

- SUBJECT:** Sales and franchise tax refunds to businesses in reinvestment zones
- COMMITTEE:** Ways and Means — favorable, with amendments
- VOTE:** 6 ayes — Craddick, Finnell, Heflin, Holzheuser, T. Hunter, Place
0 nays
5 absent — Wolens, Horn, Marchant, Oliveira, Romo
- SENATE VOTE:** On final passage — April 27 — voice vote (Ellis, Gallegos, Luna, Truan recorded nay)
- WITNESSES:** For — Kris Nielsen; Ravi K. Singhanian, Phyllis Schneider, Tyler Economic Development Council; Dale Cummings and Bill Allaway, Texas Association of Taxpayers; Rob Looney, Texas Mid Continent Oil and Gas Association, Ron Dipprey and Wendell Westlake, Dow Chemical North America; Gary Pearson, BASF Corporation; Phil Ritter, Texas Instruments Incorporated; Joe Newman, Texas Economic Development Council; Kathryn K. Hillhouse; Michael White, Greater Houston Partnership; Dane Harris, Texas Association of Business & Chambers of Commerce; Chris Shields, Corpus Christi Business Alliance and Alliance for Quality Education; Karin Richmond.

Against — None
- BACKGROUND:** The Tax Abatement Act, Tax Code Chapter 312, expires September 1, 1995. The act allows cities and counties to establish reinvestment zones within their territory and abate taxes on new facilities and expansion of existing facilities in the zone. There are six criteria for designating a reinvestment zone. The most commonly used is that the zone is reasonably likely to "contribute to the retention or expansion of primary employment or to attract major investment in the zone that would be a benefit to the property and that would contribute to the economic development of the municipality."

A tax abatement agreement may exempt from taxation all or part of the increase in value of the real property for each year covered by the

agreement for a period not to exceed 10 years and must be on the condition that the property owner make specific improvements to the property. The abatement may also be on all or part of the value of tangible personal property (other than inventory or supplies) brought to the property after the agreement. The initial agreement may be for up to five years and may be renewed for another five years.

Before a city or county grants a tax abatement it must deliver written notice of its intent to enter into the abatement agreement with the other taxing units, such as school districts, where the property is located. The other taxing units have 90 days from the date a city or county executes a tax abatement agreement to enter into an identical abatement agreement or choose not to provide the abatement.

DIGEST:

SB 345, as amended, would extend the tax abatement act from September 1, 1995 to September 1, 2001. It would also require the state comptroller to refund state sales and franchise taxes to certain businesses that paid school district taxes on property located in a city and county tax abatement reinvestment zone.

The refund to a business would equal 80 percent of the property taxes it paid to the school district, up to the amount of sales and franchise taxes the business paid during the calendar year. The refund would have to be reduced by any tax credits given the business in that year. A refund could not be made for more than five years or the length of the tax abatement, whichever was less. The refunded amount could not include earned interest.

A business would have to meet the following conditions to receive a refund:

- No refund could be made if the company made a payment instead of taxes or other payment, including gifts, grants, donations or in-kind service, to a city or county that has granted a tax abatement during the period of the tax abatement agreement. This would not include payments for taxes, fees or charges for services provided by a city or county, or to payments to an industrial district in the extraterritorial jurisdiction of a city, or to a payment that is less than \$5,000 in value in any one year.

- The business would not be entitled to a tax refund if the abatement agreement was cancelled or the business relocated outside the zone.
- The business would have to have established a new business, expanded an existing business or modernized an existing business to retain jobs in the reinvestment zone, have increased its payroll by \$3 million since the start of the abatement based on records of the Texas Employment Commission or increased the appraised value of the abated property by \$5 million from the date of the agreement (January 1, 1996, or after) and provide the comptroller with a copy of the tax abatement agreement.
- The refund application would have to include a tax receipt from the tax assessor showing the property tax paid and include enough information for the comptroller to determine what part of the taxes paid were paid to the school district that would not have been paid if the school district could have granted the tax abatement.
- The business asking for the refund would have to certify that it was complying with the abatement agreement, and the comptroller could not make a refund until the business complied. The comptroller could grant a waiver for noncompliance resulting from a natural disaster.
- A copy of the agreement would have to be on file with the comptroller and the Texas Department of Commerce before a refund could be made.
- The bill would require each taxing unit with a tax abatement agreement to include in the annual report to the Department of Commerce information related to the state refund of property taxes paid to school districts.

