HOUSE RESEARCH ORGANIZATION bill analysis 5/24/1999

SB 5
Sibley, et al. (Oliveira, et al.)
(CSSB 5 by Oliveira)

SUBJECT: Franchise tax credits for economic development activities

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 10 ayes — Oliveira, McCall, Bonnen, Craddick, Y. Davis, Heflin, Keffer, T. King, Ramsay, Sadler

0 nays

1 absent — Hilbert

SENATE VOTE: On final passage, April 20 — voice vote (Harris recorded nay)

WITNESSES: None

BACKGROUND: The franchise tax has been Texas' primary business tax since its adoption in 1907. Corporations pay the tax in exchange for state-granted privileges, including access to the state's legal system, the right to accumulate property separately from any individual, and a limitation of personal liability for officers of the corporation. About 380,000 firms are subject to the tax, of which about 165,000 reported a tax liability in 1997. The other 215,000 firms owed no tax. Franchise tax collections total about $2 billion annually.

DIGEST: CSSB 5 would create new franchise tax credits for research and development (R&D) activities, job creation, capital investments, and day care for employees' children. Each credit would have different qualifications and methods of calculation and would apply for different periods of time.

The bill would take effect January 1, 2000. A corporation could claim credits for expenses and payments incurred, jobs created, and qualified investments made on or after that date.

R&D activities. CSSB 5 would provide a franchise tax credit to corporations that made certain incremental investments in R&D activities in Texas.

The credit would equal 5 percent of the excess of qualified research expenses incurred in Texas during a given period over the base amount for the state plus 5 percent of the basic research payments for the same period. For the

purposes of this credit, the terms "base amount," "basic research payments," and "qualified research expenses" would have the definitions assigned by the federal Internal Revenue Code (26 U.S.C. 41). A corporation could elect to compute the credit in a manner consistent with the federal alternative incremental credit, and the bill would specify credit percentages for that method.

Regardless of the calculation method chosen, a corporation could double the amount of any qualified research expenses and basic research payments made in one of the following strategic investment areas:

- a county with an unemployment rate above the state average and per-capita income below the state average;
- an area that had been designated by the federal government as an urban enterprise community or an urban enhanced enterprise community before January 1, 1999;
- an area located in a municipality with a population of 500,000 or less that was nominated in 1998 for designation as a federal empowerment zone and was not located in a municipality that contained a defense economic readjustment zone (Fort Worth); or
- a county contiguous on at least three sides to a county with above-average unemployment and below-average per-capita income that also borders the Gulf of Mexico, has a population of less than 750, and has been designated by the Development Corporation Act of 1979 as the site for a spaceport (Kenedy County).

The comptroller would have to publish a list and map of strategic investment areas by September 1 of each year. A corporation could claim a credit or take a carryforward credit even if investments were made in a strategic investment area that lost that designation.

The total R&D credit, including any carryforward, claimed could not exceed 50 percent of the amount of franchise tax due in a reporting period before any other applicable credits. Corporations that established eligibility for R&D tax credits would not be eligible for a job-creation tax credit. Total credits for R&D, job creation activities, and certain capital investments, including the amount of any carryforwards, could not exceed the amount of franchise tax due in any reporting period. Corporations could elect to carry any unused credit forward for up to 20 reporting periods.

The R&D tax credit would expire on December 31, 2009. The strategic investment area status of Kenedy County would expire on September 1, 2003, unless the county had been designated as the site for a spaceport.

The comptroller would have to issue a report before the start of each legislative session stating the amount of R&D expenditures and tax credits, the geographical distribution of expenditures, and the impact of the credit on employment, personal income, capital investment, and state revenue.

Job creation activities. CSSB 5 would provide a franchise tax credit for certain qualified corporations that created at least 10 qualifying jobs in a strategic investment area. Businesses primarily engaged in agricultural processing, central administrative offices, distribution, data processing, manufacturing, R&D, or warehousing could qualify for the credit.

The amount of the credit would be equal to 25 percent of the total wages and salaries paid by the corporation for qualifying jobs during the reporting period. A qualifying job would be a new permanent full-time job that:

- was located in a strategic investment area, or in a county with a population of less than 50,000 if the job was created by an agricultural processing business;
- required at least 1,600 hours of work per year;
- paid at least 110 percent of the average weekly wage for the county in which it was located; and
- was covered by a group health-benefit plan for which the business paid at least 80 percent of the premiums.

