SUBJECT: Expanding the franchise tax definition of a passive entity to include LLCs

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 8 ayes — Burrows, Guillen, Bohac, Murphy, Noble, E. Rodriguez, Shaheen, Wray

0 nays

3 absent — Cole, Martinez Fischer, Sanford

WITNESSES: For — (*Registered, but did not testify*: Jennifer Bremer, Texas Land & Mineral Owners Association)

Against — (*Registered, but did not testify*: Dick Lavine, Center for Public Policy Priorities)

BACKGROUND: Tax Code ch. 171 provides that a passive entity is not subject to franchise tax. A passive entity is an entity that is a general or limited partnership or a trust, other than a business trust, most of whose income is composed of certain passive income. Passive income includes dividends, interest, and other types of income, but does not include income from an active trade or business.

DIGEST: CSHB 2611 would add limited liability companies to the list of entities that could qualify as a passive entity if existing passive income requirements were met.

The bill would take effect January 1, 2020, and would apply to any franchise tax report originally due on or after that date.

SUPPORTERS SAY: CSHB 2611 would equalize the treatment between limited liability companies (LLCs) and limited partnerships (LPs) by allowing LLCs that receive mostly passive income to qualify as passive entities under the franchise tax. In doing so, the bill would reduce unnecessary reporting requirements and fees for these LLCs.

Both LLCs and LPs have limited liability, so there is no reason why LPs should get special treatment under the franchise tax compared to LLCs if both earn the same types of passive income. The state is currently receiving franchise tax revenue from these LLCs that it would not be able to receive if these entities were organized as LPs.

OPPONENTS SAY: CSHB 2611 could have a negative impact on revenue in the next biennium.

NOTES: According to the Legislative Budget Board, the bill would have a direct impact of a revenue loss to the Property Tax Relief Fund of $34.6 million for fiscal 2020-21. 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.