



**Senate Finance Committee
September 4, 2024**

**Testimony of
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EXECUTIVE SUMMARY

Cutting School Property Taxes

1. To make Texans better off in the long run (by increasing tax base and jobs), property tax reduction should focus on reducing taxes on the invested capital Texas seeks to attract.
2. The 2023 property tax relief shifted the tax burden in Texas from homes to businesses.
 - Who received the relief: Single-family homes received 86% of the 2023 property tax relief. All other property (mostly business property) received 14% of the tax relief.
 - Who paid for the relief: Property tax relief is funded by state revenue from taxes paid primarily (57.8%) by businesses.
3. The shift of the tax burden to business is now structural.
 - In 2023, 43% of homestead property value and 93% of business property value was on the school property tax roll. This difference is now baked into the Texas Constitution.
 - The only source of revenue to fund current and future property tax relief is General Revenue, which is paid primarily by business.
4. **Future property tax reduction should offset the structural shift of the tax burden to businesses that occurred in 2023:**
 - **Additional compression would benefit all property owners in proportion to taxable value and would not exacerbate the shift of the tax burden.** For additional compression to reach all school districts, the legislature will have to buy down the "equity band."
 - **Exemption of business personal property would partially reverse the shift of the tax burden.** In 2023 dollars, the cost of exempting business personal property from school district property tax, and making up the difference with additional state funding to school districts, would be \$3.4 billion per year.
 - **BUT increasing the homestead exemption would exacerbate the shift of the tax burden.** With the \$100,000 homestead exemption, the proper relationship between personal income and property tax levies has already been achieved.

Eliminating Property Tax

1. The total sales tax rate necessary to replace all property tax is at least 19.27% (current 6.25% state + new 11.02% state + current 2% local).
2. The total sales tax rate necessary to replace only school district M&O taxes is at least 12.25% (current 6.25% state + new 4% state + current 2% local) and would eliminate only 35% of property taxes in Texas.
3. Currently, the highest state and local sales tax rate in the U.S. is 9.548% in Tennessee.

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I. INTERIM CHARGE

Continue Cutting Property Taxes: Identify the best combination to further increase the amount of homestead exemption and compression to continue cutting Texans' property taxes.

Additionally, establish and report on the cost of eliminating:

- School maintenance and operation property taxes;
- All school property taxes; and
- All property taxes.

Determine the fiscal consequences of each action, including whether revenue reallocations would be required for public education funding and local government funding, and impacts on the state's ability to respond to disasters and other urgent priorities. For example, determine the effect on other state programs if general revenue were used to fully replace school property taxes, particularly during economic downturns. Evaluate and report on how much state revenue would need to be generated to replace foregone property tax revenue, and from what source.

II. CUTTING SCHOOL PROPERTY TAX

- A. TTARA commends the 88th Legislature for appropriating approximately \$18 billion to reduce school district maintenance and operations taxes in tax years 2023 and 2024.
1. Under the 2023 legislation, the following property tax reduction measures were made by state law. The resulting property tax revenue loss to school districts was replaced with state revenue paid to school districts via the public school finance system.
 - a. M&O rates compressed by approximately \$0.20.
 - b. School district homestead exemption increased by 150% from \$40,000 to \$100,000.
 - c. 65 and over/disabled “tax freeze” adjusted to reflect additional compression and homestead exemption.
 2. The legislation reduced total school property tax levies by \$4.1 billion from \$43.9 billion in 2022 to \$39.8 billion in 2023. (See **Figure 1** on page 8.) The reduction is perhaps more striking on population and inflation adjusted basis, erasing 8 years of growth in school district property tax levies. (See **Figure 2** on page 8.)
- B. However, the 2023 property tax reduction shifted some of the total state and local tax burden in Texas from individuals to businesses.

1. Most of the 2023 property tax relief (compared to 2022) was realized by homeowners. (See **Figure 3** on page 9.)
 - a. \$3.55 billion (85.8%) of the tax relief was realized by owners of single-family homes.
 - b. \$600 million (14.2%) was realized by all other categories of property, the majority of which was business property.
 - c. Compared to 2022, a few categories of property realized tax increases in 2023 instead of tax reduction.
 - i. Multi-family homes (+ \$0.002 billion)
 - ii. Industrial personal property (+ \$0.056 billion)
 - iii. Oil, gas & minerals (+ \$0.080 billion)
 - iv. Real estate inventory (+ \$0.027 billion)

2. The 2023 property tax relief was funded by state taxes paid primarily by businesses. (See **Figure 4** on page 10.)
 - a. Property tax relief was funded from the state General Revenue Fund (GRF), both directly and via a transfer from the GRF to the Property Tax Relief Fund. (See Legislative Budget Board, Fiscal Size-up 2024-25 Biennium, July 2024, page 47.)
 - b. In FY 2025, 89% of the deposits to the GRF will be state tax and fee collections.
 - c. In FY2025, approximately 57.8% of the taxes to be deposited to the GRF will be paid by businesses and 42.2% will be paid by consumers. (Tax incidence is not available for \$5.8 billion of taxes and fees deposited to the GRF.)

- C. To make Texans better off in the long run, tax reduction efforts should focus on property tax and other taxes on invested capital. Taxes on invested capital work counter to the business investment Texas seeks to attract and the economic growth Texas seeks to achieve.

- D. With the substantial increase in the homestead exemption in 2023, and without a similar increase in exemptions for other property, the Texas Constitution now enshrines a larger structural difference for school M&O tax that existed previously. (See **Figure 5** on page 11.) In 2023, for school district M&O tax:
 1. \$1.1 trillion (57%) of homestead value was exempt, \$154.1 billion (7%) of business property value, and \$493 billion (96%) of agricultural property value was exempt.

