HOUSE RESEARCH ORGANIZATION bill analysis 4/28/2003

HB 104
Chavez, Quintanilla, Mowery
(CSHB 104 by Mowery)

SUBJECT: Exempting goods in transit from ad valorem taxation

COMMITTEE: Local Government Ways and Means — committee substitute recommended

VOTE: 7 ayes — Hill, Hegar, Laubenberg, McReynolds, Mowery, Puente, Quintanilla

0 nays

WITNESSES: For — A.A. Anderson, Anderson All Point Solution; Ray Perryman and Bob Vetters, Texas Warehouse Association; Larry Kelley, Wilson Warehouse and Texas Warehouse Association; Jerry Wright, Brokers Logistics and Texas Warehouse Association; Manuel Longoria, Jr., City of San Antonio; *(On committee substitute:)* Linda Sickels, Trinity Industries

Against — Dick Lavine, Center for Public Policy Priorities

On — Bob Poteet, Texas Cotton Association

BACKGROUND: Texas Constitution, Art. 8, sec. 1-j and Tax Code, sec. 11.251 exempt from ad valorem taxation "freeport" property that is located in Texas temporarily. Eligible freeport property includes goods, wares, merchandise, and other tangible personal property, including aircraft and aircraft parts used for maintenance or repairs by certificated air carriers, and ores, other than oil, natural gas, and other petroleum products. To be eligible for the exemption, property must be acquired in or imported into Texas for export; detained for assembly, storage, manufacturing, processing, or fabrication; and shipped out of state no later than 175 days after acquisition or importation.

In November 2001, Texas voters approved Proposition 10 (SJR by Duncan, et al.), amending the Constitution to allow the Legislature to exempt from taxation goods in transit that are stored temporarily en route to another location in Texas or outside the state (Art. 8, sec. 1-n). Exempt property would include the same types of goods and products eligible for the freeport exemption. The 77th Legislature, however, did not enact enabling legislation to accompany the constitutional amendment.

Under Art. 8, sec. 1-n, property eligible for the exemption must be acquired in or brought into Texas and stored at a location not owned or controlled by the property owner for not more than 270 days after acquisition or importation. Unlike “freeport goods,” goods in transit need not be shipped out of state to qualify for the exemption. Governing bodies of taxing entities may choose to tax goods in transit but must hold a public hearing before acting to do so. Owners of property eligible for the freeport exemption may apply for the goods-in-transit exemption if the Legislature enacts enabling legislation, subject to the decisions of local taxing entities. However, an owner receiving the goods-in-transit exemption may not claim the freeport exemption for the same property.

DIGEST:

CSHB 104 would implement the exemption authorized by Texas Constitution, Art. 8, sec. 1-n. The bill would define goods in transit that would qualify for the exemption; set the procedure for a taxing entity to establish the exemption and the administrative process for assessing the value of goods in transit; and amend the procedure for preparing property-tax rolls to reflect exemptions.

Definitions. CSHB 104 would define goods in transit as tangible personal property stored in a location whose owner does not have a direct or indirect ownership of the property. The property would have to be held at that location for no more than 175 days before being forwarded to another location in Texas or outside the state. The bill would exclude from the definition of goods in transit oil, natural gas, petroleum products, aircraft, dealers' inventory of motor vehicles, vessels, and outboard motors, heavy equipment, and retail manufactured housing.

Goods-in-transit exemption. The governing body of a local taxing entity could elect to tax goods in transit after holding a public hearing. The decision would have to be made before January 1 of the first tax year that the entity proposed to tax these goods. If the entity elected to tax goods in transit, those goods would remain taxable until the governing body took action to rescind or repeal its previous action and grant the exemption.

An owner of qualifying property would receive the exemption regardless of whether that person transported it to another location in Texas or outside the state. Property owners qualifying for the “freeport” exemption would not be eligible for additional exemptions for the same goods in transit.

Administrative procedures. The chief appraiser would have to determine the appraised value eligible for the exemption based on the percentage of the value of tangible personal property represented by the goods in transit. Calculation of the value for the exemption would be based on the market value of the goods in transit during the preceding year, and the current year's inventory would be used to calculate the appraised value in following years. The chief appraiser would have to exclude from the calculation the cost of equipment, machinery, or materials that were added to the goods in transit, as well as the value of other goods not transported within 175 days. The chief appraiser could use the average length of time that a component part was held to determine whether component parts held in bulk were transported within the 175-day limit.

The chief appraiser would have to examine records and other information provided by the property owner to determine the market value if either the property owner or the chief appraiser demonstrated that the initial calculation understated or overstated the market value of eligible property. If the property owner failed to provide these records within 31 days of the chief appraiser's request, the property owner would forfeit the right to claim the exemption for that year.

Property-tax roll changes. The bill would amend Tax Code, sec. 26.012(15) so that the amount of the goods-in-transit exemption would be included in the "lost property levy" amount used to determine the amount of property value that was taxable in the preceding year but not taxable in the current year. It also would amend Government Code, sec. 403.302 (d) to exclude exempted goods-in-transit from the calculation of the taxable value of property in a political subdivision.

The bill would take effect January 1, 2004.

SUPPORTERS SAY:

CSHB 104 would help stop the continuing transfer of lucrative warehousing and distribution business from Texas to adjoining states because of the discriminatory taxes on inventories. In 2001, voters overwhelmingly approved the constitutional amendment to allow the goods-in-transit exemption. This bill finally would let local governments decide whether to adopt this sensible economic development measure.

