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TEXAS NATURAL RESOURCE CONSERVATION COMMISSION

Protecting Texas by Reducing and Preventing Pollution

December 22, 2000

CERTIFIED MAIL Z577557088

The Honorable John Cornyn
Attorney General
State of Texas
P. O. Box 12548
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OPINION

RQ-0330-JC

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I.D. # 41809

Dear General Cornyn:

This is to request an opinion on the question of how certain types of production equipment should be treated under §1-1 of Article 8 of the Texas Constitution and §11.31 of the Texas Tax Code. Section 1-1 of Article 8 was filed as House Joint Resolution 86 in the Regular Session of the 74th Legislature. It was presented to the voters as Proposition 2 on the November 2, 1993 ballot. The enabling legislation was filed as House Bill 1920 and adopted in the same Regular Session. House Bill 1920 amended the Texas Tax Code and created a new §11.31, Pollution Control Property.

Section 1-1 of Article 8 of the Texas Constitution provides that the legislature may exempt from ad valorem taxation

...all or part of real and personal property used, constructed, acquired, or installed wholly or partly to meet or exceed rules or regulations adopted by any environmental protection agency of the United States, this state, or a political subdivision of this state for the prevention, monitoring, control, or reduction of air, water, or land pollution...

Section 11.31 provides for an exemption from property tax for real and personal property that is used in whole or in part for the control of air, land or water pollution. Subsections (a) and (b) of §11.31 describe the property that the Legislature exempts. Those subsections read as follows:

§ 11.31. Pollution Control Property

(a) A person is entitled to an exemption from taxation of all or part of real and personal property that the person owns and that is used wholly or partly as a facility, device, or method for the control of air, water, or land pollution. A person is not entitled to an exemption from taxation under this section solely on the basis that the person manufactures or produces a product or provides a service that prevents,

monitors, controls, or reduces air, water, or land pollution.¹ Property used for residential purposes, or for recreational, park, or scenic uses as defined by Section 23.81, is ineligible for an exemption under this section.

(b) In this section, "facility, device, or method for the control of air, water, or land pollution" means land that is acquired after January 1, 1994, or any structure, building, installation, excavation, machinery, equipment, or device, and any attachment or addition to or reconstruction, replacement, or improvement of that property, that is used, constructed, acquired, or installed wholly or partly to meet or exceed rules or regulations adopted by any environmental protection agency of the United States, this state, or a political subdivision of this state for the prevention, monitoring, control, or reduction of air, water, or land pollution. This section does not apply to a motor vehicle.

In order to obtain input on developing implementation issues, the executive director recently convened a work group composed of taxing authorities, potential applicants and public and environmental interest groups. In the course of the workgroup, a question arose as to how the statute should be interpreted with respect to certain types of equipment. The commission therefore is seeking this opinion.

Question: Is equipment, of a type new to a location, that is used to make a product and by its design limits pollution, or add-on control equipment installed on new equipment, within the category of property used for pollution control under §11.31 of the Texas Tax Code?

By "new to a location," we mean equipment for a process or product that has never been produced at that location; that is, a new facility. For purposes of this question, please assume that a facility can demonstrate by an acceptable method the percentage or portion of the property that is attributable to limiting pollution. Please also assume that by limiting pollution, production equipment can meet or exceed a state or federal environmental requirement.

In considering this question, it may be helpful to consider several examples illustrating the issues involved in this question.

¹ Section 11.31(a) narrows the application of the Constitutional provision by excluding pollution control property if the sole basis of the exemption is the fact that the property owner manufactures or produces a pollution-control product or provides pollution-control services. This exclusion has been previously interpreted by the Attorney General to exclude property that is used for pollution control on a commercial basis. Tex. Att'y Gen. LA-128 (1996).

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Example 1: In order to construct additional electric generating capacity, a proposed boiler is required to meet a limit (Best Achievable Control Technology) on the amount of oxides of nitrogen (NO_x) it could emit. The facility could meet the limit by adding control technology such as a scrubber to the end of the process (so-called add-on controls). On the other hand, the facility also could meet the limit by purchasing boilers that are designed to assure more complete combustion, thereby reducing NO_x emissions. For purposes of this hypothetical, please assume that both technologies will yield identical emissions reductions.

