TTARA
RESEARCH FOUNDATION

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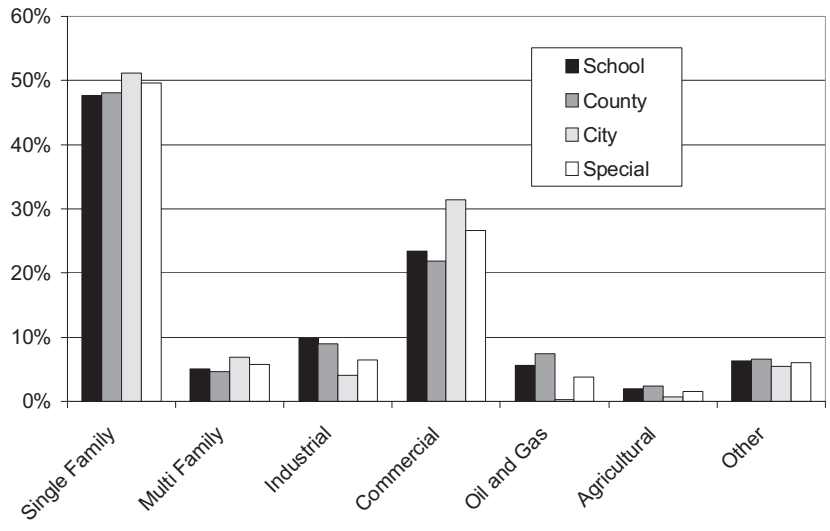
Who Really Pays: The Ultimate Incidence of the Property Tax

The 2007 property tax levy from all taxing jurisdictions in Texas is expected to total $34.6 billion. Most of this—55 percent—will go to school districts, with cities and counties each collecting about 16-17 percent and special districts about 12 percent. Within those taxing jurisdictions, the actual collections of taxes varies somewhat. With every property in the state subject to both county and school district taxes, not surprisingly these two types of jurisdictions have very similar tax bases overall (though clearly there is a wide disparity across individual districts). City tax bases, however, reflect their urban make-up—with a heavier reliance on residential and commercial properties and a lesser reliance on industrial, agricultural, and oil and gas properties (Figure 1).

The system Texas uses to categorize property—involving a number of categories ranging from "single family residential" to "commercial" to "industrial"—provides a good snapshot of what types of property there are in Texas, and how they are taxed, but doesn't really offer much in explaining who actually pays the taxes on these properties.

Figure 1
Property Taxes Paid by Type of Property By Taxing Jurisdiction



Source: Derived by TTARA Research Foundation from self report data files maintained by the Comptroller of Public Accounts

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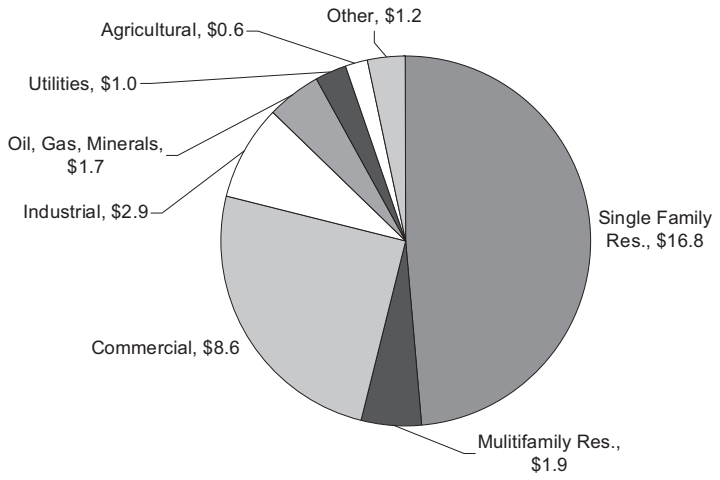
For example, just over half of the total property taxes paid in the state are levied on housing property (single and multi-family combined, Figure 2), but taxes on these properties do not automatically fall on individuals. Only 65.9 percent of all households actually own the homes they live in[1]—be they single family residences, condominiums, or mobile homes. In these cases, the owners hold the property for their individual use and pay property taxes directly (either by writing a check or by paying into an escrow account). For the remaining 34.1 percent of all households, property taxes are paid by the landlord—someone who holds the property in order to engage in the business activity of making a profit. The landlord owner is responsible for paying the property tax, though they may recover their tax cost by passing it through as a part of the rent payment. And while a real estate company may own the building and pay the tax, commercial realty contracts commonly contain a standard provision requiring tenants to pay their assigned portion of the building's property tax.

