

TTARA

Webcast Update

on Tax & Fiscal Issues

April 8, 2016

Continuing Education Credits

We are pleased to offer 1 hour of continuing education credit for attorneys, accountants, and professionals in taxation with the State Bar of Texas, the Texas State Board of Public Accountancy, and the Institute for Professionals in Taxation.

Certificates of participation have been uploaded and can be found on the Gotowebinar toolbar on the right side of your screen under the “Handout” menu. You can download and place a copy in your files. If you have trouble locating the certificate, contact Ryan at ryan@ttara.org and he will send you a copy. We will enter the State Bar of Texas credit, but accountants and tax professionals need to submit their credit to those organizations.



Agenda

- 1. Upcoming Meetings & Events**
- 2. Fiscal Update**
- 3. Court Updates**
 - a. AMC v. Hegar**
 - b. City of Austin v. Travis CAD**
 - c. ETC Marketing v. Harris CAD**
 - d. Reeves and Loving County CADs v. MidCon Compression**
 - e. EXLP and EES Leasing v. Galveston CAD**
 - f. Southwest Royalties v. Hegar**
 - g. Hegar v. Small Tobacco Coalition and Global Tobacco, Inc.**
 - h. School Finance**
 - i. Clint ISD**
- 4. Interim Committees**
 - a. Senate Natural Resources and Economic Development**
 - b. House Economic and Small Business Development**
 - c. Senate Finance**
 - d. Senate Select Committee on Property Tax Reform and Relief**
- 5. Property Tax: Truth in Taxation**
- 6. Sales Tax: Compressors**
- 7. Franchise Tax: Wholesale/Retail Rules Clarification (3.584)**

Upcoming Meetings & Events

- **Houston Luncheon in conjunction with TEI/Houston Chapter:** Tuesday, April 19, 2016 at the Westin Houston Memorial City, 945 Gessner, 11:30-1:00. Special Guest Speaker: Senator Paul Bettencourt
- **Dallas Luncheon:** Thursday, April 28, 2016 at the Westin Galleria, 13340 Dallas Pkwy from 11:30-1:00.
- **Golf Tournament:** Monday, May 23, 2016, at Falconhead Golf Club (1 p.m. start time)
- **Annual Meeting:** Thursday, October 6 and Friday October 7 at the Sheraton Austin Hotel at the Capitol.
- **Webcasts:** June 10, September 9, and November 4. (All webcasts will start at 9:30 a.m. and last no longer than an hour).

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Fiscal Update



Miracle on Ice?

What Low Oil Prices Mean for Texas

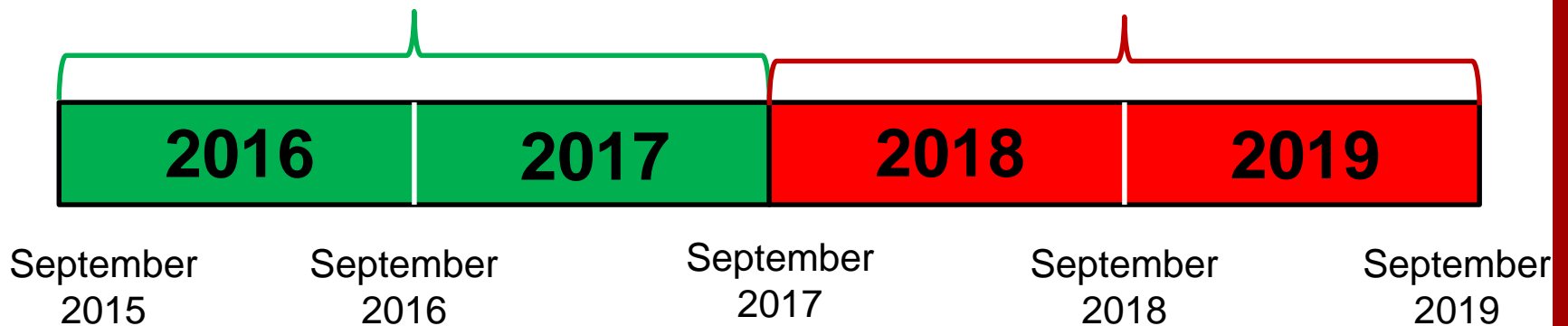
A TTARA Research Brief

- With the drop in oil prices, Texas has lost:
 - 65,000 direct jobs in oil and gas
 - 250,000 overall jobs
- Texas now lags the US in job creation for the first time in 12 years, a trend that may continue through 2016
- Much of the downturn has already been factored into the state budget, so state finances remain secure

