EVERY TEXAN

Testimony against House Bill 1556

Dick Lavine, Senior Fiscal Analyst, Every Texan
Lavine@everytexan.org

The most important task facing the Legislature each session is drafting the state budget. Due to booming Internet sales, greater-than-expected property values, and federal aid, lawmakers will have enough revenue to maintain the current level of services through 2022-23. But the long-term outlook is less rosy.

A substantial drain on future state resources will be the program of school property tax abatements known as “Chapter 313,” after its section in the Tax Code. This colossal giveaway strains the rest of General Revenue services – higher education, health and human services, and public safety – to make up for foregone local school taxes. The state budget fills in gaps in school taxes created by these special interest deals by maintaining funding for a district’s state formula aid, as if the abated value of the business property did not exist. If the property were instead taxed at its full value, local tax revenue would increase, reducing the need for state aid and allowing scarce resources to be redirected to other uses or to increasing state support for our schools.

These costly and inefficient special treatments are expected to cost the state $1.9 billion in the coming biennium and grow to $2.3 billion in 2024-25. Under current law, the program will expire at the end of 2022. No new abatements can be granted after the expiration, but all agreements signed before expiration will continue for the length of each contract, which can run for 13 years of more.

More than a dozen bills have been filed to extend Chapter 313. This report will focus on the most comprehensive proposal, HB 1556 by Rep. Jim Murphy of Houston.

HB 1556 doubles down on the extravagance of the current program

Companies signing a Chapter 313 agreement with a school district routinely agree to give back a substantial part of their tax savings to the district through a “payment in lieu of taxes” (PILT). In the early years of the program, the standard PILT was 40% of tax savings. In 2009, the Legislature capped PILTs at $100 per student in each year of the agreement. In addition, companies make “revenue protection payments” intended to offset any losses in district revenue due to quirks in school finance formulas.

Companies are expected to make $3 billion in these payments over the course of the current program, counting from 2007 through 2037. One corporate lobby association has estimated that PILTs and revenue protection payments reduce the tax benefit to companies by one-third.

The willingness of companies to make these payments is a strong warning that, according to the 2010 Comptroller's Texas Economic Development Act Report, "incentives awarded are higher than necessary to attract these projects and represent unnecessary cost to the state."

In fact, these payments may indicate that companies were attracted to Texas for other reasons and many would have located in the state without any incentive at all.

HB 1556 would eliminate these supplemental payments. But instead of offsetting this windfall to companies by reducing the size of the tax benefit, the bill would simultaneously make the tax break even more lucrative.

Under current law, a company can qualify for a "limitation on appraised value" by making an investment of between $1 million and $100 million, depending on the amount of taxable value in the school district. The company then pays school M&O (maintenance and operations) taxes only on the amount needed to qualify, regardless of the actual value above that amount, for ten years. After the limitation period, companies pay on whatever value remains. (Companies pay debt service taxes on the full appraised value at all times.)

HB 1556 would change the investment needed to qualify for a tax break to just $10 million – in districts with below-average wealth per student – or $50 million – in above-average wealth districts. This change will allow many more companies, which would not be eligible under current law, to now receive a hefty tax break. More importantly, projects would receive a 100% abatement! In other words, once a company passes the required minimum investment threshold, they are exempt from most school taxes on the entire value of the project. (Companies would pay only "golden pennies" and debt service taxes.)

HB 1556 would further expand the type of project that could qualify for this total exemption from most school taxes, exploding the potential cost to the state. Current law grants special treatment only for investments in new property. But the bill would allow renovations, expansions or other improvements in existing buildings to be included in an abatement – a much larger number of projects. Again, since these are expenditures on existing projects, they would very likely take place in Texas without a Chapter 313 tax break.

The bottom line is a two-tier property tax system, in which large manufacturing properties receive long-term exemptions, while smaller businesses and homeowners pick up the difference.

