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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Senate Has Opportunity to Protect Families Hit Hardest by House Version of HB 3, the "Tax Relief Bill"

Lt. Gov. David Dewhurst has declared, "We're very focused in the Senate on the regressive nature of some taxes, and that's why we've been focused on how we reduce the tax incidence level for the poorest in our society." (Houston Chronicle, "Reducing Taxes for Poor Is a Goal, Dewhurst Says," March 17, 2005) The House version of HB 3 would cut school property taxes, and offset the loss of revenue by raising the sales tax and other taxes, which would shift the burden onto lower- and middle-income Texans. The Senate is considering two options to protect low-income families: an exemption from sales taxes and a short-term pass-through to tenants of the benefit landlords receive from lower property taxes.

THE PROBLEMS WITH HB 3

HB 3 is intended to raise certain state taxes in order to reduce school property taxes. The bill raises no new revenue for public education, health and human services, higher education, or any other important public service. Any new state revenue raised by the bill is intended solely to cut property taxes. This is the chief problem with the bill.

HB 3 has another major problem. The new revenue would largely come from highly regressive taxes, so would result in a higher total tax bill for lower- and middle-income families, even after property taxes are reduced. This regressivity is mainly due to HB 3's heavy reliance on the sales tax to generate money. For more information on the consequences of the House version of HB 3 for families of different income levels, see: *Tax Equity Note Confirms that Most Texas Families Would Pay More Under HB 3, the "Tax Relief Bill"* (http://www.cppp.org/pop_232.pdf).

WHAT THE SENATE MAY DO

The website (www.texaschildrenfirst.org) introduced by Lt. Gov. Dewhurst at his March 16 press conference states: "*Texas Children First* seeks to protect low-income Texans in the case that state sales taxes are increased to offset property tax reductions. Lone Star Card holders will therefore receive a substantial exemption from state sales taxes. Renters will receive a short-term pass-through benefit of property tax relief until the markets adjust accordingly."

CUSHION AGAINST HIGHER SALES TAXES

Texas already offsets some of the regressivity of the sales tax by eliminating all sales taxes on certain necessities, including groceries, residential utilities (gas, water, and electricity), and medicine. In 2004, the Senate passed a tax plan (SB 1) that would have reduced the sales tax rate on <u>all</u> items by 40% for persons with Lone Star Cards. This legislation did not pass, but the proposal is the basis for the Senate's plan to protect low-income families from the tax shifts proposed by HB 3.

Some 2.2 million people – about 900,000 families – currently hold a Lone Star Card, primarily because they participate in the federal food stamp program. CPPP estimates that up to 5 million people – more than 2 million families – could be using the card, which requires a family of four to have an income below roughly $2,000 per month and limited resources. Legal immigrants may qualify under certain circumstances.

To strengthen the Senate's proposal, the state could invest in improving outreach to families eligible for food stamps or for the more comprehensive "integrated benefits issuance card" proposed by SB 46 by Sen.

Nelson — a card that would include other public benefits as well. Food stamp outreach, half of which would be funded by the federal government, would increase the number of low-income families cushioned against increased sales taxes, while bringing hunger relief and hundreds of millions of additional dollars in federal food stamp aid to Texas. The state could also choose to issue a Lone Star Card to low-income families who do not receive food stamps or other public benefits to provide them with the same reduced sales tax rate.

As an alternative to a reduced sales tax rate for low-income families, the state could distribute a "sales-tax rebate" directly to low-income families through the Lone Star or other electronic benefits card. This is similar to the targeted tax credits offered by a handful of other states to offset the taxes paid by their low-income residents.

For instance, a Texas family with an income under $22,000 would pay an average of $760 a year in state sales taxes, if the rate were the 6.75% reportedly under consideration by the Senate. (This calculation is based on the Comptroller's tax incidence study. For more information, see *Who Pays Texas Taxes?* (http://www.cppp.org/pop_226.pdf.)

The 2004 Senate proposal would have exempted 40% of this amount – $300 a year. This could be distributed directly to each family in payments of $25 per month, in the same manner as cash assistance and food stamp benefits are currently distributed through the Lone Star Card.

A flat rebate would eliminate the necessity for merchants who are not currently equipped to accept the Lone Star Card, which is used only at grocery stores and other food retailers, to invest in new scanners. Payments could also reduce the temptation for misuse of the card: a card that could be used for unlimited reduced-tax purchases could be illegally "rented out" repeatedly. A card that received a monthly sales tax rebate would prevent this kind of misuse.

PROPERTY TAX CUTS FOR RENTERS

Families who rent their homes pay property taxes indirectly, through their rent, since owners of rental property pass through some of their property tax liability to their tenants in the form of higher rent. More than one-half of all households in Texas' major cities rent their homes. Although market forces will eventually help spread the benefit of any lowering of property taxes from landlords to these tenants, the bill should contain a temporary provision to ensure that all Texans receive their fair share of a property tax cut.

In 2004 the Senate in SB 1 required landlords to provide tenants with a monthly credit or rebate of the rent equal to three-quarters of the landlord's property tax savings. Many apartment owners opposed this proposed requirement. A similar floor amendment by Rep. Rodriguez was offered during the House floor debate on HB 3 on March 14. The amendment was tabled by a vote of 96-46.

Another way to let renters share in property tax reductions is through a "circuit breaker" program – named after electric circuit breakers that protect a home from electrical overload. When a property tax bill exceeds a certain percentage of a family's income, the circuit breaker reduces property taxes above this overload level. In 1997 the House passed a circuit breaker provision as part of a larger property-tax-cut bill (HB 4), but it was not included in the final bill, which reduced property taxes by increasing the homestead exemption.

Thirty-five states offer a circuit breaker program; 25 of these programs cover at least some renters. For instance, Illinois law assumes that 25% of rent is actually property taxes passed through by the landlord. Low-income renters can claim a credit when this indirect property tax payment exceeds 3.5% of their income. The disadvantage of circuit breakers is that taxpayers must apply to receive them, so participation rates can be low.