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Contact: Chandra Kring Villanueva, villanueva@cphp.org

UPDATED: WHO PAYS TEXAS TAXES?

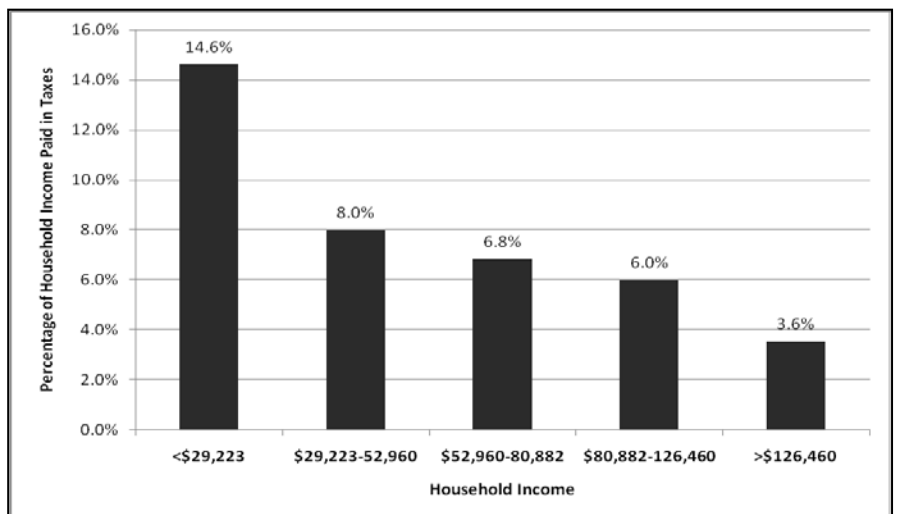
Our quality of life in Texas depends on our public structures—including public education, child health services, and transportation infrastructure—maintained by Texas tax dollars. A good tax system would not only provide adequate revenue to maintain these structures, but would also match the share of taxes paid with the share of income earned by each Texas family. The Comptroller's newly released biennial study of the fairness of the Texas state and local tax system, *Tax Exemptions and Tax Incidence*,¹ demonstrates conclusively that low- and moderate-income Texas families bear a disproportionate share of state and local taxes. We need a fairer system to fund public structures so we can improve and maintain Texas families' quality of life.

- **A good tax system would match the share of taxes paid with the share of income earned by each Texas family**
- **Texas' tax system is regressive, meaning low- and moderate-income Texans bear a disproportionate share of taxes.**
- **The school property tax is the fairest major tax paid by Texans. Reductions in school property taxes mandated in 2006 caused budget holes that must be filled with general revenue.**
- **Filling these budget holes with general revenue redistributes income from the vast majority of Texas families to the one-fifth of families with the highest income.**

Tax Fairness

Fairness of a tax system can be judged by comparing the percentage of income different households pay in taxes. In a state with a fair tax system, households with higher incomes, who can afford to pay a larger percentage of their income in taxes, pay more. In Texas, the households with the lowest incomes pay the highest percentage of their income in taxes; the households with the highest incomes pay the lowest percentage of their income in taxes. In other words, those who can least afford it pay the most. A system that takes a higher percentage of the income of a lower-income family is called "regressive." Texas has the fifth most regressive state and local tax system of the 50 states.²

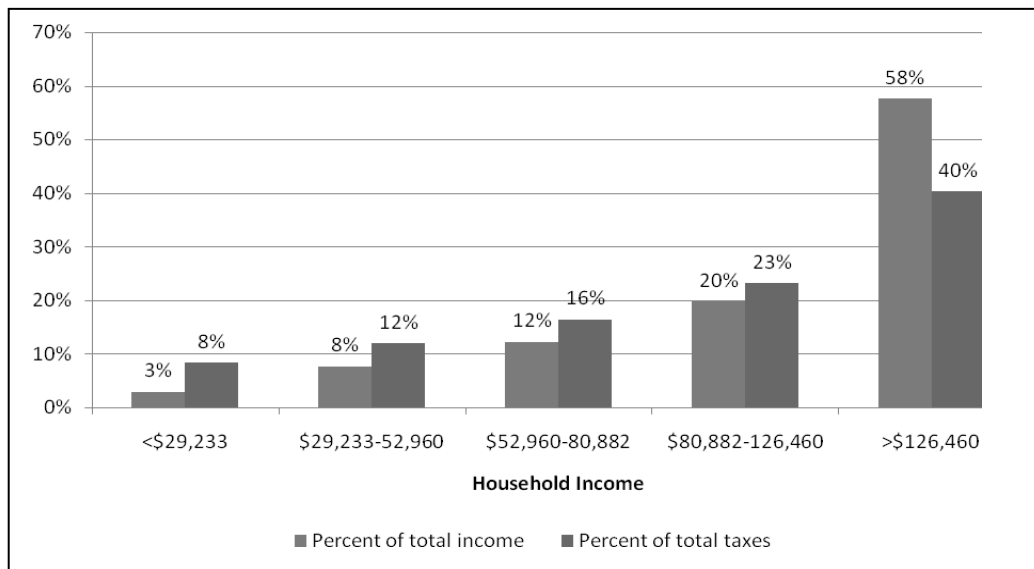
Households with the Lowest Income Pay the Highest Percentage in State and Local Taxes



