

Partial
The Myth of Texas as a
Low Tax State

Texas has a reputation as a low tax state, but that reputation doesn't live up to reality for all taxpayers. For individual taxpayers, Texas is unquestionably one of the nation's lowest taxing states. Texas state and local taxes on businesses, though, are well above the national average and are particularly burdensome on capital-intensive businesses – the huge marquee projects that states aggressively compete for.

Who Pays What? There are essentially two types of taxpayers: individuals and businesses. Individuals are well familiar with the state and local taxes they pay: sales tax is collected as a percent of the purchase price whenever they purchase many items, property tax is due on their homes.

Businesses pay those same sales and property taxes, plus a host of other taxes individuals never see. In their annual survey of state and local taxes on business, EY¹ estimates that business pays about half of all sales taxes and roughly 3/5 of all Texas property taxes. Businesses pay sales tax on supplies,

¹ EY (Ernst & Young), STRI (State Tax Research Institute), and COST (Council on State Taxation), Total State and Local Business Taxes, State-by-State Estimates for FY21, Washington, D.C., December 2022.

Tax systems are made up of two types of taxpayers: individuals and businesses.

For individuals, Texas indeed is a low tax state – only 5 states have lower overall taxes.

For business, Texas is actually a high tax state as 36 states have lower taxes.

computers, and even the utilities to run their offices.² Businesses also pay tax on the properties they occupy or use. In addition, they pay taxes individuals never see, such as corporate franchise taxes, wholesale excise taxes, severance taxes, payroll taxes, utility taxes, etc.

² Though business typically acts as the sales tax collector for the state, collecting tax from customers who buy their goods, these are not considered "business-paid" taxes. Only those taxes businesses incur on the purchase of items they use in the course of their operations are considered "business-paid" taxes in the EY Study.

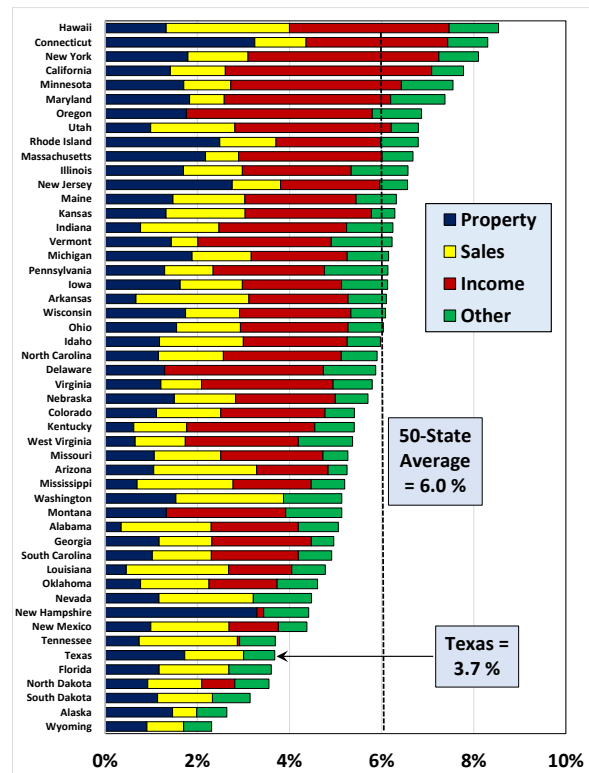
In purely academic terms, businesses don't ultimately pay taxes, people do. But that does not mean that taxes don't have an impact on business decisions—they most certainly do. Businesses either pass their taxes forward to consumers in the form of higher prices, backward to investors in the form of lower returns, or internalize them by cutting costs such as payroll. Each of these actions has adverse consequences for the business, so it will always seek to minimize the necessity to employ any of these actions. Taxes are a major operating cost, and businesses will gravitate to those locations where costs are least. Consequently, direct taxes on business are a key factor impacting economic growth and job creation.

The EY study, prepared annually for the Council on State Taxation, compares 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 that of 44 other states. Without a state personal income tax, Texas relies more on sales and property taxes, which fall in large part on businesses. Almost three-fifths of the taxes Texas state and local governments collect (59.3%) are paid by businesses versus 43.6% in the average state. Individual Texans pay 40.4% of all state and local taxes, well below the national average of 56.4%.

A Familiar Tale: Low Taxes in Texas. Though it may not feel like it when our property tax bills arrive each October, the total amount of state and local taxes paid by **individuals** in Texas is among the lowest of any state. The lack of a personal income tax saves the average Texas family of three close to \$4,000 annually. Texas state and local government taxes on average amount to 3.7% of family income—far below the national average of 6.0%. That ranks Texas 6th lowest (or 45th highest) among the 50 states.

