



TTARA

Texas Taxpayers and Research Association

July 2009

Tax Bills—81st Legislative Session

To the casual observer, it might seem that little happened on the tax front during the 81st Legislative session. Actually, the 81st session was a very active and positive one for tax legislation — particularly as it relates to local property taxes. Reforms that TTARA had advocated for years finally came to fruition, and the result is a more rational system of tax administration.

No major tax bill was needed to address the state's fiscal woes [see TTARA's post session newsletter on the budget: *The 2010-11 Texas Budget: Crisis Averted (For Now)*]. What new money the Legislature pocketed from the federal stimulus package went mostly to state spending, with only a pittance set aside for tax relief.

In this newsletter, TTARA reviews the major property, sales and franchise tax legislation passed by the 81st Legislature and signed into law by Governor Perry.

PROPERTY TAX

In the property tax arena, this session was much different than those of recent memory. The lion's share of TTARA's past efforts had been on defense, fending off proposals to lower the 10 percent appraisal cap on homesteads, increase homestead exemptions, authorize rendition audits, require sales price disclosure, and put elected officials in charge of the appraisal process. Although such bills were introduced once again this session, all failed to get any traction this time around.

Instead, it is fair to say that enacted this session were the most significant appraisal reforms since 1979

when the Peveto bill established the current county-wide appraisal system across the state. It was a landmark session for TTARA as well. Major strides were taken to enact our long-advocated changes to enhance system oversight and uniform administration, to reshape the Comptroller's school property value study, and to provide for an alternative valuation appeal mechanism.

Impetus for the positive changes was provided by the work of interim House and Senate property tax study committees chaired respectively by Rep. John Otto and Sen. Tommy Williams. They carried the principal elements of the reform legislation and deserve much of the credit for its passage. TTARA vigorously supported the reforms and was actively involved during the interim leading up to the session and in the session itself in shaping the reform agenda and winning passage of its component bills.

State Oversight

TTARA has long sought a major policy change to improve accountability and operational consistency among appraisal districts by permitting direct state regulation. This session we drafted and successfully advocated legislative approval of a provision in **HJR 36 by Otto** to accomplish that purpose. If approved by voters at November's general election, the constitutional change will empower the state to provide by statute for administrative and judicial enforcement of uniform appraisal standards and procedures on a statewide basis. The current constitutional language requiring such actions to originate in the county where the property is located is eliminated. Since required implementing legislation was not adopted, it will be a major focus of next session's property tax program.

Property Value Study

Under current law, the Comptroller conducts an annual numerical study to estimate local school values for state aid distribution purposes and to measure appraisal district performance. For many years TTARA has advocated an overhaul of the Comptroller's Property Value Study so that it focuses on the practices, procedures, and methodologies an appraisal district uses to value property. TTARA has argued that this approach would be more efficient and effective than the current practice of conducting a retrospective reappraisal (basically a "second guess" of what local values are) of property whose value already has been determined by the appraisal process.

In several pre-session meetings with the Comptroller and her staff, along with representatives of school districts, appraisal districts, and other stakeholders, and Rep. Otto and Sen. Williams and their staffs, TTARA helped craft **HB 8 by Otto**. It ultimately passed and will shape the conduct of future studies along the lines we proposed. HB 8 requires the Comptroller to conduct a traditional numerical value study in each school district only every other year, unless the district's local value was found inadequate in the prior year. In years in which a district does not have a value study, its local value will be presumed valid for distributing state aid.

Most importantly, the Comptroller is directed to review the governance, taxpayer assistance, operation, and appraisal standards, procedures, and methodology of each appraisal district at least once every two years. A school district, appraisal district, or other governmental entity must promptly comply with a request from the Comptroller for information, including that which is confidential, to be used in conducting the review. Based on the results, the Comptroller will recommend needed improvements in appraisal district practices and the Texas Department of Licensing and Regulation (TDLR) is charged with enforcing compliance. A property value study advisory committee is created comprised of one member each from the House and Senate and seven members appointed by the Comptroller – two appraisal district directors, two school district members and three

members who are school district taxpayers or have expertise in school district taxation or ratio studies.

