
Comments and Thoughts on Senate Tax Legislation

Senate Hearing March 4, 2015

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TTARA For:

Senate Bill 7 by Nelson: Provides across-the-board franchise tax relief for all current franchise taxpayers. While the property tax is a bigger barrier to business investment, a reduction in the franchise tax rate will provide broad and equal benefit to all business franchise taxpayers. TTARA would suggest amending the bill to extend a proportionate reduction to the EZ rate.

Senate Joint Resolution 29/SB 516 by Bettencourt: Extends the Freeport exemption period for inventories of tangible personal property in interstate commerce from 6 months to one year. Texas is one of only 7 states that extensively taxes inventories—of either raw materials or of goods produced. Coupled with our high business property tax rates, this places us at a severe competitive disadvantage to other states. SJR 29/SB 516 are a small step in the right directions.

Senate Joint Resolution 35/SB 758 by Bettencourt: Exempts production equipment from the property tax. Texas has among the nation’s highest effective property tax rates—particularly for industrial investment. Exempting new production equipment would lower a barrier to new investment. Tying a new property tax exemption to the sales tax exemption greatly simplifies its administration.

Senate Bill 759 by Kolkhorst: Repeals minor taxes that are administratively costly and burdensome.

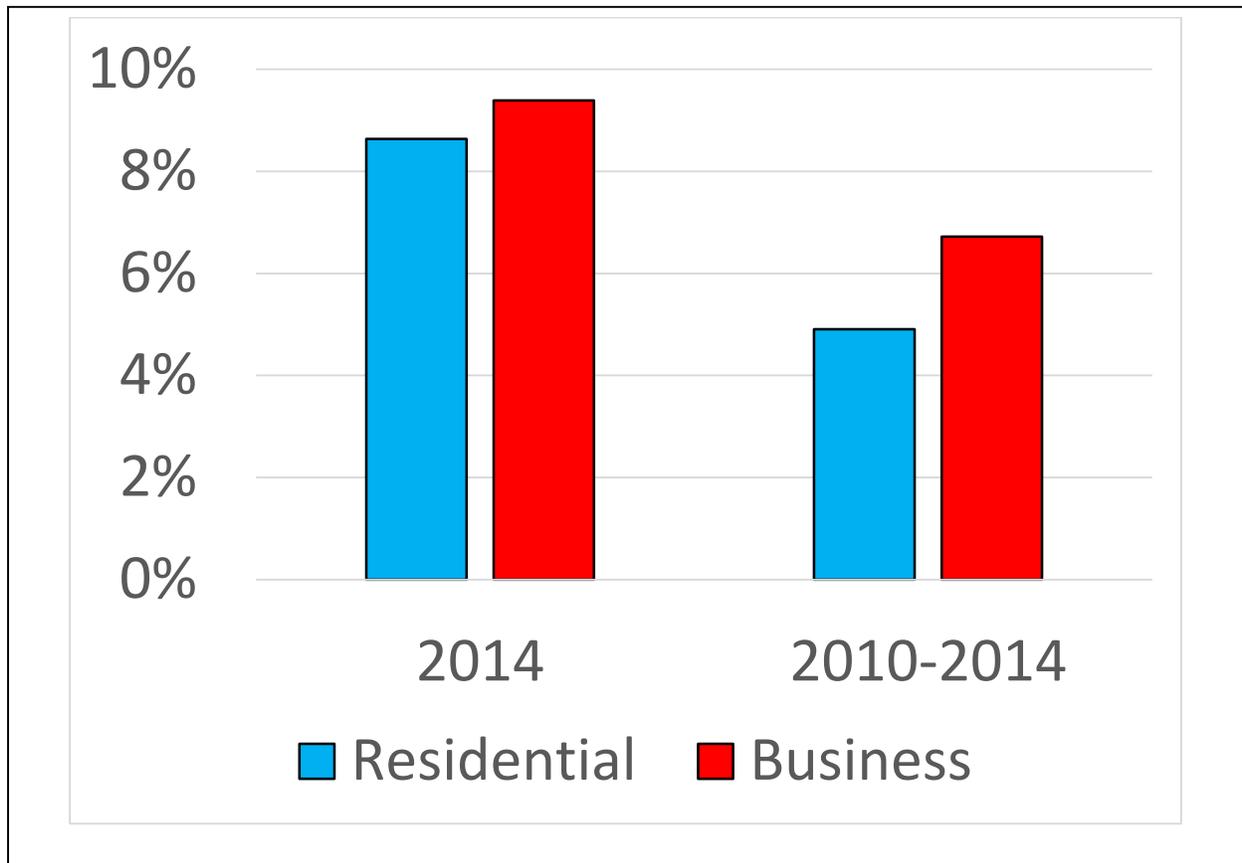
TTARA Neutral:

Senate Joint Resolution 1/SB 1: Indexes the exemption to 25% of the median home value in the state, as calculated by the Legislative Budget Board—effectively more than doubling the current exemption. TTARA is not opposed to broad-based property tax relief that includes relief for homeowners, but we would prefer that business property tax relief be a proportionate part of tax relief. Indexing the homestead exemption ensures that over time the tax base increasingly will fall on business property. We also do not believe it is appropriate to create an exemption in the Constitution for a statutorily imposed tax (sales tax on real property in Section 2 of SJR1)

TTARA Against:

Senate Bill 8 by Schwertner: Increases the small business exemption to \$4 million. This bill would remove 61,000 businesses from the franchise tax base, leaving only 56,000 businesses subject to the tax. Complaints against the franchise tax center on its complexity and the fact that it fails to account for whether a business makes a profit. Exempting more businesses from the tax does not address any of the inherent problems with the tax and makes the tax more inequitable.

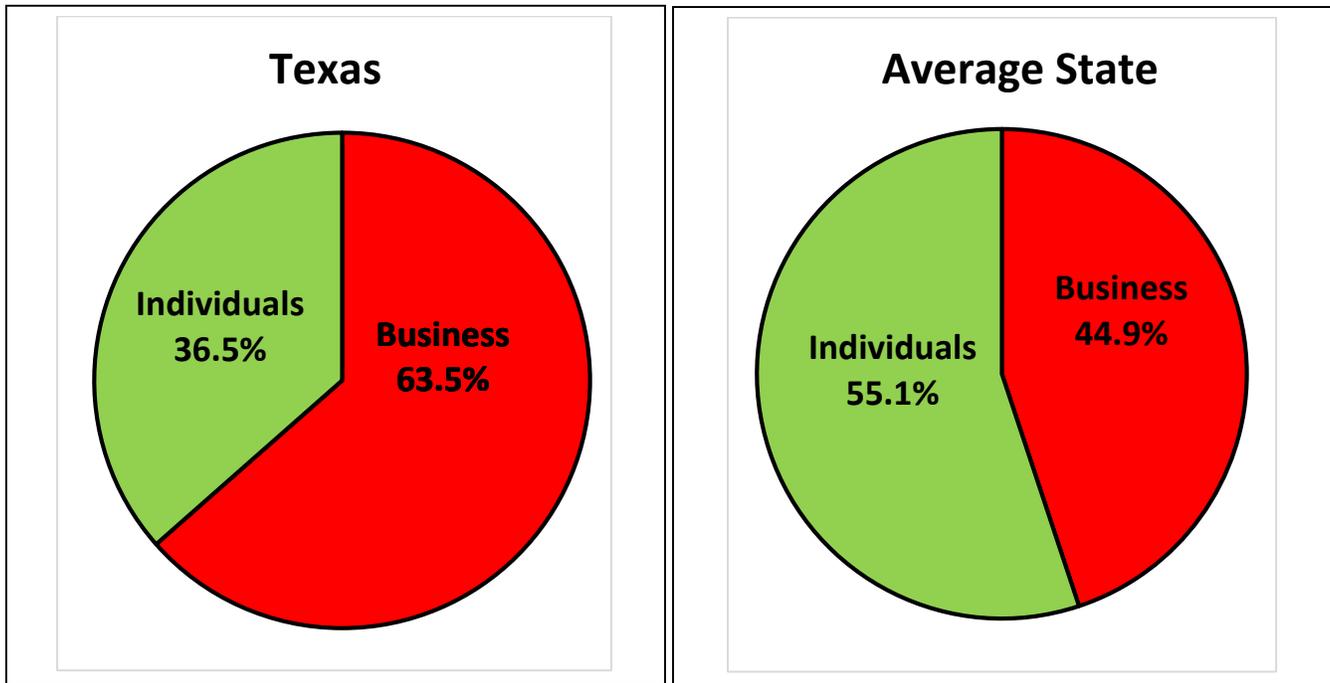
Business Property Taxes are Rising, Too



- Since the bottom of the recession, the property tax levy on residential property has increased at an annual average of 4.9 percent; the tax levy on business property has increased 6.7 percent.
- In 2014, the tax levy on residential property increased 8.6 percent; the levy on business property increased 9.4 percent.

