

# Texas Tax Policy

## Options for Reform

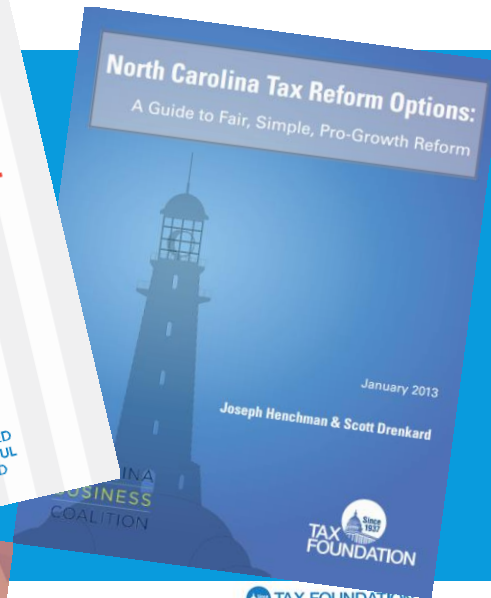
Presentation to the Texas Commission  
on Public School Finance  
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# ABOUT THE TAX FOUNDATION



we've worked for  
**81 years**

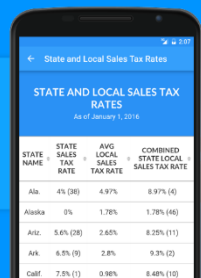
on objective  
research,  
data,  
& analysis  
at the  
federal,  
state,  
& local levels



## How do the 2016 Presidential Tax Plans Compare So Far?

	Bush	Carson	Cruz	Paul	Rubio	Santorum	Trump
10-Year GDP Growth	10%	16.0%	13.9%	12.9%	15%	10.2%	11.5%
10-Year Capital Investment Growth	28.8%	46.6%	43.9%	40.5%	48.9%	29%	29%
10-Year Wage Rate Growth	7.4%	10.9%	12.2%	11.4%	12.5%	7.3%	6.5%
Added Jobs (millions)	2.7	5.2	4.9	4.3	2.7	3.1	5.3
10-Year Static Revenue Estimate (billions)	-\$3,665	-\$5,617	-\$3,666	-\$1,797	-\$6,055	-\$3,223	-\$11,980
10-Year Dynamic Revenue Estimate (billions)	-\$1,610	-\$2,472	-\$768	+\$737	-\$2,401	-\$1,093	-\$10,135

INTRODUCING  
**FACTS & FIGURES**  
FOR YOUR SMARTPHONE



# TOPICS OF DISCUSSION

- Academic Literature on Taxes and Growth
- Overview of Texas Tax Policy
  - Tax Rates and Tax Collections
  - State-Local Tax Burden
  - *State Business Tax Climate Index*
- Suggestions for Reform

# ACADEMIC LITERATURE ON TAXES & GROWTH

In 2012, we reviewed 26 major studies that examine the relationship.

- Higher taxes are associated with slower growth.
  - All studies but three agree.
  - All studies in the last fifteen years agree.
- Authors included:
  - Christina Romer
  - Jens Arnold of the OECD



## Special Report

December 18, 2012  
No. 207

### What Is the Evidence on Taxes and Growth?

By  
William McBride, PhD

#### Introduction

The idea that taxes affect economic growth has become politically contentious and the subject of much debate in the press and among advocacy groups. That is in part because there are competing theories about what drives economic growth. Some subscribe to Keynesian, demand-side factors, others Neo-classical, supply-side factors, while yet others subscribe to some mixture of the two or something entirely unique. The facts, historical and geographical variation in key parameters for example, should shed light on the debate. However, the economy is sufficiently complex that virtually any theory can find some support in the data.

For instance, the Congressional Research Service (CRS) has found support for the theory that taxes have no effect on economic growth by looking at the U.S. experience since World War II and the dramatic variation in the statutory top marginal rate on individual income.<sup>1</sup> They find the fastest economic growth occurred in the 1950s when the top rate was more than ninety percent.<sup>2</sup> However, their study ignores the most basic problems with this sort of statistical analysis, including: the variation in the tax base to which the individual income tax applies; the variation in other taxes, particularly the corporate tax; the short-term versus long-term effects of tax policy; and reverse causality, whereby economic growth affects tax rates. These problems are all well known in the academic literature and have been dealt with in various ways, making the CRS study unpublishable in any peer-reviewed academic journal.<sup>3</sup>

So what does the academic literature say about the empirical relationship between taxes and economic growth? While there are a variety of methods and data sources, the results consistently point to significant

# ACADEMIC LITERATURE ON TAXES & GROWTH

- Some taxes burden economic growth more than others, in particular, gross receipts taxes, corporate income taxes, and individual income taxes.

