

# EFFECT OF THE 1959 TAX BILL ON STATE REVENUES

Number 4...

in a series of  
Factual Reports

TEXAS COMMISSION ON STATE AND LOCAL TAX POLICY

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THE TEXAS COMMISSION ON STATE AND LOCAL TAX POLICY

- ... was created by Chapter 486, Acts of the 56th Legislature, Regular Session
- ... is composed of nine members: three members from the State Senate appointed by the Lieutenant Governor; three members from the House of Representatives appointed by the Speaker; and three citizens of the State appointed by the Governor
- ... is directed to make comprehensive studies with respect to the equity, distribution and administration of taxes in this State
- ... may NOT recommend the adoption of any specific tax

# TEXAS COMMISSION ON STATE AND LOCAL TAX POLICY

(CH. 486, ACTS 56TH LEGISLATURE, REGULAR SESSION)

DRAWER C, CAPITOL STATION  
AUSTIN, TEXAS

December, 1960

His Excellency Governor Price Daniel and  
Honorable Members of the 57th Legislature:

The Texas Commission on State and Local Tax Policy was created by Chapter 486, 56th Legislature, Regular Session. The Commission is directed "to make comprehensive studies of property taxation and its administration by political subdivisions and by the State Government, of the operation and effects of any tax measures enacted by the Fifty-sixth Legislature, and of any other topics with respect to the equity, distribution and administration of taxes in this State."

The most important aspect of the 1959 tax legislation was its continuation of Texas' traditional policy of selective taxation. Accordingly this Commission directed its staff to devote a major part of its attention to exploring that tax policy, its implications and possible alternative tax policies. The first report in this series - Our Texas Tax Policy: Its History, Its Future - traced the history of our selective tax policy with particular concentration on the past thirty years. The second and third reports - State Tax Policy and the Individual and State Tax Policy and Business - discussed the effect of a selective tax policy on individual and business taxpayers and explored the effect of changing this policy to one of general taxation.

This fourth report is not concerned with the policy aspects of the 1959 tax legislation, but rather with the revenue effects of that tax bill. It is now generally recognized that House Bill 11, 56th Legislature, Third Called Session, fell substantially short of producing the state revenue anticipated from it. This, plus the sharp drop in oil production, accounts for the fact that the State once again faces a tax problem of major proportions. In this report an attempt is made to determine the amount by which House Bill 11 fell short of expectations and to explore the reasons why it was short.

In addition to the revenue realized directly from the tax bill of 1959, State tax revenues have been increased as a result of the reorganization of the State Comptroller's Department in accordance with enabling statutes enacted by the 56th Legislature and in line with recommendations of the Texas Research League. During the ten-month period from January 1 to October 31, 1960, the Field Operations Division made 3,291 taxpayer

audits which resulted in a net increase in tax liability of \$2,086,000. It appears that field auditing will produce at least two-and one-half times as much revenue as was normally realized under the old organizational structure. This is a very good record for the first year, and this Commission believes that State Comptroller Calvert and his staff are to be commended on the success of this phase of their departmental reorganization.

Research assistance has been made available to the Commission, without cost to the State, by the Texas Research League, a non-profit Texas corporation professionally engaged in governmental research and financed by the voluntary contributions of public-spirited citizens of this State. The research staff for this report consisted of James W. McGrew, Director, Alan E. Barnes, Homer E. Scace and Bob Norwood. The Commission and the staff wish to express their gratitude to State Comptroller of Public Accounts Robert S. Calvert and the several members of his Department who contributed their time and efforts in making detailed financial data available for this report.

This report has been carefully reviewed by the members of this Commission who are satisfied that the information contained herein is thoroughly factual and should prove helpful to all who are interested in the tax problems of the State of Texas.

Respectfully submitted,

TEXAS COMMISSION ON STATE AND LOCAL TAX POLICY

William S. Fly, Chairman

Frates S. Seeligson, Vice Chairman

John McKee, Secretary

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## EFFECT OF THE 1959 TAX BILL ON STATE REVENUES

State tax revenues in the fiscal year 1959-60 - the first year of operation under the 1959 tax bill\* - totaled \$778 million. This represented an increase of \$80 million over the \$698 million collected in 1958-59. Of the \$80 million increase, \$74 million may be attributed directly to the 1959 legislation while only \$6 million was the result of natural growth. The small amount of natural growth in the over-all tax revenue picture is due in large measure to the fact that the oil production tax declined by nearly \$12 million, thus offsetting the natural growth in other taxes. In addition, it appears that the 1959 tax bill had a definite retarding effect on the anticipated natural growth of the cigarette tax. Finally, there was a one-time revenue loss of more than \$3 million which is also chargeable to the 1959 law.

