TTARA

Texas Taxpayers and Research Association

January 2013

Fill in the blank:

Texas Is a ____ Tax State

Now that's easy. We all know the answer. Politicians have been drumming it into our heads for years. Per capita Texas taxes are fairly light, and while it may not always seem like it, especially when property taxes come due, the answer is "low," right?

Not so fast.

Taxpayers come in all shapes and sizes, but there are two distinct types—individuals and businesses.

If you're looking at it from the standpoint of your *personal* taxes, Texas most certainly is a *low* tax state. Property taxes may be high if you're a homeowner, and sales taxes, too, but the state's lack of a personal income tax saves the average Texas family of three close to $2,500 a year.

If you're answering from the perspective of your **business**, however, Texas is not necessarily a low tax state. Property and sales taxes hit hard, add Texas' franchise tax on top of that, and then throw in a variety of "specialty" taxes (if you're an oil and gas producer, a utility, an insurer, etc.). The simple truth: for many businesses, Texas most certainly is not a low tax state.

That can be a sore thumb in attracting new investment to the state—especially capital-intensive businesses on which Texas' tax mix falls most heavily—including manufacturers, utilities, oil and gas concerns, and technology businesses (often the very businesses spawning multi-billion dollar investment projects for which states compete so fiercely).

> *For **individuals**, Texas is a low tax state, ranking 46th lowest and 50 percent below the national average.*
>
> *For **businesses**, Texas is an above average tax state, ranking 21st highest, just above the national average. Our business tax burden is only slightly lower than California, but higher than Pennsylvania, Illinois, Louisiana, Virginia, and even Massachusetts.*

That doesn't mean that Texas has little to offer—just the opposite. Texas has a skilled and affordable workforce, a stable and favorable regulatory and legal environment, easy access to major markets, and a quality of life second to none. But, tax burden is a major consideration for any business, and that is where Texas fares far less favorably. Texas is able to take some of the sting out of the tax cost for new investments, however, through temporary tax abatements and other economic incentives. Absent these initiatives, Texas is at a distinct tax disadvantage relative to some of its toughest competitor states.

Evaluate Taxes Based on Who Writes the Check. In purely academic terms, businesses don't ultimately incur taxes, people do. But that does not mean that business taxes do not have an impact on the economy—they most certainly do. Businesses either pass their taxes forward in the form of higher prices, backward to investors in the form of lower returns, or internalize them by cutting costs such as reducing employees. Business taxes can cost consumers, investors, and workers. Taxes are a key operating cost, and businesses will gravitate to those locations where costs are least. Consequently, direct taxes on business are a key factor impacting economic growth and job creation.

Taxes are paid by an individual or a business and apply to either an asset (property tax), a transaction (sales or excise tax), or a revenue stream (income or gross receipts tax). This variety of levies falls differently on different segments of the economy—businesses and individuals alike (Figure 1). Some taxes—such as those on property and sales—are paid by both businesses and by individuals. Others may fall solely on one or the other—for example the franchise tax falls 100 percent on business. Thought of as the state's chief business tax, in fact the franchise tax is not the largest tax on business in Texas. In first place is the property tax (paid to school districts, counties, cities, and special districts). In second place is the sales tax. The franchise tax ranks only third among taxes paid by the business community. In fact, businesses pay almost 8 times more sales and property taxes than they do franchise tax.

A 2011 study by the national Council on State Taxation looked at how state and local taxes compare across the states based on who pays them—individuals or businesses (Figure 2). Applying a consistent methodology across states revealed that **Texas' tax structure falls more heavily on *business*** than in other states—65 percent in Texas versus a 48 percent national average. Absent a state personal income tax, Texas relies much more heavily on sales and property taxes—taxes that fall heavily on businesses. Only three states rely more heavily than Texas does on business to pay the costs of government—Alaska, North Dakota and Wyoming. These states have far less diverse economies, are much smaller than Texas, and tend to concentrate their taxes on captive resource-based industries.

