



Tax Equity Note on Senate Version of HB 3, the “Tax Relief Bill,” Shows Slight Improvement Over House Version

The Legislative Budget Board has calculated that the Senate Committee Substitute for HB 3, which is expected to be considered by the Senate on Tuesday, would increase taxes paid by 80% of Texas families. On average, only families with incomes over \$140,000 a year would save more from property tax cuts than they would pay in higher sales, cigarette, and alcohol taxes or absorb in higher prices, lower wages, or lower profits due to the proposed business tax. Significantly, families with incomes under \$13,400 would see a smaller net increase in taxes than all but the highest-income families, due to rebates made through the Lone Star Card used by food stamp and TANF recipients.

WHAT HB 3 WOULD DO

HB 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 intended 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 3 is flawed in its basic purpose.

The Senate Committee Substitute for HB 3 would increase the state sales tax rate by one-quarter of a percent (from the current 6 ¼% to 6 ½%) in 2006, with another one-quarter of a percent increase (to 6 ¾%) in 2007, contingent on voter approval of SJR 38, which would establish a state property tax. **A rate of 6 ¾% would give Texas the fourth highest state sales tax rate in the nation, behind three states (Mississippi, Rhode Island, and Tennessee) that impose a 7.0% sales tax.**

CSHB 3 would also raise other consumption taxes – on motor-vehicle sales, tobacco, and alcohol. The motor-vehicle sales tax rate would increase along with the general sales tax rate. The cigarette tax would be increased by 75 cents per pack, from 41 cents to \$1.16 per pack. Other tobacco taxes would be increased by one-quarter, as would all alcoholic beverage taxes, including those on beer, wine, liquor, and mixed drinks.

CSHB 3 would expand the franchise tax to cover all businesses except sole proprietorships and “passive entities.” Businesses would pay a tax rate of 4% on their profits plus 15% of the compensation paid to their employees (increasing to 25% of compensation in 2007, if SJR 38 is approved by the voters).

CSHB 3 would create a state property tax of \$1.10 per \$100 of taxable property value, if the voters approved SJR 38, which would authorize the tax.

MOST FAMILIES WOULD PAY MORE

The tax equity note for CSHB 3, prepared by the Legislative Budget Board (LBB), calculates the “final incidence” for the proposed tax changes in fiscal year 2007, when the bill is fully phased in. Incidence takes into account that the effect of tax changes is shifted over time from the initial impact on business to a final impact on families in prices, wages, or profits. It also calculates the cost to families at different income levels of the increased sales, tobacco, and alcohol taxes, as well as lower property taxes.

The tax equity note concludes that 80% of Texas families would see an increase in total taxes as a result of CSHB 3. Only the 10% of families with an income over \$140,000 would be expected to actually benefit from the bill, while the 10% of families with incomes between \$100,000 and \$140,000 would break even.

CSHB 3 would introduce a new program to substantially reduce the burden of the proposed tax changes on the

lowest-income families. The 800,000 households that use a Lone Star Card for food stamps or TANF benefits would receive a cash payment or additional nutritional assistance expected to average roughly \$10 per month. This additional benefit would almost entirely protect the 10% of Texas families with incomes under \$13,400 from the changes in the bill. This innovative program is an important recognition of the harsh impact of sales taxes on the lowest-income families.

This chart shows CPPP’s calculations of the impact of CSHB 3, based on the LBB’s tax equity note. The equity note divides all households into ten equal groups; this Policy Page pairs these groups into five equal income categories to make it easy to view. Each income group contains one-fifth (20%) of all Texas households – 1.65 million households.

The first column shows the average income of families in each income group, the second column shows the tax change due to HB 3 expressed in dollars, and the third column shows the tax change in terms of the percentage of family income that would be lost or gained because of the bill. Note that only families in the highest income group would see a decrease in their tax burden.

Average household income	Tax change, dollars	Tax change, % of family income
\$12,136	+\$54	+0.45%
\$31,127	+\$152	+0.49%
\$50,643	+\$180	+0.36%
\$78,062	+\$151	+0.19%
\$177,773	-\$125	-0.07%

TEXAS’ TAX SYSTEM

Texas has a very unfair tax system – the families with the lowest income pay the highest percentage of their income in taxes; the families with the highest income 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.

HB 3 would appreciably increase the regressivity of Texas’ tax system by increasing the tax load on lower- and middle-income families (except the very poorest), while decreasing the taxes paid by upper-income families.

The underlying cause of this tax shift is primarily the use of regressive taxes such as the sales, motor-vehicle sales, cigarette, and alcohol taxes, to replace the less regressive property tax. For more details on tax incidence, see *Who Pays Texas Taxes?* http://www.cppp.org/pop_226.pdf

FEDERAL DEDUCTIBILITY

The tax equity note points out that CSHB 3 would result in an initial increase in revenue in 2007 of \$482.5 million, but would ultimately increase the taxes of all households by \$679.1 million.

This discrepancy is largely due to the replacement of property taxes, which are deductible from federal personal income taxes, by sales and other consumption taxes, which are generally not deductible. A temporary provision allows sales taxes to be deducted in 2004 and 2005, but this deduction will expire before the time period covered by the tax equity note.

For more information on the sales tax deduction, see *Temporary Sales Tax Deduction No Excuse for Raising Sales-Tax Rate*, <http://www.cppp.org/products/PP215.html>.

A BETTER CHOICE

To learn what CPPP recommends to lower property taxes while adequately funding our state, see *The Best Choice for a Prosperous Texas* at http://www.cppp.org/prosperous_texas.pdf.

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