TEXAS TAXPAYERS
TTARA
AND RESEARCH ASSOCIATION

Research Report

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The Highs and Lows Of Texas Taxes

Texas has a reputation as a low tax state, but the truth is far more complex. Measured in per capita terms Texas is indeed a low tax state—31st from the top in 2017, or 18% below the national average[1]—but the statistic is misleading because there is no such thing as a "capita" tax. Taxes fall unevenly across society. Taxpayers come in all shapes and sizes, but there are two distinct types—individuals and businesses—and the tale of tax burdens is very different for each.

Individuals pay sales taxes when they buy certain items and they pay property taxes on their homes (indirectly, if they rent); but unlike the residents of 43 other states, Texans do **not** pay state taxes on their income. That savings means our state and local taxes relative to the money individuals earn rank Texas 3rd lowest—40% **below** the average across the states.[2]

Businesses also pay sales taxes on many of the items they buy (as well as collecting tax from individuals on behalf of the state) and they pay property taxes not only on the land and buildings they own, but also on the personal property within it (individuals do not). They pay a variety of gross receipts and excise taxes and they pay a business, or "franchise" tax. The average state and local tax burden on businesses in Texas relative to their economic output scores 11th highest, or 19% **above** the average of the states.

*Texas is a **low** tax state for individuals, but when it comes to business, Texas is a **high** tax state – especially for capital intensive businesses.*

In purely academic terms, businesses don't ultimately pay taxes, people do. But that does not mean that taxes don't have an impact on business decisions—they most certainly do. Businesses either pass their taxes forward to consumers in the form of higher prices, backward to investors in the form of lower returns, or internalize them by cutting costs such as payroll. Taxes are a major operating cost, and businesses will gravitate to those locations where costs are least. Consequently,

This is the latest in a series of studies TTARA has done over the years assessing state and local tax burdens on individuals and businesses across the 50 states. Though specific rankings have changed over the years, the basic story has not: Texas is a low tax state for individuals and a high tax state for most businesses.

[1] Based on the U.S Census Bureau, State and Local Finances, 2017.
[2] Derived from Total State and Local Business Taxes, October 2018, prepared by Ernst & Young for the Council on State Taxation.

direct taxes on business are a key factor impacting economic growth and job creation.

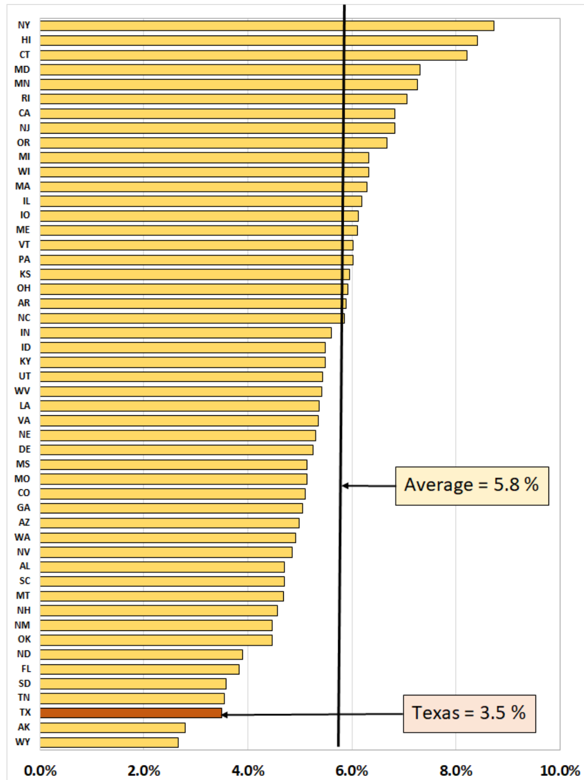
The Council on State Taxation in conjunction with Ernst and Young prepares an annual comparison of state and local taxes across the states based on who pays them—individuals or businesses. Applying a consistent methodology across states reveals that Texas' tax structure falls more heavily on business than in 45 other states. Without a state personal income tax, Texas relies more on sales and property taxes, which fall in large part on businesses. Almost two-thirds of the taxes Texas state and local governments collect (62.3%) are paid by businesses versus 43.5% in the average state. Individual Texans pay 37.7% of all state and local taxes, well below the national average of 56.5%.

