

Making the Numbers Work: Texas Tax Code Chapter 313, Its Incentives and Procedures

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Background

Energy generation is, generally speaking, a capital intensive business, and companies that look to renewable sources like sun and wind have to look to all available incentives in order to effectively compete with their fossil-fueled brethren.

One of the most important incentives is provided for by The Texas Economic Development Act. The Act allows school districts to grant tax incentives to new, large-scale development within their boundaries. Aimed at enticing companies to bring jobs and facilities to Texas, the Act was created by the Legislature in 2001 under Chapter 313 of the Texas Tax Code. The incentives involve local property taxes, which are a major cost of doing business in Texas since the state has no income tax. The Act favors large projects in small and/or poor school districts.

The focus on the taxes assessed by school districts has dual significance. As any chagrined homeowner can attest to, there are potentially dozens of types of local entities that assess property taxes. But it is the local school district that will take the largest cut – typically in the neighborhood of \$1.50 of more per \$100 of property valuation. Unlike the other local taxing entities, school districts also receive significant, direct funding from the state, which explains the role of the State Comptroller in the granting of tax incentives under the Act.

Qualified Projects

The Act authorizes the granting of tax incentives to a host of large-scale developments, including manufacturing, research and development, and

energy generating facilities.¹ Virtually any type of energy generation project qualifies, including clean coal, integrated gasification, nuclear, and – most relevant to this discussion – renewable energy and various other sources that are considered low-emitters of sulfur dioxide.

Since the goal of the Act is to stimulate job-producing developments in financially challenged areas, these projects must be in a Reinvestment Zone,² or an Enterprise Zone.³ If no such zone yet exists in the area of the proposed development, a school board also may designate an area that is entirely within the territory of the school district as a Reinvestment Zone.⁴

The Act also sets minimum investment levels.⁵ These levels vary by school districts. In small school districts containing property with total taxable value of less \$100 million, the minimum qualifying investment is \$20 million. In the largest school districts – those containing property with total taxable value of more than \$10 billion – the minimum qualifying investment is \$100 million.⁶

As jobs are a central focus of the Act, applicants must create at least 25 new jobs, meaning they cannot be transferred from elsewhere in Texas or

¹ Texas Tax Code Chapter 313.024.

² See Chapters 311 or 312 of the Texas Tax Code.

³ See Chapter 2303 of the Texas Government Code.

⁴ Texas Tax Code § 312.0025.

⁵ Texas Tax Code § 313.022-023.

⁶ The Act lowers these investment levels in so-called rural school districts, defined as those in counties with fewer than 50,000 inhabitants and relatively stagnant population growth. Texas Tax Code § 313.051 et. seq.

a replacement for a previous position.⁷ At least 80 percent of the new jobs must be “qualified.” To be “qualified,” a job must be for at least 1,600 hours a year, pay benefits and a wage that is at least 110 percent of applicable county average for manufacturing jobs. For projects that create more than 1,000 jobs, the required wage is 110 of the average weekly wage for all jobs.⁸

As for the facts-on-the-ground, the Act has been utilized extensively for wind-energy projects. Of the 98 projects as of 2010, 64 percent were wind farms.⁹ This makes sense, given the high upfront expense of the wind farms and the wide open spaces (and corresponding low populations) that they prefer.

The Incentives

The Act authorizes school districts to grant a package of incentives that include a partial cap on the appraised value of the new development, and tax credits. Here’s generally how the incentives work: after a school district approves a project, the company has two years to build it. Once built, its assessed value for purposes of the school district’s Maintenance and Operation tax rate is capped an amount approved by the school district. Importantly, this is a limited cap. School districts also assess a property tax to service their debt. An approved development will be taxed based on its fair-market value for the tax dedicated to debt service, in addition to property taxes assessed by counties, cities, or other local authorities. The tax credits come into play if the developer develops the project rapidly, and its assessed value in the first two years of the project exceeds the capped amount. In such a case, the amount of taxes the developer paid in

excess of the capped amount – which, remember, does not come into play until the third year of the project – will be credited to future tax bills.

While the Act is presented as a tool for bringing development and jobs to the state, there are important details. The value of the incentives is based upon two factors: the size of the school district and the wealth of the school district.¹⁰ School districts have only limited discretion to negotiate the cap on appraised value. In large, rich school districts, the minimum amount of the cap is \$100 million. In smaller and/or poorer districts, that minimum cap is \$20 million. What that means is that developers have much more room to negotiate for greater tax savings in the smaller districts. It also means that large projects have potential for greater tax savings. Importantly, though, school districts are only prevented from setting the cap below the statutory levels, but are free to negotiate deals for higher caps.

The Process

The first official step to gaining these tax incentives is to file an application with the applicable school district’s board of trustees. That step, however, is the culmination of detailed preparations, and the applicant must have all its ducks in a row.

The application itself is a major undertaking that will require the labor of internal number-crunchers and probably outside consultants.¹¹ The application calls for a host of detailed information, including:

(1) estimates of the impact of the project on public school state aid;

⁷ Texas Tax Code § 313.021 (2)(A)(iv); the school board can waive the new job requirement if it finds that it exceeds the relevant industry standard. See Texas Tax Code § 313.025 (f-1).

⁸ Texas Tax Code 313.021(3).

⁹ *An Analysis of Texas Economic Development Incentives – 2010*, Susan Combs, Texas Comptroller of Public Accounts.

¹⁰ Texas Tax Code § 313.027.

¹¹ Texas Tax Code § 313.025.

