

SUBJECT: Excluding certain crop dusting operations costs for franchise tax purposes

COMMITTEE: Ways and Means — committee substitute recommended

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

1 nay — Strama

1 absent — Ritter

WITNESSES: For — Bob Bailey and Chris Shields, Texas Agricultural Aviation
Association

Against — None

On — (*Registered, but did not testify*: Teresa Bostick and Ed Warren,
Comptroller of Public Accounts)

BACKGROUND: The Texas franchise tax, or “margins” tax, applies to each taxable entity
that does business or is organized in the state. The tax is calculated as
either 1 percent or 0.5 percent of taxable margin.

In general, a taxable entity’s margin is apportioned to the state to
determine the amount of tax imposed by multiplying the margin by the
fraction of the entity’s total receipts that are from doing business in the
state.

14 C.F.R., sec. 137.3 (crop dusting) defines “agricultural aircraft
operation” as the operation of an aircraft for dispensing any economic
poison, dispensing any other substance intended for plant nourishment,
soil treatment, propagation of plant life, or pest control, or engaging in
dispensing activities directly affecting agriculture, horticulture, or forest
preservation, but not including the dispensing of live insects.

DIGEST: CSHB 2451 would amend the Tax Code provisions for determining total
revenue for franchise tax purposes by directing that an agricultural aircraft
operation (crop dusting) exclude from its total revenue the cost of labor,
equipment, fuel, and materials.

This bill would take effect January 1, 2014, and would apply to a franchise tax report due on or after that date.

**SUPPORTERS
SAY:**

CSHB 2451 would relieve the crop dusting industry of an excessive burden under the franchise tax. Because crop dusting companies can deduct very little from their gross revenues, they end up owing between 15 percent and 20 percent of their net profit in margins tax at the 1 percent rate, resulting in exceptionally low net profit.

The average crop duster operation today relies on airplanes that cost as much as a million dollars each. They also buy fuel in 10,000-gallon increments and pay highly skilled pilots to deliver crop protection and fertilizer products. In many parts of the state these operations are essential in crop production, significantly increasing yields and profitability for farmers.

The agricultural aircraft operation industry is treated as a service industry under the franchise tax, rather than one producing goods, and therefore is not allowed to deduct the cost of labor, equipment, fuel and other materials. These operations have little in common with most service industries. They are much more like manufacturing or other goods-producing industries in that they pay high costs for their planes, fuel and pilots instead of simply having to buy computers and desks like many companies in the services sector. CSHB 2451 would treat them like an entity producing goods and would allow them to deduct these significant costs from their revenues.

The Legislature has made exceptions for other industries similarly situated. For example, a taxable entity furnishing labor or materials to a project for construction, improvement, or remodeling of real property is allowed to deduct those expenditures as a cost of goods sold.

The fiscal note on the bill shows a cost of \$288,000 for the 2014-15 biennium. This is a modest amount that would help a very small industry vital to Texas agriculture.

**OPPONENTS
SAY:**

CSHB 2451 would have an indirect impact on general revenue funds 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. It would reduce taxes collected for public schools

by about \$288,000 for fiscal 2014-15 and beyond, according to the Legislative Budget Board. 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 contemplate measures that reduce funds available for public education without first restoring the deep cuts it made to schools in 2011. Until these cuts are restored, any proposal to reduce revenue to the state that is not absolutely necessary should be tabled.

**OTHER
OPPONENTS
SAY:**

While the intent of CSHB 2451 may have merit, it would continue the state's piecemeal approach to the seemingly endless issues that plague the franchise tax. Under the current tax, many businesses are taxed on expenses that should be exempt, others pay unequal rates for similar activities, and still others have to pay taxes for years where they actually report a net loss of income. The Legislature should embrace comprehensive reform or elimination of the flawed franchise tax and move away from the ad hoc approach to fixing its various problems.

NOTES:

According to the fiscal note, the bill would have the direct impact of a revenue loss to the Property Tax Relief Fund in fiscal 2014-15 of \$288,000.