Surrounding states offer much more favorable inventory tax treatment. For example, Oklahoma fully exempts all freeport goods with no local "opt-out" option, and New Mexico exempts business inventories with few exceptions. Recognizing their competitive advantage, nearby states began enacting laws and promoting policies to help their warehouse operators attract new business. Many manufacturers began storing their products outside Texas, costing the state an estimated 27,000 jobs.

The predicted losses in state revenue caused by increased state reimbursement to school districts because of reduced local revenue from the exemption are exaggerated. Such losses should not exceed $11 million. In fact, many school districts, along with other taxing entities, might choose to opt out of granting the exemption and continue to tax such property. Also, the bill's fiscal-note projections do not take into account the greater sales tax revenue that would accrue from increased warehousing activity. Updated dynamic modeling performed by The Perryman Group in 2003 projects a potential annual gain of $981 million in personal income and almost 22,000 new permanent jobs.

Arguments about how much revenue would be lost to local taxing entities are beside the point, because empty warehouses yield little or no revenues. The goods and resulting economic development are generating tax revenues for Oklahoma, New Mexico, Louisiana, and Arkansas, rather than for Texas.

CSHB 104 would allow local policymakers to balance the need to attract economic development with the possible loss of tax revenues. El Paso has watched lucrative warehousing development flee into New Mexico, and those types of businesses have left southeast Texas for Louisiana because of the state's high inventory tax.

The bill also would curtail unproductive and unwise business decisions made to manipulate inventories to avoid paying the property tax. Merchandise is moved into and out of warehouses in December or even loaded on trucks for one-day trips on January 1. Hazardous agricultural chemicals are transferred to other facilities to avoid being recorded on appraisal rolls. High inventory taxes also lead to Odessa firms finding it cheaper to store inventory in Shreveport and transfer it back into the state than to store it in West Texas. A tax code should not be so complex and punitive that it provides incentives for such behavior on part of businesses.

Many appraisal districts already process requests for similar exemptions under the "freeport" provisions, and Harris County has additional responsibilities to handle exemptions for raw cocoa and green coffee because of a separate constitutional amendment approved in 2001. The administrative procedures spelled out in CSHB 104 would be relatively straightforward and easily managed by property owners and appraisal districts.

Tightening the time limit to 175 days, rather than 270 days as allowed in the constitutional amendment, would reflect the intent to exempt goods entering the stream of commerce as quickly as possible. Faster turnover of inventory helps economic development. Also, the bill would clarify the language regarding the independent relationship between the warehouse owner and the owner of the goods in transit and properly would narrow the exemption for public warehouses that store goods they do not own. The reference to a "location not owned or controlled by the property owner" in the bill as filed inadvertently could have created a "Delaware sub"-type loophole to avoid paying taxes. Legislation granting exemptions to companies that maintain warehouses for their own merchandise, such as Wal-Mart, should be considered on its own merits.

OPPONENTS SAY:

Any measure that would erode local tax bases further would be imprudent, especially in a time of revenue shortfall and fiscal uncertainty. Since 1994, state and local tax revenues have declined as a percentage of personal income. Creating a new exemption would result in substantial costs to the state as well as to local governments. Costs of such exemptions tend to have limited fiscal effects and then explode in later years. According to the comptroller, the current freeport exemption will cost $440 million in lost property-tax revenue during the next biennium. The state should impose a moratorium on new exemptions until the efficiency and appropriateness of existing exemptions are determined.

The current crisis in school finance makes CSHB 104 all the more ill-advised. Many school districts have reached the statutory rate cap of $1.50 per $100 of taxable valuation for maintenance and operations taxes, and many more districts are approaching the cap. The Legislative Budget Board (LBB) estimates that if all taxing entities granted the goods-in-transit exemption, the required state reimbursements to school districts for revenue losses in fiscal 2003 would total $36 million in fiscal 2004. This could be particularly burdensome for property-wealthy districts subject to revenue recapture under the so-called "Robin Hood" system. Also, nonreimbursable losses to cities and counties in fiscal 2003 would total $7.8 million and $11.2 million, respectively, according to LBB. Losses would continue to escalate through 2006 and beyond.

Allowing local governments to "opt out" of the goods-in-transit exemption would perpetuate existing problems with tax administration. Business and industry likely would relocate to exempt areas, creating the same tax-policy patchwork that plagues the freeport exemption. The adverse economic consequences could be disproportionately detrimental to small and rural communities that depend on a few large businesses.

Texas already has an attractive business climate. The proposed amendment unfairly would shift the property-tax burden from certain taxpayers who happen to own goods in transit to other taxpayers. It would show favoritism by subsidizing a single, relatively small industry, yet would produce little positive "ripple effect." The impact of economic losses from transborder migration of storage facilities is overstated. Realistically, such facilities can serve efficiently only markets in Dallas-Fort Worth, El Paso, and perhaps Houston. Texas should not be lured into a tax-break war with other states for dubious returns to address what amount to regional problems.

Criteria for assessing the new exemption would complicate rather than simplify the appraisal process. Determining property owners' intent could be difficult, because ambiguity in the language might allow them to claim exemptions for goods that arguably are not meant for shipment.

OTHER OPPONENTS SAY:

The limitation on holding goods should be extended to 270 days so that certified cotton warehouses could qualify for the exemption. Warehouses in Houston and Galveston have lost business to those in Memphis and other cities because of Texas' high property taxes.

The bill should include a sunset date and require a report to the Legislature on economic benefits versus lost tax revenues so that lawmakers could review the policy before approving it.

NOTES: The committee substitute would set a limit of 175 days on how long goods could be held and still qualify for the exemption, rather than the 270-day limit proposed in the original bill. The substitute also would make various changes to the definition of tangible personal property.