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**RQ-932**

February 10, 1997

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Opinion Committee

Honorable Dan Morales  
Attorney General of Texas  
Supreme Court Building  
P.O. Box 12548  
Austin, Texas 78711-2548

FILE # ML-39401-97  
I.D. # 39401

RE: Attorney General Opinion Request Regarding Whether The Freeport Exemption Provided By Section 11.251, Texas Tax Code and Article VIII, Section 1-j, Texas Constitution Applies to Exempt Property Which is not Transported Out of State by the Owner, but is Sold to an In-State Owner Who Utilizes it in Manufacturing Products Which are Shipped Out of State.

Dear General Morales:

I respectfully request your legal opinion on the following question with respect to the proper application of Section 11.251, Texas Tax Code and Article VIII, Texas Constitution:

Is a property owner allowed an exemption pursuant to the provisions of Article VIII, Section 1-j, Texas Constitution for property of the type that otherwise meets the requirements of that provision, if the property is not sold or transported out of the state by them, but is instead sold to an in-state purchaser who uses the property in manufacturing other items which are then transported out of state?

#### FACTUAL PROVISIONS

This opinion request arises in the context of a particular fact situation in Smith County. However, the question raised has state wide implications. The present situation involves Alliance Compressors, a company that manufactures air conditioning compressors. The property in question consists of the compressors and related parts and raw materials. Alliance assembles compressors which are sold to Trane Air Conditioning Company, which

in turn assembles the compressors into air conditioning units, many of which are transported to out of state buyers. It is my understanding that ownership of Alliance is by a 50/50 partnership between Trane and Lenox Air Conditioning Company.

## **LEGAL PROVISIONS**

Article VIII, Section 1-j of the Texas Constitution authorizes the freeport exemption for the purpose "(a) to promote economic development in the State, goods, wares, merchandise, other tangible personal property, and ores . . . are exempt from ad valorem taxation if: (1) the property is acquired in or imported into this State to be forwarded outside this State, whether or not the intention to forward or the destination to which the property is forwarded is specified when the property is acquired in or imported into this State: (2) the property is detained in this State for assembling, storing, manufacturing, processing, or fabricating purposes by the person who acquired or imported the property; and (3) the property is transported outside of this State not later than 175 days after the date the person acquired or imported the property in this State."

Implementing legislation is found in Section 11.251 of the Property Tax Code, which provides as follows:

### **Sec. 11.251. Tangible Personal Property Exempt.**

- (a) In this section, "freeport goods" means property that under Article VIII, Section 1-j, of the Texas Constitution is not taxable.
- (b) A person is entitled to an exemption from taxation of the appraised value of that portion of the person's inventory or property consisting of freeport goods.
- (c) The exemption provided by Subsection (b) is subtracted from the market value of the inventory or property determined under Section 23.12 to determine the taxable value of the inventory or property.
- (d) Except as provided by Subsections (f) and (g), the chief appraiser shall determine the appraised value of freeport goods under this subsection. The chief appraiser shall determine the percentage of the market value of inventory or property owned by the property owner in the preceding calendar year that was contributed by freeport goods. The chief appraiser shall apply that percentage to the market value of the property owner's inventory or property for the current year to determine the appraised value of freeport goods for the current year.
- (e) In determining the market value of freeport goods that in the preceding year were assembled, manufactured, repaired, maintained,

processed, or fabricated in this state or used by the person who acquired or imported the property in the repair or maintenance of aircraft operated by a certificated air carrier, the chief appraiser shall exclude the cost of equipment, machinery, or materials that entered into and became component parts of the freeport goods but were not themselves freeport goods or that were not transported outside the state before the expiration of 175 days after they were brought into this state by the property owner or acquired by the property owner in this state. For component parts held in bulk, the chief appraiser may use the average length of time a component part was held in this state by the property owner during the preceding year in determining whether the component parts were transported out of this state before the expiration of 175 days.

(f) If the property owner was not engaged in transporting freeport goods out of this state for the entire preceding year, the chief appraiser shall calculate the percentage of cost described in Subsection (d) for the portion of the year in which the property owner was engaged in transporting freeport goods out of this state.