Source: Texas Comptroller of Public Accounts, School District Self Reports, various years.

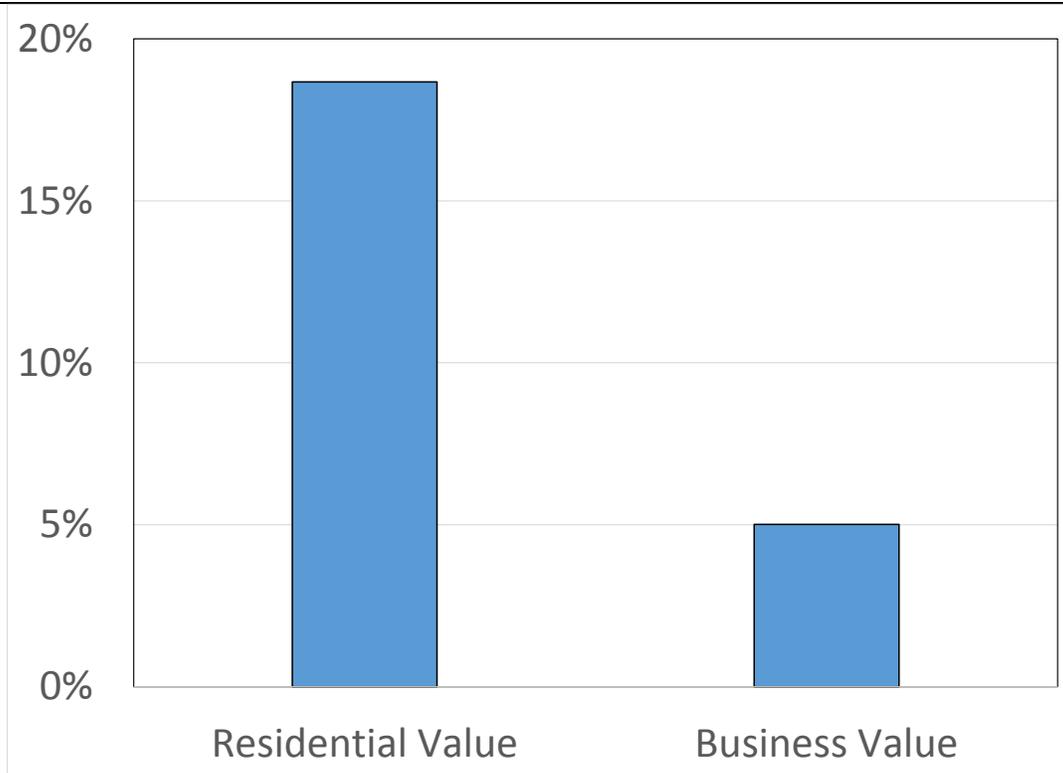
Texas Relies Heavily on Business Taxes



- In Texas, business accounts for 63.5 percent of all state and local taxes paid. Only three states rely more heavily on business to carry the load of their state and local tax system than does Texas.
- The average of all states is for business to pay 44.9 percent of all state and local taxes, well below the 63.5 percent in Texas.

Source: Council on State Taxation and Ernst and Young, Total State and Local Business Taxes: State-by-state estimates for fiscal year 2013, August 2014.