Assessing the Timeline

**Current State Budget
Passed in 2015**

**Next State Budget
2017 Legislative
Session**



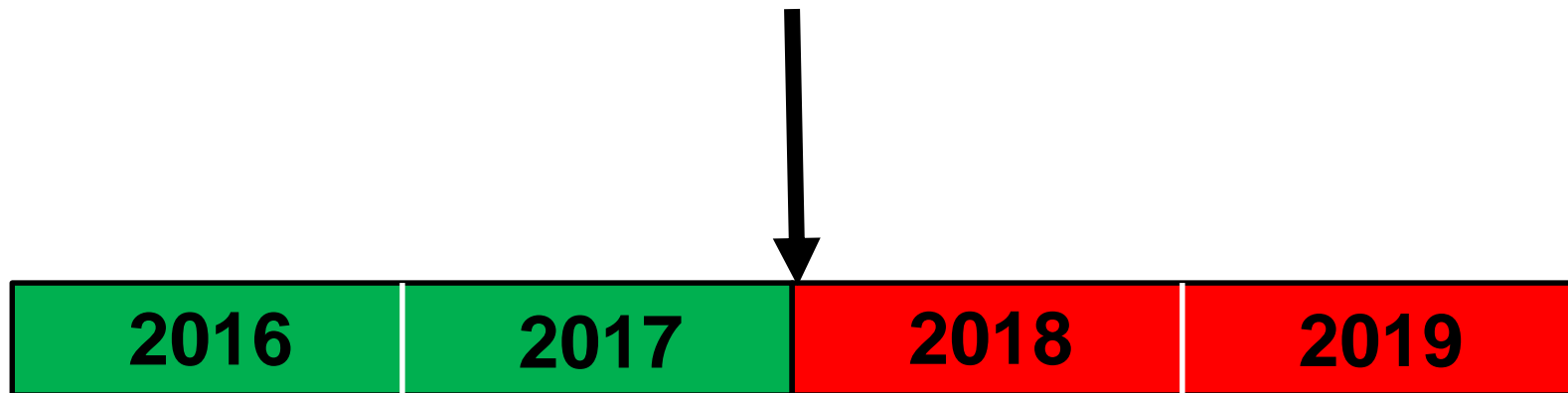
Assessing the Timeline

We are here



Assessing the Timeline

At the end of the current budget, official projections put Texas general revenue surplus at \$4.2 billion

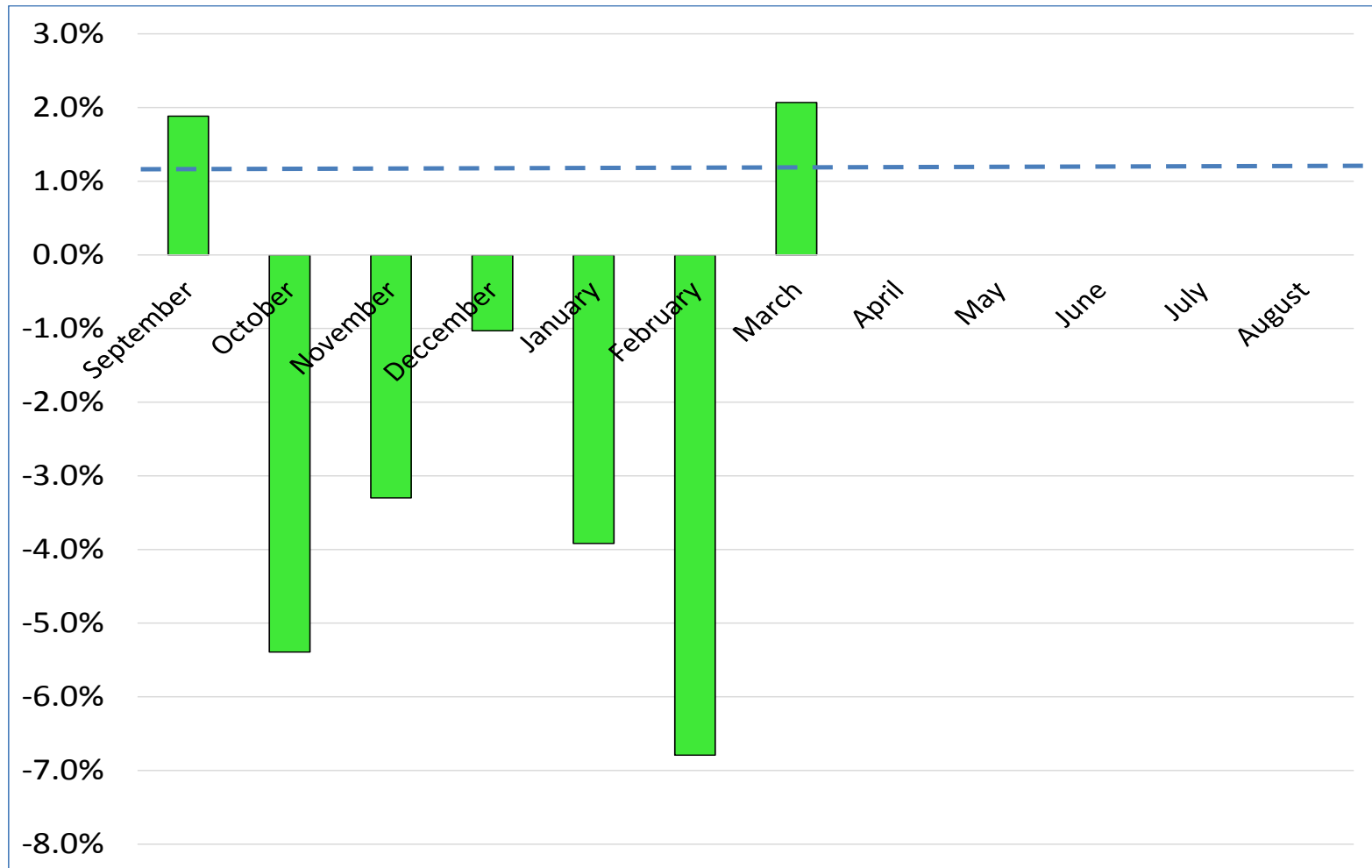


State Revenue Tracking

	2016 Projected Revenues	Projected Growth Rate	Actual Growth thru 7 Months
Sales Tax	\$ 29.1 b	1.2 %	(2.5 %)
Motor Vehicle Sales Tax	\$ 4.8 b	5.9 %	1.7 %
Severance Taxes	\$ 2.7 b	(34.7 %)	(50.2%)
Other Taxes	\$ 10.3 b	(9.9 %)	7.0 %
Non Tax Revenue	<u>\$ 6.3 b</u>	(2.3 %)	7.8 %
Total	\$ 53.3 b	(3.8 %)	(5.9 %)

