HOUSE RESEARCH ORGANIZATION bill analysis 5/2/2001

HB 1200
Brimer, et al.
(CSHB 1200 by Oliveira)

SUBJECT: Authorizing school property-tax incentives for mega-project investment

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 10 ayes — Oliveira, McCall, Craddick, Hartnett, Bonnen, Y. Davis, Heflin, Keffer, Ramsay, Ritter

0 nays

1 absent — Hilbert

WITNESSES: For — Kenneth Barr, Fort Worth City Council and Texas Municipal League; Jeff Clark, National Federation of Independent Business; Jim Greenwood, Greater San Antonio Chamber of Commerce; Mario Hernandez and Patrick Nowotny, Texas Economic Development Council; Ray Perryman; Bill Thornton, Fort Worth Chamber of Commerce; Michael White, Greater Houston Partnership

Against — Dick Lavine, Center for Public Policy Priorities

On — James LeBas, Comptroller's Office; Jeff Moseley, Texas Department of Economic Development

BACKGROUND: Tax Code, chapters 311 and 312 authorize cities, counties, and school districts to offer tax abatements and tax increment financing to qualified businesses that meet eligibility requirements. Cities and counties, but not school districts, may establish reinvestment and enterprise zones under those chapters. Government Code, sec. 403.302 holds school districts harmless for tax abatements granted within reinvestment zones before May 31, 1993. The taxable value of property in school tax abatements granted after that date is not deducted for purposes of calculating state education aid. Consequently, few school districts have granted new abatements in recent years.

DIGEST: CSHB 1200 would allow school districts to negotiate limitations on the appraised value of property for maintenance and operations (M&O) property taxation with qualifying corporations or limited-liability companies that would use the property for manufacturing or research and development. The

bill also would extend the Property Redevelopment and Tax Abatement Act until September 1, 2007.

Applicants for appraised-value limitations would have to make qualified investments of tangible personal property first placed in service after January 1, 2002, during the qualifying time period, the first two tax years beginning on or after the application approval date. Qualified investments would include property used to manufacture, process, or fabricate semiconductors in a clean-room environment; tangible personal property described in the U.S. Internal Revenue Code, sec. 1245 (generally, various real, personal, and other property subject to depreciation and amortization); and buildings housing the property.

Applicants would have to own qualified property, meaning land, new buildings or other new improvements, or tangible personal property not part of a school tax-abatement agreement and (other than clean-room equipment) first placed in service in new buildings or improvements or on the land on which they were located, if necessary for the business conducted there. The land would have to be located in a reinvestment or enterprise zone on which the applicant planned to erect a new building or improvement not in existence when they applied, not part of a school-tax abatement agreement, and on which they planned to make a qualified investment at least equal to the minimum amount required and to create at least 25 qualifying jobs. Such jobs would have to be permanent full-time jobs, not transferred from another part of the state; not created to replace previous employees; and covered by group health-benefit plans for which the applicant offered to pay at least 50 percent of the premiums.

Capitalized lease property could be considered a qualified investment. Excluded from qualified investments, however, would be land on which buildings were erected, operating lease property, and pooled property not owned by the applicant.

The required minimum investment amounts would be determined by dividing all the state's school districts into five categories, each with a different range of taxable property value or, for rural districts, taxable industrial property value in the preceding tax year.

Non-rural Districts

Category	Taxable Property Value	Minimum Qualified Investment/Limitation
I	At least $10 billion	$100 million
II	$1 billion > $10 billion	$80 million
III	$500 million > $1 billion	$60 million
IV	$100 million > $500 million	$40 million
V	Less than $100 million	$20 million

Rural Districts

Category	Taxable Industrial Property Value	Minimum Qualified Investment/Limitation
I	At least $200 million	$30 million
II	$90 million > $200 million	$20 million
III	$1 million > $90 million	$10 million
IV	$100,000 > $1 million	$ 5 million
V	Less than $100,000	$ 1 million

Rural districts would be defined as those located in counties north of the southern boundaries of Andrews, Martin, Howard, Mitchell, Nolan, and Taylor counties and west of the eastern boundaries of Hardeman, Foard, Knox, Haskell, Jones, and Taylor counties. Only 10 qualifying jobs would have to be created in districts in those counties.