The graph on page one, derived from the information in the comptroller's report, shows the range of incomes of households in each income group and the average percentage of total household income paid in state and local taxes. Each income group contains one-fifth (20 percent) of all Texas households or about 1.9 million households.

The graph below shows that the 80 percent of Texas households (four income groups) earning less than \$126,460 per year pay a higher percentage of total taxes than their percentage of total income earned in Texas. This disparity enables the top one-fifth of Texas earners to pay a percentage of total Texas taxes much smaller than the percentage of total Texas income that they receive.

The Top One-Fifth of Texas Households Pay Less than Their Fair Share of Taxes



Families eventually pay the taxes paid by businesses, such as the franchise tax or the natural gas tax. The final cost of the tax can be shifted onto workers through lower wages and onto consumers through higher prices, as well as onto shareholders through lower profits. The comptroller calculates both the initial distribution of tax by industry and the final distribution of tax by household income.

All households pay property taxes. Homeowners pay their property taxes directly, while renters pay property taxes indirectly. Their landlords initially pay the taxes on the property, and then pass the cost of the taxes on to their tenants through higher rents. The degree to which these taxes can be passed on varies with the local rental market.

Which Tax is the Fairest?

The Suits Index measures the fairness of a tax system by mathematically comparing the percentage of taxes paid and the percentage of total income received for each taxpayer. If each family paid the same percentage of income in tax, the Suits Index for that tax would be zero. Regressive taxes score less than zero on the Suits Index. All major Texas taxes score lower than zero; each is regressive.

The regressivity of different taxes varies significantly. **The school property tax is actually the fairest major tax paid by Texans. The sales tax is one of the least fair.**

The sales tax burdens low-income families more than higher-income families, since it is based on how much each family spends. Low-income families typically spend three-quarters of their income on things subject to the sales tax, middle-class families spend less than half of their income on items subject to sales tax, and the richest families spend one-quarter or less of

their income of sales-taxable items. Exemptions for groceries, residential utilities (gas, electric, and water), and prescription and over-the-counter medicines reduce somewhat the unfairness of the sales tax. Taxing business and professional services primarily used by higher-income families, but not currently taxed, could also reduce the regressivity of the sales tax.

The school property tax taxes a more equitable percentage of income from families at every income level. This may be

because families at most income levels spend similar percentages of family income on housing, In addition, business owners -who generally make more income- frequently bear the burden of business property taxes.

The \$15,000 homestead exemption and over-65 tax freeze reduce school property taxes, particularly for lower-income homeowners. Another method of introducing consideration of a homeowner's ability to pay property taxes is a circuitbreaker program, which reduces property taxes that exceed a certain percentage of a taxpayer's income. Without a circuitbreaker, the property taxes owed on a home can rise, even when a homeowner's income does not. Circuitbreakers can be targeted to individual taxpayers most burdened by property taxes, reducing their tax liability to a manageable level. Because of this careful focus, circuitbreaker programs cost much less than across-the-board rate reductions or increases in exemptions. (For more information on circuitbreakers, see www.cppp.org/research.php?aid=835)

Tax	Suits Index (from least unfair to most unfair)
School property tax	-0.09
Oil production tax	-0.14
Franchise tax	-0.23
Motor vehicle sales tax	-0.23
Sales tax	-0.26
Gasoline tax	-0.33
Cigarette tax	-0.50

Who Wins When Local Property Tax Cuts are Funded with State General Revenue?

Changes in the franchise and cigarette taxes made in 2006 only partially fund the school property tax cuts passed in the same year. The comptroller's biennial revenue estimate forecasts that the 2006 tax changes will generate \$4.5 billion in 2012-13. The property tax revenue lost by school districts due to required rate reductions is expected to total nearly \$15 billion in the coming biennium leaving a "structural deficit" of at least \$10 billion, which must be filled by general revenue.

Using state general revenue to replace local school property taxes redistributes income from the vast majority of Texas families to the one-fifth of families with the highest income-those earning more than \$126,460.

