

SUBJECT: Exempting goods in transit from ad valorem taxation in El Paso County

COMMITTEE: Ways and Means — favorable, without amendment

VOTE: 6 ayes — Keffer, Otto, Bonnen, Y. Davis, Pena, Pitts

0 nays

3 absent — Ritter, Flores, Paxton

WITNESSES: For — Tony Carter, Texas Warehouse Association (*Registered, but did not testify*: A. A. (Drew) Anderson, Larry Kelley, Bob Vettters, Texas Warehouse Association; Patricia A. Shipton, City of El Paso; Mark A. Smith, Hunt Building Corporation)

Against — None

BACKGROUND: Texas Constitution, Art. 8, sec. 1-j and Tax Code, sec. 11.251 exempt from ad valorem taxation “freeport” property that is located in Texas temporarily. Eligible freeport property includes goods, wares, merchandise, and other tangible personal property, including aircraft and aircraft parts used for maintenance or repairs by certificated air carriers, and ores, other than oil, natural gas, and other petroleum products. To be eligible for the exemption, property must be acquired in or imported into Texas for export; detained for assembly, storage, manufacturing, processing, or fabrication; and shipped out of state no later than 175 days after acquisition or importation.

In November 2001, Texas voters approved Proposition 10 (SJR by Duncan, et al.), amending the Constitution to allow the Legislature to exempt from taxation goods in transit that are stored temporarily en route to another location in Texas or outside the state (Art. 8, sec. 1-n). Exempt property would include the same types of goods and products eligible for the freeport exemption. The 77th Legislature, however, did not enact enabling legislation to accompany the constitutional amendment, nor have subsequent legislatures.

Under Art. 8, sec. 1-n, property eligible for the exemption must be acquired in or brought into Texas and stored at a location not owned or controlled by the property owner for not more than 270 days after

acquisition or importation. Unlike “freeport goods,” goods in transit need not be shipped out of state to qualify for the exemption. Governing bodies of taxing entities may choose to tax goods in transit but must hold a public hearing before acting to do so. Owners of property eligible for the freeport exemption may apply for the goods-in-transit exemption if the Legislature enacts enabling legislation, subject to the decisions of local taxing entities. However, an owner receiving the goods-in-transit exemption may not claim the freeport exemption for the same property.

DIGEST:

HB 621 would implement the exemption authorized by Texas Constitution, Art. 8, sec. 1-n. The bill exclusively would apply to property located in El Paso County (a county with a population of 650,000 or more adjacent to an international border). It would define goods in transit that qualified for the exemption; set the procedure for a taxing entity to establish the exemption and the administrative process for assessing the value of goods in transit; and amend the procedure for preparing property-tax rolls to reflect exemptions.

Definitions. HB 621 would define “goods-in-transit” as tangible personal property stored in a location whose owner did not have direct or indirect ownership of the property. The property would have to be held at that location for no more than 175 days before being forwarded to another location in Texas or outside the state. The bill would exclude the following from the definition of goods in transit: oil; natural gas; petroleum products; aircraft; dealers’ inventory of motor vehicles, vessels, and outboard motors; heavy equipment; and retail manufactured housing.

Goods-in-transit exemption. The governing body of a local taxing entity could elect to tax goods in transit after holding a public hearing. The decision would have to be made before January 1 of the first tax year in which the entity proposed to tax these goods. If the entity elected to tax goods in transit, those goods would remain taxable until the governing body took action to rescind or repeal its previous action and grant the exemption.

An owner of qualifying property would receive the exemption regardless of whether that person transported it to another location in Texas or outside the state. Property owners qualifying for the “freeport” exemption would not be eligible for additional exemptions for the same goods in transit.

Administrative procedures. The chief appraiser would have to determine the appraised value eligible for the exemption based on the percentage of the value of tangible personal property represented by the goods in transit. Calculation of the value for the exemption would be based on the market value of the goods in transit during the preceding year, and the current year's inventory would be used to calculate the appraised value in following years. The chief appraiser would have to exclude from the calculation the cost of equipment, machinery, or materials that were added to the goods in transit, as well as the value of other goods not transported within 175 days. The chief appraiser could use the average length of time that a component part was held to determine whether component parts held in bulk were transported within the 175-day limit.

The chief appraiser would have to examine records and other information provided by the property owner to determine the market value if either the property owner or the chief appraiser demonstrated that the initial calculation understated or overstated the market value of eligible property. If the property owner failed to provide these records within 31 days of the chief appraiser's request, the property owner would forfeit the right to claim the exemption for that year.

Property-tax roll changes. The bill would amend Tax Code, sec. 26.012(15) so that the amount of the goods-in-transit exemption would be included in the "lost property levy" amount used to determine the amount of property value that was taxable in the preceding year but not taxable in the current year. It also would amend Government Code, sec. 403.302 (d) to exclude exempted goods-in-transit from the calculation of the taxable value of property in a political subdivision.

