Property Tax Impact on Business Decisions
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Views expressed in this presentation are based on the experience of the presenter with multiple employers and industry positions. Comments herein are not the formal positions of a specific company or association.

Main Point: State and local taxes are a significant factor in business capital investment and operations decisions. Property taxes are a large portion of SALT.

Example of High School Trade Education after HB 5: Sweeny Petrochemical Academy

- Phillips 66 and Chevron Phillips contributed $1.6 million for the purchase of equipment, building renovations, and scholarships for juniors and seniors in nearby school districts. The building is owned by Phillips 66.
- Classes began Fall 2014 as dual credit courses in process technology, instrumentation, millwright, pipefitting and welding for a Technical Certification and opportunity for advancement to an Associate Degree.
- Instructors from Brazosport College, Phillips 66, and Chevron Phillips.
- Approximately 60 students enrolled each semester.
- Serves two school districts and candidates pool for Internship programs.
- Estimated annual wages of $75,000 with specialized Associate Degree.

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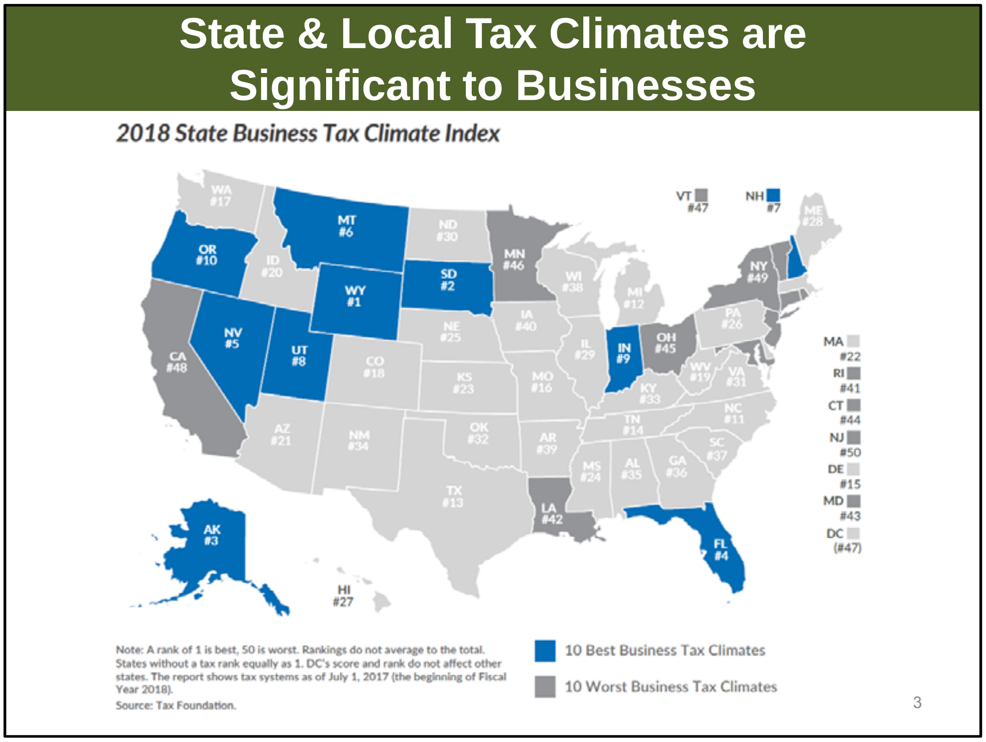
Introduction of Slide
Before I begin the tax portion of this presentation, I would like to share a good news example of high school trade education after House Bill 5, which was passed by the Texas Legislature in 2013.

