SUBJECT: Providing a $1 million total revenue exemption for the franchise tax

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 —Talmadge Heflin, Texas Public Policy Foundation; Ralph Marcantonio and Will Newton, NFIB/Texas; (*Registered, but did not testify:* George Allen, Texas Apartment Association; Brent Connett, Texas Conservative Coalition; Les Findeisen, Texas Motor Transportation Association; Matt Geske, Metro 8 Chambers of Commerce; Daniel Gonzalez, Texas Association of Realtors; Angela Hale, McKinney Chamber of Commerce; Bill Hammond, Texas Association of Business; Ron Hinkle, Texas Travel Industry Association and Texas Association of Campground Owners; Lance Lively, Texas Package Stores Association; Scott Norman, Texas Association of Builders; Richard Perez, Metro 8 Chambers of Commerce; Oscar Rodriguez, Texas Association of Broadcasters; Dan Shelley, Plumbing Heating Cooling Contractors; Chris Shields, Greater San Antonio Chamber of Commerce)

Against —Eileen Garcia, Texas Forward; (*Registered, but did not testify:* Dick Lavine, Center for Public Policy Priorities; Ted Melina Raab, Texas AFT)

On — (*Registered, but did not testify:* Teresa Bostick and Ed Warren, Comptroller of Public Accounts)

BACKGROUND: Businesses with revenue less than $1 million currently are exempt from the franchise tax. This exemption will be lowered on January 1, 2014 to cover only those with less than $600,000 in revenue.

DIGEST: HB 213 would repeal a provision that otherwise would sunset the $1 million small business franchise tax exemption on December 31, 2013. The bill would repeal provisions in session law governing the current exemption, which is set at $600,000.

It also would repeal statutory language that establishes tax discounts for various levels of total revenue below $1 million. Current law grants the following discounts to entities with the corresponding total revenue:

- 80 percent for a total revenue between $300,000 and $400,000;
- 60 percent for a total revenue between $400,000 and $500,000;
- 40 percent for a total revenue between $500,000 and $700,000; and
- 20 percent for total revenue between $700,000 and $900,000.

This bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2013.

SUPPORTERS SAY:

HB 213 indefinitely would extend the $1 million small business franchise tax exemption to small businesses that would be significantly impacted by a tax hike. The 81st Legislature in 2009 first temporarily adopted the $1 million exemption limit, which it raised from an original exemption of $300,000, and the 82nd Legislature in 2011 extended it through the fiscal 2012-13 biennium. Now that the state is in a fiscally stable position, the time is nigh to finally end the ad-hoc extensions of the small business tax exemption and set the $1 million limit in statute.

A failure to extend the $1 million exemption would be dangerous and counterproductive. Small business growth has been and continues to be a vital component of economic recovery, primarily through the generation of jobs. Small businesses also contribute directly to state coffers by paying property and sales taxes. Failing to extend the exemption would deal a major blow to small businesses that are still emerging from the recession economy. Subjecting small businesses to a higher burden would be counterproductive to goals of low unemployment, diverse economic growth, and diffused opportunity.

OPPONENTS SAY:

HB 213 would have significant, indirect impact on general revenue funds by reducing franchise tax funds flowing to the Property Tax Relief Fund, which was established by the Legislature in 2006 to offset reductions of school property taxes. It would decrease taxes collected for public schools by about $164 million for fiscal 2014-15 and beyond, according to the Legislative Budget Board. Because revenue in the Property Tax Relief Fund is dedicated to public education, any reduction of revenue in the fund must be offset with general revenue funds.

The Legislature should not contemplate measures that reduce funds available for public education without first restoring the deep cuts it made to schools in 2011. Until these cuts are restored, any proposal to reduce revenue coming in to the state that is not absolutely necessary should be tabled.

Continuing the $1 million exemption would be problematic because it would create a sheer tax cliff at that amount: make $999,999 and pay no taxes; make $1,000,001 and pay the full percentage owed. A staggered approach with discounts for various ranges of revenue, as exists on paper in current law, would be preferable over a dollar-value cliff.

OTHER OPPONENTS SAY:

HB 213 would continue the state's piecemeal approach to the seemingly endless issues that plague the franchise tax. Under the current tax, many businesses are taxed on expenses that should be exempt, others pay unequal rates for similar activities, and still others have to pay taxes for years in which they actually report a net loss of income. The Legislature should embrace comprehensive reform or elimination of the deeply flawed franchise tax and move toward enduring solutions to its various problems.

NOTES:

The Legislative Budget Board estimates HB 213 would result in a reduction of about $164 million to the Property Tax Relief Fund. Any loss to this fund must be made up with an equal amount of general revenue to fund the Foundation School Program.