# COMPARATIVE STATE TAX POLICY

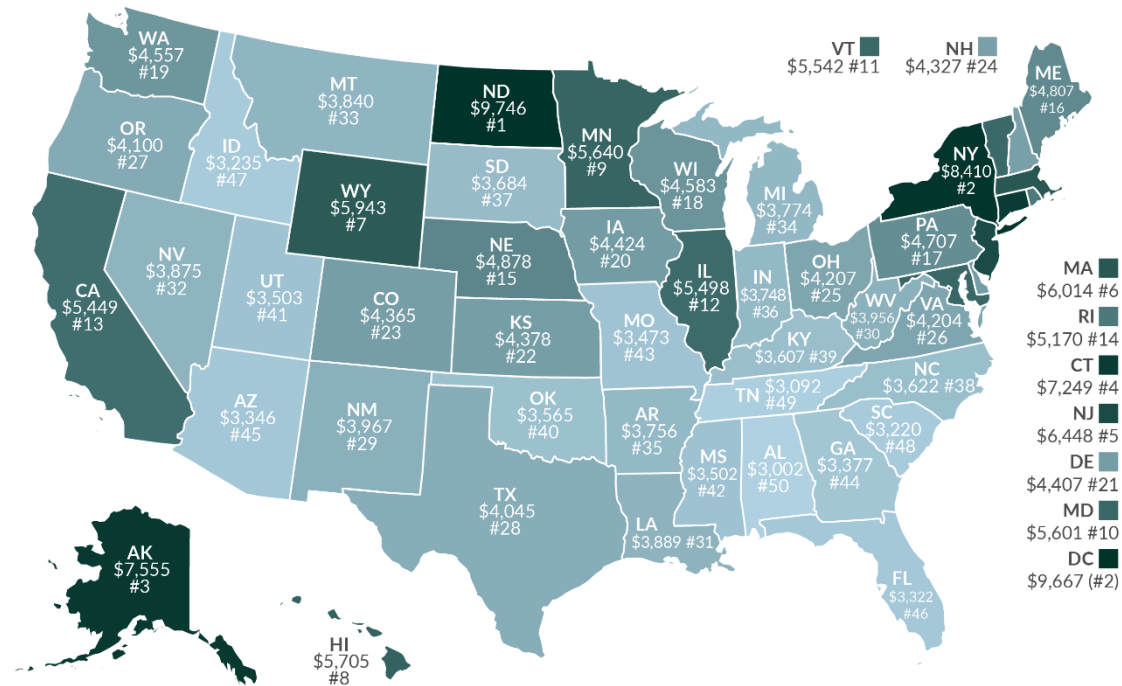
- We think of state tax policy in four large categories:
  - Tax Rates
  - Tax Collections
  - Tax Burdens
  - Tax Structure

# TAX COLLECTIONS

## STATE TAX COLLECTIONS

### How High Are Tax Collections Where You Live?

State & Local Tax Collections per Capita, FY 2014



Note: "Revenue" refers to the Census Bureau's General Revenue classification. This measure includes revenue such as taxes, fees, licenses, and intergovernmental revenue but excludes revenue from government enterprises such as utilities and liquor stores, as well as insurance trust revenue. D.C.'s rank does not affect states' ranks, but the figure in parentheses indicates where it would rank if included.