(g) If the property owner or the chief appraiser demonstrates that the method provided by Subsection (d) significantly understates or overstates the market value of the property qualified for an exemption under Subsection (b) in the current year, the chief appraiser shall determine the market value of the freeport goods to be exempt by determining, according to the property owner's records and any other available information, the market value of those freeport goods owned by the property owner on January 1 of the current year, excluding the cost of equipment, machinery, or materials that entered into and became component parts of the freeport goods but were not themselves freeport goods or that were not transported outside the state before the expiration of 175 days after they were brought into this state by the property owner or acquired by the property owner in this state.

(h) The chief appraiser by written notice delivered to a property owner who claims an exemption under this section may require the property owner to provide copies of inventory or property records in order to determine the amount and value of freeport goods. If the property owner fails to deliver the information requested in the notice before the 31st day after the date the notice is delivered to the property owner, the property owner forfeits the right to claim or receive the exemption for that year.

(i) The exemption provided by Subsection (b) does not apply to a taxing unit that takes action to tax the property under Article VIII, Section 1-j, Subsection (b), of the Texas Constitution.

(j) Petroleum products as set forth in Article VIII, Section 1-j, of the

Texas Constitution shall mean liquid and gaseous materials that are the immediate derivatives of the refining of oil or natural gas.

(k) Property that meets the requirements of Article VIII, Sections 1-j(a)(1) and (2), of the Texas Constitution and that is transported outside of this state not later than 175 days after the date the person who owns it on January 1 acquired it or imported it into this state is freeport goods regardless of whether the person who owns it on January 1 is the person who transports it outside of this state.

Section 11.251 has been amended twice, once by House Bill 1859 in 1991, and once by Senate Bill 1487 in 1993. Copies of both bills are attached as Exhibits "A" and "B", respectively. Both bills included revisions which are relevant to the determination of the issue involved here by virtue of their reference to ownership of the freeport goods by the person exporting those goods. Specifically, House Bill 1859 deleted the original statutory requirement that the property must have been owned continuously by the same person from the time it was acquired until the time it was transported out of the state. See 1991 Tex. Laws, p. 1770, Ch. 504, Sec. 1. Subsequently, Senate Bill 1487 added subsection (k) to Section 11.251, which provides that:

(k) Property that meets the requirements of Article VIII, Sections 1-j(a)(1) and (2), of the Texas Constitution and that is transported outside of this state not later than 175 days after the date the person who owns it on January 1 acquired it or imported it into this state is freeport goods regardless of whether the person who owns it on January 1 is the person who transports it outside of this state.

1993 Tex. Laws, p. 3053, Ch. 779, Sec. 1.

## LEGAL ISSUES

The purpose of this request is to obtain an opinion regarding whether the amendments cited above allow an exemption for property which is not transported out of state by the person seeking the exemption, but is instead sold to an in-state purchaser who in turn uses the property in manufacturing products, (some of) which are then transported out of state. Stated another way, does the exemption apply to goods which are sold in-state to purchasers who then utilize those products in their own manufacturing processes taking place wholly within the State, if the ultimate destination of the purchaser's products is outside Texas?

In light of the economic and administrative implications, the constitutional and statutory language is not entirely helpful in deciding this question. As mentioned above, recent amendments to the statute have deleted the requirement that the property be owned

continuously by the same person from the time it is acquired until the time it is transported. However, neither the language nor the legislative histories of those amendments address the precise question involved here. Furthermore, there is no established administrative construction of this particular issue by the agency with the authority to do so, the Comptroller of Public Account's Property Tax Division.

Obviously, resolution of this issue carries tremendous fiscal implications for local taxing jurisdictions. In light of the above considerations, I would appreciate your guidance in determining the proper interpretation of the legal provisions which allow the freeport exemption, Article, VIII, §1-j, and §11.251 of the Texas Property Tax Code. Thank you in advance for your consideration of this issue.

Very Truly Yours,

A handwritten signature in cursive script, appearing to read "Bill Ratliff". The signature is written in dark ink and is positioned above the printed name and title.

Bill Ratliff  
State Senator