THE POLICY PAGE

An Update on State and Federal Action

Center for Public Policy Priorities

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HOUSE TO VOTE TUESDAY ON CONSTITUTIONAL AMENDMENT TO PERMANENTLY REDUCE ABILITY TO FUND PUBLIC SERVICES

Proposed amendment would divert one-third of any future state revenue increase to property tax cuts

The Texas House of Representatives is about to consider a constitutional amendment (HJR 1 by Grusendorf) that would permanently reduce the ability of state and local governments to fund public services. The vote on the amendment, which is the key legislation in the current tax-cut/school-finance special session, is currently expected to be on Tuesday. <u>You must act now to avoid passage of this harmful limit on the use of future revenue.</u>

HJR 1 WOULD FURTHER WEAKEN TEXAS' INADEQUATE REVENUE SYSTEM

A major failing of the Texas state and local tax system is its inability to keep up with the growth in the need for public services, creating a "structural deficit."

A tax system should be able to grow with a state's economy, generating additional revenue without increases in tax rates. Over the past decade, the Texas tax system has consistently failed to keep up with economic growth. (The causes of this problem are described in detail in Policy Page #206, Sept. 19, 2003)

HJR 1 would worsen this deficit dramatically. The amendment would take one-third of any projected increase in state revenue in the comptroller's biennial revenue estimate, other than federal funds or constitutionally dedicated revenue, and divert it to reduce school property taxes.

Tax cuts would get absolute priority, before the appropriations process could begin to weigh the competing needs for state services. There is no provision for an override of this dedication. Even natural growth in revenue because of increased population or inflation would be subject to this diversion, so real per-capita state revenue would likely fall in each succeeding session.

HJR 1 would ensure an endless series of legislative sessions in which health and human services groups, and others relying on state funding, would have to struggle against repeated cutbacks and program shortfalls.

This provision has received little public attention, since news coverage has focused on slot machine and other aspects of the tax-cut plan. <u>**The skimming off of one-third of any future revenue increase is the most dangerous and important proposal in this debate. You must act today to let your opposition be known**</u>.

HJR 1 WOULD ALSO HINDER LOCAL GOVERNMENTS

HJR 1 would lower the current cap on the increase in taxable value of homesteads from 10 percent to 5 percent. It would also expand the limitation to cover all residential property, including vacation homes.

A cap on appraisal increases, by removing the link between the market value of a residential homestead and its taxable value, would create severe imbalances within the property tax system.

The immediate effect would be a shift of the property-tax burden from homeowners onto businesses, who would not be protected by a cap. The 40 percent of Texas families who rent their home would also have to pick up an additional share of property taxes, since they pay the tax bill of their landlord, who passes it on to them in the form of higher rents.

The comptroller's tax incidence study (http://www.window.state.tx.us/taxinfo/incidence03) shows that the 10 percent cap is among the most regressive of the current property tax exemptions – 30 percent of the benefit of the exemption goes to the one-tenth of Texas families with incomes over $170,000. In contrast, the benefit of the current homestead exemption of $15,000 is much more equally distributed.

Further details on the appraisal cap may be found in Policy Page # 210, March 19, 2004.

THE ACCOMPANYING LEGISLATION (HB 1) RELIES ON REGRESSIVE REVENUE SOURCES TO REPLACE SCHOOL PROPERTY TAXES

Three-quarters of the net new money in the accompanying legislation (HB 1 by Grusendorf) would come from just three sources, in almost equal amounts: a new tax on payrolls ($1.6 billion); an increase in the rate of the general sales, motor-vehicle sales, and boat sales taxes ($1.56 billion); and the legalization of slot machines ("video lottery terminals") ($1.5 billion).

The net total generated would be $6.2 billion, which go mainly to fund $4.7 billion in property tax cuts, with $1.5 billion for increased spending on public education. This calculation nets out the substitution of a new uniform local property tax for the current school property tax, and the substitution of the new payroll tax for the current corporate franchise tax.

All three of these revenue sources are problematic. The payroll tax – 1.25% of wages, with a cap of $500 – would function as a tax on the first $40,000 of a worker's earnings. The additional wages of higher-income employees would not be taxed, not would income received by employees in the form of stock options or capital gains. The greatest impact would be felt by lower-wage workers.

The sales tax is the root cause of the unfairness of the Texas tax system, which places the heaviest burden on those least able to pay. Consumption taxes, such as the sales tax, are extremely regressive because lower-income families spend all of their income (and sometimes more, by going into debt), while higher-income families can afford to buy all they need and still have money left over. Raising the sales tax rate to 6.75 percent, from the current 6.25 percent, would increase this unfair burden. (For more details on the Texas tax system, see The Texas Revenue Primer, Revised, March 2003, http://www.cppp.org/products/reports/revised2.pdf.)

The only new money for public education would come from the installation of electronic slot machines. Gambling revenues are notoriously uncertain and volatile. In contrast, the need for public education funding only increases from year to year.

A hidden cost is the effect of compulsive gambling on a family's income and emotional well-being. Slot machines are considered to be the most addictive and destructive form of gambling because of their easy access and instant payoffs – "the crack cocaine of gambling" according to one opponent.

A relatively small amount of revenue ($734 million) would come from raising the tax on cigarettes and other tobacco. These taxes would produce a diminishing amount of revenue as consumption continues its long-term decline. Moreover, any increase in cigarette and tobacco taxes should be reserved for health and human services funding. (For more information, see Policy Page #211, April 2, 2004).

TAX EQUITY NOTE CONFIRMS REGRESSIVITY OF HB 1 PACKAGE

The tax equity note posted on May 2, (http://www.capitol.state.tx.us/data/docmodel/784/impact/pdf/HB00001HD.PDF) shows the change in effective tax rate on families of different incomes of the changes in property, sales, and business taxes that would be made by HB 1. The effect of slot machines is apparently not analyzed.

The note, prepared by the Legislative Budget Board, confirms that only the highest income families would benefit from HB 1. The vast majority of Texas families – those with an income under $135,000 in 2006 – would see a tax increase of an average of 4.5 percent. The one-tenth of families with the highest income – over $188,000 in 2006 – would see a tax cut more than 3 percent!

The current pattern of regressivity would be reinforced by HB 1. The increase in effective tax rates would be highest for families with the lowest incomes and drop steadily as income increased.