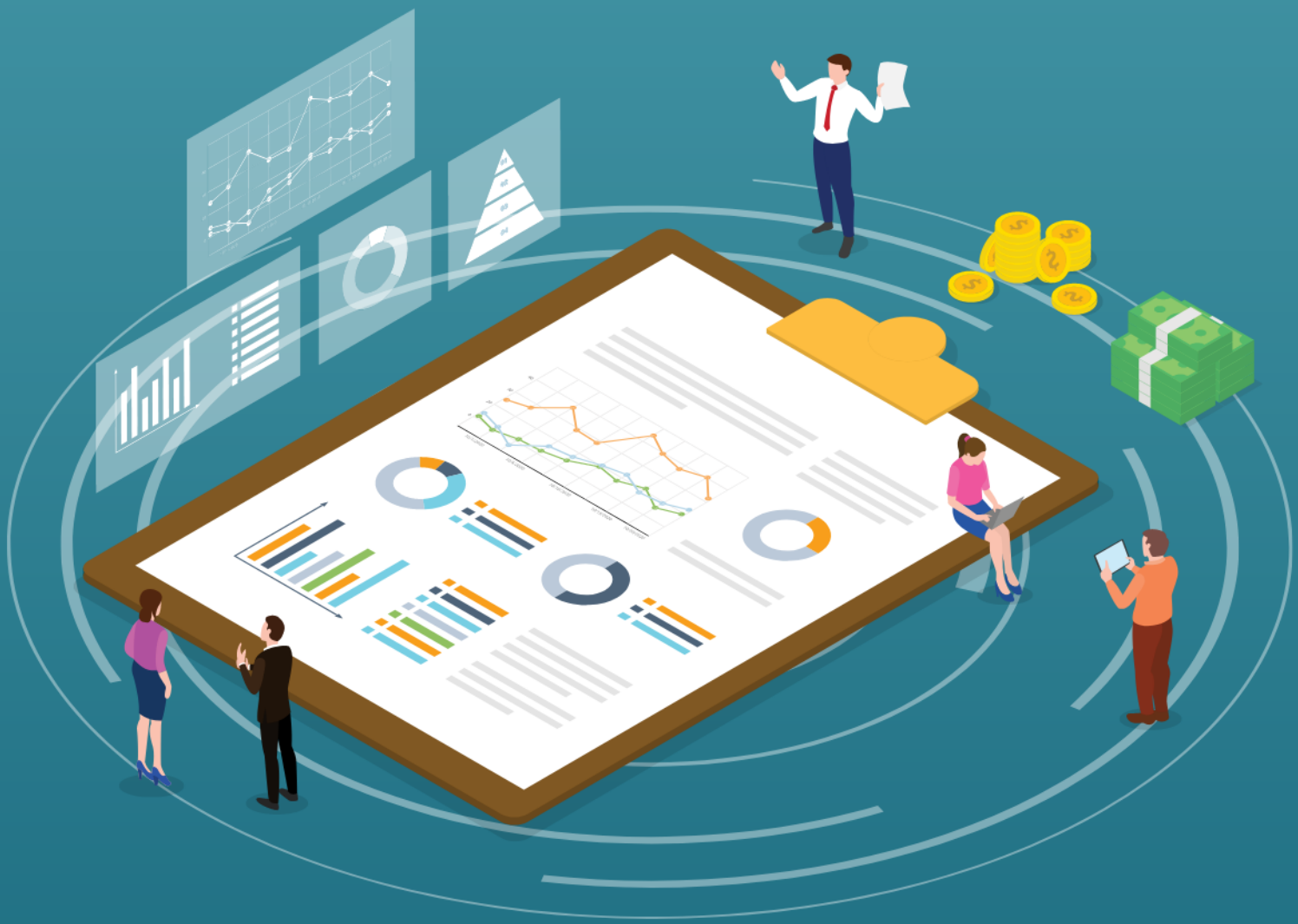
TCCRI
Texas Conservative Coalition
Research Institute

FINAL
REPORT
02.23

STATE BUDGET & TAXATION TASK FORCE: PART II



For more information about this document, please contact the Texas Conservative Coalition Research Institute:

Texas Conservative Coalition Research Institute

P.O. Box 2659, Austin, TX 78768

(512) 474-6042

www.txccri.org

Texas Conservative Coalition Research Institute (TCCRI) papers, reports, and policy proposals are authored by TCCRI staff. The contents of this document do not represent an endorsement from any individual member of the TCCRI Board of Directors or of the organization's donors. TCCRI's Board of Directors and donors hold a broad range of views on state policy. There may be some policy recommendations or statements of philosophy that individual board members and donors are unable to support. We recognize and respect their position and greatly appreciate the work of everyone involved in the organization.

Texas Conservative Coalition Research Institute

2021-2022 State Budget and Taxation Task Force

Final Report – Part 2

Contents

I. Introduction

Part I of this Task Force Report provided a brief overview of the state's current fiscal condition (including a record budget surplus) and then discussed various "structural" reforms that would: strengthen the State's constitutional spending and "pay as you go" limits; place limits on spending by local governments, subject to reasonable exceptions; protect the Economic Stabilization Fund from being used for ongoing obligations; measure the accuracy of fiscal notes used to estimate the financial impact of proposed legislation; and make the budget process more transparent.

Part II of this Task Force Report will discuss various proposals to provide tax relief and better tax administration, including a repeal or phase-out the franchise tax, various property tax relief measures, and the state's need to modernize its tax collection policies to address emerging business structures.

II. Tax Reform, Reduction, and Relief

Texas has an opportunity to show that more government is not the way forward. Rather than creating new government programs, growing existing programs, or hiring more public employees, Texas can underscore its faith in the free market by permanently lowering taxes and setting itself on a private sector path to prosperity. The state's franchise tax and local maintenance and operations (M&O) property taxes are both unnecessarily burdensome, and should be the focus of any legislative efforts to provide tax relief. Landmark legislation passed in the 86th Session (Senate Bill 2 and House Bill 3) have curbed the rapid growth of property taxes that has occurred across the state in recent years, but current property tax rates throughout the state are still quite high relative to other parts of the country. It is evident (as this report will make clear) that the benefits of providing tax relief in terms of dynamic revenue increases, as well as improvements in job creation, investment, and disposable income go a long way toward mitigating the short-term revenue losses to state and local coffers. The Legislature should pursue a number of property tax reforms, including buying down school M&O tax rates with surplus state revenue, even if doing so exceeds the constitutional spending limit; eliminating or reducing the tax of tangible personal property used in a business; and reforming the property tax appraisal process.

Raising approximately $43 billion in FY 2022, the sales and use tax is not only the single largest single tax revenue generator in the state,[1] it is also one of the least onerous and most efficient and transparent forms of taxation. Consumption taxes in general (of which Texas' sales and use tax is an example) are a superior form of taxation because they do not penalize work, savings, or investment. In 2005, then-Federal Reserve Board Chairman Greenspan testified to the following economic benefits of consumption taxes: "…many economists believe that a consumption tax would be best from the perspective of promoting economic growth… because a consumption tax is likely to encourage saving and capital formation." [2]

Contrast the sales and use tax with Texas's second and fifth largest tax revenue generators – school district M&O property taxes[i] [3] and the franchise tax,[ii] [4] respectively– and it is evident that property taxes and the franchise tax are where lawmakers should focus their tax relief efforts. These two taxes are especially punitive toward businesses, job creation, capital investment, and, in the case of the property tax, home ownership. Reforming these taxes to put the state on a path to greater economic prosperity demands bold action. Targeted tax incentive programs are always more politically viable than eliminating taxes entirely or reducing rates, but better fiscal policy requires the political will to realize the substantial economic benefits of broad-based tax reduction and elimination.

At the same time as the state levies the franchise tax and school districts levy M&O property taxes, there are numerous tax breaks offered to businesses: property tax abatements under Chapter 313 of the Tax Code,[iii] the franchise tax small business exemption, the Texas Enterprise Fund, the Moving Image Industry Incentive Program, and the High Cost Natural Gas Production Tax exemption to name just a handful.

Implicit in each of these programs is the notion that low taxes encourage economic growth. Tax incentives are based on the concept that if a business gets to pay lower net taxes because the state gives it a tax break, it will relocate to Texas, remain in Texas, or expand its operations in Texas. Each of these outcomes would boost the state's economy and create jobs. This raises an obvious question: if targeted tax reductions boost narrow sectors of the economy, why not simply cut tax rates in order to spur economic growth in all sectors? Instead, an interminable amount of effort is put into tinkering with the state's tax system by making minor changes to existing taxes and creating a multitude of "targeted" incentives. Repealing the franchise tax would make Texas one of three states in the nation without a form of broad corporate or business taxation (South Dakota and Wyoming are the others).[5] Being one of a very few states without a business tax is the ultimate incentive program, while reducing the property tax burden would attract business investment, create jobs, increase disposable income, and make home ownership more affordable.

Policymakers should also be aware of a tax issue growing in importance by the year. Ongoing advances in technology have opened up opportunities for new business models, in particular so-called "marketplace providers." These providers offer goods and services for purchase- usually on a website- but typically are not the owners or providers of the goods or services. Many marketplace providers or their users can intentionally or unintentionally exploit ambiguous statutes which were drafted without

[i] While school district M&O property taxes are not technically "state" taxes because they are set and levied at the local level, the nature of Texas' school finance system means that the state has an overriding interest in the taxes levied by school districts.

[ii] The franchise tax was the fourth-largest source of state tax revenue in FY 2022, behind sales tax, the motor vehicles sales and rental tax, and the oil production tax; however, if M&O school taxes are considered virtual "state" tax taxes, then the franchise tax was the fifth-largest state tax revenue generator for Texas in FY 2022.

[iii] As discussed below, Chapter 313 expired on December 31, 2022, so companies may no longer apply for its benefits. However, companies who entered into value limitation agreements prior to the expiration of Chapter 313 will continue to receive tax benefits in the years after 2022.

considering newer business models. As a result, these marketplace providers or their users can sometimes benefit by avoiding taxes and/or regulation to which their competitors are subject. The Legislature must seek the proper balance between rewarding innovative companies and ensuring that they are not unfairly exempted from taxes and reasonable regulation. In seeking this balance, the Legislature should authorize the Comptroller to audit marketplace providers as though they were the owners of the goods and services offered in the marketplace, and also clarify the relevant tax base for a given transaction with or through a marketplace provider.

III. Property Taxes

The 86th Legislature's signature accomplishments were overhauling the state's school finance system and implementing property tax reform that will cap the growth in local property taxes unless local voters authorize otherwise. These accomplishments, enacted through House Bill 3 and Senate Bill 2, were a much-needed response to the explosive growth of property taxes in Texas over the last two decades. In general, House Bill 3 caps the year-over-year growth of a school district's M&O property tax revenue (excluding new property in the district) at 2.5 percent unless a local election is held and voters approve a greater increase. For most taxing units other than school districts (e.g., cities and counties), a similar cap of 3.5 percent on increases in M&O tax revenue applies, again subject to voters approving a greater increase in an election.[iv]

It is difficult to overstate the importance of these two bills. While Texas is overall a low-tax state, its property taxes are among the highest in the country and have imposed a heavy burden on families across the state for too long. Prior to these bills being enacted in law, a survey by Attom Data Solutions found that Texas had the nation's third-highest effective property tax rate in 2018.[6] While the bills will restrain future growth in property taxes, their effects on existing property taxes are relatively modest; owners of $250,000 homes on average were projected to save an estimated $200 in 2019 and an estimated $325 in 2021.[7]

More recent studies indicate that Texas' property tax rates remain quite high relative to other states, even as SB 2 and HB 3 restrain increases in property taxes. The Tax Foundation rates Texas as having the sixth-highest property taxes for owner-occupied housing.[8] A recent analysis by Attom Data Solutions found that Texas was tied for the ninth-highest effective property tax rates on single family houses in 2021,[9] and a third analysis found that Texas had the seventh-highest property taxes for homeowners.[10] Rather than waiting years for the limits on HB 3 and SB 2 to move Texas towards a better ranking relative to other states, the Legislature should devote a substantial portion of the state's surplus revenue to lowering property taxes across the board.

Four reforms to pursue are: (1) using state revenue to "buy down" school district M&O taxes; (2) abolishing the business personal property tax, or if that cannot be accomplished, significantly increasing the exemption to it and indexing it to inflation; (3) requiring voter-approval elections for any property tax rates which increase property tax revenue to any extent; and (4) making the property tax appraisal process more taxpayer-friendly.

A. General Concerns with Property Taxes

[iv] A small number of taxing units, referred to as special taxing units (STUs), are subject to higher caps than those set forth in HB 3 and SB 2. Because of their relatively minor importance, this Task Force Report does not discuss STUs.

Before discussing the four reforms listed above, it is helpful to consider why property taxes are such a concern in Texas. Despite landmark property tax reform in the 86th Session, a common complaint among Texans concerns the amount of their property tax bills. From 1999 through 2021, annual property tax levies in Texas soared more than $53 billion, from $20.28 billion to $73.54 billion.[11] In recent years, property taxes have played an increasingly prominent part of the overall tax burden on Texas residents. The property tax system should be a concern for conservatives everywhere for two reasons in particular. First, as a practical matter, property taxes are particularly onerous because of a liquidity problem they pose for taxpayers. That is, the tax burden on a taxpayer rises as the value of his or her property appreciates, even if there is no readily available means for the taxpayer to use the increased value of his or property to pay the increased tax.

For example, assume a taxpayer who earns $60,000 a year pays property taxes of 2.5 percent a year on a house and land worth $180,000, or $4,500 a year. If the taxpayer's property appreciates at an annual rate of 5 percent, the taxpayer cannot readily pay the increased taxes out of the increase in the property value. In contrast, a taxpayer who is unable to pay sales tax on an item will not purchase the item in the first place and thus does not have to pay sales tax. Even prior to the explosion in housing values across the state in the last few years, taxpayers who were faced with increasing property tax bills that exceed their ability to pay were sometimes forced to borrow from a property tax lender to keep their homes.[12] A 2022 news report noted that, "The [property tax lending] industry began to flourish in Texas in the 1990s and grew steadily until the pandemic cut its fortunes short. Peaking in 2019, property tax lenders processed a total of $198 million in loans that year, according to state records. In 2020, that number dropped to a little more than $165 million.[13] The average interest rate of these loans was more than 13 percent for residential properties and almost 12 percent for commercial properties.[14]

Notably, the healthy demand for loans at high interest rates suggests that a great many property owners are struggling to pay their property tax bills. Owners who wish to avoid loans with such high rates, or who do not qualify for such loans, might be pressured into selling their homes to "downsize" and reduce their property tax bills.