Applications would have to be made on forms and contain information prescribed by the comptroller. The comptroller would have to adopt rules for determining whether property was qualified investment. The school districts' governing bodies would have to set application fees, including the costs of economic impact evaluations. Consideration of applications would be at the governing bodies' discretion. Applications receiving consideration would have to undergo third-party economic impact evaluations on the school districts' behalf. Applications would have to be decided on within 120 days of filing, unless both parties agreed to extensions.

School districts could seek assistance from the Texas Department of Economic Development (TDED), the Council on Workforce and Economic

Competitiveness, the Texas Workforce Commission, and the comptroller. Districts considering applications would have to submit copies to the comptroller, who would have to recommend within 60 days whether to approve the application. Both the comptroller and the districts would have to evaluate applications in writing based on:

- the relationship of the applicant's industry and prospective jobs to the state's long-term economic growth plans, according to the Texas Strategic Economic Development Planning Commission;
- the relative level of investment per qualifying job being created;
- the wages, salaries, and benefits of workers holding qualified jobs;
- the applicant's ability to locate or relocate to another state or another region of Texas;
- added infrastructure impact on the region, including school district revenue gains and subsequent economic effects on local and regional tax bases;
- the region's economic condition;
- the number of eligible new facilities built or expanded in the region in the two preceding years; and
- the effect of the applicant's proposal, if approved, on the number or size of the school district's instructional facilities.

For each of the first eight years after the qualifying time period, approved applicants' appraised taxable value could not exceed the lesser of the property's market value or the amounts agreed to by the school district. The limitation amounts could exceed but not be less than the minimums established for each district category.

Written limitation agreements would have to specify the qualified investments to be made on or in connection with qualified property. Other property owned by applicants but not specified in agreements would not be subject to limitation unless the school districts' governing bodies took action to include them. Agreements would have to include provisions;

- protecting future school-district revenues through adjustment of minimum valuations, payment of revenue offsets, and other negotiated mechanisms;
- requiring property owners to maintain viable presences in the districts for at least three years after the agreements expired;

- recapturing lost revenue for applicants' noncompliance plus penalties and interest; and
- specifying the tax years covered.

Agreements could include conditions requiring renegotiation by either party.

Approved applicants would be entitled to tax credits for taxes paid during the qualifying time period on the portions of the appraised value of the qualified properties exceeding the amounts of the limitations in the agreements. Tax credit applications would have to be accompanied by tax receipts showing
full payment of school taxes on the qualified property for the qualifying time period. Applicants who relocated their businesses outside school districts would not receive credits in tax years during or immediately after the relocation.

Tax credits would be payable in equal annual installments over the eight-year limitation period. Payments could not exceed half of the total school taxes imposed on the property in any one tax year. Credits not received during the limitation period would be paid during the first tax year after the limitation period expired but could not exceed the total school taxes imposed on the property in that tax year. Credits issued in error would be recoverable through subsequent additional taxes plus 7 percent interest from the date the credit was issued. Payment would be enforceable by a tax lien on the qualified property. Delinquent businesses could not receive or apply for subsequent credits.

The education commissioner would have to adopt and implement rules to reimburse school districts for tax credits granted. The bill would amend the Government Code to hold school districts harmless for granting appraised-value limitations for purposes of receiving state education aid.

The provisions on appraised-value limitations and school tax credits would expire December 31, 2007. Limitation agreements and tax credits approved before that date would continue in effect.

Chief appraisers would have to include both market value and the agreed-upon limitation of the taxable property value in appraisal records.

Information about processes or business activities submitted by applicants would be confidential unless their applications were approved.

School districts granting appraised-value limitations could not adopt tax rates exceeding their rollback rates during the first two tax years after application approval. Subsequent application approvals would extend the tax rate restriction another two years.

Property subject to a limitation agreement would be ineligible for a school tax abatement in the same tax year.

Cities and counties could assess and collect reasonable impact fees from new developments to pay for or recoup the costs of capital improvements or facility expansions necessitated by or attributable to property receiving appraised-value limitations.

