

# **TTARA Policy Briefing**

## **The Property Tax Swap: What's Really Involved?**

**February 17, 2016**

# Agenda

1. Background on Proposals
2. How the Property Tax Works
3. How the Sales Tax Works
4. Replacing School Property Taxes
5. Replacing All Property Taxes
6. Concluding Thoughts

# Economic Theory

Sales Tax Good	Property Tax Bad
Tax is due in small increments as items are purchased	Tax is due in one lump sum annually (though many may pay it through monthly escrow payments)
Spending correlates better with ability to pay	Tax bears less relationship to ability to pay
Is a broad tax, directly paid by all Texans and Texas businesses	Is a tax on those who own property (though it may be passed forward to customers)
Is less politically unpopular than most other taxes	Politically, may be the least popular tax
Depending on what is taxed and exempted, may penalize investment less	Increases the cost of investment and lowers the rate of return on capital

# OECD Ranks Taxes

The Organization for Economic Co-operation and Development in *Tax and Economic Growth*, a 2008 research paper, ranks taxes in order of the harm they do to the economy.

1. Corporate taxes
2. Personal income taxes
3. Consumption taxes
4. Taxes on immovable property (i.e. property tax)

<http://www.oecd.org/tax/tax-policy/41000592.pdf>

# Replacing the Property Tax: Works of Interest

***Enhancing Texas' Economic Growth through Tax Reform***, Texas Public Policy Foundation, August 2012. (prepared under contract by Arduin, Laffer & Moore Econometrics).

- Proposed either a 15.7% sales tax, expanded to include real estate sales, or an 11% sales tax to include real estate and a substantially expanded base.
- Did not address issues of local public finance.

[http://www.texaspolicy.com/library/doclib/2012-08-taxswap-laffer-update\\_0.pdf](http://www.texaspolicy.com/library/doclib/2012-08-taxswap-laffer-update_0.pdf)

# Replacing the Property Tax

## Works of Interest, *continued*

***Eliminating the Property Tax in Texas: A Detailed Fiscal Analysis***, Richard D. Cunningham, September 2010.

- Proposed a two-tiered tax: a 2.525% business gross receipts tax coupled with a consumer sales tax of 7.5%.
- Study recognized, but did not resolve, massive revenue changes across local taxing districts.
- Study also revealed substantial tax shifts across industries.

<http://texascenterforcommonsensegovernment.org/pdf/Eliminating-Property-Tax-in-Texas-A-Detailed-Fiscal-Analysis-11-11-10.pdf>

# Replacing the Property Tax

## Works of Interest, *continued*

- ***A “Big Idea” That’s a Bad Idea for Texas***, Billy Hamilton, July 2012.
- Contends that replacing the property tax with a sales tax would:
  - Require a 25% sales tax rate (based on Comptroller estimates), sparking high levels of tax avoidance
  - Be much more volatile than the property tax
  - Effectively turn financial control of school districts, cities, counties, and special districts over to the state

<http://www.texasntaxtruth.com/files/07-17-12-Big-Idea-Bad-Idea-Texas-Tax-Policy-Report.pdf>

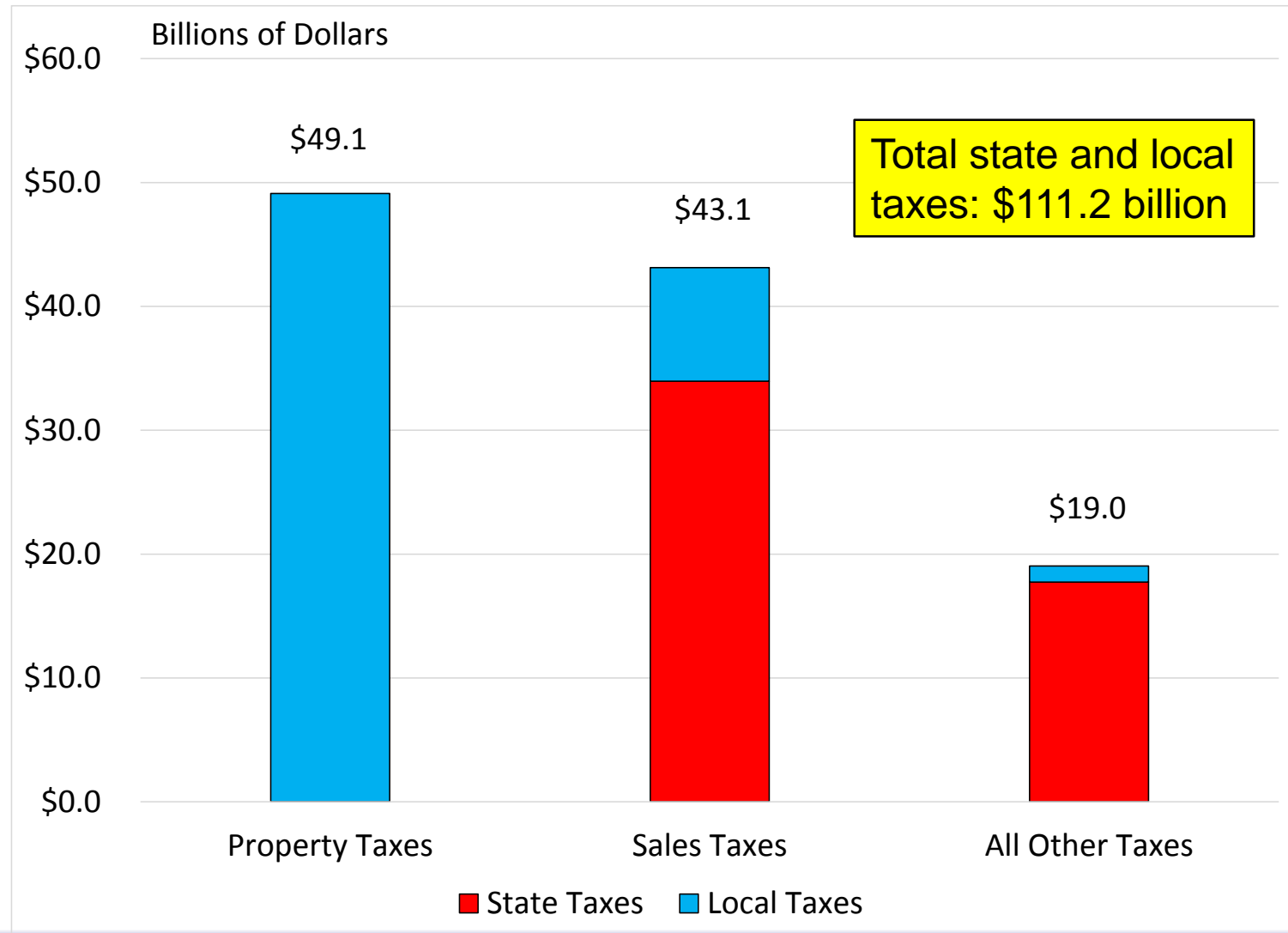
# Replacing the Property Tax Bills of Interest

- **HB 3742 by Lavender**, 83<sup>rd</sup> Regular Session (2011). Repeals the state's sales, franchise, and other taxes, replacing them with a European style VAT, levied by the state and local units of government. Disparities in local finance were not addressed.
- No other bills to eliminate the property tax have been introduced in recent sessions.