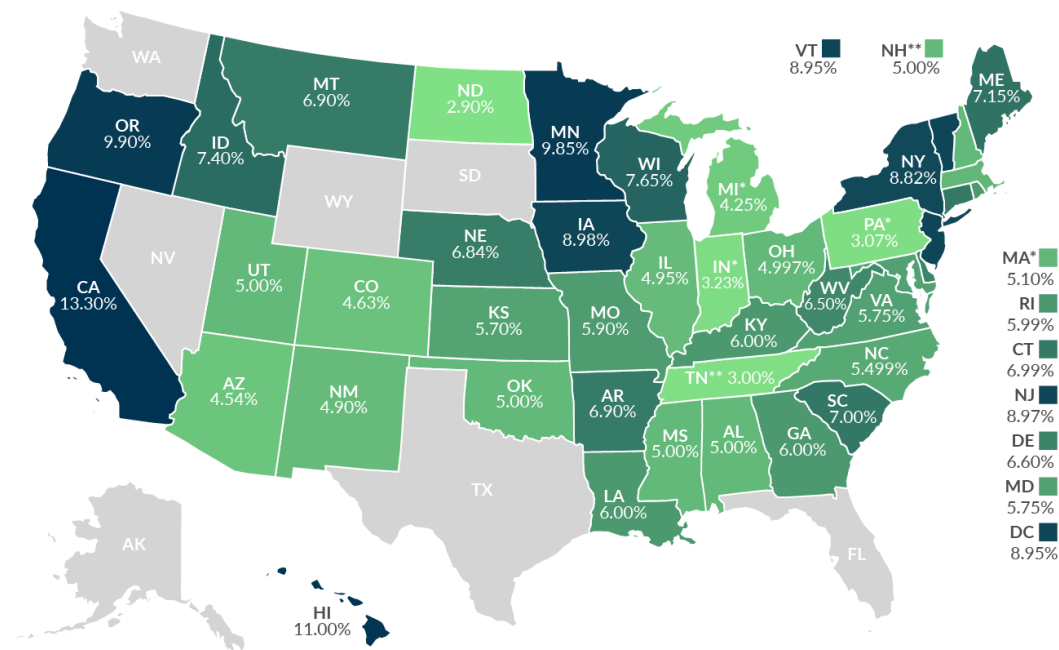
Source: Census Bureau; Tax Foundation calculations.



# INDIVIDUAL INCOME TAX

## How High Are Income Tax Rates in Your State?

Top State Marginal Individual Income Tax Rates, 2018



Note: (\*) State has a flat income tax. (\*\*) State only taxes interest and dividends income. Map shows top marginal rates: the maximum statutory rate in each state. This map does not show effective marginal tax rates, which would include the effects of phase-outs of various tax preferences. Local income taxes are not included.

Source: Tax Foundation; state tax statutes, forms, and instructions; Bloomberg BNA.