Transferring a job from one part of the state to another or replacing a previous employee would not count as creating a job.

The total job-creation tax credit, including any carryforward, claimed could not exceed 50 percent of the amount of franchise tax due in a reporting period before any other applicable credits. The credit would have to be claimed in five equal installments over five consecutive reporting periods. Corporations that established eligibility for job-creation tax credits would not be eligible for an R&D tax credit. Total credits for job creation, R&D, and certain capital investments, including the amount of any carryforwards, could not exceed the

amount of franchise tax due in any reporting period. Corporations could elect to carry any unused credit forward for up to five reporting periods.

If, in one of the five years in which the installment of a credit accrued, the number of the corporation's full-time employees fell below the number the corporation had in the year that it qualified for the credit, the credit would expire and the corporation could not take any remaining installments of the credit. The corporation still could take any portion of an installment that was carried forward from a previous year. A corporation could not convey, transfer, or assign this credit to another entity unless all of its assets were conveyed, transferred, or assigned in the same transaction. A corporation could claim a credit or take a carryforward credit even if investments were made in a strategic investment area that lost that designation.

The job-creation tax credit would expire on December 31, 2009.

The comptroller would have to issue a report before the start of each legislative session stating the amount of jobs created and tax credits, the median annual wage of jobs created, the geographical distribution of credits, and the impact of the credit on employment, personal income, capital investment, and state revenue.

Capital investments. CSSB 5 would provide a franchise tax credit to certain qualified corporations that made a qualified capital investment.

A qualified capital investment would be the purchase or lease of tangible personal property as described by 41 U.S.C. 1245(a), which covers engines, machinery, tools, and implements used in a business or held for income and subject to a federal tax allowance for depreciation or other cost-recovery methods. The property would have to be placed in service first in a strategic investment area. Businesses primarily engaged in agricultural processing in a county with a population of less than 50,000 also would qualify. Real property, building, and their structural components would not qualify.

The amount of the credit would be equal to 7.5 percent of the qualified capital investment. To qualify for the credit, a business would have to:

- pay an average weekly wage, at the location where the credit was claimed, that was at least 110 percent of the county average weekly wage;
- cover all of the employees at the location with a group health-benefit plan for which the business paid at least 80 percent of the premiums; and
- make a minimum $500,000 qualified capital investment or invest, after January 1, 2001, in a project in Texas that exceeded $500 million.

The bill would define "project" as a single capital investment or series of related investments that could encompass multiple locations, provided that they were functionally related and not more than 20 miles apart.

The total capital investment tax credit, including any carryforward, claimed could not exceed 50 percent of the amount of franchise tax due in a reporting period before any other applicable credits. The credit would have to be claimed in five equal installments over five consecutive reporting periods. Corporations that established eligibility for capital investment tax credits would not be eligible to claim a franchise tax credit for investments in an enterprise zone provided by Tax Code, sec. 171.1015. Total credits for job creation, R&D, and certain capital investments, including the amount of any carryforwards, could not exceed the amount of franchise tax due in any reporting period. Corporations could elect to carry any unused credit forward for up to five reporting periods.

The capital investment tax credit would expire, and the business would not be allowed to take any remaining installment, if the business:

- disposed of the qualified capital investment;
- took the investment out of service;
- moved the investment out of Texas; or
- failed to pay the minimum average weekly wage.

The business still could take any portion of an installment that was carried forward from a previous year. A corporation could not convey, transfer, or assign this credit to another entity unless all of its assets were conveyed, transferred, or assigned in the same transaction. A corporation could claim a credit or take a carryforward credit even if investments were made in a strategic investment area that lost that designation.

The capital investment tax credit would expire on December 31, 2009.

The comptroller would have to issue a report before the start of each legislative session stating the amount of qualified capital investments and tax credits, the average and median wages paid, the geographical distribution of investments, and the impact of the credit on employment, personal income, capital investment, and state revenue.

