Taxes and Economic Competitiveness

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Summary

1. Absent a personal income tax, Texas is a *low tax state for individuals*.

2. BUT, absent a personal income tax, Texas relies on sales and property taxes—taxes that fall heavily on business. Consequently, Texas is a relatively *high tax state for business*—particularly so for capital intensive, goods-related industries.

3. Texas' high property taxes are the single biggest sore thumb of our tax system—posing a substantial barrier to new capital investment.

4. Tax incentives are a necessary and effective tool for Texas to alleviate the economic distortions our tax system creates and to compete for new investment projects.

5. Used correctly, tax incentives can be a "win-win" for both governments and for businesses, luring companies that would not have come here otherwise, adding jobs and tax dollars to our economy.

6. New investment projects are critical not just for the direct capital and employment they provide, but also for the ancillary economic activity and jobs they create as:

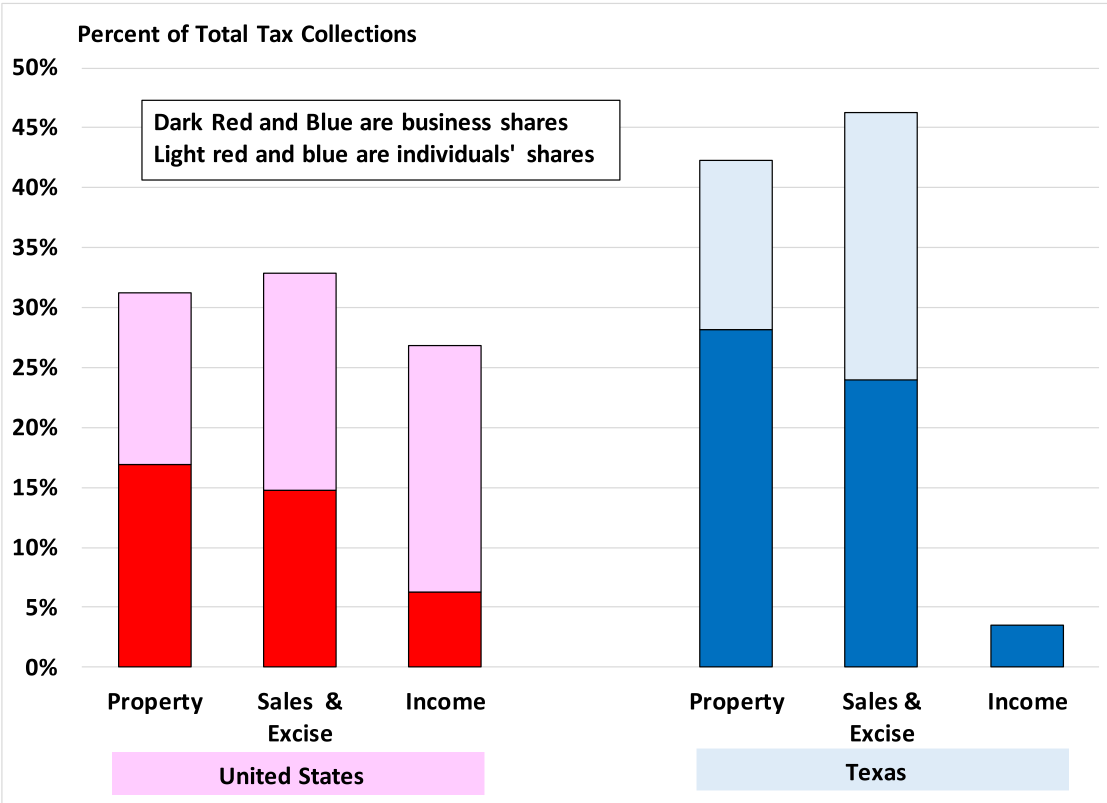
    a. the project hires workers and contractors within the community who then purchase local goods and services,

    b. the project buys goods and services from existing local companies who then hire additional workers to meet the increased demand, and

    c. those additional purchases and jobs create economic demands and activity of their own.

The Composition of State and Local Taxes

Reliance on Property, Sales, and Income Taxes: Texas and the U.S.



Notes: Texas' hybrid franchise tax, or "margin tax," is classified as an income tax for accounting purposes and is counted as such above. Excise taxes include direct taxes on products, such as utilities, insurance, alcohol and tobacco.

Source: Derived from Council on State Taxation, *Total State and Local Business Taxes, 2016*.

