LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 86TH LEGISLATIVE REGULAR SESSION

April 13, 2019

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

FROM: John McGeady, Assistant Director   Sarah Keyton, Assistant Director
Legislative Budget Board

IN RE: **SB1143** by Hughes (Relating to the appraisal for ad valorem tax purposes of tangible personal property held for sale at retail and a franchise tax credit based on the ad valorem taxes paid on such property.), **As Introduced**

Estimated Two-year Net Impact to General Revenue Related Funds for SB1143, As Introduced: a negative impact of ($149,518,000) through the biennium ending August 31, 2021.

Additionally, there would be a negative impact of ($510,999,000) through the biennium ending August 31, 2023.

The bill would make no appropriation but could provide the legal basis for an appropriation of funds to implement the provisions of the bill.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2020	($388,000)
2021	($149,130,000)
2022	($243,750,000)
2023	($267,249,000)
2024	($290,360,000)

All Funds, Five-Year Impact:

Fiscal Year	Probable Savings/(Cost) from *General Revenue Fund* 1	Probable Savings/(Cost) from *Foundation School Fund* 193	Probable Revenue Gain/(Loss) from *Property Tax Relief Fund* 304	Probable Revenue Gain/(Loss) from *School Districts*
2020	($388,000)	$0	$0	$0
2021	($151,035,000)	$1,905,000	($150,647,000)	($93,589,000)
2022	($166,676,000)	($77,074,000)	($166,288,000)	($24,517,000)
2023	($182,278,000)	($84,971,000)	($181,890,000)	($26,573,000)
2024	($197,525,000)	($92,835,000)	($197,137,000)	($28,514,000)

Fiscal Year	Probable Revenue Gain/(Loss) from *Counties*	Probable Revenue Gain/(Loss) from *Cities*	Probable Revenue Gain/(Loss) from *Other Special Districts*	Change in Number of State Employees from FY 2019
2020	$0	$0	$0	6.0
2021	($25,377,000)	($26,589,000)	($19,073,000)	6.0
2022	($27,827,000)	($29,069,000)	($21,137,000)	6.0
2023	($30,236,000)	($31,492,000)	($23,212,000)	6.0
2024	($32,552,000)	($33,803,000)	($25,257,000)	6.0

Fiscal Analysis

The bill would amend Section 23 of the Tax Code, regarding appraisal methods and procedures, to require a chief appraiser to determine the market value of a retailer's retail inventory to be the average of:
1) the market value of the retail inventory as determined under current law; and
2) the retailer's total annual sales, less sales at wholesale and sales to other retailers, for the 12-month period corresponding to the preceding tax year, divided by 12.

The bill would define "retailer" as a person who is engaged in the business in this state of selling retail inventory. Certain specified businesses would be excluded. "Retail inventory" would be defined as all tangible personal property that a retailer holds for sale in this state during a 12-month period and for which the retailer is not otherwise entitled to an exemption. Retail inventory would not include real property or inventory that is already qualified for appraisal under the special inventory provisions of the Tax Code. Certain other terms would be defined.

A retailer's tangible personal property other than retail inventory would be appraised as provided elsewhere in the Tax Code. If a retailer's sales or retail inventory are made predominately to other retailers, the chief appraiser would be required to appraise the retailer's retail inventory as provided by current law. A retailer would be presumed to be an owner of retail inventory on January 1 if, in the 12-month period ending on December 31 of the preceding year, the retailer sold an item of retail inventory to a person other than a retailer regardless of whether the retailer had an item of retail inventory for sale on January 1.

The Comptroller would be required by rule to adopt a retail inventory declaration form and a retailer would be required to file a declaration with the chief appraiser for each retail inventory location by a specified deadline. The bill sets out the minimum requirements for the declaration. A chief appraiser would be permitted to examine certain specified books and records of a retailer by following a specified procedure. A retailer who fails to timely file a declaration in a tax year would waive any right to have the retailer's retail inventory appraised as provided by the bill for that tax year.

The bill would amend Chapter 171 of the Tax Code, regarding franchise tax to add new Subchapter N to allow certain qualified entities to earn franchise tax credits for ad valorem taxes paid on retail inventory. The bill would define qualified entity as a taxable entity that is a retailer and pays ad valorem taxes on retail inventory owned by the entity and located in Texas.