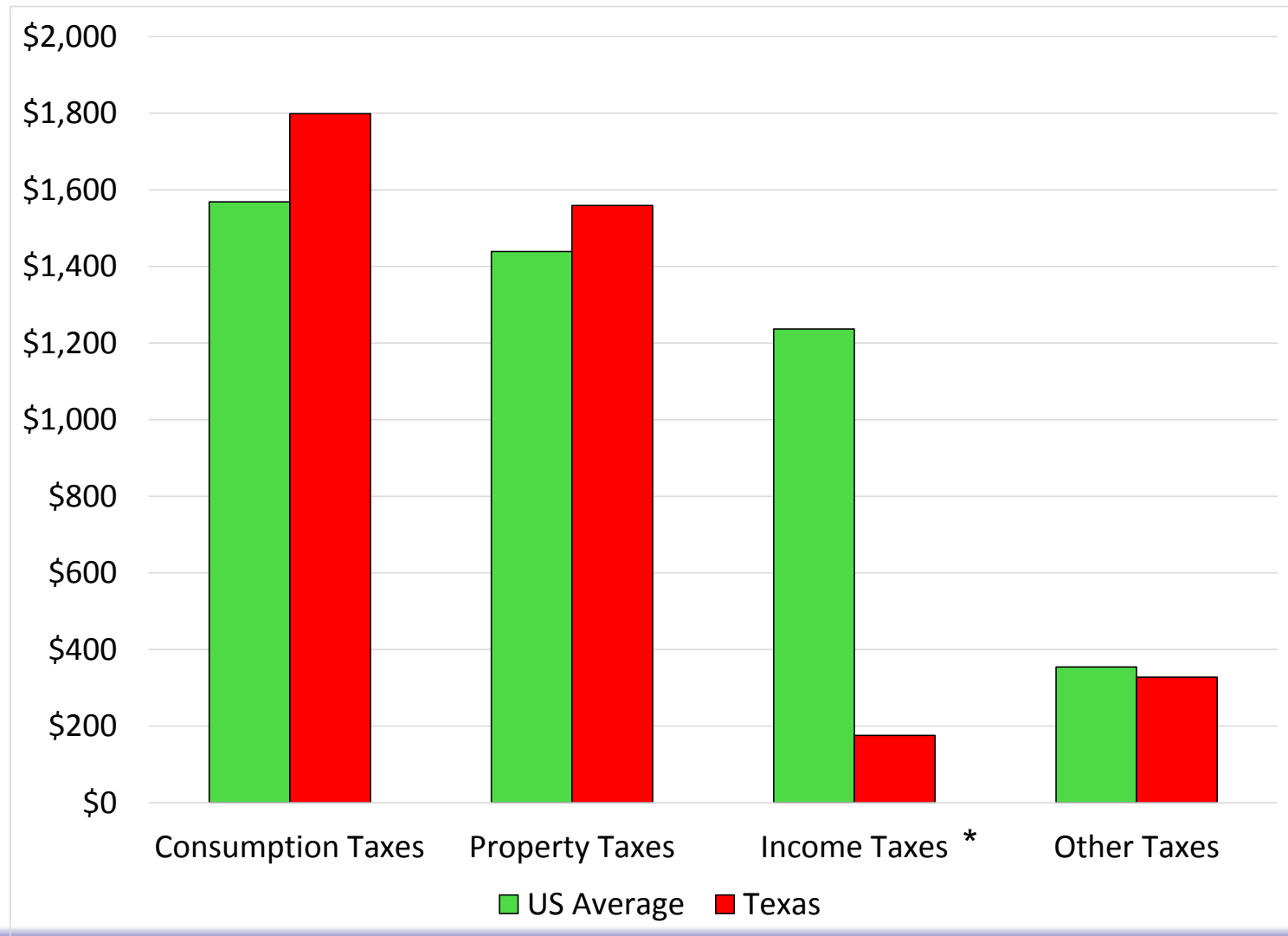
# Texas State and Local Taxes

**\* Amounts are taxes payable in FY2015**



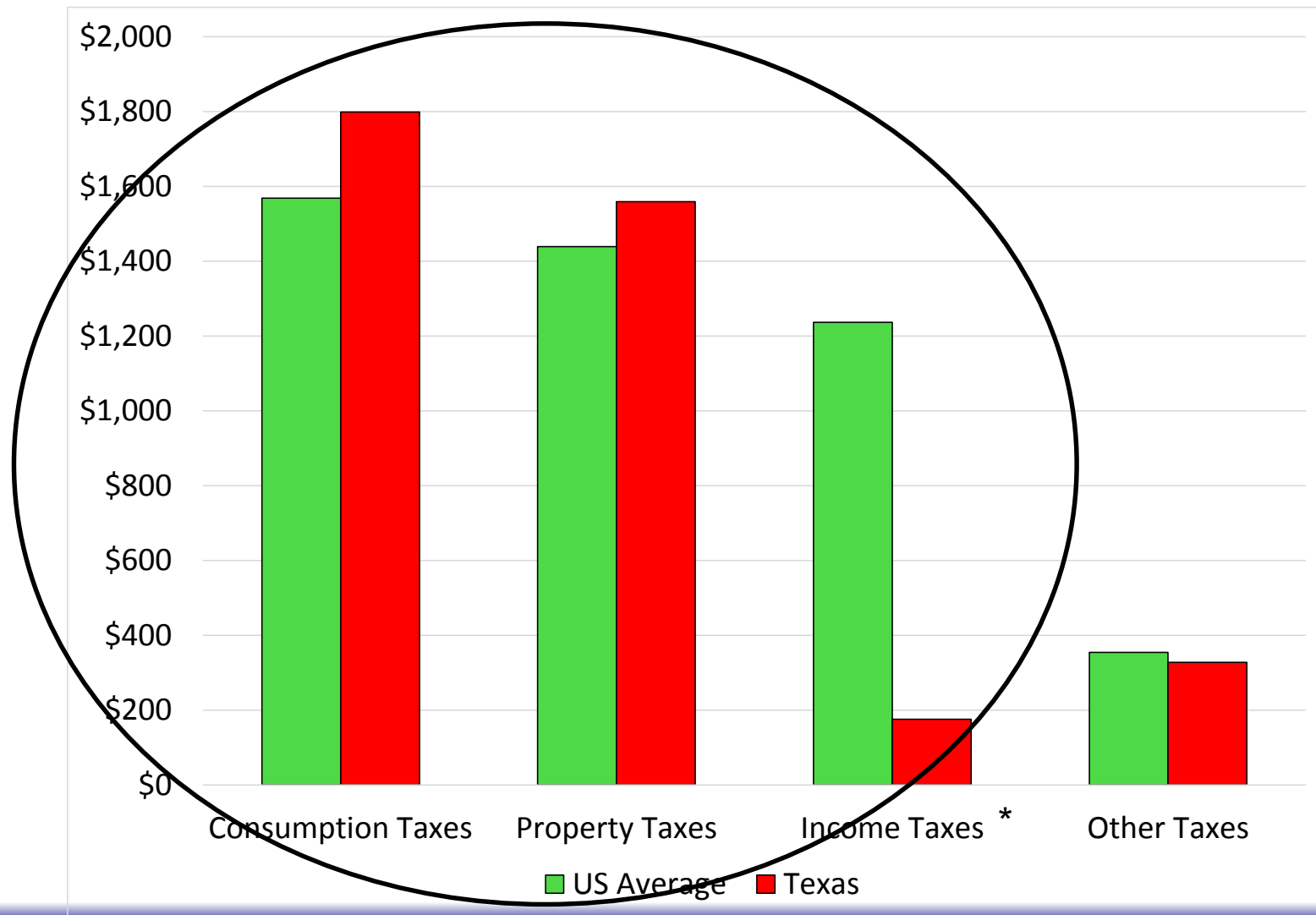
# How Texas Compares

State and Local Taxes Per Capita, 2013



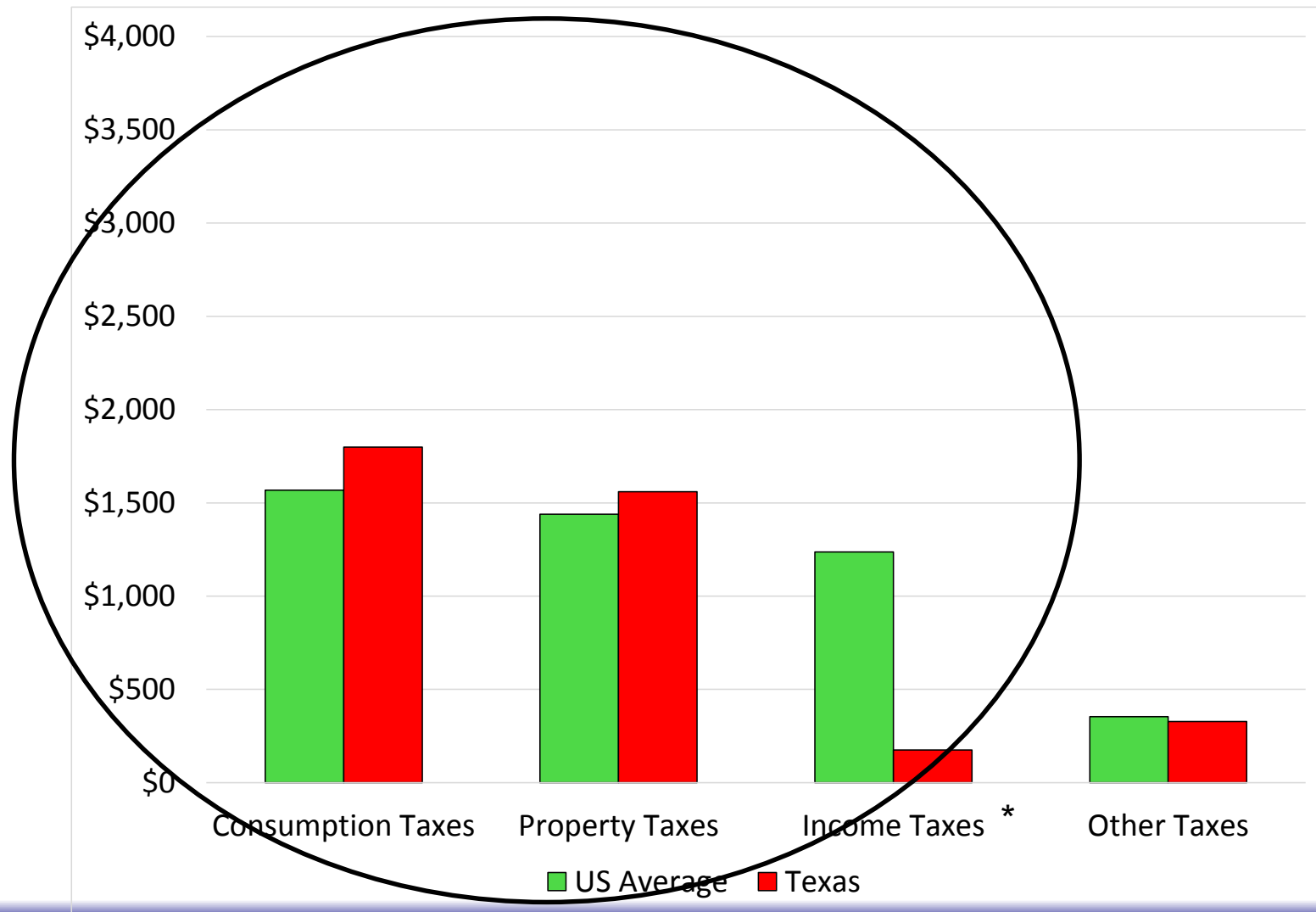
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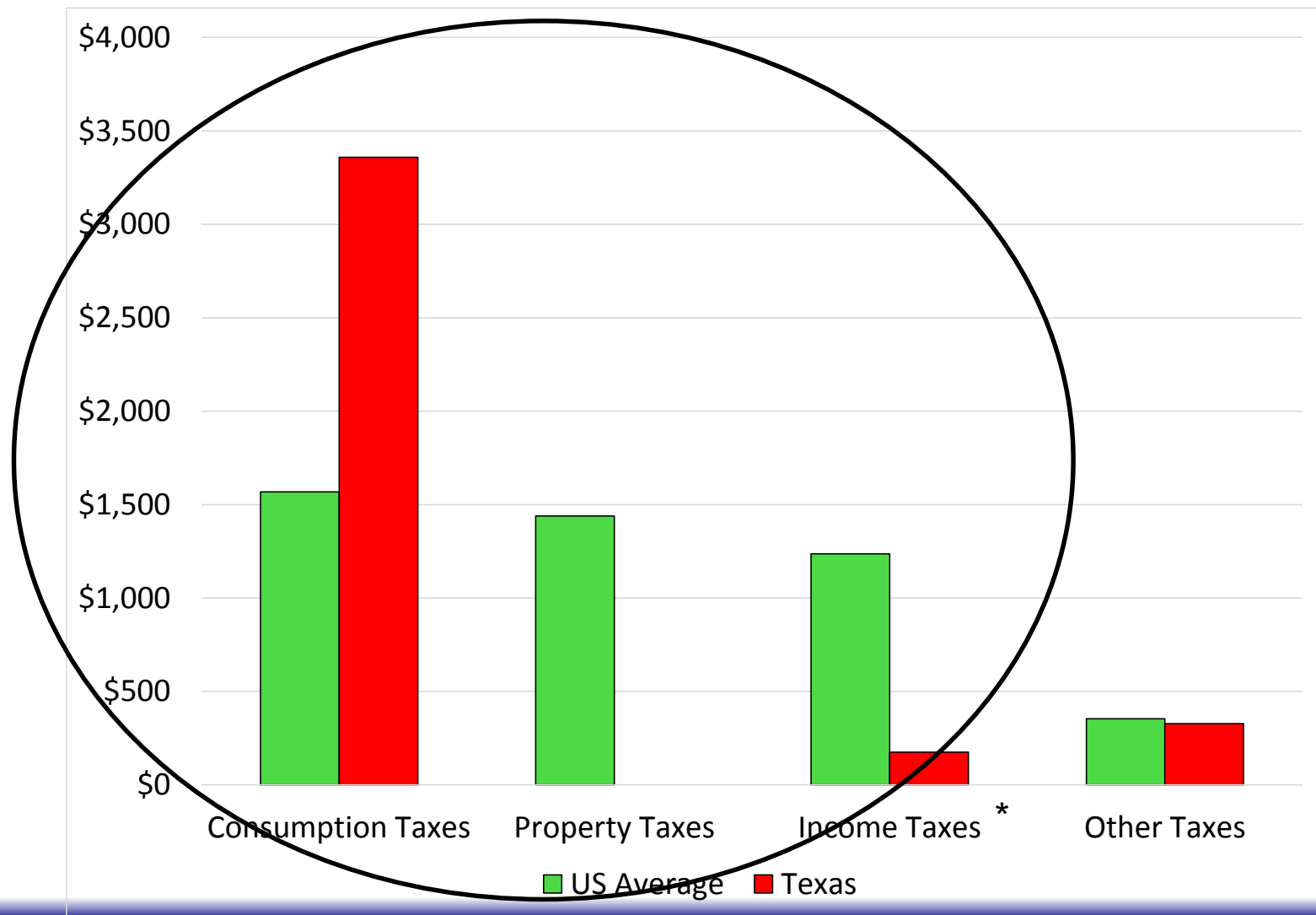
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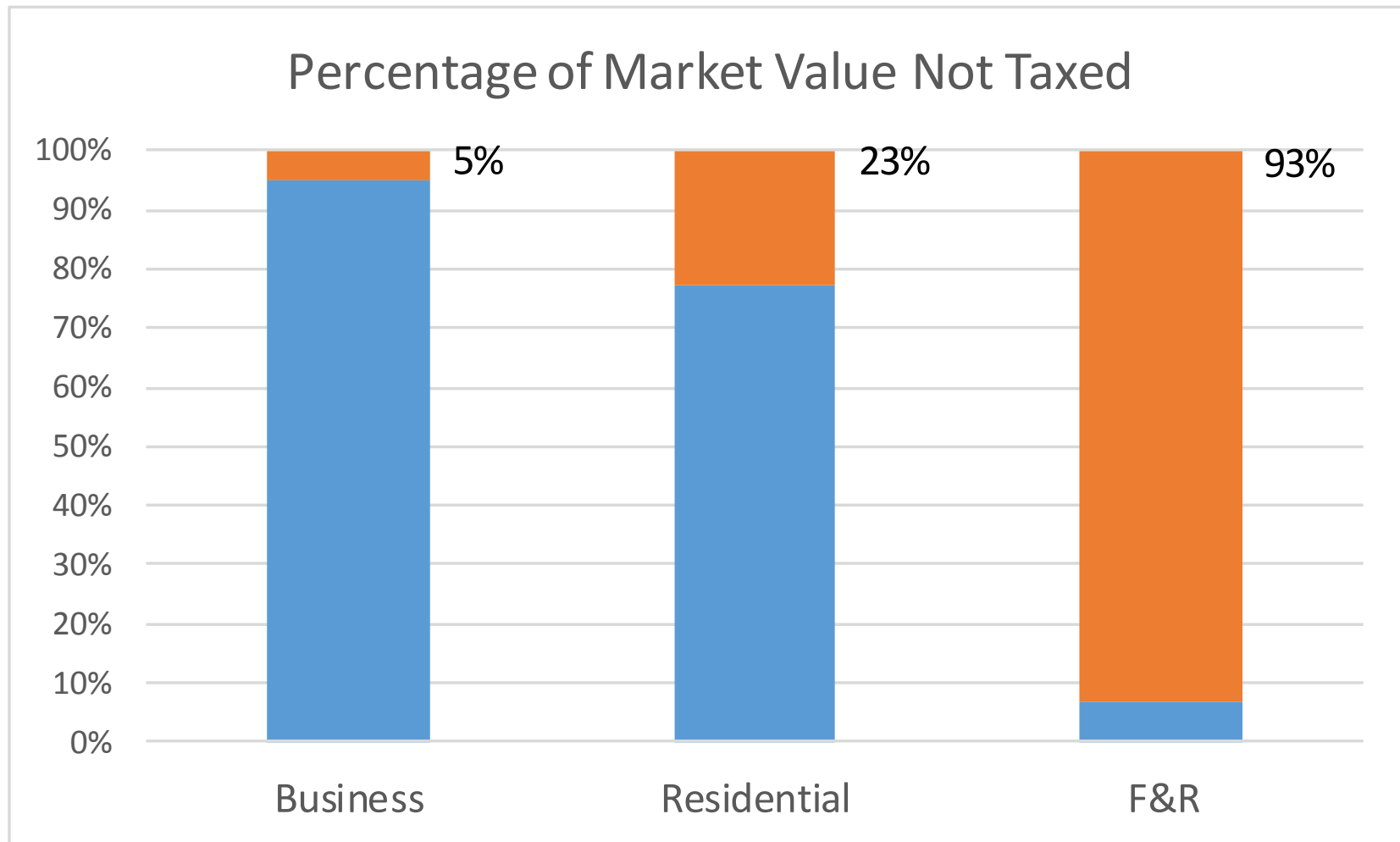
# Characteristics of the Property Tax

- Tax is levied on *property*, not individual taxpayers
- Tax base is relatively stable
- Tax rates are set each year by local taxing units to raise a specific amount of revenue
- Property is appraised each year by central appraisal districts in each county
- Tax has no direct relation to ability to pay

# Property Tax Base

- The Texas Constitution authorizes a tax on the market value of:
  - real property (primarily land, buildings, and improvements to land); and
  - tangible personal property held for the production of income (“business personal property,” such as retail inventories, furniture and equipment, etc.)
- Exemptions must be constitutionally authorized