A Familiar Tale: Low Taxes in Texas. The lack of a personal income tax saves the average Texas family of three close to $3,550 annually. Though it may not feel like it when our property tax bills arrive, the total amount of state and local taxes paid by **individuals** in Texas takes 3.5% of their income— far below the national average of 5.8%, ranking Texas 3rd lowest (or 48th highest) among the 50 states. Only Alaska and Wyoming—two other resource-rich, non-income tax states—have a lower overall tax burden on individuals (Figure 1).

The good news of low taxes on individuals is somewhat tempered by the fact that Texas' state and local taxes are "regressive"—i.e., lower income families see a higher portion of their income go to paying taxes than do wealthier families (Figure 2). Consumption and housing costs—subject to sales and property taxes—tend to claim a greater portion of the family budget for those with lower incomes than for those with higher incomes. Most other states rely heavily on personal income taxes, which are typically structured to limit the impact on those with lower incomes, resulting in a more "progressive" tax system across income groups.

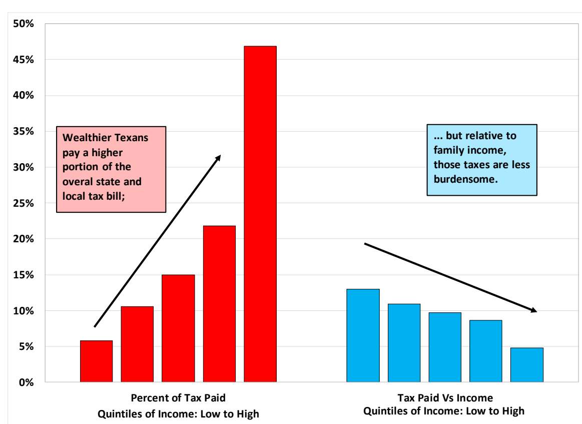
It is important to understand what regressivity

Figure 1
State and Local Taxes on Individuals
Relative to Personal Income



Source: *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2018,* Council on State Taxation and Ernst & Young, October 2019.

Figure 2
Share of Taxes Paid By Quintile of Income



Source: *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, Institute on Taxation & Economic Policy, October 2018.

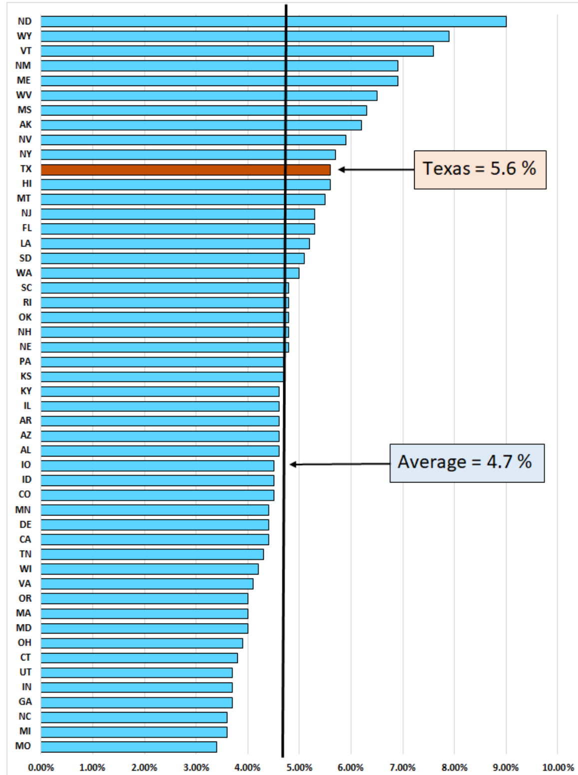
is, and what it *is not*. A "regressive" tax system does not mean the poor pay the most. It is simply a measure of how taxes relate to income levels. In fact, almost 70 % of Texas' state and local taxes are paid by upper middle class and wealthier Texas households. The poorest quintile of Texas families pay only about 6% of all state and local taxes.

The Tale Not Often Told: Texas is a High Tax State. Relative to economic output, Texas' effective tax rate on businesses is 5.6%—well above the national average of 4.7%, and ranking us 11th highest among the states (Figure 3). While that doesn't make Texas an outrageously high tax state, it clearly dispels the myth that Texas is a low tax state for businesses in general. In fact, some of the "competitor" states to which we are often compared—California, Georgia, Louisiana, Oklahoma, Tennessee, Virginia, and even Massachusetts—all have generally lower business tax burdens than Texas.