Top State Marginal Individual Income Tax Rate

Lower Higher

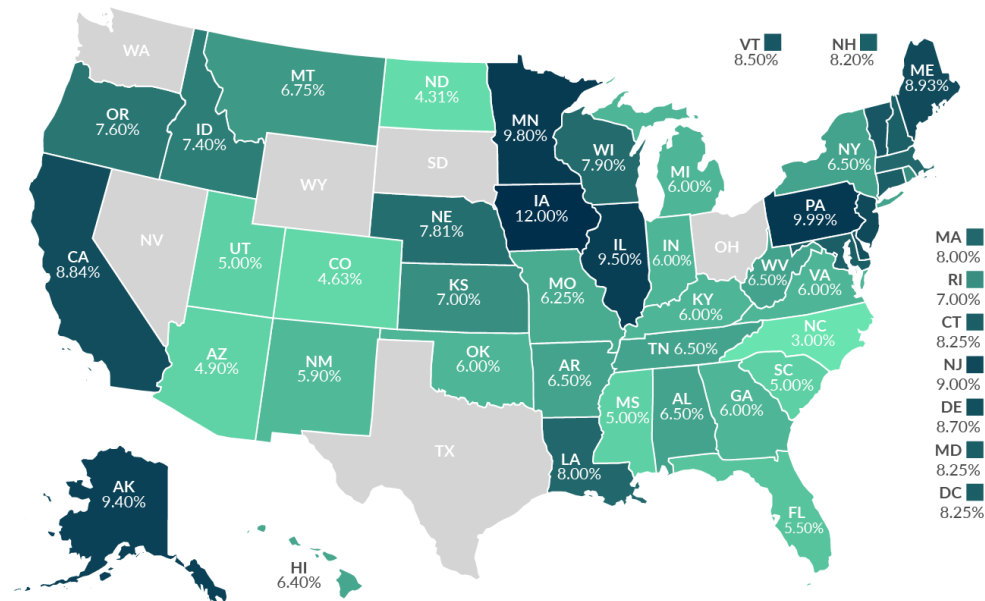


# TAX RATES

## CORPORATE INCOME TAX

### How High Are Corporate Income Tax Rates in Your State?

Top State Marginal Corporate Income Tax Rates in 2018



Note: (\*) Nevada, Ohio, Texas, and Washington do not have a corporate income tax but do have a gross receipts tax with rates not strictly comparable to corporate income tax rates. Arkansas has a "benefit recapture," by which corporations with more than \$100,000 of taxable income pay a flat tax of 6.5% on all income, not just on amounts above the benefit threshold. Connecticut's rate includes a 10% surtax, which effectively increases the rate from 7.5% to 8.25%. Surtax is required by businesses with at least \$100 million annual gross income. Illinois' rate includes two separate corporate income taxes, one at a 7.0% rate and one at a 2.5% rate.

Source: State tax statutes, forms, and instructions; Bloomberg BNA

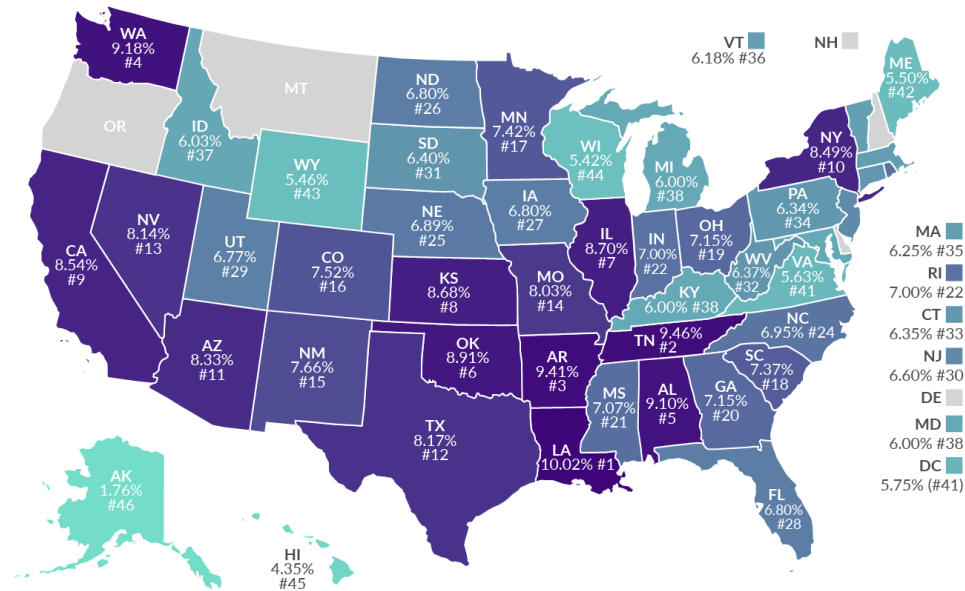


# TAX RATES

## SALES TAX

### How High Are Sales Taxes in Your State?

Combined State & Average Local Sales Tax Rates, Jan. 1 2018



Note: City, county, and municipal rates vary. These rates are weighted by population to compute an average local tax rate. Three states levy mandatory, statewide, local add-on sales taxes at the state level: California (1.25%), Utah (1.25%), and Virginia (1%); we include these in their state sales tax. The sales taxes in Hawaii, New Mexico, North Dakota, and South Dakota have broad bases that include many services. This map does not include sales taxes in local resort areas in Montana. Salem County is not subject to the statewide sales tax rate and collects a local rate of 3.3125%. New Jersey's average local score is represented as a negative.