Business Has Few Protections against Rising Property Taxes



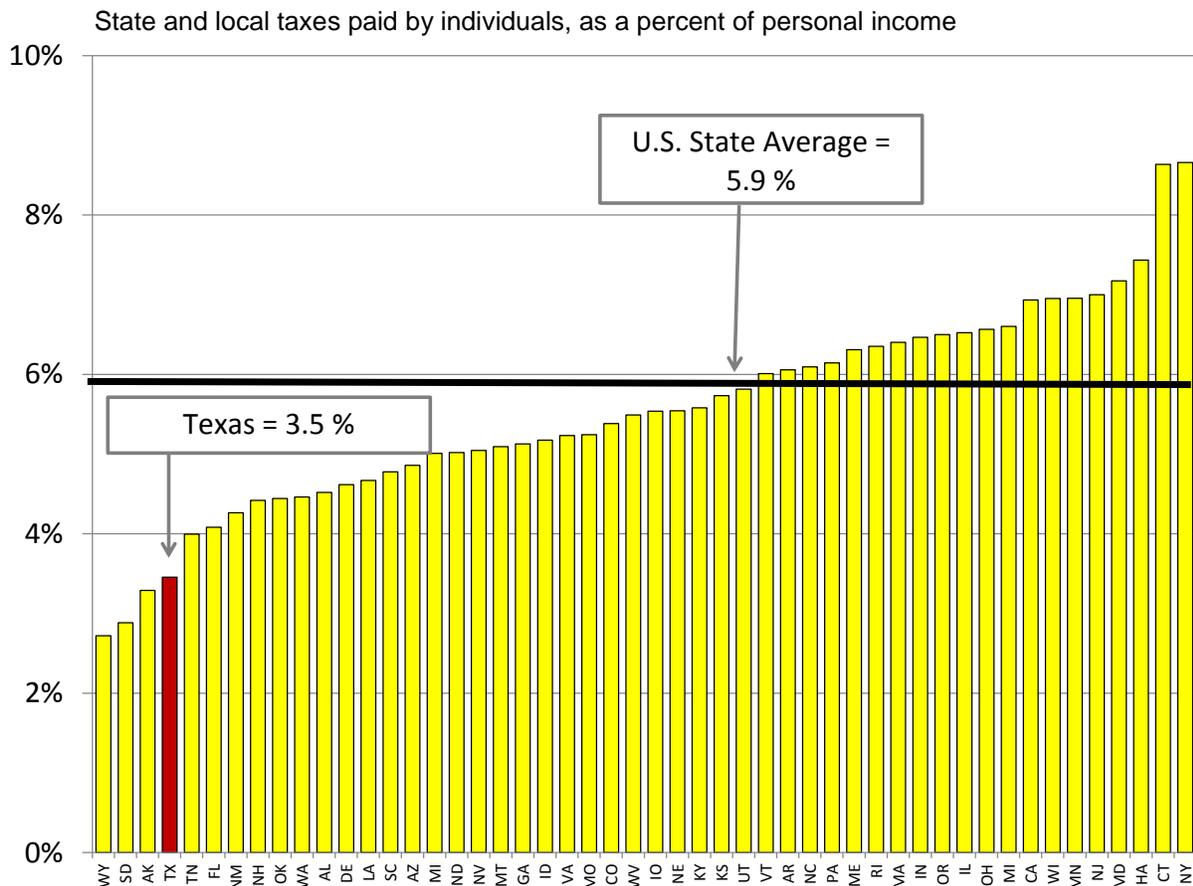
- Residential property owners benefit from a number of exemptions and tax preferences that remove 19 percent of the value of all residential property from taxation:

Basic \$15,000 Homestead Exemptions	\$74.6 billion
Optional Homestead Exemptions	38.3 billion
\$10,000 Over 65 Homestead Exemption	16.1 billion
State Veteran's/Surviving Spouse Exemption	8.0 billion
Local Option Over 65/Disabled Exemption	8.5 billion
Over 65 Tax Freeze	48.3 billion
10 Percent Cap on Residential Appraisals	22.6 billion
Historic Designation	0.5 billion
Pro-rations and Partial Exemptions	<u>0.1 billion</u>
Total Residential Property Owners	\$217.1 billion

- Business property owners benefit from a number of exemptions and tax preferences that remove 5 percent of the value of all business property from the tax rolls:

Texas Economic Development Act	\$18.1 billion
Freeport	27.7 billion
Pollution Control Equipment Mandated by Law	<u>10.2 billion</u>
Total	\$56.0 billion