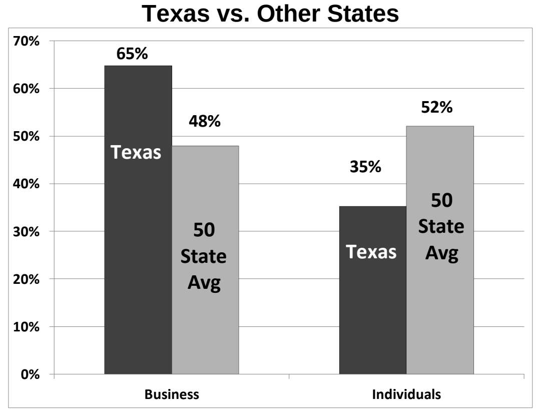
On the other hand, direct taxes paid by *individuals* account for 35 percent of all Texas state and local taxes versus 52 percent

Figure 1
Selected Texas Taxes and Who Pays Them

	Individuals	Business
Sales Tax	55.1%	44.9%
Auto Sales Tax	56.3%	43.7%
Franchise Tax	0.0%	100.0%
Gasoline Tax	83.3%	16.7%
School Property Tax	48.5%	51.5%
Oil Production Tax	0.0%	100.0%

Source: Comptroller of Public Accounts, Tax Exemptions and Tax Incidence, February 2011.

Figure 2
Who Pays State and Local Taxes?
Texas vs. Other States



Source: Calculated from *State and Local Business Taxes, 50 state Estimates for Fiscal Year 2010*, Council on State Taxation, July 2011.

for all states on average.

Still, proportionate shares of taxes are less telling than actual tax burden. A more accurate comparison of tax burden across states can be devised by relating the taxes businesses and individuals pay to a measure of economic value.

Texas state and local taxes paid by *individuals* in Texas take, on average, 2.7 percent of their personal income—less than half the national average of 5.5 percent, ranking Texas 46th highest among the 50 states. Only Alaska, North Dakota, Wyoming, and Delaware have a lower effective tax rate (Figure 3).

Texas' state and local taxes paid by *businesses* take 5.1 percent of their output—just *above* the national average of 5.0 percent, ranking Texas 21st highest (Figure 4). Still, that is a substantial improvement over recent years. The recession prompted many states to raise taxes impacting business, moving them ahead of Texas. Even so, not only does Texas assess higher taxes on businesses than many of its key competitor states for new investment—Pennsylvania, South Carolina, Ohio, Colorado, Louisiana, Michigan, Georgia, Virginia and North Carolina—but surprisingly more than Illinois, Massachusetts, and Connecticut, as well!

Individuals' Taxes and Incomes. Texas' low ranking on taxes directly paid by individuals is fairly consistent across incomes. The District of Columbia prepares a 50 state study of how taxes on individuals in the District compare with residents in other states using 5 sample families with incomes ranging from $25,000 to $150,000 annually. The D.C. study reveals that Texas taxes on families rank from 38th to 46th across the states (Figure 5). This good news of low taxes on individuals is somewhat tempered by the fact that Texas' state and local taxes are "regressive"—i.e., lower income families pay a higher portion of their income in taxes

Simple Statistics Do Lie

It is impossible to accurately encapsulate complex tax systems into a single variable. Per capita figures are commonly offered as a measure of tax burden. They compare total taxes to population, regardless of who pays the tax and implicitly assume that every dollar of taxation is somehow equal. But a *per capita* tax number is more a measure of general fiscal conservatism in the state rather than an actual measure of tax burden. Consequently, the fact that Texas per capita state *and* local tax burden ranks 33rd among the states says very little about our tax system since there is no tax on "capitas."

Even sillier are comparisons across states that only look at per capita state or local tax burdens separately. A person cannot live, and a business cannot operate, in a state without paying taxes to both. Texas' ranking as 49th in terms of per capita state tax burden may be worthy of some bragging rights, but as a statistic, it is fairly meaningless. Texans enjoy the benefit of paying among the *lowest* per capita state taxes by paying among the nation's *highest* per capita local taxes—13th highest.