# Percentage of Market Value Not Taxed - 2014



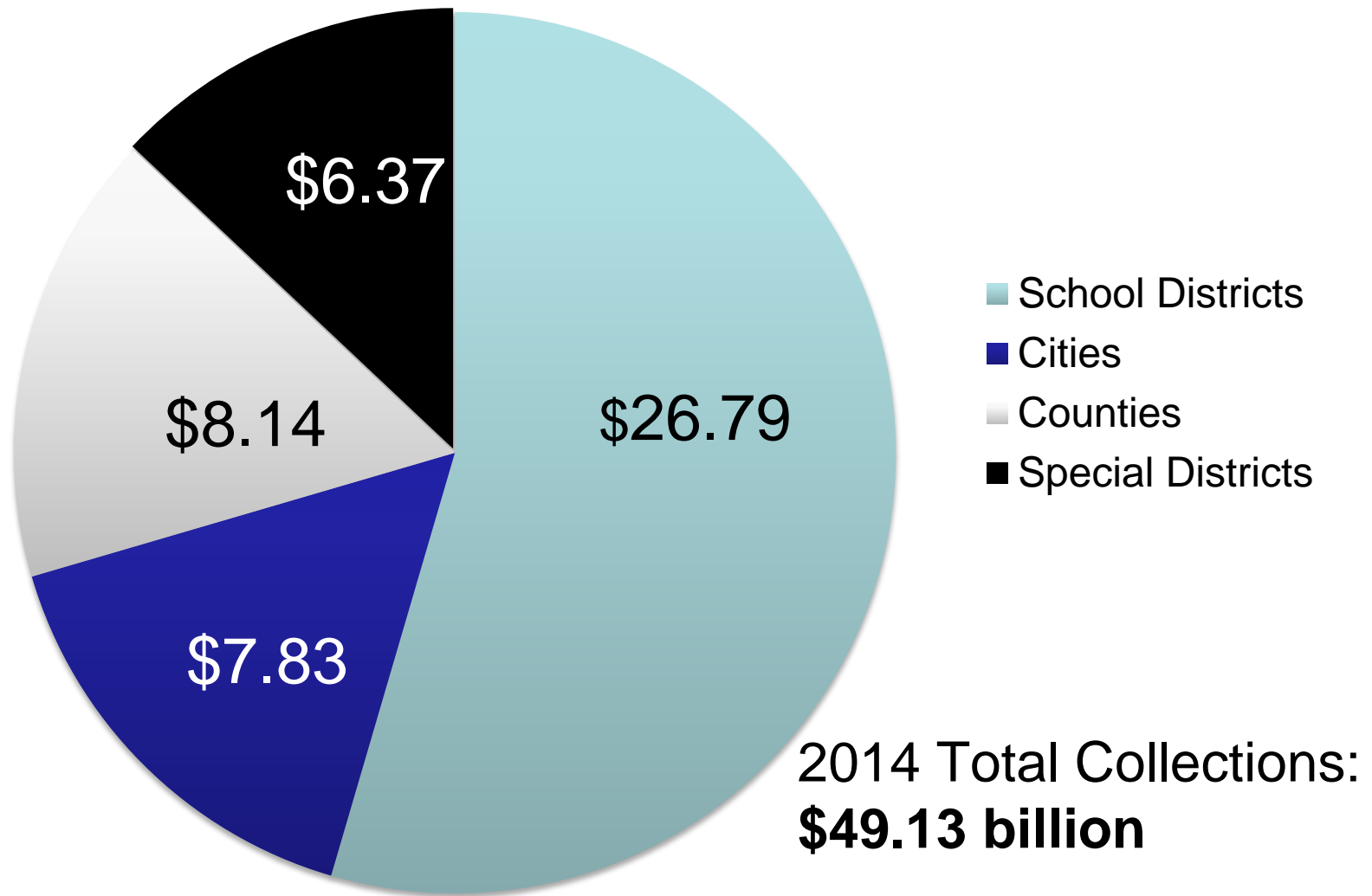
Source: Comptroller's Final 2014 ISD Self Report



# Property Tax Rates

Entity	Maximum Rates per \$100	Homestead Exemption
School districts	M&O \$1.17 I&S \$0.50	\$25,000 (state-mandated) Up to 20% with minimum of \$5,000 (local option)
Cities	Population $\leq$ 5,000: \$1.50 Population $\geq$ 5,000: \$2.50	Up to 20% with \$5,000 minimum (local option)
Counties	General fund: \$0.80 Farm-to-market roads/flood control: \$0.30 Special roads and bridges: \$0.15	\$3,000 (state-mandated) Up to 20% with \$5,000 minimum (local option)
Special Districts Source: Comptroller of Public Accounts	Community colleges: \$1.00 with no more than \$0.50 for debt service Hospital districts: \$0.75	Up to 20% with \$5,000 minimum (local option)

# Size of Tax by Taxing Jurisdiction (Billions)



Source: Comptroller of Public Accounts, 2014 tax year

# Comparing Texas Effective Tax Rates

	Urban Residential Homesteads (median value)	Urban Apartments (\$600,000 value)	Urban Commercial (\$25 million value)	Urban Industrial (\$25 million value)
Texas	1.854% (Houston)	2.391% (Houston)	2.474% (Houston)	2.571% (Houston)
US Average	1.477%	1.938%	2.099%	1.597%
Highest	4.040% (Bridgeport, CT)	5.450% (New York City)	4.215% (Detroit)	3.972% (Columbia, SC)
Lowest	0.632% (Birmingham)	0.326% (Honolulu)	0.692% (Cheyenne)	0.512% (Virginia Beach)

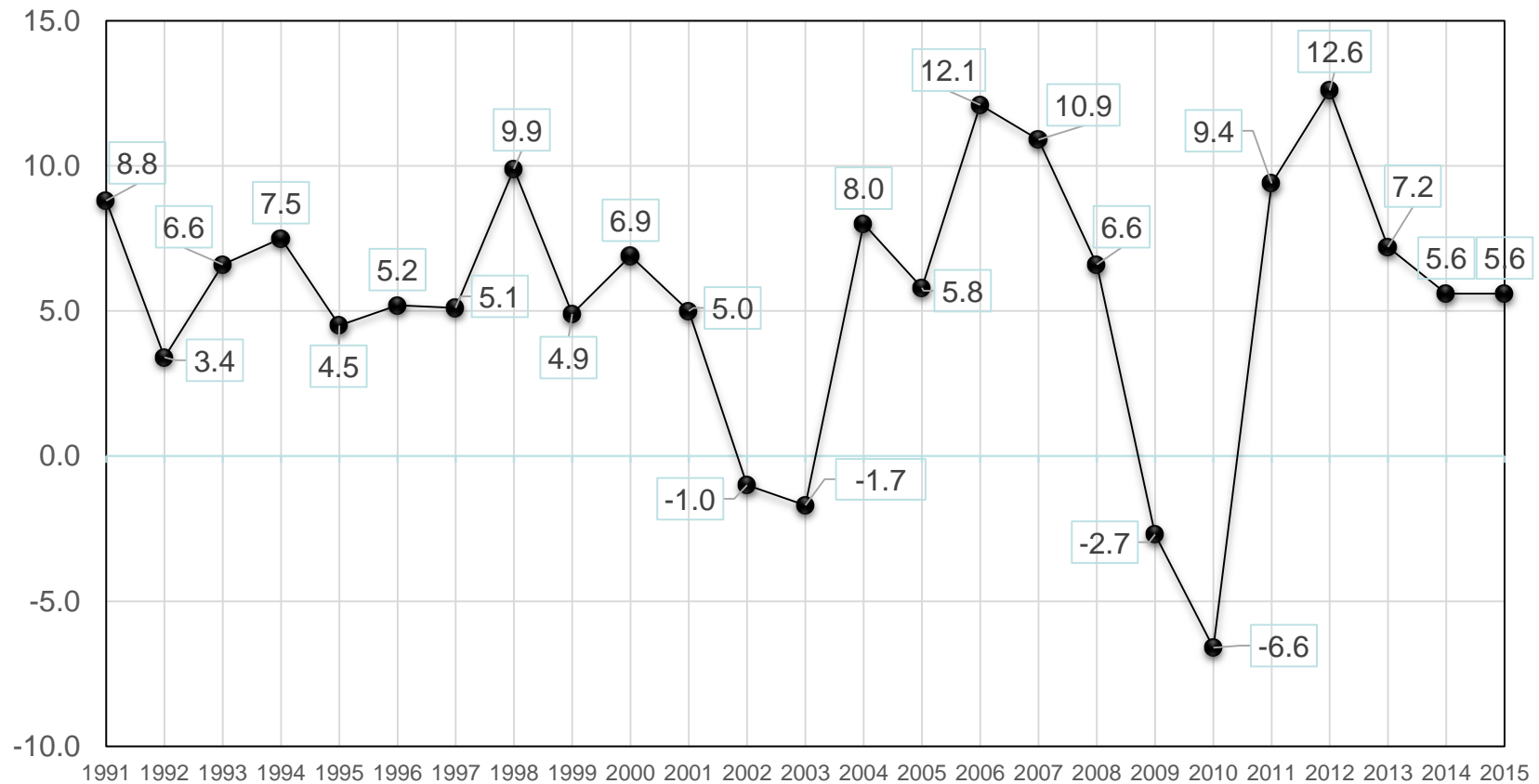
Source: Lincoln Institute of Land Policy, 50-State Property Tax Comparison Study, 2015

# Sales & Property Tax Receipts (2014)

	<u>Sales Tax</u>	<u>Property Tax</u>
Total	\$ 36.9 B	\$ 49.1 B
State	28.9	-*
School	-	26.8
County	0.5	8.1
Cities	5.2	7.8
Transit	1.8	-
SPDs	0.5	6.4

\* School property tax recapture – \$ 1.5 B

# Annual % Change in State Sales Tax Revenue



# Sales Tax Incidence

Business – 41%  
Consumers – 59%

Quintile*	Household Income	% of Total Tax Paid	% of Household Income
1	Less than \$34,161	6.9	7.5
2	34,161 – 61,955	9.9	4.1
3	61,995 – 94,319	13.8	3.6
4	94,319 – 147,411	18.8	3.1
5	More than 147,411	29.6	1.7
	Exported	20.9	
* 2.1 M Households			

# Tax Rates

- State 6.25%
- Local 1,572 – maximum 2%
  - Cities 1,150 (.25%-2%)
  - Counties 123 (.5%-1.5%)
  - Transit Authorities 10 (.25%-1%)
  - Special Purpose Districts 289 (.125%-2%)

# Special Purpose Districts-SPDs

Fire Control/EMS	90
Development/Improvement/Management	86
Crime Control	80
Library	15
Health Services	10
Hospital	8



