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Texas: Property tax exemption opportunities, pollution control property (Texas Supreme Court decision)

The Texas Supreme Court issued a decision that limits when the executive director of the state's Commission on Environmental Quality can issue a "negative-use determination" for certain types of pollution control property. These determinations affect whether the assets may be exempt from property tax.

The case is: *Brazos Electric Power Cooperative, Inc. v. Texas Commission on Environmental Quality*, No. 17-1003 (May 3, 2019). Read the state high court's [decision](#) [PDF 154 KB]

Background

Under Texas law, property used wholly or partly to prevent, monitor, control or reduce pollution is considered "pollution control property" that is at least partly exempt from ad valorem (property) tax for the life of the asset. To obtain the exemption, the property owner must apply to the executive director of the Texas Commission on Environmental Quality. If the property is partly productive and partly for pollution control, the application must include data "as the executive director requires by rule" to determine what proportion of the property is used for pollution control. Once the application is received the executive director, assuming the property is used wholly or partly for pollution control, issues a "positive-use determination" and informs the local appraiser of the outcome.

The properties at issue were heat-recovery steam generators (HRSGs) used by the taxpayer in the production of electricity. An HRSG is used in pollution control and also to increase production. As such, to determine what percentage of an HRSG is installed purely for pollution control purposes, a costs-analysis procedure (CAP) calculation is required—one that seeks to balance the pollution control and commercial benefits aspects of the property.

In this case, the electric cooperative submitted its applications using a CAP formula that, if accepted, would have resulted in a positive-use determination. The executive director, however, issued negative-use determinations for the HRSGs, which meant they were considered to be 100% non-pollution control equipment.

In the meantime, while the electric cooperative was appealing the negative-use determinations, a Texas appellate court (Third Court of Appeals) issued its decision in another ad valorem tax case involving HRSGs. That appeals court held that HRSGs cannot be determined to be 100% non-pollution control property because under Texas law, they are statutorily defined as property that is at least “partly” pollution control property. Despite that decision, the electric cooperative in this case lost its appeal before another Texas appellate court (Eighth Court of Appeals).

Confronted with contradictory decisions from the Texas appellate courts, the Texas Supreme Court subsequently granted review.

Texas Supreme Court’s decision

The first issue—and ultimately the only issue addressed by the state’s high court—was whether Texas law required a positive-use determination for HRSGs.

As explained in the decision, the executive director historically had broad discretion to make these determinations. However, in 2007, the law was amended to add new subsections to Texas Tax Code Section 11.31 that collectively curbed the executive director’s discretion. One of the amendments was the addition of new *subsection k* that included a list of “per se” pollution control property. This list (known as the “k-list”) includes HRSGs.

The state’s high court concluded that because the Texas legislature had affirmatively designated HRSGs as pollution control property and had directed the commission to “determine that” an HRSG is at least partly pollution control property, there was an abuse of discretion by the executive director by issuing the negative-use determination for the electric cooperative’s HRSGs. Although the commission had authority to remove property from the k-list, it had not done so, and as long as HRSGs were on the list, the executive director could not issue a negative-use determination for otherwise compliant HRSG applications.

KPMG observation

HRSGs can be multi-million dollar assets that are used in various industries, including oil and gas production, manufacturing, and chemical plants. This case may present opportunities for owners of HRSGs, as well as other types of per se pollution control equipment, if they have received negative-use determinations from the executive director.

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