Per Capita Tax Collections, Texas and the U.S., 2010

Taxing Unit	Texas	U.S. Avg	Texas vs US	Texas Rank
State	$1,561	$2,271	-31%	49th
Local	$1,866	$1,842	1%	13th
Total	$3,427	$4,113	-17%	33rd

Source: U.S. Bureau of the Census.

Figure 3
State and Local Taxes on Individuals Relative to Personal Income

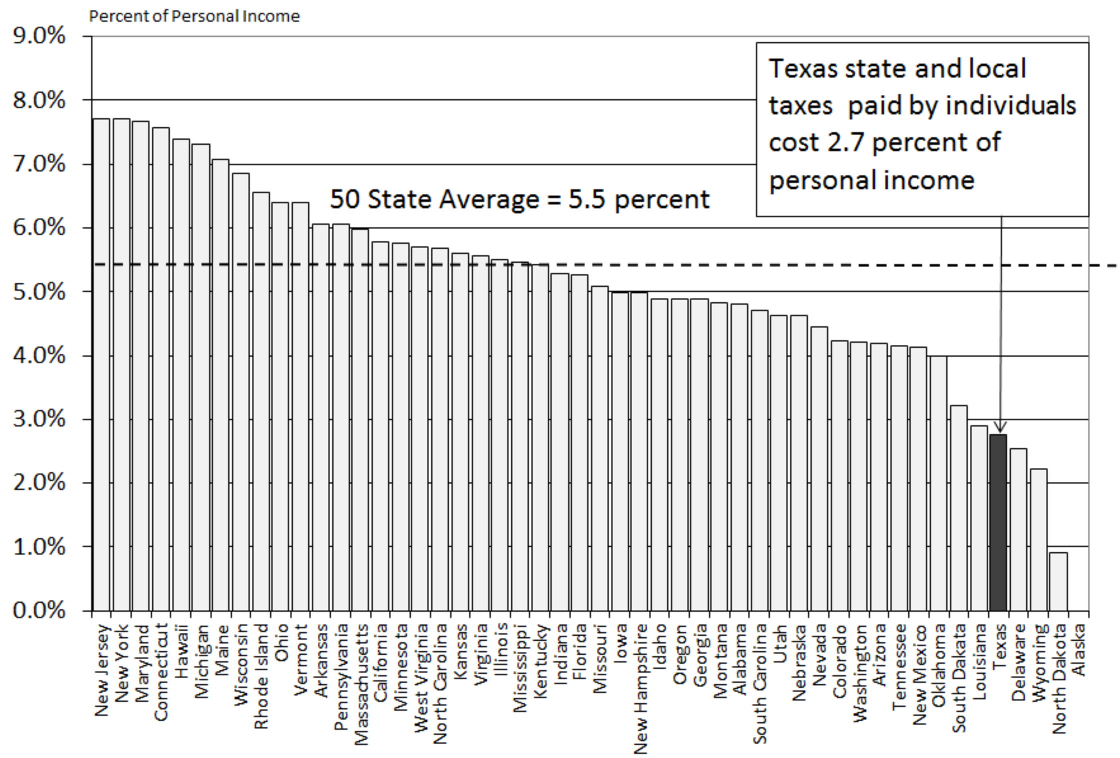
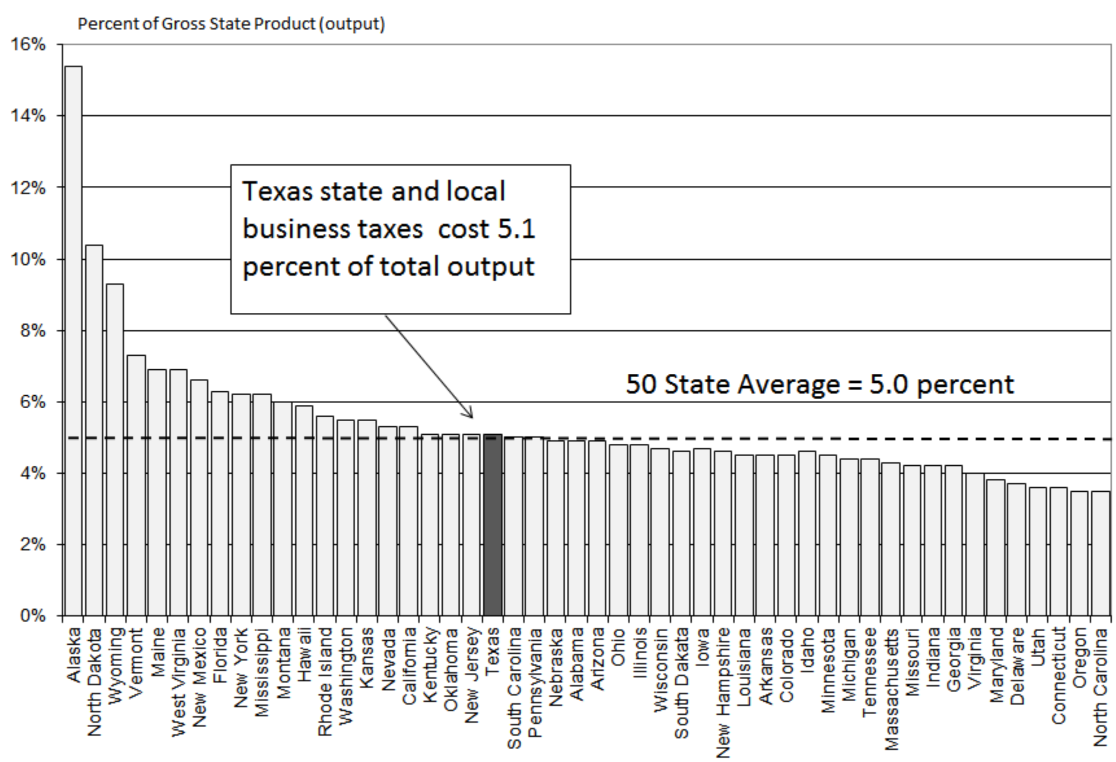