Second, and more fundamentally, property taxes are concerning to conservatives because they limit the value of private property rights. Functionally, there is a strong similarity between a property tax system and a system in which taxpayers lease property from the government for an annual fee. If taxpayers must pay government on an ongoing basis for the use of their own property, they cannot be said to have true ownership of that property. Such a lease-like arrangement is difficult to reconcile with a high regard for private property rights.

Respect for private property rights and recognition of the liquidity problems which property taxes pose for taxpayers argue against raising revenue through a property tax system. If a property tax system cannot realistically be abolished, conservatives should focus on limiting property taxes and raising necessary revenue through more efficient and equitable means.

B. Buying Down School District M&O Taxes with State Revenue

In his January 2023 Biennial Revenue Estimate for the 2024-25 biennium, the Comptroller projected that the state will end the 2022-23 biennium with a $32.69 billion surplus (after taking into account certain constitutionally-required transfers), although he emphasized that, as always, economic projections are imprecise.[15] With the largest budget surplus in the state's history, the Legislature should make property tax relief its chief priority in the 88th Session. At a minimum, for every dollar of increased state spending in the 2024-25 biennium, at least one dollar should be directed to property tax relief. Of course, under this formulation, state appropriations effectively used to fund property tax cuts would not be viewed as increased state spending, but rather as spending for tax relief.

The best way to provide Texans with property tax relief is for the state to use its surplus revenue to "buy down" school district M&O taxes, a process which is already in place due to a bill from the 86th Session. Through this process, the state compression percentage is lowered, thereby lowering the minimum and maximum property tax rates school districts can impose, with the state holding harmless school districts for the forgone local tax revenue. Under current law, the maximum and minimum rates a school district can impose vary from district to district depending on the property value in the district, although there is an absolute cap and an absolute floor that applies to all districts. For the 2022 tax year, no district may impose a Tier 1 tax rate greater than $0.8941 per $100 of taxable property value, or a rate lower than $0.8046 per $100 of taxable property value.[16]

The state has a history of buying down school M&O taxes. In response to a Texas supreme court decision, the Legislature modified the school finance system in House Bill 1 (79S3, 2006), which, among other things, slashed the maximum M&O tax rate which school districts could impose and provided state funding to "hold harmless" school districts for the lost revenue. In 2019, House Bill 3 (87R; Huberty, et al.) overhauled the school finance system, again compressing local tax rates and using state funds to increase funding for school districts. Over time, the automatic compression mechanism in HB 3 will use state revenue to reduce school district M&O tax rates.

These past measures demonstrate that the state can fulfill its constitutional duty to offer a quality education to all children in Texas, while at the same time providing property tax relief. School district M&O taxes are an attractive target to cut because they are generally the single largest component of a taxpayer's property tax bill; in the 2019 tax year, school district taxes (both M&O and I&S) comprised $36.25 billion of the $67.29 billion in property taxes statewide: 53.9 percent.[17] The vast majority of that $36.25 billion was from M&O tax revenue. In fiscal year 2019, school district M&O revenue (including recapture) totaled $27.3 billion.[18]

But there are other good reasons for providing property tax relief through a buy down of school district M&O rates. First, as a type of property tax, school district M&O taxes have all of the flaws of this category of taxes, which are discussed in detail above. Second, this approach has virtually no

administrative costs. The collection of property taxes of course has administrative and compliance costs, but simply making rates lower does not increase those costs. Third, buying down school district M&O rates delivers broad tax relief. Whereas a homestead exemption benefits only homeowners, buying down rates benefits people who own non-homestead homes and businesses. In addition, lowering school district M&O tax rates lowers costs for landlords, which in a competitive market enables them to pass on at least a portion of the savings to renters in the form of lower rent.

Fortunately, several strong bills which recognize the goal of buying down school M&O rates have recently been filed, including:

Each of House Bill 958 (87R; Oliverson, et al.) and House Bill 2074 (87R; Shaheen) would have dedicated 90 percent of the general revenue for a biennium that exceeds 104 percent of the GR for the previous biennium to reducing the state compression percentage, thereby compressing school district M&O tax rates. House Bill 59 (87R; Murr, et al.) would have outright eliminated Tier 1 M&O taxes, with the forgone revenue being replaced by an alternative mechanism, such as increased sales taxes. HB 59 was approved in committee but did not receive a vote on the House floor.

Each of the above bill authors has filed similar legislation for the 88th Session: House Bill 612 (Shaheen), House Bill 174 (Oliverson), and House Bill 29 (Murr). In addition, HB 629 (88R; Troxclair) is substantially similar to HB 612 and HB 174.

The state tends to grow its revenues over time. As the table below illustrates, if provisions like those of HB 958 had been in place starting in 2010, the state would have been able to apply almost $21 billion to ongoing compression of school district M&O tax rates. Given that school district M&O tax revenue for FY 2023 is approximately $29.5 billion, this would have meant massive property tax relief for Texans.

Table 1: Amounts hypothetically dedicated to buying down school district M&O property tax rates had HB 958 been effective for 2010-2011 and all subsequent biennia (all dollars in thousands)

Biennium	GR-R Revenue	104 Percent of Previous Biennium's GR-R	Amount Dedicated to Buying Down School District M&O Tax Rates	Cumulative Amount Dedicated to Buying Down School District M&O Tax Rates
2008-2009	$85,890,504	n/a	n/a	n/a
2010-2011	$76,569,503	$89,326,124	$0	$0
2012-2013	$90,832,218	$79,632,283	$10,079,941	$10,079,941
2014-2015	$103,658,514	$94,465,507	$8,273,707	$18,353,648
2016-2017	$108,536,421	$107,804,855	$658,410	$19,012,058
2018-2019	$111,095,016	$112,877,878	$0	$19,012,058
2020-21	$117,581,455	$115,538,817	$1,838,375	$20,850,432

Source: Comptroller's Certification Revenue Estimates (Table A-2 in each report)

Several points about the above table deserve emphasis. First, as the fiscal note to HB 958 noted, "general revenue" was not defined by the bill, but the fiscal note assumed it to be general revenue-related (GR-R) funds. The table follows that assumption. Second, the amounts in the second-from-the-right column for the 2010-2011 and 2018-2019 biennia are zero because insufficient GR-R funds would have been generated in those biennia.

Third, compression is an ongoing commitment. Once a given amount of dollars is committed to it, the same amount must be committed in future biennia to ensure that school district M&O tax rates do not rise back to their previous levels. For example, assuming HB 958 had been in place, there was insufficient GR-R revenue in the 2018-2019 biennium to provide additional compression. Nevertheless, the $19 billion worth of compression attributable to previous biennial surpluses remained in effect. While the Comptroller will occasionally see a biennium-over-biennium drop in projected revenue, as it did for the 2010-2011 biennium, the state quickly rebounds from these rare downturns. Just as it did in the 2010-2011 biennium, the state can temporarily tighten its belt while maintaining previous property tax rate compression.

Fourth, HB 958 provided a "cushion" which allows for reasonable growth in state spending. This is seen clearly in the table. GR-R was almost $4.9 billion greater in 2016-2017 than it was in the 2014-15 biennium. But of this $4.9 billion increase in state revenue, only $658.4 million was used to provide additional compression. Given this cushion, the state should be able to fund government services as needed even as it provides tax relief. Moreover, significant portion of state spending- most notably federal income- would not be affected by the provisions of HB 958.

The constitutional spending limit, discussed above, poses a challenge for policymakers seeking to buy down school district M&O rates with GR. Whereas the new statutory spending limit under SB 1336 does not apply to appropriations made for tax cuts, the constitutional spending limit does not contain an exception for appropriations made for tax relief. As of November 2022, appropriations of state tax revenue not dedicated by the constitution for the 2022-23 biennium were projected to be $101,582,185,996.[19] Given the LBB's estimate that the Texas economy will grow 12.33 percent from the 2022-23 biennium to the 2024-25 biennium, the projected constitutional spending limit for the 2024-25 biennium will be $114,107,269,529, thus permitting a spending increase of just over $12.5 billion.[20] The projected spending limit of $114,107,269,529 could change, depending on the provisions of any supplemental appropriations bill for the 2022-23 biennium and any resolution of the Legislature to break the spending limit for the 2024-25 biennium.

The subject of the expected supplemental appropriations bill for the 2022-23 biennium deserves examination. Supplemental appropriations bills customarily provide funding in several listed areas, most notably and consistently Medicaid. A November 22, 2022 memorandum from the director of the LBB provided updated figures for the spending limit and the "pay as you go" limit for the 2022-23 biennium. As of that date, projected spending for that biennium was $26.9 billion under the pay as you go limit, and $5.1 billion under the spending limit. The lower figure of $5.1 billon will be the controlling limit with

respect to the supplemental appropriations bill for 2022-23. Assuming the Legislature enacts a supplemental appropriations bill for that biennium, the appropriations in it will expand the base figure from which the spending limit for the 2024-25 is calculated. If the Legislature uses the full $5.1 billion available to it when it approves the 2022-23 supplemental appropriations bill, that will increase the spending limit for the 2024-25 biennium by approximately $5.7 billion (i.e., $5.1 billion increased by 12.33 percent, the projected rate of growth in the Texas economy). The spending limit for the 2024-25 biennium would then increase from $114.1 billion to $119.2 billion, permitting the Legislature to dedicate half (or even more) of the $32.7 billion budget surplus to buying down school district M&O tax rates.

But disregarding any supplemental appropriations bill for the 2022-23 biennium, and assuming that the current projected spending limit of $114.1 billion for the 2024-25 biennium does not change, the Legislature will be constrained in how much state revenue it can devote to providing Texans with property tax relief. Using even half of the $32.7 billion budget surplus ($16.35 billion) to increase spending would easily exceed the spending limit for the 2024-2025 biennium, and that is before even considering possible increases in state spending to keep pace with the inflation and the state's growing population. This is unfortunate, because state spending to fund local tax cuts was probably not the type of spending voters intended to restrain when they approved the constitutional amendment that is now Article 8, Section 22 of the constitution. Rather, the more intuitive explanation is that voters approved the amendment because they were concerned about a *net increase* in government spending. As a former Deputy Comptroller of Public Accounts pointed out in 2016 testimony before the House Committee on Appropriations, citing research by the Tax Policy Center:

> TELs [tax and expenditure limits] are broadly defined as rules intended to control or restrain the growth of state budgets... A majority of TELs emerged during the "tax revolt" of the late 1970s or the economic recession of 1990-91. The Texas spending limit was enacted in 1978 at about the same time that the "tax revolt" was spreading nationally in the wake of voter approval of Proposition 13 limiting local property taxes in California in June 1978.[21]

It is ironic that a measure which emerged in the wake of a movement to control property taxes now poses a potential obstacle to providing Texans with property tax relief.

Notably, early versions of House Joint Resolution 1 (65S2, 1978), which proposed the amendment that became Article 8, Section 22, provided that the spending limit did not apply to "appropriations and tax increases necessary to provide payments to school districts to replace revenue lost by partial or total abolition of ad valorem taxes."[22]

The only occasion on which the spending limit has been broken was through Senate Concurrent Resolution 20 (80R; 2007), which followed the school finance overhaul in a 2006 special session. That resolution found that that the "existing need for lower school district property taxes constitutes an emergency for the people of Texas" and authorized the spending limit to be exceeded by up to $14.2

billion. The resolution was adopted by an almost two-thirds majority in each chamber, well beyond the threshold needed.

Given the context around the adoption of the constitutional spending limit, and the 2007 precedent, the Legislature should be comfortable exceeding the spending limit to provide property tax relief. To address concerns that the spending limit will not be respected by future legislations, the Legislature should adopt a resolution proposing a constitutional amendment that requires a three-fifths majority in each chamber to break the spending limit, except that appropriations to fund tax relief are not subject to the limit.

1. Policy Recommendation: Use the Surplus to Provide Tax Relief

Dedicate at least $13.5 billion of the 2022-23 budget surplus to property tax relief through buying down school district M&O taxes, irrespective of whether doing so requires the Legislature to vote to exceed the spending limit. In conjunction with that measure, adopt a joint resolution that amends the constitution to provide that the threshold to exceed the spending limit (other than in cases of appropriations for tax relief) is a three-fifths vote in each chamber.

If the Legislature declines to override the spending limit, it should be mindful of the supplemental appropriations bill for the 2022-23 biennium. Ideally, the entire $5.1 billion available to appropriate for the remainder of that biennium should be appropriated so as to provide a higher spending limit for the 2024-25 biennium that can accommodate state financing of property tax relief. After necessary appropriations in the supplemental appropriations bill (e.g., for Medicaid), the Legislature can use the remaining portion of that $5.1 billion to provide franchise tax and/or property tax relief.

2. Policy Recommendation: Use the unspent $3 billion in ARPA funds for property tax relief.

As noted in Part I of this Task Force Report, the state still has $3 billion in unspent COVID-19-related federal aid from the American Rescue Plan Act (ARPA). Because that money is federal income, it is not subject to the spending limit, or the SB 1336 limit. It should be dedicated to property tax relief.

IV. The Business Personal Property Tax

As discussed above, Texas has some of the highest property tax rates in the country. Over the years, Texas has made efforts to lower the property tax burden its residents face through such measures as a 10 percent cap on annual increases in the appraised value of homestead residences, SB 2 and HB 3, and increases in the homestead exemption amount. On the last point, Senate Joint Resolution 2 (87S3; Bettencourt, et al.) increased the homestead exemption from $25,000 to $40,000, providing welcome relief to homeowners.

While SJR 2 is an excellent reform, it is important to note that it can place a greater share of a local government's tax burden on businesses. The caps under SB 2 and HB 3 apply on a district-wide level, not on a property-by-property basis. Thus, any reduction in property tax revenue as a result of increased homestead exemptions or the 10 percent cap on the appraised valued of homesteads can be offset by the local government raising property tax rates. As long as overall tax revenue in the district does not increase by more than the amount permitted under SB 2 and HB 3, owners of non-homestead properties- such as commercial properties- in the district can see large year-over-year property tax increases.

Part of the state's heavy property tax burden is reflected in its broad general rule that tangible personal property used in a business or for the production of income, such as a business's machinery, furniture, supplies, and inventory- is subject to local property taxes. This tax on tangible personal property tax used for the production of income is referred to herein as the "business personal property tax ("BPPT"), and tangible business personal property is referred to herein as "BPP."

A. Overview of the BPPT

Generally, taxpayers must submit a rendition statement of all tangible personal property used for the production of income that they own, or manage and control as a fiduciary, as of January 1st of a given year.[23] The rendition statement is filed with the appraisal district office in the county in which the property is taxable.[24] Taxable property is then subject to local governments' standard property tax rates. There are numerous exemptions to the BPPT; the table below lists some of the larger or better-known exemptions. The figure adjacent to each exemption is the "cost" of the exemption, i.e., the property tax revenue forgone by local governments state-wide as a result of the exemption.