# Sales Tax Rates Comparison

January 2016

	State	Texas	Max		Avg.			
	<u>%Rate</u>	<u>Rank</u>	<u>% Rate</u>	<u>Rank</u>	<u>%Rate</u>	<u>Rank</u>	<u>%Rate</u>	<u>Rank</u>
Texas	6.25	13 T	2.00	25 T	1.92	16	8.17	12
Highest	7.50 (CA)		8.50 (AL)		5.01 (LA)		9.46 (TN)	
Lowest	2.90 (CO)		0.50 (HI)		0.01 (ID)		1.78 (AK)	

No sales tax: DE, MT, NH, OR

State tax only: CT, IN, KY, MA, ME, MD, MI, NJ, RI

Local tax only: AK

# Sales Tax Design

- Tax on final sale, rental, lease or use of tangible personal property or specified services
- Liability of purchaser or user
- Collected and remitted by seller engaged in business in taxing jurisdiction or remitted by user located in taxing jurisdiction

# Texas Tax Base

- Sale, rental or lease of tangible personal property is taxable unless exempted
- Services are excluded unless specifically made taxable
- State & Local Same – limited exceptions
  - Residential utilities
  - Long distance calls

# Services Taxation Comparison

## Treatment of Services

- Generally not taxed 5 states
- Taxable unless exempted 4 states
- Specific services taxed 37 States

## Federation of Tax Administrators (FTA) Survey (2010)

- Total # services 168
- Taxed in Texas 83 (8<sup>th</sup> highest)
- Highest 160 (HI)
- Lowest 1 (AK)
- Median 55

# Exemption & Exclusion Policies

- Minimize tax pyramiding
- Minimize business distortions
- Minimize adverse economic consequences
- Reduce regressivity to avoid adverse fiscal impact on low income individuals
- Facilitate efficient tax administration/compliance
- Encourage purchase of certain items

# ***Tax Exemptions & Tax Incidence***

Comptroller of Public Accounts

(March 2015)

*The exemption estimates are unadjusted amounts, meaning that elimination or repeal of a specific exemption would not necessarily produce the dollar amounts cited in this report. Actual receipts would depend on enforcement, taxpayer compliance, effective dates of legislation repealing the exemption, taxpayer discounts, and the exact wording of the legislation.*

# Value of Exemptions

## (2015)

<u>Exemptions Total</u>	<u>\$34.6 bl</u>
• Manufacturing	14.8
– Raw Materials	13.0
– Machinery & equipment	0.8
– Utilities	0.6
– Packaging & wrapping	0.4
• Taxed by other law	13.4
– Insurance Premiums	5.5
– Motor vehicles	4.5
– Gasoline & diesel	2.7

# Value of Exemptions (cont.)

## (2015)

• <u>Exemptions Total, <i>continued</i></u>	<u>\$34.6 bl</u>
• Consumer Items	4.1
– Groceries	1.7
– Residential utilities	1.0
– Drugs	1.0
• Agricultural	0.4
– Feed, seed & fertilizer	0.3
– Machinery & equipment	0.1



# Value of Exemptions (cont.) (2015)

<u>Exemptions Total</u>	<u>\$34.6 bl</u>
-------------------------	------------------

- |                                   |     |
|-----------------------------------|-----|
| • Governments & non-profits       | 0.5 |
| • Newspapers, magazines, Internet | 0.3 |
| • Everything else                 | 1.0 |

# Value of Services Exclusions

## (2015)

<u>Services Total</u>	<u>\$7.5 bl</u>
• Professional services	2.4
– Legal	0.5
– Architectural & engineering	0.5
– Accounting & auditing	0.3
• Health care	2.2
– Doctors	1.1
– Dentists	0.4

# Value of Services Exclusions (cont.)

## (2015)

• <u>Services Total</u>	<u>\$7.5 bl</u>
• Housing costs	0.6
– Residential construction	0.2
– Residential repair & remodeling	0.1
– Real estate brokerage & agency	0.3
• Cost of living	1.0
– Auto repair	0.6
– Child day care	0.2
– Barber & beauty	0.01
• Cost of doing business	1.3
– Freight hauling	0.4
– Nonresidential construction	0.4
– Temporary labor	0.4

# Holidays

- Back-to-school
  - Friday-Sunday that falls two weeks before the first day of school for clothing, footwear, backpacks & school supplies less than \$100
- Energy & Water Efficient Products
  - Last Saturday-Monday in May for certain energy-efficient products – Memorial Day Weekend
- Emergency preparation supplies
  - Last weekend in April

# State Tax Sourcing

Based on “destination”

- Goods – where possession taken
- Services – where benefit received

# Tax Collection on Interstate Sales

- *Scripto v. Carson* (1960)
  - Presence by agent
- *Quill v. North Dakota* (1992)
  - Substantial physical presence
- Streamlined Sales Tax Project

# Engaged in Business

- Physical location
- Representative selling, delivering or taking orders for taxable items
- Texas franchisee or licensee
- Regular solicitation of sales
- Derive income from sale, rental or lease of tangible personal property
- Provide taxable services or repairs
- At least a 50% direct or indirect ownership of business in Texas

# Local Tax Sourcing

Based on “origin”

- Goods – seller’s place of business where sale is consummated or order received
- Services – seller’s place of business

Place of business

- Location operated for purpose of receiving orders for taxable goods or services
- Three or more sales made or orders taken



# Place of Business

- Multiple places of business
  - Location where order first received if placed in person by purchaser
  - Otherwise location from which order is shipped

# Local Tax Sourcing

## Multiple places of business

- Location where order is received
- Order not received at place of business – Texas business location where order is fulfilled
- Order not received or fulfilled at place of business – Texas location where delivered or purchaser takes possession
- Use tax – collected if possession taken at location where total local tax is more than that which applies where order is taken provided vendor has place of business at that location

# Returns/Remittances

- Both state and local taxes remitted
- Includes local tax allocations
- Due 20<sup>th</sup> of month after end of filing period
- Annual – less than \$1,000 a year
- Quarterly – less than \$1,500 per quarter
- Monthly - \$1,500 or more per quarter
- Direct pay permits
  - \$800,000 or more of annual taxable purchases for own use

# Discounts

- Timely Filer - 0.5%
- Prepayment – 1.25%
  - Must remit at least 90% of estimated liability
  - Due 15th of preceding month
  - Due 15th of second month of preceding quarter

# Property Tax Levies (2014)

(billions \$)

	<u>M&amp;O</u>	<u>I&amp;S</u>	<u>Total</u>
School	21.4	5.4	26.8
County	7.0	1.1	8.1
City	5.6	2.2	7.8
SPDs	5.0	1.4	6.4
Total	39.0	10.1	49.1

Note: Revenue per 1% sales tax rate (current base) – \$4.6 B

# Texas Public Education System 2014-15 School Year

- **1,219** school districts (#1 in the nation)
  - 1,018 Independent School Districts  
(Size ranges from 13 – 211,000 students)
  - 201 charter schools, military, special districts
- **8,656** (613 charters included) campuses

Source: TEA Snapshot 2014-15

# Texas Public Education System (cont.)

## 2014-15 School Year

- **5.232 million** enrolled students (#2 in nation behind California)
  - 4.975 million in ISD's (95.1%)
  - 0.257 million in charter schools (4.9%)
  - Enrollment increases 80,000 students per year
- **673,140** school employees (#1 in nation)
  - **342,192** teachers (**51%**)

Source: TEA Snapshot 2014-15

# District Staff Breakdown

	# Full-Time Equivalents	% of Total	Avg. Base Salary
<b>Teachers</b>	<b>342,192</b>	<b>51%</b>	<b>\$50,715</b>
<b>Campus Administrators</b>	19,680	3%	\$74,292
<b>Central Administrators</b>	6,995	1%	\$96,907
<b>Professional Support</b>	65,119	10%	\$59,791
<b>Educational Aides</b>	64,641	9%	\$19,586
<b>Auxiliary Staff</b>	174,514	26%	\$24,237
Source: TEA Snapshot 2014-15	<b>673,140</b>		



# Student Population

	1999	2014	Growth/ Decline
Hispanic	39%	52%	+13%
White	44%	29%	-15%
African American	14%	13%	-1%
Other	3%	6%	+3%
Source: TEA Snapshot 2014-15	100%	100%	

# Student Population

	1999	2014	Growth/ Decline
<b>Economically Disadvantaged</b>	48%	59%	+11%
<b>Limited English Proficient</b>	12%	18%	+6%

Economically disadvantaged is defined as eligible for the free and reduced price lunch program. Eligibility income requirements are between **\$31,525 (free) - \$44,863 (reduced) annual income** for a family of four. (130% and 185% of poverty which is \$24,250).

Source: TEA Snapshot 2014-15

# Public Education Funding

- Public Education is paid for with:
  - **local property tax** revenue
  - **state tax** revenue
  - **federal** revenue
- The **more taxable property value** per weighted student that a district has, the **less state aid** it receives.
- Districts with **high levels of taxable value** must send a check to the state or to another district.

