HOUSE RESEARCH ORGANIZATION bill analysis | 5/8/2013 | HB 1475 Hilderbran (CSHB 1475 by Hilderbran)

SUBJECT: Exclusion of certain flow-through costs for franchise tax

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 7 ayes — Hilderbran, Otto, Bohac, Button, Eiland, N. Gonzalez, Ritter

2 nays — Martinez Fischer, Strama

1 absent — Ritter

WITNESSES: For — Billy Hamilton, David Nolen, Roger Soape, American Association of Professional Landmen (*Registered, but did not testify*: Allen Beinke, Texas Aggregates and Concrete Association; Robert Flores, Texas Association of Mexican-American Chambers of Commerce)

Against — (*Registered, but did not testify*: Ted Melina Raab, Texas AFT)

On — Ed Warren, Texas Comptroller of Public Accounts

BACKGROUND: Tax Code, sec. 171.1011(c) establishes what constitutes taxable revenue for the purpose of computing a taxable entity's margin.

Sec. 171.1011(c)(1)(B) establishes which items are to be subtracted from taxable revenue for the purpose of computing taxable margin.

Sec. 171.1011(g) establishes exclusions from total revenue for certain flow-through payments, including subcontracting payments for services, labor, or materials used for design, construction, remodeling, or repair of real property.

DIGEST: HB 1475 would allow an entity primarily engaged in performing landman services to exclude from total revenue subcontracting payments to nonemployees for landman services on behalf of the taxable entity.

The bill would define landman services as:

- performance of title searches to determine ownership of or curing title defects related to oil, gas, or other related mineral or petroleum interests;
- negotiation of the acquisition or divestiture of mineral rights for oil

and gas exploration, development, and production; or

- negotiation or management of contracts or agreements related to the ownership of mineral interests oil and gas exploration, development, and production.

The bill would take effect January 1, 2014.

SUPPORTERS SAY:

HB 1475 would allow the deduction of subcontracting payments for landman services for the purpose of calculating the franchise tax. Current law allows for certain flow-through costs made to subcontractors to be excluded from total revenue to determine the an entity's franchise tax, and payments to contract landmen should also be deductible.

While state law generally does not allow a taxable entity to deduct from its total revenue any pass-through payments made to subcontractors, the Texas Tax Code does allow exclusions from total revenue for certain flow-through payments to subcontractors for payments for services, labor, or materials used for construction or repair of real property.

The Tax Code contains no provision that allows for any other payments or costs associated with subcontractors to be deducted from an entity's total taxable revenue, yet a corporation is permitted to deduct all costs associated with the use of subcontractors on its federal income tax return.

In determining taxable margin, entities that employ a landman on a contract basis to perform the same functions, work under the same conditions, and maintain the same hours as actual employees may not exclude as compensation or deduct as pass-through payments compensation paid to these contractors. This bill would amend the Tax Code to put payments to contract landmen to be deducted from an entity's taxable margin and make the franchise tax calculation more consistent.

OPPONENTS SAY:

HB 1475 would have an indirect negative impact on general revenue funds of more than $1.8 million in fiscal 2014-15 and beyond by reducing franchise tax funds flowing to the Property Tax Relief Fund, which was established by the Legislature in 2006 to offset reductions of school property taxes. Because revenue in the Property Tax Relief Fund is dedicated to public education, any reduction of revenue in the fund must be offset with general revenue funds.

The Legislature should not consider reducing funds available for public education without first restoring the cuts made to schools in 2011. Until these cuts are restored, any proposal to reduce revenue for the state that is unproductive and should be set aside.

OTHER OPPONENTS SAY:

HB 1475 would continue the fragmented approach to adjusting inconsistencies related to the franchise tax instead of pursuing comprehensive reform. The Legislature should embrace broad reform instead of tinkering with a deeply flawed franchise tax.

NOTES:

The Legislative Budget Board estimates that the bill would have a direct negative impact to the Property Tax Relief Fund of $1,827,000 for the 2014-15 biennium, and $912,000 per year thereafter. Any loss to the Property Tax Relief Fund would have to be made up with an equal amount of General Revenue to fund the Foundation School Program.