Sales and Use Tax To be filled out by enterprise project and filed with the Comptroller's Office. Sales tax refund is \$2,000 per job for enterprise projects. Refund only applies to state sales taxes.	1

Texas Skills Development Fund Forms

Application Forms	
• Proposal Submission Form Application is made to the Texas Workforce Commission per requirements set in the Texas Labor Code, Chapter 36.	6
• Private Partner Information Form A separate form must be completed for each private partner participating in the proposed project. Information must include title of each occupation, standard occupational classification, hourly wage range, and the number of new workers receiving training.	5
• Curricula and Budget Management Forms. The applicant must report all training courses by category, training hours, and administrative and direct program costs for the propose project. Separate forms include: - o Business Technical Training Curricula and Direct Training Cost Detail: Program Services - o General Technical Training Curricula and Direct Training Cost Detail: Program Services - o Non Technical Training Curricula and Direct Training Cost Detail: Program Services - o Training Curricula and Direct Training Cost Detail Summary - o Equipment Purchases - o Curricula & Budget Management Form	14
• Local Workforce Development Board Review and Comment Form This form must be completed and signed by the Local Workforce Development Board in the workforce area where project participants will be employed at the completion of the training project.	1
• Signed Agreement Between the Applicant and Private Partner This agreement must outline each entity's roles and responsibilities if a grant is awarded and must be included as an appendix to the Proposal Submission Form	1

How a 313 Agreement Works: The Taxpayer

The Texas Economic Development Act, is commonly referred to as “Chapter 313,” named for the chapter in the Tax Code in which it resides. The programs allows a school district to grant a temporary (up to 10 years) limitation on the taxable value of a new investment project. Existing property is not eligible for a limitation—only new property that does not exist at the time of the application.

A project must file an extensive application to the local school district for the limitation on forms promulgated by the Comptroller. The project must meet certain investment and job thresholds. If the school district decides to act on the application it must first forward the application to the Comptroller. If the Comptroller determines that the project:

- Qualifies as an investment eligible for the limitation under the law, and will
- Generate a greater amount in taxes than the amount of benefits it will receive, and
- That the limitation is a determining factor in the decision to invest capital, then

the Comptroller may issue a certificate of those findings the school district, which may then act on the application. If approved, the school district and the project must enter into a formal agreement stipulating the terms of the limitation. The Comptroller requires a standard agreement form be used.

If the school district approves the application, it may offer the project a temporary limitation on the amount of property value that will be subject to the district’s maintenance and operations taxes for a period not to exceed ten years. A district may NOT fully abate a project’s value—some portion of value must be added to the tax rolls, even during the limitation period. This results in higher property tax collections for the district, and a corresponding reduction in the district’s state aid.

