



**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, which demonstrates conclusively that low- and moderate-income Texas families bear a disproportionate share of state and local taxes. Data from the study reveal that raising the state sales tax rate to pay for cuts in school property taxes would increase taxes for 80% of families and benefit only those with the highest incomes.*

**TAX FAIRNESS**

The simplest way to judge the fairness of a tax system is to compare the percentage of income different families pay in taxes. In a state with a fair tax system, families in all income groups would pay a similar percentage of their income in taxes. In Texas, 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.

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.

Even taxes that are initially paid only by businesses, such as the corporate 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.

Avg. Annual Family Income	Taxes Paid	% of Income Paid in Taxes
\$12,100	\$1,720	14.2%
\$31,100	2,550	8.2
\$50,600	3,560	7.0
\$78,100	5,080	6.5
\$177,800	9,090	5.1

**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 chart above, which is derived from the information in the comptroller’s report, shows the average income of families in each income group, the average amount of major state and local taxes paid by families in the income group, and the average percentage of total family income paid in taxes. The comptroller’s report divides all households into ten equal groups; this Policy

Tax	Suits Index (listed from least unfair to most unfair)
Natural gas tax	-0.03
School property tax	-0.06
Franchise tax	-0.13
Motor vehicle sales tax	-0.15
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 tax paid by Texans; the sales tax is one of the least fair.

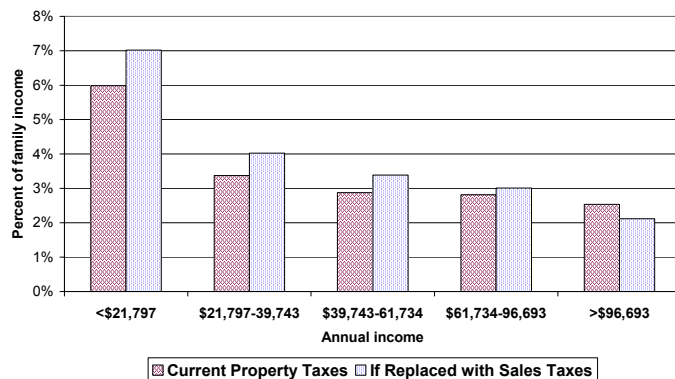
The sales tax imposes a larger burden on low-income families than on higher-income families, since it is based on how much each family spends. Low-income families typically spend three-quarters of their income on things subject to the sales tax, middle-class families spend less than half of their income 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 and 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 IF THE SALES TAX RATE WERE INCREASED TO FUND PROPERTY TAX CUTS?**

Any increase in the rate of the regressive sales tax in order to generate new revenue to replace less regressive school property taxes will be a tax increase for 80% of Texas families, and a tax cut only for those families with the highest income – those earning more than \$96,700.

**Most Families Would Pay More If the State Raised the Sales Tax To Cut Property Taxes**



This chart shows the percentage of family income paid in property taxes currently (the left-hand bar in each pair) and the percentage that would have to be paid to raise same amount of money statewide exclusively from sales taxes (the right-hand bar) in order to demonstrate the resulting shift in tax incidence. The average family in all four lower- and middle-income brackets would pay more in sales taxes than they would gain in lower property taxes, if sales taxes were raised to pay for property cuts.

The new temporary federal deduction for sales taxes may make a higher sales tax rate look more appealing. However, in order to benefit from a sales-tax deduction, a family has to itemize its deductions on its federal income tax return. Most Texas taxpayers do not have enough deductible expenses to make it worth itemizing their deductions. Instead, the majority of taxpayers take the standard deduction.

In 2002, the most recent year that detailed data are available from the Internal Revenue Service, only 23.8% of Texas taxpayers itemized deductions on their federal income tax returns. Moreover, the benefit of itemization is concentrated among the highest income taxpayers. For more on the sales tax deduction, see <http://www.cppp.org/products/PP215.html>.

The comptroller's study, Tax Exemptions and Tax Incidence, can be found at <http://www.window.state.tx.us/taxinfo/incidence05/>

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