For purposes of the bill, school districts could designate areas entirely within their boundaries as reinvestment zones. Districts' governing bodies would have to determine that creating zones and granting appraised-value limitations on property within them would contribute to the expansion of primary employment or attract major investment that would benefit property in the zones and the district and would contribute to regional economic development. Districts could seek county and municipal recommendations before making designations.

Chief appraisers annually would have to send TDED lists of properties in their districts worth $100 million or more. TDED would have to issue a statewide compilation to each legislator.

CSHB 1200 would require TDED, the Council on Workforce and Economic Competitiveness, the Attorney General's Office, and the comptroller to report on tax incentive and economic development laws enacted in other states since 1990. The initial report would be due before December 31, 2002, to the governor, lieutenant governor, and House speaker. It would have to be updated annually and include recommendations for legislative action.

TDED would have to add to its annual report to the governor and to its biennial report to the Legislature a list of prospective projects proposing to

invest at least $100 million in the state, including those that located outside Texas. TDED would have to state the primary reasons for not locating in Texas. It also would have to evaluate the bill's incentives and provide detailed information on the limitation agreements transacted during the preceding biennium.

This bill would take effect January 1, 2002, except for the section extending the Property Redevelopment and Tax Abatement Act until September 1, 2007. That section would take effect September 1, 2001.

SUPPORTERS SAY:

Texas is falling behind other states in attracting major new industrial projects. According to the authoritative *Site Selection* magazine, Texas has dropped from first in 1990 to 37th in 2000 in terms of new manufacturing facilities. Since 1997, Texas has lost at least 12 major projects to other states that would have invested more than $4.5 billion and created approximately 5,200 new jobs.

One of the main reasons for this decline is that the state's school property tax burden penalizes capital-intensive businesses and industries, particularly manufacturing and research and development. Manufacturing's 35 percent property and franchise tax burden is disproportionate to that of other industries by twice as much as the next highest sector. Other states are taking advantage of this situation by offering attractive tax incentives to counteract Texas' otherwise optimal business climate.

CSHB 1200 would give local school officials the tools they need to compete with other states and attract high-impact business investment to their communities, regardless of their size or location. It would allow them to cap appraised values for property taxation using an eight-year sliding scale on mega-industrial projects that met stringent criteria. It would not create a new abatement, because districts still would collect tax revenue. Recipients of the tax benefits would pay their fair share, both up front and after the fact, restoring some balance to the property tax system.

The program created by this bill would be completely optional. It would allow local control and negotiation to fit districts' specific needs and goals. CSHB 1200 has been customized for rural districts by linking qualified

investment to taxable industrial property value, removing the skewing factors of district size and mineral values.

To lessen the burden on school districts, the bill would require economic impact studies by third parties and would allow districts to recover consulting costs through application fees. Districts also could avail themselves of state agency expertise.

This bill would allow school districts to offer long-sought and much-needed tax incentives for which the state would hold them harmless at minimal cost. The comptroller estimates a general revenue gain of $4.2 million during the first five years and a fiscal 2006 cost of only about $36 million in net school tax revenue ($42 million less almost $6 million in revenue feedbacks). That loss is based on the assumption that businesses that would have located in Texas without the incentives provided by CSHB 1200 would have generated that much school tax revenue. The amount would represent less than one-third of 1 percent of the current annual appropriation of more than $11 billion to the Foundation School Program. Current trends indicate, however, that these businesses likely would not locate here without additional incentives.

On the other hand, CSHB 1200 would create thousands of well-paying new jobs. The estimated 10-year increases in retail sales ($3.7 billion) and total manufacturing (about $55 billion) would increase sales tax and other tax revenue to cities, counties, and the state. Without property tax relief, these businesses will not come, and Texas would receive neither the additional revenue nor the economic benefits.

Encouraging mega-project investment is crucial to long-range economic growth and development. It leads to extensive supplier networks, expansion of original projects, and construction of other large facilities. Such projects also help redefine regional economies, such as high technology in Central Texas and petrochemicals along the Gulf Coast.

The current economic slowdown makes enactment of CSHB 1200 all the more crucial to keep Texas at the forefront of technological growth. The bill has broad-based support from the business and education communities.