State and local tax systems are often described as a "three-legged stool," relying on:

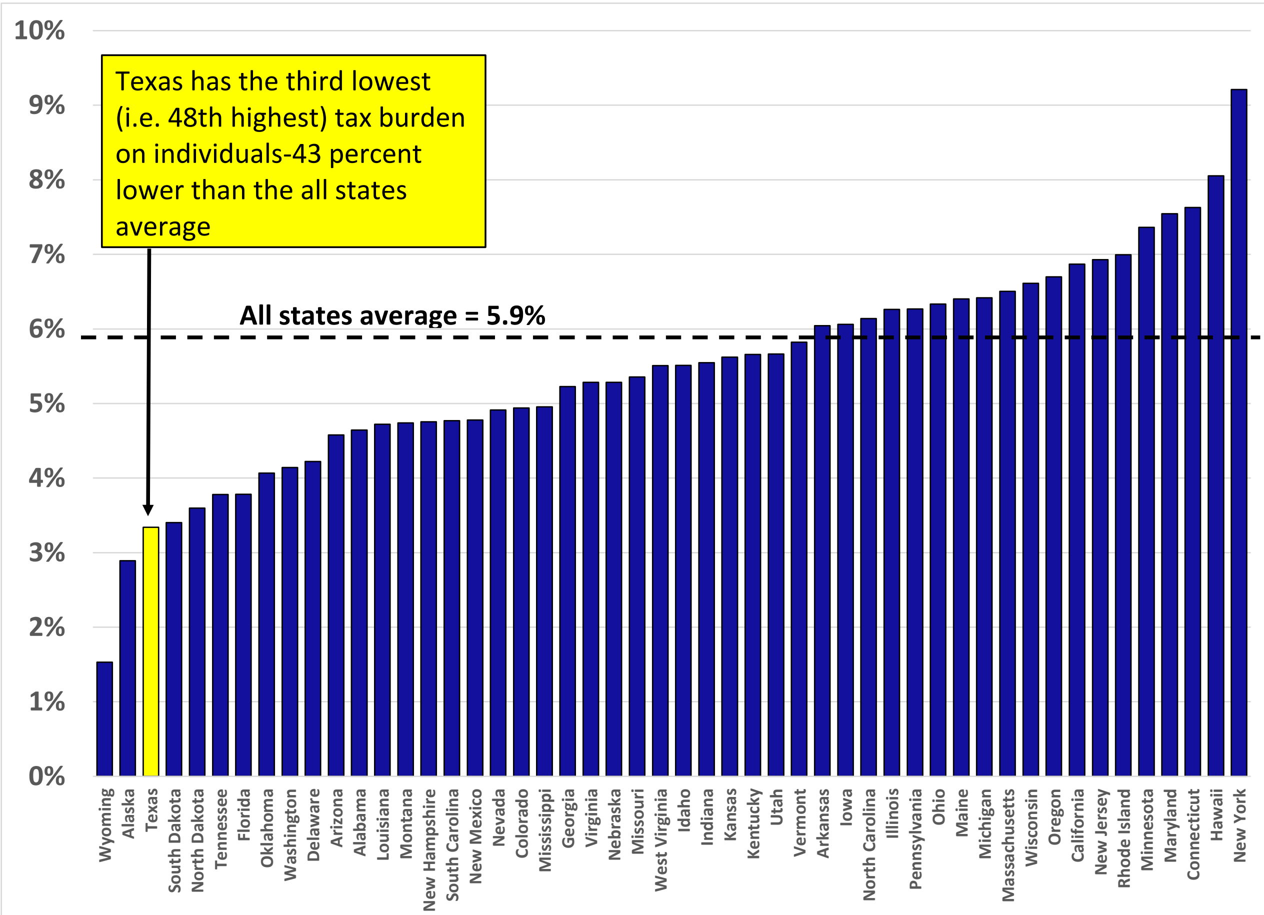
1) sales,
2) property and
3) income taxes.

Texas is one of 7 states that do not levy a personal income tax. We rely much more heavily on sales and property taxes—taxes for which businesses bear a substantial burden.

While Texas' franchise tax draws a great deal of ire, the biggest single tax business pays in Texas is the property tax, followed by the sales tax. Business property and sales taxes combined are more than 20 times the amount of franchise taxes levied.

Individual Tax Burden

State and Local Taxes as a Percent of Personal Income, 2016



Source: Derived from Council on State Taxation: Total State and Local Business Taxes, 2016

Texas state and local taxes equal 3.3 percent of personal income—43 percent *below* the average state's 5.9 percent.

