LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 86TH LEGISLATIVE REGULAR SESSION

April 3, 2019

TO: Honorable Dustin Burrows, Chair, House Committee on Ways & Means

FROM: John McGeady, Assistant Director   Sarah Keyton, Assistant Director
Legislative Budget Board

IN RE: **HB2397** by Clardy (Relating to a sales and use tax refund and franchise tax credit for certain businesses that make investments in qualified opportunity zones.), **As Introduced**

Estimated Two-year Net Impact to General Revenue Related Funds for HB2397, As Introduced: a negative impact of ($3,123,992,000) through the biennium ending August 31, 2021.

Additionally, the bill will have a direct impact of a revenue loss to the Property Tax Relief Fund of ($1,133,520,000) for the 2020-21 biennium.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2020	($1,129,000)
2021	($3,122,863,000)
2022	($3,186,054,000)
2023	($3,255,275,000)
2024	($3,319,904,000)

All Funds, Five-Year Impact:

Fiscal Year	Probable Revenue (Loss) from *General Revenue Fund* 1	Probable Revenue (Loss) from *Property Tax Relief Fund* 304	Probable Revenue (Loss) from *Cities*	Probable Revenue (Loss) from *Transit Authorities*
2020	$0	$0	$0	$0
2021	($3,121,734,000)	($1,133,520,000)	($16,290,000)	($5,590,000)
2022	($3,184,925,000)	($1,197,078,000)	($16,940,000)	($5,820,000)
2023	($3,254,146,000)	($1,265,388,000)	($17,620,000)	($6,050,000)
2024	($3,318,775,000)	($1,340,854,000)	($18,320,000)	($6,290,000)

Fiscal Year	Probable Revenue (Loss) from *Counties and Special Districts*	Probable (Cost) from *General Revenue Fund* 1	Change in Number of State Employees from FY 2019
2020	$0	($1,129,000)	11.0
2021	($3,290,000)	($1,129,000)	11.0
2022	($3,420,000)	($1,129,000)	11.0
2023	($3,560,000)	($1,129,000)	11.0
2024	($3,700,000)	($1,129,000)	11.0

Fiscal Analysis

The bill would amend Chapter 151 (Sales and Use Tax) and Chapter 171 (Franchise Tax) of the Tax Code to provide tax refunds and credits for qualifying businesses making certain types of investment expenditures in economic opportunity zones. The bill defines an economic opportunity zone as a census tract that, as of September 1, 2019, was designated as a qualified opportunity zone under Public Law No. 115-97 (the Tax Cuts and Jobs Act).

For the purposes of establishing a franchise tax credit, the bill would define a qualifying investment as an investment to: (1) remodel, rehabilitate, or construct a structure owned or leased by the entity that is located in an economic opportunity zone; or (2) purchase equipment or machinery to be located in or used in the operation of a structure owned or leased by the entity that is located in an economic opportunity zone. To be eligible for the credit, an entity would be required to make a qualifying investment on or after September 1, 2019, and in an amount of at least $100,000.

The amount of franchise tax credit established would be equal to 25 percent of the total qualifying investment. The total amount of credit claimed on a franchise tax report, including the amount of any carryforward, could not exceed the amount of tax due after any other applicable tax credits. Credits not used could be carried forward for not more than five consecutive reports. An entity could not claim more than one franchise tax credit.

The bill would allow entities that make a qualifying investment to sell or assign all or part of the credit that may be claimed for that investment to one or more entities. The bill specifies that there is no limit to the total number of transactions for the sale or assignment of the franchise tax credit.

Any sale or notice does not extend the period for which a credit may be carried forward, and does not increase the total amount of the credit that may be claimed. Additionally, qualifying investment could only be counted once in determining the amount of the tax credit available, and only one entity may claim a credit for the same qualifying investment.

Entities would be required to apply for a franchise tax credit on or with the report for the period for which the credit is claimed. Prior to claiming, selling, or assigning a franchise tax credit, the entity would be required to request a certificate of eligibility from the Comptroller's Office. The bill requires certain documentation to be included with the entity's request. Both the entity that sells or assigns a franchise tax credit, as well as the entity that receives the credit, would be required to jointly submit written notice of the sale or assignment to the Comptroller not later than the 30th day after the date of the sale or assignment. The bill requires certain information be included in the notice.