The bill would take effect January 1, 2008.

**SUPPORTERS
SAY:**

HB 621 would help stop the continuing transfer of lucrative warehousing and distribution business from El Paso County to Mexico and New Mexico because of discriminatory taxes on inventories. In 2001, voters overwhelmingly approved the constitutional amendment to allow the goods-in-transit exemption. This bill would authorize taxing jurisdictions in El Paso County to offer a tax exemption on goods-in-transit, establishing a trial program that could demonstrate the economic benefit of such an exemption for other parts of the state.

Situated on an international and a state border, El Paso County uniquely would benefit from the exemption offered under HB 621. El Paso County warehouse operators face challenges from competitors operating in Mexico and New Mexico.

By exempting business inventories with few exceptions, New Mexico offers much more favorable inventory tax treatment than Texas. Recognizing this competitive advantage, New Mexico has enacted laws and promoted policies to help its warehouse operators attract new business. As a result, Santa Theresa, New Mexico has become home to several warehouses, posing a significant threat to the warehouse industry in El Paso. According to a 2000 report by the Perryman Group, Texas already has lost an estimated 27,000 jobs as manufacturers have begun storing their products outside the state, and HB 621 would help stem this tide.

Because the bill would be limited to El Paso County, the cost impact on the state in offsetting the cost to local school districts would be minimal — less than \$1 million per year according to the Legislative Budget Board (LBB). In addition, because the exemption would be voluntarily offered by a local taxing unit, school districts, along with other taxing entities in El Paso County, could choose to opt out of granting the exemption and continue to tax such property. Also, the bill's fiscal-note projections do not take into account the greater sales tax revenue that would accrue from increased warehousing activity.

HB 621 would stimulate El Paso County's economy by arming local districts with an important economic development tool. Arguments about how much revenue would be lost by local taxing entities are beside the point, because empty warehouses yield little revenue. Currently, the goods and economic development in question are generating tax revenues for New Mexico, rather than Texas.

Tightening the time limit to 175 days, rather than the maximum 270 days allowed by the Constitution, would reflect the intent to exempt goods entering the stream of commerce as quickly as possible. Faster turnover of inventory helps economic development.

**OPPONENTS
SAY:**

Any measure that would erode local tax bases would be imprudent, even if the proposal were limited to a single large urban county. Local taxing districts in El Paso County would see their revenues undermined if they

chose to adopt the exemption, and the “hold harmless” provisions of HB 1, 79th Legislature, third called session likely would transfer the cost of the property-tax exemption from school districts in El Paso County to the state. With the cost of education and government services outpacing revenue collection at the local and state level, now is not the time to carve out an unnecessary tax exemption.

HB 621 would be the first step in enabling a costly expansion of the goods-in-transit exemption to other localities. Warehouse operators in El Paso unfairly would gain an advantage against their in-state competitors. This imbalance likely would lead a future legislature to expand it to the rest of the state. Such an expansion would be expensive, likely costing the state and local jurisdictions tens of millions of dollars in lost tax revenue.

Texas already has an attractive business climate. The proposed amendment unfairly would shift the property-tax burden in El Paso County from certain taxpayers who happen to own goods-in-transit to other taxpayers. It would show favoritism by subsidizing a single, relatively small industry, while producing little positive “ripple effect.”

Criteria for assessing the new exemption would complicate rather than simplify the appraisal process. Determining property owners’ intent could be difficult because ambiguity in the language might allow them to claim exemptions for goods that arguably were not meant for shipment.

OTHER
OPPONENTS
SAY:

HB 621 should not be bracketed to El Paso County, because the local economies of many other communities in Texas also would benefit from the goods-in-transit exemption offered under the bill. HB 621 should be amended so that any local taxing entity in Texas could take advantage of this economic development opportunity.

Alternatively, the bill should include a sunset date and require a report to the Legislature on economic benefits versus lost tax revenues so that lawmakers could review the policy before continuing it or expanding it beyond El Paso County.

NOTES:

According to the LBB, the tax exemption in HB 621 would result in an estimated loss of \$845,000 in general revenue-related funds in fiscal 2008-09. This cost would result from the need to offset the loss of school district property tax revenue with state funds.

The companion bill, SB 501 by Duncan, has been referred to the Senate Finance Committee.

During the 2003 and 2005 regular sessions, the Legislature considered legislation similar to HB 621. HB 104 by Chavez, considered by the 78th Legislature in 2003, would have authorized a goods-in-transit exemption throughout the state of Texas, not just in El Paso County. The bill passed the House but died in the Senate Finance Committee. HB 121 by Chavez, considered by the 79th Legislature in 2005, also would have authorized a goods-in-transit exemption throughout the state of Texas, not just in El Paso County. That bill was reported favorably by the Local Government Ways and Means Committee, but died in the Calendars Committee.