2. Thus, 43% of homestead property value, 93% of business property value, and 7% of agricultural property was taxed.
- E. To address the imbalance:
1. Forego further increases in the homestead exemption. If the objective is to ensure that property taxes do not grow faster than personal income, that objective has been achieved for now. (See **Figure 6** on page 12.)
 - a. In 2020, property tax levies had increased by 68% and personal income had increased by 55% compared to 1994 (adjusted for population and inflation).
 - b. The 2023 school property tax relief inverted that relationship. In 2023, property tax levies had increased by 48% and personal income had increased by 57% compared to 1994 (adjusted for population and inflation).
 2. Exempt business personal property.
 - a. 2023 school district property tax levies on commercial personal property: \$2.009 billion
 - b. 2023 school district property tax levies on industrial personal property: \$1.415 billion
 3. To provide additional rate compression in all school districts, the legislature will have to address the “equity floor.”
 - a. 58% of school districts are at the “equity floor” MCR tax rate, leaving unrealized M&O tax rate compression on the table. (See **Figures 7 and 8** on page 13.)
 - b. School districts at the “equity floor” will see minimal future rate compression through the mechanism in current law.
 - c. Two options to provide additional rate compression to these districts:
 1. Appropriate funds to reduce the “ceiling” and “floor” rates
 2. Expand the “equity band” to 15% or 20% (from 10%), providing a more significant allowable differential between the highest and lowest tax rates. Consideration will need to be given as to whether this creates a “tax equity” problem.

- F. Address the ability of school districts to increase I&S taxes as the state compresses M&O taxes.
 - 1. A substantial part of the state-funded reduction in school district M&O taxes was offset by higher school district I&S taxes in 2023. (See **Figure 9** on page 13.)
 - a. School district M&O taxes were reduced by \$5.0 billion to \$28.5 billion (-15%).
 - b. School district I&S taxes increased \$0.9 billion to \$11.2 billion (+9%).
 - c. Net property tax relief was \$4.1 billion (-9%).
 - 2. To address rising school district I&S levies, require voter approval of any I&S tax rate that would be used to prepay debt of a school district. Prepayment means any debt payment in excess of the minimum debt service.

III. ELIMINATING PROPERTY TAX

- A. Local property taxes in Texas are approximately equivalent to all state taxes collected in Texas. In 2023:
 - 1. Property taxes collected by local governments in Texas totaled \$82.12 billion.
 - 2. All taxes collected by state government in Texas totaled \$82.146 billion.
- B. To replace all property tax with additional sales tax, the total state and local sales tax rate would have to exceed 20%.
 - 1. In FY 2023, the state sales tax rate was 6.25% and yielded \$46.58 billion in sales tax revenue. That equates to \$7.45 billion for each percentage point of state sales tax.
 - 2. Local jurisdictions are permitted to levy sales taxes that, in the aggregate, do not exceed 2%. Thus, in most Texas localities the total sales tax rate is 8.25% (6.25% state + 2% local).
 - 3. To raise \$82.12 billion, the state sales tax rate would have to increase by approximately 11.02 percentage points.
 - 4. The total state and local sales tax rate necessary to raise the \$82.1 billion needed to replace all property tax is at least 19.27% (current 6.25% state + new 11.02% state + current 2% local).
 - 5. The actual rate required to offset tax avoidance (legal and illegal) would have to exceed 20%.

6. Currently, the highest state and local sales tax rate in the U.S. is 9.548% in Tennessee.
- C. To replace only school district M&O taxes would require increasing the total sales tax rate in Texas to over 12.25% (current 6.25% state + new 4% state + current 2% local).
- D. Considerations for a tax swap:
1. If local property taxes were replaced with state sales tax, how would state sales tax proceeds be distributed to fund counties, cities and other local governments? Would local jurisdictions lose local control?
 2. If local property taxes were replaced with local sales tax, how would local sales tax rates be decided?
 - a. If an additional local sales tax at a constant rate were allowed (perhaps an additional 11.02%), the new local sales tax would not necessarily raise the same amount of revenue as property tax in a given jurisdiction. A bedroom community would raise less than average, and a retail area would raise more than average.
 - b. Would certain local jurisdictions (perhaps cities and counties) have priority in levying an additional sales tax? It's already a race to the current 2% cap. What happens to local jurisdictions that don't have room under the cap?
 3. How would current local debt obligations, for which property tax revenue is pledged, be managed?
 4. The sales tax is a more regressive tax than the property tax, especially after the 2023 increase in the homestead exemption. Would a tax swap increase regressivity of our tax system overall?
 5. How would a tax swap affect the Texas economy and the attractiveness of Texas as a business location?

Figure 1:

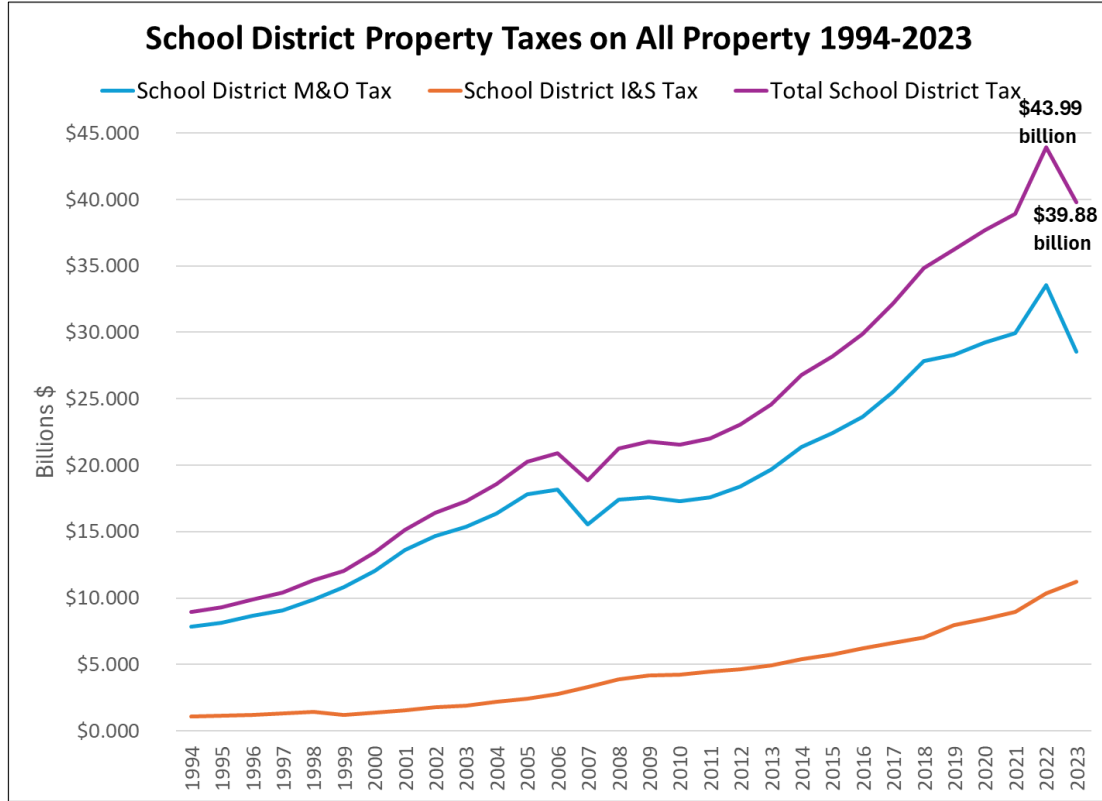


Figure 2:

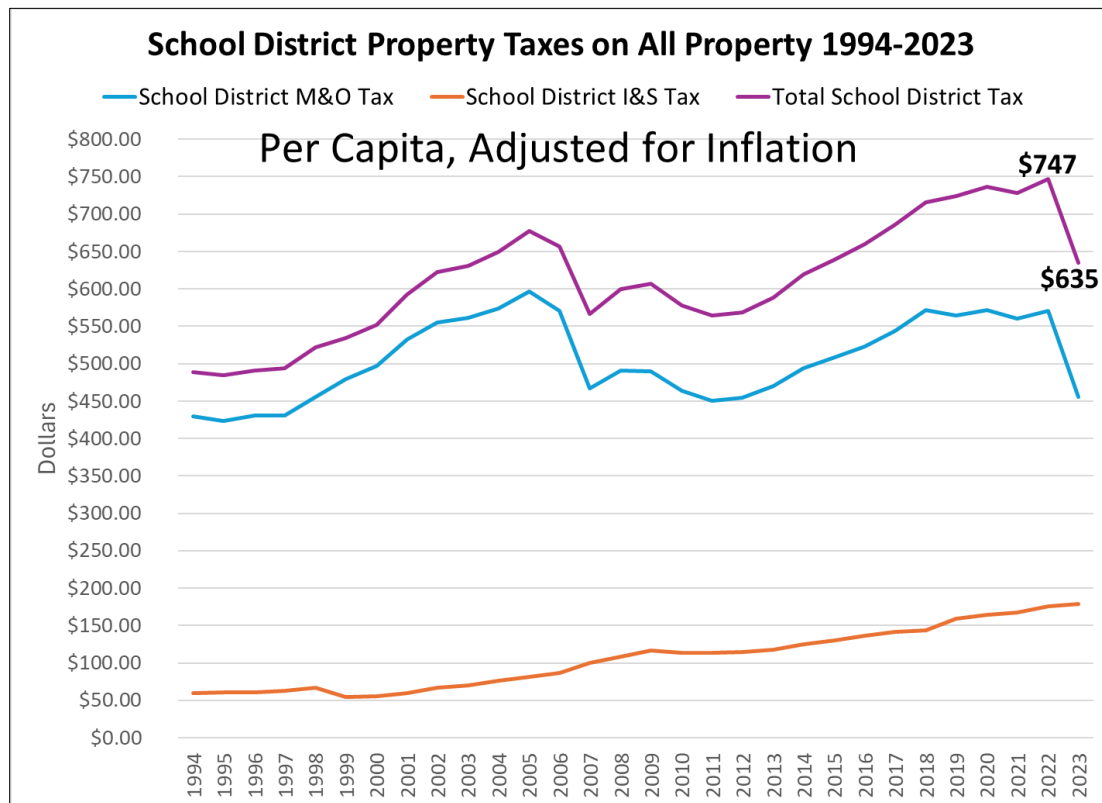


Figure 3:

Tax Year 2023 – Tax Year 2022 School District Property Tax Levies by Category of Property (Billions)

	TY 2023	TY 2022	\$ Difference	% Difference	% of Tax Relief
Single Family	\$17.483	\$21.037	(\$3.554)	(17%)	85.8%
Multi-Family	\$3.736	\$3.734	\$0.002	--	--
Mobile Homes	\$0.085	\$0.102	(\$0.017)	(16%)	0.4%
Vacant Lots	\$0.886	\$0.897	(\$0.011)	(1%)	0.3%
Commercial Real	\$7.111	\$7.448	(\$0.337)	(4%)	8.1%
Commercial Personal	\$2.009	\$2.050	(\$0.041)	(2%)	1.0%
Industrial Real	\$1.886	\$1.946	(\$0.060)	(3%)	1.4%
Industrial Personal	\$1.415	\$1.358	\$0.056	4%	(1.4%)
Oil, Gas & Minerals	\$2.347	\$2.267	\$0.080	3%	(1.9%)
Utilities	\$1.176	\$1.230	(\$0.054)	(4%)	1.3%
Real Property Inventory (new homes/lots)	\$0.249	\$0.222	\$0.027	12%	(0.6%)
Special Inventory (dealer inventory)	\$0.117	\$0.129	(\$0.012)	(9%)	0.3%
Farm & Ranch Land	\$0.185	\$0.212	(\$0.027)	(13%)	0.6%
Farm & Ranch Improvements	\$1.087	\$1.281	(\$0.194)	(15%)	4.7%
Vehicles	\$0.000	\$0.001	(\$0.001)	--	--
Intangible Personal (stock value-ins. co.)	\$0.000	\$0.000	--	--	--
TOTAL	\$39.772	\$43.914	(\$4.142)	(9.4%)	100.0%