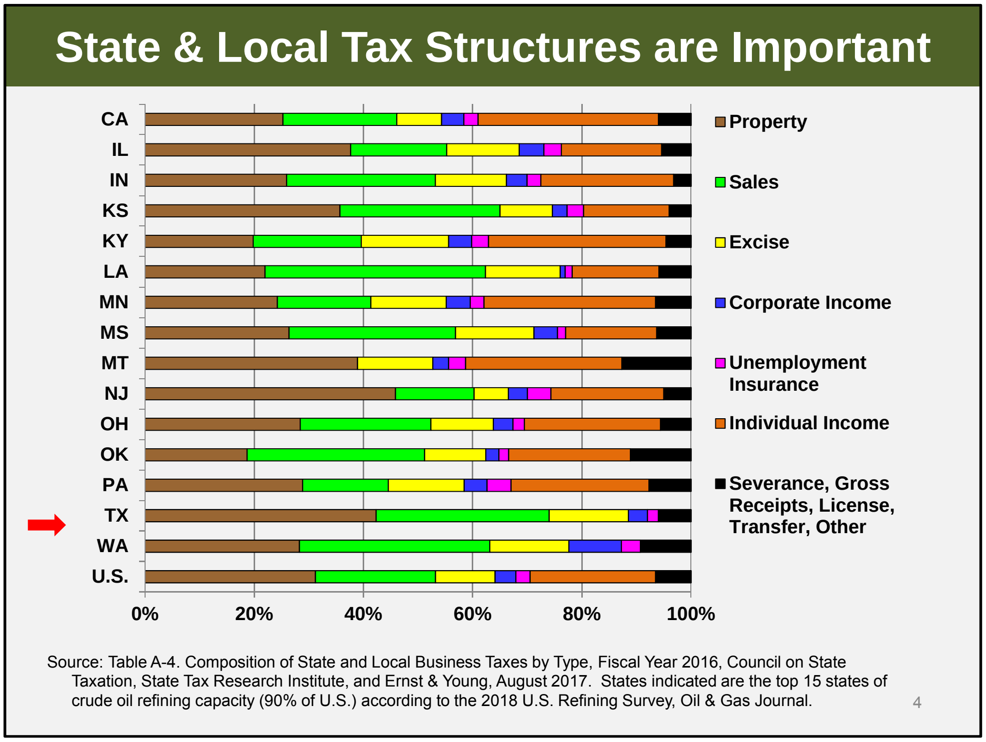
This academy is located between Sweeny and Old Ocean, Brazoria County, TX.



State and local taxes (SALT) are significant in business financial decisions and performance. The Tax Foundation's annual State Business Tax Climate Index rate five SALT categories: Individual Income Tax; Sales Tax; Corporate Income Tax; Property Tax; and Unemployment Insurance Tax. The Executive Summary says:

- "While there are many ways to show how much is collected in taxes by state governments, the Index is designed to show how well states structure their tax systems, and provides a roadmap for improvement."
- "The absence of a major tax is a common factor among many of the top 10 states. Property taxes and unemployment insurance taxes are levied in every state, but there are several states that do without one or more of the major taxes: the corporate income tax, the individual income tax, or the sales tax ... This does not mean, however, that a state cannot rank in the top ten while still levying all the major taxes. Indiana and Utah, for example, levy all of the major tax types, but do so with low rates on broad bases."
- "The states in the bottom 10 tend to have a number of afflictions in common: complex, nonneutral taxes with comparatively high rates."

The "2018 State Business Tax Climate Index" may be accessed at
https://taxfoundation.org/state-business-tax-climate-index-2018/



An entire state tax structure should be considered when comparing state and local taxes (SALT) in one state with other states. However, specific revisions could be made in each category to implement certain improvements. Property tax is often the highest revenue generating tax, which is my primary experience and the focus of this presentation.

The *Total State and Local Business Taxes – State-by-State Estimates for Fiscal Year 2016* report can be accessed at http://www.ey.com/Publication/vwLUAssets/ey-total-state-and-local-business-taxes-2016/$File/ey-total-state-and-local-business-taxes-2016.pdf

State & Local Tax Amounts are Important

($ billions, except SALT per Capita)