Example 2: The owner of a new boiler elects to construct the facility so that it will emit less NO_x than is required to meet best achievable control technology or the requirements of 30 TAC Chapter 117 . Again, the emissions level could be achieved by adding controls to the end of the process. Alternatively, the same emissions level could be reached by a unit that is designed to achieve more complete combustion.

We have been able to identify three plausible responses to the question posed by this letter. First, one could conclude that neither add-on controls nor productive equipment that serves to limit pollution can be deemed pollution control equipment if they are installed on or are new equipment under §11.31. Second, one could conclude that add-on controls installed on new equipment can qualify as pollution control equipment under §11.31, but new production equipment that by its design limits pollution cannot. Finally, one could determine that both add-on controls installed on new equipment and new productive equipment that in part serves to limit pollution at a new location may be deemed pollution control property under §11.31. An analysis of the merits and limitations of each of these outcomes is discussed in detail below.

1. Neither add-on controls nor productive equipment that serves to limit pollution can be deemed pollution control equipment if they are installed on, or are new equipment under, §11.31.

This interpretation relies on a reading of §11.31 which argues that pollution cannot be prevented, monitored, controlled or reduced where no pollution existed in the past. Under this interpretation, new add-on controls at existing production equipment would be eligible for an exemption since they would serve to prevent or reduce pollution. New add-on controls at new production equipment, however, would not be eligible. Likewise, new production equipment that emitted less pollution than similar existing equipment would not be eligible for an exemption.

This construction of the statute would be the most conservative available. The interpretation would treat new production equipment and add-on controls (i.e., 100% pollution control equipment) equally. This interpretation is consistent with the contention that any new equipment used for pollution control at a new plant would not be within the intent of the statute.

However, this interpretation would be a departure from current program practice and would treat similar equipment in a dissimilar manner. Equipment that is used wholly to limit pollution, i.e., some types of add-on controls, would be treated differently depending on whether it was added onto new or existing equipment. Likewise, production equipment that is designed to limit pollution would be treated differently depending on whether it was new or replacement equipment. There is no clear statutory basis for either distinction, and in fact, the use of language such as "installation," "excavation," "equipment," "reconstruction," "replacement," "improvement" "used," "constructed," "acquired," and "installed" in §11.31(b) seems to make no such distinction between replaced and newly constructed equipment. Finally, this interpretation would seem to contradict the contention that all property used to prevent, monitor, reduce or control pollution be covered under §11.31 and §1-1.

2. Add-on controls installed on new equipment can qualify as pollution control equipment under §11.31, but new production equipment that by its design limits pollution, cannot.

Under this construction, add-on controls under §11.31 prevent or reduce the pollution from new equipment. However, new production equipment that in part limits pollution would not prevent or reduce pollution under §11.31. This distinction rests on the idea that new production equipment that in part limits pollution is the source of the pollution and therefore cannot reduce, prevent, monitor, or control the pollution. For new production equipment, then, pollution cannot be prevented, monitored, controlled or reduced where no pollution existed in the past. This interpretation distinguishes between methods of control based on their physical relation to production equipment. In other words, add-on controls would be eligible for an exemption, but new production equipment that by its design internally controls pollution would not be eligible for an exemption. Likewise, new production equipment that emits less pollution than similar existing equipment would not be eligible for an exemption.

This interpretation of the statute would not be as conservative as that described above, but would be more conservative than the option described below. In addition, this approach generally follows the past practices of the commission in that the interpretation would treat equipment that is used entirely to control pollution in a similar manner, regardless of whether it is used at an existing or new location. With respect to equipment that is wholly used for pollution control, this construction also would be consistent with the view that all property used to prevent, monitor, reduce or control pollution be covered under §11.31 and §1-1. For equipment that is used in part to limit pollution, this interpretation would be consistent with the view that property limiting or monitoring pollution that is installed at a new location is not within the intent of the statute.