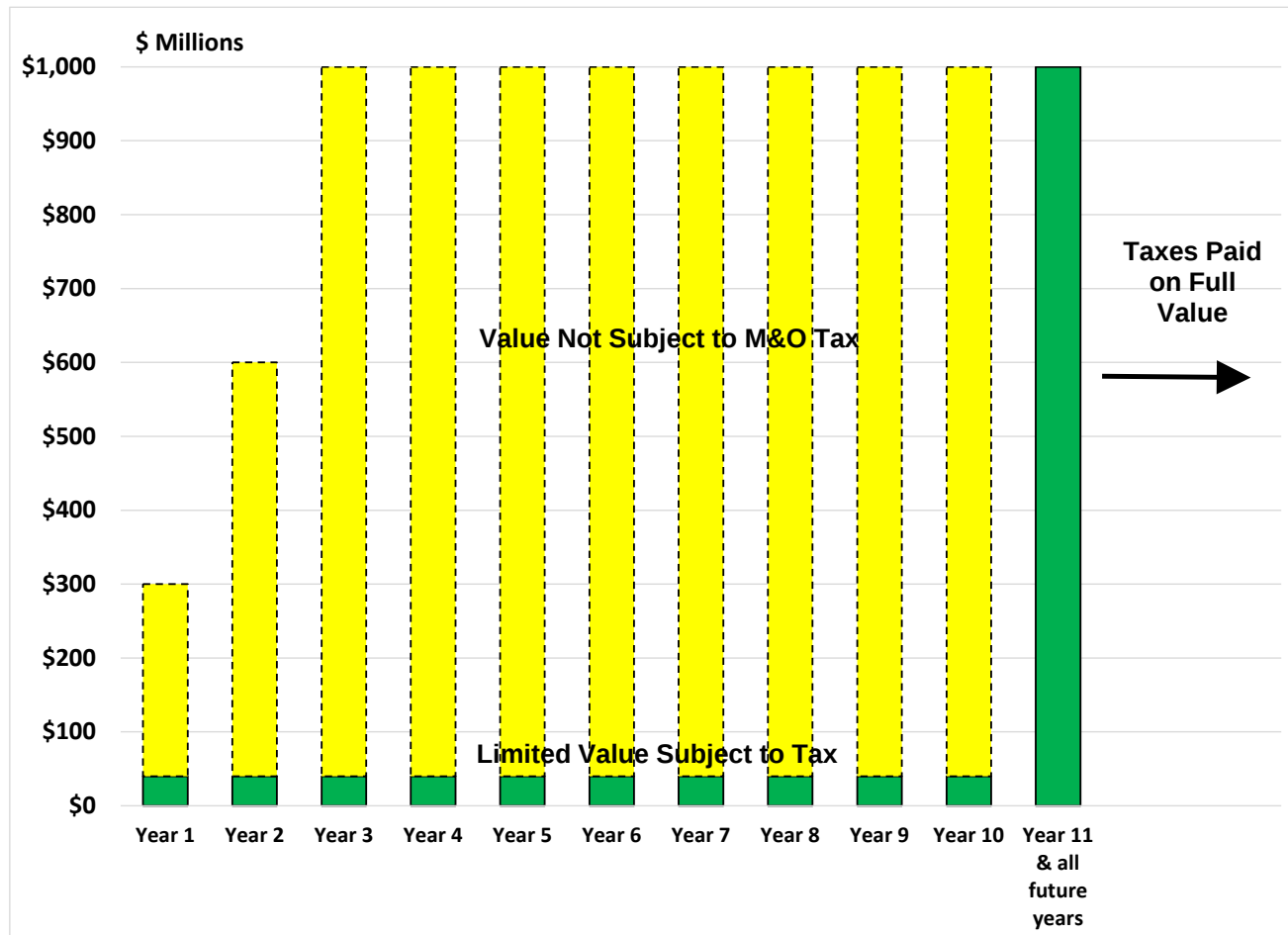
School districts typically demand the project share a portion of its tax savings, typically requiring up to 40 percent of the tax be paid to the district. These “supplemental payments” are NOT including in school funding formulas and are “free and clear” to the district.

In addition to the application and the agreement, projects and school districts must file numerous progress reports on either an annual or biennial basis.

Critics of the program often erroneously equate the amount of the temporary reduction as being a state “cost.” In fact, a project must demonstrate that absent the incentive, they will not make the investment. Consequently, there is no real cost to the state; in fact, the program makes money by attracting new investment that would not otherwise, turning empty fields into taxpaying industrial facilities.

Further, there is a misperception that somehow the state pays districts for awarding a limitation. In fact, districts granting a limitation see a reduction in state aid as a result of the additional taxable value being added to their tax base.

How a 313 Agreement Works: The Taxpayer



The above example demonstrates how a Chapter 313 limitation works on a \$1 billion project with a \$40 million, 10 year limitation granted by the school district.

In this example, the project receives a temporary ten year limitation on the amount of taxable value in the amount of \$40 million. The limitation applies only to new property put in place; existing taxable property may not be removed from the tax rolls.

During the first two years, the project is under construction, and while it has not reached its operational value of \$1 billion, the value of “construction in place” is still limited to \$40 million, as it is through year ten of the project (as shown by the green portion of the bar). The limitation remains in effect once the project becomes operational, temporarily exempting \$960 million in value from the tax rolls (shown in yellow).

After ten years, the limitation expires (it may not be renewed), and the project is fully taxable.