Source: 2023 Preliminary ISD Self Report. Comptroller's Property Tax Assistance Division: TTARA calculations

Figure 4:

Estimated Initial Incidence of General Revenue Funds FY2025 (in billions)

Source of General Revenue	Contribution to GR	Business		Consumer		Unkown		Other	
		Share	%	Share	%	Share	%		%
Limited Sales and Use Tax*	\$44.98	\$18.81	41.8%	\$26.17	58.2%	\$ -	-	\$ -	-
Oil Production Tax	\$7.12	\$7.12	100%	\$0.00	0%	\$ -	-	\$ -	-
Motor Vehicle Sales and Use Tax*	\$5.72	\$2.45	42.7%	\$3.28	57.3%	\$ -	-	\$ -	-
Franchise/Business Margins Tax	\$4.46	\$4.46	100%	\$0.00	0%	\$ -	-	\$ -	-
Natural Gas ProductionTax	\$4.13	\$4.13	100%	\$0.00	0%	\$ -	-	\$ -	-
Insurance Premium Taxes	\$3.36	\$3.36	100%	\$0.00	0%	\$ -	-	\$ -	-
Gasoline Tax*	\$0.01	\$0.00	22.6%	\$0.01	77.4%	\$ -	-	\$ -	-
Total taxes for which incidence is available	\$69.79	\$40.33	57.8%	\$29.46	42.2%	\$0.00		\$ -	
Other taxes and fees for which incidence is not available	\$5.80					\$5.80	100%		
Non-tax and non-fee sources of revenue	\$9.19							\$ 9.19	100%
Total Est. Net General Revenue-Related Funds FY2025	\$84.78	\$40.33	47.6%	\$29.46	34.7%	\$5.80	6.8%	\$ 9.19	10.8%

* Amount excludes tax allocated to Texas Parks and Wildlife Department, Texas Historical Commission and State Highway Fund.

Estimated Initial Incidence of Property Tax Relief Fund FY2025 (in billions)

Source of General Revenue	Contribution to PTRF	Business		Consumer		Unkown		Other	
		Share	%	Share	%	Share	%		%
Motor Vehicle Sales and Use Tax*	\$0.037	\$0.016	42.7%	\$0.021	57.3%	\$ -	-	\$ -	-
Franchise/Business Margins Tax	\$1.913	\$1.913	100%	\$0.000	0%	\$ -	-	\$ -	-
Total taxes for which incidence is available	\$1.950	\$1.93	98.9%	\$0.02	1.1%	\$0.00		\$ -	
Other taxes and fees for which incidence is not available	\$0.709					\$0.709	100%		
Non-tax and non-fee sources of revenue	\$0.006							\$ 0.006	100%
Total Est. Net General Revenue-Related Funds FY2025	\$2.66	\$1.93	72.4%	\$0.02	0.8%	\$0.709	26.6%	\$ 0.006	0.2%

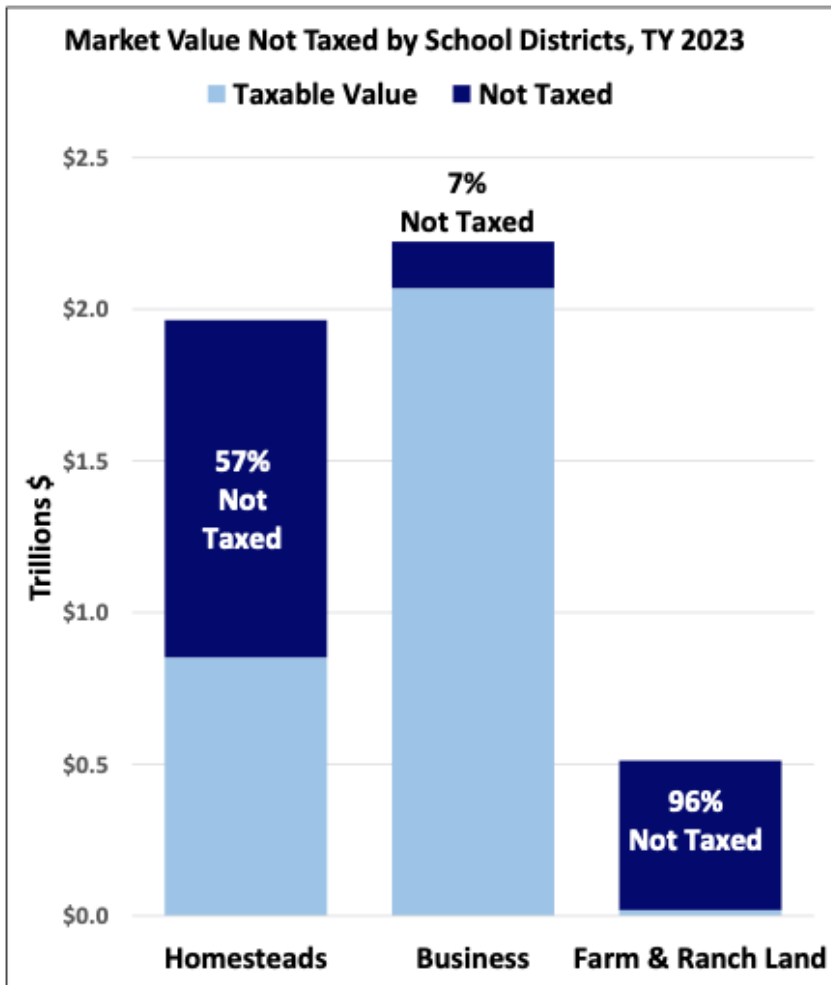
Sources:

Contribution to GR figures are from Biennial Revenue Estimate 2024-2025 Biennium, Table A-3.