Alternative Appeal

TTARA also strongly supported and helped draft and win passage of **HB 3612 by Otto**, which creates for the first time an alternative method for appealing appraised values. Beginning next year, a three-year pilot program in Bexar, Cameron, El Paso, Harris, Tarrant, and Travis Counties will allow a taxpayer with real or personal property (other than industrial or mineral) valued at more than \$1 million to appeal an Appraisal Review Board (ARB) order to the State Office of Administrative Hearings (SOAH).

The number of appeals over the three-year period is limited to 3,000, with the total allocated among the counties based on the proportionate number of lawsuits filed in each. Hearings will be held in the county where the property is located and will be presided over by an administrative law judge required to have knowledge of appraisal methodology and the proper method for determining the appeal of a protest.

An appeal to SOAH is an election of remedies and an alternative to a district court appeal. The appeal is de novo and a property owner may be self-represented or may be represented by an attorney, CPA, registered property tax consultant, or any other person not prohibited from appearing in a SOAH hearing. The amount of taxes not in dispute must be paid and the prevailing party will be reimbursed for costs of the appeal by the losing party, including a refund or retention of the \$300 filing fee.

Other Appeal Changes

Additional changes to the appeal process made in other bills also merit noting. Patterned after the current practice in Harris County, **HB 1030 by Calle-gari** requires in part that appraisal districts in counties of 500,000 population or more implement a system allowing a residential homestead owner to electronically: file a notice of protest; receive and review comparable sales data and other evidence; and receive, accept or reject a settlement offer. The bill

also mandates that, in a county with over 3.3 million population or an adjacent county over 350,000 population (currently affecting only Harris and Ft. Bend Counties), ARB members will be appointed either directly by the local administrative district judge or by a panel of 3-5 commissioners selected by the judge.

HB 986 by Villareal makes some important changes, including extending the time to file a petition for review of an ARB order from 45 to 60 days after the order is entered, or at any time after the hearing but before the 60-day deadline.

Changes to the binding arbitration provisions for residential and other property valued at \$1 million or less were made in **SB 771 by Williams**. It provides for an expedited arbitration procedure with no more than one hour of argument and testimony per side and a filing fee reduced from \$500 to \$250. Licensed attorneys and CPAs are allowed to serve as arbitrators and CPAs also are allowed to represent a property owner at an arbitration proceeding.

Lastly, if approved by voters, a provision of **HJR 36 by Otto** will establish constitutional authority for two or more adjoining appraisal districts to establish a joint ARB to hear valuation appeals. Implementing legislation, **HB 3611 by Otto**, will become effective upon the amendment's passage and will allow appraisal district boards to provide for consolidated appeals by interlocal contract.

Property Valuations

At interim committee hearings, affected homeowners testified about their difficulty in coping with escalating property taxes resulting from very large increases in their property values caused by nearby commercial development. That testimony struck a responsive chord with legislators. As a result, **HJR 36 by Otto** also puts before voters a constitutional amendment authorizing legislation to base the taxation of a residence homestead solely on its value for residential use, regardless of the property's highest and best use. **HB 3611 by Otto** would implement the change.

The omnibus reform bill originating in the Senate, **SB 771 by Williams**, mandates a number of significant changes in the methods used to value property. A chief appraiser is directed to take into account all available evidence specific to a property in determining its market value. Further, a property value that was lowered on appeal in the previous year may not be increased unless the chief appraiser meets the burden of proof to show the increase is supported by substantial evidence when all reliable and probative evidence in the record is considered as a whole.

With regard to comparable sales used in the valuation of property, SB 771 requires that they must have occurred within 24 months of the valuation date, unless not enough sales occurred during the two-year period to constitute a representative sample. Comparable sales also must be adjusted to appropriately account for any change in market value between the date of the comparable property's sale and the valuation date. The determination of comparability is to be made by considering similarities of location, square footage, age, condition, access, amenities, views, income, operating expenses, occupancy, and the existence of deed restrictions, easements, or other legal burdens affecting marketability.