How a 313 Agreement Works: The School District and State Aid Formulas for Maintenance and Operations

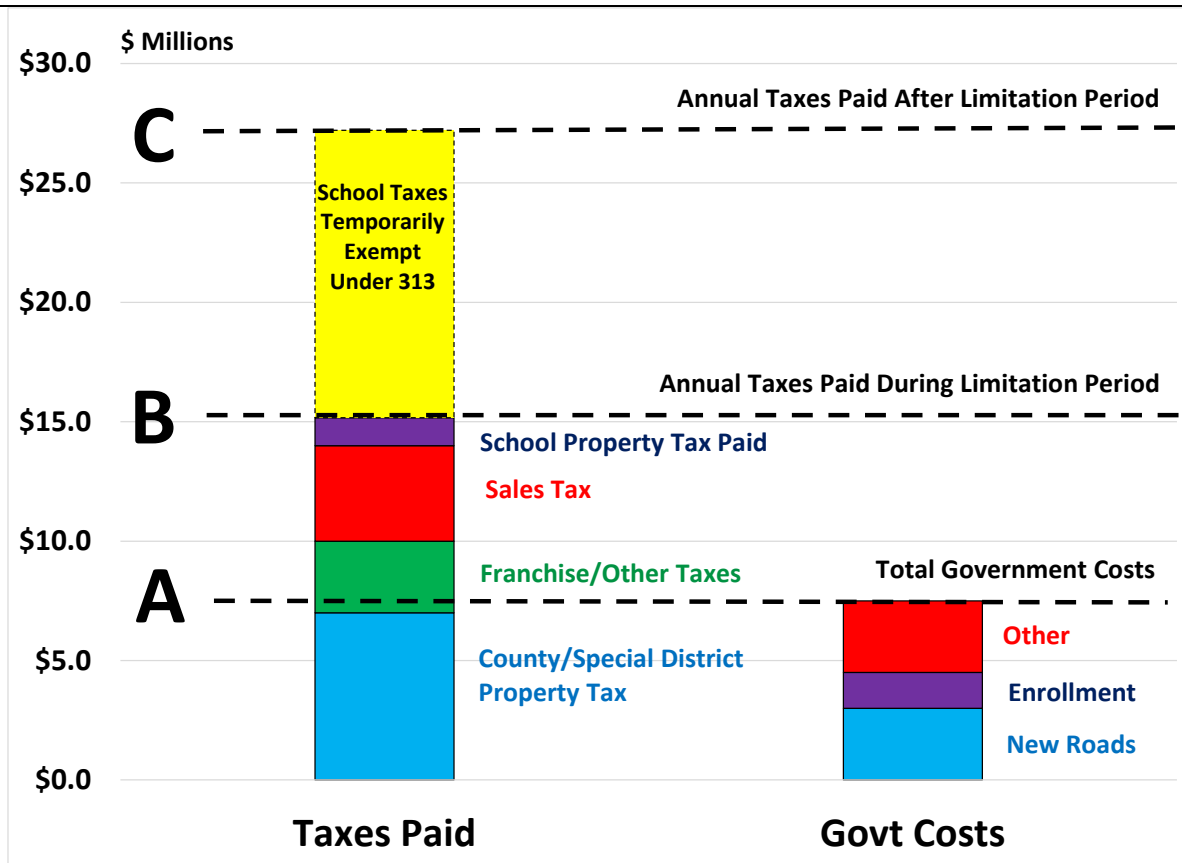
Year	Baseline Without Project (\$ millions)			With Project (\$ millions)			Difference (\$ millions)		
	Entitlement	Local Share	State Share	Entitlement	Local Share	State Share	School Taxes	State Aid	Net
1	\$128.5	\$50.0	\$78.5	\$128.5	\$50.4	\$78.1	\$0.4	(\$0.4)	\$0.0
2	\$128.5	\$50.0	\$78.5	\$128.5	\$50.4	\$78.1	\$0.4	(\$0.4)	\$0.0
3	\$128.5	\$50.0	\$78.5	\$128.5	\$50.4	\$78.1	\$0.4	(\$0.4)	\$0.0
4	\$128.5	\$50.0	\$78.5	\$128.5	\$50.4	\$78.1	\$0.4	(\$0.4)	\$0.0
5	\$128.5	\$50.0	\$78.5	\$128.5	\$50.4	\$78.1	\$0.4	(\$0.4)	\$0.0
6	\$128.5	\$50.0	\$78.5	\$128.5	\$50.4	\$78.1	\$0.4	(\$0.4)	\$0.0
7	\$128.5	\$50.0	\$78.5	\$128.5	\$50.4	\$78.1	\$0.4	(\$0.4)	\$0.0
8	\$128.5	\$50.0	\$78.5	\$128.5	\$50.4	\$78.1	\$0.4	(\$0.4)	\$0.0
9	\$128.5	\$50.0	\$78.5	\$128.5	\$50.4	\$78.1	\$0.4	(\$0.4)	\$0.0
10	\$128.5	\$50.0	\$78.5	\$128.5	\$50.4	\$78.1	\$0.4	(\$0.4)	\$0.0
Year 11 & after	\$128.5	\$50.0	\$78.5	\$128.5	\$60.0	\$68.5	\$10.0	(\$10.0)	\$0.0