Monthly Sales Tax Growth, FY 2016

Percent Change from the Same Month in the Prior Year

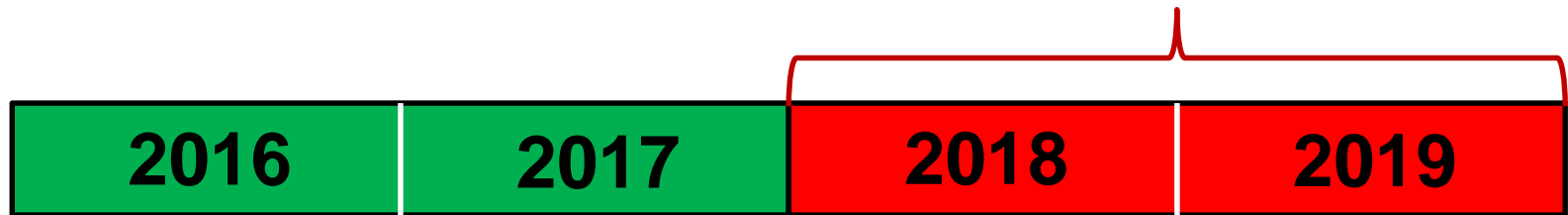


Current Budget Status, 2016-17

- The decline in oil and gas is worse than anticipated
- State revenues are lagging official projections, but are within a reasonable margin of error
- Supplemental appropriations are likely for Medicaid (perhaps \$1 billion)

Assessing the Timeline

**Next State Budget
2017 Legislative
Session**





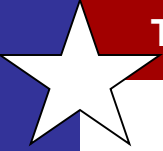
Ordinary and Extraordinary Budget Items, 2017

Ordinary (Traditional) Items

Public Education	~ \$2.4 billion
Medicaid (w/o ACA expansion)	~ \$3.0 billion
Employee Benefits	~ \$1.0 billion

Extraordinary Items

New Highway Fund Dedication	\$5.0 billion
Retired Teacher Health Insurance	~ \$1.6 billion
School Finance Reform (court mandated)	?
Southwest Royalties (court decision)	\$4 – 5 billion
AMC v. Hegar	\$6 – 9 billion



Court Updates

AMC v. Hegar

Texas Court of Appeals, 3rd District (No. 03-14-00397-CV)

Travis County District Court

- Court ruled that film presentation met the “perceptible to the senses” test of selling tangible personal property, but also relied on language in statute specific to film
- Comptroller warned that court’s decision for the taxpayer could substantially expand the cost of goods sold deduction to services providers, costing Texas as much as \$6 billion in refunds and \$1.5 million in annual prospective losses



AMC v. Hegar: Appellate Timeline

April 30, 2015: 3rd Court of Appeals ruling in favor of the taxpayer is issued

June 5, 2015: State files motion requesting a rehearing, contending that the court has substantially expanded the definition of “tangible personal property”

December 30, 2015: Taxpayer files response to state’s motion for rehearing, arguing the court’s decision was not as broad as the state contends

January 19, 2016: State files reply to taxpayer’s response


Court has not yet ruled on rehearing



City of Austin v. Travis CAD ***(3rd Ct. of Appeals Case #03-16-00038-CV)***

Issue: City challenges the level of appraisal of commercial real property (Category F1) and vacant land (Category C1) and the constitutionality of equal and uniform appeals statute

- District Court ruled against City – 11/6/15
 - Court lacked jurisdiction to hear case and City lacked standing to challenge statute's constitutionality
- 3rd Court of Appeals
 - City filed appeal – 1/26/16
 - Motion to dismiss due to City's lack of standing and failure to exhaust administrative remedies – 3/1/16
 - City response claims that dismissal motion improperly addresses merits of case and not court's jurisdiction – 3/9/16
 - Response to City that jurisdictional issues are adequately presented and ripe for resolution – 3/28/16



ETC Marketing v. Harris CAD **(S.Ct. Case #15-0687)**

Issue: Whether natural gas temporarily stored in Texas during its transport out-of-state is taxable or exempt as goods in interstate commerce

- District Court granted summary judgment motion against taxpayer – 2/29/12
- 1st Court of Appeals affirmed – 5/5/15
 - Without declaring the gas was in interstate commerce, the opinion deemed the gas was taxable even if it were because the taxpayer failed to demonstrate a lack of substantial nexus as required by the first prong of the *Complete Auto* standard
- Petition for Supreme Court Review – 10/14/15
 - TTARA filed *amicus* in support of review petition – 10/19/15
 - Consideration of factors pertinent to income and sales tax nexus such as taxpayer's physical presence and general business activities in state are not relevant
 - Appropriate test of property tax nexus is presence of property in a taxing unit for more than a temporary period
 - ETC filed brief on merits 3/23/16
 - Unopposed motion granted to extend deadline for HCAD brief to 5/12/16



Reeves and Loving County CADs v. MidCon Compression
(S.Ct. Case #15-0969)

EXLP & EES Leasing v. Galveston CAD (S.Ct. Case #15-0683)

Issue: Constitutionality of heavy equipment valuation Tax Code §23.1241

- ***MidCon Compression***

- District Court held statute unconstitutional as applied and determined situs to be in Loving and Reeves County where compressors were in use – 8/23/13
- 8th Court of Appeals reversed unconstitutional ruling and upheld situs determination – 9/23/15
 - Appraisal districts did not meet burden of proof on valuation issue and within legislative discretion to enact a special valuation methodology for heavy equipment inventory
 - MidCon failed to demonstrate Legislature intended to fix situs at business location where rented
- Petition for Supreme Court review filed 2/26/16 and response to petition waived 3/8/16

- ***EXLP Leasing***


- District Court held statute unconstitutional as applied and determined situs to be in Galveston County where compressors were in use – 8/25/15
- 14th Court of Appeals upheld situs but reversed & remanded constitutionality issue to District Court since neither party adduced evidence to conclusively resolve valuation issue – 8/25/15
- EXLP petition for Supreme Court review objected to remand – 11/24/15
 - GCAD response filed 3/21/16 and EXLP reply deadline extended to 4/26/16



Southwest Royalties v. Hegar **(S.Ct. Case #14-0743)**

Issue: Eligibility of below-ground equipment (especially piping) for sales tax exemption as property used in manufacturing

- District Court ruled against taxpayer – 4/30/12
 - Did not meet burden of proof to show equipment directly made or caused a chemical or physical change
- 3rd Court of Appeals affirmed – 8/13/14
 - Did not meet burden of proof to show Comptroller's interpretation unreasonable
- Supreme Court Oral Argument – 3/8/16
 - SW Royalties: statute not ambiguous, Comptroller's interpretation not in harmony with statute, processing equipment qualifies, minerals become TPP when severed
 - State: mineral extraction is not processing, processing and fabrication must be part of manufacturing process, minerals not TPP until they reach the surface, physical change caused naturally by changes in temperature and pressure
 - Justices' questions primarily focused on when minerals become TPP and whether processing alone is qualifying use



Hegar v. Small Tobacco Coalition and Global Tobacco, Inc.

