Public School Finance
Looking Beyond the Bottom Line

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Public school finance is arguably the most complex state public policy topic. In the wake of the recent unsuccessful legislative reform attempt, the State of Texas and a coalition of approximately 70 property poor and property wealthy school districts are preparing for yet another Travis County District Court showdown.

At the same time, as the legislature continues its deliberation on the topic of public school finance, corporate general counsels should pay close attention to the legislature's activities because the resulting action will have a direct bearing on the corporate bottom line. The business community is a primary stakeholder, regardless whether the consequences stem from either judicial or legislative mandate.

This topic reaches far beyond the immediate corporate tax and financial implications. The business community has a direct interest in, and must focus on, enhancing and promoting a world-class system of education from which companies draft its qualified workforce. Corporate general counsels should ensure that their companies are actively engaged in legislative deliberations. The business community must refine and expand its leadership role in development of meaningful public policy, striking an appropriate balance between contributing its fair tax share to educate the school children of Texas and shouldering a lopsided percentage of the financial burden.

In 1984 the business community served as a key catalyst to reform Texas' public education system. In subsequent legislative sessions the business community delivered meaningful expertise to the legislature on the various types of tax proposals that would threaten and undermine Texas' favorable business environment.

Currently, via interim committees, special workgroups and the Office of the Governor, the legislature is studying and deliberating policy alternatives that will change our tax structures and revamp the school finance system. The general goal is to reduce local school property taxes and increase other tax revenues generated by the state. Corporate general counsel's should pay close attention to the various options under consideration to raise that state money; namely, expanding the sales tax base to cover a number of services and replacing the corporate franchise tax with some other tax on businesses.

Corporate general counsels will be tracking three major policy issues: (1) the amount of school property tax reduction; (2) revenue alternatives; and (3) school issues. First, for most school districts, the current maintenance and operations tax rate is pegged close to or right at the maximum ceiling allowed by state law, $1.50 per $100 of property valuation. State lawmakers hear the collective demand for relief by property taxpayers. The Senate would like to provide from $1.00 to $0.50 of tax relief while the House would like to provide from $0.25 to $0.50 of property tax relief. The Governor appears to be more comfortable with the House target.

Second, regarding revenue alternatives, the Senate desires greater local property tax relief. For that objective, the demand for more state money would require consideration of broader revenue initiatives. While both legislative chambers examine global revenue elements – sales tax base expansion, sales tax rate increases, and cigarette tax increases – the Senate is also looking at authorizing video lottery and replacing the franchise tax with a substantial business activity tax. The Senate business activity tax proposal included the application of taxation to company payroll and profits, resulting in twice as much revenue relative to the current franchise tax. The House is evaluating a 1.25% payroll tax or an alternative capped at $500 per employee, which would raise much less than the Senate proposal. Greater the local property tax relief results in a larger state tax bill to cover the lost property tax revenue.

Third, with respect to school issues, lawmakers truly seek to provide for an effective education system. The issues include incentive funding, teacher pay raises, proper distribution of state aid, and how to mathematically reduce "recapture" (the current Robin Hood method of delivering "wealthy" district revenue to relatively "poor" districts).

While the three major policy issues will consume the public debate, the corresponding restructuring of the state's tax system will affect your corporate bottom line. Offsetting local property taxes with other taxes will create winners and losers. However, tax numbers on a spreadsheet will not convey the whole story of how your company will be affected by the school finance debate. Corporate general counsels should wisely look beyond the bottom line because important ancillary issues will impact your business corporate tax exposure. These issues include tax administration, loophole closing, and establishing case law precedent.

Tax Administration. The sideline matter of tax administration and related legal costs could be more threatening than new taxes. For example, the legislature recently prohibited the Comptroller from issuing tax refund checks in excess of $250,000 per business taxpayer, per biennium. Taxpayers are now required to claim refunds in the form of credits against future tax payments or seek a specific appropriation from the legislature. Further, the State Auditor has been empowered to review tax refund claims, potentially injecting a further roadblock into legitimate tax refunds.

Loophole closing. Expressing disfavor on legal business tax avoidance structures, commonly referred to as the "Delaware sub" and "Geoffrey's sub," both the House and Senate are considering a total replacement of Texas' corporate franchise tax. Both structures involve the legal creation of corporate subsidiaries outside the state. Under proposed reforms, these business structures would no longer provide tax savings and may actually become more costly. Resulting in costs, businesses will respond accordingly by altering company business structures to eliminate or modify these entities.

Establishing Case Law Precedent. The House is considering a payroll tax of 1.25% of payroll, with a limit of $500 per employee. The Senate is considering a Michigan-style business activity tax. Either policy option would create a substantial shift of tax liability across industries and, in the longer term, result in a substantial amount in litigation costs to Texas businesses as a new body of interpretive case law is established over time. Compliance costs of a business activity tax could be substantial due to new administration, the uniqueness of the tax, and complex multi-state apportionment issues.

Conclusion. Your client interests, both to the company and to the community, strongly suggest that the corporate general counsels engage in the legislative process for the development of positive changes to the Texas system of public school finance.