Texas is the third lowest taxing state for individuals, behind the resource-rich and sparsely-populated states of Wyoming and Alaska.

The absence of a personal income tax saves the average Texas family of 3 roughly $3,400 each year.

Even though our property and sales taxes are higher than the national average, and even though it may not seem like it when property tax bills are mailed out, **<u>Texas is an overall *low* tax state for individuals</u>**.

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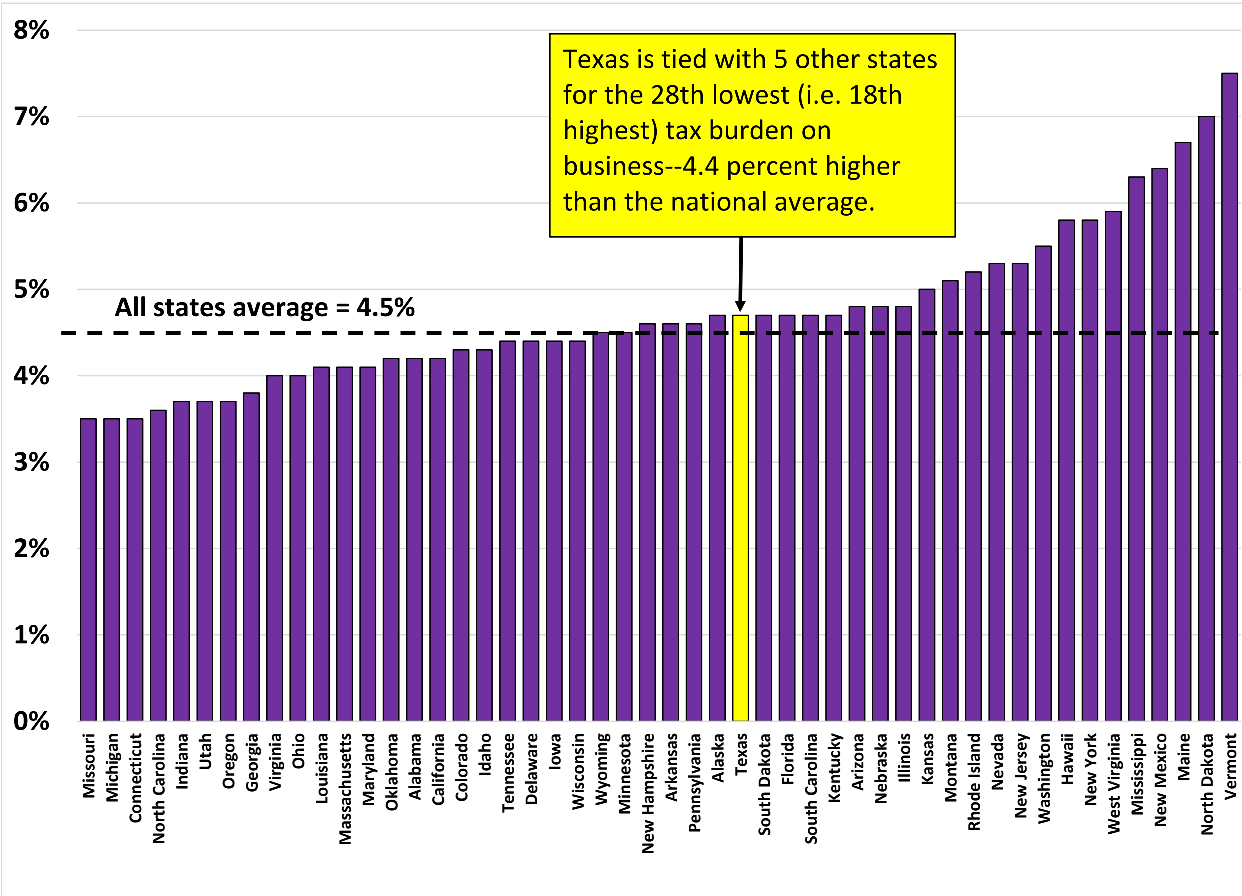
Business Tax Burden

State and Local Taxes Relative to Economic Output, 2016



Source: Council on State Taxation: Total State and Local Business Taxes, 2016.

Absent a personal income tax, Texas relies more heavily on sales and property taxes—taxes a large percentage of which is paid by business.

Texas is a relatively *high* tax state for business when measured by tax burden relative to economic output —tied with 5 other states for 28th place. Texas state and local business tax burdens are 4.4 percent *above* the national average.

