Testimony before the House Committee on Ways and Means

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Business Assessments of Texas

Viewed Positively

- Reasonable regulatory and judicial environment
- A Right-to-Work State (i.e. one may not be compelled to join a labor union as a condition of employment)
- World-class port facilities
- Available land at generally reasonable cost
- A growing state with a relatively good of labor
- Stable and affordable energy resources
- Centrally located to both coasts
- Lack of a personal income tax—a boon to small business and to corporate headquarters

Viewed Negatively

- Long term water availability is a concern, but is being addressed
- Transportation networks are strained, but is being addressed
- While labor is in relatively good supply, certain categories of skilled workers may be more limited
- State and local taxes, particularly property and sales taxes, are higher than average and are particularly burdensome for capital intensive industries

Tax Incidence

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.

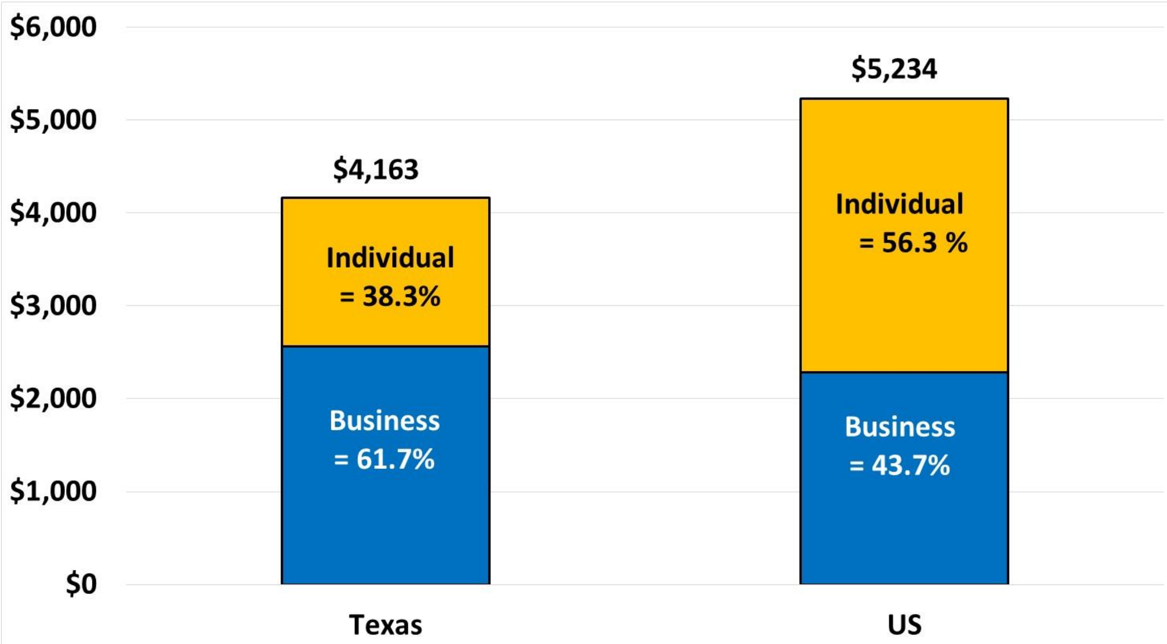
Businesses may incur taxes on their purchases (e.g. sales tax, fuels taxes), their real estate and personal assets (e.g. property tax), and be subject to special industry taxes on gross receipts (e.g. utilities, insurance). Businesses respond to taxes in one of three ways:

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.

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 of the item.
- Property tax is paid by the *owner* of the property, whether an individual or a business.
- Franchise tax is paid by the business entity.
- Severance taxes and industry-specific gross receipts (e.g., insurance, utility) taxes are paid by the business.

Who Pays State and Local Taxes?



