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# State and Local Taxes and the Texas Economy

Dale Craymer  
President, Texas Taxpayers and Research Association  
(512) 472-8838  
[dcraymer@ttara.org](mailto:dcraymer@ttara.org)  
[www.ttara.org](http://www.ttara.org)

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# Tax Incidence

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There are two basic types of taxpayers:

1. *Businesses*, and
2. *Individuals*.

In Texas, *individuals* incur direct taxes on many of their purchases and their real estate, but unlike most states, not on their income.

*Businesses* may incur taxes on their purchases (e.g. sales tax, fuels taxes), their assets (e.g. property tax), their sales (e.g. cigarette, alcohol), and be subject to special industry taxes on gross receipts (e.g. utilities, insurance). Businesses respond to taxes in one of three ways:

1. Pass the cost of the tax forward to individuals in the form of higher prices,
2. Pass the tax backward to owners in the form of lower profits, and/or
3. Pass the tax backward to individuals by reducing expenses, such as payroll or relocating or shifting investment to a lower cost location.

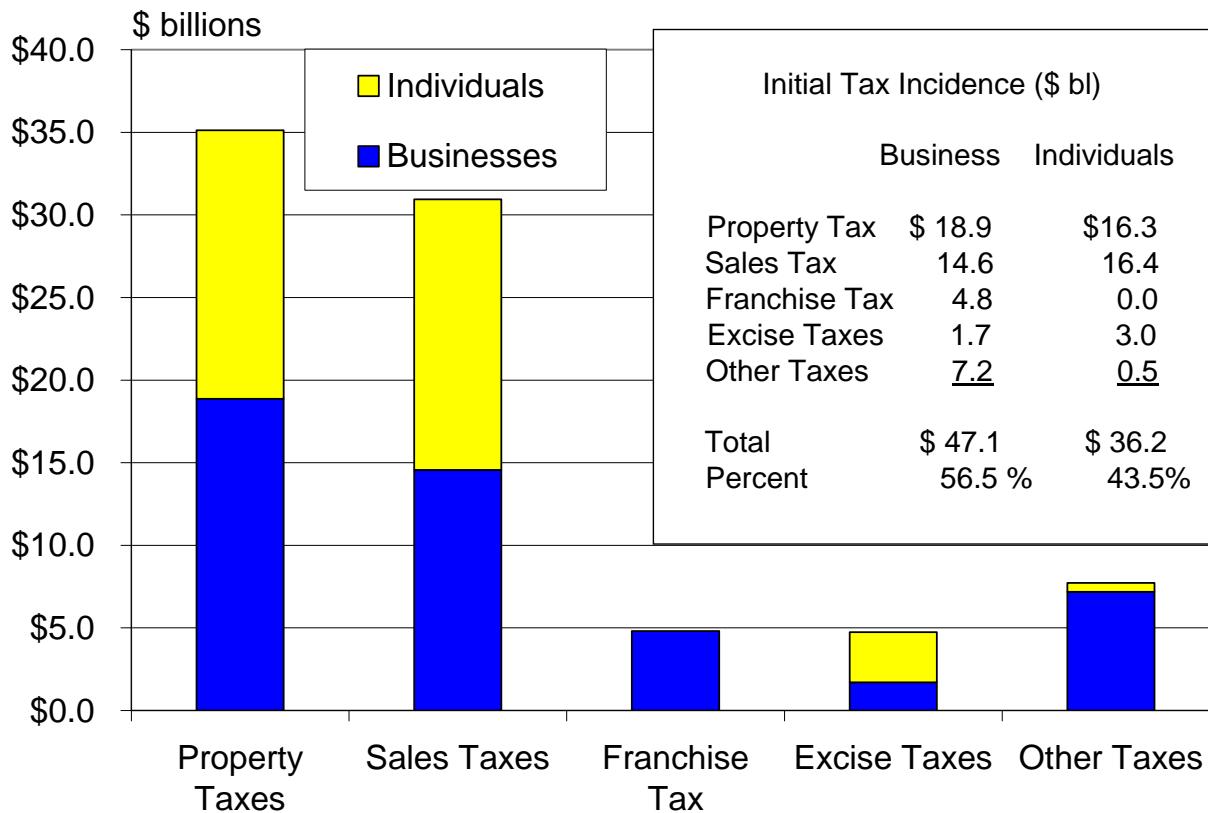
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Note about the initial incidence assignments in this analysis...

