

**Surplus**

Funds Set Aside Last Session for School Finance	\$	1,800	
Vetoed Funds		475	
Funds in Excess of Revenue Estimate		2,000	
<b>Total Surplus</b> (in millions)	\$	<b>4,275</b>	

**Emergency Needs**

	Min	Max
Hurricanes	\$ 300	\$ 500

**Anticipated 06-07 Supplemental Needs**

Textbooks & Other TEA Obligations	295	465
Medicare Clawback	-	475
Health and Human Services	150	800

**Other Potential Appropriations Needs**

TRBs	-	120
ERS/TRS Retirement Funds	-	870
Deferrals	-	1,000

<b>TOTAL</b> (in millions)	\$	<b>745</b>	\$	<b>4,230</b>
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**NOTE: Creating \$0.15 local discretion costs approximately \$2.3 billion for one year.**

## Texas Tax Reform Commission Reformed Franchise Tax

The commission's plan reforms the franchise tax by broadening the base, lowering the rate, and extending coverage to all active businesses receiving state law liability protection. The primary tax rate is lowered from 4.5% to 1% or 0.5%, depending on the type of business.

The current franchise tax on the higher of net income or net worth (capital) is only assessed on corporations and limited-liability companies (LLCs). The majority of these businesses, however, avoid the tax by using tax planning opportunities or simply avoiding the corporate form altogether. The recent spread of new business forms such as limited-liability partnerships have benefited from the state's protections previously available only to corporations while avoiding the tax levy designed to reflect the value of that protection.

### **Who would pay:**

Companies with liability protection, including corporations and LLCs currently subject to the franchise tax, partnerships, limited partnerships, limited-liability partnerships, professional associations, and business trusts, to name a few.

### **Who would not pay:**

- Sole proprietorships and general partnerships owned solely by natural persons.
- Small businesses with \$300,000 or less in total revenue (indexed to inflation and double the current small business exemption of \$150,000.)
- Passive unincorporated investment entities, where at least 90% of federal gross income is from passive investments.
- Non-profit and other organizations currently exempt under franchise tax.

### **New tax base with low rate:**

In addition to increasing the number of businesses subject to the tax, the underlying tax base would be changed to a business' margin rather than net income or net worth. As a result, the primary tax rate would be lowered from 4.5% to 1%. However, trade businesses engaged primarily in wholesale or retail activities would pay 0.5%, in recognition of the low profit margins basic to the industry.

To calculate the margin, a business would start with its total revenue and be allowed to deduct either employee compensation (including health, retirement, and workers' compensation benefits) or cost of goods sold, computed in a manner similar to that used for federal income tax purposes. The deduction for wages and cash compensation (excluding benefits) could not exceed \$300,000 per employee (indexed to inflation.) Affiliated groups of businesses with 80% common ownership would be required to report on a unitary (i.e., same general line of businesses or vertically integrated with strong centralized management) combined basis and must elect the same deduction. Multi-state businesses would determine their Texas portion of the margin using the same apportionment calculation currently used for the franchise tax. The maximum taxable margin would be 70% of total revenue.

Unlike previous proposals, employers would be rewarded, not punished, for hiring people and providing health and retirement benefits, as all three would lower their tax.