

SUBJECT: Property tax exemption for owners leasing to a school facility

COMMITTEE: Ways and Means — favorable, without amendment

VOTE: 8 ayes — Hilderbran, Otto, Bohac, Button, Eiland, N. Gonzalez, Ritter, Strama

0 nays

1 absent — Martinez Fischer

WITNESSES: For — David Dunn, Texas Charter Schools Association; Tommy Fuller, Universal Academy; Joseph Riggs, Responsive Education Solutions (*Registered, but did not testify*: Rodrigo Carreon; Brent Connett, Texas Conservative Coalition; Eric Glenn, Texas Charter School Association; Addie Smith, Texas Charter Management Organizations; Justin Yancy, Texas Business Leadership Council)

Against — Donald Lee, Texas Conference of Urban Counties; (*Registered, but did not testify*: Dick Lavine, Center for Public Policy Priorities)

On — Marya Crigler, TAAD Legislative Committee, Travis Central Appraisal District

DIGEST: HB 1360 would allow a person to receive a property tax exemption for any property owned and leased to a qualified school. The exemption could be granted only if the school used the property exclusively for educational purposes and the property was reasonably necessary for the operation of the school.

Claiming a property tax exemption. In order to claim a property tax exemption, the owner would have to:

- certify to the school that the rent for the lease of the property would be reduced by the amount of the reduction on property taxes;
- provide the school with a disclosure document stating the amount of the tax reduction that resulted from the exemption and the

method the owner would use to ensure the rent charged reflected the reduction; and

- show the rent charged for the lease reflected the reduction in the amount of taxes on the property resulting from the exemption.

Qualifying school. In order to qualify for the exemption, a school would have to:

- be organized and operated primarily for the purpose of engaging in educational functions;
- normally maintain a regular faculty and curriculum and normally have a regularly organized body of students in attendance;
- be operated in a way that does not result in accrual of distributable profits or compensation in excess of a reasonable allowance;
- use its assets in performing educational functions or the educational functions of another educational organization; and
- by charter, bylaw, or other regulation adopted by the organization to govern its affairs provides that, upon dissolution, the organization's assets are to be transferred to this state, the United States, or an educational, charitable, religious, or other similar organization.

Effective date. The bill would take effect January 1, 2014, providing the corresponding constitutional amendment (HJR 83) was approved by voters. If not, then then bill would have no effect.

**SUPPORTERS
SAY:**

HB 1360 would fix an inequality in tax law that burdens small private and charter schools.

Under current law, charter and private nonprofit schools are exempt from having to pay property taxes. However, this exemption only applies if a school is able to purchase a property in its name. Many small charter and private schools that have a tax exemption are unable to finance the purchase of a property, and are thus left with only the option of leasing space. Unfortunately, assuming a lease results in the school having to pay property taxes indirectly, as the property owner passes the cost of paying the taxes to the school.

HB 1360 would create a method to transfer, in effect, a property tax exemption to a charter or private school that leased space from an individual. Under the bill, the owner would have to certify the market

value of the property and then indicate the reduction in rent that the school enjoyed.

Following the certification, the owner would then receive a property tax exemption for the amount of the reduced rent. This would generate a savings to the property owner that would be passed on to the school. Money that schools must pay toward taxes is diverted from teacher salaries, improved technology, curriculum expansion, and other critical items.

Charter schools, in particular, are at a distinct disadvantage compared with public schools when it comes to facilities funding. They are not allowed to levy taxes to pay for their facilities and are ineligible for programs that provide state funding to help eligible school districts with facilities costs. HB 1360 would help put small charter schools on a more level field in regard to property taxes.

Charter schools are small-scale actors that fill specific and unique needs in their respective communities. Charter schools educate only about 3 percent of all public students, and HB 1360 would only impact those that rent their facilities. As such, the bill's fiscal impact on the state would be minimal, but the impact on these schools would be significant.

HB 1360 would not create a slippery slope of similar leasing exemptions for other entities, as the issue it would be addressing is unique to schools in this particular situation. The bill would not grant an exemption for any use other than property needed for "educational purposes" that was "necessary for the operation of the school," creating a narrow universe of applicability.

**OPPONENTS
SAY:**

HB 1360 would upend the long-standing practice of only providing tax exemptions to someone who owns land. The bill would open the floodgates to similar measures each seeking a tax exemption for discounting property for a noteworthy purpose.

Since time immemorial, tax exemptions have been tied to the owner of land. The scope and history of the rule is illustrated by the fact that public entities, including public schools, religious organizations, and nonprofits, all entities that have well-established tax exemptions under the law, do not receive or confer any tax exemption for leased property. If HB 1360 passed, it would give private schools, private universities, and potentially

charter schools — depending on a still-unclear interpretation of Property Code, sec. 11.21(d) — a completely special and unique exemption that was unavailable to anyone else.

This would put the state on a slippery slope with regard to granting exemptions for leased, discounted space. If enacted, HB 1360 would invite similar bills in future sessions creating similar leasing exemptions for public schools, churches, governmental entities, nonprofits, hospitals, clinics, etc. The Legislature would have trouble giving any of those groups a principled explanation for why they should not be granted the same allowance as private and charter schools.

In addition, the bill provides a fertile landscape for all manner creative business arrangements and evasive practices to take root. It would be hard for an appraisal district to independently evaluate what a property owner claims to be fair market rent. There would be nothing keeping a property owner from using generous estimates of fair market rent to enjoy a larger tax exemption than is justified. Appraisal districts have little experience in evaluating the market value of such arrangements. They would not have an effective way to check abusive practices.

The Legislative Budget Board's estimated fiscal impact for the bill is deceptively low, since it is based on current taxpayers operating under current law. The proposed changes in the law would encourage practices that would end up causing a more significant loss of future revenue. This loss in revenue would represent a transfer of property taxes from the regular school district to the alternative school.

NOTES:

The Legislative Budget Board estimated the bill could have a negative impact to the general revenue fund of \$1.8 million for fiscal 2014-15, and \$8.6 million in the subsequent biennium. The fiscal note also finds an additional cost to school districts, counties, cities, and special districts.

HJR 86 by Ritter, the Constitutional amendment necessary for HB 1360 to be effective, has been set for floor debate today on the House Major State Calendar.