

SUBJECT: Increasing the total revenue exemption for the margins tax to \$1 million

COMMITTEE: Ways and Means — favorable, without amendment

VOTE: 11 ayes — Oliveira, Otto, Bohac, Hartnett, Hilderbran, C. Howard,  
P. King, Paxton, Peña, Taylor, Villarreal

0 nays

WITNESSES: For — Michele Gregg, Texas Apartment Association; (*Registered, but did not testify*: Renea Beasley, Independent Electrical Contractors of Texas; Paul Cauduro, Texas Association of Business; Bob Elouf, Environmental Air Systems, Inc.; Allyson Hoag, G&H Air Conditioning and Heating, Inc.; Amanda Jones, Air Conditioning Contractors of America Greater Houston; Steve Koebele, Texas Association of Personnel Consultants; Lance Lively, NFIB Texas; Todd McAlister, Texas Air Conditioning Contractors Association; Mike McLamore, Texas Association for Home Care; Will Newton, NFIB Texas; Peggy Ruffin, Spark A/C-Heat (Ruffin, Inc.); Andrew Warren III

Against — Dick Lavine, Center for Public Policy Priorities; (*Registered, but did not testify*: Luke Bellsnyder, Texas Association of Manufacturers; Bill Hammond, Texas Association of Business)

On — Dale Craymer, Texas Taxpayers & Research Association; Eugene Kasberg

BACKGROUND: Under Tax Code, sec. 171.002, a business is not required to pay any margins tax and is not considered to owe any tax if:

- the computed tax owed by the entity is less than \$1,000; or
- the amount of the total revenue from its entire business is less than or equal to \$300,000.

Under Tax Code, sec. 171.0021, small businesses are entitled to certain discounts under the margins tax:

- a taxable entity with annual total revenue that is at least \$300,000 but less than \$400,000 is eligible for a discount of 80 percent on its tax liability;
- a taxable entity with annual total revenue that is at least \$400,000 but less than \$500,000 is eligible for a discount of 60 percent on its tax liability;
- a taxable entity with annual total revenue that is at least \$500,000 but less \$700,000 is eligible for a discount of 40 percent on its tax liability;
- a taxable entity with annual total revenue that is at least \$700,000 but less than \$900,000 is eligible for a discount of 20 percent on its tax liability.

Beginning in tax year 2010, these thresholds will be indexed biennially for inflation.

Tax Code, sec. 171.1016, also attempts to provide relief to small businesses by providing them with an E-Z computation for determining margins tax liability. A business with revenue of not more than \$10 million may choose to compute its margins tax liability by multiplying its taxable revenue by 0.575 percent.

**DIGEST:** HB 4765 would amend the Tax Code, sec. 171.002(d) to increase the total exemption from the margins tax from a revenue ceiling of \$300,000 to \$1 million. The exemption would take effect on January 1, 2010.

HB 4765 would sunset the \$1 million tax exemption and allow it to revert to \$300,000 on January 1, 2012.

The bill would take effect on January 1, 2010.

**SUPPORTERS SAY:** HB 4765 would deliver needed tax relief to the small businesses that constitute the backbone of the Texas economy and create most new jobs. According to comptroller estimates, 39,000 small businesses would benefit from raising the margins tax exemption to \$1 million. The average tax relief would be a reduction of \$4,359.

HB 4765 would provide instant tax relief. Under the margins tax, payments on a particular year are due in May of the following year. Taxes on revenues earned in 2009 are not due until May of 2010. If HB 4765 were enacted, small business owners and their accountants would know

their tax had been eliminated, and they could begin investing or spending those saved tax dollars immediately.

HB 4765 would include a sunset provision so that future Legislatures were not obligated to expenditures or reductions in revenues that did not have an ongoing funding source. Further, HB 4765 would enact targeted tax relief designed to help small business make it through the recession. Once the economy improved, the margins tax would revert back to being the broad-based tax it was designed to be. Making the cuts permanent would undermine this critical goal.

HB 4765 would not endanger future federal stimulus funds. Fears that it would be speculative. This tax cut would be paid for with state general revenue, not stimulus dollars. Further, HB 4765 would not directly violate any of the guidance from the federal government on how to spend the stimulus funds. Most of the concern about a tax cut is that it would mean fewer state dollars going to education through the Property Tax Relief Fund. The point of the fiscal stabilization funds given to the states by the federal government is to prevent cuts in certain social services. Under both the House and Senate proposed budgets, overall funding to education would be increased, achieving the goals of the federal fiscal stabilization programs.

HB 4765 would deliver targeted tax relief to small businesses, the group affected by the margins tax that most needs relief. Lowering the EZ calculation rate from 0.575 to 0.4 would not target small businesses as effectively and would more than double the revenue loss, to \$402 million.

**OPPONENTS  
SAY:**

HB 4765 would cost millions of dollars in lost general revenue for the next biennium. According to the LBB, HB 4765 would result in a loss of \$172 million. A cut in general revenue of this size would reduce the state's ability to fund critical public services. Moreover, during an economic downturn, public spending on critical needs better stimulates the economy than tax cuts for business would.

The margins tax was designed to be a broad-based tax. HB 4765 would drastically move away from that premise. Sound tax policy dictates that taxes should be broadly based, to allow tax rates to be as low as possible at all points and for all payers. HB 4765 would remove margins tax liability from 39,000 businesses. This would move 80 percent of payers from the tax base and would drastically violate the broad-based principle. If HB

4765 were enacted, fewer businesses would be paying the margins tax than were paying the old franchise tax, defeating one of the primary reasons for enacting the margins tax — to broaden the tax base and require all businesses of all types to pay their fair share.

HB 4765 could threaten Texas' eligibility to receive future stimulus funds from the federal government. HB 4765 would reduce the revenue going into the Property Tax Relief Fund, which supports the Foundation School Program. In order to fulfill the state's public school finance obligations this revenue loss would have to be replaced by another funding source. The House and Senate proposed budgets for fiscal 2010-11 would use \$1.77 billion in federal stabilization dollars to shore up the Foundation School Program. The U.S. Department of Education may find that HB 4765 reduces revenue to the Foundation School Program. The Education Department also may determine that the state paid for this tax cut with federal funds that can be used only to restore education funding stemming from declining tax revenue, not from voluntary tax cuts. In order to ensure compliance with federal American Recovery and Reinvestment Act, the fiscal stabilization dollars are being disbursed in two phases. Texas could be putting a significant share of future stimulus payments at risk by enacting a margins tax cut.

OTHER  
OPPONENTS  
SAY:

HB 4765 would not provide enough relief to small businesses. A better approach would be to lower the EZ calculation rate. This would preserve the broad base of the margins tax and has the potential to deliver relief to a broader swath of taxpayers, not just small businesses.

NOTES:

A related bill, SB 19 by Patrick, would raise the margins tax exemption to \$1 million and reduce the EZ calculation rate from .575 to .4. According to the LBB, SB 19 would cost the state \$402 million over the next fiscal biennium. SB 19 was left pending in the Senate Finance Committee on April 9.

On April 30, the House adopted a Calendars Committee rule providing that no amendment to HB 4765 will be in order unless it is revenue neutral. For purposes of the rule, revenue neutral means that the total cost of the bill may not exceed \$172, 123,000 for the fiscal 2010-2011 biennium and that there are no other additional costs in any other biennium.