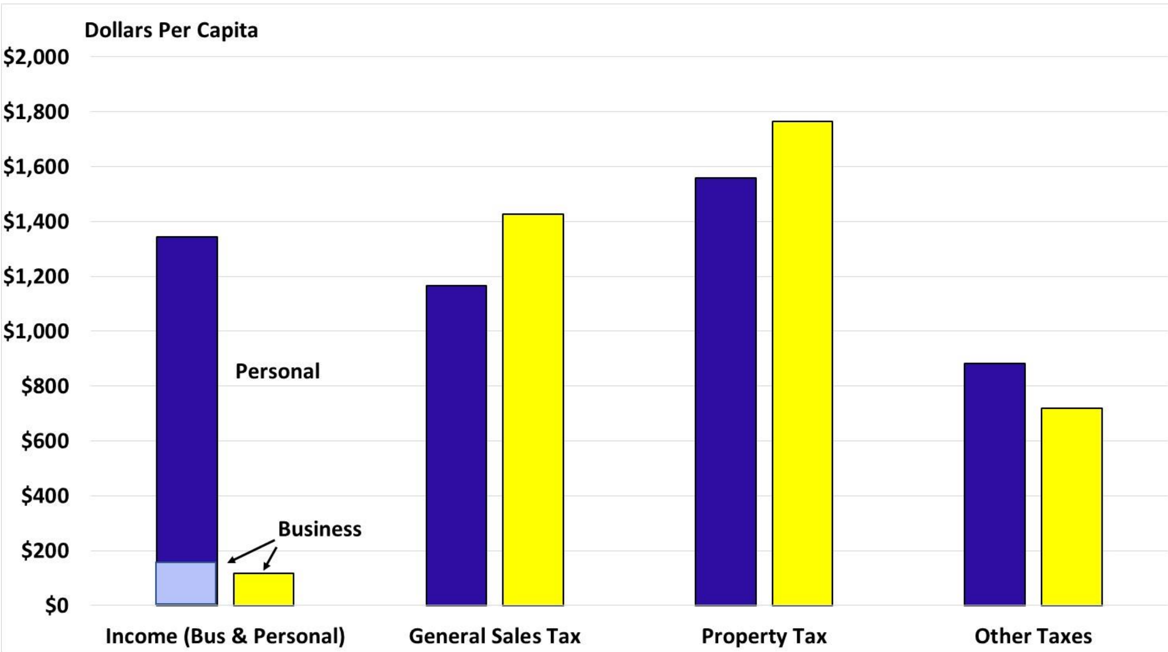
Source: Council on State Taxation, *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2017*.

By many measures, Texas' state and local tax burden is well below the national average. On a per capita basis, Texas state and local taxes per capita totaled $4,163, or 20 percent below the national average of $5,234.

However, it is important to note there are two types of taxpayers: individuals and businesses.

Lacking a personal income tax, Texas relies on business to pay 61.7% of our tax load—far above the 50 state level of 43.7%.

