THE POLICY PAGE
An Update on State and Federal Action

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LATEST TAX-SHIFT BILL IS SAME OLD STORY: RAISE SALES AND CIGARETTE TAXES TO CUT PROPERTY TAXES, MAKE LITTLE CHANGE IN BUSINESS TAXES, GENERATE NO NEW MONEY FOR SCHOOLS

This past Friday, the House Select Committee on Public Education Reform voted out the latest tax-shift bill (HB 8), which would once again 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.

THE BILL WOULD SHIFT TAXES, NOT INCREASE MONEY FOR EDUCATION

HB 8 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. HB 8 is flawed in its basic purpose.

Almost half of the new revenue in HB 8 would come from an increase in the state sales tax rate by three-quarters of a cent – from the current 6 1/4 % to 7 %. **This would place Texas in a tie for the highest state sales tax rate in the nation. Only three other states (Mississippi, Rhode Island, and Tennessee) impose a sales tax of 7.0%.**

Two-thirds of the money raised by HB 8 would come from consumption taxes: an increase in rates of the general sales tax and motor-vehicle sales tax to 7.0%; an expansion of the sales tax based to include car repairs, Internet access, and computer repair and maintenance; and the use of presumptive value in calculating the tax on used car sales (the "liar's affidavit").

Increasing the state cigarette tax by $1.00 to $1.41 per pack, along with similar increases in other tobacco taxes, would account for another 21% of new revenue.

New business taxes would raise only 12% of the new revenue in HB 8. The Delaware and Geoffrey's franchise tax loopholes would be closed and businesses would lose their discount for timely filing of sales tax payments – raising revenue – but capital tax pyramiding would be eliminated – reducing state 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.

FUTURE STATE REVENUE INCREASES WOULD BE DIVERTED TO PROPERTY TAX CUTS

HB 8 would dedicate at least 15% 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 HB 8 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 unanticipated 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 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.

One analysis being circulated purports to compare the benefit of the proposed property tax cut to the cost of the proposed sales tax increase and concludes that most Texas families would gain from the changes in HB 8. However, this analysis compares, for an average family, a property tax cut of 27 cents, which would cost $3.1 billion in 2007, to a sales tax increase of 3/4%, which would cost $1.7 billion – almost half of which is originally paid by business -– completely ignoring the impact on wages and prices of the sales taxes paid by business. The analysis also ignores the cigarette and business tax changes that pay for the rest of the property tax cut. It is no surprise that, when the full benefit is compared to a fraction of the cost, it looks like everyone wins.

HB 8, unlike most earlier tax-shift proposals, would devote some of the new revenue to increasing the homestead exemption – from the current $15,000 to $22,500. Because the additional $7,500 is a larger proportion of the value of a lower-value house than of a higher-value house, an increased exemption would be a small move away from regressive taxation. The increased exemption would cost $535 million in 2007.

The rest of the revenue would go to reducing property tax rates – to $1.29 in 2006 and $1.22 in 2007 – at a cost to the state of $3.1 billion in 2007. 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 be unaffected by the increased homestead exemption and 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 $279 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 HB 8 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 $110 million less than from a revenue source that grew by 5% a year from 2007.

JOB GROWTH WOULD BE NEGLIGIBLE

Proponents of shifting public-education funding from property taxes to sales taxes rely on "dynamic revenue estimates" prepared by the comptroller to claim that lower property taxes would generate tens of thousands of new jobs. These speculative gains would be insignificant in a state economy of more than ten million workers. In addition, the estimate apparently does not consider the effect of local-option enrichment taxes, which could cut in half any net property tax reductions, with similar effects on projected job growth.

The same new tax revenue, if invested instead in improving public and higher education, could generate better long-term returns through a more highly skilled workforce earning higher levels of income.

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