(2) estimates of the tax benefit to applicant through the tax credit and the limitation on the appraised value;

(3) estimates of required revenue protection funds the district may be entitled to in the agreement;

(4) estimates of extraordinary educational expenses the district may be entitled to in the agreement;

(5) estimates of the supplemental payment cap described in Tax Code, §313.027(i);

(6) general analysis of the range of possible effects of the project on the school district and on neighboring school districts' facilities needs;

(7) estimates of increased state aid associated with increased enrollment; and

(8) any other information the district is able to provide that the comptroller deems necessary to analyze the impact of the project on state and local public school revenues.¹²

The application also must include specific and detailed descriptions of the property subject to the appraised value limitation, the "qualified investment" to be made on the property, the number and types of jobs to be created and maintained, the wages, salaries and benefits to be paid, and other disclosures.¹³

It is important for applicants to put their best foot forward at this early state. First, the numbers and representations must be correct. When it grants tax breaks to a project, a school board must make a finding that the information provided by the applicant was true and correct.¹⁴ Second, school districts have discretion in the

size of the tax incentives. Spending the time and money up front to put together comprehensive and accurate information will likely pay dividends when it comes time to negotiate.

These materials must be submitted to the school district, who must then forward all this information on to the State Comptroller's Office. The next step is up to the school district. Its board of trustees must determine if the application is "completed." This does not mean it is approved, but simply mobilizes a host of administrative activity. The school district, for its part, must compile a host of information regarding the project's effect on its budget. The State Comptroller's Office also initiates an economic impact evaluation of the project.¹⁵ Included, among more basic information, in the evaluation:

(1) the relationship between the applicant's industry and the types of qualifying jobs to be created by the applicant to the long-term economic growth plans of the state;

(2) the relative level of the applicant's investment per qualifying job to be created by the applicant;

(3) the number of qualifying jobs to be created by the applicant;

(4) the wages, salaries, and benefits to be offered by the applicant to qualifying job holders;

(5) the ability of the applicant to locate or relocate in another state or another region of this state;

(6) the impact the project will have on this state and individual local units of government;

¹² Texas Administrative Code §§ 9.1053 (a)(1), 9.1054 (c)(3).

¹³ Texas Administrative Code § 9.1053 (a)(1)(A)(i-vii).

¹⁴ Texas Tax Code § 313.025 (f)

¹⁵ The State Comptroller must first make a prerequisite finding that the project qualifies for assistance under the Act. Texas Tax Code §§ 313.024; 313.025 (h)

(7) the economic condition of the region of the state at the time the person's application is being considered;

(8) the effect of the applicant's proposal, if approved, on the number or size of the school district's instructional facilities;

(9) the projected market value of the qualified property of the applicant as determined by the comptroller;

(10) the proposed limitation on appraised value for the qualified property of the applicant;

(11) the projected dollar amount of the taxes that would be imposed on the qualified property, for each year of the agreement, if the property does not receive a limitation on appraised value with assumptions of the projected appreciation or depreciation of the investment and projected tax rates clearly stated;

(12) the projected dollar amount of the taxes that would be imposed on the qualified property, for each tax year of the agreement, if the property receives a limitation on appraised value with assumptions of the projected appreciation or depreciation of the investment clearly stated;

(13) the projected effect on the Foundation School Program of payments to the district for each year of the agreement;

(14) the projected future tax credits if the applicant also applies for school tax credits; and

(15) the total amount of taxes projected to be lost or gained by the district over the life of the agreement.¹⁶

The evaluation is due within 91 days of the acceptance of the application.¹⁷ In the evaluation, the State Comptroller also must render a

recommendation to the school district. This recommendation is vital. Without it, the school district's board of trustees must approve the application by a two-thirds supermajority, rather than the simple majority needed if the Comptroller does issue a recommendation.

Subject to extension for various reasons, the school district's administration then has 151 days to present to the board of trustees the completed application for consideration. If it approves the application, the school board must make factual findings on every element that the State Comptroller was to address in its evaluation. The school district and applicant also must enter into a written agreement that specifically describes the project subject to the appraisal cap. The agreement must contain additional provisions, including the amount of the valuation cap (subject to the statutory minimums), recapture mechanisms in the event of default and a requirement that the developers maintain a presence in the district for three years after the incentives expire. The agreement could contain additional provisions such as supplemental payments if the school district incurs extraordinary educated-related expenses related to the project. The project must comply to the agreed-upon amount of investment and jobs, or face the full assessment of taxes in any year it is out of compliance.¹⁸

The Outlook

The Act is slated to sunset in 2014. The Comptroller's Office has lodged some criticisms that could, in the long-term, conceivably affect its application to renewable energy projects. Among those criticisms are that school districts are too willing to waive the job-creation requirements. A full 60 percent of the projects are not subject to the job-creation

¹⁶ Texas Tax Code §§ 313.025 (e); 313.026.

¹⁷ Texas Tax Code § 313.025 (d).

¹⁸ Texas Tax Code § 313.027 (b).

requirements.¹⁹ While the majority of projects receiving incentives pursuant to the Act are wind farms, those wind farms have created only 14 percent of the qualifying jobs.²⁰ The wind farms also have received 37 percent of the tax benefits.²¹ There also has been criticism that school districts accept payments in lieu of taxes, which are not factored into the state's school funding formula, meaning the state is concerned that it is bearing a disproportionate share. Given the state's recent budget challenges, these criticisms should be acknowledged by renewable energy developers as they consider the details and timing of new projects.

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¹⁹ *An Analysis of Texas Economic Development Incentives – 2010*, Susan Combs, Texas Comptroller of Public Accounts, p. 18.

²⁰ *Id.*, at p. 21, table 3.

²¹ *Id.*, at p. 18.