The State government began its fiscal year on September 1, 1959, with a General Revenue Fund deficit of \$26.7 million. Estimates by the State Comptroller, made when the current appropriations bill was certified, predicted that this deficit would decline to \$18.9 million by the end of the fiscal year on August 31, 1960. Actually, the deficit on that date was \$34.6 million.

The deficit estimate is the end result of a complicated series of estimates of tax revenue, non-tax receipts and expenditures. Errors in any one of several thousand items can cause a significant change in the

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\*H. B. 11, 56th Leg., 3rd C. S.

end result. Fortunately, in many cases these errors will tend to cancel out - for example, an over-estimate of tax revenue might be wholly or partially canceled out by an over-estimate of expenditure.

In the 1959-60 fiscal year the Comptroller's estimates of tax revenue were some \$22 million too high, based on a detailed analysis of 24 major state taxes as shown by Table 1. These estimates (which were made in August of 1959 and which have subsequently been substantially revised in the light of experience) predicted that these taxes would produce \$797 million in the 1960 fiscal year whereas they actually produced only \$775 million. Broken down between those taxes which, directly or indirectly, affect the General Revenue Fund and those which affect other funds, it is found that the estimate for General Fund taxes was \$27.5 million too high while the taxes affecting other funds were under-estimated by slightly more than \$5 million.

#### HOW GOOD ARE THE REVENUE ESTIMATES?

It has frequently been alleged that the revenue estimates of the Comptroller of Public Accounts tend to be ultra-conservative. This does not appear to be borne out by the results of the last few fiscal years and certainly not by the experience of 1959-60. On the other hand, the 1959-60 results would seem to indicate that his estimates have erred on the side of being too liberal. It seems worthwhile to examine this point since it may have some bearing on legislative action in 1961.

In total, the major tax collections amounted to 97.2% of the amount estimated by the Comptroller. The "estimating error," therefore, was 2.8% with most of this error concentrated in those tax areas directly affected

Table 1

Comparison of Comptroller's Estimates and Actual Revenue  
From Major State Taxes, Fiscal Year Ended  
August 31, 1960

(Dollar Amounts in Thousands)

Tax	Comptroller's Estimate	Actual Revenue	Variation from Estimate	
			General Fund	Other Funds
<b>A. Taxes Affected by 1959 Legislation:</b>				
Cigarette	\$ 84,842	\$ 79,238	\$- 5,604	\$
Corporation Franchise	65,308	59,957	- 5,351	
Motor Vehicle Sales	26,884	27,303	+ 419	
Liquor & Wines	17,572	16,038	- 1,534	
Utilities	9,663	9,599	- 64	
Miscellaneous Excises	9,262	7,094	- 2,168	
Tobacco Products	6,941	6,612	- 329	
Severance Beneficiary	6,870	152	- 6,718	
Hotel Occupancy	2,567	2,225	- 342	
Sub-Total, Group A	<u>\$229,909</u>	<u>\$208,218</u>	<u>\$-21,691</u>	<u>\$</u>
<b>B. Other Major Taxes:</b>				
Motor Fuel	\$180,190	\$185,307	\$+ 1,279	\$+3,838
Oil Production*	140,352	124,538	-15,814	
Vehicle Registration	74,347	75,734		+1,387
Gas Production	49,680	52,233	+ 2,553	
State Ad Valorem	36,691	37,587	+ 747	+ 149
Insurance Companies	31,999	32,212	+ 458	- 245
Beer	18,338	18,807	+ 469	
Inheritance	8,900	12,608	+ 3,708	
Driver Licenses	6,731	6,924	+ 193	
Telephone Companies	7,665	7,908	+ 243	
Sulphur Production	3,515	4,005	+ 490	
Poll	2,700	2,828	+ 128	
Cement	2,616	2,279	- 337	
Store	2,327	2,557	+ 230	
Well Servicing	1,144	1,021	- 123	
Sub-Total, Group B	<u>\$567,195</u>	<u>\$566,548</u>	<u>\$- 5,776</u>	<u>\$+5,129</u>
<b>GRAND TOTAL</b>	<u>\$797,104</u>	<u>\$774,766</u>	<u>\$-27,467</u>	<u>\$+5,129</u>
			<u>\$-22,338</u>	

\*Includes oil regulation tax.

Source: Estimates provided by State Comptroller's Department. Actual revenue from Annual Report of Comptroller of Public Accounts.





structure made up exclusively of selective taxes and is even more likely when new taxes are added to that system - especially when these new taxes are wholly original with Texas and there is not even the experience of other states upon which to draw.

In addition to the estimating difficulties of a selective tax structure, revenue estimating in Texas is complicated by an elaborate system of dedicated taxes and special funds. The effect of the fund structure on the Legislature's ability to control expenditures is often exaggerated, but the fund structure does certainly confound the estimating problems of the Comptroller. Finally the biennial budget system of Texas makes it necessary for the Comptroller to forecast revenues some 32 months in advance of collection. This, to say the least, is a difficult task.