- Sales and motor vehicle sales taxes: tax due is on the sale of a taxable item and is paid by the purchaser. For example, while a retailer collects the tax and remits it to the state, the tax is paid by the purchaser.
- Property tax is paid by the owner of the property, whether an individual or a business.
- Motor fuels tax is paid by the ultimate consumer of the fuel (state law actually requires the tax be passed on to the consumer).
- Franchise tax is paid by the business entity.
- Severance taxes and industry gross receipts taxes are paid by the business.
- Excise taxes on consumer products (tobacco and alcohol) are paid by the consumer.



# Texas State and Local Taxes on Businesses and Individuals, 2008



Source: Texas Taxpayers and Research Association

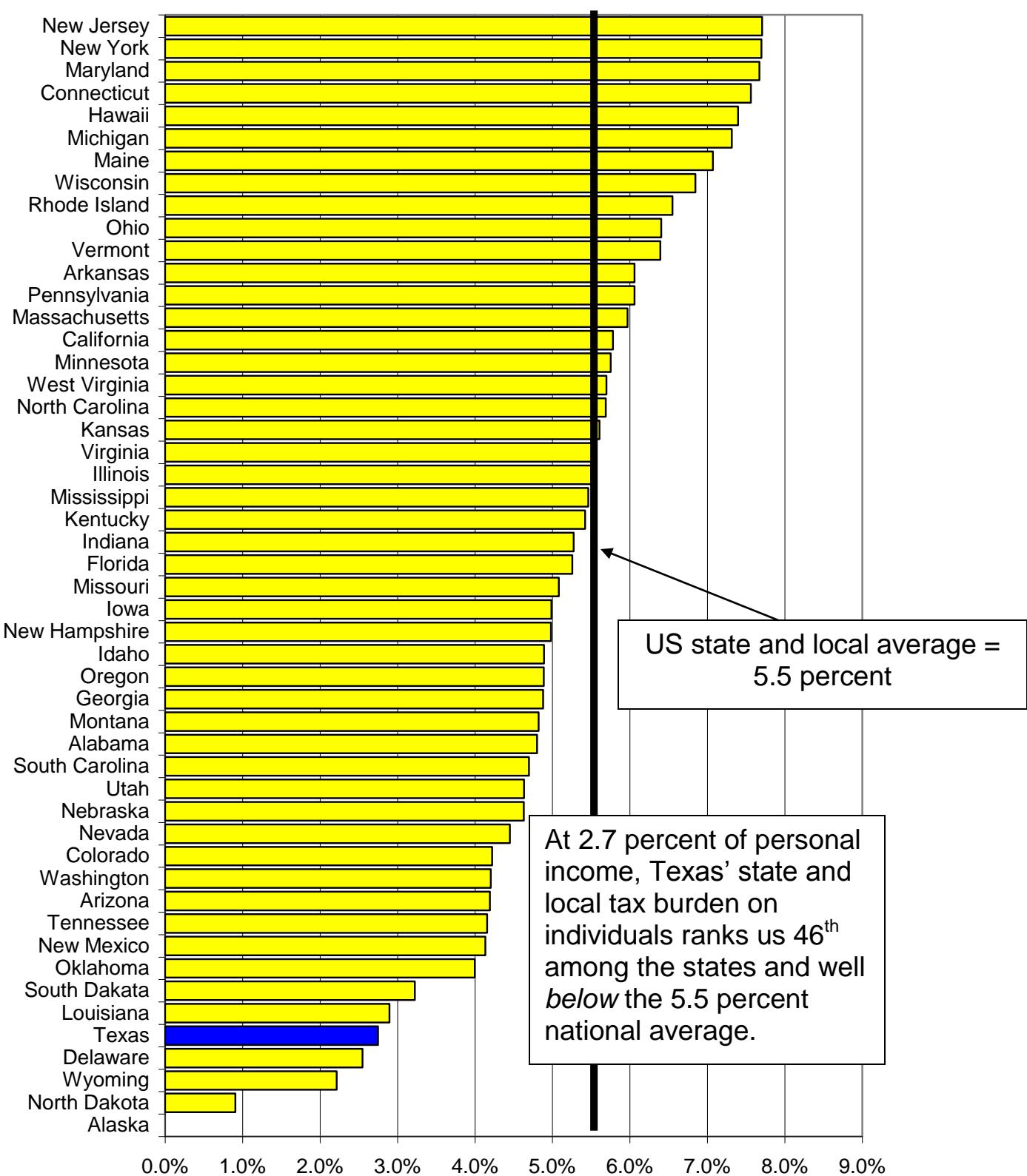
The biggest tax businesses pay in Texas is not the franchise tax—what is typically thought of as Texas’ “business tax.” The biggest tax paid by the business community is the property tax—levied by 1,024 independent school districts, 254 counties, over 1,000 cities, and over 1,600 special purpose taxing units throughout the state.