Table 2: Select Exemptions to the Business Personal Property Tax (2021) and their Estimated Value

Exemption	Estimated Value of the Exemption in 2021
For income-producing personal property valued at under $500	$0.3 million
For farm products	$215.3 million
For offshore drilling equipment not in use	$6.0 million
For mineral interests worth less than $500	$1.4 million
For solar and wind energy devices	$2.0 million

For railroad rolling stock	$24.5 million
Motor vehicles for income production and personal use	$4.7 million
For pollution control property	$166.9 million
For freeport property[25] and cotton stored in warehouses	$445.1 million
For tax increment financing	$162.2 million
For projects under the Texas Economic Development Act (Chapter 313)	$768.7 million

Source: Comptroller, Tax Exemptions & Tax Incidence Report (December 2020)

As the table below illustrates, the BPPT generates significant revenue for local governments. In 2019, business tangible personal property constituted roughly 9.5 percent of the statewide property tax base and the BPPT generated approximately $6.4 billion in revenue.

Table 3: Estimated Revenue from the BPPT (2016-2019)

	2016	2017	2018	2019
School District Taxable Value of Property in the State*	$2,212,416,373,472	$2,372,613,114,570	$2,627,116,227,955	$2,904,482,076,269
Estimated School District Taxable Value of BPP**	$252,357,428,244	$251,702,775,926	$261,097,825,674	$274,831,253,434
Estimated Percentage of School District Taxable Value Consisting of BPP***	11.41%	10.61%	9.94%	9.46%
Total Property Tax Levy in the State******	$56,078,877,952	$59,405,007,493	$63,770,631,797	$67,286,472,095
Estimated Property Tax Levy on BPP*******	$6,396,590,438	$6,302,083,217	$6,337,889,861	$6,366,858,180

Source: The underlying data is from the Comptroller, *Biennial Property Tax Report, 2016 and 2017* and *Biennial Property Tax Report, 2018 and 2019 (collectively, the "Comptroller's Biennial Tax Reports").*

**This value is only an approximation of the total taxable property in the state; due to differing local tax exemptions and several state statutes (e.g., Chapter 313, Tax Code), the total tax base for school districts is somewhat different than the tax bases for cities and counties.*

***This estimate is derived by summing the school district taxable values for Commercial Personal, Industrial Personal, and Special Inventory (categories L1, L2, and S, respectively) in the Comptroller's Biennial Tax Reports.*

****This estimate is obtained by dividing School District Taxable Value of Property in the State by Estimated School District Taxable Value of BPP.*

*****This estimate is determined by adding together the property tax levies by school districts, cities, counties, and special districts, as they are set forth in the Comptroller's Biennial Tax Reports.*

******This estimate is calculated by multiplying the Total Property Tax Levy in the State by the Estimated Percentage of School District Taxable Value Consisting of BPP. This number is approximate; because property tax rates vary by local taxing unit, total revenue from the BPP is not necessarily the same as the number that is equal to the product of the Total Property Tax Levy in the state and the Estimated Percentage of School District Taxable Value Consisting of BPP.*

B. Economic Dynamics of the Current BPPT

As economist Dr. John Merrifield noted in a recent paper, "The widespread persistence of [BPP] taxation is [a] testament to its sole virtues; inertia and obscurity."[26] The BPPT is poor tax policy for several reasons. First, it violates the principle of "horizontal equity"- the idea that similarly situated taxpayers should be treated equally. Under current Texas law, a business must pay property taxes on the tangible

personal property it holds for the production of income (inventory, furniture, equipment, supplies, etc.). Intangible property, however, is generally exempt from the BPPT (although a few types of intangible property are taxable). A retailer, for example, potentially faces a significant burden under current law in that its inventory is subject to property tax. Similarly, a manufacturing business may face high taxes as a result of the machinery it uses in the manufacturing process. In contrast, service-oriented businesses, such as software companies and accounting and law firms, are far less likely to face significant property taxes on their property because the bulk of their assets are often intangible.

Second, the BPPT imposes significant compliance costs on businesses. In cases where taxation is appropriate policymakers should aim to minimize the transactional and compliance costs associated with the tax. However, property taxes are generally costly to administer and comply with when compared to other forms of taxation. Under the current BPPT system, a business must determine the value of its tangible assets in preparing its rendition statement to the applicable appraisal district. Although a taxpayer may submit a good faith estimate of value, the taxpayer must be prepared to defend this estimate. Even a small business may have dozens of items for which a value must be reported, and determining the value of an item can involve significant research by the taxpayer. Alternatively, a taxpayer may provide the historical cost of the item of property and the year in which it was purchased, but this requires a taxpayer either to keep records of his or her purchases for a long period of time, and in some cases to know what the previous owner of an item of property paid for it. A dispute between a taxpayer and the appraisal district over the value of the taxpayer's tangible personal property must be settled at an appraisal review board hearing or in court. Many taxpayers opt to retain professional assistance in calculating or contesting their BPPT liability, which of course imposes further costs on them. As the Senate Finance Committee stated in an August 2020 report:

> Industries that rely heavily on inventory have identified the business personal property tax as a significant burden. In addition, small business owners report difficulties in compliance, given the complexities involved in reporting and assigning values to their assets. Texas law requires business owners to report business personal property to the appraisal district for assessment and taxation. This process can be costly for both taxpayers and the appraisal district. (internal footnotes omitted).[27]

The BPPT imposes compliance costs not just on taxpayers, but also on local governments. In 1995, the Texas Legislature passed House Bill 366 (74R), which, in conjunction with House Joint Resolution 31, established a $500 exemption for taxpayers subject to the BPPT.[28] HJR 31 provided in part that:

> The Legislature may exempt from ad valorem taxation tangible personal property that is held or used for the production of income and has a taxable value of less than the minimum amount sufficient to recover the costs of the administration of the taxes on the property, as determined by or under the general law granting the exemption.

As the House Research Organization's analysis of HB 366 explained, some counties were incurring administrative costs with respect to properties with little value that were subject to the BPPT, to the

point that the administrative costs exceeded the revenue raised by the tax.[29] It should be noted that the $500 exemption was not indexed to inflation, even though that would be appropriate given the rationale for its creation. Fortunately, the exemption was increased to $2,500 by Senate Bill 1449 (87R; Bettencourt, et al.).

A third aspect of the BPPT which makes it poor policy is that it applies to businesses even when those businesses are operating at a loss. Businesses often incur losses in their first several years of existence. Startups, struggling businesses, and capital-intensive businesses are especially vulnerable to shouldering a tax burden which is entirely disconnected from their profitability or their ability to pay the tax. Ideally, startups should be directing their cash flow into expanding their workforces and developing their offered products and/or services, rather than dealing with an administratively burdensome tax. The burden of the BPPT on small and new businesses is exacerbated by the lack of a cap on the tax; in contrast, annual increases in the appraisals of residential homesteads, for example, are generally capped at 10 percent.

Fourth, the BPPT distorts economic behavior. While all taxes affect behavior to some extent, policymakers should aim to disrupt the interactions of businesses and consumers as little as possible so that a free market can function most efficiently. In the case of the BPPT, businesses have an incentive to minimize their capital investment and inventory holdings. For example, a business considering a purchase of expensive machinery to produce goods more efficiently may opt instead to use less efficient manual labor in light of the BPPT. In turn, this decision results in lower productivity, stunting economic growth. As the Tax Foundation has stated, "There is evidence that the elimination of [the BPPT] increases investment in capital. In Ohio, policymakers exempted manufacturing equipment from the state's [BPPT], resulting in greater capital investment and a shift from labor."[30] Similarly, a company may refrain from ordering additional inventory due to concern that its holdings will be subject to the BPPT.

C. Economic effects of increased exemptions to the BPPT

Repealing the BPPT should be the goal of the Legislature, but if that cannot be accomplished, increasing exemptions to the BPPT would still provide substantial economic benefits to the state. While a BPPT is flawed by its nature, there are several aspects about Texas' version that make it particularly burdensome

First, as noted above, Texas has very high property tax rates relative to most of the country. Thus, all else being equal, an exemption from property tax in Texas is more valuable than in other states. Second, Texas is the largest-producing state of both oil[31] and natural gas.[32] Given the size of its oil and gas industry, Texas is an especially poor place in which to impose a BPPT, which by its nature burdens capital-intensive industries in particular. Third, according to the Tax Foundation, 43 states included tangible personal property in their tax base to at least some extent in 2018,[33] but Texas is one of only nine states that fully taxes inventory (subject to exemptions such as the Freeport exemption).[34]

Finally, and perhaps most importantly, Texas' base exemption of $2,500 is trivial. Assuming a combined local property tax rate of 2 percent, the current $2,500 exemption is worth only $50 each year. According to the Comptroller, the total annual revenue forgone by local taxing units as a result of the exemption when it was set at $500 was a mere $300,000. Even if the increased exemption of $2,500 were fully utilized by all of the businesses that claimed the $500 exemption, the cost of the exemption to the state would be very minor. The inadequacy of Texas' base exemption is apparent when comparing it the corresponding figures for many other states:

Table 4: Exemptions from Business Personal Property Taxation by State (2018 data)

State	Base Exemption
Oregon	$17,000
Nebraska	$10,000
Montana	$100,000
Florida	$25,000
Washington	$15,000
Colorado	$7,700
Utah	$10,800
Idaho	$100,000
Indiana	$40,000 (per county)
Delaware	Full (no tax)
Hawaii	Full (no tax)
Illinois	Full (no tax)
Iowa	Full (no tax)
New York	Full (no tax)
Ohio	Full (no tax)
Pennsylvania	Full (no tax)
Minnesota	Full, except for certain centrally-assessed BTTP*
South Dakota	Full, except for certain centrally-assessed BTTP
New Jersey	Full, except for certain centrally-assessed BTTP
New Hampshire	Full, except for certain centrally-assessed BTTP
North Dakota	Full, except for certain centrally-assessed BTTP

Source: All data is from the Tax Foundation, "States Should Continue to Reform Taxes on Tangible Personal Property," (Aug. 2019), except for Indiana, which updated its statute in 2019.

*The five states with the exemption of "Full, except centrally-assessed BTTP" exempt most tangible personal property except for certain centrally-assessed industries, such as public utilities or oil and natural gas refineries.

Increasing exemptions to the BPPT (or eliminating it altogether) would likely provide a net benefit to the state. A corollary of the BPPT's distortion of economic behavior is that businesses have a strong incentive to operate in low-tax jurisdictions. Indeed, much of the "Texas Miracle" is credited to Texas government out-competing other states by welcoming migrating and new businesses through a combination of low taxes and light regulation.

Ohio is an instructive example; the state overhauled its tax system in 2005, which among other things eliminated its BPPT on new investment in manufacturing and phased out its BPPT on other business tangible personal property. For the next four years, Ohio won Site Selection Magazine's "Governor's Cup" award as the state with the most major business expansion projects.[35] This success has been

lasting; Ohio earned the second-highest ranking (behind Texas each year) from 2014 through 2020 in terms of the number of expansion projects.[36]

Texas is perhaps an even better example of how economically powerful reducing BPPT can be- it is the winner of the Governor's Cup the last ten years.[37] Although Texas has a BPPT, unlike Ohio, the state grants generous BPPT exemptions to many companies relocating to, or starting in, Texas. For example, the Texas Economic Development Act (sometimes referred to as "Chapter 313") grants school districts the authority to enter into tax incentive agreements with businesses in exchange for promised economic development, such as capital investment and job creation. The program expired on December 31, 2022, but agreements in place before that date continue to be in force. Under these tax incentive agreements, qualifying businesses are exempted from paying all or a portion of school district maintenance and operations ("M&O") taxes that would otherwise be due on commercial buildings and non-inventory business tangible personal property over a period of ten years. Although Chapter 313 is a flawed program, there is no doubt that its tax incentives are attractive to relocating businesses.

While Chapter 313 is a complex program with advantages and disadvantages, the Comptroller reports that, through 2021, companies receiving Chapter 313 tax incentives have invested $150 billion in the state.[38] The rationale for Chapter 313's tax incentives also applies to increasing BPPT exemptions; businesses seeking expansion are likely to invest in jurisdictions with lower property tax burdens. Unfortunately, Chapter 313 is targeted exclusively at large companies making capital investments and does not offer property tax relief to most small businesses.

D. Policy Recommendations

The BPPT is a flawed tax that penalizes certain types of businesses, such as capital-intensive businesses and retailers, is administratively burdensome, applies to businesses regardless of profitability, and erodes the state's competitive edge relative to other states. The Legislature should work toward the long-term goal of eliminating the tax in light of these inherent flaws. In the above-mentioned paper by Dr. John Merrifield, various options for BPPT relief were presented if the BPPT cannot be repealed in its entirety. These options include:

- Increasing the amount of the exemption from the BPPT from its current $2,500;
- Eliminating school district M&O taxes on BPP, of if that cannot be done, at least on inventory; and
- Eliminating the BPPT (both school and non-school M&O taxes) on inventory.

The flaws of the BPPT bear a striking resemblance to those of the much-criticized franchise tax. One important difference between the two taxes is that the Legislature has acted to minimize the burden that the franchise tax places on small businesses in particular. Businesses with gross receipts below the current "no tax threshold" of $1.23 million, which is indexed for inflation, are exempt from paying the tax. In addition, taxpayers with a calculated tax liability of less than $1,000 are excused from paying the

tax. In 2017, of the 1.3 million businesses potentially subject to the franchise tax, only 121,000 actually owed tax due to these exemptions.[39]

In contrast, the base exemption for the BPPT is only $2,500 and therefore small businesses still feel the impact of the tax. If the Legislature is not able to repeal the BPPT, it should consider dedicating a significant amount (perhaps $1 billion annually) to increasing the exemption.

Estimating the fiscal effect of a greatly increased exemption to the BPPT is challenging. Senate Bill 763 (84R; Bettencourt, et al.) would have increased the exemption to $50,000 (the exemption was $500 at the time). Assuming an average combined local property tax rate of 2.0 percent, the $50,000 exemption would provide meaningful tax relief ($1,000) each year to small businesses. Moreover, the increased exemption should be indexed to inflation.

Although SB 763 did not pass into law, its accompanying fiscal note projected that within a few years the increased exemption would result in annual costs of $176 million to the state and roughly $215 million to local governments.[40] Extrapolating the fiscal effects of a bill today from the fiscal note from a 2015 bill is challenging and does not yield a firm number. However, the Legislature could set aside significant funds (such as $1 billion annually) for BPPT relief, and the LBB then could determine the point at which the exemption could be set to yield a fiscal effect of $1 billion. Based on the fiscal note to SB 763, it is likely that $1 billion in annual funds could raise the exemption to $50,000 or more.