# Foundation School Program

## 1. School Finance Formulas

- a. Increased revenue for **small and mid-size** school districts
- b. Increased revenue for more **difficult to educate** students
- c. State **recaptures** revenue above a certain property wealth level
- d. **State/local split** of district's entitlement

## 2. Local Enrichment

- a. State **equalizes** local revenue between \$1.01 - \$1.17
- b. **Six pennies** are **not subject to recapture**
- c. Remaining pennies **are subject to recapture** above a certain property wealth level
- d. **State/local split** of cost of enrichment

## 3. Facilities

- a. State **equalizes** very low-wealth districts; **no recapture**

# Foundation School Program

## Total Cost (Billions) 2015-16 School Year

	Total Cost	State Share	Local Share
Tier 1 Entitlements	\$36.1	\$18.1	\$18.0
Enrichment Pennies	\$ 3.6	\$ 1.8	\$ 1.8
<b>M&amp;O Cost</b>	<b>\$39.7</b>	<b>\$19.9</b>	<b>\$19.8</b>
Debt Service	\$ 6.0	\$ 0.6	\$ 5.4
<b>M&amp;O and Debt Service</b>	<b>\$45.7</b>	<b>\$20.5</b>	<b>\$25.2</b>
		45%	55%
<b>Recaptured M&amp;O Levy</b>			<b>\$ 1.6</b>
<b>Total School Property Tax</b>			<b><u>\$26.8</u></b>

Source: TEA Summary of Finance

# M&O Tax Replacement

1. How will we calculate a district's entitlement?
  - a. Current formulas
  - b. New formulas
  - c. Block grant
2. Will **school districts be authorized to levy a sales tax** for their share or will we have a **state funded system**?
3. Will the new system meet constitutional test of efficiency?

# M&O Tax Replacement-Local Sales Tax

1. School district share determined by a locally levied sales tax.
  - a. Will there be a **minimum rate** required?
  - b. Will there be a **maximum rate** allowed?
  - c. Will the state **recapture** revenue raised in excess of the district's entitlement?
  - d. Could have 1,018 different sales tax rates.
  - e. Many **small property wealthy** districts will not raise very much in sales tax.

# M&O Tax Replacement-State Sales Tax

1. Totally state funded system – **no local share**
  - a. Amount of revenue required would be generated by a state sales tax rate.
  - b. How would the rate be set?



# Funding Stability

1. Will the sales tax rate be adjusted each year to fund **enrollment growth** and other increased costs?
  - a. 80,000 students x \$10,000 = **\$800 million per year**  
**(\$2.4 billion per biennium)**
  - b. Currently much of the cost is paid for by **rising property values**
  
2. Will the **sales tax rate automatically increase**, or will the Legislature have to act?
  - a. If the Legislature has to act, what happens during the interim year?

# Local Enrichment

1. Will we allow districts to levy a **local option enrichment tax**?
  - a. Sales Tax?
  - b. Property Tax?
  
2. If so, **will we equalize** the levy? **Recapture** the levy?
  - a. Supreme Court has said we can have unequalized enrichment on top of a constitutional system.

# Local Control

1. Will school boards be authorized to adopt budgets without limitations?
2. If school districts are totally financed with state funds, will **state approval** of budgets be required?
  - a. Legislature
  - b. TEA
  - c. LBB
  - d. SBOE

# I&S Tax Replacement – Local Sales Tax

1. \$72 billion school bonds; **\$117 billion** outstanding principal and interest; \$6.0 billion paid per year
2. Will 1,018 school districts be **authorized to levy a local sales tax** for existing debt repayment?
3. Will there be a **maximum rate** allowed?
4. Will the state **equalize** the debt payments?
5. Will bond issuers and investors accept **local sales tax as guarantor**?
6. Will the **Permanent School Fund** still be used as a guarantee for bonds?

# I&S Tax Replacement – State Sales Tax

1. Will there be a **maximum rate** allowed?
2. Will bond issuers and investors accept **state sales tax as guarantor**?
3. Will the **Permanent School Fund** still be used as a guarantee for bonds?
4. Will the state pay for **charter school debt**?

# Local Control - New Debt Paid with Local Sales Tax

1. Will 1,018 school districts be **authorized to levy a local sales tax** for new debt repayment?
2. Will there be a **maximum rate** allowed?
3. Will the state **equalize** the debt payments?
4. Will bond issuers and investors accept **local sales tax as guarantor**?
5. Will the **Permanent School Fund** still be used as a guarantee for bonds?

# Local Control - New Debt Paid with State Funds

1. Will **local voter approval** be necessary for **new debt** if **state funds** will be used to retire the debt?
2. Will **state approval** be required for **new debt** because **state funds** will be used to retire the debt?
  - a. Legislature
  - b. TEA
  - c. LBB
  - d. Bond Review Board
  - e. Attorney General

# Distribution Issues

1. Property Wealthy Districts
  - a. Reimburse all of the property tax the district levied, or
  - b. Reimburse the amount they were allowed to keep after recapture?
  - c. Hold harmless?
2. Will your community generate enough sales tax to replace its current property tax?
3. If locally levied sales tax, **will the state recapture excess sales tax collections** and redistribute?



# Let's Begin With Some Very, Very Rough, Back-of-the Envelope Math

*All numbers presented here are theoretical  
and subject to review by the Comptroller.*

# Option 1: Expand the Sales Tax

- Expand the sales tax to eliminate essentially all exemptions except
  - manufacturing materials, and
  - items taxed under other law; and
- Extend the tax to services.

# Replacement Revenue

Item	Revenue (\$ ml)	Comments	Individual Share	Business Share
Groceries & Food	\$1,801	Taxed in 14 states (some lower rate)	98%	2%
Water	\$268	All uses—business & residential	22%	78%
Residential Gas & Electricity	\$979	Was taxable prior to 1979	100%	0%
Industrial Gas & Electricity	\$660	Industrial, mining, & agricultural	0%	100%
Manufacturing Equipment	\$758	Was taxable prior to 1989 phase-out	0%	100%
Packaging Materials & Containers	\$643	Business packaging	0%	100%
Agricultural Items	\$593	Fertilizers, livestock, etc.	0%	100%
Medicine	\$955	Prescription & over-the-counter	47%	53%
Internet access	\$284	May be pre-empted by federal law	50%	50%
Other Exemptions	\$1,304		20%	80%
Construction labor	\$697	Residential & Non-residential	30%	70%
Personal Services	\$368	Hair care, funerals & child care	100%	0%
Medical Services	\$2,186	Doctors, dentists & hospitals	22%	78%
Licensed Professionals	\$1,283	Lawyers, accts, architects, engineers	20%	80%
Other Business Services	\$2,175	Temporary labor, freight, brokers	5%	95%
Veterinary Services	\$66		100%	0%
Automobile services	\$618	Repair labor & car washes	80%	20%
<b>Total</b>	<b>\$15,636</b>		<b>45%</b>	<b>55%</b>

# Option 1: Expand the Sales Tax

Property Tax Revenue Target	<u>\$49.1 bl</u>
State Sales Tax Base Expansion	\$15.6 bl
Local Sales Tax Base Expansion	<u>\$ 4.5 bl</u>
Total New Sales Tax	\$20.1 bl
Still Short	\$29.0 bl

# Option 1: Expand the Sales Tax

Property Tax Revenue Target	<u>\$49.1 bl</u>
State Sales Tax Base Expansion	\$15.6 bl
Local Sales Tax Base Expansion	<u>\$ 4.5 bl</u>
Total New Sales Tax	\$20.1 bl
Still Short	\$29.0 bl

**Tax everything  
at a 12.5% tax  
rate**

# Impact on Who Pays

(Billions)

Current Law	Business	Individuals	Total
Sales Tax	\$11.8	\$17.1	\$28.9
Property Tax	<u>\$29.5</u>	<u>\$19.6</u>	<u>\$49.1</u>
Total	\$41.3	\$36.7	\$78.0
<b>Sales Tax Swap</b>			
Sales Tax	\$38.3	\$39.7	\$78.0
<b>Difference</b>			
Difference	(\$3.0)	\$3.0	