In determining the value of property appraised on the basis of rental income, SB 771 prohibits the chief appraiser from separately appraising any personal property (i.e., furniture, fixtures and equipment) valued as a portion of the income of the real property, and further requires the real property's value to include the combined value of both.

Regulation

HB 2447 by Flynn abolished The Board of Tax Professional Examiners (BTPE) as a separate agency and transferred its functions to the Department of Licensing and Regulation (TDLR). Although housed at TDLR, the Comptroller will have a major roll in regulatory activities. The Comptroller is required to enter into a memorandum of understanding with TDLR to perform a number of functions, including: providing information on tax professional educational needs, reviewing and approving all re-

quired courses and examinations, and assisting in both administrative proceedings and the prosecution of violations.

Though TTARA was not directly involved in the legislation, we have long supported strengthening the educational and ethical standards for property tax consultants. **HB 2591 by Thompson** makes a number of important changes to these standards, including: adding classroom education and examination requirements; limiting the number of consultants that may be simultaneously supervised by a registered senior property tax consultant; and specifying certain unethical practices including: engaging an attorney without the consent of the owner, soliciting business by promising a specific result, and implying that a website used for solicitation of business is a government website.

Pollution Control Exemption

As authorized by a 1993 constitutional amendment advocated by the Texas Association of Taxpayers (TAT), one of TTARA's predecessor organizations, equipment used to control pollution may be exempted from property taxes. Eligibility is determined by the Texas Commission on Environmental Quality (TCEQ). Legislation last session directed the TCEQ to adopt by rule a nonexclusive list of 18 categories of pollution control equipment that could qualify for either partial or total exemption (so-called Tier 4 exemptions). A Legislative Budget Board (LBB) interim review of the program led to the filing of HB 3206 by Edwards to tighten up the process. TTARA objected to the bill as filed based on its retroactive effect and an unduly restrictive methodology for making Tier 4 partial use determinations. We negotiated and supported a compromise which passed the House and was subsequently added in the Senate to **HB 3544 by Lucio**.

The bill requires the TCEQ to make Tier 4 use determinations by using the same uniform methodology currently employed in evaluating partial use applications under the agency's longstanding Tier 3 process. It also creates a permanent advisory committee made up of representatives of taxing units, environmental groups, appraisal experts, and taxpayers, to-

gether with environmental engineering experts, to assist the TCEQ. Finally, the bill grandfathers existing final Tier 4 determinations made on applications filed before January 1, 2009.

Abatements

Without reauthorization this session, Chapter 312, Tax Code, which authorizes cities and counties to enter into tax abatement agreements with property owners, would have expired on the first of September. TTARA strongly supported and helped pass **HB 773 by Oliveira** extending the scheduled expiration date for an additional 10 years, until September 1, 2019.

Two other problems with Chapter 312 had to be dealt with as well and TTARA had an active role in their resolution. The first was created by Attorney General Opinion GA-600, which stated that a county was not authorized to execute a tax abatement agreement with the owner of abated property located on leased land. The second was occasioned by a request for an AG opinion by the Jefferson County Attorney, who questioned whether the terms of a tax abatement agreement could defer its effective date to a time subsequent to its execution. Both of these issues were favorably resolved in two bills passed by the Legislature, **SB 1458 by Seliger** and the identical **HB 3896 by Oliveira**. It is now clear that property on leased land may be abated and that the beginning of an abatement period may be deferred. If these bills had not been passed, there was a very real possibility that many existing tax abatement agreements could have been challenged in court and possibly invalidated.

School Value Limitations

In recent years, the state's school tax value limitation program under Chapter 313, Tax Code, has come under fire from opponents of tax incentives. Attacked as either "corporate welfare" or as a school district "shakedown" of taxpayers, several bills were introduced this session which would have effectively killed this critically important economic development tool. TTARA worked closely with both supporters and critics of the program to help

craft and shepherd through the legislative process a reasonable package of amendments to continue the program.