It should also be noted that, with the state facing a perennial tax problem in recent years, the State Comptroller has been under more or less constant pressure to make his estimates optimistic. It has been stated that "It takes considerable courage to project future revenues at a level never experienced in the past. The burden of proof is heavy, and the implications of failure are tremendous."\* The Texas Comptroller, while refusing to depart too far from supportable estimates, has shown the type of courage referred to, and there is no evidence that the Legislature has been required to levy unnecessary taxes as a result of overly cautious revenue estimating.

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\*James A. Arnold, Jr., "Budget Estimates and Tax Policy," National Tax Journal, December 1953, p. 392.

ESTIMATED AND ACTUAL  
COLLECTIONS FROM H. B. 11

From the very beginning of the Regular Session, the 56th Legislature adopted the practice of preceding each tax bill by a "fact sheet" which summarized the changes being made and attached revenue estimates for each tax. These revenue estimates were always based on the assumption that a full 24 months revenue would be collected in the 1959-61 biennium. It was, of course, recognized that there would be some lag in collections the first year, but the amount of this lag could not be ascertained until the actual effective date of the Act was known. In making these estimates, the Legislature called upon the technical facilities of the State Comptroller, the Legislative Council and the Texas Research League. There were, however, a few estimates that were derived from other and less reliable sources.

The fact sheet which accompanied H. B. 11 of the Third Called Session claimed a total additional revenue from new and increased taxes of a little over \$182 million. Apparently it was anticipated that some \$98 million of this would be realized in the first year of the biennium and the balance (\$84 million) in the second year, the major difference between the two years being the additional 33.33% surtax on the 1959 franchise tax to be collected during the Fall of 1959.

As indicated by Table 2, the State Comptroller lowered this estimate for 1959-60 to a little over \$91 million. Primarily this represented a reduction to allow for the normal one or two month lag in collections plus a substantial reduction in the estimated collections from some of the new items in the Miscellaneous Excise Tax.

While it is not possible to precisely trace the amount directly attributable to H. B. 11, it appears that actual collections from this tax

measure amounted to \$81.2 million, including the \$7.8 million of protested Severance Beneficiary Tax payments. Excluding these protested payments, the 1959 tax bill produced \$73.9 million of usable state revenue in the first year of the biennium.

Table 2

Comparison of Advance Estimates and Actual Revenue From  
1959 Tax Bill, Fiscal Year Ended August 31, 1960

(Dollar Amounts in Millions)

	Legislative Estimate	Original Comptroller's Estimate	Actual Revenue
Increased MV Sales Tax	\$ 7.5	\$ 6.8	\$ 7.0
Increased Cigarette Tax	33.4	33.0	26.5
New Tobacco Tax	7.5	6.9	6.6
Increased Utilities Tax	1.5	1.7	1.7
Increased Franchise Tax	22.6	22.6	21.2
New and Increased Miscellaneous Excises*	11.0	6.9	4.7
Impose Severance Beneficiary Tax	7.6	6.9	8.0
Impose Hotel Tax	3.3	2.6	2.2
Increase Liquor Tax	<u>3.6</u>	<u>3.7</u>	<u>3.8</u>
Total New Revenue	\$98.0	\$91.1	\$81.7
Less: Protested SB Tax Payments			<u>- 7.8</u>
Total Usable Revenue			\$73.9

\*Includes permit fee revenue.

Examination of the detail in Table 2 reveals that some of the tax measures proved very disappointing in the first year of their operation.

This was especially true of the cigarettes, franchise and miscellaneous excise taxes. On the other hand, if the severance beneficiary tax is eventually upheld, it will prove to be somewhat more productive than had been anticipated.

Based upon this first year's experience, it now appears that the 1959 tax bill will actually produce about \$158 million in the full biennium. Approximately \$18 million of this will represent collections under the Severance Beneficiary Tax and there seems little likelihood that these funds will be usable during the current biennium even if the tax is eventually upheld by the courts. Usable revenue from the 1959 tax bill will, therefore, approximate \$140 million during the biennium.

#### ANALYSIS OF INDIVIDUAL ITEMS IN TAX BILL

The following section is devoted to an individual analysis of the major revenue raising measures of H. B. 11.

#### MOTOR VEHICLE SALES TAX

This tax was originally imposed at the rate of 1% in 1941. The rate was temporarily increased to 1.1% in 1950. In 1951 the 1.1% rate was made permanent and certain provisions designed to strengthen administration of the tax were added. In 1959 the tax rate was increased to 1.5%. In addition, the county assessor-collector's fee for serving as the collection agent of the State was reduced from 5% to 3.5%. A provision (as yet unused) giving the Comptroller the power to establish minimum values was also added.