(S.Ct. Case #14-0747)

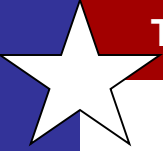
Issue: Constitutionality of special fee on cigarette sales by non-settling cigarette manufacturers

- District Court ruled for taxpayer – 11/15/13
- 3rd Court of Appeals affirmed – 8/15/14
 - Violates equal and uniform provision by creating suspect tax classification
 - Impermissible to impose different taxes on sale of same products
- Supreme Court reversed – 4/1/16
 - TTARA submitted *amicus* objecting to “same product” test
 - Opinion holds numerous considerations can provide legitimate basis for tax classifications and insistence on “same products” test is not valid
 - Remanded for consideration of equal protection/due process claim and whether Coalition had standing to challenge statute

School Finance Lawsuit



***Waiting.....Waiting.....7 months, 7 days
since Texas Supreme Court Oral Arguments***



School Finance Lawsuit

Timeline

Initially Filed	October 11, 2011
Ruling from the Bench	February 4, 2013
Unconstitutional	
Re-hearing due to Changes	January 21, 2014
Formal Ruling	August 28, 2014
Unconstitutional	
Appealed to TX Supreme Court	September 26, 2014
Supreme Court Oral Arguments	September 1, 2015
Supreme Court Ruling	??????????????



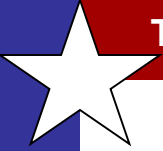
School Finance Lawsuit

Possible Actions

- **Dismiss the Case.** Direct the plaintiffs to address their issues with the Legislature.
- **Remand the case back to District Court.** Could be assigned to three-judge panel.
- **Unconstitutional Ruling on all claims.** Findings in favor of the plaintiffs. Would include an injunction.
- **Constitutional Ruling on all claims.** Findings in favor of the State. Would NOT include an injunction.
- **Mixed Ruling – Part Constitutional and part Unconstitutional.** Would include an injunction.

Clint ISD Lawsuit

- Three parents of students in **Clint ISD** filed suit against the district claiming
 - **The district distributes funds inequitably among its campuses (\$3,500 per ADA disparity)**
 - Texas Supreme Court **dismissed the case** on April 1 because the parents did not exhaust all administrative remedies before filing suit
 - School District Administration
 - School Board
 - Texas Education Agency Commissioner



Interim Committees



Senate Natural Resources and Economic Development Committee

- **Craig Estes**, Chair in lieu of retiring Troy Fraser
- Economic development is only one of several committee assignments
- Charge #3: Economic Development: Evaluate the effectiveness and necessity of programs and resources currently used to support economic development in Texas. Make recommendations regarding continuation of effective strategies, modification of existing administrative or regulatory barriers, and the reduction or elimination of ineffective programs.



Senate Natural Resources and Economic Development Committee

- Hearing held in Austin, April 1
- In support of Chapter 313 and other incentive programs
 - Texas Chemical Council
 - Texas Association of Manufacturers
 - Texas Association of Business
 - Texas Taxpayers and Research Association
- Committee skeptical of Chapter 313 because of the high “cost” to the state



House Committee on Economic and Small Business Development

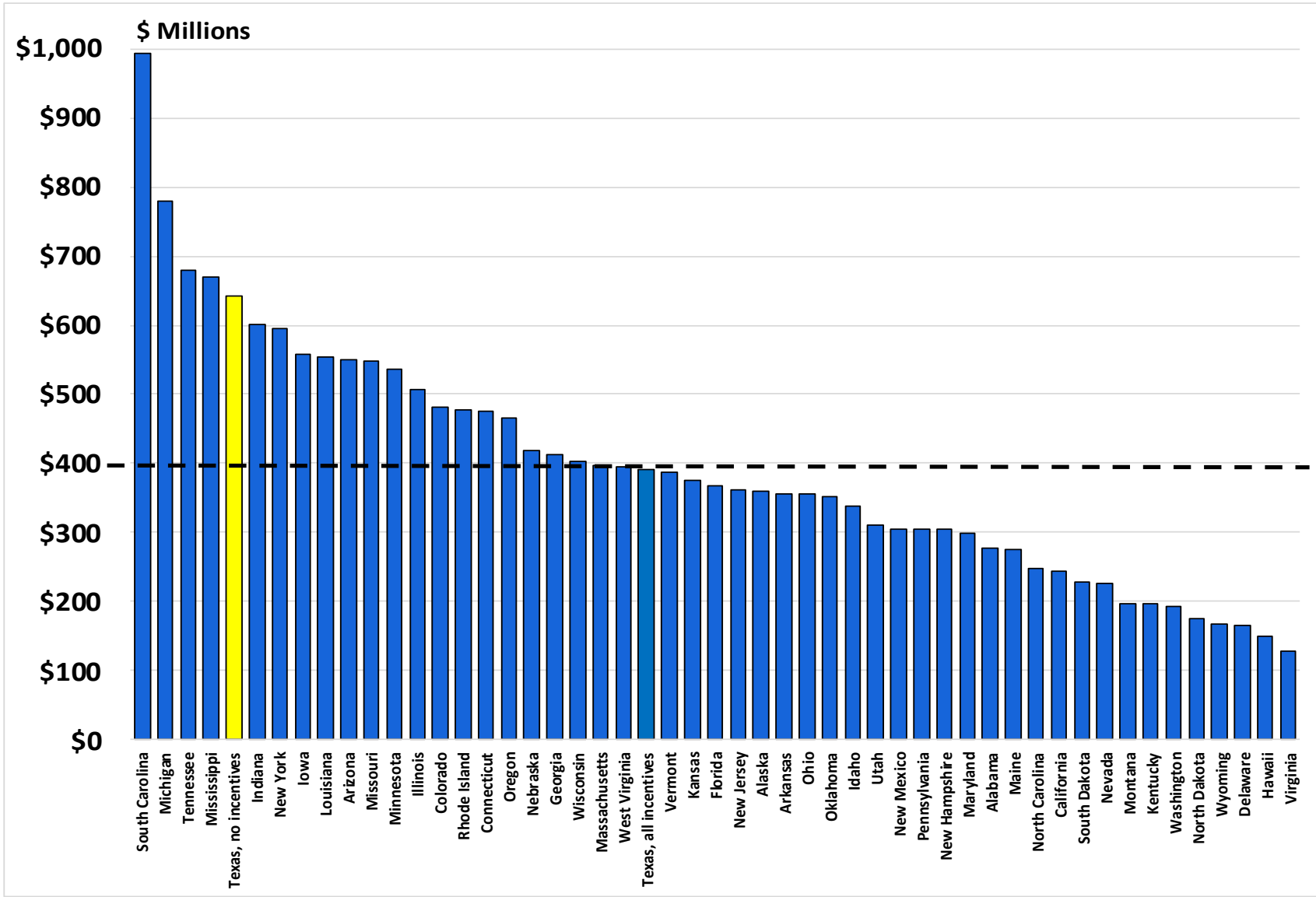
- Angie Chen Button, Chair
- Hearing held in Garland, April 6
- In support of Chapter 313 and other incentive programs
 - Texas Chemical Council
 - Texas Association of Manufacturers
 - Texas Taxpayers and Research Association
- Committee is generally supportive of Chapter 313 and other incentive programs, but want to ensure programs are not abused