State	State Taxes	Local Taxes	Total SALT	SALT Paid by Business	Business Share of SALT	Business Share v. U.S.	Population	SALT per Capita	SALT per Capita v. U.S.
CA	$161.5	$82.7	$244.2	$94.9	38.9%	-11.4%	39,536,653	$6,180	22.1%
IL	$41.3	$33.8	$75.1	$33.9	45.2%	3.0%	12,802,023	$5,870	16.0%
IN	$18.3	$8.6	$26.9	$11.3	41.8%	-4.8%	6,666,818	$4,030	-20.4%
KS	$8.5	$5.8	$14.3	$6.6	46.6%	6.2%	2,913,123	$4,910	-3.0%
KY	$12.3	$5.2	$17.5	$7.8	44.6%	1.6%	4,454,189	$3,930	-22.3%
LA	$9.5	$8.5	$18.0	$8.7	48.0%	9.3%	4,684,333	$3,840	-24.1%
MN	$26.1	$8.1	$34.2	$13.3	38.9%	-11.4%	5,576,606	$6,130	21.1%
MS	$7.8	$3.0	$10.8	$5.6	51.5%	17.3%	2,984,100	$3,620	-28.5%
MT	$2.8	$1.4	$4.2	$2.0	48.4%	10.3%	1,050,493	$4,000	-20.9%
NJ	$34.3	$30.3	$64.6	$26.8	41.5%	-5.5%	9,005,644	$7,170	41.7%
OH	$29.8	$24.7	$54.5	$22.0	40.4%	-8.0%	11,658,609	$4,670	-7.7%
OK	$8.7	$4.7	$13.4	$6.6	48.9%	11.4%	3,930,864	$3,410	-32.6%
PA	$40.5	$29.4	$69.9	$29.6	42.4%	-3.4%	12,805,537	$5,460	7.9%
TX	$54.3	$57.1	$111.4	$68.5	61.5%	40.1%	28,304,596	$3,940	-22.1%
WA	$23.6	$14.4	$38.0	$21.9	57.6%	31.2%	7,405,743	$5,130	1.4%
U.S.	$973.3	$675.6	$1,648.9	$724.1	43.9%		325,719,178	$5,060	

Source: *Total State and Local Business Taxes State-by-State Estimates for Fiscal Year 2016*, Tables 4 (SALT $) and 5 (business share), Council on State Taxation, State Tax Research Institute, and Ernst & Young, August 2017. States indicated are the top 15 states of crude oil refining capacity (90% of U.S.) according to the 2018 U.S. Refining Survey, Oil & Gas Journal. Population (July 1, 2017) from www.census.gov.

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Percent paid by businesses and SALT per capita are common benchmarks. There may be legitimate reasons for some differences, but these may be useful in the mix of many other data points for lawmakers and other decision makers. A few observations:

- For most states on this slide and total U.S., the state tax is significantly more than the local tax.
- The business share of SALT in TX is significantly more than the U.S. (only AK, ND, and WY have a higher business share than TX).
- The SALT per Capita for TX is significantly less than the U.S.

The *Total State and Local Business Taxes – State-by-State Estimates for Fiscal Year 2016* report can be accessed at http://www.ey.com/Publication/vwLUAssets/ey-total-state-and-local-business-taxes-2016/$File/ey-total-state-and-local-business-taxes-2016.pdf

Property Tax Structures are Important

State	Assessment Ratios[1]	Inventories[1]	Oil & Gas Reserves	Personal (tangible)[1]	Pollution Control[4]
		Common Exemptions			
CA	100%	T	T	T	T
IL	33 1/3%	E	E	E	Very low value
IN	100%	E	E	T	E
KS	11.5%-30%	E	E	T	T
KY	100%	T	E	T	T
LA	10%,15%,25%	T	E	T	T
MN	.45%-2%	E	E	T	E
MS	10%,15%,30%	T	E	T	T
MT	1.35%-12%	E	E	T	E
NJ	varies by county	E	E	E	E
OH	35%	E	E	E	E
OK	10%-15%	T	E	T	T
PA	Varies	E	E	E	T
TX	100%	T	T	T	E
WA	100%	E	E	T	E
All States					
Taxable		**8[2]**	**3[3]**	**38[2]**	**23[4]**
Exempt		**42**	**47**	**12**	**27**

1 *CCH State Tax Reports* and explanations from state agencies
2 Table 6, *State and Provincial Property Tax Policies and Administrative Practices : 2012 Update of 2009 Compilation and Report*, International Association of Assessing Officers, 2013
3 *CCH State Tax Reporters* and industry knowledge (also taxable in Utah)
4 *CCH State Tax Smart Charts* and specific law
States indicated are the top 15 states of crude oil refining capacity (90% of U.S.) according to the 2018 U.S. Refining Survey, Oil & Gas Journal.

