

SUBJECT: Sales tax exemptions for property used in manufacturing processes

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 9 ayes — Craddick, Ramsay, Grusendorf, Heflin, Holzheuser, Horn, Oliveira, Telford, Williamson

0 nays

2 absent — Stiles, Thompson

WITNESSES: None

BACKGROUND : Sect. 151.318 of the Tax Code exempts from sales tax tangible personal property used or consumed in or during the manufacturing process. The exemption does not apply to certain machinery or equipment, including intraplant transportation equipment.

The comptroller had interpreted this provision to deny sales tax exemptions for equipment and material not directly used in the manufacturing process. That interpretation was overturned by the Austin Court of Appeals in *Sharp v. Tyler Pipe* (919 S.W.2d 157) and *Sharp v. Chevron Chemical Co.* (924 S.W.2d 429) as too narrow a reading of the statute. The Texas Supreme Court declined the review the decisions.

DIGEST: CSHB 1855 would amend Tax Code sect. 151.318 to specify that a sales tax exemption would apply to tangible personal property *directly* used or consumed in or during the manufacturing process *and* that directly made or caused a physical change to the product or any intermediate or preliminary product that would become an ingredient or component part of the final product.

The bill would specifically exempt actuators, steam production equipment and its fuel, in-process flow through tanks, cooling towers, generators, heat exchangers, electronic control room equipment, and computerized control units that are used to power, supply, support, or control equipment used to generate electricity, chilled water or steam for final sale.

The bill would define intraplant transportation equipment not eligible for the exemption as any equipment used to move a product or raw material in connection with the manufacturing process, including all piping and conveyor systems.

CSHB 1855 would add to the list of property not eligible for the exemption machinery and equipment or supplies used to maintain or store tangible personal property.

Any taxpayer claiming an exemption under sect. 151.318 would have the burden of proving that the exemption was applicable.

The bill would take effect October 1, 1997.

**SUPPORTERS
SAY:**

CSHB 1855 would close a loophole in the Tax Code that some manufacturers currently are exploiting at a cost of millions of dollars to Texas tax revenues. The exemptions for items used in the manufacturing process was never intended to cover all items associated with that process. Although the intent of the Tax Code seems clear, the appeals court has sided with manufacturers, opening up the door for further appeals for exemptions for items purchased to facilitate the normal course of manufacturing operations. CSHB 1855 would preempt moves to expand the exemption to everything from electricity to janitorial and office supplies on the grounds that these items are used in the production process and clarify beyond doubt the original intent of the law.

CSHB 1855 would properly shift the burden of proof in contested tax issues to the applicant, which stands to gain from any decreased taxes.

The bill would have a positive fiscal impact to the general revenue fund, bringing close to \$400 million over the next five years, according to the Comptroller's Office, \$127.2 million in fiscal 1998-99 alone.

**OPPONENTS
SAY:**

CSHB 1855 would define too strictly the materials exempt under sec. 151.318. It could impose new taxes on certain materials and equipment essential to processing oil or gas that cause a chemical or physical change without actually coming into physical contact with the oil or gas. It could result in taxation of air compressors, turbines, pumps, quality control

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equipment, robotic assemblies and other categories of equipment that have previously, and for good reason, been exempt from taxation.

NOTES:

The committee substitute allowed exemptions to machinery and equipment used in the production of intermediate or preliminary products that eventually become part of the final product.

HB 4 by Craddick and Junell, the tax revision bill passed by the House on April 26, contains a provision similar to CSHB 1855.