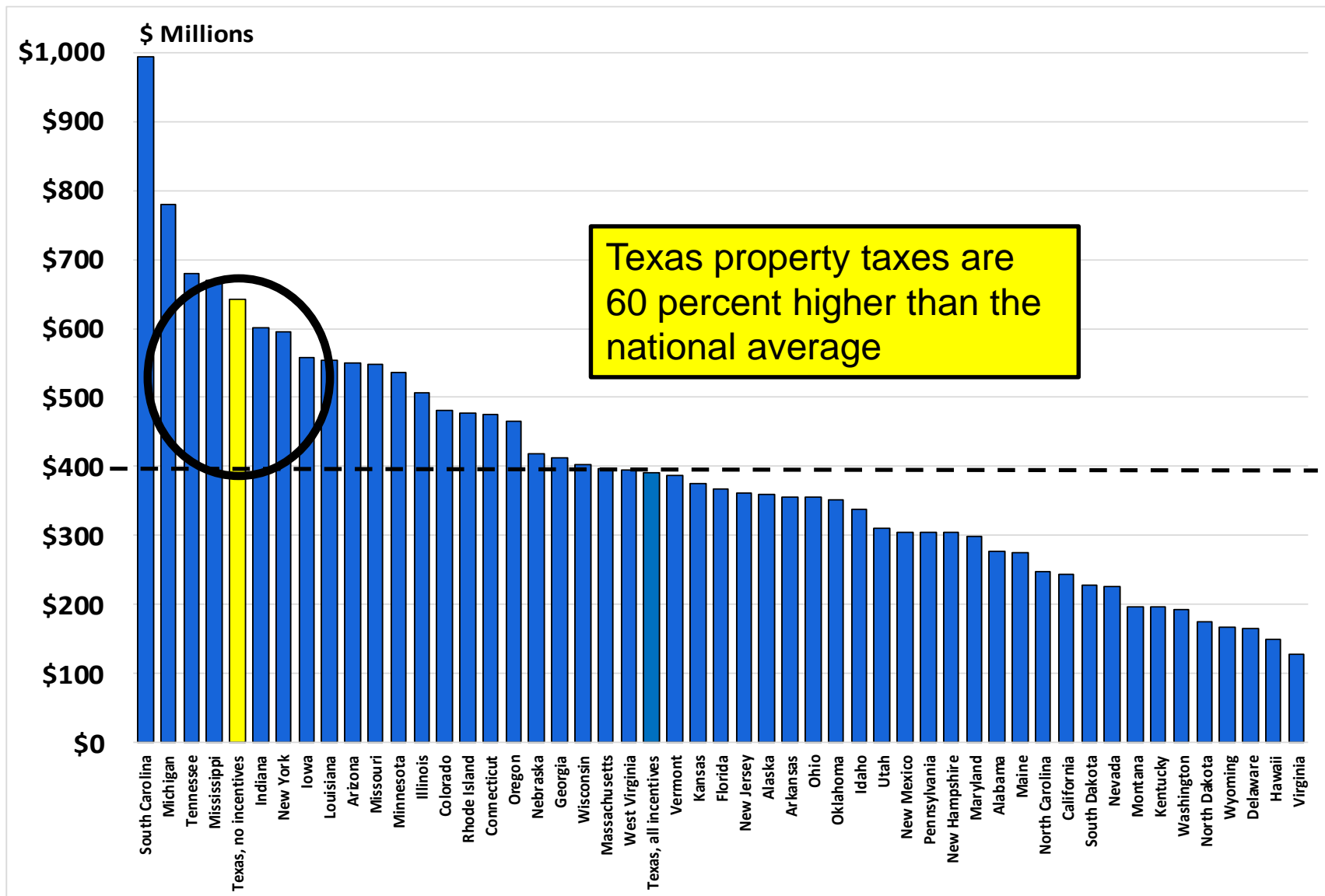
General Economic Development Themes

Legislature	Business Community
Schools benefit at the state's expense; skepticism about the high cost of Chapter 313	"Cost" figures are erroneous because they assume <u>all</u> projects are coming absent any limitations
Program requires more scrutiny and oversight	Current paperwork burden of the program is unnecessarily burdensome and limits its effectiveness
School districts are abusing the program by demanding supplemental payments, which are ignored in school finance formulas	Supplemental payments limit the effectiveness of the program, but schools may not approve agreements without them