Alternatively, the state could borrow a concept from the franchise tax and provide that any business with gross receipts under the inflation-adjusted no-tax-due threshold for the franchise tax (currently $1.23 million) for the applicable year is exempted from the BPPT.

Because Article VIII, Section 1(g) of the constitution essentially requires that the property exempted from the BPPT be such that the cost of administering the tax on the exempted property would (but for the exemption) exceed the revenue raised by taxing it, a constitutional amendment (such as Senate Joint Resolution 36, 84R) would likely be necessary.

Another method of delivery property tax relief could avoid the need for a constitutional amendment. If the BPPT cannot be repealed, the Legislature could still provide partial relief from the BPPT by largely exempting inventory- a subset of BPP- from all property taxation, or at least school district M&O taxes. In a 2018 opinion,[41] the Texas supreme court indicated that, while property in Texas is subject to taxation in proportion to its value, “value” does not necessarily mean market value. Rather, the Legislature has signification discretion in determining how “value” is calculated for property tax purposes. For example, under current statute,[42] the value of dealer heavy equipment (e.g., farm equipment) for property tax purposes is calculated with reference to the dealer’s annual sales.

By the same logic, the Legislature should have the authority to provide that inventory in Texas is calculated other than by reference to its fair market value. Indeed, this approach has been tried before, although the bill in question did not become law. House Bill 2589 (85R; Button, et al.) would have

phased-in a dramatic reduction in property taxes on retail inventory. Under the bill, most types of inventory would have been valued for property tax purposes in the relatively taxpayer-friendly manner in which motor vehicle inventories are valued under current law, which is done by reference to annual sales. However, the bill would have phased in this provision over nine years; during the phase-in period, inventory would have been valued at the greater of the method described in the preceding sentence or a declining-over-time percentage of the market value of the inventory.

1. Policy Recommendation (Main): Eliminate the BPPT in its entirety.

The legislature should eliminate the BPPT entirely based on the aforementioned reasons. This could carry a biennial cost of $14 billion or more, and accordingly might require a phase-in similar to that in HB 2589. If the BPPT cannot be eliminated, consider the options below.

2. Policy Recommendation (Alternative): Exempt BPP from School District M&O Taxation

3. Policy Recommendation (Alternative): Increase the BPPT exemption to $50,000 or more

4. Policy Recommendation (Alternative): Exempt businesses that have gross receipts under the franchise tax no-tax threshold (currently $1.23 million) from the BPPT

5. Policy Recommendation: Exempt inventory from the BPPT or from School District M&O.

E. Require tax rate elections for any taxing unit that increases revenue year-over-year (subject to certain exclusions)

As discussed above, the 86th Legislature made remarkable strides in restraining the future growth of property taxes in the state. The Legislature should continue to expand on the foundation laid by SB 2 and HB 3 by asking the fundamental question: why should voter approval of any year-over-year increase in M&O tax revenue not be required? Currently, growth in year-over-year M&O revenue (excluding revenue from new property) is capped at 2.5 percent or 3.5 percent, although some smaller taxing units and community college districts have an 8 percent cap. In addition, the 2.5 and 3.5 percent caps are temporarily eased in the case of disasters. A strong argument can be made that *any* annual increase in M&O revenue (except for that attributable to new or improved property) should require voter approval.

The requirement of voter approval is already present to a large extent with interest and sinking (I&S) taxes that fund capital improvement projects because voters must approve the issuance of new bonds.

Allowing local governments to increase taxes every year without an election could lead to the presumed default that M&O revenue "should" increase to the capped amount every year. This presumption is counter to the idea that government should constantly be examining its expenditures and seeing how it can reduce taxes as technology progresses and society becomes wealthier. Proponents of allowing local governments to raise increased revenue without an election will point to inflation and how it erodes the value of money over time. This erosion, their argument goes, justifies small increases in annual revenue to keep spending in real dollars constant. This argument should be countered by two considerations.

First, notwithstanding the spike in inflation in 2021 and 2022, inflation in the coming years is likely to be low. According to the Federal Reserve Bank of St. Louis, and expected average annual inflation over the next 30 years as predicted by the financial markets was just 2.26 percent as of December 2022.[43]

Second, property tax caps do not apply to newly constructed properties or to new improvements to existing property. Given the rate at which Texas is growing, these exceptions to the cap will generate significant revenue for local governments.

Third, and most importantly, Texas voters have shown a consistent willingness to approve the issuance of debt when local governments can provide a good reason for that issuance. As touched upon above in this Task Force Report's discussion of local spending, "in the November 2022 elections, 106 local governments in Texas held 212 bond elections, with 139 of these being carried, approving new debt totaling $19.3 billion (a 65.6 percent passage rate)."Because revenue for current operations is even more critical to local governments' functioning than long-term projects financed by debt, one would expect the voter approval rate for M&O revenue increases to be even higher than that for bond issuance. This consideration should ease concerns that the budgets of local governments will be reduced over time through inflation.

Texas has been an economic beacon to the rest of the country over the last few decades. It will continue to be and property values across the state will continue to rise. Despite the reforms of SB 2 and HB 3, the Senate Committee on Property Tax aptly stated in its November 2020 interim report: "Taxpayers are in desperate need for additional property tax relief. As property values continue to increase, tax rates must fall. To that end, the tax code should be amended to require a vote on any rate increase over the no-new-revenue rate."[44]

If implementing the above suggestion proves to not be feasible, the Legislature could consider less sweeping but still substantial reforms. An obvious reform would be to move towards a standardized property tax cap of 2.5 percent. There is little reason for counties and cities to be subject to a 3.5 percent, while schools are subject to a 2.5 percent cap. Additionally, as discussed in TCCRI's *Education & Workforce Task Force Report,* community college districts are currently subject to an 8 percent cap. Given their underwhelming track record over the last decade (discussed in detail in that Task Force

Report), community college districts should either be subject to a 2.5 percent cap, or to a cap based on an inflation-adjusted cost per enrolled student. In any case, local voters should retain the ability to approve proposed tax rates that exceed caps.

1. *Policy Recommendation: Require any rate in excess of the no-new-revenue rate to be approved by local voters in an election*
2. *Policy Recommendation: Alternatively, equalize the caps on local taxing units' year-over-year tax revenue growth at 2.5 percent (unless the special taxing unit exception applies)*
3. *Policy Recommendation: Require voter approval for any proposed tax rate by a community college district that would increase inflation-adjusted, per-student expenditures*
4. *Policy Recommendation: Alternatively, lower the current 8 percent cap on year-over-year growth in property tax revenue applicable to community college districts to 2.5 percent*

V. The Texas Economic Development Act (Chapter 313)

A. Background

In 2001, the Legislature enacted The Texas Economic Development Act (TEDA[v]), codified as Chapter 313 of the Tax Code. TEDA allows a school district's board of trustees to attract investment and jobs by offering entering into a valuation limitation agreement with businesses which apply. Value limitation agreements provide for a 10-year limitation on the appraised value of property for school district M&O property taxes. Crucially, the tax revenue foregone by the school district under these agreements is substantially replaced for the school district by the state.[45] According to data from the Comptroller in its 2023 biennial report on TEDA, the value limitation agreements in place as of June 1, 2022 will provide businesses participating in Chapter 313 with approximately $12.25 billion in gross tax benefits over the lifetime of those agreements.[46] Due to a flood of applications in 2022, many agreements were finalized after June 1, 2022; thus, the $12.25 billion figure underestimates the "cost" of Chapter 313 agreements in place as of January 2023. The Legislature extended TEDA on previous occasions but opted not to do in the 87th Session. As a result, expired on December 31, 2022.[vi]

However, it is crucial to note that value limitation agreements in place by the expiration will continue in force after the expiration date. Predictably, once it became clear that Chapter 313 would expire at the end of 2022, hundreds of businesses submitted applications to "beat the clock" and take advantage of the law's grandfathering provision. From 2016 through 2021 (inclusive), there were 44, 68, 90, 133, 91, and 135 TEDA applicants, respectively. In light of the pending expiration of the program, the number of applicants in 2022 soared to 416. The increase was so great that the Comptroller's staff was overwhelmed and could not process all of the applications before Chapter 313 expired. When frustrated companies sued, arguing that they were entitled to have their applications honored because the state did not meet the deadlines in the applicable statute, the Texas supreme court declined to craft a judicial remedy, instead stating that plaintiffs must seek relief through the Legislature.[47] Nevertheless, as of June 1, 2022, there were 598 Chapter 313 agreements in effect. As a result, Chapter 313 companies will continue to receive billions of dollars in subsidies for years to come, irrespective of the December 31, 2022 expiration date.

There will undoubtedly be calls during the 88th Session to devise a replacement program for Chapter 313. **In light of this, two points should be emphasized**. First, as discussed above in detail, the ideal tax relief policy is for the state to buy down school district M&O taxes. This policy is administratively simple, even-handed, broad-based, and avoids several problems that have plagued the Chapter 313 program.

Second, if the Legislature chooses to replace Chapter 313 with a different targeted incentive program, such as the suggested franchise tax credit discussed below, the program should be crafted to avoid the

[v] The terms "TEDA" and "Chapter 313" are used interchangeably in this Task Force Report.
[vi] See Section 313.171(a), Tax Code.

shortcomings of Chapter 313. Doing so requires an understanding of the following background on the entire program, and a discussion of both the program's strong points and its shortcomings.

Property qualifying for incentives under TEDA must be used in one of ten fields: manufacturing, research and development, clean coal projects, advanced clean energy projects, renewable electric generation (wind), renewable electric generation (non-wind), electric power generation (integrated gasification combined cycle), nuclear electric power generation, computer centers used in connection with the preceding fields, and "Texas priority projects," the last of which requires qualifying capital investments of at least $1 billion. Several of the ten categories are unrepresented among the current TEDA projects, and as discussed below, renewable energy and manufacturing projects account for the vast majority.

School districts participating in Chapter 313 agreements often receive "supplemental payments" or "payments in lieu of taxes" (PILTs), which are payments from businesses which equal a percentage of their tax savings under TEDA. The size of PILTs is negotiated between the school district and the business and varies from project to project. Notably, PILTs that school districts receive are excluded from the public school funding formula.

TEDA's purposes are as follows:[48]

> (1) encourage large scale capital investments in this state;
> (2) create new, high paying jobs in this state;
> (3) attract to Texas new, large scale businesses that are exploring opportunities to locate in other states or other countries;
> (4) enable local government officials and economic development professionals to compete with other states;
> (5) strengthen and improve the overall performance of the economy of Texas;
> (6) expand and enlarge the ad valorem property tax base of Texas; and
> (7) enhance this state's economic development efforts by providing school districts with an effective local economic development option.

The legislative intent behind the enactment of the statute was that school districts would approve only those projects which among other things created new, high-paying jobs. In other words, the Legislature intended job creation meeting a certain threshold to be a requirement for a business to claim Chapter 313 incentives. That threshold was 25 "qualifying jobs," or in the case of rural areas, 10 such jobs. Qualifying jobs are full-time jobs which entail at least 1,600 hours annually, offer health insurance, and pay 110 percent of the county's average manufacturing wage. A subsequent amendment to the statute clarified that qualifying jobs need not be employees of the business; for example, employees of third parties who contract with the business might be qualifying employees.

In addition to the job creation requirement, the Legislature imposed a type of net benefit test. Under this test, approval for Chapter 313 agreements was conditioned on total state and local tax revenue collected from the project being "reasonably likely" over a 25-year period to exceed the amount of tax

revenue forgone as a result of the incentive. A subsequent amendment to the statute, however, provided that the Comptroller may still approve a project even if it fails to make the "reasonably likely" determination if it finds that the project still provides a net benefit to the State.

The State Auditor's Office periodically performs an audit of the Chapter 313 program by examining at least three of the school districts which are parties to value limitation agreements. Compliance with Chapter 313's requirements has improved in recent years; this is due in part to a provision in HB 3390 (83R, 2013) which required the Comptroller to conduct an annual review of businesses receiving Chapter 313 benefits. To further improve transparency and accountability, the Comptroller has recommended in past audits that school districts have a document retention policy in place so that it may verify information it has reported to the Comptroller previously.[49]

B. Subsidies generally and their debated role in business recruitment

TEDA is a complex program which has its strengths but needs improvement in several key respects. Tax subsidies, while commonplace, should be viewed with skepticism and to the extent they are supported, must be periodically re-evaluated with a critical eye. Subsidies in general distort the workings of a free market, create incentives and drawbacks for market participants which would not otherwise exist, and often fail to achieve their intended goals. A quick glance at the federal subsidies for agricultural production and student loans illustrate why skepticism is justified. According to an October 2020 *New York Times* report, the federal government was on pace to spend up to $46 billion on agricultural subsidies that year.[50] Whether these subsidies help poor farmers or make food meaningfully cheaper to Americans is highly questionable. These subsidies disproportionately benefit households with greater income than the average U.S. household.[51] Furthermore, commodity costs accounted for only ten percent of the retail cost of food in the U.S. from 2000 to 2015;[52] thus, subsidizing commodity production is not likely to significantly alter food prices for consumers.

Crop insurance aptly illustrates the absurd distortions subsidies can cause. The Congressional Budget Office found that, from 2000 to 2016, agricultural producers participating in the Federal Crop Insurance Program received $65 billion more in claims payments than they paid in premiums. Moreover, this fact was not attributable to one or two severe disasters over that time period; in every year during that period except one, claims paid out to farmers exceeded the insurance premiums collected from them.[53] Such an arrangement cannot accurately be termed insurance. While there are obviously beneficiaries of subsidies, there are also many losers; however, this can be difficult to discern because the detrimental effects are often more diffuse and spread out over a larger group of people than the benefits are. In the case of farm subsidies, taxpayers cover the cost of the subsidy.

TEDA clearly picks winners and losers to some extent by favoring certain companies. Only companies in certain industries qualify (unless making a very large capital investment) and small businesses are less likely to have the sophistication and/or resources to avail themselves of TEDA's benefits. If significant

property tax revenue is forgone under TEDA, local governments and the state will eventually rely even more heavily on taxpayers who do not enjoy special tax breaks. On the other hand, property tax rates in Texas are among the highest in the country, and businesses understandably must weigh that when deciding whether to relocate here. As Chapter 313 states at its outset: "[G]iven Texas' relatively high ad valorem taxes, it is difficult for the state to compete for new capital projects without temporarily limiting ad valorem taxes imposed on new capital investments."[54] Seen in this light, the subsidies granted under TEDA can be seen as a distortion which (at least partially) offsets the initial market distortion caused by having high property taxes relative to most states. Ideally, local governments in Texas would rely more on consumption taxes and less on property taxes. Until that goal is attained, however, the state's policymakers must realize that the state's high property tax rates offset many of its otherwise attractive traits to businesses.