The legislative estimate of \$7.5 million the first year of the new tax increase was made at a time when the draft of the proposed tax bill

included a provision requiring dealers to submit detailed invoices with their affidavit setting forth the taxable value of the sale. This provision was estimated to increase the yield of the tax by \$500,000 a year. It met with opposition from automobile dealers and was deleted in the final version of the tax bill, but the revenue estimate was not changed. Thus the increased tax rate has produced exactly what the Legislature had hoped it would - \$7 million in the first year.

#### THE CIGARETTE TAX

The increase in the cigarette tax - from 5-cents to 8-cents per pack - was the keystone of the 1959 tax bill. Both the Legislature and the State Comptroller estimated that this increase would produce over \$64 million during the current biennium and thus account for well over one third of the total new revenue to be realized from H. B. 11.

The 1959 legislation not only increased the tax. It also reduced the discount given to distributors buying the tax stamps from 3% to 2.25% of the face value of the stamps.\* In addition it provided that credit for stamp purchases should be extended to distributors for a period not to exceed 15 days. This so-called credit provision proved later to have a significant effect on state revenues in 1959-60. Finally, the tax law imposed a "floor stock" tax of 3-cents per pack on all cigarettes in the possession of wholesale and retail dealers, provided that the dealer had a minimum of 2,000 cigarettes (normally ten cartons) on hand on the effective date of the new tax.

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\*Although the percentage discount was reduced, the amount of discount per pack was increased. For example, in a case of 50 cartons (500 packs) the old tax was \$25, of which the distributor received 75¢ from the 3% discount. At the new tax rate, the tax on a 50-carton case is \$40, of which the distributor receives 90¢, representing the 2.25% discount.

Prior to the passage of the new tax bill the Comptroller had been estimating cigarette tax revenue for 1959-60 at a figure which implied an estimated sale of 1,069,000,000 packs during the year. Following passage of H. B. 11 he lowered this estimate to 1,054,000,000 packs in anticipation of some loss of consumption due to the higher tax. He also estimated that the floor stock tax would produce \$2.4 million and this, plus the current sales, gave him an over-all estimate of \$84.8 million for the 1959-60 fiscal year. Although recognizing that the new 15-day credit provision might result in a one-time loss of revenue (because some of the money would be outstanding at the end of the fiscal year) he was unable to assign a figure to this provision since there was no experience to go on.

The revenue actually produced amounted to \$79.2 million, consisting of \$1.2 million in floor stock tax and \$78 million in current sales. The Comptroller's estimate was, therefore, \$5.6 million too high. Examination of the records of the State Treasurer on stamp sales indicates that this difference consisted of:

Over-estimate of Floor Stock Tax	\$1.2 million
Credit Sales Outstanding August 31	3.1 "
Over-estimate of Current Consumption	1.1 "
Unaccounted For	0.2 "
	<u>\$5.6 million</u>

The unaccounted for \$200,000 probably represents a slight lag between the accounts of the Treasurer and the State Comptroller.

It actually appears that the cigarette tax increase had a much more pronounced effect on consumption than the figures above indicate. The trend of cigarette consumption in Texas (as indicated by tax stamp shipments of the Treasurer) has closely followed the national pattern. That is, consumption dropped in 1953 and 1954 and then went on to new heights in each

succeeding year.\* In Texas the consumption of cigarettes in 1956 was 29 million packs above that of 1955. Annual increases thereafter amounted to 25 million, 45 million and 66 million packs respectively for 1957, 1958 and 1959. By sharp contrast, Texas' consumption in 1960 was 6 million packs less than in 1959 whereas national consumption increased by nearly 5%.

The sale of tax-paid cigarettes in Texas and all neighboring states increased between 1956 and 1959 but in 1960 the sales in Texas declined while sales in the neighboring states increased by a more than usual amount:

	<u>Percentage Change in Sales, 1956-59</u>	<u>Percentage Change in Sales, 1959-60</u>
TEXAS	+ 18.8%	- 0.6%
Arkansas	+ 11.2	+ 8.2
Louisiana	+ 20.4	+ 8.1
Oklahoma	+ 15.8	+ 7.0
New Mexico	+ 30.1	+ 8.5

Note: 1956-59 comparison from Tobacco Tax Council.  
1959-60 comparison based on stamp sales in Texas  
and state revenue reports in other states.

The evidence is, therefore, very strong that the sharp increase in the Texas tax rate has had an effect upon consumption. The question is, how much effect has it had?

To answer this question the research staff analyzed monthly tax stamp shipments of the State Treasurer for a period of ten years - from September

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\*Various explanations are given for the 1953-55 decline. The most logical is that the popularity of "king-size" cigarettes reduced consumption by including about 20% more tobacco in each pack. Then the revelations regarding the alleged connection between cancer and smoking further reduced consumption. In response to this, the industry began producing filter-tipped king-size cigarettes with the result that the tobacco content again declined to about that normally found in non-tipped "regular" size cigarettes.