Texas State and Local Taxes Compared to 50-State Averages



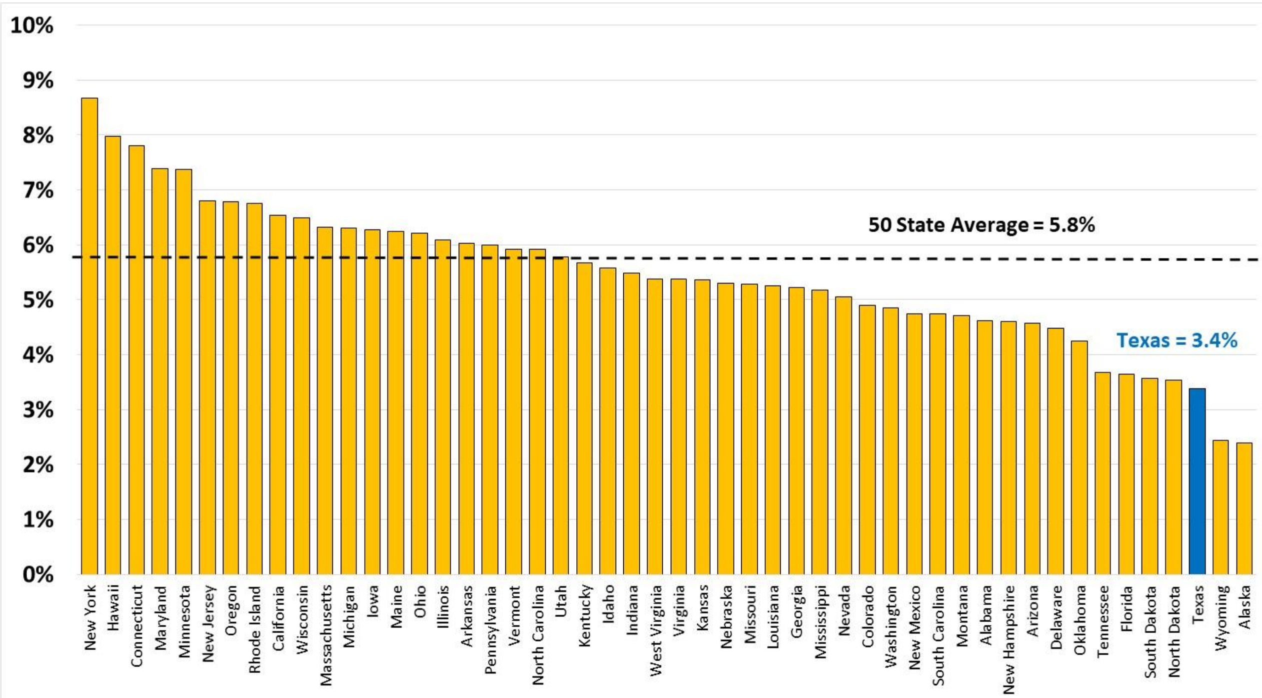
Source: Council on State Taxation, *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2017*.

State and local tax systems are often described as a "three-legged stool," reflecting roughly equal legs of 1) income (both business and personal), 2) sales, and 3) property taxes (although other taxes—such as severance and excise taxes can be substantial).

By comparison, given our lack of a state personal income tax—saving the average Texas family of three roughly $3,500 per year—Texas's system could be more appropriately described as a "two-legged" stool.

BUT, there is a trade-off for not having a personal income tax: Texas has much higher than average sales and property taxes—taxes that fall heavily on business.

Individual Tax Burden Relative to Personal Income, 2015



Source: Council on State Taxation, *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2017*.

Texas ranks 47th among the states in terms of state and local taxes levied on individuals, relative to personal income. Texas state and local taxes equates to 3.4 percent of total personal income—well below the 50-state average is 5.8%. Our state and local tax burden on individuals is 42% below the national average.

While Texas has relatively high property and sales taxes the absence of a personal income tax makes Texas a very low tax state for individuals. The absence of a personal income tax saves the average Texas family roughly $3,500 annually.

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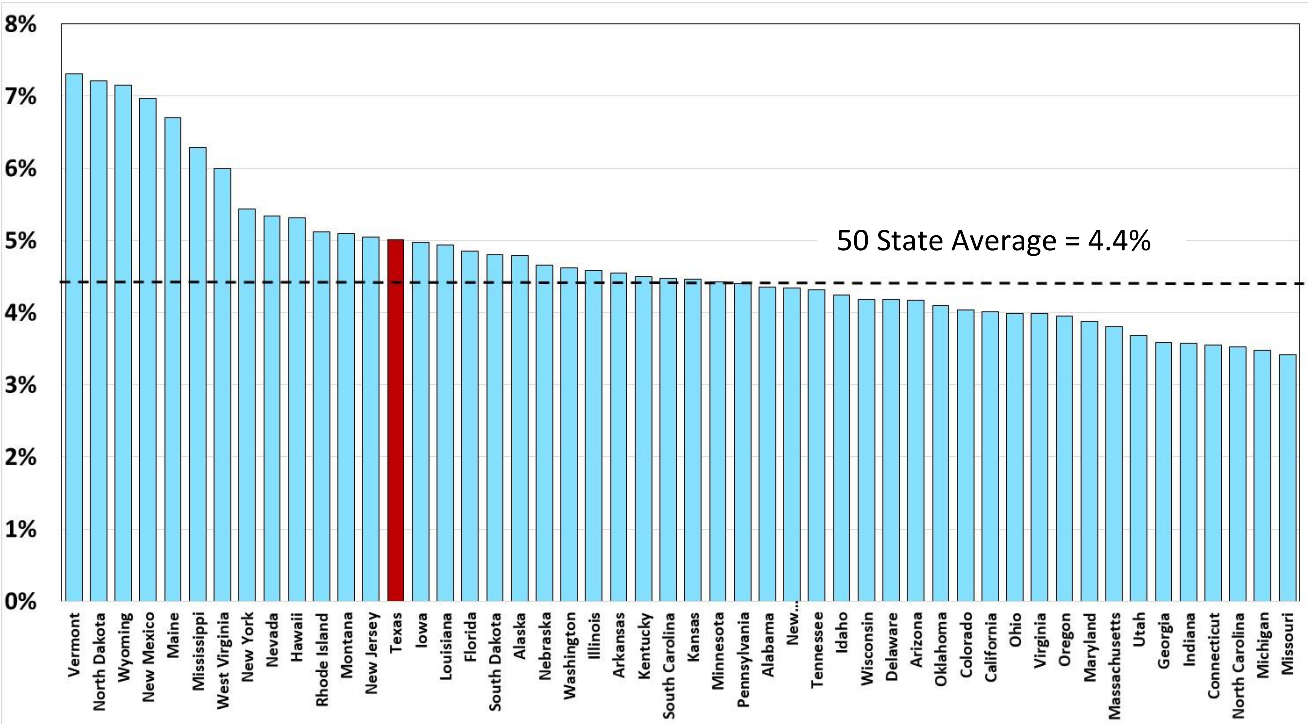
The Taxes Business Pays in Texas, 2017