It is difficult to overstate how fierce interstate rivalries for attracting business have become in recent years. In 2013, Tesla informed the representatives of several Western states that it would be opening a "gigafactory" and invited them to submit subsidy packages for evaluation.[55] Nevada eventually won the competition; however, Tesla ultimately expanded to Austin, Texas as well, encouraged by local governments granting it property tax breaks worth tens of millions of dollars.[56] In a particularly prominent example, Amazon in 2018 opted to construct its "H2Q" headquarters in Arlington, Virginia and Long Island, New York. As an inducement to making this decision, Amazon received incentives and subsidies from state and local governments worth $2.8 billion, and potentially worth up to $5.5 billion.[57] Some of these incentives went well beyond tax breaks; for example, Virginia agreed to make almost $300 million in infrastructure investments, and state and local leaders pledged to work with universities to increase the number of computer science degree-holders in the area.[58]

The selection of Virginia and New York occurred only after intense lobbying by interested parties; according to Amazon, it received at least 238 bids from interested parties, states, and Canadian provinces during the selection process.[59] The competition to be the location of HQ2 was intensified by Amazon's projections that the project would lead to $5 billion in capital investments and the creation of 50,000 jobs.[60]

The pressure on cities and states to aggressively court large businesses if they want those businesses to expand into those locations was emphasized still further in early 2019. Although polling showed that the Amazon expansion into Long Island was popular with locals, it garnered public criticism as corporate welfare from several prominent New York politicians. In response, Amazon abruptly cancelled the expansion into Long Island, citing difficult relationships with local leaders.[61]

The lessons of the Amazon and Tesla expansions, and those of other prominent businesses in recent years, is that state and local leaders are expected to put forth incentive and subsidy packages that are competitive with those of other states. In short, businesses rationally weigh the incentives of relocating to a given area. Conservative policymakers are faced with a dilemma; either support tax subsidies and accept the market distortions they cause in exchange for the capital investment and jobs that large businesses' expansion brings to an area, or maintain a principled, no-subsidy style of governance and

run the risk of falling behind economically as large businesses expand elsewhere. Two related considerations compound the dilemma. First, there is no way to easily measure the net benefit (or net detriment) of a tax incentive or tax subsidy program as complex as Chapter 313. Second, if Chapter 313 tax incentives are granted to some businesses, there is no way to know what would have happened in the absence of those incentives. For example, some might argue that the state would be better off attracting businesses if it directed Chapter 313 tax subsidies towards general tax relief for all Texans. As noted below, there is some evidence that Chapter 313 subsidies are accepted by some companies which would have relocated to Texas even without the incentives.

C. Benefits of TEDA and failings of the current system

The Comptroller publishes updates on the status of TEDA in January of odd-numbered years. These reports[vii] highlight some of the positive effects of TEDA. The recently-released 2023 report indicated that there were 598 active agreements as of June 1, 2022. Through these agreements, TEDA has succeeded in attracting $150 billion in capital investment to Texas through 2021, and total capital investment over the life of the agreements is expected to swell to $261 billion. Because not all Chapter 313 agreements have a 100 percent value limitation, TEDA still boosted the M&O property tax base throughout the State by more than $14 billion in the 2021 tax year, and that number may increase in the future as the value limitation agreements made pursuant to TEDA expire and property goes on to the tax rolls at its fair value. TEDA also boosted the I&S property tax base throughout the state by more than $81 billion in the 2021 tax year, and I&S revenue is not abated in any way under the program. In addition, TEDA created an estimated 62,200 jobs in the state in 2021.[62]

There are aspects of TEDA, however, which raise serious concerns. First, the subsidies granted under TEDA are quite large: the total gross tax benefit provided to companies with agreements under TEDA (as of June 1, 2022) through 2021 was $3.16 billion, and over the lifetime of those agreements that figure is projected to swell to $12.25 billion. Such a massive subsidy calls for an examination into whether TEDA is accomplishing the goals set forth by the Legislature, particularly when families and businesses statewide bear a heavy property tax burden (notwithstanding the strong reforms of HB 3 and SB 2).

Second, some data indicates that the job creation attributed to TEDA might be overstated. As noted above, the Comptroller estimates that 62,200 jobs, “direct and otherwise” were created by TEDA in 2021, but that number is far from certain. Due to an amendment to the statute, the Comptroller has relied upon economic multipliers published by the Department of Commerce in reaching its estimate. Although using multipliers is in accord with the amended statute, they unfortunately are not precise, and their accuracy is impossible to verify. However, TEDA requires companies who benefit from TEDA to report the number of *actual* qualifying and non-qualifying jobs they have directly created. The significant

[vii] In addition to the official reports, the Comptroller also publishes Summary Data supplements regarding Chapter 313. This Task Force Report’s references to the Comptroller’s Chapter 313 biennial reports include the Summary Data supplements. As their name suggests, the Summary Data supplements provide a brief overview of key points relating to existing Chapter 313 agreements.

discrepancy between the qualifying jobs directly created and the estimated jobs created is illustrated by the Comptroller's 2023 report, which states that 62,200 jobs were directly or indirectly created by TEDA in 2021 alone, but also states that the entire number of jobs directly created by TEDA through 2021 is only 14,032.[viii] Of that 14,032 figure, 9,850 were qualifying jobs. Thus, as the table below illustrates, for every qualifying job directly created through 2021 as a result of agreements active as of June 1, 2022, a gross tax subsidy of more than $320,000 was "spent" (importantly, this number has the potential to increase dramatically in the future[ix]). The subsidies are even more striking after taking into account the remarkable fact that just a handful of the 598 projects in the Comptroller's 2023 report accounted for a vastly disproportionate percentage of those 9,850 qualifying jobs; for example, just 11 projects by 12 companies (one project was apparently a joint effort by two companies) accounted for 4,642 of those qualifying jobs, or 47.1 percent.[63]

The job numbers are particularly unimpressive for renewable energy companies with active agreements as of June 1, 2022, which accounted for 65 percent of the 598 Chapter 313 agreements in place on that date. With only 1,149 qualifying jobs directly created by these companies through 2021 under these agreements, the renewable energy companies that are parties to these agreements have received tax benefits of $900,000 for every qualifying job directly created through 2021.

Table 5: Key Data relating to the 598 TEDA Agreements in Place as of June 1, 2022

Category*	# of Active Projects (as of June 1, 2022)	# of Qualifying Jobs Directly Created Through 2021	Reported Investment Through 2021 (in millions, rounded)	Estimated Gross Tax Benefit Received Through 2021 (in millions, rounded)	Estimated Total Gross Tax Benefit Over Life of Agreement (in millions, rounded)	Tax Benefit Received through 2021 per Qualifying Job Directly Created through 2021	Tax Benefit Received over life of Agreement per Qualifying Job Directly Created through 2021**
Manufacturing	209	8,701	$102,127	$2,113	$9,000	$242,846	$1,034,364
Research & Development	1	0	$113	$10	$10	n/a	n/a
Renewable Energy Electric Generation (Wind)	210	969	$35,370	$921	$1,954	$950,464	$2,016,512
Renewable Energy Electric	178	180	$12,741	$113	$1,291	$627,778	$7,172,222

[viii] Per conversations with Comptroller staff, the number of jobs directly created by companies receiving TEDA benefits reflect cumulative data, but with one caveat; companies do not have to report jobs data once five years have passed from the expiration of the value-limitation agreement.

[ix] The Comptroller's 2023 report states that a total of $12.25 billion in gross tax benefits will be provided over the life of all Chapter 313 agreements in place as of June 1, 2022. The Comptroller indicates that 9,850 qualifying jobs have been created under TEDA through 2021 yielding a ratio of approximately $1.24 million in lifetime gross tax benefits for every qualifying job created thus far. Consistent with the above discussion, the ratio is even greater for renewable energy projects.

Generation (Non-Wind)							
Total	**598**	**9,850**	**$150,351**	**$3,157**	**$12,255**	**$320,508**	**$1,244,162**

Source: Comptroller, Texas Economic Development Act Summary Data 2023

**Categories with no active projects (e.g., nuclear power and clean coal) are not shown.*

**Shows the gross subsidy per qualifying job directly created assuming there is no future net job creation; some companies, however, are required to create more jobs in the future to satisfy the promises made on their applications.

Furthermore, for many companies with agreements under TEDA, there is no guarantee that they will create more qualifying jobs in the future on a net basis. But it is certain that they will continue to receive tax benefits under TEDA for years to come. If renewable energy companies with TEDA agreements as of June 1, 2022, create a net total of zero jobs beyond 2021 for the duration of their TEDA agreements, those companies will have received a staggering subsidy of more than $2.8 million for each qualifying job directly created. Paying a subsidy of this size for the creation of a job the salary of which is only a tiny fraction of this amount is questionable policy at best.

As discussed above, TEDA contains a statement of legislative intent that school districts should approve only those TEDA applicants who, among other things, "create high-paying jobs." Crucially, however, TEDA was amended in 2007 to allow a school district to waive the job creation requirement if it finds that the statutory job creation requirements that would otherwise apply exceed the number of employees needed to operate the facilities on the property which is the subject of TEDA incentives. Since then, waivers have become so common that the number of companies receiving them exceeds the number of companies satisfying the job creation requirements of the original statute. Among renewable energy companies, requesting the waivers has since become the rule. In a 2013 report, the Comptroller discussed the proliferation of waiver requests in light of the statute being amended:

> Of 95 projects initiated since the job waiver was authorized, 52 have had the minimum job creation requirement waived. Of this number, 45 (87 percent) are in the renewable energy industry. So, while the program continues to succeed in attracting large scale capital investment, projects are committing to fewer new, high-paying jobs in their Chapter 313 contracts.[64]

Third, although TEDA has thus far expanded the property tax base throughout Texas to some extent, its potential to do so in the future is not entirely clear. The hope is that when TEDA agreements expire, businesses will then pay property taxes at normal rates on their property in Texas. Projecting the size of this benefit is difficult, however, because property can depreciate and companies can fail. Speaking of the difficulty in projecting future revenue gains due to TEDA, the Comptroller has said:

> As noted above, state law requires the Comptroller's office to determine whether a proposed Chapter 313 project is reasonably likely to generate enough tax revenue to offset the loss due to the tax limitation within 25 years. Yet economic projections over such a long period are uncertain at best. Economic conditions change; companies and

> industries rise and fall. Some Chapter 313 projects fail to produce the predicted rise in property values. Among the 13 projects with tax limitations that ended from 2013 to 2015, actual market values in the last year of the limitation period ranged from 28 percent to 125 percent of the initial market value. While most were within 20 percent of their initial projections, the wide range of values shows the volatility of assumptions made about as-yet-unbuilt projects.[65]

Thus, under current law, it is possible for a business to benefit from subsidies during a 10-year value limitation agreement, and then pay taxes on the greatly reduced value of its property after the agreement expires. Such an arrangement creates significant risk that the tax benefits received by the business will outnumber the taxes paid by the business. To guard against this possibility, then-Representative Springer proposed a recapture provision in House Bill 1987 (84R, 2015). That bill provided for recapture of forgone property tax revenue under a TEDA agreement if, in the first tax year after the agreement expires, the market value of the property in question is less than 80 percent of its market value when the project was approved.

Fourth, a fundamental and currently unanswered question about TEDA is whether it has truly attracted companies to Texas as a result of its subsidies, or whether companies that would have done business in Texas even in the absence of TEDA are happily taking "free money." Proponents of TEDA argue that the state and local governments are not losing anything by granting tax breaks to lure companies, because they would not have received any tax revenue from the companies without being able to lure them with tax breaks. The analysis, however, is more nuanced than that. Texas consistently ranks high in terms of attracting business for a variety of reasons. Thus, it is reasonable to suppose that at least some of the investments made and some of the jobs created under TEDA agreements would have been made and created even in the absence of TEDA. Currently, the Comptroller must certify that the Chapter 313 incentives were "a determining factor" in a company doing business in Texas before value limitation agreement is approved.[x] There is no statutory guidance, however, on how the Comptroller should determine this. Anecdotal evidence suggests that a company's claim that Chapter 313 is a determining factor in its desire to do business in Texas is essentially accepted at face value.[66]

The conclusion that TEDA subsidies which are "paid out" are not always truly necessary to attract businesses to Texas accords with the fact that PILTs are made pursuant to TEDA. The PILTs that most businesses with TEDA agreements make to school districts indicate that TEDA is providing property tax incentives greater than those needed to entice business. For example, a business which receives a $100 gross tax benefit and then repays $20 of that to the local school district evidently did not need a $100 tax benefit to seal its decision to do business in Texas; an $80 benefit would have been sufficient. Although PILTs are subject to a cap,[67] the Comptroller in its 2023 report indicated that renewable energy projects are returning 16 percent of their tax benefits back to the school districts through PILTs, while R&D and manufacturing projects are returning 14 percent and 13 percent, respectively. Because PILTs

[x] Technically, the Comptroller may still approve a project even if the incentives were not a determining factor if it finds that the project still provides a net benefit to the State. Tex. Tax Code 313.026(f).

school districts receive are outside the public education funding formula, districts have an incentive to push for PILTs. As the Comptroller noted back in 2010, this arrangement may provide an incentive for districts to enter into agreements which are not beneficial to the State.[68]

Reviewing the goals the Legislature set for TEDA, it appears that there has been significant investment by the targeted industries since its enactment. How much of this investment is directly attributable to TEDA is unclear. As a result of this investment, the state's property tax base has significantly grown, and it is quite possible that it will grow considerably more when the TEDA agreements expire.

Weighing against those benefits are the sheer size of the tax benefits under TEDA, which appear to be greater than necessary to attract investment to Texas. Perhaps more importantly, the number of jobs created under TEDA relative to the tax benefits granted appears quite underwhelming unless one is willing to rely on projections based on an unverified multiplier. Even if the multiplier were assumed to be accurate, one can still question why only certain industries are eligible to apply for TEDA's benefit. Alternatively, the tax benefits similar to those under TEDA could be applied to all businesses and individuals statewide through broad-based property tax relief, rather than being concentrated in a handful of specific industries. Not only would such an arrangement be more equitable, but it might have its own multiplier effect.

