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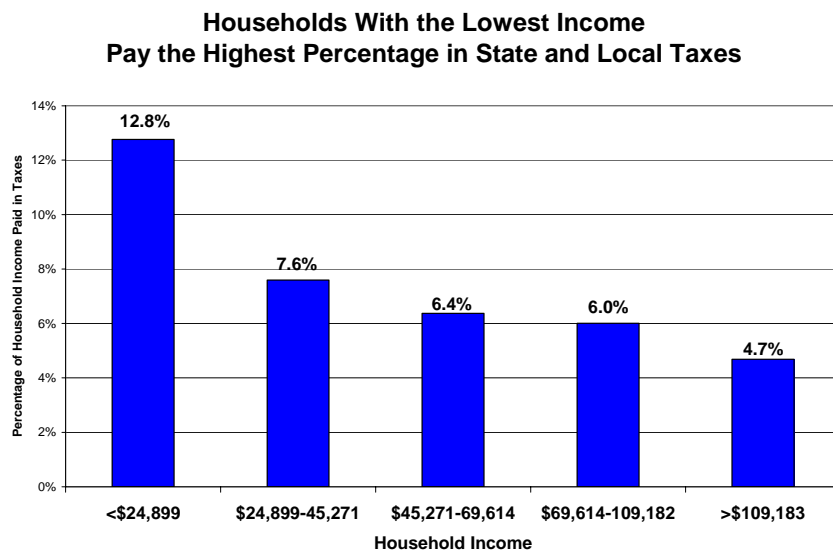
No. 284

WHO PAYS TEXAS TAXES?

The Comptroller has just released her biennial study of the fairness of the Texas tax system, *Texas Exemptions and Tax Incidence*,¹ which demonstrates conclusively that low-and moderate-income Texas families bear a disproportionate share of state and local taxes.

TAX FAIRNESS

The simplest way to judge the fairness of a tax system is to compare 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 that 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



¹ <http://www.window.state.tx.us/taxinfo/incidence07/>

² *Who Pays?* A Distributional Analysis of the Tax Systems in All 50 States, 2nd Edition (2003), The Institute on Taxation & Economic Policy, <http://www.itepnet.org/whopays.htm>

The graph above, which is derived from the information in the comptroller's report, shows the average income of households in each income group, the average amount of major state and local taxes paid by households in the income group, and the average percentage of total household income paid in taxes. Each income group contains one-fifth (20%) of all Texas households – 1.75 million households.

Even taxes that are initially paid only by businesses, such as the franchise tax or the natural gas tax, are eventually paid by families. 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.

It is also important to note that 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, 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?

Another way to judge the fairness of a tax is the Suits Index, which mathematically compares the percentage of taxes paid and the percentage of total income received for each taxpayer. If each family paid the same percentage of its income in tax, the Suits Index for that tax would be zero. If the tax is regressive, then the Suits Index is less than zero. All major Texas taxes have an index lower than zero; each is to some extent regressive. (The comptroller studied the franchise tax as it existed before the reforms of the 2006 special session.)

Tax	Suits Index (listed from least unfair to most unfair)
Natural gas tax	0.001
School property tax	-0.06
Franchise tax	-0.11
Motor vehicle sales tax	-0.14
Sales tax	-0.18
Gasoline tax	-0.25

There is a significant difference in the degree of regressivity of different taxes. **The school property tax is among the fairest taxes paid by Texans. The sales tax is one of the least fair.**

The sales tax imposes a larger burden on low-income families than on 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 even less of their income of sales-taxable items. The unfairness of the sales tax is somewhat reduced by the exemptions for groceries, residential utilities (gas, electric, and water), and prescription and over-the-counter medicines. Taxing business and professional services that are primarily used by higher-income families, but are currently not taxed, could also reduce the regressivity of the sales tax.

The school property tax comes closer to taking the same percentage of income from families at every income level. This may be because the percentage of family income spent on housing is relatively constant for most income levels. In addition, taxes on business property are frequently borne by business owners, who tend to have higher incomes. The \$15,000 homestead exemption and over-65 tax freeze reduce school property taxes, particularly for lower-income homeowners.

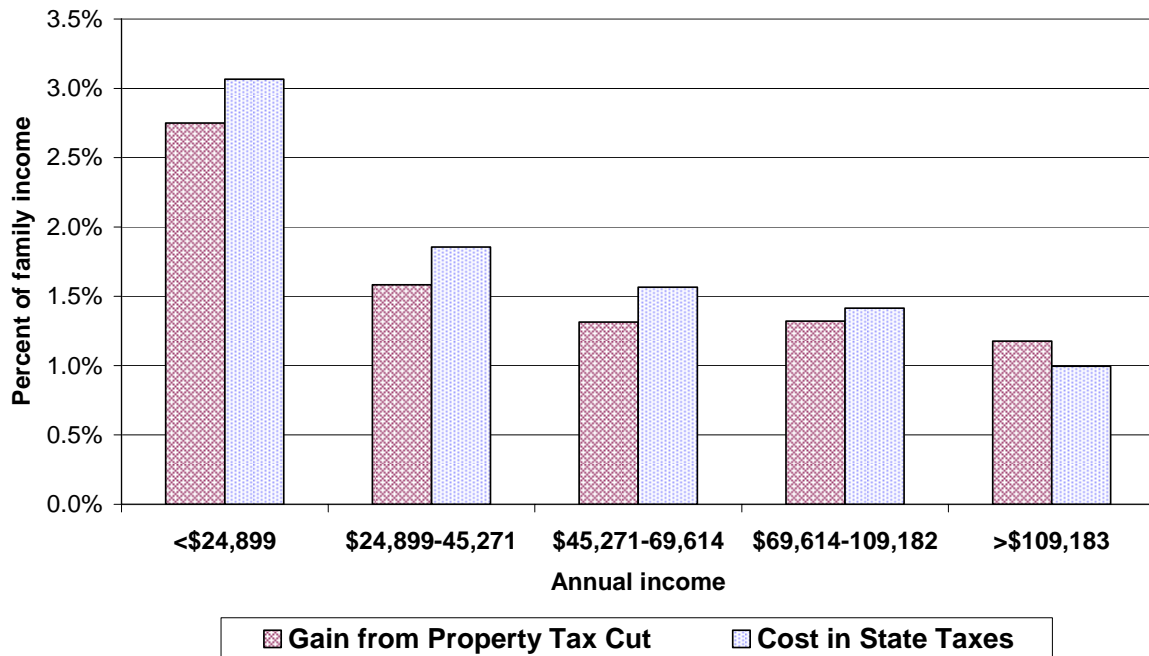
WHO WINS WHEN LOCAL PROPERTY TAX CUTS ARE FUNDED WITH STATE GENERAL REVENUE?

The school property tax cuts passed in the 2006 special session are only partially funded by the changes in the franchise, cigarette, and used car sales taxes made during that session. HB 2, the bill that pays for the cut in school property taxes to \$1.00 per \$100 of property value in 2008, appropriates \$6.1 billion in general revenue, in

addition to the \$8.1 billion in revenue from the special-session changes.

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 \$109,200.

Most Families Lose When Property Taxes Are Replaced with General Revenue



This chart shows the percentage of household income saved by a \$6.1 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, gasoline tax, and natural gas tax (the right-hand bar). These four taxes account for 80% of state tax revenue, so 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.

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