Figure 2
Total Property Taxes Paid to All Taxing Jurisdictions
2007 Tax Year, 2008 Fiscal Year ($ billions)



Source: TTARA Research Foundation.

Similarly, the state's business property categories offer little insight as to which industries pay the tax. Of the roughly $8.6 billion in taxes paid on commercial property in Texas, some of it may fall on service businesses, retail operations, or even the corporate headquarters of a manufacturing company.

To get a better idea of how the property tax falls across individuals and the businesses which make up the Texas economy, the TTARA Research Foundation has estimated the distribution of the various property types across individuals and across lines of business. The property category "single family residential" includes not just stand-alone homes, but also condominiums and mobile homes that are owner-occupied, as well as single family rental homes. U.S. Census Bureau data on housing ownership was used with Texas property value data to estimate the total taxable values of owner-occupied homes and of rented homes. These estimates were matched with consumer expenditure survey data from the U.S. Bureau of Labor Statistics to determine how

[1] U.S. Bureau of the Census, Housing Vacancies and Homeownership Annual Statistics: 2005, Table 13. Homeownership Rates by State: 1984 to 2005.

Figure 3
The Property Tax and Residential Property
($ Millions)

Category of Property				Ownership
Single Family	$16,077			
Farm & Ranch Improvements	$627	→	$15,154	Individuals/Homeowners
Mobile Homes	$106		$3,530	Rental Property
Vehicles	$5			
Multi-Family	$1,870			

Note: Some jurisdictions tax motor vehicles owned for personal use. Since these taxes fall on individuals, they are classified here as "Individuals/Homeowners." Numbers may not add due to rounding.

Source: TTARA Research Foundation.

housing costs cut across categories of families by income. To estimate taxes paid on business properties, taxes on the various property categories were allocated across their appropriate industries. For categories of property that cut across multiple industries, data from Internal Revenue Service on assets and depreciation were used as well as data from the Energy Information Agency concerning commercial space requirements per worker by industry. *Implicit in this approach is the assumption that commercial leases tend to be "triple net" leases in which the tenant is responsible for the property taxes the landlord must pay.* Rather than assigning the property taxes to the real estate industry, they are assigned to the industry leasing the property, which is contractually bound to pay the tax. Residential rental property typically does not have triple net provisions, and is assigned to the real estate industry, though the amounts are shown separately for informational purposes.

Individuals/Homeowners

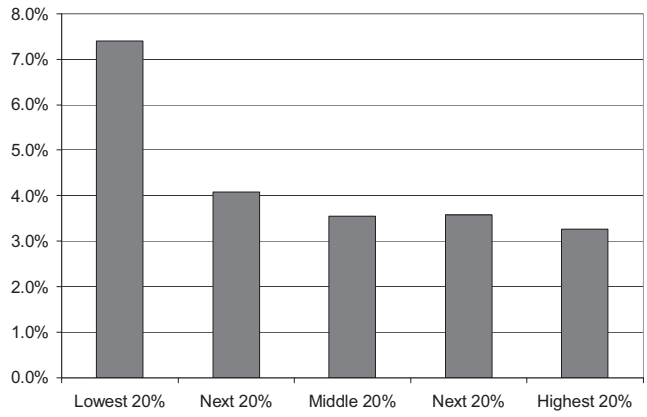
For Texas homeowners, the domicile of choice is clearly a stand-alone single family home. An estimated 84.1 percent of all single family homes are owner-occupied, while only 26.3 percent of all multifamily units are owner-occupied.[2] Based on homeownership rates and estimated average home values, $15.2 billion, or 43.7 percent of all property taxes paid in Texas are those Texans pay on the homes they own and occupy (Figure 3 above). The remaining taxes are paid by landlords who hold their property for business purposes, including residential rental property, which accounts for $3.5 billion, or 9 percent of all property taxes paid.