HB 1556 would eliminate all job creation and wage requirements

Chapter 313 of the Tax Code states explicitly, "The purposes of this chapter are to… create new, high-paying jobs in this state." (Sec. 313.003(2)). In its original form, the program required that 80% of all new jobs would have to pay at least 110% of the average manufacturing wage in the county. At least 25 such jobs would have to be created in most districts, ten such jobs in certain smaller or poorer counties. Over time both the minimum job creation and wage requirements have been weakened, but at least some framework remained.

HB 1556 would completely eliminate all job creation and wage requirements.

Projects would qualify for a 100% tax exemption based only on the amount of expenditure, without regard to the number or quality of jobs that might be created. The only minor check would be that wages paid to employee and construction contractors would have to exceed 10% of the company's tax savings each year – a very low hurdle.

HB 1556 leaves in place many of the defects of Chapter 313

Every Texas has published [a review of the problems with the current law](). Here are some of the shortcomings of Chapter 313 outlined in that piece that would remain, even if HB 1556 were enacted:

These tax giveaways are outmoded.

Chapter 313 was created in 2001 to compensate for Texas' relatively high property tax rates at the time, which were thought to discourage large-scale manufacturing investments in the state. But school property tax rates have been reduced significantly in the past 20 years, diminishing the need for special tax breaks to attract new development. When the program was established, the maximum school property tax rate for maintenance and operations ("M&O" – the part of property taxes affected by Chapter 313 agreements) was $1.50 per $100 of property valuation. With the passage of HB 3, the school-finance bill enacted in 2019, the maximum M&O rate statewide is now below $1.09 and mandated to drop lower. Certain districts with rapid growth of property values can go as low as 82.5 cents.

Thus, the tax burden on a new capital investment in Texas has fallen to just over two-thirds of that imposed in 2001 and is slated to continue to drop further under the mandatory "tax rate compression" of HB 3. The special treatment thought necessary 20 years ago is no longer appropriate.

These tax giveaways are unnecessary.

Lawmakers created Chapter 313 to incentivize the creation of high-paying jobs and investments in the state by allowing school districts to choose to reduce a company's property taxes if the companies made certain investments. This special treatment was intended to benefit companies choosing to locate in Texas rather than in another state.

A key question in economic development is whether a project would have located in Texas *without* an incentive. A **2017 study** by Professor Nathan Jensen of The University of Texas at Austin concluded that 85% of the projects receiving Chapter 313 tax breaks would have located in Texas without this special treatment.

The Comptroller has approved Chapter 313 agreements despite clear evidence that projects would have located in Texas without an incentive. For instance, the boom in natural gas production in the Permian Basin generated many applications for projects to process the gas on its way to petrochemical plants located near Corpus Christi and Houston. Similarly, tax giveaways have gone to liquefied natural gas (LNG) export facilities on the Texas Gulf Coast. The geography of Texas, including local features like salt domes, ports, or existing pipeline connections, clearly determines where these projects must be located, even without tax breaks — no coastal project would have gone to Oklahoma, for example.

In fact, two multi-billion-dollar LNG projects continue to be developed in Brownsville even after the local school district rejected their applications for Chapter 313 tax giveaways. Similarly, several wind and solar farms have been developed without seeking a Chapter 313 agreement. **This demonstrates that factors other than tax breaks usually determine where investments are located.**

The Comptroller concedes that its approval of agreements does not require that Chapter 313 special treatment be the determining factor in a location decision, but merely one determining factor among many. In fact, Chapter 313 is explicit that only this easy-to-pass test is required, despite repeated claims in legislative debate that a stricter "but for" screen is applied — that "but for" a Chapter 313 tax break, the project would not locate in Texas. The Comptroller applies an even less stringent test, accepting the argument that a project would not be "financially feasible" without the tax break. Not that the project would locate in another state, but simply that the expected profit would be too small if the firm had to pay full property taxes on the project.