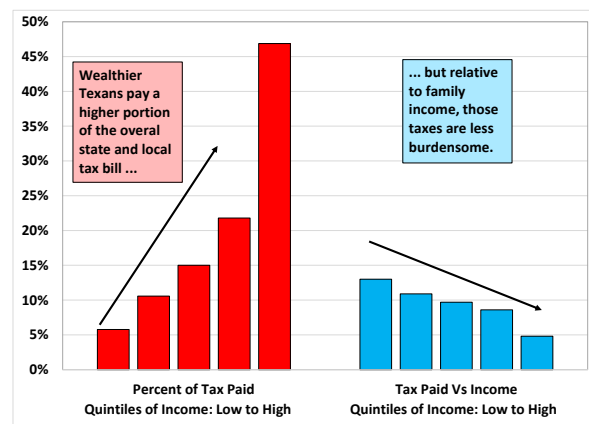
The good news of low taxes on individuals is somewhat tempered by the fact that Texas' state and local taxes are "regressive"—i.e., lower income families see a higher portion of

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



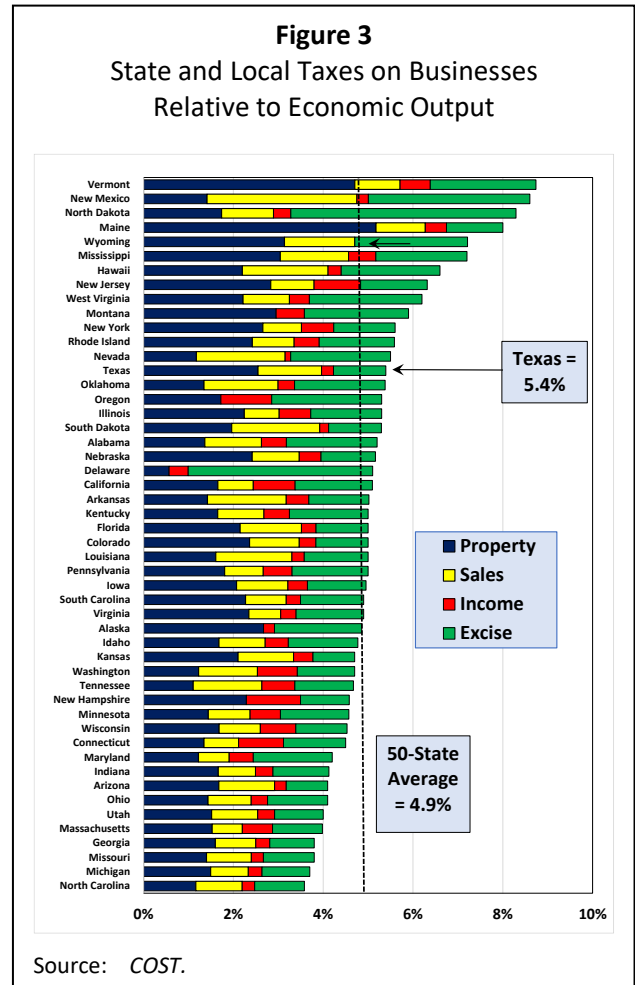
Source: *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, Institute on Taxation & Economic Policy, October 2018.

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 *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 5.4%—well above the national average of 4.9%, and ranking us 14th 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 take into account all taxes businesses pay, including severance taxes (included in the Excise and Other Taxes category). Other resource-rich states also tend to rank high: New Mexico is second, North Dakota is third, Wyoming is fifth. However, these less-populous states are far less economically diverse than Texas. North Dakota’s severance and production taxes account for over half of its state tax revenue and in Wyoming they equal about a third. In contrast, severance taxes accounted for just 8% of Texas’ state tax revenue in 2021.



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.

Texas sales tax rates are among the highest nationally, and the tax base is broader than that of most other states. Texas’ combined state and local sales tax rate tops out at 8.25%, though the effective rate across the state is a bit lower at 8.2% according to the Tax Foundation, as not all sales occur in local areas imposing a full 2%

local tax.³ That ranks Texas' combined sales tax rate 14th highest among the states.

Texas' sales tax base is relatively broad as well, ranking 15th broadest by TTARA estimates.⁴ While state sales taxes commonly apply to purchases of *tangible personal property*, Texas is among the more aggressive states when it comes to taxing purchases of *services*.⁵

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.

A Closer Look at Property Taxes. The property tax falls differently on individual homeowners and on owners of business, or income-producing properties. All real estate (i.e., land and buildings) is subject to property tax, but businesses must also report and pay tax on the personal property they own (machinery, equipment, supplies, and even inventories of raw materials and finished products).

For homeowners, effective property tax rates (the amount of actual tax paid relative to the property's full market value) are high in Texas

³ Janelle Fritz, Tax Foundation, State and Local Tax Rates, Midyear 2022, <https://taxfoundation.org/publications/state-and-local-sales-tax-rates/>.