These figures score all taxes businesses pay, including severance taxes. Other resource-rich states also tend to rank high: North Dakota in first, Wyoming in second. However, they are far less economically diverse than Texas. North Dakota's severance and production taxes account for over half of its state tax revenue and about a third in Wyoming. In contrast, severance taxes accounted for just 8.7% of Texas state tax revenue. Excluding severance taxes from state comparisons would move Texas from 11th highest to 14th highest—with a burden still 15% higher than the average state.

It should be emphasized that "business" is not a single enterprise—far from it. It is a mix of profit-seeking pursuits ranging from the very large to the very small; from capital-intensive to labor-intensive; and from goods-producing to services-producing. These diverse businesses are impacted in very different ways by the state's tax structure. Relying so much on sales and property taxes, Texas' tax burden falls most heavily on goods-producing and capital-intensive industries, but relatively lightly on service-producing industries.

Figure 3
State and Local Taxes on Businesses
Relative to Economic Output



Source: *COST.*

Figure 4
The High Cost of Texas Property Taxes

	Effective Tax Rate	Rank Among the States
Homesteads		
Median-Valued Urban Home	1.778%	15
Median-Valued Rural Home	1.167	23
Commercial Property		
Urban $100,000 Value	2.388%	16
Urban $25 ml. Value	2.388%	18
Rural $1 ml. Value	1.964%	24
Urban Apartment	2.417%	12
Rural Apartment	2.539%	8
Industrial Property		
Urban $1 ml. Value	2.393%	3
Urban $25 ml. Value	2.393%	3
Rural $100,000 Value	2.539%	2
Rural $1 ml. Value	2.539%	2

Source: *50 State Property Tax Comparison Study for Taxes Paid in 2018*, Minnesota Center for Fiscal Excellence and the Lincoln Land Institute, June 2019.

Texas property tax rates are higher and the base is broader than in most other states (Figure 4). Property taxes in Texas apply not just to land and buildings, but also to tangible personal property used in the production of income—essentially business-owned personal property, including inventories. Personal property is wholly or largely exempt in 12 states and 43 provide an exemption for business inventories.[3] In Texas, local jurisdictions are able to offer a limited “Freeport” exemption, but it only applies to goods to be shipped outside the state within a certain period of time and not inventories in general.

Texas sales tax rates are among the highest nationally as well—ranking 13th when local taxes are included.[4] The sales tax is typically thought of as a consumer tax, yet businesses pay 43 cents of every dollar the state collects.[5] Texas, as well as every other state, offers a sales tax exemption for raw materials directly consumed in the manufacturing process, but many other basic business purchases are subject to tax, such as equipment not directly used in manufacturing, office and building supplies, furnishings, commercial utilities, etc. While state sales taxes commonly apply to purchases of *tangible personal property*, Texas is among the more aggressive states in taxing *services*.[6]

While the lack of a personal income tax results in higher business property and sales taxes, it also offers some advantages to the business community. Small and start-up companies are better able to retain capital and reinvest in their businesses. Further, without a state personal income tax Texas is an attractive location for CEOs looking to locate company headquarters. The irony, though, is that many manufacturers headquartered in Texas find it cheaper to build their production facilities elsewhere.

Taxes are not the sole determinants of business investment decisions. Clearly, market conditions that drive revenues head the list, and on the cost side, labor, land, and transportation are important—most of which fall in Texas’ favor. Regulatory issues are also key—another boost for Texas. Still, when it comes to taxes, Texas is at a disadvantage when compared to many of our competitor states.

[3] Tax Foundation, States Should Continue to Reform Taxes on Tangible Personal Property, Fiscal Fact No. 668, August 2019.
[4] Tax Foundation, State and Local Tax Rates, 2020, https://taxfoundation.org/2020-sales-taxes/.
[5] Texas Comptroller of Public Accounts, Tax Exemptions & Tax Incidence, November 2018.
[6] Federation of Tax Administrators, By the Numbers, *FTA Survey of Services Taxation – Update*, July-August 2017.