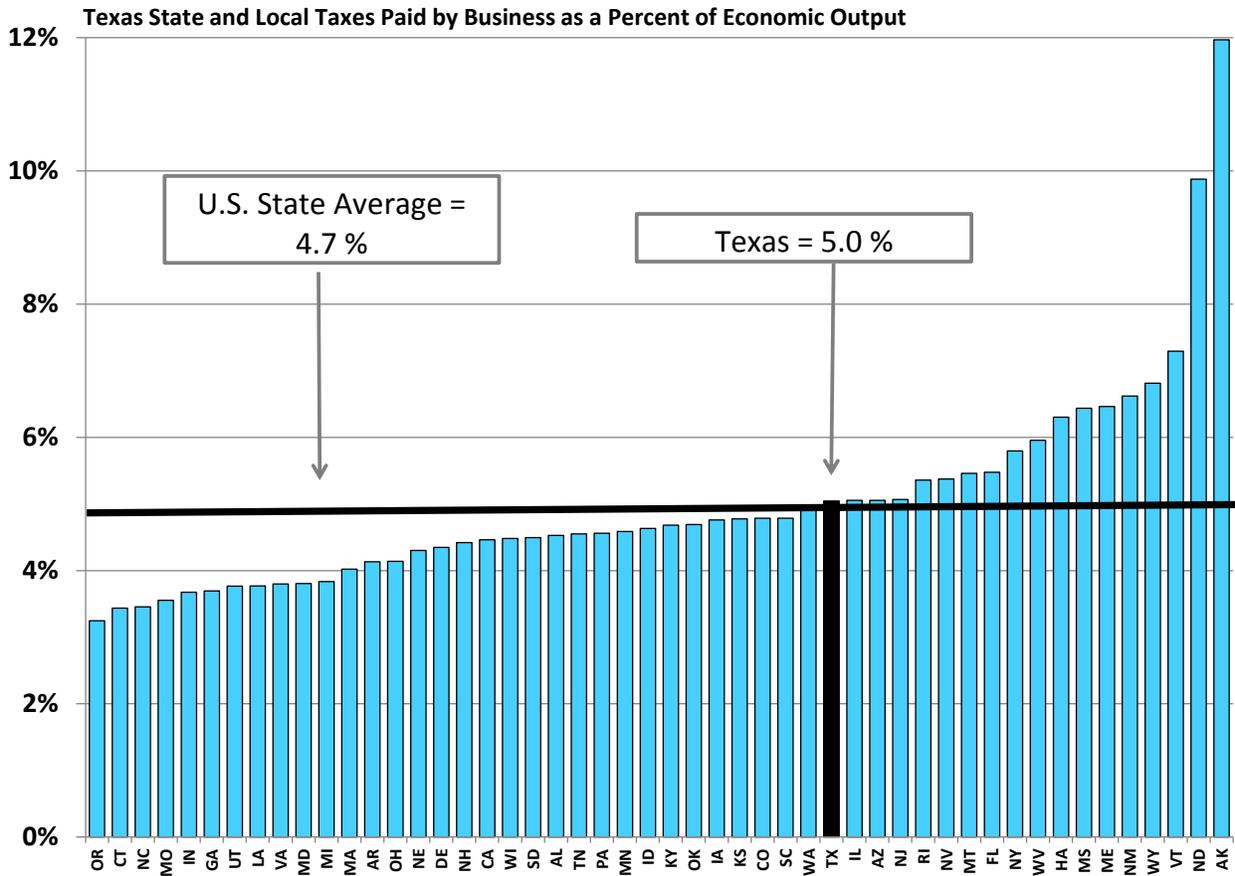
Texas Is a Low Tax State for Individuals



- Texas is the nation’s fourth lowest state in terms of state and local taxes paid by individuals relative to personal income—42 percent BELOW the national average.
- Texas is one of a handful of states that does not have a personal income tax—saving the average Texas family roughly \$3,000 annually.
- Absent a personal income tax, Texas spending is lower than most other states, but Texas also relies more heavily on the property tax and the sales tax than do other states.

Source: Council on State Taxation and Ernst and Young, *Total State and Local Business Taxes: State-by-state estimates for fiscal year 2013, August 2014.*

Texas is NOT a Low Tax State for Businesses



- Absent a personal income tax, Texas relies more heavily on property and sales taxes—taxes which fall on businesses and individuals alike. That heavy reliance on taxes shared with business results in Texas having an above average state and local tax burden on business.
- Texas state and local business taxes ranks Texas 33rd among the states in terms of business taxation—8 percent above the national average.
- The largest tax business pays in Texas is NOT the franchise tax. Businesses in general pay almost 10 times more in property and sales taxes combined than they pay in franchise taxes.