School districts assess approximately 55 percent of all property taxes paid in the state, with cities and counties accounting for roughly 16 percent each and special districts approximately 12 percent.

The second largest tax businesses pay in Texas are the sales taxes paid to the state, and to over 1,400 taxing jurisdictions—mostly cities, but also metropolitan transit authorities, and other special purpose districts.



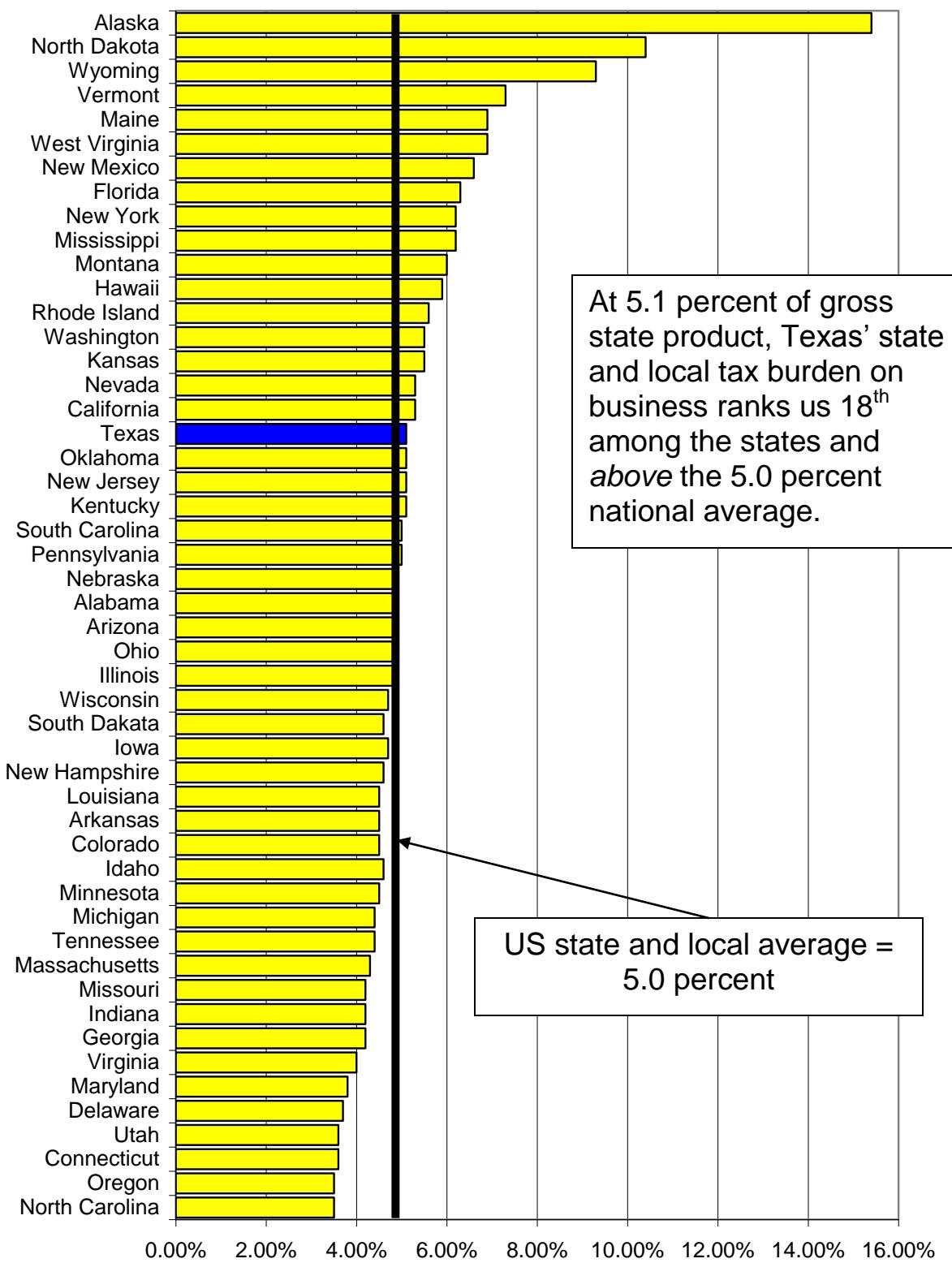
# Individual Tax Burden Relative to Personal Income



