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TEXAS TAXES: A Fact Book

Today's Texas tax system is the product of a long history of decisions made by the legislature, the courts, and the citizens of the state. The tax system is dynamic, and may change with the next taxpayers' referendum, court decision or legislative session. This publication presents basic information about Texas's current public revenue system, with emphasis on taxes at the state and local government levels.

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http://agecon.tamu.edu/ageco/faculty/stal/taxfact.htm (html)
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http://agrinet.tamu.edu/centers/ageco/publications/fp97-15.pdf (Adobe Acrobat pdf)

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State Revenue Sources

In 1996, 49 percent of state government revenues came from taxes, the largest of all sources (see Figure 1). The remainder came from the federal government (29 percent); licenses, fees, permits, fines and penalties (9 percent); lottery proceeds (4 percent); and interest, investments and other (9 percent).

Since 1982, when the oil and gas price boom began to wane, the share of total state revenue coming from taxes has declined from about 64 percent to 49 percent (see Figure 2). The share of revenue from interest, investments and land has also declined. The percentage of revenue from the federal government and from fees and other sources has increased.

The most important state tax is the sales tax (see Figure 3). The combined general sales tax and special sales tax on motor vehicles and manufactured housing make up 65 percent of all state tax collections. Other important taxes are motor fuels (12 percent) and the corporate franchise tax (8 percent). An array of other taxes make up the remaining 15 percent of tax revenues.

Once major contributors to state revenue, oil and natural gas severance taxes have declined steadily over the last 2 decades. In each year since 1972, oil and gas production in Texas has fallen below the previous year's production. Dramatic world price increases during the late 1970s and early 1980s overshadowed the trend of declining production, creating a false sense of wealth as oil and gas severance taxes rose to nearly a third of all state tax revenue. In 1995, oil and gas severance taxes combined were about 5 percent of all state level taxes (see Figure 3). This source of revenue will likely continue to decline in the future, with occasional and temporary upswings due to prices.

The tax base, rate, and levy of the state sales and motor vehicle, franchise, motor fuels, and alcohol and cigarette taxes will be discussed in later sections of this report. There are a number of minor taxes that are not discussed in this publication. These include: cement tax, oil and gas well servicing tax, bingo tax, sulfur tax,

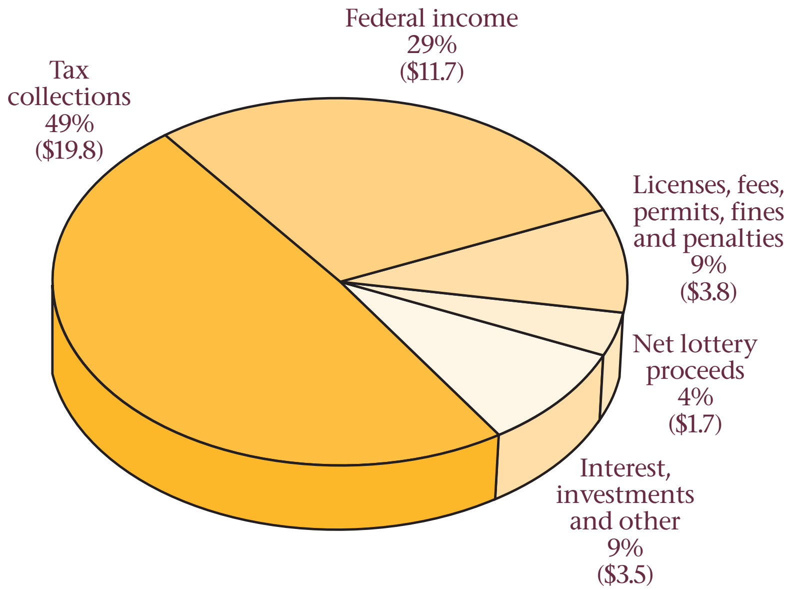

Figure 1. Texas Revenue by Source—Fiscal Year 1996 (Billions of Dollars).