Day care for employees' children. CSSB 5 would provide a franchise tax credit for corporations that established and operated a day-care center or purchased day-care services for their employees' children. Corporations could share the costs of establishing and operating a day-care center so long as the center provided care primarily to their employees' children. The amount of the credit would be the lesser of:

- $50,000;
- 50 percent of the corporation's qualifying expenditures, which would include planning, building, equipping, expanding, and operating a day-care center or purchasing day-care services; or
- 90 percent of the tax due for a reporting period.

The credit could be claimed for qualifying expenditures made during an accounting period only against the tax owed for that period. A corporation could not convey, transfer, or assign this credit to another entity unless all of its assets were conveyed, transferred, or assigned in the same transaction.

The comptroller would have to issue a report before the start of each legislative session stating the amount of qualifying expenditures and tax credits, the geographical distribution of expenditures, and the impact of the credit on economic development and state revenue.

The comptroller could combine the required reports on the four tax credits into a single report.

SUPPORTERS SAY:

CSSB 5 is a "Marshall Plan" to encourage investment, new businesses, and job creation in economically distressed areas throughout Texas, particularly along the Texas-Mexico and Texas-Louisiana borders. All or parts of about 90 counties would contain "strategic investment areas." The job creation and capital investment tax credits would apply only to expenditures in strategic investment areas, and the R&D tax credit would double in these areas.

This bill would keep Texas competitive with other states in securing high-technology businesses, R&D, and new manufacturing plants. It also would give corporations incentives to provide health and day-care benefits for their employees.

The bill would be an effective, prudent use of state funds to encourage economic development and job creation and would have positive ripple effects throughout the state's economy. CSSB 5 would invest part of the current state surplus to improve economic conditions in poorer counties, create new jobs, bring new businesses to the state, and preserve the state's high-tech economy.

R&D activities. CSSB 5 would help keep Texas at the forefront of technological innovation. A set of strong clusters of research facilities is a requirement for maintaining strong economic growth, productivity, and income. The state has created a knowledge-based economy, but Texas cannot afford to rest on its laurels.

Texas is not keeping pace with other states in attracting research. Industrial R&D spending in Texas is about two-thirds of the national average in terms of the percentage of gross state product. Texas is last among the five largest states. Other states are creating more attractive environments for technology-based businesses, largely through tax incentives for R&D. At least 32 states offer some form of tax relief for R&D activities. To maintain Texas' position in the forefront of high technology, Texas needs to develop a more favorable tax policy for these businesses. The R&D credit in CSSB 5 is one of the governor's priorities for attracting businesses to Texas.

A tax credit for R&D offers the most bang for the buck. Study after study has shown that these types of tax credits produce substantial increases in gross state product, personal income, investment, and jobs. A Standard and Poor's study calculated the net payoff as six to one. That is, for every dollar lost in state tax revenue, six dollars are created in the economy. Sales, franchise, and property taxes on that revenue would offset about half of the loss to the state.

The bill would limit the credit to incremental spending — that is, it would apply only to the increase in R&D spending over the previous year. Structuring the incentive in this manner would place the maximum incentive on businesses to increase their investments in R&D while not giving these

businesses a tax break for research they already were conducting. Also, the credit would be nonrefundable, meaning that it could not exceed the amount of tax that a corporation owed in any year. The credit envisioned in CSSB 5 follows federal definitions and procedures, which would make it relatively easy to calculate.

Encouraging the growth of high-tech industries in Texas would improve the state's economic landscape by fueling the creation of new, high-wage jobs. High-tech wages in Texas average $50,000 per year, compared to the $28,000 average non-tech wage. New inventions and other technology breakthroughs provide spillover effects that can multiply their benefits many times over.

The bill is structured to encourage manufacturing to follow R&D spending. Companies that invested in R&D activities in strategic investment areas would receive double the credit compared to investments in other areas of the state. They would receive additional franchise tax credits for capital investments made in those areas. Many companies benefit from having their innovators and manufacturers near one another, and the credits in CSSB 5 would encourage businesses to move both their R&D and manufacturing investments to Texas. The research tax break would be doubled for investments in strategic investment areas to encourage more companies to site their new activities and plants in the state's economically less developed areas.

Tax incentives may not be the most important factor that a business considers when choosing a location for a new plant or new investment. However, they are the one factor that is under the direct control of a legislature, and they are often the "swing" factor. All else being equal, or virtually equal, a company will choose the route of lowest costs.