Source: Derived from Council on State Taxation: Total State and Local Business Taxes, 2012.



# Business Taxes Relative to Private Economic Output



Source: Council on State Taxation: Total State and Local Business Taxes, 2012.



# Comparing Key Texas Taxes to Other States

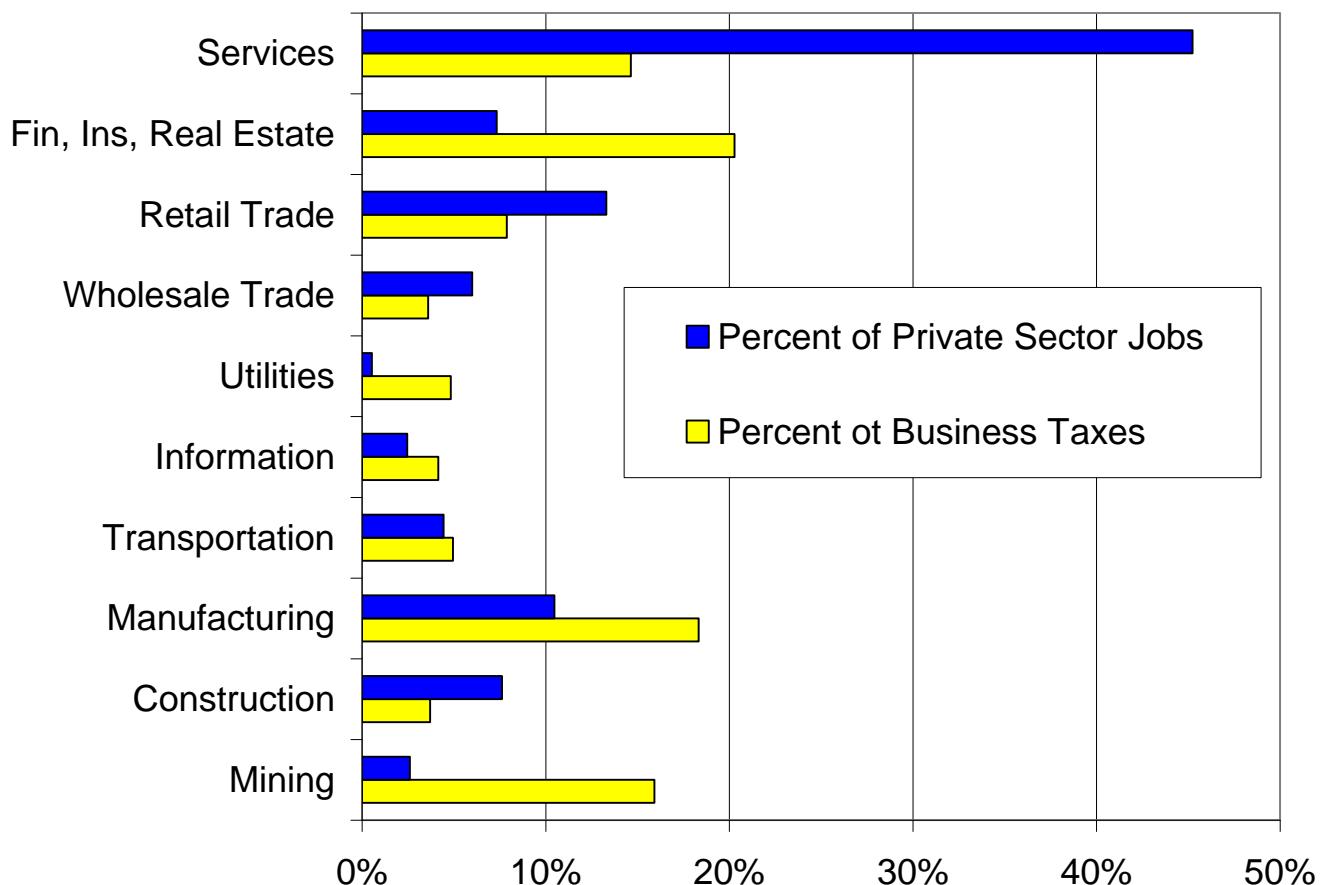
Tax	Current Rate and Base	Comparison
<b>Sales Tax Rate</b>	State Tax Rate: 6.25%  Local Taxes: Generally capped at 2.0 %; average is 1.89%  Average Combined Rate: 8.14%	State Rate: 13 <sup>th</sup> (tied) highest  Combined Rate: 11 <sup>th</sup> highest
<b>Sales Tax Base</b>	Generally applies to all 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)
<b>Property Tax Rate</b>	<u>Residential property</u> : average effective tax rate in 2010 was just under 2.0 percent of market value  <u>Industrial property</u> : average effective tax rate in 2010 was about 2.5% of market value	<u>Residential property</u> : Texas' effective tax rates rank us 10 <sup>th</sup> highest nationally  <u>Industrial property</u> : Texas' effective tax rates rank us 3 <sup>rd</sup> highest nationally
<b>Property Tax Base</b>	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: 9 states exempt all business tangible personal property; inventories are exempt in all but 9 states; 29 states offer some type of Freeport exemption
<b>Business Franchise Tax</b>	Texas' franchise tax is unlike the net business income tax levied by most other states; Texas' effective tax rate relative to economic output was 0.37% in 2011.	Relative to economic output, Texas' franchise tax ranks 24 <sup>th</sup> highest among the states, but is about 6 percent below the national average.