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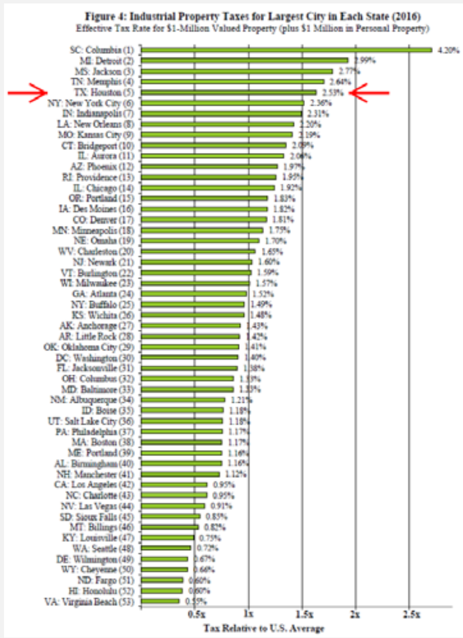
The point of this slide is not to be a definitive reference but provide a sample of some of the major categories in property tax structures.

- Assessment ratios are multiplied against taxable values to calculate assessed values. As tax rates apply to all taxpayers, this means that in Louisiana, for example, taxpayers with a 15% ratio pay 1.5 times the proportional tax as 10% category taxpayers and those in 25% pay 2.5 times. States with different ratios generally provide a lower ratio for residential and higher ratio(s) for business, some with the highest for public service property (e.g., interstate pipelines and electric utilities). States with the same ratio for all taxpayers are generally considered more tax friendly to business.
- Statutory exemptions are part of every tax structure. E.g., most states realize a tax on inventory is not good for business at any level … but exempting it is a big fiscal note if it's currently taxable. Only three states (CA, TX, and UT) have a property tax on minerals in place as most states have a higher severance tax or other tax in lieu of a property tax. States that exempt pollution control generally realize the federal or state government required the business to make the additions, so lawmakers chose not to add tax on top of an unfunded mandate.
- Most states also allow discretionary tax abatements for a temporary period, generally a tool for local government to enhance economic development.

Abbreviations: E = exempt, LE = limited exemption, LO = local option, and T = taxable.

Effective Tax Rates are Important



Source: 50-State Property Tax Comparison Study for Taxes Paid in 2016, Lincoln Institute of Land Policy and Minnesota Center for Fiscal Excellence, June 2017

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This chart is shown only as an example of the range of effective property tax rates in different states, another significant factor in budgeting or economic models for major projects. "Effective Tax Rate" in this context is the assessment ratio for industrial property x the actual tax rate, also calculated as tax rate / taxable value. Differences in ETR may be significant for existing properties or potential sites for capital investment.

The 50-State Property Taxes Comparison Study for Taxes Paid in 2016 report can be accessed at https://www.lincolninst.edu/sites/default/files/pubfiles/50-state-property-tax-comparison-for-2016-full.pdf

Other Property Tax Concerns

- Stability and transparency of tax structure
- Compliance burden
- Valuations
- Appeal process (uniform, efficient, timely)
- Local government budgets (relates to tax rates)

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Businesses often have specific property tax concerns in specific states, but these are common concerns.

- Stability and transparency help businesses to plan long-term economics. External events are inevitable (e.g., oil prices), but a stable, pro-business tax structure helps to minimize that risk and provide a positive business climate.
- Compliance burdens impact business and government. Most companies support reasonable accountability, but it should be balanced with reasonably simple compliance requirements and burden of time, systems, etc.
- Valuations are always a concern, but often a bigger concern in low economic cycles with lower market values (when property tax may be a larger percentage of net income).
- Some states have appeal processes that are generally resolved in the same year (e.g., Texas) while other states put an appeal “in the queue” and hearing scheduled years later (e.g., California). Delayed hearings increase the uncertainty of a reasonable outcome … and a bigger challenge for uniformity.
- Local government budgets (and related property tax rates) may positively or negatively impact project or operational economics by relatively low, typical, or high property taxes. In general, relatively low taxes (with minimal but reasonable regulations) are good for a vibrant business climate.