The comptroller would be required to adopt rules and forms to administer the state-tax refund. The comptroller also would have to submit a report on the state-tax refund December 1 of each year beginning December 1, 1999. The comptroller could perform audits necessary to administer the refund.

The bill would require that specific terms of a tax abatement contain each term agreed to by the owner of the property, require the property owner to certify annually that it is in compliance with the terms of the agreement,

and allow the city council to cancel or modify the agreement for failure to comply with the agreement.

The bill would take effect September 1, 1995, except that extension of the sunset provision would take effect August 31, 1995.

**SUPPORTERS
SAY:**

The bill would extend the ability of cities and counties to offer tax abatements to support economic in their communities until September 1, 2001. This economic development tool, in effect since 1981, has proven to be very effective and should be continued.

The bill would also allow a business to receive a state franchise and sales tax credit, beginning in 1998, that would be equal to 80 percent of the school taxes paid on property in the abatement zone under certain conditions. To qualify the business would have to increase the abated property value by \$5 million or add \$3 million to the abated business' payroll.

The state-tax refund would allow school districts to participate in tax abatement agreements without jeopardizing state aid. SB 7, the school finance law passed in 1993, added the value of property subject to a tax abatement agreement to the total taxable property of the district, causing a loss in state aid. The poorer the district, the more state aid would be lost if the district granted a tax abatement.

Before enactment of SB 7, state funding of public education took tax abatements into consideration by providing those school districts state aid to adjust for the loss of local property tax from an abatement agreement. The effect of SB 7 is that school districts are not participants in tax abatements, and since school property taxes make up a large percentage of property taxes paid by business, the value of the tax abatements given by cities and counties has diminished. Tax abatement, as an incentive for businesses to locate in Texas, is no longer as valuable as it was before SB 7. This bill would once again make abatement an important incentive to get business to locate or expand in Texas.

According to the comptroller's 1993 Property Value Study, 144 school districts had tax abatement agreements in effect (most prior to SB 7).

These school districts are located throughout the state, not just in large industrial areas like the Gulf Coast, and range widely in wealth (Wichita Falls to Edgewood in San Antonio).

Tax abatements are important in attracting and retaining business and the economic activity they bring to a community. If Texas wants to compete with other states in attracting the type of capital investment that increases property values and helps to fund all schools, then the state must have a mechanism to allow school districts to participate in tax abatement agreements. A recent survey by the Texas Association of Taxpayers found that all the surrounding states (Louisiana, Oklahoma, Arkansas and New Mexico) and other major economic competitors (South Carolina, Ohio, Indiana, Tennessee, Utah, Arizona, Illinois, New York, New Jersey, Florida and Colorado) offer extensive tax abatement programs to attract major investment. This survey did not account for incentives offered by foreign competitors.

Detractors of tax abatement as a economic development tool downplay the impact of local taxes on business location decisions. But the truth is that abatement is a serious consideration, especially when all other factors are similar, as they often are in regional competition. Two recent business enterprises — a computer chip manufacturing company and a chemical manufacturing plant — considered Texas but located elsewhere, citing high school taxes as one factor in their decision.

To show that the property tax burden in Texas is serious, one company did a study and found that a investment of \$200 million could cost it \$60 million in property taxes over 20 years in Texas compared to about \$18 million in Louisiana, \$8 million in Alabama and \$15 million in South Carolina.

The cost of these abatements to Texas taxpayers as a whole would be small. The fiscal note shows a cost of nearly \$24 million in 1998 and around \$50 million to \$55 million for subsequent years. This money would be well worth the increased sales taxes generated by the increased economic activity that comes from the local investment attracted by abatements.

The requisite increase in property values, set in the Senate-passed version at \$10 million, would be lowered to \$5 million by the House committee amendment to allow smaller businesses, as well as larger one, to be encouraged to move to Texas. The state would still come out ahead, as it is the small and medium companies that employ most of the workforce.

