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LEGISLATION 532 7

Tax overhaul bill draws flak from all sides

■ Detractors say the bill is nothing more than a state income tax, and Senate leaders have problems with it, too.

By JAY ROOT and R.A. DYER

STAR-TELEGRAM AUSTIN BUREAU

AUSTIN — The ink had barely dried on a massive tax overhaul passed by the Texas House on Tuesday when prominent Senate leaders began taking potshots at it and critics on both the left and the right called it an income tax in disguise.

“The Republican-led Texas House of Representatives accomplished something Democrats have wanted to do for decades, but could not. The state of Texas now has an income tax,” fumed conservative activist Michael Quinn Sullivan, executive at the Texas Public Policy Foundation in Austin.

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At issue is House Bill 3, which would increase the sales tax, extend it for the first time to items such as bottled water and auto repair services, close loopholes companies have been using to avoid business taxes, and reduce property taxes.

Some critics, such as Sullivan, say the way the new business tax would be structured amounts to an income tax on certain business owners.

The bill passed the House 73-68 but faces an uncertain fate in the Senate, where leaders favor smaller sales tax increases and what they see as a less onerous business tax.

The sharp differences and criticism ensure that no solution to the state’s school finance woes will come quickly, despite a court order requiring one by October. The chambers have until late May to agree on a compromise version before the clock runs out on the 79th Texas Legislature.

Even then, the controversy over business taxes could open up new legal attacks. Critics say that extending business taxes to now-exempt partnerships actually creates a personal income tax on some business owners. That’s because the income of partners is treated like personal income under the Texas Constitution.

That provision was spearheaded by then-Lt. Gov. Bob Bullock, a Democrat who saw his political life flash before him in the early 1990s after promoting the creation of a personal income tax. Eager to get back into the good graces of the voters, he ensured that the state could never enact one without the voters’ approval.

Buck Wood, a Democratic lawyer who specializes in school finance law, said the House bill would clearly create an income tax on many business owners — and therefore require a public vote, as mandated by the state Constitution.

But since the legislation does not call for a public referendum, major provisions of the law would become moot, he said.

“This thing will be gone before the ink is dry,” Wood said. “House Bill 3 is so clearly unconstitutional, there wouldn’t be any disputed facts for the Supreme Court.”

The Texas Constitution says the Legislature cannot impose a tax on the net income of persons “including a person’s share of partnership” without a public referendum.

“The language [of the Constitution] is so clear, there’s no question about it,” Wood said.

Alexis DeLee, a spokeswoman for House Speaker Tom Craddick, R-Midland, denied the bill created an income tax and said it would provide a “tremendous amount” of property tax relief. The money raised from the new revenue, about \$5.4 billion a year, would go toward cutting school property taxes by a third.

“The leadership wouldn’t pass something through that wouldn’t pass legal muster,” DeLee said. The House plan also got a boost Tuesday when the Texas Association of Busi-





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ness, an influential lobby group, endorsed the proposal.

But Senate leaders found little to like about the legislation, other than that it's designed to raise money exclusively for property tax reduction.

"There are some philosophical differences, there's no question about it," said state Sen. Florence Shapiro, R-Plano. "We'll make adjustments."

Shapiro, chairwoman of the Senate Education Committee, criticized the business tax proposal, the taxes on bottled water and snacks, and the way property taxes are distributed to schools under the House plan.

"I don't think this body will go to a full penny [increase] on the sales tax," Shapiro said. "I don't think this body agrees with a payroll tax at all."

An employer-paid payroll tax is one element of the House plan, which allows companies to pick either the existing state franchise tax or pay 1.15 percent on the salaries of each employee.

The business tax overhaul — so controversial that it threatened to torpedo the bill — is aimed at closing loop-

holes that have made the franchise tax essentially voluntary.

But Lt. Gov. David Dewhurst, the Republican who presides over the Senate, has repeatedly criticized the idea of applying business taxes to salaries.

"I think a broad-based low rate that's based upon revenue and income is fairer than a payroll tax, which taxes entry-level jobs and hurts companies that have lots of employees," Dewhurst said.

Another looming conflict: a statewide property tax. The Senate is strongly leaning toward one because, as proponents note, it would solve the equity issue that has repeatedly left the \$30 billion public education system under attack in the courts.

Currently, wealthy districts must share property tax money with poor ones. A statewide property tax would make the redistribution automatic by putting a certain amount of property tax revenue into the state Treasury.

"We are definitely in support of a statewide property tax," Shapiro said. "It ... gets us out of court on the equity issue."

Craddick supports the idea, but it would require an amendment to the Constitution — and therefore 100 votes in the House. The Republicans have an 87-63 majority in the House, but more than a dozen Democrats would have to join the effort even if every Republican supported it.

And with relations between the parties in the House stuck somewhere between bad and poisonous, the proposition is dicey. Most Democrats want any tax increases to go for increased education spending, but both House and Senate leaders say the new money would go exclusively for property tax reductions.

"I don't think that the majority of the Democrats are interested in doing anything that's not going to be in the long-term best interest of our kids," said state Rep. Pete Gallego, D-Alpine. "If all we're going to be doing is rearranging the deck chairs on the Titanic, I don't think most Democrats will be interested."

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