Contribution to Property Tax Relief Fund figures are from Biennial Revenue Estimate 2024-2025 Biennium, Table A-10.

The business and consumer share percentages are from the Comptroller's Tax Exemptions & Tax Incidence Report - February 2023.

Figure 5:



Source: 2023 Preliminary ISD Self Report, Comptroller's Property Tax Assistance Division; TTARA calculations

Figure 6:

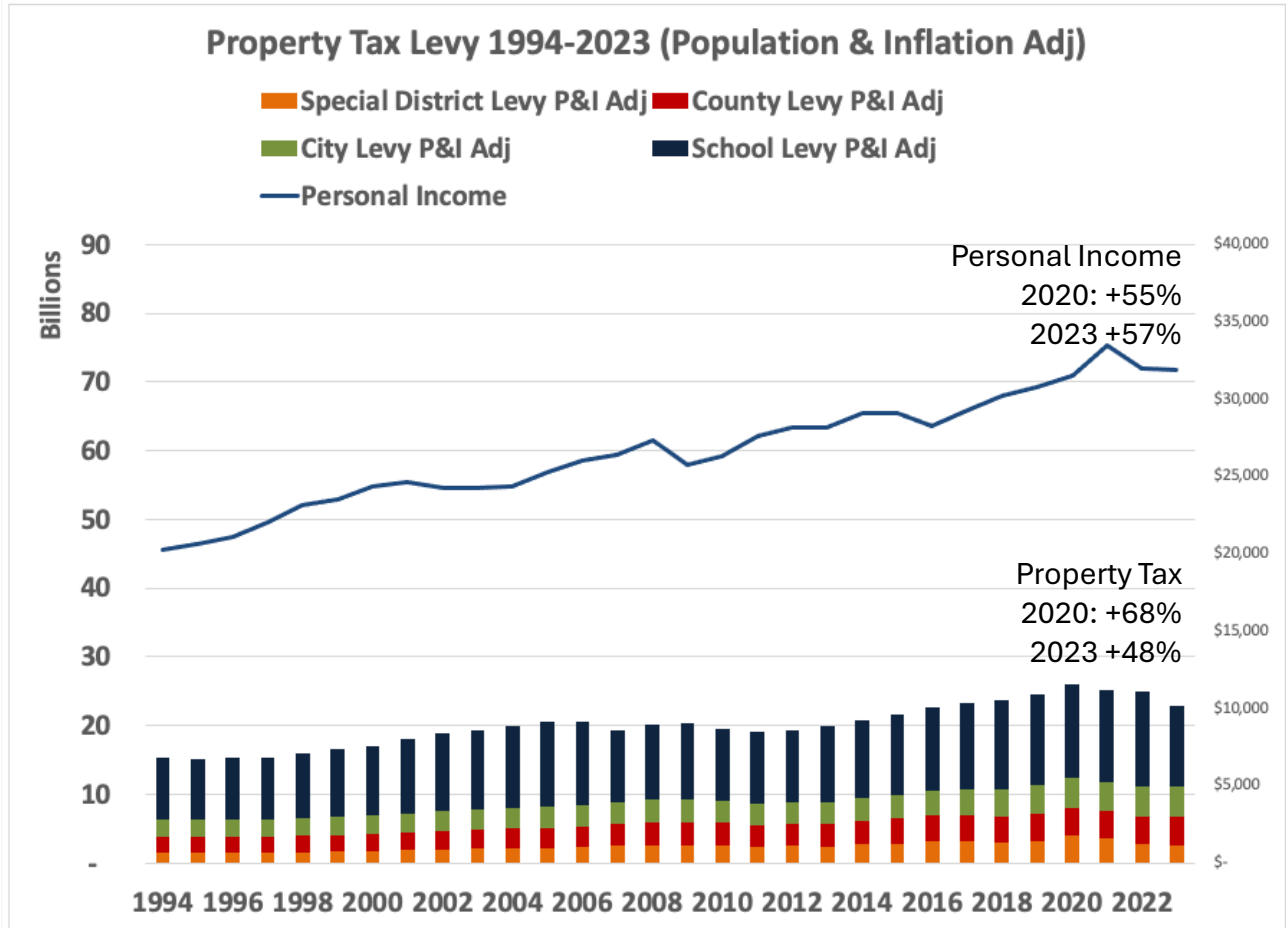


Figure 7:

School District Tax Rate Compression Tax Year 2024

	Value Growth TY23 to TY24	Statewide "Ceiling"	"Equity Floor" (90% of Ceiling)	# Districts at "Ceiling"	# Districts at "Equity Floor"
TY 2024 Maximum Compressed Rate (MCR)	2.87%	\$0.6855	\$0.6169	72 (7%)	585 (58%)

Figure 8:

Examples of "Equity Floor" Limitation Tax Year 2024

School District	Value Growth	MCR w/o Equity Floor	MCR with Equity Floor	Rate Comp at Equity Floor	Unrealized Rate Compression
Knippa ISD	176.93%	\$0.2424	\$0.6169	\$0.0381	\$0.3745
Buckholts ISD	105.09%	\$0.3094	\$0.6169	\$0.0023	\$0.3075
Malone ISD	74.93%	\$0.3754	\$0.6169	\$0.0238	\$0.2415
Lockney ISD	85.79%	\$0.3795	\$0.6169	\$0.0711	\$0.2374
Rogers ISD	50.96%	\$0.4204	\$0.6169	\$0.0023	\$0.1965
Sherman ISD	46.41%	\$0.4335	\$0.6169	\$0.0023	\$0.1834
Freer ISD	52.40%	\$0.4416	\$0.6169	\$0.0374	\$0.1753
Penelope ISD	38.61%	\$0.4595	\$0.6169	\$0.0045	\$0.1574
Coahoma ISD	36.81%	\$0.4626	\$0.6169	\$0.0023	\$0.1543
Brazos ISD	36.01%	\$0.4675	\$0.6169	\$0.0023	\$0.1494

Figure 9:

Tax Year 2023 – TY 2022 School District Property Tax Levies (Billions)

	TY 2023	TY 2022	\$ Difference	% Difference
School District M&O Taxes	\$28.6	\$33.6	(\$5.0)	(15%)
School District I&S Taxes	\$11.2	\$10.3	\$0.9	9%
Total School District Taxes	\$39.8	\$43.9	(\$4.1)	(9%)

Source: 2023 Preliminary ISD Self Report, Comptroller's Property Tax Assistance Division; TTARA calculations

Who Benefits from the 2023 Property Tax Relief?