In truth, whether Texas is a high tax state for a particular business depends on the activity the business is in. Capital intensive, goods-related industries bear the brunt from our property and sales taxes, while services-related firms tend to be less affected.

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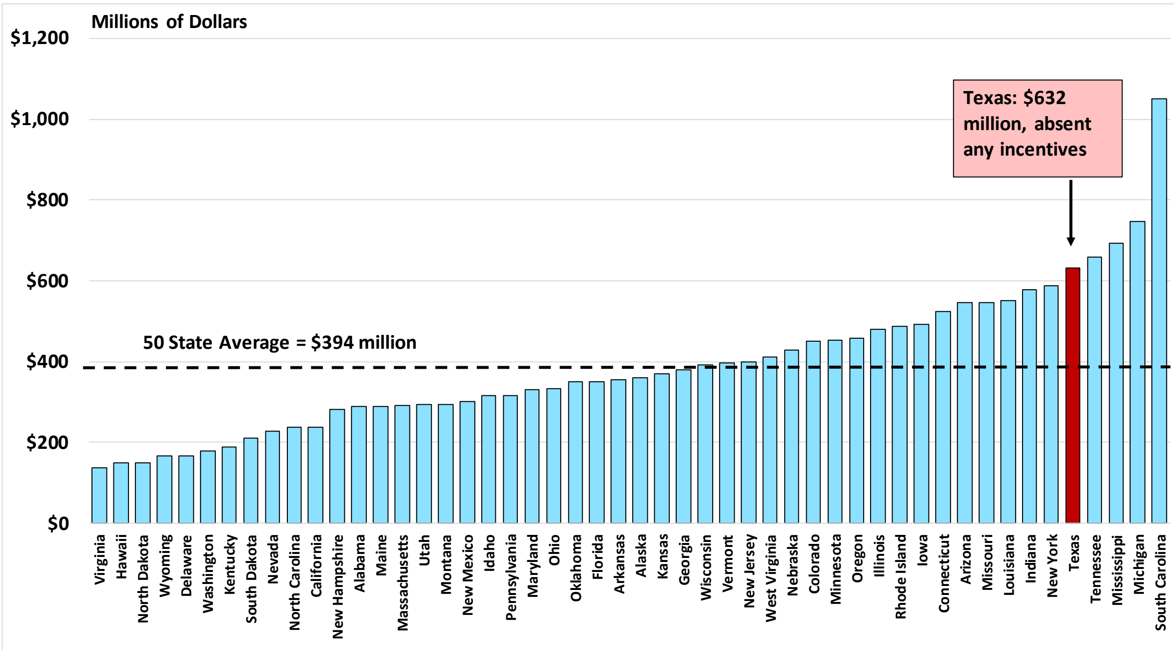
Industrial Property Taxes Across the States

Taxes Due on $1 Billion Investment over a 25 Year Lifespan



Notes: Building and land valued at $500 million, and personal property valued at $500 million. Tax shown is based on the average total property tax rate at a location in each state's largest city. No incentives are considered.

Source: Based on 50-State Property Tax Comparison Study for Taxes Paid in 2016, Lincoln Institute of Land Policy and the Minnesota Center for Fiscal Excellence, June 2017.

Texas' property taxes are among the highest in the nation. For an industrial facility, Texas on average has the 5th highest property taxes—a huge barrier to capital investment. Texas subjects business personal property, including business inventories, to the property tax, while some states do not tax personal property and most states exempt inventories.

Over a 25-year life, a $1 billion investment would pay substantially different amounts in property tax (absent any incentives)—ranging from less than $150 million in Virginia to over $1 billion in South Carolina.

Absent incentives, a $1 billion investment in Texas would pay about $632 million in property tax over a 25-year life—60 percent, or close to $240 million, higher than the national average.

If the project were able to avail itself of all applicable Texas city and county tax abatements (Tax Code Chapter 312) and school tax value limitations (Tax Code Chapter 313), it's 25-year tax bill would drop to roughly $420 million—still 6 percent higher than the average cost in a location in an alternative state, assuming that state did not offer incentives (an unlikely event).

