TEXAS TAXPAYERS TTARA AND RESEARCH ASSOCIATION
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A Tale of Two Tax Systems: The High (Business) Tax Cost of Texas

Texas has a reputation as a low tax state, but the truth is far more complex. Measured in per capita terms Texas is a low tax state—31st from the top in 2012—but the statistic is misleading because there is no such thing as a "capita" tax. Taxpayers come in all shapes and sizes, but there are two distinct types—individuals and businesses, and the tale of tax burdens is very different for each.

Individuals pay sales taxes when they buy certain items; they pay taxes on their real estate (and indirectly on a home they may rent); but unlike the residents of 43 other states, Texans do not pay state taxes on their income. Our state and local taxes on individuals rank Texas 47th highest (or 4th lowest)—42 percent **below** the average across the states.

Businesses pay sales taxes on the items they buy; they pay taxes not only on the real estate they own, but also on the personal property within it (individuals do not). They pay a variety of gross receipts and excise taxes and they pay a business, or a "franchise" tax. The average state and local tax burden on businesses in Texas scores 18th highest, or 8 percent **above** the average of the states. Businesses also face a burdensome system of tax administration that translates into higher operating costs.

In purely academic terms, businesses don't ultimately pay taxes, people do. But that does not mean that taxes don't have an impact on business decisions—they most certainly do.

*Texas is a **low** tax state for individuals, but when it comes to business, Texas is a **high** tax state with a burdensome system of tax administration.*

Businesses either pass their taxes forward to consumers in the form of higher prices, backward to investors in the form of lower returns, or internalize them by cutting costs such as payroll. 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.

The Council on State Taxation in conjunction with Ernst and Young prepares an annual comparison of state and local taxes across the states based on who pays them—individuals or businesses. Applying a consistent methodology across states reveals that Texas' tax structure falls more heavily on business than all but three other states. Almost two thirds of the taxes Texas state and local governments collect—63.5 percent are paid by businesses (Figure 1)—versus 44.9 percent for the average state. Absent a state personal income tax, Texas relies much more heavily on sales and property taxes—taxes that fall heavily on businesses. Individual Texans account for 36.5 percent of all state and local taxes, well below the national average of 55.1 percent.

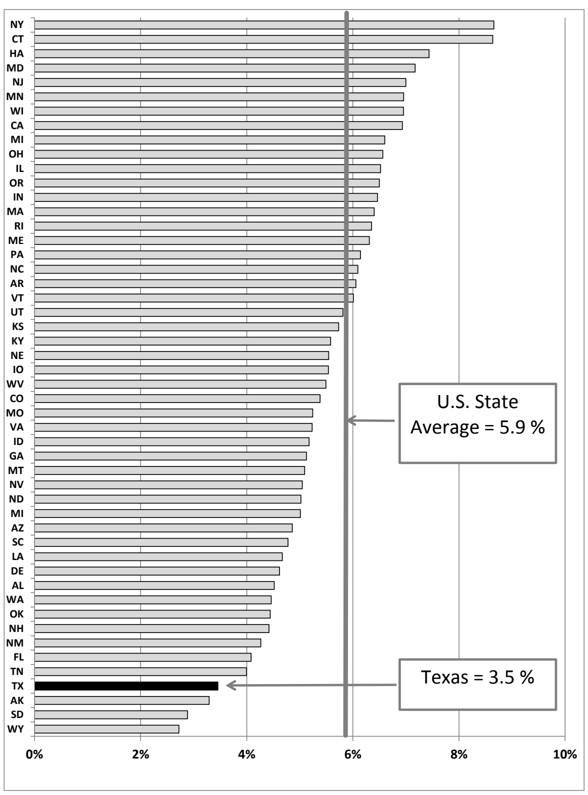
A Familiar Tale: Low Taxes in Texas. The lack of a personal income tax saves the average Texas family of three close to $3,000 annually. Relative to income, the total amount of state and local taxes paid by **individuals** in Texas is 3.5 percent—well below the national average of 5.9 percent and ranking Texas 47th highest among the 50 states. Only Alaska, South Dakota, and Wyoming, have a lower overall effective tax rate on individuals (Figure 2).

Figure 1
State and Local Tax Reliance
Texas versus the U.S.

	Business	Individuals
Texas	63.5%	36.5%
United States	44.9%	55.1%

Source: *Total State and Local Business Taxes: State-by-state Estimates for Fiscal Year 2013,* Council on State Taxation and Ernst & Young, August 2014.

Figure 2
State and Local Taxes on Individuals
Relative to Personal Income



Source: *COST.*

The 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 than do wealthier families. Consumption and housing costs—subject to sales and property taxes—tend to claim a greater portion of the family budget for those with lower incomes than of 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, resulting in a more "progressive" tax system across income groups.

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, over two-thirds of Texas' state and local taxes are actually paid by upper middle class and wealthier Texas households (Figure 3). The poorest twenty percent of Texas families account for only about 6 percent of all state and local taxes paid.

The Tale Not Often Told: Texas is a High Tax State. Texas' effective tax rate on businesses is 5.0 percent—above the national average of 4.7 percent, and ranking us 18th highest among the states (Figure 4). While that doesn't make Texas an outrageously high tax state, it clearly dispels the myth that Texas is a low tax state for businesses in general. In fact, some of the "competitor" states to which we are often compared—California, Georgia, Louisiana, Oklahoma, Tennessee, Virginia, and even Massachusetts—all have generally lower business tax burdens than Texas.