⁴ To calculate the breadth of sales tax bases, data on general sales tax collections from the US Bureau of the Census for 2020 for each state was divided by their effective sales tax rate as determined by the Tax Foundation. This estimate of taxable sales was then divided by private sector gross state product from the US Bureau of Labor Statistics to determine what share of each state's economy was subject to that state's sales tax.

⁵ Federation of Tax Administrators, *By the Numbers, FTA Survey of Services Taxation – Update*, July-August 2017.

Figure 4
The High Cost of Texas Property Taxes

| | Effective Tax Rate | Rank Among the States |
|-----------------------------|--------------------|-----------------------|
| Residential Property | | |
| Median-Valued Urban Home | 1.69% | 10 |
| Median-Valued Rural Home | 1.18% | 23 |
| Urban Apartment | 2.22% | 10 |
| Rural Apartment | 2.39% | 8 |
| Industrial Property | | |
| Urban \$1 ml. Value | 2.27% | 6 |
| Urban \$25 ml. Value | 2.27% | 6 |
| Rural \$100,000 Value | 2.26% | 4 |
| Rural \$1 ml. Value | 2.26% | 4 |

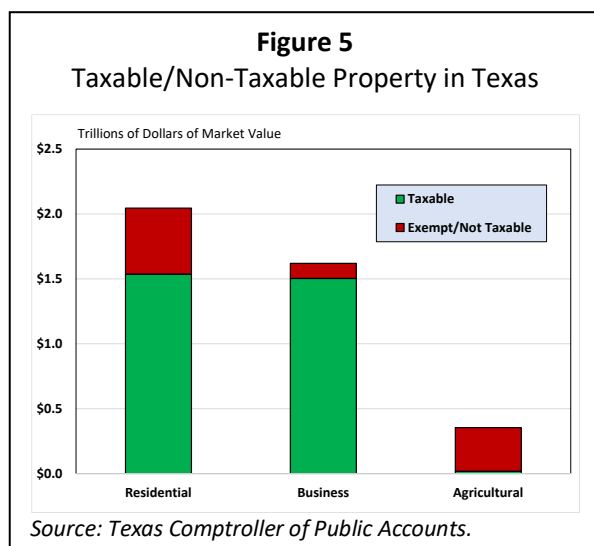
Source: *50 State Property Tax Comparison Study for Taxes Paid in 2021*, Minnesota Center for Fiscal Excellence and the Lincoln Land Institute, July 2022.

relative to other states, at 1.69%⁶. Property taxes on a median-valued Houston home rank 10th highest nationally (Figure 4), and 27% above the national average. Texas raised its school homestead exemption in 2022; had the exemption been in effect in 2021, Texas' effective property tax rate would have dropped to 1.60% and Texas would have dropped two places in the rankings to 12th highest, or 20 percent above the national average.

Effective property tax rates on industrial property in Texas, such as a manufacturing plant, are about a third higher than that for homeowners at 2.27%, ranking us 6th highest and a whopping 62 percent above the average rate across the 50 states. Texas business property taxes apply not just to land and buildings, but also to tangible personal property *used in the production of income*, including inventories. Personal property is wholly or largely exempt in 12 states and 43 others provide a specific exemption for business inventories.⁷ In Texas, local jurisdictions are

⁶ Lincoln Institute of Land Policy and the Minnesota Center for Fiscal Excellence, *50-State Property Tax Comparison for taxes paid in 2021*, July 2022.

⁷ Tax Foundation, *States Should Continue to Reform Taxes on Tangible Personal Property*, Fiscal Fact No. 668, August 2019.



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 businesses also do not benefit as much from various exemptions, as do homeowners (Figure 5). Various homestead exemptions remove, on average, 25% of the market value of a home from property taxation.⁸ Business property can avail itself of exemptions for goods in transit, pollution control equipment, and certain new investment projects under the no-longer-available Chapter 313 of the Tax Code. These exemptions amount to about a 7% discount of the market value of business property in the state.

Agricultural property is subject to special methods of appraisal based on the productivity of the land. These effectively exempt most of a farm and ranch property’s value – saving many farmers and ranchers from bankruptcy if forced to pay tax on full market value.

Though Texas property taxes consistently rank among the highest of states, there is progress to report. In 2019 Texas lawmakers passed far-reaching reforms in HB 3 by Huberty/Taylor and SB 2 by Bettencourt/Burrows. These bills essentially bring tax rates down as property

⁸ Figures developed using school tax data from the Comptroller.

values rise. From 2018 to 2021, Texas’ effective tax rate on homeowners dropped from 30% above the national average to now 27%; the effective tax rate on industrial property dropped from 65% above the national average to now 62% higher. Rates are dropping slowly, though the changes have had little impact on how Texas compares overall.

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.

About TTARA

The Texas Taxpayers and Research Association (TTARA) is a non-profit membership-supported organization of businesses and individuals interested in state and local fiscal policies in Texas and the way those policies impact our economy. For almost 50 years TTARA has provided informative analysis of Texas state and local tax policy.

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