Property taxes take a bite out of the homeowner's family budget at all income levels (Figure 4). A tax is said to be *regressive* if it takes a bigger bite out of lower income households than wealthier households, and *progressive* if the reverse is true.

[2] U.S. Bureau of the Census, 2000 Census, Table H32. Tenure by Units in Structure, Census 2000 Summary Data File 3.

Dividing households into five quintiles of income—ranging from the lowest to the highest—reveals that the households in the lowest income quintile on average see roughly 7 percent of their incomes go towards paying property taxes.

Figure 4
Homeowner's Property Taxes By Income Grouping



Source: TTARA Research Foundation, compiled from U.S. Bureau of Labor Statistics, Consumer Expenditure Survey

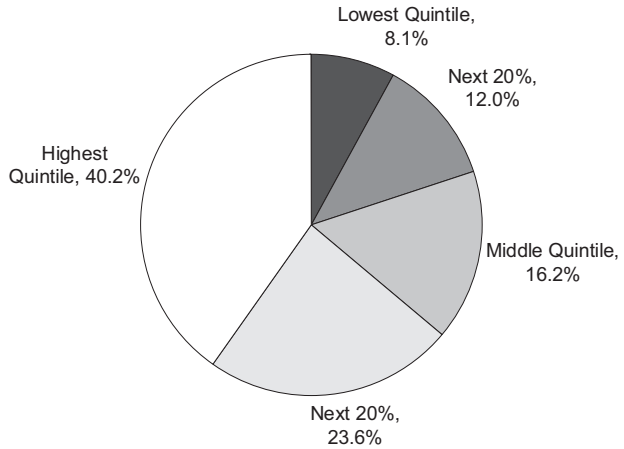
It should be noted, however, that "low-income" is not equivalent to "poor." The lowest quintile may include persons with substantial assets who are living off their savings. The low income category also may include families in which the household head is young and early in their career or studies. Excluding this lowest income group, homeowner's property taxes appear to be mildly regressive, taking from slightly over 4 percent to 3.3 percent as family incomes increase.

Regressivity is often erroneously confused with who pays a tax. Just because the tax may take a larger proportion of the family budget from lower income groups than higher income groups does not mean that lower income households pay most of the tax. In fact, the wealthiest quintile pays 40 percent of all homeowner property taxes (Figure 5); the wealthiest forty percent of all Texans pay almost two-thirds of all property taxes.

Business Properties

Including rental properties, business pays most of the property tax in Texas—56.3 percent, or $19.5 billion (Figure 6). Not surprisingly, capital intensive industries such as Mining (largely oil and gas), Manufacturing and Finance, Insurance and Real Estate (FIRE) are large payers, but interestingly, so too are Trade and Other Services (a broad category including professional services, personal services, health care, entertainment, etc.) While these industries may not directly write a check to the tax collector, the common practice

Figure 5
Homeowner's Property Taxes Paid by Quintile of Income

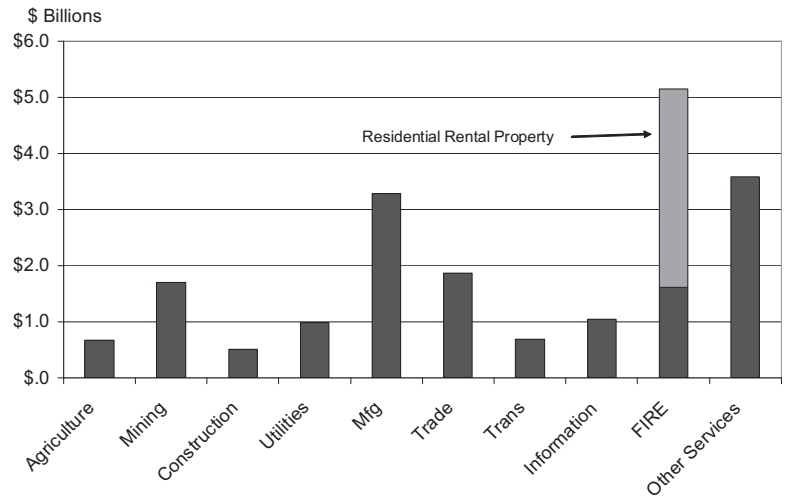


Source: TTARA Research Foundation, compiled from U.S. Bureau of Labor Statistics, Consumer Expenditure Survey

in commercial leasing is for the real estate concern that actually owns the property to require that tenants directly reimburse them for the ad valorem taxes on the leased property. Retail and services are among the largest lessees of commercial realty.