1950 through August 1960. Based on this analysis it appears that consumption during the 1959-60 fiscal year could have reasonably been expected to total 1,092,000,000 packs. Actual consumption was 1,040,000,000 packs and the apparent loss for the year totaled 52 million packs.

Recognition of this loss puts a different perspective on the tax increase of 1959. With no change in the law, Texas would probably have collected nearly \$53 million from its cigarette tax in 1959-60 whereas actual collections totaled \$79.2 million. The tax bill thus produced an additional \$26.2 million of tax revenue consisting of the following components:

Net State Revenue on 1,040 million packs at 8¢ per pack	\$ 81.3 million
Less: Net State Revenue on 1,040 million packs at 5¢ rate	-50.4 "
Increased Net Revenue Due to Rate Increase	\$ 30.9 million
Plus: Floor Stock Tax	1.2 "
Gross Additional Revenue	\$ 32.1 million
Less: Credit Provision (one time loss)	- 3.1 "
Less: Consumption Loss of 52 million packs at 5¢ per pack	- 2.5 "
Less: Increased Discount to Distributors	- 0.3 "
Net Additional Revenue Due to Tax Increase	\$ 26.2 million

It thus appears that the 1959 tax increase on cigarettes reduced Texas consumption by 52 million packs or about 5% with a consequent loss of State revenue of \$2.5 million per year. Some of the loss can be explained. Sales in August of 1959 were some 8 million packs above that which would normally be expected. This was probably the result of advance buying in anticipation of the tax increase effective on September 1. Tax exempt sales in military installations have been running about a million packs a month over sales in 1959 and apparently this accounts for about 14 million packs a year. This is strong evidence that the military exemption is encouraging outright evasion of the tax. The remaining 30 million pack loss of consumption is apparently a pure and simple decline although it may reflect some tax avoidance in areas bordering on states with lower rates.

THE LIQUOR  
TAX INCREASE

The apparent effect of the tax increase on the consumption of cigarettes naturally raises the question of whether the increase on liquors and wines had the same effect. The 1959 tax bill increased the tax on liquor from \$1.408 to \$1.68 per gallon and made an across-the-board increase of 20% in the tax rates applied to various types of wine. A floor stock tax on all wholesale and retail distributors was also enacted.

Examination of the liquor tax stamp shipments of the State Treasurer for the past several years discloses that the total gallonage of liquor for which tax stamps were sold approximated 8.5 million gallons in 1957 and 1958. This increased sharply to 9.5 million gallons in 1959 and fell off to 8.3 million gallons in the 1959-60 fiscal year.

Closer examination reveals that this probably does not represent a decrease in consumption. The key to an understanding of what actually happened appears to lie in breaking sales down between the first nine months and the last three months of each fiscal year:

	<u>1956-57</u>	<u>1957-58</u>	<u>1958-59</u>	<u>1959-60</u>
	- - - - (thousands of gallons) - - - -			
September 1 - May 31	6,783	6,781	6,869	6,449
June 1 - August 31	<u>1,771</u>	<u>1,719</u>	<u>2,677</u>	<u>1,852</u>
Twelve Months Total	8,554	8,550	9,548	8,301

It seems obvious that something caused an extraordinary sale of liquor at the distributor level in the period from June 1 through August 31, 1959. It seems reasonable to assume that this was caused by a belief among distributors that the pending tax legislation would not include a floor stock tax and they thus attempted to build up their inventories prior to the

imposition of a higher tax rate. This assumption is strengthened by the fact that the floor stock provisions of the act were promptly challenged in court.

In view of the heavy sales during the Summer of 1959, it is not surprising that sales were off some 6% during the first nine months of the 1959-60 fiscal year. The fact that sales during the last three months compare very favorably with those of years prior to 1959 seems clear evidence that the tax rate increase of 1959 did not adversely affect consumption.

Wine stamp tax sales indicate no decrease in consumption and no unusual buying activity in anticipation of a tax increase.

This is not to say that taxes can be indefinitely increased on liquors and wines without affecting consumption. While substantial, the 1959 increase on the liquor and wine tax rates were nowhere near the magnitude of the increase applied to cigarettes.

Revenue from the tax increase amounted to \$3.7 million in 1959-60, consisting of:

Current Consumption of Liquor	\$2.3 million
Current Consumption of Wine	0.2 "
Floor Stock Taxes	1.2 "
Total	<u>\$3.7 million</u>

#### THE CORPORATION FRANCHISE TAX

The second largest revenue producer of the 1959 tax bill was the corporation franchise tax. H. B. 11 added a 33.33% surtax to the 1959 tax which had already been paid by most corporations and, in addition, added a 22.22% surtax to the taxes due in 1960 and 1961. In effect this provided for a rate of \$3.00 per \$1,000 of capital, surplus and debt for 1959 and a rate of \$2.75 for 1960 and 1961. In 1962 the tax is scheduled to revert to the permanent \$2.25 rate.