Why Texas Doesn't Always Land the Project Even When We Offer the Best "Package"

A	B	C	D	E	F
State	Property Taxes Due Absent Incentives	Tax Savings from Incentives	Net Property Tax Cost to Project	Tax Treatment of:	
				Business Personal Property	Business Inventories
Florida	$350 million	$50 million	$300 million	Taxed	Exempt
Pennsylvania	$316 million	$0 million	$316 million	Exempt	Exempt
Wisconsin	$392 million	$75 million	$317 million	Taxed	Exempt
Georgia	$380 million	$0 million	$380 million	Taxed	Exempt
Texas	$632 million	$212 million	$420 million	Taxed	Taxed

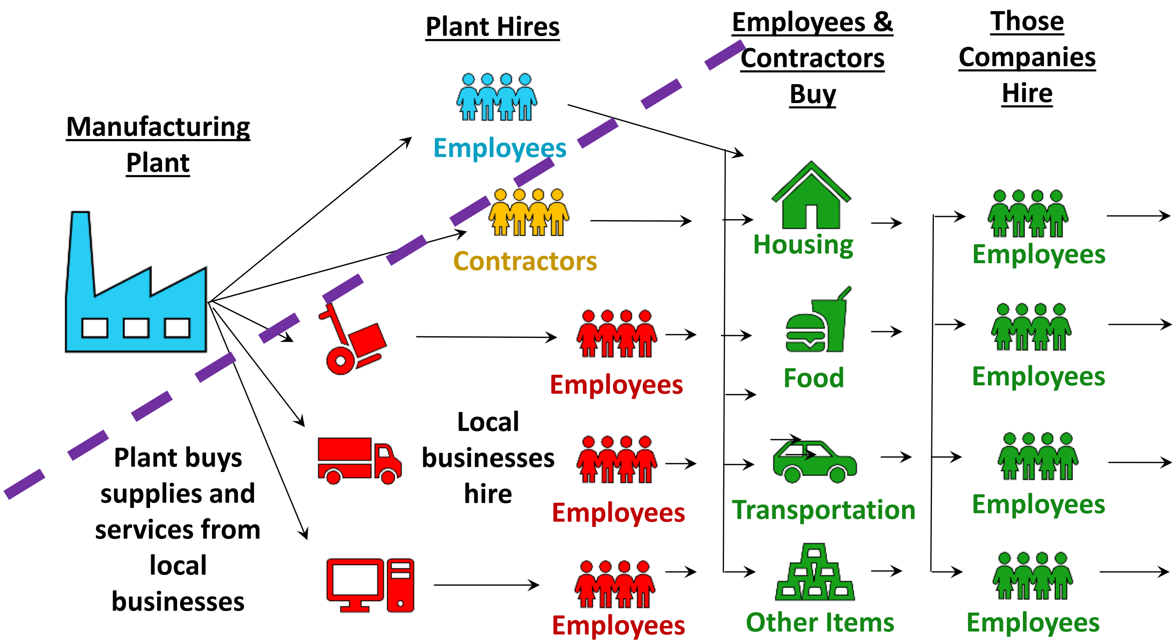
Notes: Building and land valued at $500 million, and personal property valued at $500 million. Tax shown is based on the average total property tax rate at a location in each state's largest city.

Texas is able to offset the high property tax cost of certain new investments through locally-administered incentive programs which may allow the project to pay reduced amount of property taxes for up to 10 years (Tax Code Chapters 312 and 313).

In the above example a project considers 5 locations, and the final decision comes down to the location where the project would pay the least in property taxes. Texas by far offers the most "valuable" incentives package—over 3 times more than either Florida or Wisconsin. Two states—Pennsylvania and Georgia offer nothing. Still, Texas ends in last place in the company's evaluation because of the high taxes the project would pay once the incentives expire. Even with the best incentive "package," Texas has the highest project tax burden of the five locations.

While Texas appeared to "save" $212 million from incentives offered but not taken, the state actually *lost* $420 million in potential new taxes by losing the project.

The Economic Multiplier of New Investment



Texas' evaluation process of incentives barely scratches the surface of the complete economic impacts of projects. Typically, we evaluate the project itself and the number of permanent employees a project commits to hire. Often ignored are the contractor jobs a project hires, and the impacts the project has on local communities.

For example, the project and its direct jobs are shown in blue, above the purple line. This is what the state typically reviews. However, projects typically hire construction and permanent contractors-additional jobs which are generally excluded from the state's evaluation of the project. Further, the project also buys goods and services from local companies, who in turn hire additional workers to meet the increased demand.

All of these workers—be those at the project site or those in support—buy housing, food, transportation and other items from businesses in their local communities, which in turn leads to additional jobs and hiring, additional purchases in the local economy and so on.

This process is commonly referred to as the "multiplier" effect of new investment.