It should be emphasized that "business" is not a single enterprise—far from it. It 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. Relying heavily on sales and property taxes, Texas' tax burden falls most heavily on goods-related and capital-intensive industries, but relatively lightly on those engaged in services.

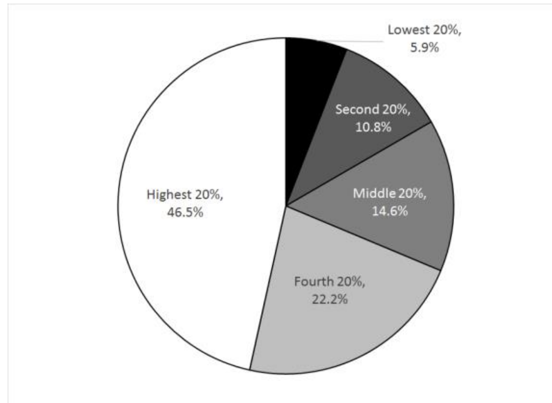
Texas property tax rates are higher and the base is broader than those of most other states (Figure 5). Property taxes in Texas apply not just to land and buildings, but also to tangible personal property used in the production of income—essentially business-owned personal property, including inventories. While 11 states exempt personal property, 43 offer an exemption for business inventories. In Texas, local jurisdictions are able to offer a limited "Freeport" exemption, but it applies only to goods to be shipped outside the state within a certain period of time. The exemption does not apply to inventories in general.

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 (i.e., transportation and storage), furnishings, commercial utilities, etc. While state sales taxes commonly apply to purchases of *tangible personal property*, Texas is among the more aggressive states in taxing *services* under the sales tax.

While the lack of a personal income tax places additional demands on business-heavy property and sales taxes, it does offer some advantages to the business community. Small and start-up companies are better able to retain capital and reinvest in their business. Further, the lack of a state personal income tax makes Texas an attractive location for many CEOs looking to locate their headquarters. The irony, though, is

Figure 3

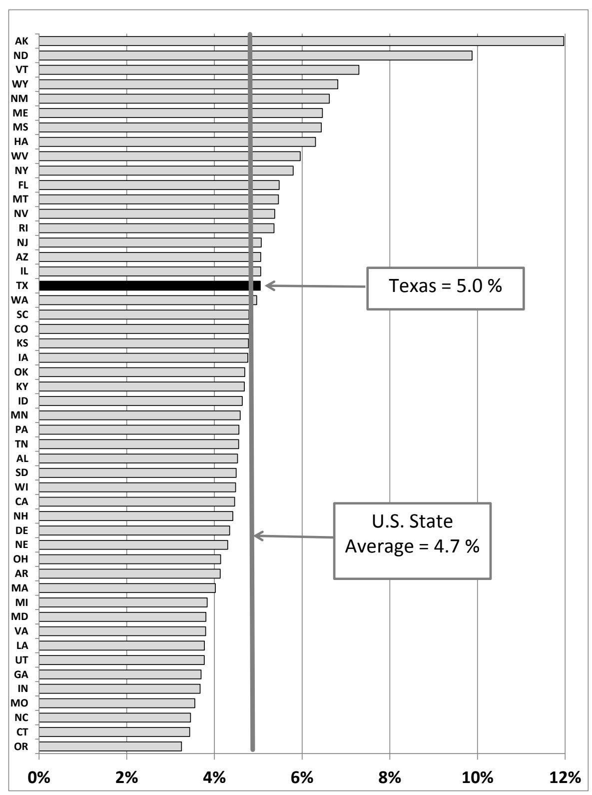
Share of Taxes Paid By Quintile of Income



Source: *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, Institute on Taxation & Economic Policy, January 2013.

Figure 4

State and Local Taxes on Businesses Relative to Economic Output



Source: *COST.*

that many manufacturers headquartered in Texas find it cheaper to build their actual production facilities elsewhere.

Beyond the size of the check, Texas is a high-cost state for tax compliance. Texas ties with 4 other states for 35th place in the Council on State Taxation's scorecard of state tax appeals and procedural requirements. Texas receives low scores for its lack of independence in tax dispute resolution and tax payment requirements, and is also marked down for discriminatory interest rates charged to taxpayers, and franchise tax filing burdens.

Taxes are not the sole determinants of business investment decisions. Obviously market conditions (which drive revenues) head the list, and on the cost side, labor, land, and transportation are important—most of which fall in Texas' favor. Regulatory issues are also key—another boost for Texas. Still, when it comes to taxes, Texas stands at a disadvantage to many of our competitor states.

Figure 5

The High Cost of Texas Property Taxes

	Effective Tax Rate	Rank Among the States
Homesteads		
Urban $150,000 Home	1.896%	16
Urban $300,000 Home	1.943%	16
Rural $150,000 Home	1.790%	16
Commercial Property		
Urban $100,000 Value	2.417%	21
Urban $25 ml. Value	2.417%	22
Urban Apartment	2.549%	12
Rural $1 ml. Value	2.404%	10
Industrial Property		
Urban $1 ml. Value	2.559%	6
Urban $25 ml. Value	2.559%	6
Rural $25 ml. Value	2.404%	5

Source: *50 State Property Tax Comparison Study*, Minnesota Center for Fiscal Excellence and the Lincoln Land Institute, March 2014.