Figure 4
State and Local Taxes on Businesses Relative to Economic Output



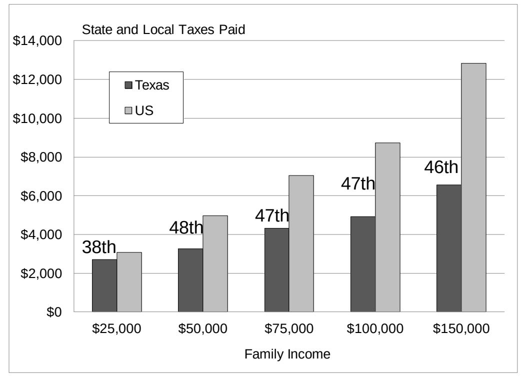
than do wealthier families (Figure 6). This is common with most states, but those states like Texas, that rely more heavily on sales and property taxes, tend to have more regressive tax systems. Consumption and housing costs tend to claim a greater portion of the family budget for those with lower incomes than those with higher incomes. Most other states rely heavily on personal income taxes, which are typically structured to limit the impact on those with lower incomes. With standard deductions and exemptions, and in some cases progressive tax rates (rates increasing with income), the income tax is more progressive than sales and property taxes.

It is important to understand what tax regressivity is, and what it is not. A "regressive" tax system does not mean the poor pay most of the tax, nor does it mean the wealthy avoid it. It is simply a measure of how taxes relate to different income levels. In fact, almost two-thirds of Texas' state and local taxes are actually paid by upper middle class and wealthier Texas households (Figure 7). The poorest twenty percent of Texas families account for only about 8 percent of all state and local taxes paid.

Business Taxes, Though, Not So Low. It should be emphasized that "business" is not a single enterprise—far from it. Instead, business is a mix of profit-seeking pursuits ranging from the very large to the very small; from capital-intensive to labor-intensive; and from goods-producing to services-producing. These diverse businesses are impacted in very different ways by the state's tax structure, and in fact, it is the capital-intensive, goods producing industries that are most impacted, because of Texas' high property and sales taxes.