Tax Cost of a \$1 Billion Industrial Facility

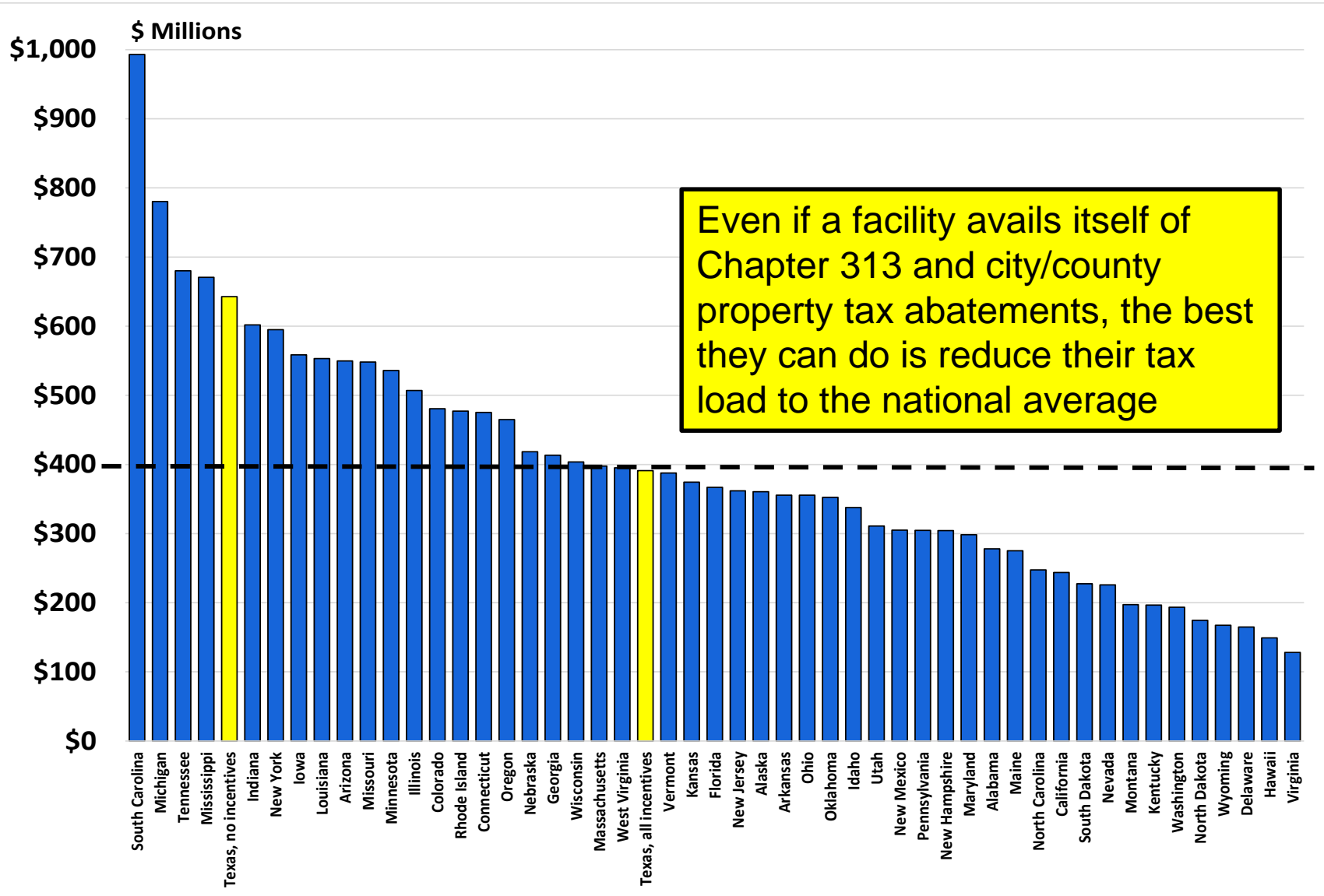


Tax Cost of a \$1 Billion Industrial Facility

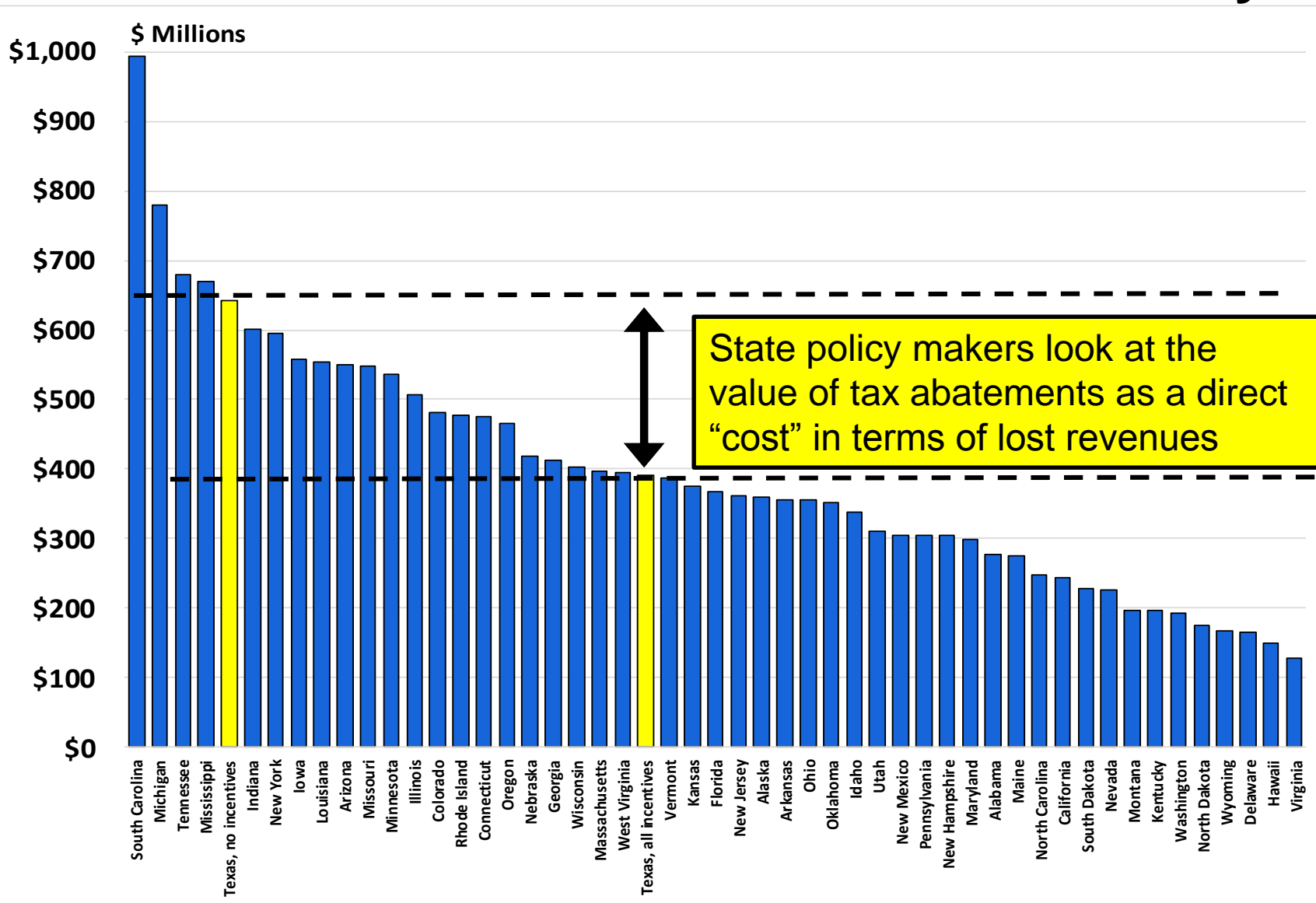