Key Points

- Total school district property tax levies for tax year 2023 were \$4.1 billion (9%) lower than in tax year 2022.
- A total of \$3.5 billion (86%) of the \$4.1 billion of total school district property tax relief was realized by single-family homes. The remaining \$0.6 billion of tax relief was realized by business and other non-homestead property.
- Approximately \$1.1 trillion of homestead value was eliminated from the tax base in TY 2023, while only \$154.1 billion of business property was exempt from taxation.
- Only 43% of homestead value was subject to school district property tax in TY 2023, in contrast to 93% of business value.

The tax relief package passed by the 88th Legislature and approved by voters on November 7, 2023, delivered a great deal of school district property tax relief as promised. However, most of that property tax relief was realized by homeowners and has set Texas on a course of taxing residential and business property unequally.

Based on preliminary 2023 property values released by the Comptroller’s office on January 31, 2024, the Texas Taxpayers and Research Association examined the effect of the property tax relief package on various types of property. The package included (1) compression of school district maintenance & operations (M&O) rates by approximately \$0.20, (2) 150% increase in the school district state mandated homestead exemption to \$100,000 (from \$40,000), and (3) adjustment of the 65 and over/disabled “tax freeze” to reflect these actions, resulting in lower maximum tax bills for those individuals.

Overall, statewide total school district property tax levies for tax year (TY) 2023 were 9% lower than in

tax year 2022, falling to \$39.8 billion from \$43.9 billion. Levies for maintenance and operations (M&O) were reduced by 15% to \$28.6 billion from \$33.6 billion, but the savings was mitigated by a 9% increase in school district property taxes levied to pay debt service (I&S) from \$10.3 billion to \$11.2 billion (Table 1).

Owners of single-family homes benefited most from the property tax relief package. A total of \$3.5 billion (86%) of the \$4.1 billion of total property tax relief was realized by single-family homes due to the combination of tax rate compression, homestead exemption increase, and 65+/disabled tax freeze adjustments. School district property tax levies on single-family homes fell by 17% to \$17.5 billion from \$21.0 billion. The remaining \$0.6 billion (14%) of tax savings was spread across various business and farm and ranch properties (Table 2).

When added to all other types of homestead exemptions (local option, over 65, disabled, veteran, first responders, 10% appraisal cap, tax deferrals, historical designations), the 150% increase in the

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Source: 2023 Preliminary ISD Self Report, Comptroller’s Property Tax Assistance Division; TTARA calculations

Who Benefits from the 2023 Property Tax Relief?

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Mobile Homes	\$0.085	\$0.102	(\$0.017)	(16%)	0.4%
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Vehicles	\$0.000	\$0.001	(\$0.001)	--	--
Intangible Personal (stock value-ins. co.)	\$0.000	\$0.000	--	--	--
TOTAL	\$39.772	\$43.914	(\$4.142)	(9.4%)	100.0%

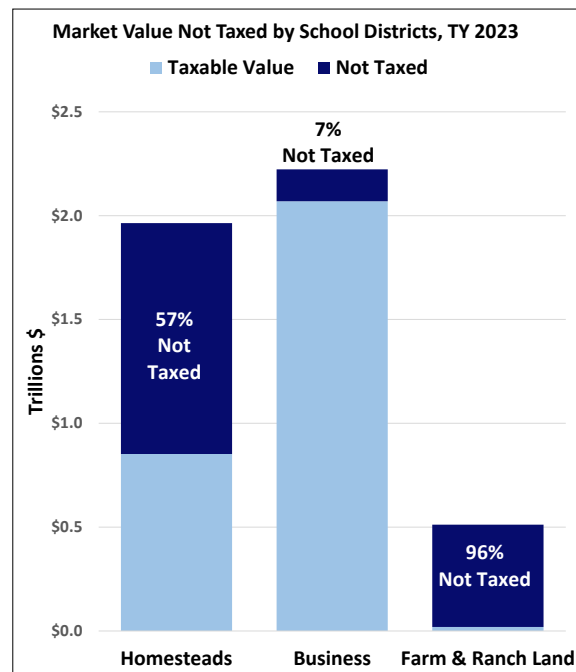
Source: 2023 Preliminary ISD Self Report, Comptroller's Property Tax Assistance Division; TTARA calculations

mandatory statewide school district homestead exemption to \$100,000 from \$40,000 resulted in the elimination of \$1.1 trillion of homestead value (owner-occupied single-family homes) from the tax base. Consequently, 57% of the total market value of homesteads in the state was not subject to a school district property tax in 2023 (70% of single-family homes are homesteads.)

In contrast to the dramatic expansion of the homestead exemption, existing exemptions from school district property taxes for business property and productivity valuations for farm and ranch land were unchanged by the tax relief package. The total amount of business property (commercial, industrial, oil & gas, utilities, multi-family, inventories, vacant lots) exempt from school district property tax in 2023 was \$154.1 billion, only 7% of the \$2.2 trillion in total market value. Special productivity valuations for farm and ranch land removed 96% of its \$493 billion in market value from the school district tax rolls in 2023.

In summary, while the tax relief package passed by the 88th Legislature and approved by voters on November 7, 2023, delivered a great deal of school district property tax relief to homeowners as promised, it also dramatically altered the structure of the school district property tax base and enshrined that structure in the Texas Constitution.