Studies show that corporations typically capture only half of the benefits of their own research. The knowledge they develop also benefits their suppliers, customers, and even their competitors. CSSB 5 would lower the cost of their research, thereby increasing the value of the benefits the investing corporations would receive.

Major R&D investments cluster near universities, such as along Route 128 in Boston (the Massachusetts Institute of Technology), in the Silicon Valley of California (Stanford), and in the North Carolina Research Triangle (Duke, the

University of North Carolina, and North Carolina State University). However, the presence of a strong research university is not enough. Purdue University graduates the most engineers in the country, yet an R&D cluster never has formed in Indiana. Strong R&D clusters strengthen their university partners by providing research funding for professors and training opportunities for students.

CSSB 5 particularly would benefit start-up bioscience and health-care technology companies. This industry has tremendous potential, and other states are designing tax incentives specifically targeted to biotech companies to lure those entrepreneurs.

Job creation activities. CSSB 5 would provide a franchise tax credit for certain new jobs created in strategic investment areas.

Permanent jobs with health-care benefits are at a premium in the state's 90-plus counties with an unemployment rate above the state average and per-capita income below the state average. This credit would lead to the creation of good-paying, permanent, full-time jobs with full health benefits in these counties and in other areas of the state that are strategic investment zones. The credit would be a relatively inexpensive way to encourage corporations to create new jobs in areas where unemployment is a problem.

The bill would require these jobs to remain for at least five years. The credit would be calculated at the time the job was created, but it would have to be claimed in equal installments over five years. If in any year the number of full-time employees fell below the number that existed when the credit was first claimed, the rest of the credit would be forfeited.

Corporations primarily engaged in agricultural processing, data processing, distribution, manufacturing, R&D, and warehousing would be eligible for the credit. These businesses are best able to move their operations or initiate new plants in strategic investment areas and are, by their nature, capable of creating many new jobs. The bill also would provide credits to companies that moved their central administrative offices to one of these areas.

CSSB 5 also would represent an important first step toward increasing the state's value-added agricultural processing capacity. Agribusiness companies that created agricultural processing jobs in counties with a population below

50,000 would be eligible for the job-creation tax credit. The vast majority of agricultural products must be shipped out of the state for processing, meaning that Texas fails to capture significant value from its agricultural production. Value-added processing would bring jobs and economic development to the state's more rural counties.

Capital investments. CSSB 5 would provide a simple, straightforward tax credit that would attract new manufacturing facilities to the state's most economically disadvantaged areas.

Texas' ranking as a site for new manufacturing facilities fell to sixth in 1998 from first in 1996. The total number of new plants has plummeted by more than one-third in only two years. Texas has been surpassed by other states in relative attractiveness for major projects and manufacturing facilities. Now more than 40 states have some form of investment tax credit to bolster their efforts to attract new plants and expansions of existing facilities. Both bring new jobs, new investment, and new tax revenues.

Texas' business tax burden falls more heavily on capital-intensive firms because of the way in which the franchise tax is calculated and because of the reliance on property taxes to fund education and local government. These firms create many of the high-skill, high-wage jobs in the state, and they are the very firms at greatest risk of relocating or choosing to site new plants in other states.

CSSB 5 would encourage the creation of high-skill, high-wage jobs. Only firms that paid above-average wages and that provided all of their employees at the particular location with health benefits could qualify for the tax credit. The credit would apply to firms who placed manufacturing equipment into service in areas where the local economy was underperforming. Agribusiness corporations that placed equipment into service in counties with a population of less than 50,000 also would be eligible for the credit.

The bill also would extend the tax credit to any company that invested at least $500 million in a project anywhere in the state. This "mega-investment" policy alone could result in nearly $2 billion in annual private-sector expenditures, $1 billion in annual gross state product, $500 million in annual personal income, and around 12,000 new, permanent jobs. Currently, it is up to cities and counties to string together the incentives necessary to lure that

kind of investment into this state. CSSB 5 would throw the state's commitment behind local efforts to bring big corporate investments into Texas.

Day care for employees' children. CSSB 5 would provide an incentive for employers to invest in high-quality child care for their employees. New on-site child-care centers would help reduce the waiting lists for other day-care centers and would give more children the opportunity to obtain high-quality licensed care given by better trained teachers.