The bill would allow qualified entities to earn a franchise tax credit equal to the difference between the amount of ad valorem taxes paid by the qualified entity during the period on which a report is based that are derived from the taxable value of the entity's retail inventory and the amount of ad valorem taxes the entity would have paid during the period on which a report is based if the taxable value of that inventory were an amount determined by the retailer's total annual sales, less sales at wholesale and sales to other retailers, for the 12-month period corresponding to the preceding tax year, divided by 12. A qualified entity would not be eligible for a credit for a year in which the calculated amount of ad valorem taxes based on average monthly sales exceeded the calculated amount of ad valorem taxes based on the taxable value of retail inventory.

The bill would allow a qualified entity to carry forward any unused amount of credit for not more than three consecutive reports. A total credit claimed, including the amount of any carryforward, could not exceed the amount of franchise tax due for the report after all applicable credits.

The bill would allow a qualified entity to sell or assign all or part of any credit earned. Any entity to which all or part of the credit is sold or assigned may also sell or assign all or part of the credit to another entity. There would be no limit on the total number of transactions for the sale or assignment of all or part of the credit earned. The sale or assignment of the credit would not extend the period for which a credit may be carried forward and would not increase the total amount of the credit that may be claimed.

The bill would require an entity that sells or assigns credits and the entity to which credits are sold or assigned to submit written notice of the sale or assignment to the Comptroller's Office on a form promulgated by the Comptroller's Office. The bill would require the notice to include the date of the sale or assignment; the amount of the credit sold or assigned; the names and federal tax identification numbers of the entities involved in the sale or assignment; the amount of the credit owned by the selling or assigning entity prior to the sale or assignment; and the amount of credit retained by the selling or assigning entity after the sale or assignment.

The bill would require the Comptroller's Office to adopt rules relating to the new subchapter.

The bill would make conforming changes.

The bill would take effect on January 1, 2020; however, provisions related to the franchise tax credit would only apply to a report originally due on or after January 1, 2021.

Methodology

The method of calculating the market value of retail inventory provided by the bill would produce an appraised value that is, for most businesses, below the market value as it is currently calculated. Consequently, the bill would create a cost to local taxing units and to the state through the operation of the school funding formulas.

The estimate was based on information on current retail inventory taxable values from appraisal districts and retail sales information from the U.S. Census Bureau and Comptroller records. Retail inventory taxable values as calculated under current law were projected through a five-year period and compared to the taxable values calculated as provided by the bill to estimate the taxable value losses.

Projected tax rates were applied to the taxable value losses through the five-year projection period to estimate tax revenue losses to school districts, special districts, cities and counties. Under provisions of the Education Code, the school district tax revenue loss is partially transferred to the state. Projected school funding rates were applied to estimate the state loss and the net school district loss.

In the first year of a taxable value loss, state recapture is reduced (a state loss). Because of the use of lagged year property values, in the second and successive years of a taxable value loss, state recapture is further reduced and the previous year's school district loss related to the Tier 1 rate is generally transferred to the state through the Tier 1 funding formulas (a state loss).

In the school district enrichment formula (Tier 2), property values do not reflect the first-year value loss because of the one-year value lag. Because the formula does reflect a tax collections decline in that year, school districts lose Tier 2 funding creating a state gain. In the second and successive years the previous year's enrichment loss is generally transferred to the state (a state loss).

The school district debt (facilities) funding formula does not reflect the first-year taxable value loss because of lagged property values. In the second and successive years, a small portion of the previous year's school district facilities loss is transferred to the state (a state loss).

The estimated reduction in franchise tax revenue, resulting in a loss to the Property Tax Relief Fund, is based on retail inventory data from County Appraisal Districts and the U.S. Department of Commerce. The reduction in franchise tax revenue in the Property Tax Relief Fund would result in increased costs to the General Revenue Fund through the operation of the school finance formulas.

The Comptroller's office reports that administrative costs to implement provisions of the bill would total $388,000 per year starting in fiscal year 2020. The administrative cost estimate reflects the funds necessary to hire six accounts examiner IIIs to handle the anticipated increase in taxpayer credit refunds. It is estimated that more than 32,000 entities would be eligible to claim this credit. Processing credit applications and applicable transfers, verification of credits on original and amended reports, tracking carryforward credits as well as credits that have been sold or assigned necessitates the additional staff.

Local Government Impact

The estimated fiscal implication to units of local government is reflected in the table above.

Source Agencies: 304 Comptroller of Public Accounts

LBB Staff: WP, KK, SD, SJS