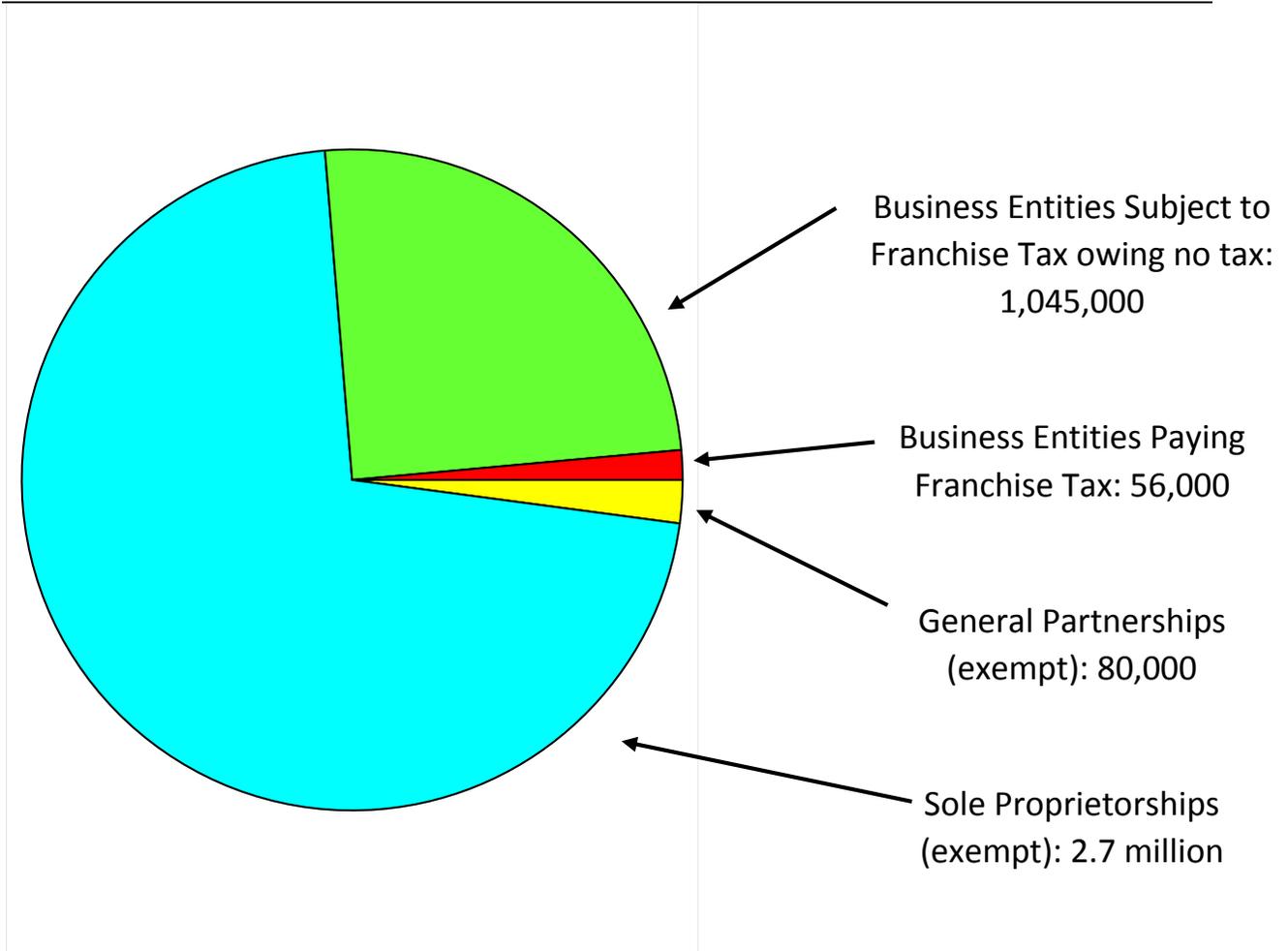
Source: Council on State Taxation and Ernst and Young, Total State and Local Business Taxes: State-by-state estimates for fiscal year 2013, August 2014.

