THE POLICY PAGE
An Update on State and Federal Action

Center for Public Policy Priorities
900 Lydia Street, Austin, Texas, 78702 PH: 512.320.0222 www.cppp.org

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HOUSE WAYS & MEANS BILL WOULD RAISE SALES AND CIGARETTE TAXES TO CUT PROPERTY TAXES, MAKE LITTLE CHANGE IN BUSINESS TAXES

The House Ways and Means Committee has voted out a tax bill that would rely heavily on raising consumption taxes to fund property tax cuts. The tax equity note confirms that this type of tax shift inevitably increases taxes paid by lower- and middle-income families, while benefiting only families with the highest incomes. A portion of any future increase in state revenue would be dedicated to cutting property taxes, crippling our ability to meet the growing needs of public education and health and human services. In addition, the new general revenue generated by the bill would grow more slowly than the property taxes it is intended to replace.

(This Policy Page was revised on July 5 to reflect the information in the fiscal and tax equity notes for CSHB 3, which were released after 5 PM on Friday, July 1.)

THE BILL WOULD SHIFT TAXES, NOT INCREASE MONEY FOR EDUCATION

CSHB 3 is intended to raise certain state taxes in order to reduce school property taxes. It is designed to be revenue neutral – any new state revenue raised by the bill is to be used solely to cut property taxes. This is the chief problem with the bill.

More than cutting property taxes, Texas needs to improve public education, adequately fund health and human services, increase access to higher education, and support other important public services. CSHB 3 is flawed in its basic purpose.

Half of the new revenue in CSHB 3 would come from an increase in the state sales tax rate by a full penny – from the current 6 1/4 % to 7 ¼ %. **This would give Texas the highest state sales tax rate in the nation. No other state imposes a sales tax greater than 7.0%.**

More than two-thirds of the money raised by CSHB 3 would come from consumption taxes: the increase in the sales tax rate, an increase in the motor-vehicle sales tax rate to 7.35%, an expansion of the sales tax based to include car repairs and bottled water, and use of presumptive value in calculating the tax on used car sales (the “liar’s affidavit”).

Increasing the cigarette tax by $1.01 to $1.42 per pack, along with similar increases in other tobacco taxes, would account for another 17% of new revenue.

New business taxes would raise only 15% of the new revenue in CSHB 3. The Delaware and Geoffrey’s franchise tax loopholes would be closed, accounting for less than 10% of new revenue. The number of businesses paying to support state services would not otherwise be increased and the way the franchise tax is calculated would not be changed. Businesses would lose their discount for timely filing of sales tax payments and would pay sales taxes on custom computer programs.

FUTURE STATE REVENUE INCREASES WOULD BE DIVERTED TO PROPERTY TAX CUTS

CSHB 3 would dedicate at least 15 percent of any future increase in state revenue (excluding federal funds and constitutionally dedicated revenue) to property tax cuts. This money would be distributed to school districts to fund an equal percentage cut in school property taxes in every district.

In addition, any increase in state revenue attributable to CSHB 3 that is greater than projected by the comptroller when the bill is passed would also be entirely devoted to property tax cuts.

The Texas state/local revenue system already suffers from a “structural deficit” – our tax system does not grow fast enough to keep up with the growth in need. (For more details, see *The Texas Revenue Primer* http://www.cppp.org/files/7/rev_primer_web.pdf) Diverting 15% or more of this already inadequate revenue growth to tax cuts would ensure that Texas would continue to fall behind in its support of vital state services. In addition, any unexpected good economic news that increased revenue from the taxes raised by this bill would benefit only property taxpayers, not those receiving state services.

MOST FAMILIES WOULD PAY MORE

Before the House can vote on a tax bill, the Legislative Budget Board (LBB) must prepare a tax equity note that calculates the "final incidence" of proposed tax changes – the cost to families at different income levels of the increased and broadened sales tax, higher tobacco taxes, and changes in business taxation. (However, a tax equity note is not required before adoption of a conference committee report – the final version of a bill.)

The tax equity note, which was prepared after the committee voted out the bill, reveals that only the 20% of Texas families with incomes over $100,000 per year would benefit from the bill. For the vast majority of families, the cost of higher consumption taxes would more than offset the benefit of lower property taxes. The underlying cause of this tax shift is the use of the regressive sales tax to replace the relatively less regressive property tax. (For more details on tax incidence, see *Who Pays Texas Taxes?* http://www.cppp.org/files/7/pop_226.pdf.)

Like the sales tax, a cigarette tax is highly regressive. However, because smoking is a health risk, and higher cigarette taxes reduce smoking – particularly among more price-sensitive teenage smokers – an increase in the tax would have offsetting beneficial effects.

The benefits of cuts in property tax rates go initially to businesses, which pay more than half of all property taxes in Texas, and to homeowners. Renters pay property taxes too, but indirectly through their rent payments to their landlords. Renters would benefit from the proposed property tax cuts only to the extent that lower taxes are reflected in lower rents.

In addition, replacing property taxes, which are deductible from federal personal income taxes, with sales taxes, which are generally not deductible, increases the federal income taxes paid by Texans. Because of these lost deductions and because some of the benefits of the bill would flow to out-of-state shareholders, overall the bill would increase the taxes on all Texas households by $532.8 million in 2007. (For more information on the sales tax deduction, see *Temporary Sales Tax Deduction No Excuse for Raising Sales-Tax Rate*, http://www.cppp.org/files/7/November%208.pdf.)

NEW REVENUE WOULD GROW MORE SLOWLY THAN PROPERTY VALUES

The new revenue that would be raised by CSHB 3 would not grow as quickly as the property taxes that it is intended to replace. Property values are currently forecast to increase by roughly 5% per year. The fiscal note shows that, starting in 2007, when the proposed changes would be fully phased in, new general revenue would never grow as fast as 5% per year. In fact, in 2010 the new general revenue generated by the bill would be $284 million less than from a revenue source that grew by 5% a year from 2007.

A BETTER CHOICE

The best way to significantly cut property taxes and meaningfully increase revenue for public education is through a state personal income tax. See *The Best Choice for a Prosperous Texas,* http://www.cppp.org/files/7/prosperous_texas.pdf