This is a greatly simplified illustration for a school district with taxable value of \$5 billion and 25,000 weighted students, offering a ten year, \$40 million limitation to a \$1 billion project. For simplification, no underlying annual change in values or enrollment is assumed.

The above example illustrates the finances of a school district both with and without the 313 project. The baseline illustrates the district's finances without the project. With the project and the temporary limitation in place, the district's taxable value increases by \$40 million, which yields additional property tax revenue of \$400,000. The district's state aid is reduced by this amount. Once the limitation expires, the district gains an additional \$10 million in tax revenue, and state aid is reduced by this amount.

Under current Texas school finance formulas, the district does not gain additional net maintenance and operations revenue. The 313 limitation does not apply to debt service taxes, so the district would be able to reduce its debt service tax rate by 20 percent.

Evaluating the “Cost” of Incentives All Wrong



Texas evaluates the “cost” of incentives all wrong. Current state analysis equates the “cost” of a project as the amount of tax benefits a project receives (the amount between lines B and C in the above chart).

This completely ignores the amount of new taxes a billion dollar project brings to the state. In the above example, a project comes to Texas, and is granted a \$40 million school tax value limitation, that for the first ten years of the project will save them \$12 million annually in school taxes (the yellow portion under “Taxes Paid”). The project, however, will still pay some school property taxes (shown in purple, because Chapter 313 requires a portion of the project’s value must be subject to tax). The project will also pay city/county property taxes, as well as sales taxes, franchise taxes, bringing their annual tax bill during the limitation period to \$15.2 million.

The state and local governments make a “profit” from the project, while they must build some new roads and classrooms to handle the new population, as well as hire additional some new teachers to handle the increase in enrollment, their costs total \$7.5 million annually, well below the \$15.2 million in taxes the project pays (the difference between C and B, above). Further, when the limitation expires, the project will pay \$27.2 million in taxes, far above the direct costs incurred by the state and local communities to support the project.

Recommendations

1. **Simplify.** Texas should **simplify** the application and reporting process, focusing on *quality* of information, not *quantify* of information.
2. **Consolidate.** Texas should **consolidate** application and reporting requirements, providing a single point of contact to process applications and assist applicants through the process.
3. **Evaluate.** Texas should establish a standardized matrix of factors to be used to objectively **evaluate** a project that seeks incentives, focusing on the potential value and returns to the state. That matrix should include:
 - o economic benefits,
 - o fiscal benefits, and
 - o intangible benefits.

The evaluation should also recognize potential costs of a project—not the value of the incentives, but the potential cost associated with any project-related demands for additional public services

A Rational Matrix for Evaluating Incentives and Projects

Projects seeking incentives should provide some type of benefit to the state, be it:

- economic,
- fiscal, or
- intangible.

In evaluating those incentives, the state should look not just to the **operational** period of the project, but also the impact of **construction**. Further, the state should consider the **ancillary** (indirect and induced) economic impacts of the project. In evaluating the “cost” of a project, the state should look at the cost of providing public services to the project and the population it attracts.

Factors for Evaluation	Benefits		Costs	
	Direct Project	Ancillary Activity	Direct Project	Ancillary Activity
1. Economic Factors				
Investment				
Business Activity (Output)				
Jobs				
Wages and Income				
2. Fiscal Factors				
Tax and Other Revenues				
Public Service Costs				
Grants and Financing				
3. Intangible Factors				
Prestige				
Publicity				
Lifestyle Considerations				
Diversification/ Infrastructure/ Other Issues				