Notably, Governor Abbot has expressed serious reservations about TEDA. House Bill 2826 (84R, 2017) provided that an entity seeking a TEDA agreement for a project that covers more than one school district, the entity must seek separate approval for the project from each of those school districts. As the bill analysis for the introduced version of HB 2868 noted:

> [W]hen determining the eligibility of school district property in more than one district for a limitation on appraised value under the Texas Economic Development Act, single projects extending across multiple school districts are evaluated by each portion of the project, and each portion must separately qualify for a limitation agreement, sometimes posing a significant burden.[69]

In essence, the job creation and investment requirements imposed by the TEDA requirements must generally be met in *each* school district from which a project is seeking a tax exemption or reduction. This creates a higher burden for a project than if it happened to be located in just one school district. HB 2826 sought to amend these requirements such that the necessary job and investment requirements would be based on the entirety of the project, regardless of whether portions of the project are located within multiple school districts. However, in vetoing the legislation (which passed the House 131-12 and the Senate 25-6), Governor Abbott wrote that:

> Chapter 313 of the Tax Code allows for certain businesses to negotiate with school districts for lower appraisal valuations and, as a result, lower school property taxes. While the program may sometimes have a positive impact on local economic development, serious concerns exist about its oversight, its transparency, and its value to the taxpayers.

> According to a 2013 report by the Comptroller's Office, Chapter 313 cost the taxpayers $341,363 for every new job created by the program. The Comptroller estimates that House Bill 2826 will ultimately cost State taxpayers $100 million per biennium. I cannot support expansion of an incentive program that has not been proven to deliver the value taxpayers deserve.[70]

As emphasized above, the best replacement for Chapter 313 is simply using state revenue to buy down school district M&O tax rates. Such an approach benefits all businesses (and individuals) statewide, and does not involve the government favoring certain types of business. If, however, the Legislature decides that a targeted incentive for certain businesses is needed, it should consider crafting the replacement program such that the only benefit to a qualifying company is a franchise tax credit for property taxes paid by the applicable company. This credit could not reduce a company's franchise tax liability below zero but could be carried forward until it is exhausted. The administration of this tax credit would avoid the problems of the Chapter 313 program but would still primarily benefit the type of companies Chapter 313 was intended to benefit: large businesses that create high-paying jobs and make large capital investments in the state

1. Policy Recommendations

If the Legislature decides that a targeted incentive program for relocating businesses is necessary, it should take the following steps:

1) Provide a qualifying company with a non-refundable franchise tax credit for property taxes paid by the applicable company, which can be carried over from year to year until fully used.
2) Require projects to satisfy minimum, non-waivable job creation and capital investment requirements. Alternatively, if job waivers are deemed justified in certain cases, reduce the tax incentive provided to the applicant proportionately.
3) The program should be administered exclusively at the state level (perhaps by the Comptroller).

If a successor program permits tax abatement agreements between school districts and companies, the following recommendations should be implemented:

4) Provide for recapture of forgone property tax revenue under a tax abatement agreement if, in the first tax year after the agreement expires, the market value of the property in question is less than 80 percent of its market value when the project was approved.
5) Prohibit any payments from a company to a school district, such as the supplemental payments that were often made pursuant to Chapter 313 agreements. These payments were simply proof that Chapter 313 subsidies were often greater than necessary to attract investment to Texas.
6) Require the school district to hold a public hearing at least 30 days before entering into the agreement.

7) In the interest of encouraging meritorious applications under the successor program, if the government body tasked with processing applications (whether a school district, the Comptroller, etc.) uses its discretion to reject an application, it should be required to (a) state its reasons for the rejection, and (b) afford the rejected applicant a public hearing at which it can appeal that decision. If a government body uses discretion to reject an application, it should be required to refund any otherwise nonrefundable application fee to the applicant.

VI. The Franchise Tax

The tax base for the franchise tax, referred to as a business's margin, equals the business's total annual revenue minus its choice of a deduction. When calculating its margin, a business can generally choose to deduct one of the following from total revenue: 30 percent of total revenue; cost of goods sold; cost of compensation; or $1 million. Once the business's margin is known, the franchise tax liability is calculated by multiplying it by the applicable tax rate. Currently, the franchise tax rate is 0.375 percent for retailers and wholesalers, and 0.75 percent for other businesses.

There are, however, two provisions for small businesses to ease the burden of the franchise tax. First, businesses with gross receipts under the "no tax due threshold"- which is currently $1.23 million but is adjusted periodically for inflation- owe no tax. Second, businesses with less than $20 million in gross receipts can opt for the EZ Computation Rate, which simplifies the tax calculation process and results in a tax rate of 0.331 percent, but does not permit the deductions that can be claimed under the standard, more complex calculation method.

Since the current iteration of the Texas franchise tax was first collected in 2008 (and even before it was enacted), the tax has been controversial and a source of much criticism. Many of these criticisms stem from the fact that the franchise tax is a form of (gross) margins taxation, which is generally acknowledged to be an inefficient form of taxation with high compliance costs for businesses that are subjected to it.[71] Rather than being based on the income or profit of a business, the franchise tax is based on the gross receipts of a business. According to a June 2022 Tax Foundation report, Texas is one of only seven states to levy a gross receipts tax, although several others permit local gross receipts taxes.[72] Since 2017, several states have beaten back attempts to impose a gross receipts tax by highlighting the flaws of such a tax.[73]

Understanding these issues and the negative impact that the franchise tax is having on the state's business climate,[74] the Texas legislature has already set itself on the path toward elimination of the franchise tax. In the 2015 legislative session, House Bill 32 reduced the rates of the tax by one-quarter, increased the annual maximum revenue threshold for filing an "EZ" franchise tax return from $10 million to $20 million, and lowered the EZ filing tax rate by 42 percent. House Bill 32 (84R, 2015) also directed the Comptroller of Public Accounts to study the future fiscal and economic effects of repealing the franchise tax. Per the Legislative Budget Board (LBB), the cuts to the franchise tax enacted in HB 32 amounted to a $2.6 billion tax reduction over the course of the 2016-17 biennium alone. The Comptroller's 2024-25 Biennial Revenue Estimate, released in January 2023, projected that the tax would raise $11.83 billion throughout the 2022-23 biennium, with $3.55 billion going to the Property Tax Relief Fund and the remaining $8.28 billion going to general revenue.[75] For the 2024025 biennium, those numbers are expected to increase to $3.78 billion and $8.83 billion, respectively.[76]

During the 86th Session, Senate Bill 66 (Nelson | companion bill House Bill 2759; Murphy) would have phased out the franchise tax gradually in the following manner: if a BRE for a given biennium shows

general revenue-related funds available for certification by the Comptroller that are more than five percent greater than the same figure for the preceding biennium, half of the excess funds would be used to lower franchise tax rates. The process would be repeated each subsequent biennium. Over time, this mechanism would result in an elimination of the franchise tax.

The 85th Session also offered some interesting paths to eliminating the franchise tax. House Bill 28 would have accomplished a phaseout of the franchise tax by first identifying the lesser of $3.5 billion or the ending balance of general revenue-related funds available for certification for the preceding biennium. Franchise tax rates would then be set to generate franchise tax savings equal to this amount. The process would be repeated each biennium. When the franchise tax so adjusted would be less than 15 percent of the franchise tax rate effective on September 1, 2017, the franchise tax would be eliminated entirely. Additionally, HB 388 (85R; Rep. Murphy) would have phased out the franchise tax on a definite date. It would have phased out the franchise tax by reducing it incrementally each year for four years, then keeping the tax rate constant for one more year before eliminating the tax entirely.

House Bill 3000 (87R; Cason) would have repealed the franchise tax and, for the 2022-23 biennium only, would have tapped the ESF to replace the forgone franchise tax revenue. Even more aggressively, House Bill 3404 (87R; Guillen) would have eliminated the franchise tax on January 1, 2022, with no provision for the forgone revenue. House Bill 391 (88R; Goldman), also proposes immediate repeal of the franchise tax.

Although the foregoing bills were not enacted into law, the Legislature should continue to pursue the idea behind them. Given the state's strong financial position, outright repeal of the franchise tax is possible and should be pursued. If immediate repeal is not feasible, then a phase out of the tax should be considered.

A. The fiscal and economic imperative of eliminating the franchise tax

Although the franchise tax is the state's primary business tax, it generated only 7.3 percent of all state tax revenue and 3.1 percent of all state revenues in FY 2022.[77] Incrementally reducing or slowing the growth of state outlays by one or two percent for each of the next two or three biennia could see the tax phased out five or six years from now. Alternatively, the tax could be entirely eliminated in the 88th Legislature.

Americans for Tax Reform has argued that "the [franchise] tax has significantly diminished the competitive advantage that Texas companies have over their out-of-state competitors. Worse, for all the economic harm the margins tax does, it generates relatively little revenue for state government coffers."[78] Professor John Mikesell of Indiana University described the franchise tax as follows:

> [The franchise tax is] a badly designed business profits tax, like those that emerged in the newly independent states of the former Soviet Union...combin[ing] all the problems of minimum income taxation in general—excess compliance and administrative cost, penalization of the unsuccessful business, undesirable incentive impacts, doubtful equity basis—with those of taxation according to gross receipts.[79]

By eliminating the franchise tax, Texas would join states such as New Jersey, Kentucky, and Michigan, all of which repealed their gross receipts taxes within a few years of adopting them after realizing the flaws of that manner of taxation.

1. Policy Recommendation: Eliminate the Franchise Tax Through a Phaseout

Like all forms of margin-based taxation (where tax liability is based on the top-line revenue of a business, rather than some calculation of net income) the Texas franchise tax has serious flaws. The tax is complex, with businesses having a multitude of ways to calculate their liability, unclear rules pertaining to what can be excluded from "total revenue" in adjusting their gross revenue, as well as what items can be included in the deductions for either "cost of goods sold" or "compensation." Margins taxation is also especially punitive for businesses that have narrow margins and can create situations in which businesses owe tax to the state despite having recorded a loss. The Tax Foundation summarized problems with the tax thusly:

> With the Texas margin tax collecting far less in revenue than expected, causing significant confusion and compliance costs, resulting in significant litigation and controversy over "cost of goods sold" definitions, and facing calls for substantial overhaul and even repeal, it should not be used as a model tax reform for any other state.[80]

Eliminating the franchise tax – which again, accounted for only 3.1 percent of all state revenue and 7.3 percent of all state tax revenue in FY 2022- would make Texas one of only three states without a corporate income tax or gross receipts-style business tax,[81] which would be a boon for investment, job creation, and economic growth. The Legislature should continue its phaseout of the franchise tax. To avoid a situation in which repeal of the tax exacerbates an unanticipated shortfall in state revenue, the Legislature could eliminate the franchise tax over time by using as a template legislation from the 85th or 86th legislative sessions that was discussed above, such as SB 66 (86R; Nelson). Using such bills as a model would ensure that the phaseout of the franchise tax goes smoothly.

VII. Tax Equity, Marketplace Providers, and Tax Administrative Efficiency

A recurring question for conservative policymakers is how the existing framework of federal, state, and local tax laws should apply to new products and technologies. On one hand, policymakers should welcome the emergence of companies offering new and innovative goods and services for which there is demand (for example, Uber). On the other hand, policymakers must be aware that the business model of new companies is often such that the application of tax rules and associated regulations to these companies lacks clarity and/or enforcement mechanisms. In competing against such new companies, traditional companies might effectively be penalized by policymakers by being subjected to a more onerous tax system even though they provide essentially the same service. An uneven playing field of this nature would be a textbook example of government improperly picking winners and losers in the marketplace. Moreover, as discussed below, companies with non-traditional business models can pose serious challenges to the Comptroller's efforts to ensure compliance with the state's tax laws.

House Bill 1525 (86R; Burrows) is a good example of legislation dealing with the issue of newer companies competing on a level playing field. The bill, which passed into law, requires "marketplace providers" to collect sales tax on taxable items delivered to purchasers in Texas. A marketplace provider is a company which runs a marketplace (often a website) and processes sales or payments for sellers. The enactment of HB 1525 followed shortly after the 2018 United States Supreme Court's decision in *South Dakota v. Wayfair, Inc.*,[82] in which the court overruled its precedent and held that a state could require "remote" sellers (i.e., those which lack a physical presence in the state) to collect and remit sales tax to the state with respect to their sale of taxable items to persons in the state.

As the court noted in *Wayfair*, South Dakota (like most states) has a use tax which requires purchasers to submit use tax on their purchases if a remote seller did not collect sales tax. However, as the court further noted, consumer compliance rates regarding the use tax are "notoriously low."[83] That fact is not surprising given the difficulty tax authorities in face in auditing the vast number of consumers who make purchases in a given year from remote sellers. Because remote sellers prior to *Wayfair* were able to sell items to consumers without collecting sales tax (and because most consumers were not paying use tax as they were required to), these sellers had a significant competitive advantage over sellers with a physical presence in the applicable state who had to collect tax. A rational consumer, faced with the choice of purchasing an item from a remote seller on the one hand or a store with a physical presence in his or her state on the other hand, would likely prefer purchasing from the remote seller if all other factors were equal, thereby avoiding the payment of sales tax. To be competitive, the store with the physical presence in this example would be forced to reduce its pre-tax prices in order to offset the tax advantage that the remote seller has. As the court summarized:

> [Pre-*Wayfair* precedent] puts both local businesses and many interstate businesses with physical presence at a competitive disadvantage relative to remote sellers. Remote sellers can avoid the regulatory burdens of tax collection and can offer de facto lower prices

> caused by the widespread failure of consumers to pay the tax on their own. . . . In effect, [Pre-*Wayfair* precedent] has come to serve as a judicially created tax shelter for businesses that decide to limit their physical presence and still sell their goods and services to a State's consumers—something that has become easier and more prevalent as technology has advanced.[84]

It is important to emphasize that the advantage which remote sellers enjoyed pre-*Wayfair* was inextricably tied to tax administration; if consumers had complied with use tax laws, remote sellers would not have enjoyed an advantage over stores with a physical presence in the relevant state. But because governments have limited resources, ensuring widespread consumer compliance with the use tax is extraordinarily difficult.

Legislation such as HB 1525 should be applauded because it furthers the goal of a competitive marketplace. By making marketplace providers responsible for collecting and remitting sales tax, the bill eliminated artificial advantages some businesses enjoyed over their more traditional competitors. In an ideal marketplace, businesses innovate and develop goods and services which consumers value. Businesses which do a superior job of innovating are rewarded by increased business from consumers. In contrast, a marketplace is warped when government grants one group of businesses an arbitrary tax advantage over its competitors. House Bill 1525 ensures that a remote seller trying to out-compete its rivals with a physical presence in Texas must do so on a level playing field.

The 86th Legislature considered two bills that were conceptually similar to HB 1525, each of which passed the House but failed to become law. House Bill 3579 (Burrows) would have required online travel agencies (OTAs) such as Expedia and Priceline to collect and remit hotel occupancy tax (HOT) from people who purchase hotel rooms through their websites; currently, hotels alone have that responsibility. House Bill 2872 (Burrows, et al.) would have required companies which pair car owners with people seeking car rentals to collect and remit the motor vehicle gross rental receipts tax. These two bills and HB 1525 generally resemble each other in that they target companies acting as a sort of middleman between buyers (or renters) and sellers online. Notably, substantively-similar bills were filed in the 87th Session. House Bill 2889 (Meyer, et al.) was modeled on HB 3579, and House Bill 2415 (Meyer, et al.) was modeled on HB 2872. Although each of HB 2889 and HB 2415 failed to become law, the latter passed the House.