There is no "but for test" — that the project would not locate in Texas "but for" a Chapter 313 tax break.

These agreements bring less taxable value than anticipated.

A key argument put forward by proponents of Chapter 313 abatements is that, after expiration of the 10-year cap on the taxable value of a project, the state will benefit from the additional revenue generated by school property taxes on each project. **But the amount of taxable value remaining on the tax rolls after the abatement expires is only a fraction of the original investment.**

An examination of the actual final taxable value of those projects listed in the Comptroller's latest report that have reached the end of their abatement period shows that an average of only one-third of the initial investment in these projects remains on school district tax rolls. Even a look at the projections offered by all the projects in that report, which may present an unrealistically rosy scenario of their future value out as far as 2037, shows that an average of only 42% of the original investment is expected to be available to support public education at the end of each Chapter 313 agreement.

These agreements are a costly way to create new jobs.

A current statutory goal of Chapter 313 is to "create new, high-paying jobs in this state." But even assuming that Chapter 313 tax breaks are necessary to attract these projects, the cost per job created is unreasonably high. A standard goal for economic development incentives is to keep the cost of subsidies to between $10,000 and $20,000 per job created. In contrast, considering the total gross tax benefits over the life of all reported Chapter 313 agreements, **the cost per job created is well over $1 million.**

The number of jobs to be created and their required wages have been successively reduced as Chapter 313 has been amended. Companies now need to pledge to create only 10 or 25 jobs, depending on the school district, with waivers of even this minimum routinely granted. And the wage standards for these jobs, and others created by the project, have been watered down significantly.

A better approach to economic development would concentrate on improving public and higher education, including workforce training, and improving transportation, utility, and public health infrastructure. Strengthening these public systems would both attract new business investment and benefit all residents of Texas.

These agreements are subject to little oversight.

The Comptroller has delegated enforcement of the program's provisions to school districts, which have no incentive to question a company's claims of meeting job creation or wage level requirements. The State Auditor is required to review at least three agreements a year, but these reviews are woefully inadequate. The only check on compliance by the companies that they fulfilled the required job creation and wage standards is that the school district “submitted all required monitoring reports” to the Comptroller. The reports themselves are not audited by the school districts or State Auditor to determine if job or wage figures are accurate or sufficient.

The Comptroller is required to examine the wages of the minimum required number of jobs, but only for agreements signed since 2013, when this provision was added. There have been no clawbacks due to this weak oversight clause. In contrast, the Texas Enterprise Fund, a similar incentive program, has collected millions of dollars in liquidated damages for non-performance.

The benefits of Chapter 313 abatements go to out-of-state shareholders and high-income Texans.

Chapter 313 abatements go primarily to multinational manufacturing firms and large-scale wind farms. The Comptroller’s Tax Exemption & Tax Incidence study shows that more than half of the benefits of Chapter 313 agreements are “exported” — received by households outside of Texas. And, of the benefits that are received by Texans, half go to households with an annual income of at least $156,000.

Ownership of stock in the large publicly held corporations that reap Chapter 313 benefits is not distributed equally among American racial and ethnic groups. Chapter 313 thus exacerbates existing wealth inequalities in our society while reducing property tax revenue that could be invested in the next generation of Texans. Total state and local school revenue would be higher if there were no Chapter 313 abatements, yet the state still maintained its spending. Limiting school revenue limits the opportunities for many Texas children, especially children of color.

Ending tax abatements should be part of the post-pandemic revenue discussion.

Lawmakers should not renew Chapter 313, instead letting the current authorization expire at the end of 2022. Lawmakers need a sustainable source of revenue to support public services over the long-term, including fulfilling their commitment to improving school funding while reducing school-finance inequality. Ending Chapter 313 abatements should be part of the long-term answer. This would free up future state revenue to invest in future generations of Texans and ensure that large and profitable corporations pay their fair share of supporting our schools.