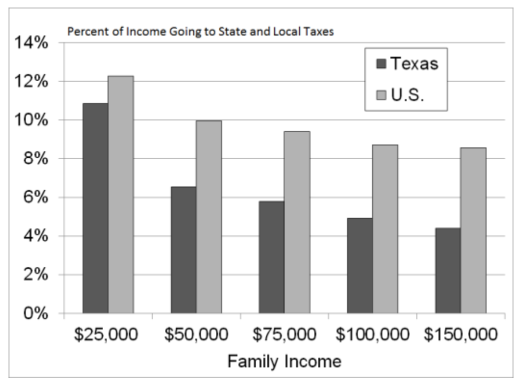
Texas property taxes are higher and broader in their application than those in most other

Figure 5
State and Local Tax Burden by Income



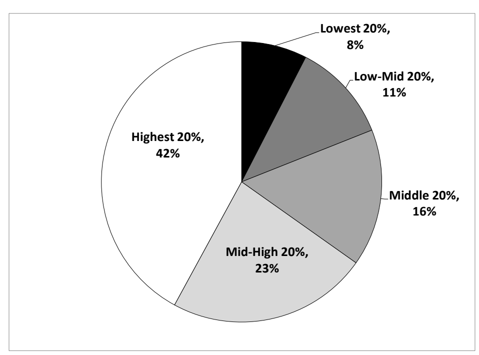
Note: Figures are for a family of three living in the state's largest metropolitan area (Houston).

Figure 6
State and Local Taxes Relative to Income



Source for Figures 6 & 7: *Tax Rates and Tax Burdens in the District of Columbia – A Nationwide Comparison, 2011,* Government of the District of Columbia, Natwar M. Gandhi, Chief Financial Officer.

Figure 7
Share of Individuals' Texas Tax Burden By Quintiles of Income



Source: Computed by TTARA using Consumer Expenditure Survey data from the US Bureau of Labor Statistics.

$19 Billion in Incentives? How the New York Times Got It Wrong

Recently the New York Times published a story about state business incentives. The Times apparently decided the story needed a villain, and that Texas, the state with the healthiest economy, would make a good one. Texas' success, the Times essentially concluded, stemmed from its willingness to buy its way to prosperity by doling out $19 billion of annual tax breaks companies couldn't get anywhere else.

That's a curious conclusion given that the numbers in this newsletter are based on actual taxes due after exemptions are taken into account and reveal that Texas is far from a low tax location for business.

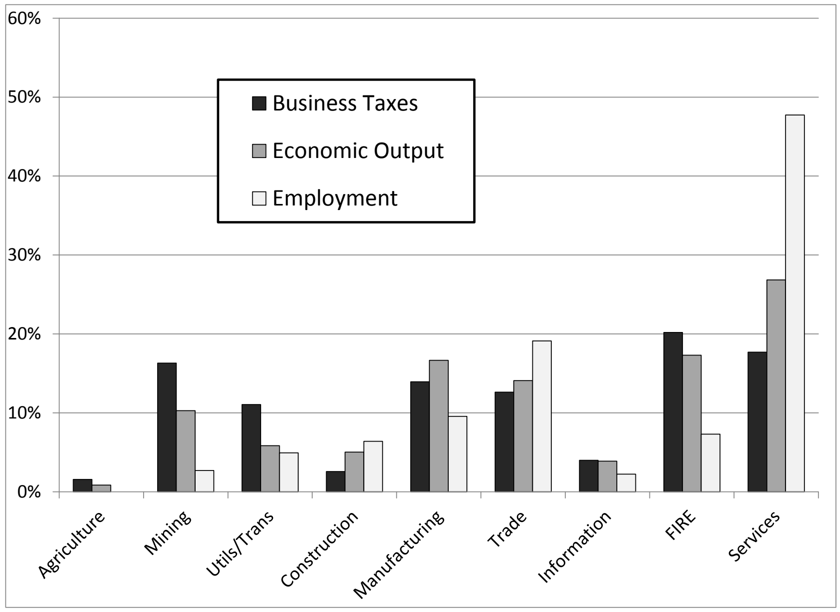
Unfortunately, the Times analysis was so wrong that even the public watchdog group that provided them with the bulk of their data said the paper misused their data. The data was drawn from public records, and Texas' transparency worked against it. State law requires Texas' Comptroller to conduct a biennial evaluation of the state's major tax exemptions, including cost estimates. One of the largest of our tax exemptions is the exemption for raw materials consumed in manufacturing—accounting for well over half of the $19 billion in "incentives" the Times assigned to Texas. While every other state offers a similar exemption, few actually estimate its value. Since the Times had no way to score the exemption in most other states, it simply ignored them. The Times "analysis" is rife with similar miscounts. Another multibillion business "incentive" is how Texas values agricultural property for tax purposes—similar to how it is done in every other state, but again, only Texas is scored for it. The Times' selective system of counting simply has little to offer in terms of serious analysis.