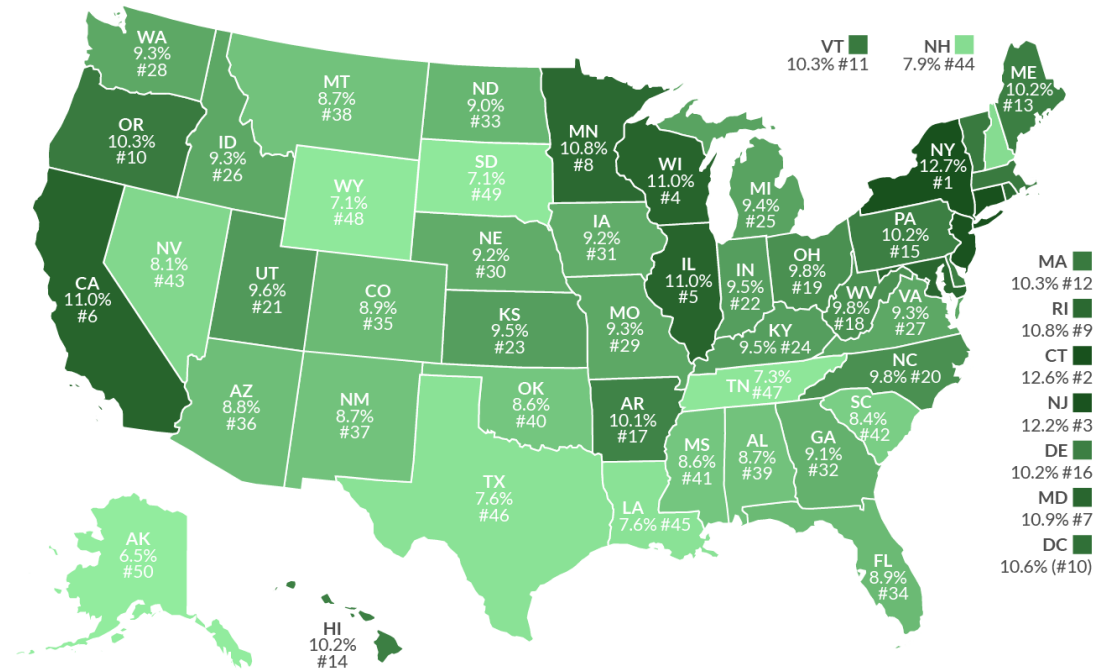
Source: Sales Tax Clearinghouse, Tax Foundation calculations, State Revenue Department websites



# STATE-LOCAL TAX BURDENS

## State-Local Tax Burdens by State

State-Local Tax Burdens as a Percentage of State Income, FY 2012



Note: As a unique state-local entity, Washington, DC is not included in rankings, but the figure in parentheses shows where it would rank.

Source: Tax Foundation calculations, U.S. Census Bureau, Rockefeller Institute, Bureau of Economic Analysis, Council on State Taxation, and Travel Industry Association.

State-Local Tax Burden as a Percentage of State Income



# STATE BUSINESS TAX CLIMATE INDEX

- Comprehensive look at state tax structures
- The **how** rather than the **how much**
- Five areas of tax:
  - Individual income taxes
  - Corporate income taxes
  - Sales and excise taxes
  - Property taxes
  - Unemployment insurance taxes