An obvious reason for these bills is tax administration: the Comptroller cannot realistically audit more than a tiny fraction of sellers in the state to determine if they are fulfilling their tax collection and remittance obligations. Just as it is administratively much easier for the Comptroller to audit a single entity (such as eBay) which facilities a vast number of remote sales rather than audit thousands of sellers on eBay, it is much easier to audit a few OTAs rather than hundreds of hotels, and much easier to audit a few car rental platform companies rather than auditing thousands of people renting out their vehicles on these platforms. As the fiscal note to HB 1525 stated: "The expected increases in tax collections [as a result of the bill] are attributable to greater efficiency of tax administration and

convenience and avoidance of undue burdens for taxpayers when responsibility for collection and remittance rests with marketplace providers rather than myriad individual sellers."[85]

If bills with provisions such as those in HB 2872 and HB 3579 are considered in the 88th Session, they deserve support due to their ability to make tax administration more uniform and efficient, thereby eliminating tax advantages which some companies might effectively have due to consumer non-compliance with tax laws. This support, however, should be contingent on a clarification of what constitutes the relevant tax base. Defining the proper tax base is crucial in analyzing the provisions of these two bills and requires some background on the business models used by OTAs and car rental platforms.

A. Online Travel Agencies

OTAs typically act simply as a distributor for a hotel company rather than actually buying hotels rooms and re-selling them to consumers at marked-up prices. Under the distributor model, a hotel typically agrees to list its room on the OTA's website at a discounted price in exchange for the increased visibility which the OTA listing provides. The discounted price the hotel and the OTA negotiate is sometimes referred to as the "room price" and is not revealed to the consumer. When a consumer purchases a hotel room on an OTA's website, it pays a single fee which has three components: the room price, the OTA's service fee for its services, and a tax recovery charge attributable to the HOT that is due on the room price (again, the consumer does not see this three-part itemization). The service fee charged by the OTA allows it to cover the costs of its various services (search engine capabilities, research on hotel room availability, negotiation with hotels, etc.) and earn a profit. The OTA transmits the tax recovery charge to the hotel, and the hotel in turn remits the HOT to the Comptroller.

Some parties, including many taxing authorities, argue that the amount of the tax base for purposes of calculating the HOT due should include not just the room price but also the OTA's service fee. The relevant statute provides that "[State HOT] is imposed on a person who, under a lease, concession, permit, right of access, license, contract, or agreement, pays for the use or possession or for the right to the use or possession of a room or space in a hotel costing $15 or more each day."[86] The state HOT is six percent "of the price paid for a room in a hotel."[87] Municipalities are authorized to charge additional HOT.[88] Responsibility for collecting the HOT falls to the persons "owning, operating, managing, or controlling a hotel."[89]

Courts in Texas have generally held that the tax base for purposes of the HOT excludes OTAs' service fees.[90] When a consumer purchases a room from a hotel using an OTA's website, the price paid for a room in the hotel- the relevant price under statute- is the room price. This fact is not altered by the OTA's business decision to not disaggregate the service fee from the room price in its invoice to the consumer. Notably, the statute provides that the price of the room for purposes of calculating the HOT tax base excludes the cost of hotel food and services, unless those services relate to cleaning and preparing the room for a consumer's stay. If the cost of the hotel's own food and services are excluded

from the HOT base, it stands to reason that the service costs of a third party (i.e., the OTA) should be excluded as well.

In contrast to the tax advantage remote sellers enjoyed over brick-and-mortar stores prior to the enactment of HB 1525, OTAs are not gaining an advantage in the marketplace due to their service fees not being included in the HOT base. Indeed, hotels welcome the opportunity to enter into contracts with OTAs under which they discount room prices, because they know that the OTAs' services are so popular with consumers that the discounted prices can be offset by a greater volume of customers. If anything, OTAs increase competition in the marketplace because they permit small hotels to better compete with hotel chains by obtaining equal visibility through OTA websites.

The Legislature should seek to maintain the current exclusion of OTAs' service fees from the HOT. Provided that is done, a bill with provisions like those in HB 3579 should be supported because it improves the efficiency of tax administration. Although such a bill would actually increase the number of entities responsible for collecting and remitting HOT by adding OTAs to that list of entities, it would still result in better tax administration through "scaling"; rather than auditing hundreds of hotels for HOT compliance, the Comptroller could direct much of its resources to auditing a few OTAs that account for a huge number of sales.

B. Car Rental Platforms

House Bill 2872 aimed to improve tax administration by making "marketplace rental providers" (MRPs) of motor vehicles responsible for collecting and remitting motor vehicle gross rental receipts tax (GRRT) to state and local taxing authorities. Chapter 152 of the Tax Code subjects "gross rental receipts," which is defined as "value received or promised as consideration to the owner of a motor vehicle for rental of the vehicle," to the GRRT.

Currently, MRPs such as Turo and Getaround, sometimes referred to as peer-to-peer car sharing platforms- operate websites which match people seeking rental cars with people seeking to rent out their cars. These companies transmit payment from the renter to the vehicle owner after deducting a fee for their services. As the Comptroller acknowledges, the MRPs have no duty to collect the GRR due.[91] But because the Comptroller lacks the resources to audit thousands of vehicle owners renting out their vehicles on these platforms, tax compliance by motor vehicle owners using MRPs is presumably quite poor. HB 2872 would have improved tax administration by allowing the Comptroller to focus its resources on a handful of car rental providers. Similar to HB 3579, HB 2872 deserves support because of its potential to improve tax administration. However, again similar to HB 3579, support for HB 2872 should be contingent on properly defining the tax base for the GRRT.

The definition of the tax base in an MRP transaction greatly affects competition in the marketplace for rental cars because traditional car rental companies must pay GRRT on their gross receipts. The GRRT is ten percent of gross receipts. Many large urban local governments in Texas levy a sports and community

venue tax of up to five percent of the price of a car rental.[92] In all, traditional car rental companies may be required to increase their fees to consumers by 25 percent just to cover their tax obligations. In contrast, an MRP currently collects no GRRT with respect to a car rental it facilitates in Texas and vehicle owner compliance with GRRT remission is presumably very poor. Similarly, an MRP and vehicle owners who list on their websites can effectively avoid paying airport concession fees and venue district taxes. Because a person opting to rent a car through a traditional car rental company must pay heavy taxes, if all other factors are equal, he or she will likely prefer to rent through an MRP. This poses the same general problem HB 1525 was designed to combat; an uneven playing field among businesses which is created by inadequate tax compliance by certain consumers.

Before analyzing the matter of the proper tax base in an MRP transaction, an argument sometimes made in defense of the current functional tax advantage of MRPs (and of the owners renting out their cars through them) should be addressed. The argument begins by noting that traditional car rental companies do not pay sales tax on their purchase of motor vehicles. In contrast, owners renting out their cars through MRPs must pay sales tax when they purchase their cars. To subject them to the GRRT as well, the argument goes, would be unfair because it results in a type of double taxation. This argument has superficial appeal but fails to withstand scrutiny in full context. Traditional car rental companies are indeed exempted from paying sales tax on the vehicles they purchase.[93] However, this exemption applies only if the company satisfies its minimum rental tax liability; it must collect at least as much in GRRT as it would have paid in sales if the sales tax exemption did not apply. If a traditional car rental company purchases a car sales-tax free and retires the car from service before it has satisfied the minimum rental tax liability, it must make up the shortfall.[94] Thus, the company escapes sales tax only to the extent it does not escape the GRRT. In addition, as the Comptroller clarified in 2019, a taxpayer who both rents out his or her car and uses it for personal use may claim a credit against the GRRT for the sales tax paid on the car, provided that he or she does not claim a credit for the portion of the sales tax paid that corresponds to the period in which the car was for personal use.[95] Thus, the law treats traditional car rental companies and owners renting out their cars in an even manner by providing them with a credit against sales tax. With that argument dismissed, the focus returns to the question of what the proper tax base for the GRRT should be in the context of an MRP transaction.

HB 2872 would have answered the question of the proper tax base for the GRRT by stating that all gross receipts of a MRP with respect to a car rental are presumed to be subject to the GRRT (unless the vehicle owner has an exemption from the GRRT). Thus, if a person rented a car for $100 from a vehicle owner through the use of an MRP, and the MRP transmitted $70 of that amount to the owner, the MRP would collect and remit GRRT on the full $100. This yields the same GRRT revenue that a $100 rental from a traditional car rental company would yield.

There is no question that the $70 the owner receives in the example above should be subject to the GRRT, concession fees, and venue district taxes. The owner in this case is clearly being compensated for the temporary use of his or her vehicle and as such has gross rental receipts. However, the treatment of the remaining $30 is less clear. This $30 undoubtedly facilitates the rental transaction between the renter and the vehicle owner, but it is in the nature of a matchmaking or finder's fee rather than

consideration paid for the use of a vehicle. If the renter and the vehicle owner in the transaction had perfect knowledge of each other, they would not need to use an MRP. Rather, they could enter into a rental transaction in which the vehicle owner would charge a price that is probably less than $100. Similar to the fee charged by OTAs, the $30 fee above represents the service fee an MRP charges the renter, which covers the cost of the MRP's services (search engine capability, facilitating auto insurance coverage, payment processing, etc.) and its profit. As a third-party service fee, the $30 should not be grouped together with the $70 the vehicle owner receives, and should not be subject to the GRRT.[xi]

Unlike remote sellers who enjoyed a pricing advantage over brick-and-mortar businesses due solely to tax advantages (which in turn were attributable to consumer non-compliance with the law) prior to the enactment of HB 1525, MRPs have grown in large part because they provide an innovative service for which there is consumer demand. In contrast to traditional car rental companies, MRPs devised a business model which allows them to list vehicles available for rental without the need to actually own those vehicles. In other words, their business model has bifurcated vehicle ownership from the ancillary services which traditional car rental companies provide. By doing so, they have made it possible for owners of motor vehicles to rent their cars out and for renters to choose from an extensive offering of cars in their area.

The growth of industries such as OTAs and MRPs clearly poses challenges for tax administration. Designating OTAs and MRPs as the parties responsible for collecting and remitting applicable taxes makes a great deal of sense by allowing taxing authorities to greatly reduce the number of entities they must audit to ensure compliance with the law. The Legislature should support such measures because of their potential to make tax enforcement simpler, but should be careful not to discourage innovation. Support for bills such as HB 3579 and HB 2872 should be contingent on ensuring that third party intermediaries are not subject to HOT and GRRT (as applicable) on the value of the services they provide.

1. Policy Recommendation: Improve Tax Administration in the Marketplace

Following HB 1525 (86R), require marketplace providers connected to the hotel and/or car rental industries to collect and remit applicable taxes so that tax administration is improved. However, avoid the overly broad approach of HB 2415 (87R) and HB 2889 (87R) and define the applicable tax base such that the fees attributable to the marketplace providers' services are not subject to the tax which the underlying activity (e.g., renting hotel rooms or renting motor vehicles) is.

[xi] Of course, the $30 portion might be subject to other state and local taxes, e.g., sales tax.

VIII. Endnotes

[1] *See* Texas Comptroller, *Monthly State Revenue Watch* https://comptroller.texas.gov/transparency/revenue/watch/all-funds/ ("All Funds Historical Data" Excel file in right sidebar) (last visited January 17, 2023).

[2] The Federal Reserve Board, "Testimony of Chairman Alan Greenspan," (March 3, 2005), https://www.federalreserve.gov/boarddocs/Testimony/2005/20050303/default.htm.

[3] LBB estimates that local funding of school M&O, including recapture, will exceed $29.5 billion in FY 2023. See *2022-2023 Fiscal Size Up* (March 2022), https://www.lbb.texas.gov/Documents/Publications/Fiscal_SizeUp/Fiscal_SizeUp_2022-23.pdf (Figure 158).

[4] *See* Texas Comptroller, *Monthly State Revenue Watch* https://comptroller.texas.gov/transparency/revenue/watch/all-funds/ ("All Funds Historical Data" Excel file in right sidebar) (last visited January 17, 2023). The franchise tax is the fourth-largest source of state tax revenue per that link; however, if M&O school taxes are considered virtual "state" tax taxes, then the franchise tax was the fifth-largest revenue generator for Texas in FY 2022.

[5] Janelle Fritts, "State Corporate Income Tax Rates and Brackets for 2022*," Tax Foundation* (January 18, 2022), https://taxfoundation.org/state-corporate-income-tax-rates-brackets-2022/.

[6] Attom Data, "U.S. Property Taxes Levied on Single Family Homes in 2018 Increased 4 Percent to More Than $304 Billion," (April 2, 2019), https://www.attomdata.com/news/market-trends/attom-data-solutions-2018-property-tax-analysis/

[7] Shannon Najmabadi, "Here's What We Know about the Legislature's Final Property Tax Reform Bill," *Texas Tribune* (May 24, 2019), https://www.texastribune.org/2019/05/24/property-tax-reform-texas-legislature/#:~:text=For%20the%20owner%20of%20a,2020%20and%20%24325%20in%202021.&text=The%20final%20version%20of%20the,around%20the%20reduced%20election%20trigger.

[8] "Taxes in Texas," *Tax Foundation,* https://taxfoundation.org/state/texas (last visited January 17, 2023).

[9] Attom Data, "Property Taxes on Single-Family Homes Rise Across U.S. in 2021, to $328 Billion," (April 14, 2022), https://www.attomdata.com/news/market-trends/home-sales-prices/attom-2021-property-tax-analysis/

[10] John S. Kiernan, "Property Taxes by State," (March 2, 2022), https://wallethub.com/edu/states-with-the-highest-and-lowest-property-taxes/11585.

[11] Data for 1999 is from the Legislative Budget Board, *Fiscal Size-up 2022-231* (March 2022), https://www.lbb.state.tx.us/Documents/Publications/Fiscal_SizeUp/Fiscal_SizeUp_2020-21.pdf (p. 48). Data for 2021 is from the Comptroller, *Biennial Property Tax Report, 2020 and 2021* (December 2022) (p. 5).

[12] Texas Office of Consumer Credit Commissioner, "Property Tax Lenders," https://occc.texas.gov/industry/property-tax-lenders (last visited January 17, 2023).

[13] Waylon Cunningham, "High-Interest Property Tax Lenders Gear Up for 'Best Year We'll See for a Long Time," *San Antonio Report*, (April 20, 2022), https://sanantonioreport.org/property-tax-lenders/.