# Impact on Industries

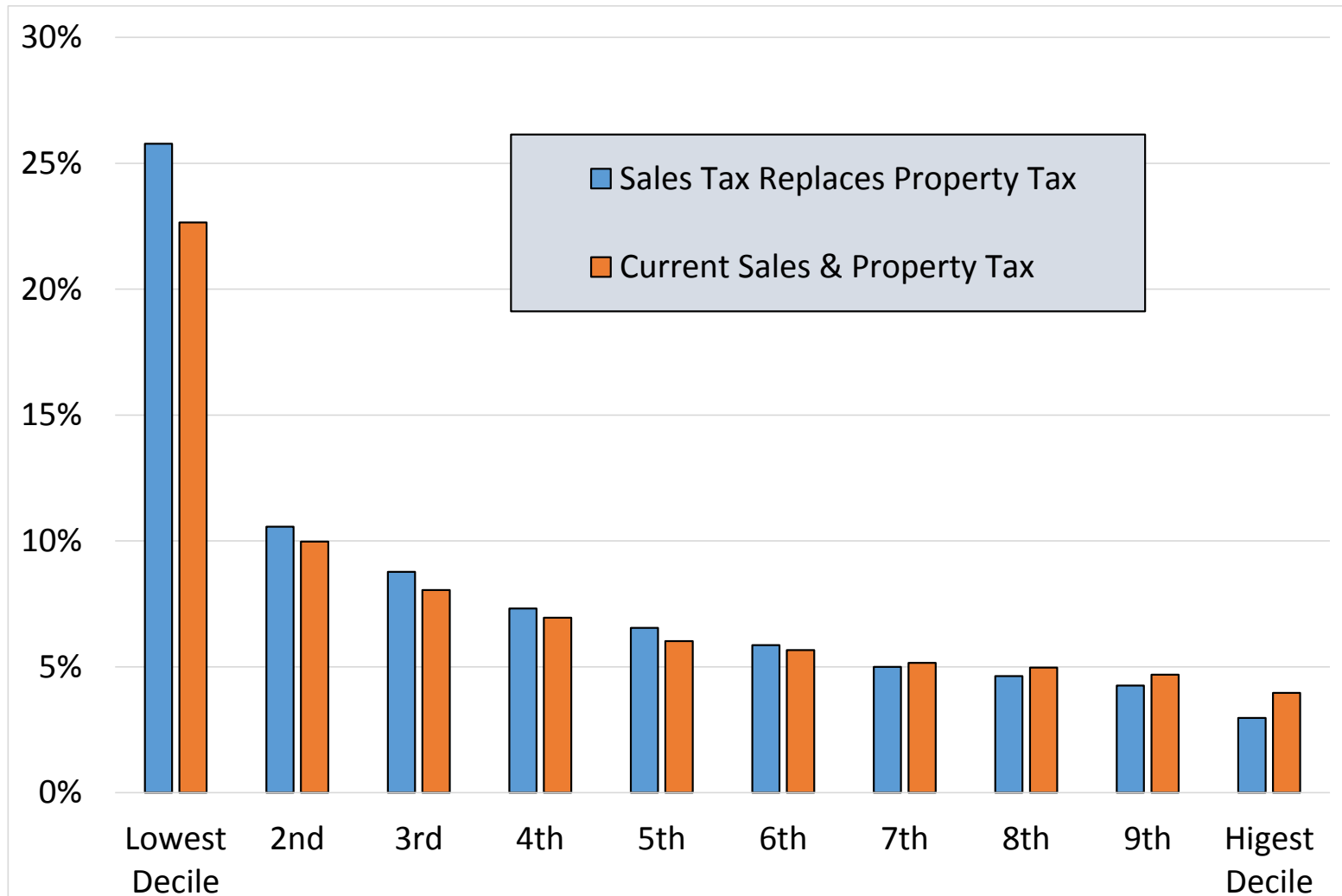
## Winners and Losers (Generally)

**WINNERS:** Capital intensive industries, such as oil and gas, manufacturing, and utilities may see their overall tax burden decline (depending on what is taxed).

**LOSERS:** Services industries will pay higher prices to purchase the goods they use and will have to charge their customers sales tax

# Impact on Families

## Sales/Property Taxes as a Percent of Family Income





## Option 2: Expand the Sales Tax, Including to Real Estate Sales

Property Tax Revenue Target	<u>\$49.1 bl</u>
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State Sales Tax Base Expansion	\$15.6 bl
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Local Sales Tax Base Expansion	\$ 4.5 bl
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Add: Real Estate Sales	<u>\$ 8.2 bl</u>
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Total New Sales Tax	\$28.3 bl
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Still Short	\$20.8 bl
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# Option 2: Expand the Sales Tax, Including to Real Estate Sales

**Tax everything, including real estate, at an 11% tax rate**

Property Tax Revenue Target	<u>\$49.1 bl</u>
State Sales Tax Base Expansion	\$15.6 bl
Local Sales Tax Base Expansion	\$ 4.5 bl
Add: Real Estate Sales	<u>\$ 8.2 bl</u>
Total New Sales Tax	\$28.3 bl
Still Short	\$20.8 bl

# Taxing Real Estate Sales

- A transactions tax on real estate is prohibited under the Texas Constitution
- How will the real estate market react to a transactions tax?
  - Long term homebuyers will be rewarded because of the elimination of property taxes
  - Homebuyers will have to come up with a bigger down payment
  - Likely to depress short term sales because buyer is “underwater” longer
  - How do you address tax planning?

# Up Front Costs

Price of Home = \$ 200,000

20 % down payment = \$ 40,000

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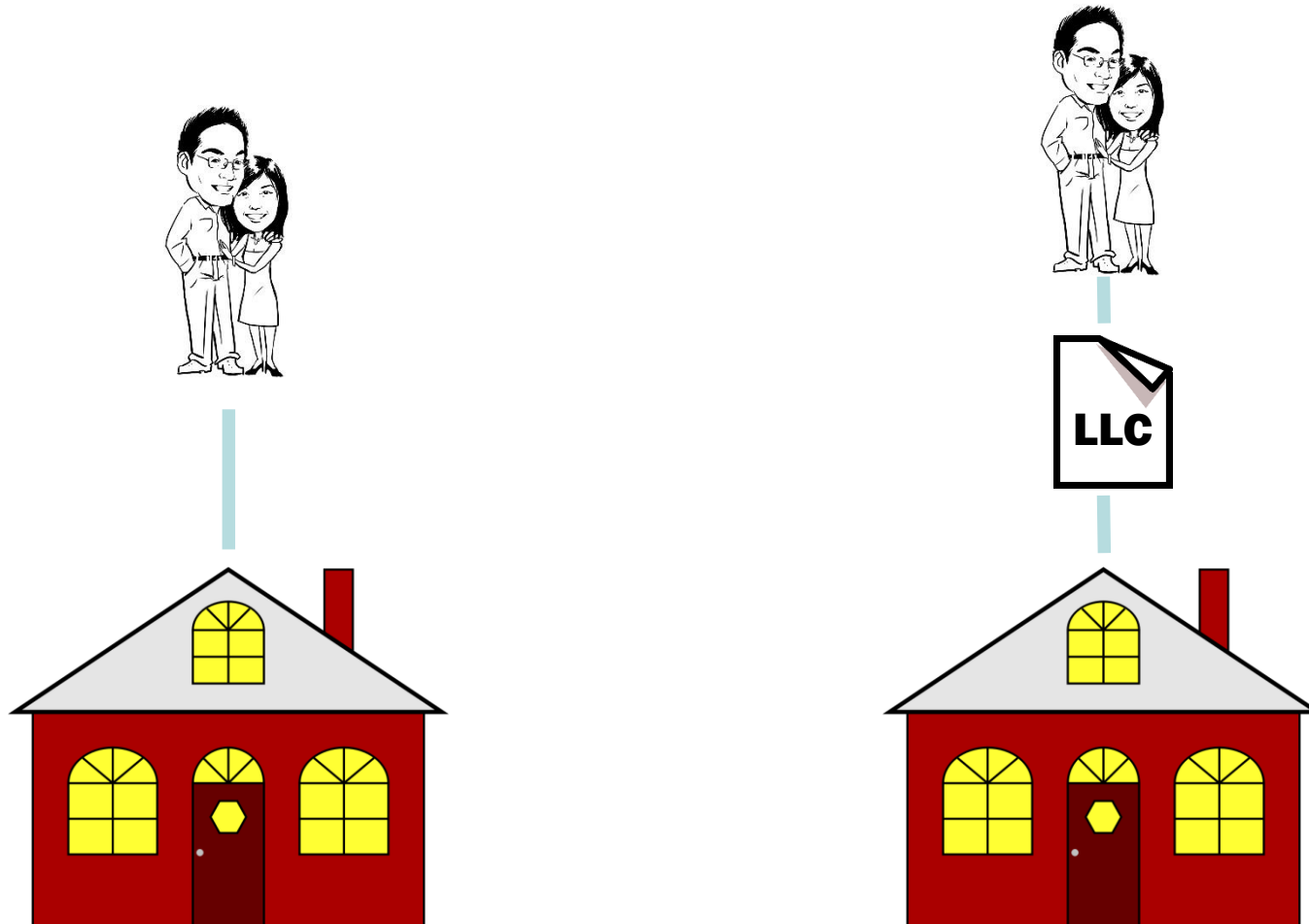
Sales Tax Due (at 11%) = \$22,000