However, the interpretation could be argued to use different definitions of prevent, reduce, control and monitor based on whether equipment is used in whole or in part to limit pollution. Viewed in this light, the construction would treat the two types of property differently, that is, add-on controls

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versus production equipment. In turn, this distinction could be viewed as failing to give full meaning to all of the terms of the statute. Under this interpretation, equipment that is not wholly used to limit pollution also would be treated differently depending upon whether it replaced existing property or was used for the first time in that location. There again is no clear statutory basis for such a distinction. This interpretation seems to contradict in part the contention that all property used to control, monitor, reduce or prevent pollution be covered under §11.31 and §1-1.

3. Both add-on controls installed on new equipment and new productive equipment that in part serves to limit pollution at a new location may be deemed pollution control property under §11.31.

This interpretation would treat equipment in the same manner, regardless of whether the equipment is used in whole or in part to limit pollution. The interpretation also would be consistent with the contention that all property used to control, monitor, reduce or prevent pollution be considered pollution control property under §11.31.

However, this interpretation would be inconsistent with the view that pollution control equipment at a new location would not be within the intent of the statute. This approach is a departure from the past practices of the commission. Finally, this construction is the least conservative approach available and could potentially reduce revenues in some jurisdictions.

Thank you for your consideration of this very complex and significant issue. We are including several attachments that have been reviewed by commission staff concerning the history of the constitutional amendment and of House Bill 1290. Also attached is a brief description of the commission's program that implements §11.31. We have also attached a list of persons who have attended the recent stakeholder meetings. These persons may be interested in submitting briefs or additional information to you concerning the requested opinion. If we can provide you with any additional information to assist you in your consideration of this question, please do not hesitate to call me at 239-5505, Mr. David Duncan in our Environmental Law Division at 239-3465, or Ms. Susan Owen in our Environmental Law Division at 239-0576.

Sincerely,



Robert J. Huston, Chairman

Texas Natural Resource Conservation Commission

Attachments

Implementation of Proposition 2 Program

The program implementing the exemption is divided under Section 11.31 between two groups of entities. The executive director of the Texas Natural Resource Conservation Commission (TNRCC) is responsible for determining whether equipment is used for pollution control, and, if used in part, to determine what proportion of the equipment is pollution control property. Second, local appraisal officials must determine the value of pollution control property.

The executive director has implemented his responsibilities by dividing potentially exempt equipment into three tiers. Tier I equipment is that equipment that is on the executive director's Predetermined Equipment List (PEL). The PEL describes property such as scrubbers or low-NOx burners that is sufficiently standardized to allow a determination to be made in advance of the percentage used for pollution control. Property on this list may be used in whole or in part for pollution control. Tier II property is non-standardized property that is used entirely for pollution control. Tier III property is non-standardized property that may be used in part for pollution control. Thus, property in Tiers II and III requires individual review to determine whether it is used for pollution control, and in Tier III, the percentage of property so used.

Recently, the executive director has seen a rise in applications requesting determinations of equipment that is used in making a facility's product, but also operates, in part, for pollution control. The executive director expects that with the application of new standards under the State Implementation Plan (SIP) for ozone that may require emission reductions of up to 90%, replacement of equipment will increasingly be used in order to meet standards. At the same time, new, stringent standards for Total Maximum Daily Load plans will mean that new plants may be meeting their environmental requirements through better designed production equipment.

The exemption program went into effect in the 1994 tax season, and has been in operation for seven tax seasons. The executive director has reviewed 4,827 applications, of which 221 were Tier II applications and 159 Tier III applications. As described above, the executive director is not responsible for valuing the property exempted. However, estimates provided to the executive director indicate that the value of the property exempted to date is approximately 7.7 billion dollars.

As the number of applications have increased, the executive director decided to review the manner in which these determinations have been made. In order to receive sufficient input, the executive director convened a work group composed of taxing authorities, potential applicants and public and environmental interest groups. The group provided input on several issues, including the treatment of productive equipment that is replaced in order to meet an environmental requirement and the future replacement of that replacement equipment.

The commission took into account some of the work group recommendations. The commission considered the issues surrounding replacement of production equipment for environmental reasons, and concluded that such productive equipment can be treated, in part, as pollution control property under Section 11.31. The commission also concluded that the equipment replacing such equipment should also be eligible for a determination.