Only 43% of the total market value of homestead property statewide was subject to school district property tax in 2023, in contrast to 93% of the market value of business property. This disparity will continue unless the constitution is amended to eliminate it, but will have less significance if the state continues to compress school district M&O tax rates.



Source: 2023 Preliminary ISD Self Report, Comptroller's Property Tax Assistance Division; TTARA calculations

Should We Eliminate Local Property Taxes?

Key Points

- In the 2023 tax year, local property taxes totaled \$82.1 billion, equal to ALL taxes collected by the state.
- Replacing all property taxes with sales tax revenue would require a sales tax rate of over 19%.
- Repealing all exemptions and exclusions would generate approximately \$55.1 billion, two-thirds of total property taxes.

The local property tax is arguably the most maligned tax paid by Texans, and property owners have not hesitated to let their state legislators know how they feel. The tax rate and the property's taxable value are determined annually, making it prominently visible to taxpayers. In 2023, property taxes collected by local governments in Texas totaled \$82.1 billion, equal to ALL taxes collected by the state (Figure 1). The total property tax levy in 2023 was composed of \$40.1 billion in property tax levied by school districts (49%), \$15 billion levied by cities (18%), \$14.3 billion levied by counties (17%), and \$12.6 billion levied by special districts (15%) as illustrated in Figure 2. The rallying cry against the property tax has been, "You don't own property in Texas; you pay rent on it annually through the property tax." In response, the Texas legislature has attempted to stem the rise in the tax even though the state does not control the rates set by local taxing jurisdictions or the appraised values determined by the market and quantified by local appraisal districts. Limiting the rise in property tax levies has proved to be a daunting task.

Past Efforts to Reduce Property Taxes

The 79th Legislature (2005) passed HB 1, appropriating \$7 billion to reduce school district maintenance and operations (M&O) tax rates by 33.3% over two years. No limitation was placed on school district I&S tax rates (to make debt payments for school facilities) or on the tax rates levied by counties, cities, and special districts, so the effort to reduce school M&O tax went largely unnoticed as other taxes grew to fill the void. The 86th Legislature (2019) passed HB 3, mandating that school district M&O tax rates be reduced if taxable values increase by more than 2.5%, and SB 2, which placed a limit of 3.5% on additional revenue permitted for cities and counties without voter approval. Building on that momentum, the 88th Legislature (2023) spent \$18 billion for the 2023-2024 biennium to reduce school district M&O tax rates further, increase the school district homestead exemp-

Figure 1

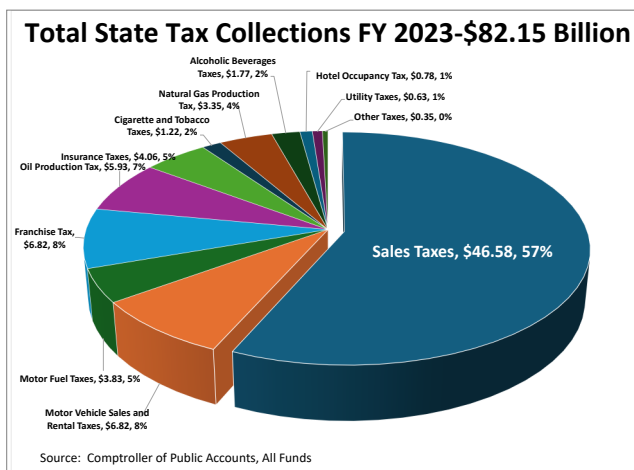
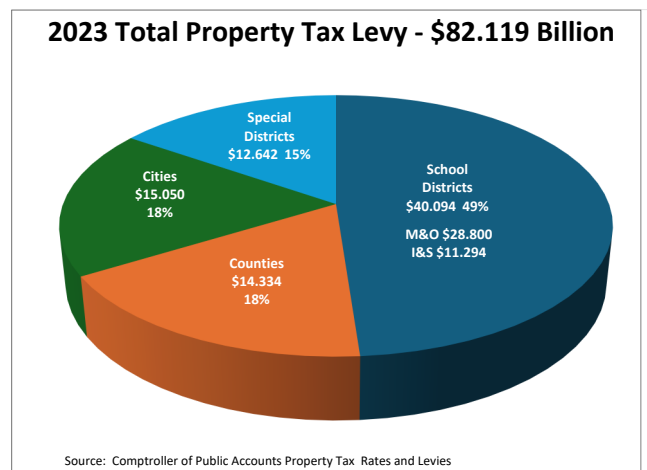


Figure 2



Should We Eliminate Local Property Taxes?

tion by 150%, and adjust the taxes paid by homeowners 65 years or older or disabled. Their effort resulted in a decrease in school district taxes of \$4.1 billion.

Despite these efforts, calls to eliminate the property tax have become more prevalent. However, taxpayers do not seem ready to forego the services provided by the taxing units levying the tax, such as public education, police protection, firefighters, emergency first responders, garbage and recycling pickup, and public libraries. Therefore, the question arises: If we eliminate the property tax but maintain the services provided, how do we pay for those services?

Considerations

Most proposals to eliminate the property tax center around two possibilities: Replace the property tax with an expansion of the sales and use tax (sales tax for short); and/or use a portion of any state surplus to buy down property taxes each biennium. The state sales tax raised \$46.6 billion in fiscal year 2023 at a tax rate of 6.25% to help finance the state’s budget, equating to \$7.4 billion for each percentage point of tax. Local taxing jurisdictions may impose an additional 2% to help finance their budgets, resulting in a total sales tax rate of 8.25% in most Texas localities.

The sales tax is paid by consumers on taxable items and, at 8.25%, is the 14th highest sales tax rate in the nation according to the Tax Foundation’s [2023 midyear ranking](#). To replace the total \$82.1 billion property tax levy would require a sales tax increase of over 11 percentage points, resulting in a total sales tax rate of 19.27%, which is 2.3 times the current rate, and exceeding the current highest sales tax rate in the nation of 9.548% (Tennessee) by almost 10 percentage points. A total sales tax rate even higher than 19.27% would likely be required to make up revenue lost to tax avoidance in both legal and illegal forms, especially in areas of Texas that border another state with a far lower sales tax rate.