Texas property taxes are 60 percent higher than the national average

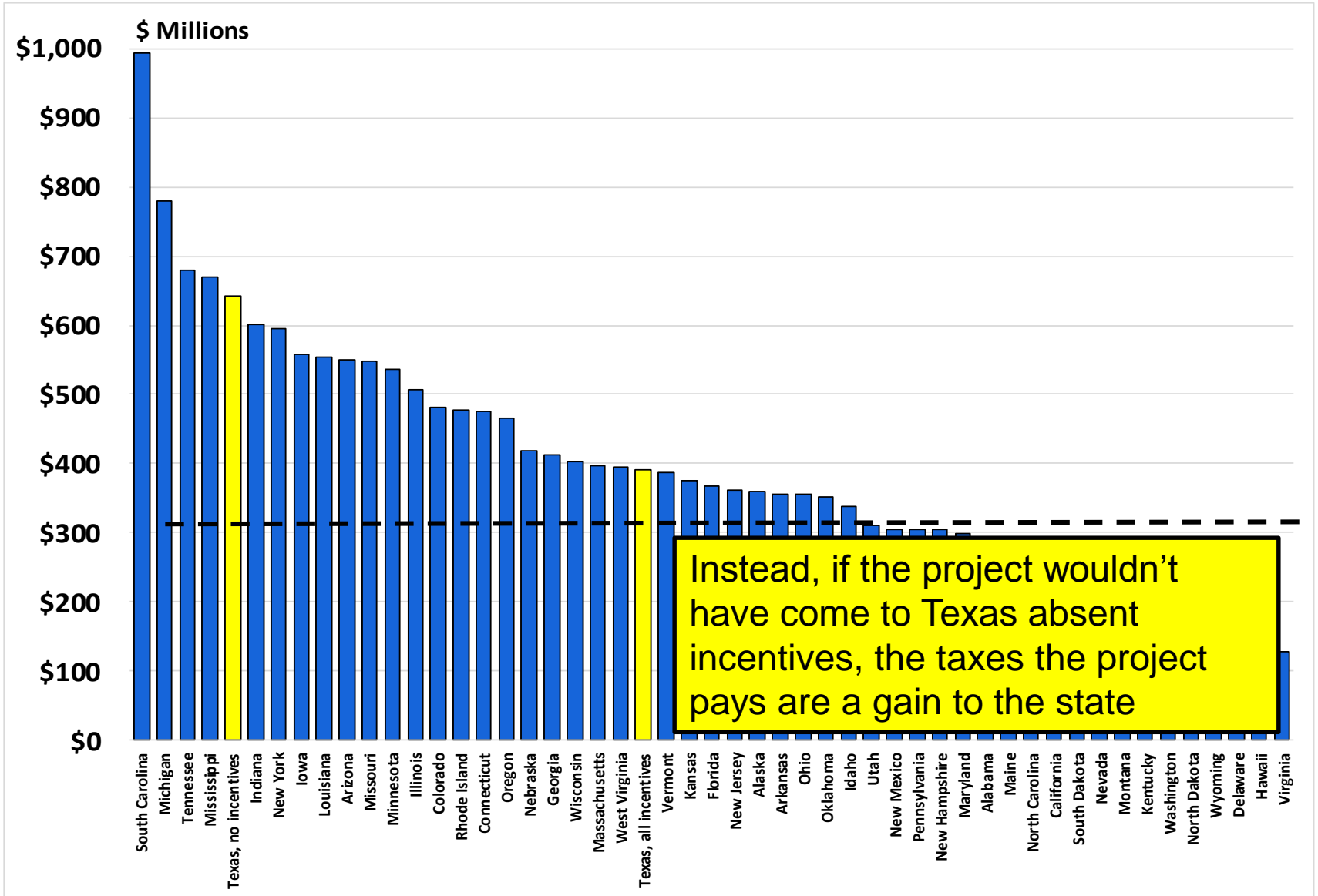
Tax Cost of a \$1 Billion Industrial Facility