Studies demonstrate that employees are more productive, happier, and less likely to miss work when their children are being cared for on site. Parents can see their children on break or at lunch, and children have the security of knowing that a parent is nearby.

Nineteen states have tax incentives for firms that provide day-care benefits to their employees, both on-site and in the community. Most of these states provide tax credits of 30 to 50 percent of the businesses' costs. Florida offers a 100 percent deduction for the start-up costs of an on-site child-care facility.

The bill would enable many small to medium-sized corporations to offer day-care services to their employees, which these businesses currently cannot afford to do.

Reporting requirements. CSSB 5 would require the comptroller to produce biennial reports on the effectiveness and economic benefit of tax incentives. Such reports would give the Legislature enough quantitative evidence to determine whether these incentives should be extended, modified, or eliminated. Appropriations are justified and reviewed biennially. Tax exemptions — which, like appropriations, involve the directing of state funds — ought to be reviewed periodically as well.

OPPONENTS SAY:

CSSB 5 would benefit mostly large corporations for business decisions they would make with or without the tax breaks. The bill represents poor fiscal policy and would place tax breaks for manufacturing ahead of other state needs. Its benefits would come at a high cost, and many Texans might not benefit at all. According to the tax equity note, almost a third of the resulting tax losses in the upcoming biennium would be exported out of state,

benefitting non-Texas consumers, out-of-state shareholders, and the federal government.

This bill is not an investment of the current state budget surplus. Instead, it is a raid on future budgetary resources in the name of economic development and job creation. The tax breaks are structured so as to hide their true cost. The initial cost would be small, but the effect of these breaks would balloon in later years. The fiscal note estimates a $179 million cost for fiscal 2000-01, all of which would occur in fiscal 2001. The cost would more than double in fiscal 2004, to $367 million, which is nearly 15 percent of current franchise tax collections, and would keep growing beyond that. Its effects would be felt long after its 2009 sunset.

CSSB 5 would create a budgetary time bomb because of provisions requiring some credits to be claimed over several years and allowing firms to carry forward unused portions of credits, some for up to 20 years. Credits earned during times of a surplus could be claimed in years of budget deficits, which would force further tax hikes or budget cuts, all to pay for research, job creation, or investments that already had occurred. In a few years, as much as $1 billion in unclaimed credits could be piled on the books.

Texas is still competitive with other states and does not need to enact a series of corporate tax cuts to attract and retain businesses. Texas recently was named the state with the best business climate in a survey conducted by Development Counselors International and the International Development Research Council. Executives cited the absence of a state income tax, a varied work force, an excellent climate, and a positive image as reasons why the state is a desirable location to start or relocate a business. Other factors include the state's proximity to Mexico, the availability of commuter and cargo transportation, low real estate prices, lower costs of living than other states, and access to renowned research universities.

Taxes should not be reduced until schools, health care, and human service programs are fully funded. Texas has substantial unmet needs in all these areas. If the Legislature determines that a tax cut is desirable, broad-based tax-rate reductions would produce more benefits for the state economy in terms of job creation and capital formation in relation to the revenue the state would lose. Narrow exceptions to taxation do help some Texans, but they produce little in terms of overall economic benefit. All Texans have

contributed to the state through higher taxes, and all Texans should share fairly in a tax cut.

R&D activities. R&D tax credits reward firms for engaging in investments they would engage in without the credit. There is scant evidence to suggest that such credits actually bolster the economy, cause firms to relocate, or increase employment. These tax credits are advertised as good for start-up businesses hungry for capital. In reality, R&D tax breaks help big corporations. Seventy percent of a similar tax credit in Missouri benefitted just three companies: Boeing, Monsanto, and Southwestern Bell. Sixty other companies split the remainder.

The R&D tax credit in CSSB 5 would not help start-up businesses at all, being based on the incremental increase of research over the previous year. Companies that start up have no previous year, so they would not receive the credit until their second year. If they invested heavily in that first year, they might not achieve an incremental increase in research for several more years, and thus would not receive any benefits from this tax incentive.

Industry already is engaged in substantial R&D activity in Texas. Since 1990, the number of patents granted to Austin companies has grown 151 percent. The Dallas-Fort Worth area has seen a patent increase of nearly 60 percent. Texas has long been a pioneer in R&D, with firms such as Texas Instruments, Electronic Data Systems, Bell Helicopter, and Compaq fueling an information-age economy. Firms engaged in research related to defense, oil and gas exploration and recovery, agriculture, and space science have spent billions of dollars on R&D in Texas. All of this has occurred without a single state corporate income-tax incentive aimed at R&D activities.