Because a sales tax rate of 20% is unpalatable to many, recent proposals have focused on replacing only the school district M&O tax, which totaled \$28.8 billion in 2023. This would require increasing the sales tax rate by almost four percentage points to over 12% and would replace only 35% of total property taxes. Property taxes levied by cities and counties and those levied by school districts for debt service would most likely continue to increase, and consumers could end up paying higher sales taxes in exchange for little or no decrease in their property taxes. Table 1 illustrates the various sales tax rates necessary to replace different property tax components.

Table 1

Type of Taxing Jurisdiction	2023 Total Property Tax Levy			State and Local Sales Tax Rate to Replace Total Levy		State and Local Sales Tax Rate to Replace M&O Levy		State and Local Sales Tax Rate to Replace I&S Levy	
	(Billions)	2023 M&O Levy (Billions)	2023 I&S Levy (Billions)	Tax Rate to Replace Total Levy	Additional Percentage Points to Replace Total Levy	Rate to Replace M&O Levy	Additional Percentage Points to Replace M&O Levy	Rate to Replace I&S Levy	Additional Percentage Points to Replace I&S Levy
School Districts	\$ 40.094	\$ 28.800	\$ 11.294	13.63%	+5.38	12.11%	+3.86	9.77%	+1.52
Counties	\$ 14.334	\$ 12.500	\$ 1.834	10.17%	+1.92	9.93%	+1.68	8.50%	+0.25
Cities	\$ 15.050	\$ 10.890	\$ 4.159	10.27%	+2.02	9.71%	+1.46	8.81%	+0.56
Special Districts	\$ 12.642	\$ 9.645	\$ 2.998	9.95%	+1.70	9.54%	+1.29	8.65%	+0.40
Total	\$ 82.119	\$ 61.834	\$ 20.285	19.27%	+11.02	16.55%	+8.30	10.97%	+2.72

Source: Comptroller of Public Accounts Property Tax Rates and Levies; TTARA calculations

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Many have advocated repealing exemptions and exclusions to expand the tax base of the sales tax rather than increasing the rate. According to the Comptroller's 2023 [Tax Exemptions & Tax Incidence Report](#), if ALL exemptions and exclusions were repealed, an additional \$55.1 billion would be generated by the sales tax – only two-thirds of the revenue required to replace all property taxes (Table 2). Pursuing this option would result in consumers paying increased sales taxes in addition to the remaining property taxes.

Conclusion

Several issues must be carefully considered before a concerted effort to replace local property taxes with increased state sales tax is embarked upon.

- How would swapping some or all of the property tax for a higher sales tax rate affect economic growth in Texas and the state's attractiveness as a business location compared to other states?
- Would a 20%+ sales tax rate give rise to significant tax avoidance?
- How would repealing current exemptions and/or exclusions affect economic growth in Texas and the state's attractiveness as a business location compared to other states?
- The sales tax is a more regressive tax than the property tax, especially after the new \$100,000 homestead exemption. Would a tax swap increase regressivity of our tax system overall?
- Comptroller has estimated that individual consumers initially pay 58% of the sales tax while paying 44% of the school district property tax beginning in 2023. How would a property-tax-for-sales-tax swap shift the tax burden?
- A new funding mechanism for local jurisdictions would have to be developed. Theoretically, local property tax could be swapped for local sales tax, but in real life, a local jurisdiction's sales tax base will not necessarily yield the same amount of revenue as its property tax base. On the other hand, if local property tax were replaced by state sales tax, a mechanism to distribute state funds to counties, cities, and other local governments would need to be developed.
- Finally, is it worthwhile to increase state sales tax collections to replace only a portion of the local property tax?

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Table 2

Value of Sales Tax Exemptions (Billions)		
Consumer Items		\$ 6.134
Groceries	\$ 3.926	
Residential Utilities	\$ 1.162	
Drugs	\$ 1.046	
Manufacturing		\$ 11.885
Raw Materials	\$ 9.277	
Machinery & Equipment	\$ 1.143	
Manufacturing Utilities	\$ 1.178	
Other Manufacturing	\$ 0.287	
Agricultural		\$ 0.580
Taxed by Other Law		\$ 20.577
Insurance Premiums	\$ 9.547	
Motor Vehicles	\$ 5.644	
Motor Fuels	\$ 4.359	
Other Taxed by Other Law	\$ 1.027	
Governments & Non-profits		\$ 0.484
Research & Development Activities		\$ 0.259
Other		\$ 2.302
Total Exemptions		\$ 42.221
Value of Sales Tax Service Exclusions (Billions)		
Construction Labor		\$ 1.029
New Residential	\$ 0.216	
New Non-Residential	\$ 0.653	
Residential Repair & Remodeling	\$ 0.160	
Personal Services		\$ 0.558
Hair, Nail & Skin Care	\$ 0.112	
Death Care	\$ 0.088	
Child Day Care	\$ 0.224	
Other Personal Services	\$ 0.134	
Business & Professional Services		\$ 10.192
Physician, Dental, & Other Health Care	\$ 3.433	
Legal	\$ 0.698	
Accounting & Auditing	\$ 0.461	
Architectural & Engineering	\$ 0.605	
Computer System Design & Programming	\$ 1.082	
Employment Agency & Temp Labor Supply	\$ 0.799	
Financial Securities Brokerage & Other Financial	\$ 0.750	
Management Consulting & Public Relations	\$ 0.601	
Real Estate Brokerage & Agency	\$ 0.489	
Research & Development	\$ 0.356	
Other Business & Professional	\$ 0.918	
Other Services		\$ 1.103
Total Service Exclusions		\$ 12.882
Total Exemptions and Service Exclusions		\$ 55.103

Source: Comptroller of Public Accounts, 2023 Tax Exemptions & Tax Incidence Report