Key Texas Taxes Compared to Other States

Tax	Current Rate and Base	Comparison
Sales Tax Rate	<p>State Tax Rate: 6.25%</p> <p>Local Taxes: Generally capped at 2.0 %; average is 1.9%</p> <p>Average Combined Rate: 8.15%</p>	<p>State Rate: 11th (tied) highest</p> <p>Combined Rate: 11th highest</p>
Sales Tax Base	Generally applies to all sales of tangible personal property excluding food, medicine and residential or industrial utilities; and a number of services	Texas' base is generally broader than that of other states because we tend to tax more services than other states (only 7 states tax more services)
Property Tax Rate	<p><u>Residential property</u>: average effective tax rate in 2013 was just under 2.0 percent of market value</p> <p><u>Industrial property</u>: average effective tax rate in 2013 was just under 2.6% of market value</p>	<p><u>Residential property</u>: Texas' effective tax rates rank us 16th highest nationally</p> <p><u>Industrial property</u>: Texas' effective tax rates rank us 6th highest nationally</p>
Property Tax Base	Texas taxes all real estate plus any tangible personal property used for business purposes (equipment and inventory); goods in interstate commerce are exempted at local option (i.e. Freeport property)	Texas' base is generally broader than that of other states: 11 states exempt all business tangible personal property; inventories are generally exempt in all but 7 states; 29 states offer some type of Freeport exemption
Business Franchise Tax	Texas' franchise tax is unlike the net business income tax levied by most other states; Texas' effective tax rate relative to economic output was 0.35% in 2013.	Relative to economic output, Texas' franchise tax ranks 27 th highest among the states, about 10 percent below the national average.

Source: Texas Taxpayers and Research Association.

The Franchise Tax and Texas Business Forms



- There are an estimated 3.8 million business entities in Texas, most of which are sole proprietorships that do not formally register with the state nor do they receive any special liability protections under state law. Another 80,000 are general partnerships, again, which do not formally register with the state and which do not receive liability protections under state law. There are 1.1 million registered businesses—corporations, limited liability companies, limited partnerships, etc.—formally registered with the state subject to the franchise tax. Only 117,000 of those pay franchise tax. Most are exempted by the \$1 million receipts deduction.
- If the small business exemption were increased to \$4 million:
 - only 1 in every 68 businesses in the state would be subject to the franchise tax, and
 - only 1 in every 20 formally-registered, liability-protected entities will pay tax.
 - Businesses with \$4 million in total revenues could be subject to a “cliff” in which the next dollar of income could trigger a \$28,000 tax liability

Source: Texas Taxpayers and Research Association and Comptroller of Public Accounts.

Indexing the Homestead Exemption Shifts More Tax onto Business

Tax Calculation	Year 1	Year 2 (5% growth in value)	Increase in Tax Due
Homestead:			
Assessed Value	\$133,000	\$139,650	
Homestead Exemption	<u>33,250</u>	<u>\$34,913</u>	
Net Taxable Value	99,750	104,737	
Tax Rate (per \$100)	<u>\$1.30</u>	<u>\$1.30</u>	
Tax Due	\$1,297	\$1,362	+\$65
Business Property:			
Assessed Value	\$133,000	\$139,650	
Exemptions	<u>0</u>	<u>0</u>	
Net Taxable Value	\$133,000	139,650	
Tax Rate (per \$100)	<u>\$1.30</u>	<u>\$1.30</u>	
Tax Due	\$1,729	\$1,815	+\$86

Indexing the homestead exemption to the median market value of a home creates an ever-increasing exemption for one group of taxpayers. The above example illustrates two properties—one a homestead and the other a business that are equally valued. Because of the homestead exemption, the homeowner pays less tax than the business property. In year 2, the value of both properties increase by 5 percent. The increase in the homestead exemption limits the tax impact of the five percent appraisal increase for the homestead exemption but the business property enjoys no similar benefit. Assuming the tax rate does not change, the business sees its growth in market value trigger an \$86 dollar school tax increase, but the homeowner, whose market value also increases by 5 percent, only sees a \$65 tax increase.

The disparity will grow over time.

Source: Texas Taxpayers and Research Association.