During the 1959-60 fiscal year the State collected the regular tax due at the rate of \$2.25 plus a 22.22% surtax on the 1960 tax plus the 33.33% surtax due on the 1959 tax. These three components were expected to raise \$65.2 million whereas they actually produced \$60 million.

The bulk of this error was due to two things: 1) Two major franchise taxpayers, heretofore organized as domestic corporations, were reorganized and two new corporations, with charters from another state, were created. Under the franchise tax law these new corporations will not be liable for a franchise tax payment until 1961.\* Ordinarily these two corporations would have paid \$2.1 million in 1960. 2) Credits for payment of the unconstitutional gas gathering tax amounting to \$1.2 million were applied against franchise tax payments in 1959-60.

These two factors account for \$3.3 million of the \$5.3 million difference between the Comptroller's estimate and the actual yield of the franchise tax. The balance of the error was due to an over-estimate of the amount that the franchise tax would produce without any increase. Applying to this basic estimate the percentage surtax naturally magnified the dollar amount of the error.

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\*Art. 12.06 (1) Whenever a private domestic corporation is chartered in this State or whenever a foreign corporation applying for a permit has theretofore done no business in Texas, its initial tax shall be payable within ninety (90) days after the expiration of one (1) year from the date of the filing of such charter or the granting of such permit. . . .

This provision has been in the Texas franchise tax law for many years. It was not changed in any manner by the 1959 tax bill. The reorganized corporations are, in fact, new corporations that had to secure a permit to do business in Texas and they therefore came under the above section of the statute.

THE MISCELLANEOUS  
EXCISE TAXES

In 1941 the State enacted selective sales or excise taxes on radios, cosmetics and playing cards. Subsequently the radio tax was broadened to include television sets. When it became evident that the 56th Legislature would expand the list of selectively taxed sales, the decision was reached to rewrite this law so as to tighten administrative provisions and, more important, provide a uniform administrative framework into which additional selectively taxed items could be fitted if future Legislatures should desire to further expand the selective tax list. Among other things, this uniform administrative framework provided that these excises were to be sales and use taxes rather than merely taxes on the gross receipts from the proceeds of certain sales.

In its final form, the Miscellaneous Excise Taxes section did the following:

1. Increased the rate of the tax on radios and television sets from 2.2% to 3%.
2. Made phonographs and record-players taxable at the rate of 3%. (Under the old act a combination radio-phonograph was taxable but a plain phonograph was exempt.)
3. Made the component parts of radios, television sets and phonographs taxable at the rate of 3%.
4. Redefined cosmetics so as to make the state definition conform to the Federal definition of "toilet preparations." Rate unchanged.
5. Redefined playing cards so that definition would include pinochle as well as bridge and poker decks.
6. Added the following new selectively taxed sales:
  - (a) Air conditioners at 3%.
  - (b) Non-commercial boats and boat motors at 1.5%.
  - (c) Precious stones, precious metals and furs provided said stones, metals and furs have a value in excess of \$25.00. Tax rate of 3%.

So long as the selective sales taxes had included only three basic items (radios-TVs, cosmetics and playing cards) the Comptroller had reported collections from each separately. Faced with a greatly expanded list of selectively taxed items and with administration certain to be complicated by a provision for monthly, rather than quarterly returns, the Comptroller decided that the cost of separately accounting for each category would not be justified by the information derived. He therefore took advantage of the fact that all of these excises were levied as part of one administrative "package" and established accounting controls over the entire group rather than over each individual category. Comments on the revenue from individual items, therefore, are not precise in all instances.\*

The Legislature - in part misled by enthusiasts for some of the new excise taxes - expected the miscellaneous excise taxes to be highly productive. Ignoring the problem of collection lag in the first year, the legislative estimates placed the annual yield of the miscellaneous excise taxes at \$14.3 million annually or an increase of \$11.8 million over the previous yield.

The Comptroller revised these estimates substantially but still placed his estimate at \$9.3 million for the first year and at \$10.3 million for the second year when a full 12 months' collections would be available.

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\*The Comptroller was strongly advised to adopt this uniform accounting system by the Texas Research League staff which was then engaged in a study of his department. It has certainly justified itself in savings resulting from fewer and simpler tax returns, less handling and lower accounting costs. Had quarterly returns been required, it would have been a relatively simple matter to select an adequate sample from which the revenue from individual tax categories could be closely estimated. The use of monthly returns, however, resulted in the accumulation of more than 400,000 returns during the year. Detailed analysis of this many returns proved to be almost impossible, especially since the collecting tax division was never able to keep current with the necessary processing and filing.