Tax Cost of a \$1 Billion Industrial Facility



Tax Cost of a \$1 Billion Industrial Facility



Senate Finance Committee Testimony

- Interim Charge: *Study the benefits, including the dynamic effects, of continuing to phase out the franchise tax. Consider alternative approaches to funding the Property Tax Relief Fund.*
- TTARA testimony
 - Pros
 - Met most policy goals – additional funds for school property tax reduction, expanded to all liability-protected entities, increased participation of service providers, eliminated tax avoidance planning strategies
 - Cons
 - Complexity increases compliance and administration costs
 - Only 1 in 10 liability-protected companies pay tax
 - Relatively low compared to other states but overall business tax burden remains high
 - Still unsettled issues under review

Finance Committee Testimony (cont.)

- Recommendations
 - Property tax reduction provides greater benefit
 - Continue to pursue reduction by lowering tax rate
 - Do not increase small business exemption
 - Any alternative tax should be simple in application and similar to those in other states
 - Abolish Property Tax Relief Fund by consolidating with general revenue



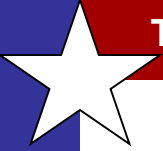
Senate Select Property Tax Relief and Reform Committee Testimony

- Interim Charge: Recommend ways to promote transparency, simplicity, and accountability and options to further reduce the tax burden.
- Three road hearings so far in San Antonio, Harlingen and Lubbock
- April 27 in Arlington next – Houston (May 10) and East Texas to be scheduled
- TTARA testimony at first road show in San Antonio in January emphasized key points:
 - Cuts or protections should benefit all property owners
 - Tax abatements are necessary to compete for capital investment
 - All property should be appraised at market value
 - Controlling tax rates is only effective way to limit growth in levies
 - No oversight of rate setting and voters lack effective way to control increases
 - Texas system is one of best administered in the country



Senate Select Property Tax Relief and Reform Committee Testimony (cont.)

- Committee has heard public testimony (mostly complaints) about a wide range of tax administration issues, including:
 - Rapidly growing taxes
 - Quality of Appraisal Review Boards
 - Negative impact of equal and uniform appeals
 - Lack of transparency in the setting of tax rates
- Apparent that ARB and rate adoption changes are in the offing
- Chairman Bettencourt has stated repeatedly that valuation challenges by taxing entities must go and that he and Lt. Gov. Patrick are committed to enhancing the ability of voters to control increases



Property Tax



County Energy Transportation Reinvestment Zones (CETRZs)

- Adoption of §§221.1071-1072, Transportation Code, in 2013 that allows counties to create reinvestment zones and use the taxes on incremental value to pay for road projects inside the zone
- Irregularities in the determination of incremental values and calculation of effective and rollback tax rates uncovered by TTARA members
- Our search for information about what's taken place continues, focused on Dimmit, La Salle and Reeves Counties
- Our open records requests have yet to produce all relevant information
- So far, we've discovered Dimmit County adopted a 2015 tax rate above the rollback limit without following required procedures
- A number of oil and gas companies have made payments under protest and litigation is under consideration
- The quest to document the level of "untruth" in taxation continues

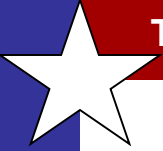


Sales Tax



O&G Compressor Taxability

- March 15, 2016 – Audit division memo to all audit personnel concerning gas compressors
 - Exempt
 - Boost pressure for sales purposes
 - Connected to multiple pieces of equipment that do more than extract water
 - Taxable
 - Stand-alone – no other equipment in immediate vicinity
 - Used to enhance production
 - Connected to dehydrator or other equipment that removes water or condensation
- Revision/Clarification
 - Compressors that support processing equipment, including scrubbers and dehydrators, are exempt
 - Taxpayer may provide evidence on use, including divergent use portion



Franchise Tax



Franchise Tax

Who is a Wholesaler/Retailer

171.002 (c) A taxable entity is primarily engaged in retail or wholesale trade only if:

1. its total revenue from retail or wholesale trade is greater than the total revenue from trades other than the retail and wholesale trades;
2. except [for restaurants], less than 50 percent of its total revenue in retail or wholesale trade comes from the sale of products it produces or products produced by an entity that is part of an affiliated group to which the taxable entity also belongs; and
3. the taxable entity does not provide retail or wholesale utilities, including telecommunications services, electricity, or gas.



Wholesaler/Retailer Why Does it Matter?

Under current Texas law, a wholesaler/retailer qualifies for half the rate of other taxpayers.

According to the U.S. Department of Labor:

“Wholesalers” engage in selling merchandise to:

- retailers;
- industrial, commercial, institutional, farm, construction contractors, or professional business users; or
- other wholesalers;
- or acting as agents or brokers in buying merchandise for or selling merchandise to such persons or companies;

“Retailers” engage in selling merchandise for personal or household consumption

Franchise Tax Rule Redraft

3.584 Margin: Reports and Payments

Proposed Rules Provision	Current Agency Policy
<p><i>A taxable entity produces the product that it sells if the taxable entity acquires the product and makes modifications to the product that increase the sales price of the product by more than 10%.</i></p>	<p><i>A product is not considered to be produced if modifications made to the acquired product do not increase its sales price by more than 10%</i> Current Rule 3.584(d)(3)(b)</p>
<p><i>A taxable entity produces the product that it sells if the taxable entity manufactures, develops, or creates tangible personal property that is incorporated into, installed in, or becomes a component part of the product that it sells.</i></p>	<p><i>A taxable entity will be considered the producer of the products it sells [and not a wholesaler/retailer] if the taxable entity ... produces a component part of the product</i> STAR 201503580L</p>



Thanks for Joining Us!

If you have any questions or comments, please feel free to contact TTARA staff.

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