OPPONENTS
SAY:

The Texas economy is growing and expanding at a level not seen in more than a decade, and tax abatements are now only taxpayer-subsidized icing on the cake for corporations. Generally, tax abatements are used during economic down cycles to boost investments. Texas does not have to shift revenue to private corporate at the expense needed services at this time.

Most public finance experts agree that state and local taxes have little or no effect on business location decisions because they are a smaller percentage of total business costs. A 1989 survey by the Tax Research Association of Harris County for the Select Committee on Tax Equity found that basic economics, not tax rebates, dictated plant location. A recent study in Alabama showed that many of the jobs and capital investment made in the enterprise zone program would have been created without the need to give away \$6.6 million in taxes.

Two years ago, the state set up a new school-finance system that discourages school districts from joining cities and counties in tax abatement giveaways. SB 345 is the corporate solution to recouping those lost tax revenues. It would cut corporate expenses by shifting the cost of school taxes onto state taxpayers. The fiscal note indicates the cost to the state would begin at \$50 million a year and rise in following years.

The state sales and franchise refund to cover school district property tax refund would be a reverse-funded mandate because would require the state to rebate 80 percent of school district taxes and yet give the state no say in the decision to grant the abatement. If the state is going to be a silent partner to tax abatements, then it should have some control over their availability.

Local governments give abatements to businesses that would have made the same decision to locate without the tax giveaway. For example, the *Houston Post* on February 12 reported that Houston granted the HEB

grocery chain an abatement on a \$5.1 million regional warehouse that the company admitted had it had already planned to locate in Houston. Harris County gave Rohm and Haas an abatement on a \$15-million plant expansion, even though the company had been in Deer Park for 44 years and had no intention of moving elsewhere.

If the state absorbs the majority of the cost of tax abatements, then it should control the abatement process by limiting the number of abatements and choosing, or at least having a say in choosing, which requests are granted. Local governments would have to weigh only the cost of foregone city and county taxes against the potential benefit of a new investment, ignoring the cost of sales and franchise taxes to be rebated by the state. This could distort the economic calculation since the total cost of the abatement would not be borne by local taxpayers.

Many corporate location choices compare adjoining counties and regions within Texas. Allowing a major part of the value of an abatement to be paid by the state without any control would permit cities and counties to escalate the value of the abatements with the state paying the bulk of the tab.

State tax dollars would be better invested in improving Texas's capacity for long-term growth. The success of a state's economy depends on the vitality of its businesses, the strength of its physical infrastructure, and its human, financial and technological resources. These resources are the basis for future economic prosperity. The state is strong in economic diversity, business competitiveness and investment and machinery and equipment.

Rather than give away tax breaks to companies that would likely locate in Texas anyway, tax revenues would be more effectively used to support public and higher education, social and health services and protect the environment. Texas ranks low among states in rates of crime, teen pregnancy, high school graduation, health coverage and poverty rates — this is where tax dollars should be spent.

OTHER
OPPONENTS
SAY:

The comptroller's first report on the relation between state-tax refunds and the economy should be filed before the 1999 Legislature meets, instead of after, to allow for quicker review of the program's effectiveness.

Qualifications for state refunds should be based on a percentage increase of payroll or property value, not on specific dollar amounts, to allow smaller businesses to qualify for these tax breaks.

Giving businesses back their state sales and franchise taxes can only be viewed as a type of welfare program for corporations. If the state is going to give such a large subsidy to corporations, it should insist that they operate under the same sort of standards the state plans to impose on individual welfare recipients. For instance, businesses that qualify for the tax refund should be made to sign responsibility agreements similar to those the state welfare reform legislation would require AFDC recipients to sign. Corporations that get refunds could at least pledge to be good corporate citizens (by not polluting the environment, engaging in discriminatory practices, etc.). Also, the state may want to limit the refunds to three years, to encourage businesses to become fully self-sufficient, in the same way that AFDC benefits would be limited.

NOTES:

The House committee amendments would lower the state-tax rebate qualification for increase of property value from \$10 million to \$5 million, reinstate the six criteria for a reinvestment zone and clarify that payments by businesses to cities and counties giving tax abatements do not apply to utilities or to payments of less than \$5,000 in value.