Source: Council on State Taxation, *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2017*.

Texas state and local taxes on business are equivalent to 5.0% of gross state product ranking 13% above the average state. That makes Texas a relatively high tax state business—ranking 14th among the 50 states.

While the ranking is not extraordinarily high, by no means is Texas a low tax state for business.

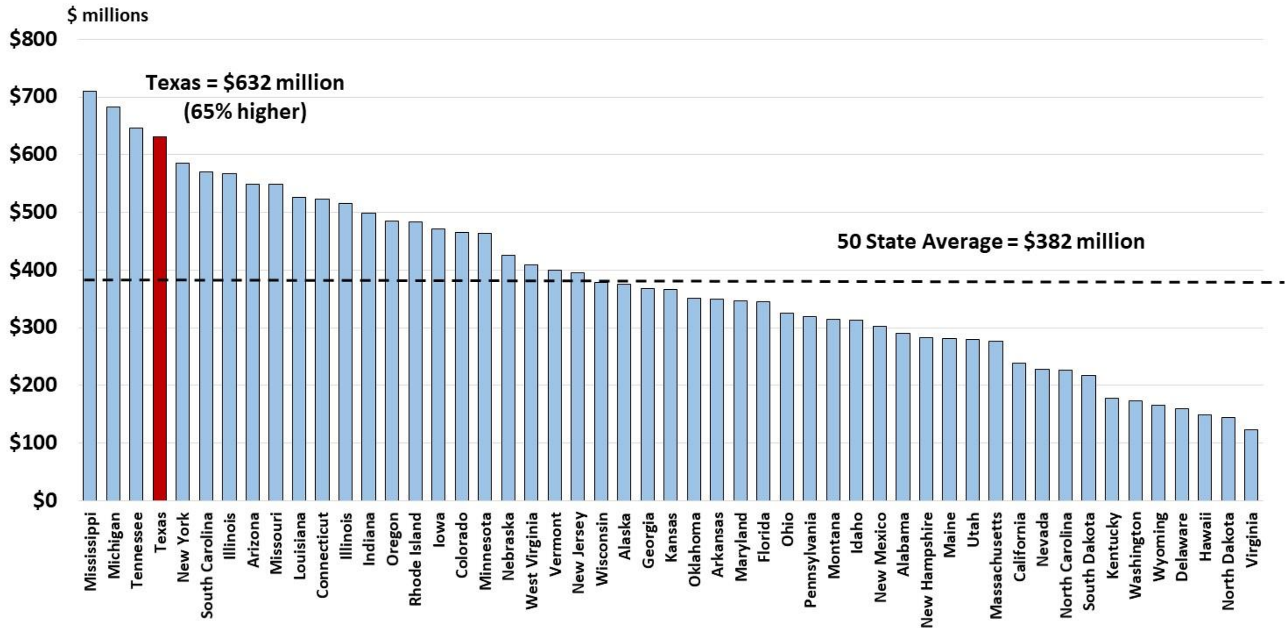
Texas' heavy reliance on property and sales taxes particularly impact both capital intensive and goods producing industries. In particular, for capital-intensive industries Texas is a very high tax state because of our high rates and broad-base property taxes.