The chart on page five shows the percentage of household income saved by a \$10 billion reduction in property taxes (the left-hand bar in each pair) and the percentage paid to raise the same amount of money statewide from the major states taxes-the sales tax, motor vehicle sales tax, and gasoline tax (the right-hand bar). These three taxes account for 75 percent of state tax revenue, so they approximately demonstrate the resulting shift in tax incidence caused by using general revenue to pay for property tax cuts.

The average household in all four lower- and middle-income brackets pays more in state taxes than it gains in lower property taxes.

Tax Exemptions for High-Cost Natural Gas

Texas severance tax policy for high-cost natural gas operations provides great financial benefits for natural gas producers. The stated tax rate on natural tax production is 7.5 percent of market value; however, according to the Legislative Budget Board, special tax treatment has reduced many producers' tax liability to zero and eroded the overall tax rate to between 1.1 and 1.9 percent.

The tax incidence of natural gas production was not included in the latest version of the comptrollers report because the amount of revenue collected in natural gas taxes has been eroded, through exemptions, to below the threshold to be included in the report.

Some Texas Taxes Are Paid by Non-Texans

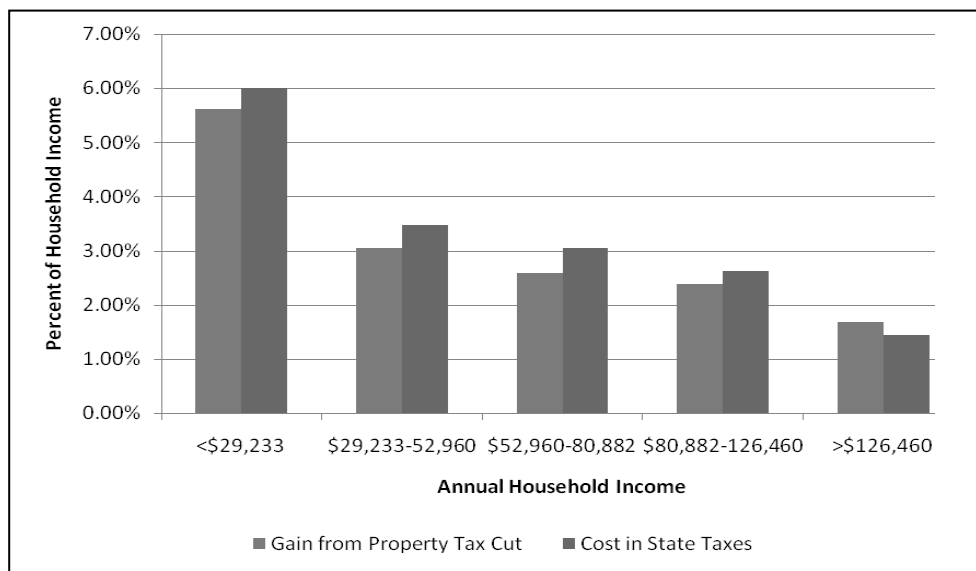
Certain Texas taxes are passed on to non-Texans, primarily through higher prices. For instance, more than half of the oil production tax is exported, so that the final incidence is not borne by in-state households, since much of the oil produced in Texas is processed here but sold out-of-state. Similarly, nearly one-third of the franchise tax initially paid by Texas business is passed on to out-of-state consumers or shareholders.

Increases in the rates of these taxes, or elimination of exemptions or deductions, could raise state revenue needed to maintain public services, but not proportionately increase taxes borne by Texas households.

Conclusion

The comptroller's report shows conclusively that Texas' tax system is regressive and unfairly burdens Texas families that can least afford it. Texas should consider fairer tax systems that consider families' ability to pay. To learn more about fairer, more adequate tax systems, read "The Best Choice for a Prosperous Texas: A Texas-Style Personal Income Tax," available at: www.cppp.org/research.php?aid=766.

Most Families Lose When Property Taxes Are Replaced with General Revenue



ENDNOTES

¹ Online at: www.window.state.tx.us/taxinfo/incidence/96-463TaxIncidence02-11.pdf

² *Who Pays?* A Distributional Analysis of the Tax System in All 50 States, 3rd Edition (2009), Institute on Taxation & Economic Policy, www.itepnet.org/whopays3.pdf

The Center for Public Policy Priorities (CPPP) is a non-profit, non-partisan policy institute committed to improving public policies to better the economic and social conditions of low- and moderate-income Texans. We pursue this mission to achieve our vision for a BETTER TEXAS. You can learn more about CPPP at <http://www.cppp.org>.