Actually the excises produced \$7.1 million in 1959-60 and may be expected to produce around \$8.2 million in 1960-61.

Essentially what happened may be summarized as follows:

1. The tax on radio and TV component parts was "sold" to the Legislature by an interested group who hoped to see a restrictive license fee made part of the law. To promote this non-tax end, the group greatly exaggerated the revenue to be expected from this tax. Attempts to check on these estimates resulted in further confusion since reliable concerns attempting to aid in the estimate apparently misunderstood the nature of the intended tax and supplied data on "servicing charges" which included both parts (taxable) and labor (non-taxable).
2. To make certain that auxiliary duct-work was not taxable as part of an air conditioning installation, the Legislature inserted the phrase "self contained air conditioner" at several points. Subsequently the Attorney General (with good precedent) ruled that this limited the tax to room air conditioners and excluded central air conditioning installations.
3. The estimate for jewelry and furs was based on Federal excise tax collections in Texas. The State definitions, however, departed widely from the Federal definitions. In addition, the Texas tax does not apply to items having a value of less than \$25.00.
4. On the other hand, the new definition of cosmetics and the application of a use tax to this commodity resulted in substantially increasing the revenue in this instance. This was one excise which the Legislature did not think would produce more revenue and even the Comptroller greatly under-estimated the additional revenue that would be forthcoming.

The \$8.2 million which the miscellaneous excises are now expected to produce with a full twelve months of collections may be broken down as follows:

Radios-TV Sets	\$2,200,000
Phonographs	400,000
Component Parts	250,000
Cosmetics	1,570,000
Playing Cards	30,000
Air Conditioners, Boats, Precious Stones, Precious Metals and Furs	<u>3,750,000</u>
Total	\$8,200,000

The revenue data for the first five items is reasonably well-known or can be closely estimated; the breakdown between air conditioners, boats and the "jewelry and fur" taxes has proven much more difficult to obtain but all evidence is that the bulk of this revenue (probably \$2.5 to \$2.7 million) comes from the air conditioner tax.

While this \$8.2 million falls substantially short of the \$14.3 million estimated for the Legislature, it does represent a substantial increase over the yield of this type of excise prior to 1959. The original excise taxes produced only a little over \$2.5 million annually, consisting of \$1.6 million from the radio-TV tax and \$900,000 from the cosmetics tax.

The large - and surprising - increase in the cosmetics tax revenue was due partly to the new definition which caused the tax to apply to a larger number of items and which was especially productive because it meant that the tax would now apply to expensive luxury items such as perfumes. This redefinition probably accounted for at least \$200,000 a year in additional revenue. The second factor affecting this tax was its conversion from a gross receipts to a sales and use tax, thus making certain sales heretofore deemed to be in interstate commerce taxable under the use tax provision. This particularly affected some major distributors which sell cosmetics on a door-to-door basis. These companies promptly instructed their agents to collect the tax from their customers and remit it to the state. These collections total some \$400,000 a year.

#### THE TOBACCO PRODUCTS TAX

The new tax on tobacco products was levied as a logical extension of a selective tax system that includes a relatively heavy tax on cigarettes.



The tax on cigars is at the rate of one-tenth of one cent per cigar for so-called "little cigars" (i.e., those weighing less than 3 pounds per 1,000 and therefore comparable in size to cigarettes), three-quarters of a cent on larger cigars retailing for not more than 3.3 cents a piece and 1.5 cents per cigar for larger cigars retailing for more than 3.3 cents each. Smoking and chewing tobacco is taxed at 25% of the factory list price. The law imposes no tax on snuff.

Estimates made for the Legislature and based on a full twelve months' collections envisioned that this tax would raise \$7.5 million the first year, consisting of \$500,000 floor stock tax and \$7 million current collections. In consideration of the collection lag during the first year, the Comptroller lowered this estimate to \$6.9 million. Actually the tax produced only \$6.6 million with the difference being attributable entirely to the fact that the floor stock tax fell nearly \$300,000 below expectations. In recent months the tax has been running right around \$600,000 a month, thus indicating that the yield in 1960-61 will approximate \$7.2 million or slightly more than either the legislative or Comptroller estimates.

Federal tobacco tax collections indicate that this tax will probably not display any strong growth potential although the industry does appear to be on an upturn at this particular time. Since the Texas tax is closely modeled after that of Oklahoma, the experience of Oklahoma with this tax in recent years may be indicative of the pattern in Texas. Collections from the Oklahoma tobacco products tax for the past five years were:

<u>Fiscal Year Ending June 30</u>	<u>Gross Collections</u>
1955	\$1,155,000
1956	1,092,000
1957	1,048,000
1958	1,190,000
1959	1,323,000

It can be seen that the Oklahoma tax has only recently started to increase in yield and it may be reasoned that Texas entered this tax field at a propitious time.