Texas' Key Taxes Compared to Other States

Tax	Current Rate and Base	Comparison
Sales Tax Rate[1]	State Tax Rate: 6.25% Local Taxes: Generally capped at 2.0 %; average is 1.92% Average Combined Rate: 8.17%	State Rate: 13th highest Combined Rate: 12th highest
Sales Tax Base[2]	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 Rates[3]	<u>Residential property</u>: average effective tax rate in 2016 was 1.80 percent of market value <u>Commercial property:</u> average effective tax rate in 2016 was 2.36 percent of market value <u>Industrial property</u>: average effective tax rate in 2016 was 2.54% of market value	<u>Residential property</u>: Texas' effective tax rates rank us 15th highest nationally, 20 percent above the national average <u>Commercial property</u>: 19th highest nationally, 13 percent above the national average (this does not include business personal property or inventories) <u>Industrial property</u>: Texas' effective tax rates rank us 4th highest nationally, or 65 percent above the national average
Property Tax Base[4]	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 10 states (4 states partially tax inventories).
Business Franchise Tax[5]	Texas' franchise tax is unlike the net business income tax levied by most other states; Texas' effective tax rate relative to economic output was 0.22% in 2017.	Relative to economic output, Texas' franchise tax ranks 33rd highest among the states, about 40 percent *below* the national average; however, Texas'franchise tax is far more complex than business taxes in other states, resulting in a much higher compliance cost.

[1] Rate comparisons are from the Tax Foundation, *State and Local Sales Tax Rates 2018*.
[2] Federation of State Tax Administrators, *Sales Taxation of Services, 2017 Update*.
[3] Rate comparisons are drawn from Lincoln Institute of Land Policy and the Minnesota Center for Fiscal Excellence, *50-State Property Tax Comparison Study, for taxes paid in 2017*.
[4] From the Tax Foundation, *States Moving Away from Taxes on Tangible Personal Property* and *Does Your State Tax Business Inventory?*
[5] From the Council on State Taxation, *FY17 State and Local Business Tax Burden Study*.

Property Taxes on a $1 Billion Industrial Investment Project (25 Year Life)