In general, Texas has a relatively high property tax burden but the property tax “process” is probably the best in the U.S.

Typical Property Tax Model for New Project

Estimated Property Taxes

Project Express

IF Built at Site #2, County, State

Amounts in Millions

Tax Year	Year	Appraised Value: Real	Appraised Value: Personal	Appraised Value: TOTAL	Tax Rate	Tax Without Abatement	Estimated Tax Exemptions and Abatements: Pollution Control	Estimated Tax Exemptions and Abatements: Non-School	Estimated Tax Exemptions and Abatements: School	Estimated Tax Exemptions and Abatements: PILOTs	Estimated Tax Exemptions and Abatements: Net Total	Estimated Tax
2020	0	178.5	31.5	210.0	2.105	4.42	0.22	1.80	1.70	-0.16	3.56	0.86
2021	1	306.0	71.3	377.3	2.111	7.96	0.40	3.24	3.28	-0.16	6.76	1.20
2022	2	293.3	50.6	343.9	2.116	7.28	0.36	2.96	2.97	-0.16	6.13	1.14
2023	3	280.5	47.8	328.3	2.121	6.96	0.35	2.84	2.82	-0.16	5.84	1.12
2024	4	267.8	45.0	312.8	2.126	6.65	0.33	2.71	2.67	-0.16	5.55	1.10
2025	5	255.0	42.2	297.2	2.132	6.34	0.32	2.58	2.52	-0.16	5.26	1.08
2026	6	242.3	39.4	281.6	2.137	6.02	0.30	2.45	2.38	-0.16	4.97	1.05
2027	7	229.5	36.6	266.1	2.142	5.70	0.29	2.32	2.23	-0.16	4.67	1.03
2028	8	216.8	33.8	250.5	2.148	5.38	0.27	2.19	2.08	-0.16	4.38	1.00
2029	9	204.0	30.9	234.9	2.153	5.06	0.25	2.06	1.93	-0.16	4.08	0.97
2030	10	191.3	28.1	219.4	2.158	4.74	0.24	0.00	0.00	0.00	0.24	4.50
↓												
2045	25	85.0	46.5	131.5	2.241	2.95	0.15	0.00	0.00	0.00	0.15	2.80
Total Estimated Property Taxes with CWIP						**116.24**	**5.81**	**25.15**	**24.57**	**-1.60**	**53.93**	**62.30**
Net Present Value After Tax Cost of Debt						**82.33**	**4.12**	**21.56**	**21.10**	**-1.36**	**45.42**	**36.91**
Average Annual Tax after Completion						**4.33**	**0.22**	**0.84**	**0.82**	**-0.05**	**1.82**	**2.51**

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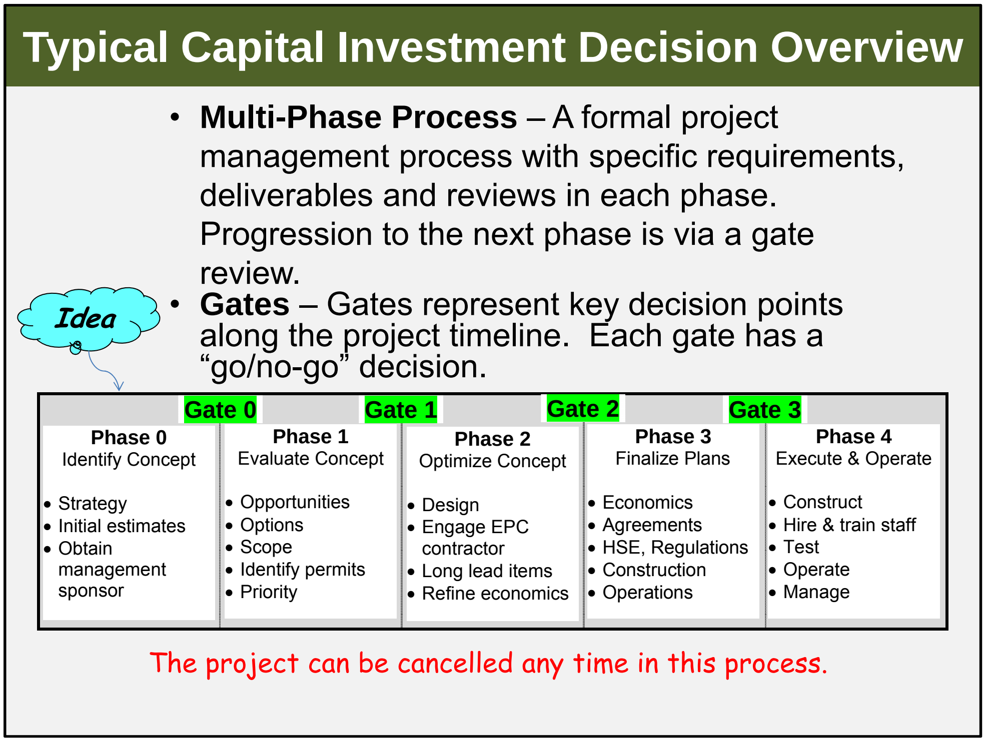
This model is a practical example of how property tax structures impact business projects.