#### THE SEVERANCE BENEFICIARY TAX

The severance beneficiary tax is a tax, at a rate of 1.5 per cent, of the value of natural gas, which is to be ultimately paid by the person who has a prior right under a written contract to take title to gas produced from particular lands, leases, or reservoirs. The tax is intended to fall upon the user or "the person who ultimately takes title to the gas in this State." This "last purchaser" characteristic creates most of the differences between the beneficiary tax and the usual production or severance tax, which is essentially on the producer and royalty owner.

Unprocessed natural gas is valued, for tax purposes, at the mouth of the well. The market value of residue gas is the value of the gas remaining after the extraction of liquid hydrocarbons at the facility at which the liquid hydrocarbons are extracted. (The value of liquid hydrocarbons extracted is not subject to this tax.) Administrative and compliance problems are compounded by the fact that the severance beneficiary - the

last purchaser or user within the State - in many instances is not one of the parties to the transaction at the point where the taxable value of the gas is established.

First collections of the severance beneficiary tax were due the last day of October 1959, on gas produced during September 1959. From the first month, the constitutionality of the tax was contested. In the first month, \$97,000 was paid without legal protest; \$585,000 was paid by taxpayers who then took action in the District Court to have the tax declared unconstitutional. During the fiscal year ending 1959-60, actual collections totaled \$8 million, of which more than \$7.8 million was paid under protest. On the basis of the experience of this first year, collections for the biennium ending August 31, 1961, are estimated at about \$18.5 million. The revenue estimate made by the State Comptroller at the time the severance beneficiary tax was enacted in 1959 was \$14.6 million.

In the Court action, the taxpayers raised many contentions concerning the constitutionality of the tax; primary among these is the question of whether this tax law violates the commerce clause of the United States Constitution. In answer, the State Attorney General has argued that the tax is essentially a severance tax that can be levied only by the state in which the gas is produced.

The District Court has held that this tax law is invalid as to gas purchased, received and transported in Texas by pipeline companies for interstate transmission in that it is contrary to the commerce clause (Sec. 8, Art. I) of the U. S. Constitution. This ruling is by District Judge Jack Roberts whose ruling that the prior gas gathering tax was unconstitutional was upheld by the U. S. Supreme Court. The State has appealed

and it seems certain that an appeal will be taken, in due course, to the U. S. Supreme Court.

HOTEL  
OCCUPANCY TAX

The imposition of a 3% tax on the cost of occupancy of any room or space in a hotel (broadly defined as any place offering sleeping accommodations to the public) provided that the cost of the accommodation exceeds \$2.00 per night. Permanent residents (i.e., those occupying the same premises for at least thirty consecutive days) are exempt. Accommodations provided by educational institutions (colleges) and charitable or religious institutions (YMCA, YWCA, YMHA, etc.) are exempt.

The original estimates indicated that this tax would produce around \$3.3 million annually. The Comptroller estimated \$2.6 million for the first year (allowing for collection lag) and \$3.1 million the second year. Actually the tax produced \$2.2 million in 1959-60. It appears, however, that the two months' revenue (July and August) which constituted the collection lag in the first year is among the most productive for this tax and collections in 1960-61 can reasonably be expected to approximate \$2.9 million or a little more.

It should be noted that the difficulties attendant upon the inauguration of any new tax were magnified in this instance because it proved very difficult for the Comptroller's Department to assemble a reasonably complete initial taxpayer list even though industry associations did what they could to be helpful. This, plus the fact that the law contains no penalties or other devices designed to facilitate voluntary compliance by the taxpayers, probably resulted in some taxable receipts going unreported in

the first part of the fiscal year.\* It is anticipated that much of this problem has, or soon will be, cleared up although the addition of penalty and interest provisions to the statute would probably aid in this respect.

THE UTILITY  
TAX INCREASE

The 1959 tax bill increased the rates of the State gross receipts tax on public utilities - i.e., privately owned electric, gas and water utilities - by approximately 20%. The legislative estimates envisioned that this tax would produce \$1.5 million annually whereas the Comptroller estimated \$1.7 million. The difference was based in part on the fact that the tax is payable in advance and there was thus an additional \$100,000 due on taxes paid in July of 1959. The remaining difference was traceable to the fact that the Comptroller had made an upward revision in his estimates of the yield of the utilities tax at the old rates after the legislative estimate was made. The tax increase produced the estimated \$1.7 million.

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\*The Comptroller is given auditing powers and failure to collect and remit the tax is a misdemeanor. Experience indicates, however, that civil penalties are far more effective in tax enforcement than criminal penalties alone. It is virtually impossible to secure a criminal conviction for failure to comply with a tax statute.

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