# STATE BUSINESS TAX CLIMATE INDEX

**Overall:** 13th

Corporate: 49th

Individual: 6th

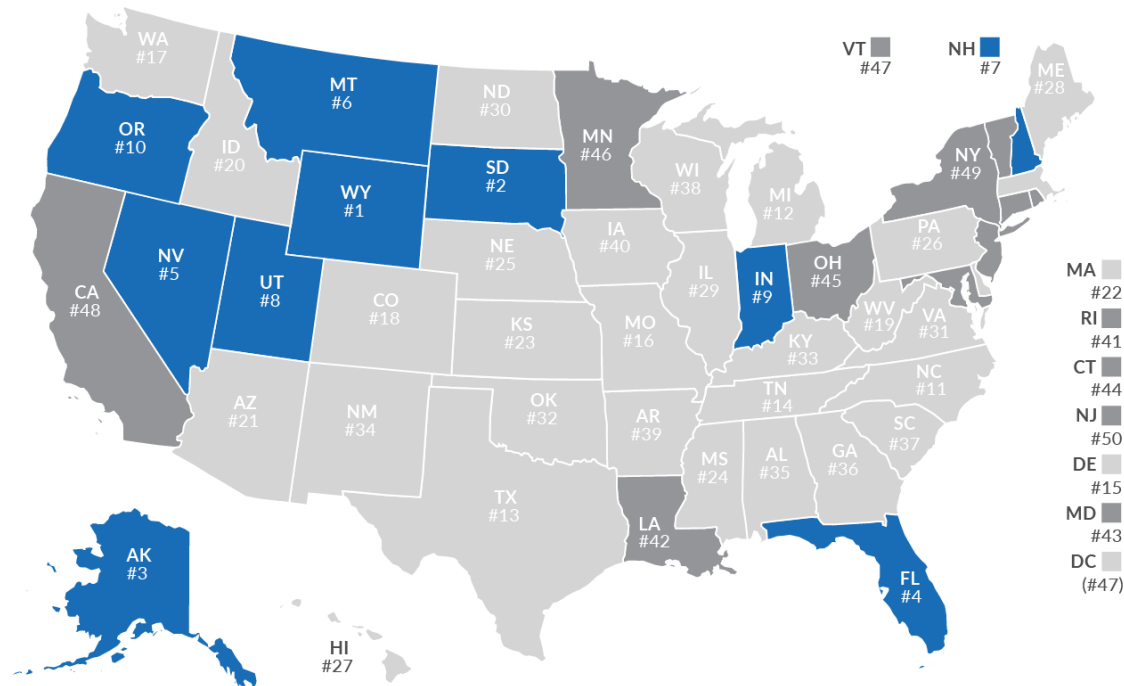
Sales: 37th

Unemployment Insurance: 26th

Property: 37th

# STATE BUSINESS TAX CLIMATE INDEX

## 2018 State Business Tax Climate Index



Note: A rank of 1 is best, 50 is worst. Rankings do not average to the total. States without a tax rank equally as 1. D.C.'s score and rank do not affect other states. The report shows tax systems as of July 1, 2017 (the beginning of Fiscal Year 2018).  
Source: Tax Foundation.

- 10 Best Business Tax Climates
- 10 Worst Business Tax Climates

# STATE BUSINESS TAX CLIMATE INDEX

## CORPORATE INCOME TAX

- The franchise tax hurts TX's score considerably. Gross receipts taxes are a fundamentally flawed type of tax.
- Texas is one of only five states--Delaware, Ohio, Nevada, Texas, and Washington-- that uses a gross receipts tax as its business tax.

# STATE BUSINESS TAX CLIMATE INDEX

## INDIVIDUAL INCOME TAX

- Texas is quite competitive on its individual income tax, but does lose points for including pass-through businesses under the Margin tax.



# STATE BUSINESS TAX CLIMATE INDEX

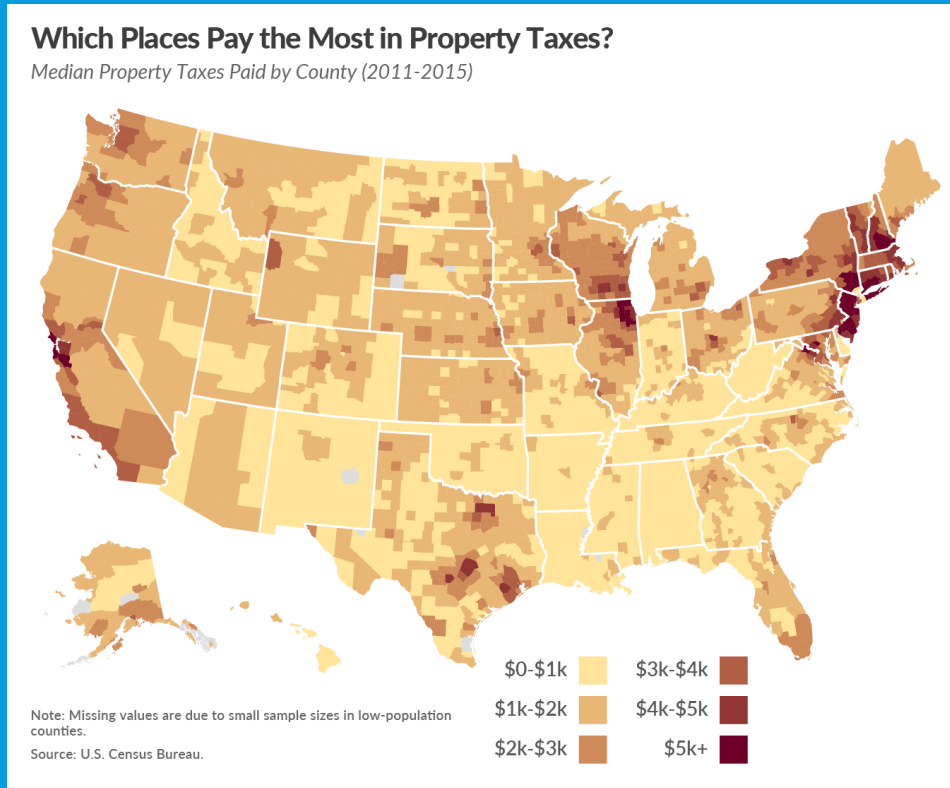
## SALES TAX

- Texas includes a number of business inputs in the sales tax base, such as office equipment and business leases.
- At the same time, the state exempts a number of consumer goods, such as groceries. State also has a sales tax holiday.
- The state taxes services more than other states, but many are still exempt, including medical, real estate, fitness, barber, and veterinary.