Another way to look at the property tax is relative to economic measures.

Figure 6
Property Taxes Paid By Line of Business



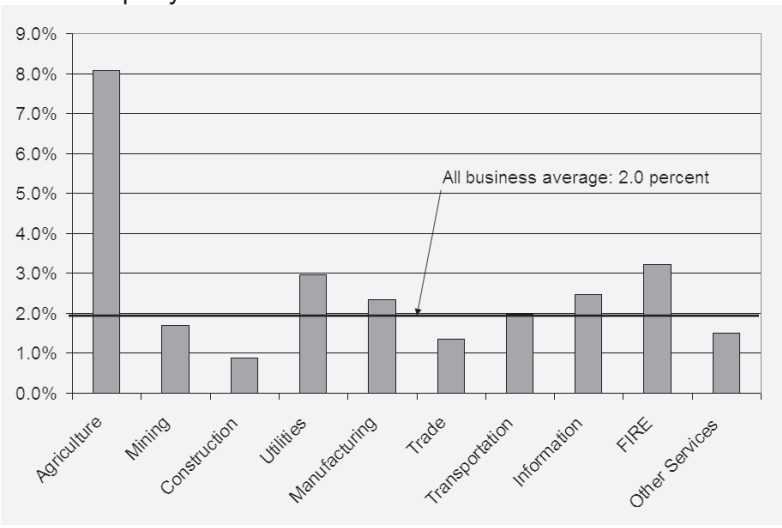
Source: TTARA Research Foundation.

Industries vary widely in terms of property taxes paid relative to their contribution to gross state product (a common measure of economic output; Figure 7). While agriculture tends to pay a small portion of overall property taxes, relative to gross state product, this land-intensive industry's taxes are equal to 8.0 percent of their gross product—a figure which is based on actual taxes paid, *after* taking into account the agricultural productivity deduction. Utilities (primarily electricity generators and natural gas providers) are incredibly capital intensive, as are telecommunications providers, as part of the Information industry. Their property taxes relative to their gross state product are high, as well.

A more dramatic disparity can be seen relative to jobs within each industry (Figure 8). On average, for each worker they employ, Utilities pay over $21,000 in property taxes; and Mining (largely oil and gas concerns) pays about $8,000—both well above the all industry average of $2,258 per worker. Also above average are Finance, Insurance and Real Estate, Manufacturing and Information.

Texas' heavy reliance on these capital intensive industries is having an effect on Texas tax policy considerations. Since 1998, these capital-intensive industries that Texas property taxes fall most

Figure 7
Property Taxes as a Percent of Gross State Product



Source: TTARA Research Foundation.

heavily on have lost 8,000 jobs. The industries that account for Texas' job growth over the past decade are the more labor-intensive services, Trade, Construction and Transportation. As these new jobs are created, bringing more households to Texas, putting more children in public schools, putting more cars on Texas highways and putting more demands on government infrastructure and services, the property taxes their employers lawfully pay may lag behind public spending pressures. That shifts more of the tax burden onto capital intensive industries and homeowners.

Figure 8
Property Taxes Per Employee and Texas Job Growth Since 1998

Industry	Property Taxes Per Employee	New Jobs Since 1998 (thou.)	
Utilities	$21,687.1	-1.1	Lost 8,000 Jobs
Mining	$8,285.5	46.2	
Finance, Insurance & Real Estate	$7,990.0	108.4	
Information	$4,767.5	-18.9	
Manufacturing	$3,507.7	-142.6	
All Industry Average	**$2,258.0**	**1,272.1**	
Transportation	$1,766.7	52.4	Gained 1.3 million jobs
Trade	$1,116.5	183.2	
Other Services	$923.4	907.8	
Construction	$800.2	136.7	

Note: Jobs are as reported by the U.S. Department of Labor, Bureau of Labor Statistics, and exclude farm jobs.

Source: TTARA Research Foundation.

Another View of Ultimate Incidence

The tax incidence analysis here is generally based on what is called "initial incidence," i.e. assigning the burden of the tax to the person or the entity that actually bears the responsibility, legally or contractually, for paying the amount of the property tax.