Industry “clustering” also prompts growth in R&D spending. Texas has several such clusters already established, such as the Silicon Prairie in the Austin area and the Richardson-Plano telecom corridor. Clustering creates a pooled labor market for workers with industry-specific skills, attracts firms that supply the industries with raw and finished materials, and generates high technological spillovers as innovations “leak” and workers move from one firm to another. Again, these clusters have sprung up without a single state corporate income-tax incentive aimed at R&D activities.

Think tanks across the ideological spectrum are producing research claiming that this tax incentive would have no significant impact on the state economy and would cause no significant increase in employment, investment, or income. The comptroller's dynamic revenue analysis predicts that it would create 2,900 new jobs during fiscal 2004, at a cost to the state of nearly $60,000 per job.

CSSB 5 would rely on past R&D spending to establish a base level from which the incremental R&D expenditures were calculated. Past spending is often a poor estimate of the amount a firm would have spent without the credit. More perversely, the bill actually might discourage R&D spending by some companies by denying them a subsidy if they had a higher base level of spending. These companies would receive no benefit, but some of their competitors would. Thus, an R&D tax credit structured as in CSSB 5 can distort the allocation of research spending across firms, with an incalculable effect on spillover benefits, jobs, and investment.

The link between R&D spending and "downstream" manufacturing is tenuous. Little evidence suggests that a business will move or establish its manufacturing centers near to where its innovators are working. Even if the R&D credit succeeded in encouraging more investment in those activities, there is no guarantee that manufacturing would follow. In fact, the effect of CSSB 5 could be to subsidize the creation of jobs in other states.

An R&D tax credit also would subsidize the federal government, because a state tax credit for R&D activities increases a firm's federal tax liability.

Job creation activities. CSSB 5 is well-intentioned in seeking to bring new manufacturers, agricultural processing plants, and certain other businesses to economically distressed areas. However, its proposed tax credits for job creation are too broad and would reward businesses that already are in these areas more than encourage new businesses to move in. Also, the bill would encourage the creation of low-skilled jobs for which the salary would be only nominally above the county average and still below the state average.

In fact, the requirement that the company pay an average salary 10 percent above the average county wage and pay for 80 percent of employees' health-care coverage could put the credit out of range for many corporations. Many jobs in manufacturing, administration, distribution, and warehousing earn less

than the average salary in a given area because of market pressures and an oversupply of labor. The credit ultimately could reach 25 percent of the salaries, but it would equal only 5 percent in the first year, 10 percent in the second, and so on. The credit might not be enough. At the same time, eliminating these minimum-salary and health-coverage requirements would reward companies that hired people at low wages and provided them with no health coverage. This paradox indicates that the credit as proposed would not be an optimal solution to the problems of unemployment and low economic performance.

Franchise tax credits provided to corporations for job creation should be used to subsidize the costs of worker training and additional education, such as community college courses or technical schooling, and not just to hire the worker. By improving the education of the labor force, counties become more attractive to high-tech and service industries, which typically pay more in salaries and offer better benefit packages.

Capital investments. CSSB 5 would provide an overly broad tax incentive to certain corporations who placed at least $500,000 of manufacturing equipment, machinery, engines, and similar items in service within a strategic investment area. Because it would not be limited to corporations that did not have a previous presence in the particular investment area, the credit would reward companies who were already there and engaged in normal business operations. A corporation should not receive tax credits for upgrading existing plant or equipment or altering its productive capability if those changes do not result directly in new jobs or in increased wages.

CSSB 5 would give corporations a franchise tax exemption for placing in certain areas equipment and machinery that also is exempt from the sales tax. A corporation making a $500,000 purchase in Texas of machinery used in a manufacturing process would be exempted from paying more than $40,000 in sales taxes.

State tax incentives like the ones in CSSB 5 place counties that are adjacent to a strategic investment area but are not in the area themselves at a great disadvantage when it comes to attracting and maintaining businesses in their counties. Local governments may have to offer property tax abatements or reductions in order to compete with the state-offered tax reduction. The state

has significantly more resources with which to help the neighboring county than the non-strategic investment area has to help itself.