[14] *Id.*

[15] Comptroller, *2024-25 Biennial Revenue Estimate* (January 2023), https://comptroller.texas.gov/transparency/reports/certification-revenue-estimate/2022-23-update/

[16] Texas Education Agency, "2022 Maximum Compressed Rates," https://tea.texas.gov/about-tea/news-and-multimedia/correspondence/taa-letters/2022-maximum-compressed-tax-rates (last visited January 17, 2023).

[17] Legislative Budget board, *2022-23 Fiscal Size-Up*, (March 2022), https://www.lbb.texas.gov/Documents/Publications/Fiscal_SizeUp/Fiscal_SizeUp_2022-23.pdf (Figure 41).

[18] Id., Figure 158.

[19] Legislative Budget Board, "Legislative Budget Board Implementation of the

Limit on Growth of Certain State Appropriations," (November 2022), https://www.lbb.texas.gov/LBB_Meetings/Technical_Memorandum_LBB_Meeting_11_30_22.pdf (p. 3).

[20] Legislative Budget Board, Memorandum (November 30, 2022), https://www.lbb.texas.gov/LBB_Meetings/11_30_22_Motion_Memo.pdf.

[21] Legislative Budget Board, "Constitutional Limitations on Spending," (May 18, 2016), https://capitol.texas.gov/tlodocs/84R/handouts/C0302016051810001/351b91fc-a897-4202-878b-b796ff18930f.PDF (PDF page 26/34).

[22] House Study Group, Bill Analysis for CSHJR 1 (65S2, 1978), https://lrl.texas.gov/scanned/hroBillAnalyses/65-2/HJR1.pdf (PDF page (27/27); House Joint Resolution (65S2, 1978), https://lrl.texas.gov/LASDOCS/65CS2/HJR1/HJR1_65CS2.pdf (PDF page 51/123).

[23] Section 22.01(a), Tax Code.

[24] Section 22.23, Tax Code.

[25] The freeport exemption applies to goods, wares, ores and merchandise other than oil, gas and petroleum products, and to aircraft or repair parts used by a certificated air carrier. The freeport goods qualify if they leave Texas within 175 days from the date they are brought into or acquired in the state. For more detail, see Comptroller, "The Freeport and Goods In Transit Exemptions," https://comptroller.texas.gov/economy/local/transit-exemptions/ (last visited January 17, 2023).

[26] Dr. John Merrifield, "The Business Personal Property Tax: Everything a Tax Should not Be," (November 2022) (available upon request through TCCRI).

[27] Senate Finance Committee, "Interim Report," (August 2020), https://senate.texas.gov/cmtes/86/c540/c540.InterimReport2020.pdf (p. 23).

[28] Codified as Section 11.145, Tax Code.

[29] House Research Organization, Bill Analysis of House Bill 366 (April 12, 1995), https://hro.house.texas.gov/pdf/ba74r/hb0366.pdf#navpanes=0

[30] Garrett Watson, "States Should Continue to Reform Taxes on Tangible Personal Property," *Tax Foundation* (Aug. 2019), https://taxfoundation.org/tangible-personal-property-tax/#_ftnref28.

[31] United States Energy Information Administration, "Oil: Crude and Petroleum Production Explained," https://www.eia.gov/energyexplained/oil-and-petroleum-products/where-our-oil-comes-from.php (last visited January 17, 2023).

[32] United States Energy Information Administration, "Frequently Asked Questions," https://www.eia.gov/tools/faqs/faq.php?id=46&t=8 (last visited January 17, 2023).

[33] Garrett Watson, "States Should Continue to Reform Taxes on Tangible Personal Property," *Tax Foundation* (Aug. 2019), https://taxfoundation.org/tangible-personal-property-tax/#_ftnref28.

[34] Janelle Fritts, "Does Your State Tax Business Inventory," *Tax Foundation* (March 17, 2021), https://taxfoundation.org/state-business-inventory-tax-2021/.

[35] Site Selection Press Release, "Ohio Wins Site Selection Magazine's Governor's Cup Award for 2009" (March 3, 2010), https://siteselection.com/press/releases/100303.htm?_ga=2.227949405.1516866566.1575299989-913645058.1575299989

[36] Business Wire, "Ohio Leads Site Selection's Governor's Cup Rankings for Fifth Consecutive Year," (March 4, 2019), https://www.businesswire.com/news/home/20190304005646/en/Ohio-Leads-Site-Selection%E2%80%99s-Governor%E2%80%99s-Cup-Rankings. See also Site Selection Magazine, "The 2019 Governor's Cups," https://siteselection.com/issues/2020/mar/the-2019-governors-cups-cover.cfm (showing results for 2019). Doug Buchanan, "Ohio Ranked No.1 in the U.S. for Corporate investment," *Columbus Business First* (March 1, 2021), https://www.bizjournals.com/columbus/news/2021/03/01/ohio-ranked-no-2-in-the-u-s-for-corporate.html (showing results for 2020).

[37] "The 2019 Governor's Cups," *Site Selection Magazine* (March 2020), https://siteselection.com/issues/2020/mar/the-2019-governors-cups-cover.cfm; see also Doug Buchanan, "Ohio Ranked No.1 in the U.S. for Corporate investment," *Columbus Business First* (March 1, 2021), https://www.bizjournals.com/columbus/news/2021/03/01/ohio-ranked-no-2-in-the-u-s-for-corporate.html (showing 2020 ranking).

[38] Comptroller, *Texas Economic Development Act Chapter 313 Summary Data 2023* (January 2023), accessible at https://comptroller.texas.gov/economy/local/ch313/biennial-reports.php.

[39] Texas Taxpayers and Research Association, "Texas Franchise Tax" (July 2018), https://ttara.org/wp-content/uploads/2018/11/FranchiseTaxReport_Final.pdf

[40] Fiscal Note to Senate Bill 763 (March 1, 2015), https://capitol.texas.gov/tlodocs/84R/fiscalnotes/pdf/SB00763I.pdf#navpanes=0

[41] *EXLP Leasing, LLC v. Galveston Central Appraisal District,* 554 S.W.3d 572 (Tex. 2018).

[42] Section 23.1241, Tax Code.

[43] Federal Reserve Bank of St. Louis, "30-Year Breakeven Inflation," https://fred.stlouisfed.org/series/T30YIEM (December 2022 data is as of January 17, 2023).

[44] Senate Committee on Property Tax, "Interim Report" (November 2020), https://senate.texas.gov/cmtes/86/c586/c586.InterimReport2020.pdf (PDF page 18 of 116).

[45] Comptroller, *Report of the Texas Economic Development Act* (2017), PDF page 3 of 334 (compiling information on projects for which agreements were in place on or before August 31, 2018).

[46] Comptroller, *Report of the Texas Economic Development Act* (2021).

[47] Brian Lopez, "Texas Supreme Court Says It Can't Force the State to Process Deluge of Applications for Tax Break Expiring this Year," *Texas Tribune* (December 30, 2022), https://www.texastribune.org/2022/12/30/texas-supreme-court-chapter-313-tax-breaks/.

[48] Section 313.003, Tax Code.

[49] State Auditor's Office, "Selected Major Agreements Under the Texas Economic Development Act" (July 2018), https://sao.texas.gov/Reports/Main/18-037.pdf.

[50] Alan Rappeport, "Trump Funnels Record Subsidies to Farmers Ahead of Election Day," *New York Times* (October 12, 2020), https://www.nytimes.com/2020/10/12/us/politics/trump-farmers-subsidies.html

[51] Chris Edwards, "Reforming Federal Farm Policies," *Cato Institute* (April 12, 2018), https://www.cato.org/publications/tax-budget-bulletin/reforming-federal-farm-policies

[52] Congressional Budget Office, "Options to Reduce the Budgetary Costs of the Federal Crop Insurance Program," (December 2017), https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53375-federalcropinsuranceprogram.pdf (p. 2)

[53] Id.

[54] Section 313.002(2), Tax Code.

[55] See "Tesla Motors Dealing as States Play Factory Poker," *Economic Times* (September 1, 2014), https://economictimes.indiatimes.com/news/international/business/tesla-motors-dealing-as-states-play-factory-poker/articleshow/41411049.cms.

[56] Staff, "Tesla Secures Tax Breaks for Cybertruck Factory in Texas," *Reuters* (July 14, 2020), https://www.reuters.com/article/us-texas-tesla/tesla-secures-tax-breaks-for-cybertruck-factory-in-texas-idUSKCN24F2YV.

[57] Lydia DePillis, "Helipads and Everything Else Amazon Is Getting Out of its Deals with New York and Virginia," *CNN* (November 14, 2018), https://www.cnn.com/2018/11/13/business/amazon-hq2-subsidies/index.html

[58] Christian Gonzales, et al., "How State and Local governments Win at Attracting Companies," McKinsey (September 13, 2019), https://www.mckinsey.com/industries/public-and-social-sector/our-insights/how-state-and-local-governments-win-at-attracting-companies#.

[59] Matt Day, "Amazon Refuses Arizona's Cactus as Bidders for HQ2 Climb to 118," *Seattle Times* (September 19, 2017), https://www.seattletimes.com/business/amazon/amazon-refuses-arizonas-cactus-as-bidders-for-hq2-climb-to-118/.

[60] Amazon HQ2 Request for Proposal (undated), https://images-na.ssl-images-amazon.com/images/G/01/Anything/test/images/usa/RFP_3._V516043504_.pdf (last visited January 17, 2023).

[61] Laura Stevens, et al., "Amazon Cancels HQ2 Plans in New York City," *The Wall Street Journal* (February 14, 2019), https://www.wsj.com/articles/amazon-cancels-hq2-plans-in-new-york-city-11550163050.

[62] Comptroller, *Report of the Texas Economic Development Act* (January 2023) (p. 3).

[63] Those 12 companies are: Samsung Austin Semiconductor, LLC; Caterpillar, Inc.; Dow Chemical Company; Pandora Methanol, LLC; Texas Pellets, Inc.; Oxiteno USA LLC; Corpus Christi Liquefaction, LLC; Voestalpine Texas LLC; Natgasoline LLC; Occidental Chemical Corporation; Ingleside Ethylene, LLC; and FMC Technologies, Inc.

[64] Comptroller, *Report of the Texas Economic Development Act* (2013).

[65] Id.

[66] See, e.g., Patrick Michels, "Free Lunch," *Texas Observer* (March 15, 2016), https://www.texasobserver.org/chapter-313-texas-tax-incentive/.

[67] Section 313.027(i), Tax Code.

[68] Comptroller, *Texas Economic Development Act Report* (2010).

[69] Bill Analysis of HB 2826 (84R, 2015), available at https://capitol.texas.gov/tlodocs/84R/analysis/pdf/HB02826H.pdf#navpanes=0.

[70] Governor Abbott, Veto Proclamation for HB 2826 (84R, 2015), (June 19, 2015), https://lrl.texas.gov/scanned/vetoes/84/hb2826.pdf#navpanes=0.

[71] Ben Wilterdink, "Margin Tax is the Epitome of Bad Tax Policy," *American Legislative Exchange Council* (July 9, 2014), https://alec.org/article/margin-tax-epitome-bad-tax-policy/.

[72] Janelle Fritts, "Does Your State Have a Gross Receipts Tax?" Tax Foundation (June 7, 2022), https://taxfoundation.org/state-gross-receipts-taxes-2022/.

[73] Garrett Watson, "Resisting the Allure of Gross Receipts Taxes: An Assessment of Their Costs and Consequences," *Tax Foundation* (February 6, 2019), https://taxfoundation.org/gross-receipts-tax/#_ftnref75.

[74] Scott Drenkard, "The Texas Margin Tax: A Failed Experiment," *Tax Foundation* (2015).

[75] Comptroller, *2024-25 Biennial Revenue Estimate* (January 2023).

[76] Id.

[77] Comptroller, *Monthly State Revenue Watch,* https://comptroller.texas.gov/transparency/revenue/watch/all-funds/(Historical Data Excel file in right sidebar).

[78] Chris Buki, "Time to Eliminate the Texas Margins Tax," *Americans for Tax Reform* (Jan. 16, 2013), https://www.atr.org/time-eliminate-texas-margins-tax-a7413/.

[79] As quoted in Scott Drenkard, Tax Foundation, "The Texas Margin Tax: A Failed Experiment," (January 14, 2015), available at https://taxfoundation.org/texas-margin-tax-failed-experiment/.

[80] Joseph Henchman, "Texas Margin Tax Experiment Failing Due to Collection Shortfalls, Perceived Unfairness for Taxing Unprofitable and Small Businesses, and Confusing Rules," *Tax Foundation* (2011) (emphasis added).

[81] Janelle Cammenga, "State Corporate Income Tax Rates and Brackets for 2019", *Tax Foundation* (February 27, 2019), https://taxfoundation.org/state-corporate-rates-brackets-2019/.

[82] *South Dakota v. Wayfair, Inc.*, "138 S.Ct. 2080 (2018), https://www.supremecourt.gov/opinions/17pdf/17-494_j4el.pdf.

[83] Id.

[84] Id.

[85] Legislative Budget Board, Fiscal Note to House Bill 1525 (86R), (May 3, 2019), https://capitol.texas.gov/tlodocs/86R/fiscalnotes/pdf/HB01525F.pdf#navpanes=0.

[86] Section 156.051, Tax Code.

[87] Section 156.052, Tax Code.

[88] Section 351.002, Tax Code.

[89] Section 156.053, Tax Code.

[90] See, e.g., *City of San Antonio v. Hotels.com* (5th Cir., 2017), https://caselaw.findlaw.com/us-5th-circuit/1881090.html; *City of Houston v. Hotels.*com, L.P., 357 S.W.3d 706 (Tex. App.- Houston [14th District] 2011), https://www.courtlistener.com/opinion/2539283/city-of-houston-v-hotels-com-lp/.

[91] Comptroller, Private Letter Ruling 20220524125452 (July 15, 2022), https://star.comptroller.texas.gov/view/202207023L.

[92] Comptroller, "Motor Vehicle – Local Sports and Community Venue District Tax for Short-Term Rentals," https://comptroller.texas.gov/taxes/motor-vehicle/venue.php (last visited January 17, 2023).

[93] Section 152.061, Tax Code.

[94] Comptroller, "Motor Vehicle Rental Tax Guide: Managing Your Rental Fleet," https://comptroller.texas.gov/taxes/publications/96-143/management.php#:~:text=Your%20minimum%20motor%20vehicle%20rental,vehicle%20you%20buy%20to%20rent. (Last visited January 17, 2023).

[95] Comptroller, "Tax Policy News: 201907002L," (July 2019), https://star.comptroller.texas.gov/view/201907002L.