Many studies of taxes, including the Comptroller's biennial tax incidence study, invariably turn to the issue of "final incidence," or who "ultimately" pays a particular tax. These studies make a series of assumptions about how business responds to taxes and estimate the ultimate effect on consumers by income grouping. The analysis will yield a result that the ultimate impact of a particular tax is either regressive, progressive, or proportional.

The common contention "businesses don't pay taxes, people pay taxes," can lead to a gross oversimplification of the issue of tax incidence. Clearly businesses do pay taxes, but like any cost, a business must account for it somehow. Economists generally identify three ways in which a business may respond to taxes: through prices, profits, and/or costs. Depending on the choice a business makes (or is assumed to make), the results can ultimately be regressive, progressive, or proportional relative to individual incomes.

It is commonly assumed that businesses simply pass taxes forward by reflecting it in the price of the goods and services they sell. Should a business opt to pass taxes forward in the price of its product, the result tends to be regressive because lower income groups tend to spend a greater portion of their income on goods and services.

A business may pass its taxes backwards by operating at a lower profit margin. The result of this action tends to be more progressive in nature, because business owners or stockholders tend to be within higher income groups (an assumption that may fail to consider many of the investments of modern pension funds). But just as the price of goods is subject to competition, so too is the rate of return on investments. If business owners see that a particular line of business in Texas offers a lower return than elsewhere, eventually they may choose to invest elsewhere.

A third response a business can make with regard to taxes is to cut its operating costs. This may involve limiting pay to its employees, paying less to suppliers (who in turn may have to cut their costs), or even relocating to another state in which taxes are lower. In this case, the result tends to be more harmful to the middle class—the company employees may see their wages cut, or they may be laid off.

There is little hard data as to how businesses actually respond to taxes. Generally impacts such as layoffs or relocations are rarely immediate, and may take place over time, during which a number of factors may also enter into the equation. Further, the response a business takes in Year One may not be feasible in Year Four. A business may temporarily decide to "absorb" the tax increase, but ultimately over time may choose to reduce its costs or shift its investment elsewhere.

The most common assumption in many ultimate impact studies is that taxes are simply passed forward to consumers in the form of higher prices. This may be true for certain activities which must take place locally—such as lawn care, or barber services—when all competitors are facing the same pricing/tax structure. But it is not true for many of today's consumables. Texas manufacturers of computers, for example, compete in a free market with computer manufacturers in other states and other nations. A Texas manufacturer cannot simply decide to raise their prices in response to higher taxes when non-Texas manufacturers can hold their prices steady.

Nor in a competitive capital environment can Texas companies choose to operate at a reduced profit. Seeing that Texas might offer a lower rate of return, investors will tend to look elsewhere. Over time, nationally and globally competitive companies will gravitate towards locations where they can maximize their return. This may ultimately mean that the business's decision to go elsewhere will cost middle class Texans in lost wages and in jobs.

Because economists simply do not know exactly how or when businesses respond to taxes, the results of any analysis of "ultimate" tax incidence are suspect. It must be understood that the results are determined not by the data used, but by the assumptions made, as the Comptroller's Office notes in their tax incidence study:

> *...it nevertheless must be recognized that the results depend not upon hard science but upon subjective assumptions—and that the only thing that can be said with certainty is that no one really knows how taxes (particularly those levied on property and business) are shifted."*[3]

And finally, one should be cautioned in evaluating a single tax, even one as large as the property tax. A tax by itself may seem fair or unfair, based on its merits, but ultimately it serves as just one part of a broader tax system, and what matters is how the entire system operates. Two states may have equally regressive sales taxes, but if one offers an income tax credit for sales taxes paid, it would be misleading to claim the two sales taxes have the same impact on people.

In that vein, property taxes are high in Texas, yet because the state does not levy a personal income tax, the actual tax burden on individuals is among the lowest in the 50 states. On the other hand, because Texas relies heavily on property and sales taxes—two taxes that fall heavily on business—Texas is not a low tax state for business, especially for capital intensive companies.

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[3] Tax Exemptions & Tax Incidence, Susan Combs, Texas Comptroller of Public Accounts, February 2007.