All information input into this model is arbitrary for demonstration purposes only.

- In reality, cost, income and market factors may change the appraised value of a specific property from year-to-year. However, the concept in this model is typical for project planning.
- A similar 25-year model is prepared for every site option for a major project, including estimated appraised values, tax rates, pollution control exemption, tax abatements, and payments-in-lieu-of-taxes related to tax abatements.
- Tax abatements are often important, but only to temporarily reduce the tax to improve the net present value of project economics in the early years of the project. ***The estimated tax is the primary focus for comparison with competing site options*** (along with other economic projections). I.e., the site with the lowest estimated tax is the most tax competitive, not necessarily the site with the highest tax exemption or abatement.

Abbreviations: PILOTs = Payment-in-lieu-of-Taxes. CWIP = Construction Work-in-Progress.



Most companies have a capital investment approval process with specific requirements in each phase before it is allowed to proceed through each "gate", which are management "go/no-go" decisions.

Many factors influence capital investment decisions, including:

- Limited discretionary capital AFTER significant capital dedicated to government mandates (e.g., environmental) and "stay in business" needs (e.g., replacements).
- Projected business climate (often a long lead time from early evaluation to beginning of operation).
- Intense competition within a company is typical between unrelated business segments (e.g., oil/gas production, refineries, pipelines) or a decision to hold cash for future opportunities, buy back stock, etc.
- Site selection for discretionary capital includes prioritizing business needs and potential opportunities but is determined by the best expected economic returns, including risk, compared to other investment alternatives. Property taxes are significant in the economic evaluation.

It's not unusual for this process to stop (cancel) or pause (restart later) if a major event occurs (e.g., stock market falls) or management is not willing to accept the financial risk at the time

Abbreviations: EPC = Engineering, Procurement, and Construction. HSE = Health, Safety, and Environmental.

Suggested Rules for Lawmakers

1. "Taxes matter to business. Business taxes affect business decisions, job creation and retention, plant location, competitiveness, the transparency of the tax system, and the long-term health of a state's economy. Most importantly, taxes diminish profits. If ***taxes*** take a larger portion of profits, that ***cost is passed along to either consumers (through higher prices), employees (through lower wages or fewer jobs), or shareholders (through lower dividends or share value), or some combination of the above***. Thus, <u>a state with lower tax costs will be more attractive to business investment and more likely to experience economic growth</u>.

Source: 2018 State Business Tax Climate Index, Tax Foundation, Washington, DC 11

I'll end my presentation with two suggested rules for lawmakers regarding State and Local tax policy. These are from the Tax Foundation.

- I've often heard policy makers or the general public say taxes are a pass through, the implication is only to customers. Notice rule 1 says taxes are passed along in one of three ways - consumers, employees, or shareholders - or some combination of the three.
  Taxes matter to business … and lower tax costs are more attractive to business investment.
- Changes in tax law either helps or hurts the state's competitive position relative to other states and countries.

The "2018 State Business Tax Climate Index" may be accessed at https://taxfoundation.org/state-business-tax-climate-index-2018/