# STATE BUSINESS TAX CLIMATE INDEX

## PROPERTY TAX

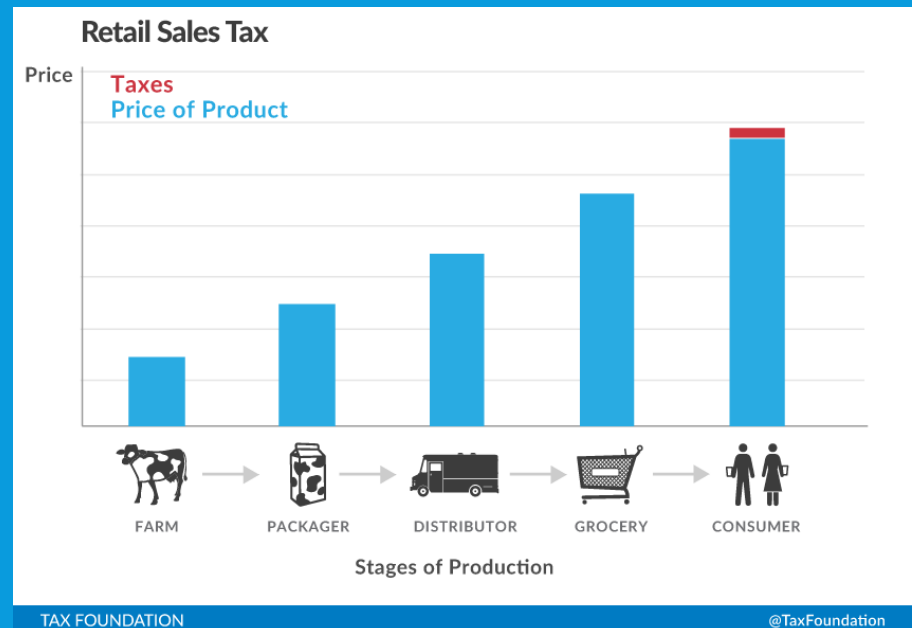
- The property tax in Texas is higher than many other states, but most states have much more diverse tax bases.
- The state's property tax also includes non-residential property, such as intangibles and inventory.