A more professional and objective analysis of state business incentives—*Location Matters*—was prepared by the Tax Foundation (www.taxfoundation.org). This study evaluated 7 sample companies in different industries and compared their tax burdens in each of the 50 states—a daunting and time-consuming task. What the Tax Foundation found is not surprising to anyone who has read this far—Texas' tax structure impacts different types of businesses differently, and many other states may offer less burdensome tax systems.

states. Property taxes in Texas apply not just to land and buildings, but also to tangible personal property used in the production of income—essentially personal property, including inventories, owned by business. While at least 9 states do not tax personal property at all, over 40 exempt business inventories. Texas does not, although local jurisdictions can allow a limited "Freeport" exemption for goods about to be shipped outside the state. The exemption only applies to goods in transit; it does not apply to inventories of raw materials. Texas property tax rates are also among the highest across the nation. According to the Lincoln Land Institute, Texas' effective property tax rate on industrial property ranks 4th highest—67 percent *above* the national average.

The sales tax applies to the sale of tangible personal property, unless specifically exempted, and to a number of specifically itemized services. Texas sales tax rates are among the highest nationally as well—11th, when local taxes are included. The sales tax is typically thought of as a consumer tax, yet businesses pay almost 45 percent of it. While Texas, as every other state, offers a sales tax exemption for raw materials directly consumed in the manufacturing process, many other basic business purchases are subject to tax—equipment not directly used in manufacturing (such as that for transportation, research and development, and storage), furnishings, commercial utilities, etc.

Figure 8
Shares of Business Taxes and Private Sector Output And Non-Farm Employment



Source: Texas Taxpayers and Research Association, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics.

While the lack of a personal income tax places additional demands on property and sales taxes to the detriment of business operations, it does offer some distinct benefits to business. Small and start-up businesses are better able to retain capital and reinvest in their business in Texas than in most other states. Further, the lack of a state personal income tax does make Texas an attractive location for many CEOs looking to locate their headquarters. The irony, though, is that many manufacturers headquartered in Texas find it cheaper to build their actual production facilities elsewhere.

Putting it all together, Texas' reliance on sales and property taxes means tax burdens are not uniformly distributed across industries. Capital intensive and goods-producing industries—agriculture, mining (i.e. oil and gas extraction), manufacturing, utilities, finance, and information—account for two-thirds of the state's business paid taxes, yet account for just over half of the state's economic output, and only about a quarter of the state's jobs.[1]

On the surface it may seem by some measures that Texas is a low tax state, and for individuals, it is. But Texas' mix of property and sales taxes concentrates the tax burden more heavily on businesses, and in particular, capital intensive businesses. That puts Texas at a relative disadvantage to many other states, at least from a tax standpoint, in attracting new investment—particularly the multibillion dollar investment projects.

Taxes are an important consideration in business investment decisions, and in overall economic growth. While Texas' economic climate has ample things to brag about, the high level of direct taxes on business is certainly not one of them. Texas is clearly leading the nation out of a horrendous recession, but much of that growth has been sparked by a boom in oil and gas investment, driven by the application of new technologies. That investment may be masking that underneath it all, Texas' business economy still has some challenges to overcome.

[1]In the private, non-government, sector.

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