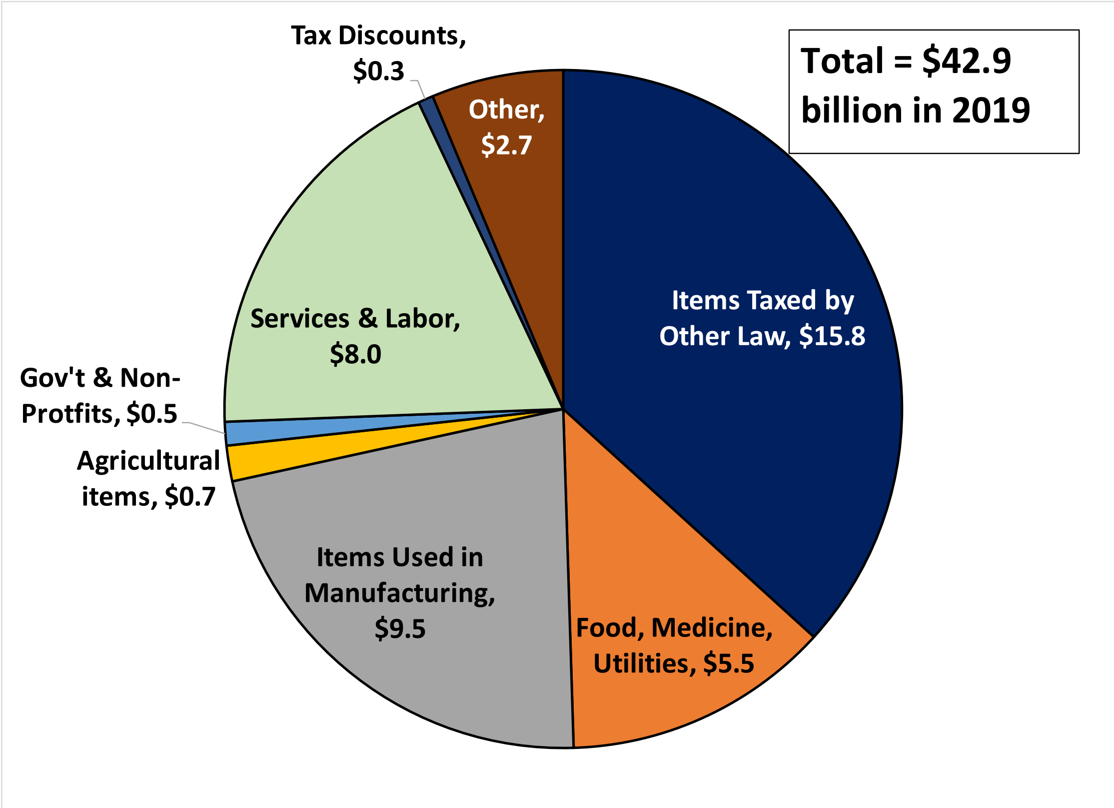
Based on *50 State Property Tax Comparison Study, For Taxes Paid in 2017* by the Minnesota Center for Fiscal Excellence and the Lincoln Institute of Land Policy.

The above chart illustrates the total property taxes on an industrial facility valued at $1 billion million over its 25-year lifespan across the various states.

The average state and local property taxes paid over the life of the facility nationwide is $382 million. In Texas, the facility, if it received no city/county property tax abatements or Chapter 313 school tax limitations, would pay $632 million in property taxes—65 percent higher than the national average.

If the facility received a 10-year city/county property tax abatement and a ten year 313 value limitation of $80 million, the project's lifetime property tax bill would be about $405 million—still higher than the average of other states—assuming those states did not offer any incentives of their own.

The Lure of Tax Exemptions, Exclusions, and Discounts



According to the Comptroller, exemptions, exclusions, and discounts reduced state sales tax collections by $42.9 billion in 2019. The Comptroller's report is often used as a guide to raise revenue—either to relieve other taxes or to fund new programs—however; many of the perceived revenue gains are illusory.

The largest category of sales tax exemptions are items taxed under another law. Extending the sales tax to these items (crude oil, motor vehicles, motor fuels, insurance premiums, etc.). Extending the sales tax to these items would constitute double taxation unless the existing taxes were repealed, which would substantially reduce any revenue gain.

The second largest category is items used in manufacturing—mostly raw materials, which no other state taxes. Extending the sales tax to raw materials may increase the tax cost of manufacturing items in Texas, even if the revenue were used to reduce property taxes.

Food, medicine, and consumer utilities—among the more popular exemptions—account for $5.5 billion.

Services and labor—items excluded from the sales tax rather than specifically exempted—account for $8.0 billion. This revenue may not be achievable, as the taxation of services is fraught with administrative difficulties as many of these services are provided across state lines and are difficult to pinpoint to Texas.

Bills Referred to Ways and Means Relative to Actual Taxes Paid, 2017

In 2017, a total of 425 bills were filed and referred to the Ways and Means Committee (including Senate bills).

Just over half—227 of those bills related to property tax (about the same proportion the property tax represents of all state and local taxes paid).

About a sixth of those bills related to sales tax—proportionately less than the proportion the sales tax represents of state and local tax collections. This implies some degree of satisfaction with the sales tax, or at least the perception that it is in less need of change.

Roughly an eighth of bills referred to committee related to the hotel tax—a tax levied by both local governments and the state. Most of the bills dealt with provisions specific to local communities.

About an eighth of bills referred to Ways and Means related to the franchise tax.