HOUSE RESEARCH ORGANIZATION bill analysis | 5/6/1999 | HB 551 Goolsby, Oliveira (CSHB 551 by Oliveira)

SUBJECT: Exempting certain small corporations from the franchise tax

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 8 ayes — Oliveira, Bonnen, Craddick, Heflin, Hilbert, Keffer, T. King, Ramsay

0 nays

3 absent — McCall, Y. Davis, Sadler

WITNESSES: For — Jeff Clark, Texas Association of Business and Chambers of Commerce; Robert Howden, National Federation of Independent Business; Bob Johnson, Printing and Imaging Association of Texas; David Pinkus, Small Business United of Texas

Against — None

On — Linda Eads, Office of the Attorney General

BACKGROUND: The franchise tax has been Texas' primary business tax since its adoption in 1907. Corporations pay the tax in exchange for state-granted privileges, including access to the state's legal system, the right to accumulate property separately from any individual, and a limitation of personal liability for officers of the corporation. About 380,000 firms are subject to the tax, of which about 165,000 reported a tax liability in 1997. The other 215,000 firms owed no tax. Franchise tax collections are about $2 billion annually.

Corporations make two sets of calculations to determine their franchise tax liability. The first calculation determines the firm's taxable capital, which is roughly the firm's total assets minus its debits, or net worth. For corporations with operations in other states, net worth is apportioned to Texas based on the share of the company's business done in the state. The second calculation determines the firm's earned surplus, which is roughly the firm's federal taxable income plus the compensation paid to its officers. Earned surplus also is apportioned to Texas based on the share of business done in the state.

A tax rate of 0.25 percent is applied to the taxable capital, and a 4.5 percent tax rate is applied to the earned surplus. For all practical purposes, the firm pays the higher of the two tax liabilities. Under current law, firms with a franchise tax liability of less than $100 are not required to pay the tax, although they must file a public information report containing name and address information about the corporation, its officers, and corporations that it owns or that own it.

DIGEST:

CSHB 551 would exempt any corporation from paying the franchise tax if its gross receipts were less than $100,000 during the year, or if its franchise tax liability was less than $100. The bill would require any corporation subject to the tax, regardless of whether it owed tax, to file a public information report with the comptroller.

The bill would allow the comptroller to require a corporation that owed no franchise tax to file an abbreviated tax report, in lieu of tax forms prescribed by the comptroller, stating the corporation’s gross receipts. Such an abbreviated report could not require the corporation to calculate its taxable capital or earned surplus.

The bill would require the comptroller to report to the Legislature and the governor on the bill’s effect on the state economy, including the effect on new job creation. The report would have to include an assessment of the law’s effectiveness in achieving its intended purpose, whether the changes had created any problems in administering the franchise tax, and recommendations on whether to retain, eliminate, or amend the exemption. The comptroller would have to submit this report before the beginning of the 79th Legislature, Regular Session, in 2005.

CSHB 551 would take effect January 1, 2000. Its provisions would sunset on January 1, 2006.

SUPPORTERS SAY:

CSHB 551 would make it easier for small businesses to get on with business. Despite a growing economy, many small businesses are struggling to make ends meet. This bill would reduce the time and effort needed to calculate franchise taxes, and it would allow small businesses to submit information reports in lieu of complicated tax forms if their annual gross receipts were less than $100,000. The cost of calculating the franchise tax often exceeds the total tax liability for small corporations, especially for small, family-owned businesses with five or fewer employees.

CSHB 551 would reduce taxes paid by small corporations by an estimated $57 million during fiscal 2000-01. Putting this money back in the hands of small businesses would lead to job creation. Employment growth in this state depends primarily on small businesses.

The bill would provide a temporary tax exemption and expedited reporting requirement that would sunset in six years. It would require the comptroller to report on the bill's effect on the state economy and the administration of the tax and on whether the bill had achieved its purposes.

OPPONENTS SAY:

CSHB 551 would provide a tax break and a paperwork reduction to corporations that do not need either. Corporations that owe the franchise tax should pay it, as they should not receive the privileges of being incorporated without paying the tax that guarantees those privileges. Already five of every six businesses in the state pay no franchise tax because they are partnerships, sole proprietorships, or some other form of business organization other than a corporation. The biggest beneficiaries of the bill are finance, insurance, real estate, and manufacturing corporations, all of which already pay federal income taxes using complicated federal forms. The paperwork reduction is not worth the cost to the state, and the bill's price tag of $57 million could be spent better in other ways.

Taxes should not be reduced until schools, health care, and human service programs are fully funded. Texas has substantial unmet needs in all these areas. If the Legislature determines that a tax cut is desirable, broad-based tax-rate reductions would produce more benefits for the state economy in terms of job creation and capital formation in relation to the revenue the state would lose. Narrow exceptions to taxation do help some Texans, but they produce little in terms of overall economic benefit. All Texans have contributed to the state through higher taxes, and all Texans should share fairly in a tax cut.

OTHER OPPONENTS SAY:

Small businesses need relief from the financial and administrative burden of the franchise tax, but CSHB 551 would exempt them by using the wrong measure of business income. The bill should exempt corporations based on net earnings, not gross receipts. Individuals who incorporate their business interests may receive a hefty profit on $100,000 in gross earnings, while a small business with several employees may earn a substantially smaller profit on $200,000 in gross earnings. This bill would exempt the former but not the latter. Businesses that can afford to pay the tax and absorb the expense of calculating it ought to be required to do so.

NOTES: The original bill would have exempted only firms with gross receipts below $100,000 from the franchise tax.

The companion bill, SB 148 by Fraser, passed the Senate on February 25 and has been referred to the House Ways and Means Committee.