The bill would also allow entities to receive a one-time refund of sales and use taxes paid by the entity on certain purchases. To be eligible for a tax refund, the bill would require that an entity first apply and qualify for the franchise tax credit for investment in economic opportunity zones. The entity could receive the one-time refund for sales and use taxes paid on the purchase of the following: (1) labor and building materials to remodel, rehabilitate, or construct a structure owned or leased by the entity that is located in the economic opportunity zone and that is the basis for the entity's eligibility for the franchise tax credit; and (2) equipment or machinery to be located in or used in the operation of a structure owned or leased by the entity that is located in the economic opportunity zone and that is the basis for the entity's eligibility for the franchise tax credit.

The amount of the one-time refund paid to the qualifying entity could not exceed the lesser of: (1) 25 percent of the total amount of sales and use taxes paid by the business entity on the purchases described previously; or (2) $50,000. Entities would be required to apply to the Comptroller to receive the refund.

The bill would require the Comptroller to adopt rules necessary to implement and administer these tax credits and refunds.

The bill would take effect January 1, 2020, and the franchise tax credits it creates could only be applied to a report originally due on or after that date.

Methodology

The Tax Cuts and Jobs Act allows the chief executive officer of each state, the District of Columbia, and the five U.S. possessions to designate certain census tracts as qualified opportunity zones if they meet federal qualifications as low-income communities. This bill does not specify that the economic opportunity zone be a census tract that is located in Texas. As a result, this fiscal note estimate is based on the assumption an entity would be entitled to a credit if it made a qualifying investment in any of these designated economic opportunity zone. According to the U.S. Department of the Treasury, there are nearly 9,000 designated qualified opportunity zones across the country, in which approximately 35 million Americans live. Under federal law, this designation lasts for 10 years.

Also, the language in the proposed Section 171.9265(b), limiting an entity to one claim of credit, is vague. First, with regards to combined groups, it is assumed that, because credits are taken at the combined group level, this limit would apply for all entities within a combined group. Secondly, this fiscal note estimate assumes that this limitation, as it refers to a claim of credit, does not limit the establishing of credits that may be sold or assigned for another entity to claim.

Credits earned on qualified capital expenditures after the January 1, 2020 effective date would not be expected to be certified as eligible and claimed on franchise tax reports due in May, 2020. Consequently fiscal implications for franchise tax would not be expected before fiscal 2021. Eligibility for sales tax refunds would depend on prior qualification for franchise tax credits, which would probably delay initiation of sales tax refunds until fiscal 2021 as well.

The magnitude of credits that may be established under provisions of the bill, combined with assignability and carryforward, would be expected to result in elimination of net franchise tax collections until a few years after expiration of the qualified opportunity zones in 2028.

For refundable sales taxes, as the bill does not limit the entitlement to refund to sales tax imposed by Chapter 151, the estimated fiscal impact anticipates motor vehicle sales tax and local sales taxes will be subject to refund.

Federal law allows the designation of a qualified opportunity zone to last 10 years. According to the U.S. Department of the Treasury, each state nominated the maximum number of eligible tracts, and there will not be an opportunity for additional or revised designations. Additionally, the designations are based on the boundaries of the census tract at the time of designation, and do not change over the 10-year period, even if the boundaries of the tract are redefined in future Census releases. As a result, similar fiscal implications would continue through 2028, after which net franchise tax collections would begin to grow as the stock of credits subject to carryforward diminishes.

The administrative cost estimate reflects the funds necessary to hire 11 tax auditor IIIs to provide refund verification activities. There are 628 census tracts in 145 Texas counties designated as opportunity zones. Texas has 1,658,952 taxpayers that hold a franchise tax permit but not a sales tax permit. Five percent of these eligible taxpayers would equal 82,948 taxpayers asking for a refund. Verification procedures are expected to be challenging due to the carry over provision and the provision that would allow an entity to sell or assign all or part of the credit to one or more entities, who then may sell all or part of the credit to another entity. Additionally, there is no limit on the total number of transactions for the sale or assignment of all or part of the total credit authorized.

Local Government Impact

There would be a corresponding loss of sales and use tax revenue to units of local government.

Source Agencies: 304 Comptroller of Public Accounts

LBB Staff: WP, KK, SD