Total due up front = \$62,000

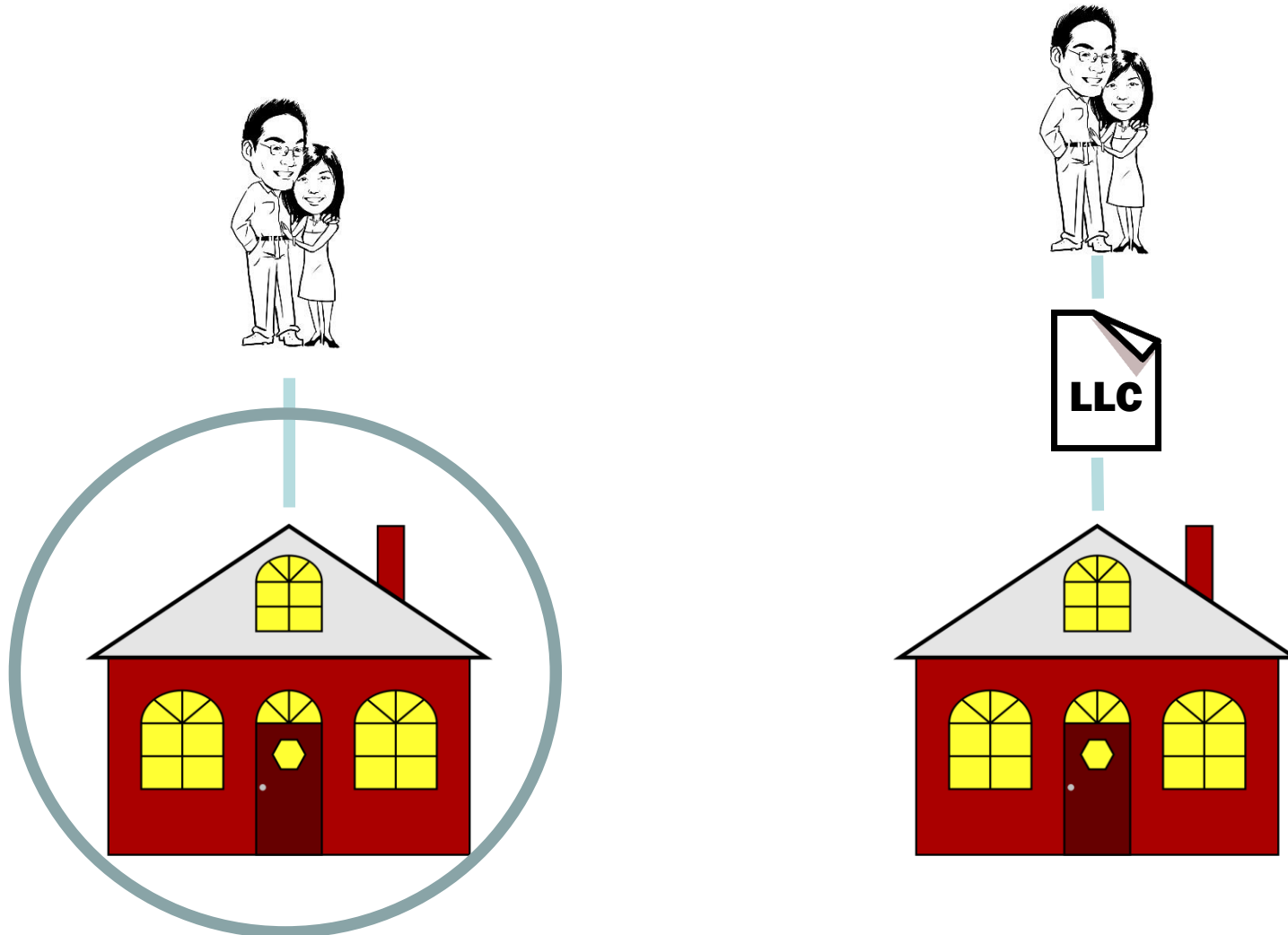
# How Long Underwater?

- Because of commissions and closing costs, it takes roughly two years of appreciation for buying a home to make more financial sense than renting.
- Adding another 11 percent or so to up-front costs, may increase the “break-even” period of owning a home to roughly 4 years

# Can You Avoid Transfer Taxes?

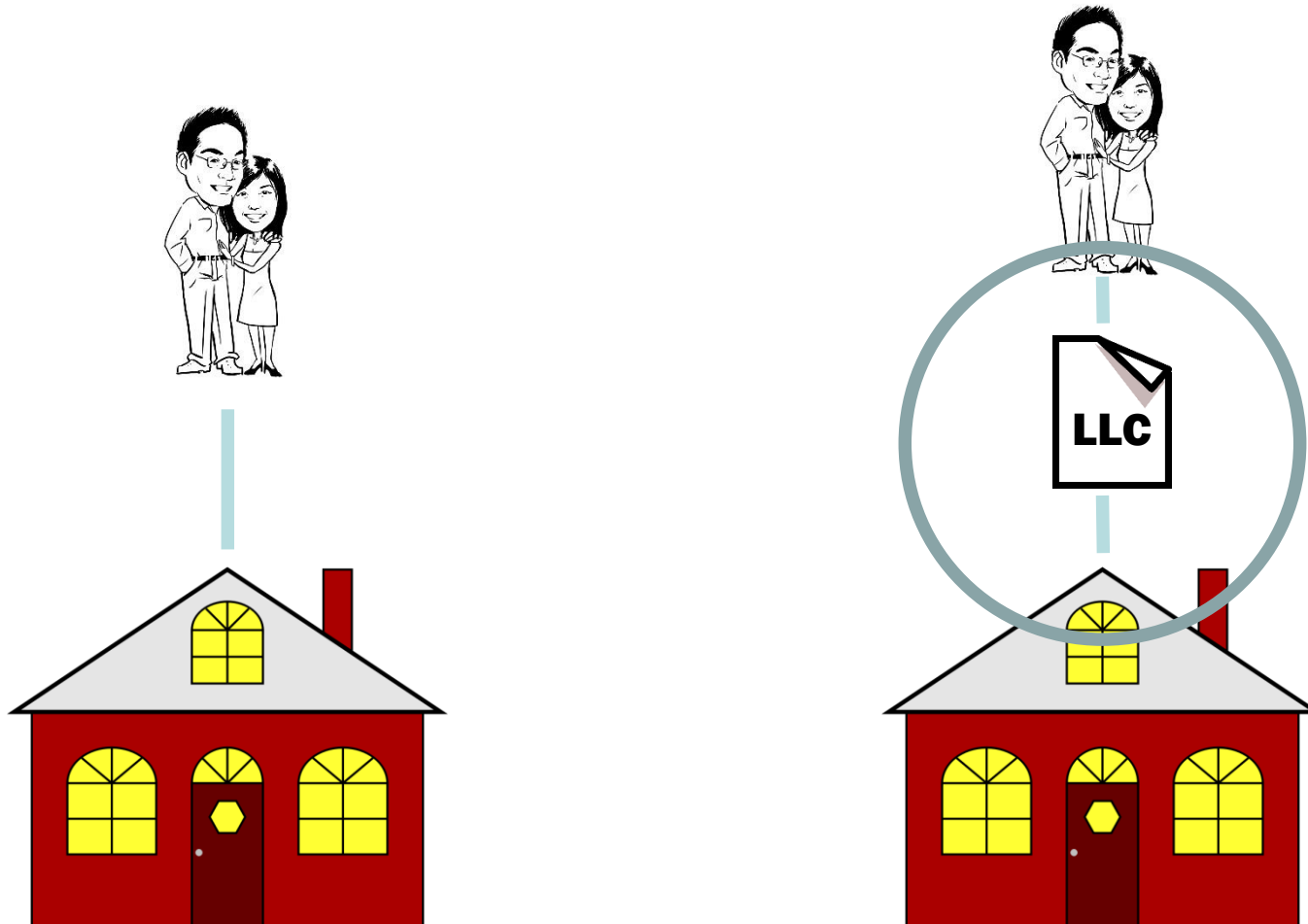


# Can You Avoid Transfer Taxes?





# Can You Avoid Transfer Taxes?



# Sales Tax Avoidance

- The higher the sales tax rate and the broader the sales tax base, the greater the likelihood that people will turn to tax avoidance:
  - Buying over the Internet from sellers who do not collect Texas sales tax (and cannot be compelled to under federal law)
  - Buying big ticket items out of state and bringing them into Texas
  - Encourages businesses to internalize taxable activities
  - Buying services out of state

# Impact on Revenue Gains

- In 2012, the Comptroller's Office cautioned that tax avoidance and administrative barriers would force a much higher tax rate than simple math might suggest—as much as one fourth higher

## Option 3: Simply Increase the Sales Tax Rate

- In 2012, the Comptroller's Chief Revenue Estimator stated that the actual sales tax rate necessary to eliminate the property tax would be a state tax rate of 23 percent, with the current local sales tax bringing the total tax rate to **25 percent**.

# Issues of Local Finance: Will the Sales Tax Be...

- A uniform statewide tax (as assumed on previous slides), or
- A locally-specific sales tax in which each jurisdiction sets their own sales tax rate necessary to replace property tax revenue?

# A Uniform Statewide Tax?

- The Legislature will have to establish some method to distribute property tax replacement moneys to local districts
  - Will the state use formulas, and if so what elements will they contain?
  - Will the state simply provide an amount equal to past property taxes, and if so, will there be any adjustments for local growth patterns?
  - Will the appropriations bill simply provide a block grant to each jurisdiction?
  - Who bears the risk if sales taxes fall short?

# A Locally-Set Sales Tax Rate?

- The vast disparity in sales tax bases across local jurisdictions could result in a patchwork of widely varying local sales taxes
- Prohibitively high sales tax rates could be required in:
  - Bedroom communities with much property, but little retail activity (e.g. Alamo Heights, Highland Park, Bellaire)
  - Rural areas (much property, but little retail activity)
  - Downtown urban areas with much commercial office space, but relatively less retail (Dallas, Houston)
- Communities with high retail activity (such as outlet malls) will be able to impose much lower sales taxes than other areas, possibly attracting retail businesses from high tax communities (e.g. San Marcos, Katy)

# Financing Facilities & Infrastructure

- What mechanism will the state provide for financing facilities and infrastructure?
  - A local option sales tax (and if so, how will undeveloped areas pay for new infrastructure)?
  - Will bond investors accept a sales tax guarantee, and if so, how will jurisdictions respond in the event the sales tax doesn't generate enough to meet debt service needs?
  - Will the state take over all facilities funding, and if so, what will the approval process entail?
  - Retain a portion of the property tax, but only for debt service?



# Other Issues to Be Addressed

- If some portion of the property tax is to be retained, how do you **control against local tax increases** diminishing the amount of property tax relief
- How do you address differences in **cash flow** and how do you **transition** to a new tax regime?
  - The property tax is an annual tax due by the end of January
  - The sales tax is paid as you purchase items throughout the year
  - In the initial year, people may have to pay both taxes

# Conclusions

- Replacing the property tax with sales tax is more than just a math exercise
- Success will require a careful assessment of economic effects created by new tax policy and how and whether to address them
- Success will require tackling many very complex issues of local finance
- Don't forget local politics!!!

# Thanks for Joining Us!

If you have any questions or comments, please feel free to contact TTARA staff.

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