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# The Mix of Texas Business Taxes and Texas Employment

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Note: Data is from 2008.

Source: Texas Taxpayers and Research Association and the US Bureau of Labor Statistics.

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Texas taxes are not evenly distributed across the economy.

Capital-intensive industries (finance, utilities, information, transportation, manufacturing, and mining) account for roughly 68 percent of all business taxes paid, yet account for only 28 percent of the state's private sector employment.

Labor-intensive industries (services, wholesale trade, retail trade, construction) account for roughly 32 percent of all business taxes, yet account for 72 percent of the state's private sector employment.

Over the previous 10 years, the services industry has accounted for two-thirds of the state's job growth.



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## Evaluating the Good and the Not-so-good

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Texas has a great deal to offer in attracting new business investment to the state, but our tax system is not necessarily a beneficial part of that evaluation.

Because of our heavy reliance on property and sales taxes, Texas' tax system falls heavily on the business community and on capital intensive enterprises—oil and gas extraction, manufacturing, utilities, and real estate—in particular.

Our tax system falls relatively lightly on labor intensive enterprises such as services. These enterprises tend to use less capital to produce output.

Texas' lack of a state personal income tax is not solely of benefit to individuals; it also provides certain benefits to the business community, as well. It encourages small business development by allowing retention of capital which can be reinvested into the business. It also, in conjunction with certain favorable aspects of the franchise tax, makes Texas an attractive location for business headquarters. In 2012, 52 Fortune 500 companies were headquartered in Texas—up from 36 in 1998.

However, in the absence of a personal income tax, high property and sales taxes mean that Texas is not necessarily an attractive location for manufacturing plants and other capital intensive business operations.

Consequently, tax incentives can be an effective tool for mitigating the impacts of our high base level of business taxes. Texas local governments are able to offer new investment projects a temporary property tax abatement or limitation. Cities and counties are able to offer ten year abatement agreements; school districts may offer 8 year limitations on taxable value with a partial credit for the first two years of a project.