OPPONENTS SAY:

Texas needs to attract more and better-paying jobs, but the best way to compete is by providing what companies really need in a new location: a skilled workforce, good transportation, and nearby markets. The state cannot provide these incentives without money to invest in improved schools and better roads. If companies coming to Texas can avoid their fair share of property taxes, other Texans will have to pay more for these critical needs.

CSHB 1200 would allow some school districts to waive almost all property taxes for certain new businesses for 10 years, exempting hundreds of millions of dollars worth of new property from school taxes. The beneficiaries would include businesses that would have moved to Texas anyway.

The rankings cited for attracting manufacturing jobs and investment are misleading. In the *Site Selection* study, Texas was in the top six every year of the 1990s. The drop in 2000 was an aberration and should not form the basis for state economic and school finance policy, especially a change of this magnitude.

Texas has many other attractive aspects to its economy, which continues to grow and compete nationally and internationally. Measuring its health based on one sector is a narrow diagnosis. Tax burden is only one of many factors executives weigh before deciding where to locate their companies.

The ripple effects of the bill are overstated. For example, the fiscal note's revenue cost per job of $38,000 is too high; a better benchmark would be $25,000. The full impact of tax breaks is unknowable, making such incentives a gamble with future tax revenue. There is no way to measure accurately how much economic activity and property-tax base growth is attributable to any tax incentive program. Some portion of the state's future increase in taxable property value would occur without this bill at no revenue loss to the state.

The bill would not penalize school districts in state education aid, but neither would they stand to gain any additional state revenue, because it would be reduced by the amount of property tax revenue collected from the new investment. The bill would not address the real problem: high property taxes due to inadequate state aid to education.

Benefits should not be linked to the size of school districts. This would allow businesses to move into smaller, high-growth counties and pay less in taxes than they would in larger counties that might not be able to offer comparable deals and require higher minimum investments. In turn, the districts would have less revenue to pay for expansion that an influx of workers might cause. Texans would be better served by linking tax breaks to investment in low-income, economically depressed areas, as other legislation has done.

The mechanisms in the program may be too complex to be workable for less experienced districts. They might be tempted to take advantage of provisions they did not fully understand and might find themselves overmatched in negotiations with big business.

The program proposed by CSHB 1200 is potentially divisive. It could pit reluctant districts needing to maintain revenue against eager chambers of commerce and economic development groups wanting to attract more business and industry. Also, districts could offer incentives inconsistent with city and county programs, creating possible conflicts.

OTHER OPPONENTS SAY:

Too few industries would be eligible to participate in this bill's program. Texas' economy is diverse and increasingly service- and information-oriented. Businesses in those sectors, not just manufacturing and research and development, should be included. Also, the definition of rural districts should be broadened to include more counties left out of the bill.

The state's school finance system may be approaching another crisis. Several wealthy school districts have filed suit challenging the so-called "Robin Hood" plan of revenue recapture. Many districts are nearing the statutory M&O tax rate cap of $1.50 per $100 property valuation. It would be more prudent to postpone this proposal until 2003 so that these and other issues in the school finance and property tax systems can be addressed.

NOTES:

Among differences from the bill as filed, the committee substitute would:

- allow counties and cities to charge reasonable impact fees;
- categorize rural school districts separately for determining minimum qualified investment and appraised-value limitation;

- reduce the number of required qualifying jobs in rural districts to 10;
- specify that only companies engaged in manufacturing and research and development activities would be eligible;
- require written agreements between school districts and property owners;
- make consideration of applications discretionary but require districts to obtain third-party economic impact evaluations of applications under consideration;
- modify the information that property owners would have to submit with applications and include in annual reports on qualifying jobs;
- remove the Legislative Budge Board's role in recommending to districts whether to approve applications;
- increase from seven to eight the number of years that districts would be required to pay tax credits;
- modify the definition of "qualified property";
- modify provisions on legislative findings, purposes, and intent; and
- change the expiration date from 2012 to 2007.

The companion bill, SB 679 by Harris, was considered in a public hearing by the Senate Finance Committee on March 15 and left pending.