CSSB 5 would place no dollar limit on the capital investment tax credit, which means that certain corporations could receive huge tax breaks. For example, the bill would reward General Motors richly for its decision to invest $500 million to expand its Arlington manufacturing plant.

Day care for employees' children. There is no question that on-site day-care facilities improve the morale, productivity, and loyalty of employees and improve the image, attractiveness, and profitability of corporations. For precisely those reasons, the state should not subsidize corporate day-care benefits.

One of the main reasons that an employer provides day-care benefits is to compete with other potential employers for potential workers who possess highly marketable skills. CSSB 5 would provide a tax incentive to companies to add day care to the list of benefits that make the company more attractive than another employer. The people who would benefit most from these services are not hourly wage employees who cannot afford day care.

The intention may be to reduce the cost to employers on the assumption that they would provide the day-care services at no cost or at a reduced cost. However, CSSB 5 would not prohibit corporations who built in-house day-care centers from making a profit on those centers, either by charging their employees or by providing services to non-employees' children.

The resources this tax credit would consume would be better spent on helping poorer families, such as those trying to work their way off welfare, to obtain high-quality day care and early education for their children.

OTHER OPPONENTS SAY:

The state should not limit its tax breaks to corporations simply because its business tax is levied solely on certain corporations. Businesses organized in other forms also can make valuable R&D contributions, invest in economically disadvantaged areas, create jobs, and provide day care for their employees. Instead of franchise tax cuts, the incentives contained in CSSB 5 ought to be in the form of state sales-tax rebates, subject to annual or lifetime limits. This would spread the benefit to all businesses in the state.

A more appropriate approach to tax relief would be to reduce sales taxes on certain items. Despite a booming economy, many Texas families are struggling to make ends meet. Instead of providing tax breaks to corporations to boost their profits, the state ought to be spending its surplus revenues to provide exemptions from its most regressive tax, the sales tax. Legislation that already has passed the House to exempt over-the-counter medications, diapers, and school supplies could be jeopardized by passage of a large set of corporate tax breaks.

R&D activities. The only fair R&D tax credit is one that applies to all R&D spending conducted in the state. An R&D credit structured as in CSSB 5 could distort the allocation of research spending across firms because of its reliance on year-to-year changes in spending. A non-incremental credit also would be easier to administer and calculate.

Job creation activities. This credit should not be limited to certain business activities. All corporations that create jobs in strategic investment areas should be eligible for the credit. Because of its requirement that a corporation create at least 10 new jobs, the bill unfairly would prevent small businesses from being able to take advantage of the credit. A small credit to a small business may allow it to hire another employee.

The bill should require that the median salary, not the average salary, be used to determine eligibility, so that a small number of higher-salaried managers would not skew the average salary upward. Also, the bill should require that the total salaries and benefits not fall below the level in the year for which the credit was claimed, to prevent the corporations from decreasing wages once they had qualified for the credit.

Day care for employees' children. The bill should limit this credit to corporations who initiate day-care services in strategic investment areas, and the credit should apply only for the first few years. The bill also should limit the benefit to strategic investment areas where there is a shortage of day-care centers and the typical working family cannot afford available services.

Also, the credit should be limited so that the corporation could not earn a profit on the day-care center and still qualify for the credit. In other words, the credit should be the lesser of 50 percent of the corporation's qualifying

expenses, 90 percent of its total franchise tax liability, or the net cost to the corporation of providing day-care services, taking into account all revenues that the day-care center generated for the corporation. The maximum credit for any year should be $50,000.

NOTES:

The House committee substitute amended the Senate-passed bill by:

- adding the section providing tax credits for day care;
- expanding the definition of strategic investment area to include a portion of Fort Worth and Kenedy County;
- increasing the maximum tax credit for R&D to 50 percent of the amount of tax due, from 25 percent;
- adding the $500 million project eligibility to the capital investment section;
- adjusting the period during which the capital investment tax credit could be claimed; and
- expanding the comptroller's reporting requirements.

According to the bill's fiscal note, changes made by the committee substitute added $410.6 million to the bill's five-year cost to the state through fiscal 2004, of which $175 million would be in the fifth year.