HB 3676 by Heflin extends the sunset date of the program by three years, to 2014. It also incorporates the provisions of a recent attorney general opinion clarifying that lessees may apply and receive a value limitation. Changes made to the qualifying period, the time during which the applicant must meet certain minimum investment thresholds (roughly the project's construction period), allow the qualifying period to begin immediately or be deferred.

The application review provisions are changed to expand the items of study to better assess the benefits of the project, and the role of the Comptroller is enhanced by the authority to assess a project's eligibility. Further, if the Comptroller does not recommend a project, the school district will be penalized with a loss in state aid should the school board subsequently approve the application.

With voter approval, a school district is no longer prohibited from raising tax rates above the rollback rate during the first two years of the project. Payments to the school districts by successful applicants are newly limited to \$100 per student per year of the agreement and new "clawback" provisions negate the limitation should an applicant fail to make the legally-required qualified investment or create the required number of new jobs. The Comptroller is expected within the next several weeks and months to issue new forms and propose new rules to implement the changes. TTARA will be actively involved in this process.

FRANCHISE TAX

Only three bills dealing with the franchise tax passed. **HB 4765 by Oliveira** raises the small business exemption from the current \$300,000 to \$1,000,000 for the next two years, then falling to \$600,000 in the years thereafter. The \$172 million cost to the state over the next biennium was partly financed through **HB 2154 by Edwards**, which increased taxes on smokeless tobacco by shifting from

a value-based tax to a higher one based on volume. The increase in the small business exemption may do little to quell complaints about the revised franchise tax, even though it exempts 40,000 taxpayers, because businesses with over \$1 million in total receipts actually experienced the largest increases in liability compared to the old "earned surplus" tax. Chairman Oliveira has promised that the franchise tax will be intensely studied over the interim.

HB 4611 by Oliveira clarifies how banks apportion their loans and securities (consistent with traditional practice). **SB 636 by Seliger** was amended late in the session to allow travel agents to exclude expenses paid to others from their total revenue in calculating the franchise tax.

SALES TAX

It was comparatively rather quiet on the sales tax front this session – so quiet in fact that the Comptroller did not even propose the usual "technical" bill to make tax administration changes. Perhaps the most significant action concerned what didn't pass, rather than what did.

Two Percent Cap

Numerous attempts were made to allow the two percent aggregate local sales tax cap to be exceeded for various purposes. TTARA was actively involved in opposing such efforts and in the end all were thwarted and the cap remains intact, at least until next session. There's little doubt that proposals to bust the cap will be back next time around – the sales tax remains a favored place for local governments to look for additional revenue to finance a wide variety of public purposes.

Administration

Two provisions of note did pass. One of particular interest to retailers was added by a House floor amendment to **SB 1199 by Ogden** and provides that a seller is entitled to receive a credit or reimbursement equal to the amount of the sales tax refunded when a purchaser receives either a full or partial re-

fund of the sales price of a returned item. Under current policy, a credit or reimbursement of sales tax on refunds only applies to full refunds and a restocking fee must be claimed by the seller to offset the cost of any partial refunds.

After several attempts in prior sessions, legislation was adopted to address the so-called "Roomstore" issue and settle the controversy over which local governments are entitled to receive the sales tax when an item is purchased and delivered from different locations of the seller. A House floor amendment to **SB 636 by Seliger** attached the contents of **SB 1202 by Deuell** to change the current sourcing of local sales taxes by requiring that, if a retailer has multiple business locations, a sale is considered to have occurred at the place of business where pay-

ment in person is first accepted instead of where delivery of the item purchased is made.

Exemptions

Among the raft of sales tax exemptions that were introduced, the few that were enacted include: **SB 958 by Hegar** for machinery and equipment exclusively used in an agricultural aircraft operation; **SB 1929 by Watson** for items sold to or used to construct, maintain, expand, improve, equip or renovate media production facilities; **HB 1801 by Bohac** adding school supplies to the current 3-day sales tax holiday; and **HB 3144 by Gonzalez Tourelles** for items used on farms or ranches in the building of roads or water facilities or in the production of agricultural products.

Texas Taxpayers and Research Association (TTARA)
400 West 15th Street, Suite 400
Austin, TX 78701