# SUGGESTED REFORMS

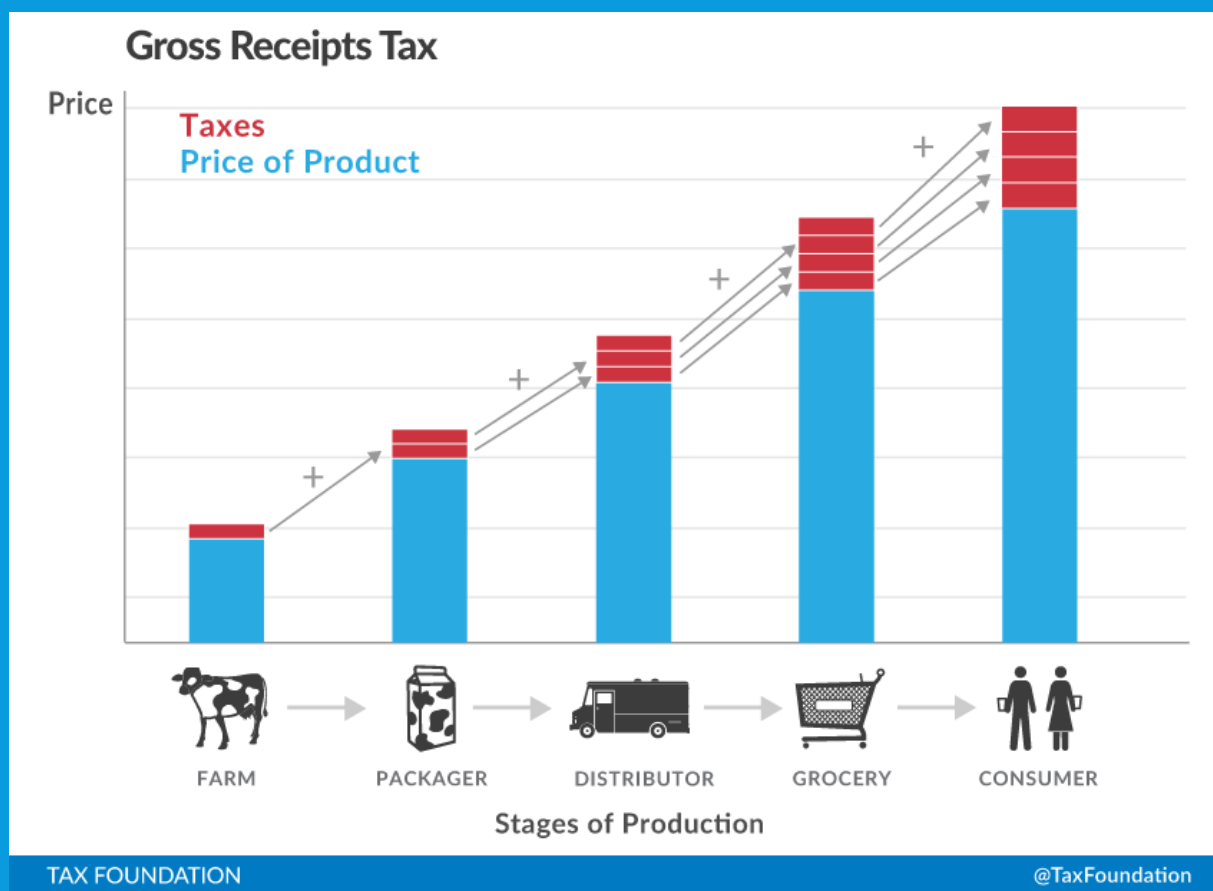
## MARGIN TAX

- Repealing the franchise tax would improve Texas's competitiveness, reduce costs for consumers and improve job opportunities.
- Gross receipts taxes, such as the margin tax, lead to tax pyramiding.



# SUGGESTED REFORMS

## MARGIN TAX



# SUGGESTED REFORMS

## MARGIN TAX

- Repealing the franchise tax would improve Texas's competitiveness, reduce costs for consumers and improve job opportunities.
- Texas has made progress on this front, including lowering the rates and expanding the EZ filing option.

**Texas Margin Tax Repeal in the  
State Business Tax Climate Index**

	Current Law	With Margin Tax Repeal
<b>Overall</b>	13	3
<b>Corporate</b>	49	1
<b>Individual</b>	6	1
<b>Sales</b>	37	37
<b>Unemployment Insurance</b>	26	26
<b>Property</b>	37	37

# SUGGESTED REFORMS

## OTHER OPTIONS

- Texas could also look at expanding its sales tax base to include more services, but the state already has a broader sales tax base than most states.
  - Texas has the 12th most broad sales tax breadth.

Number of Taxable Services	
Arkansas	72
Florida	63
Louisiana	55
New Mexico	158
Mississippi	72
Tennessee	67
Texas	83
Washington	158

# SUGGESTED REFORMS

## OTHER OPTIONS

- However, there are still a number of services that are not taxed in Texas, but are taxed in a comparable state. These include:
  - Barber shops and beauty parlors
  - Dating services
  - Debt counseling services
  - Fishing and hunting guide services
  - Gift wrapping services
  - Coin-operated laundry
  - Personal instruction (dance, golf, tennis, etc.)
  - Tax return preparation
- Key with any base expansion is to ensure business inputs are not taxed.

# SUGGESTED REFORMS

## OTHER OPTIONS

- Similarly, the state could eliminate some of the goods that are currently exempt, such as groceries.
  - These exemptions are large. In fiscal year 2019, the grocery exemption costs \$3.2 billion and the over-the-counter drugs costs \$284 million.
- Blanket exemptions provide sales tax relief to all individuals not just low-income households.
- The state could expand its sales tax base to include these items and then provide more targeted relief elsewhere in the code.
  - Expanding to services is likely more progressive than goods as well, helping to mitigate regressivity.



# CONCLUDING THOUGHTS

## TEXAS

- The Texan tax code is quite competitive, with no individual or corporate income taxes, and a broad sales tax base.
- However, the state's margin tax hampers the state's ability to compete. While focus is on property tax reforms, repealing the margin tax is the best way to improve TX's tax climate.
- If the state would like to reduce its reliance on the property tax, expanding the sales tax base can provide additional revenue.

# QUESTIONS

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