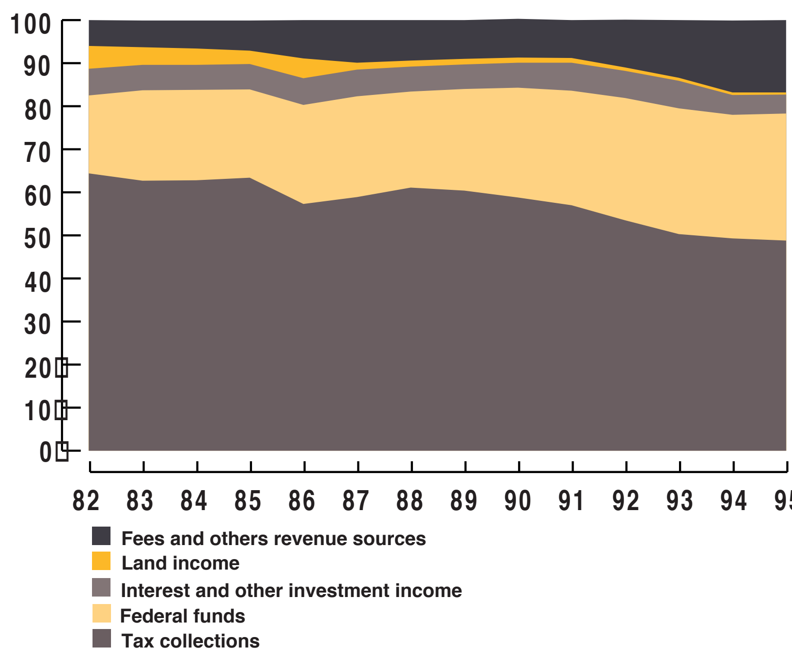

Figure 2. Major Sources of Revenue for Texas State Government.

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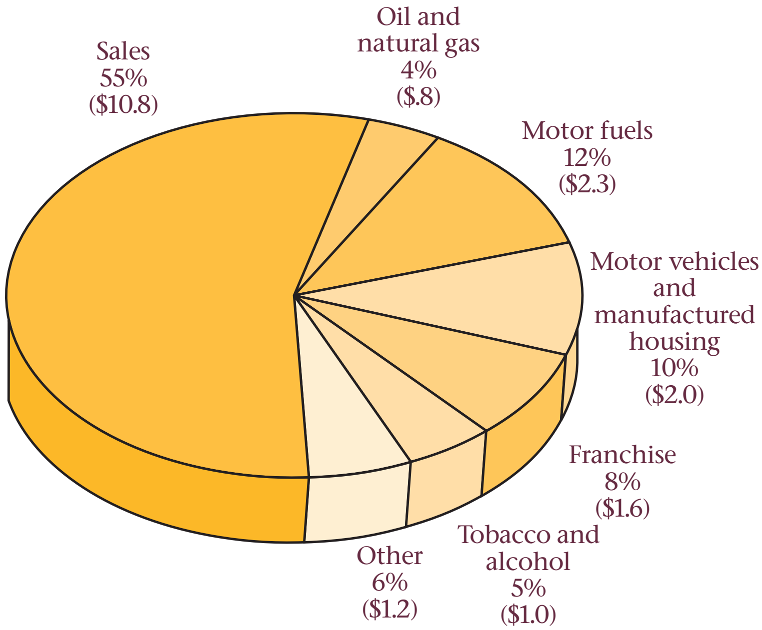

Figure 3. Tax Revenue by Source—Fiscal Year 1996 (Billions of Dollars).

coin-operated amusement tax and other minor taxes. Altogether, these taxes make up less than 0.2 percent of total state tax collections (Sharp). Fees, which range from drivers' licenses to fishing permits to road tolls, are not included in this document.

Local Tax Revenues

Local government taxes are more limited. The most important tax for schools, counties, municipalities, and special taxing entities is the property tax. In 1995, local property taxes were the largest single tax paid by Texans, amounting to almost $16 billion. Texas had a state level property tax until 1980, when it was phased down and finally discontinued. Property taxes are collected by nearly 3,500 separate local taxing jurisdictions across the state (Report of the Staff Work Group).

The property tax is the sole source of local tax revenue for schools and numerous special districts (hospital, airport, rural fire prevention, community college, etc.). Moreover, it is the primary source of revenue for cities and counties. Although most cities have elected to adopt a sales tax (1 percent), revenue from property taxes is more than twice that from sales taxes. Cities earn revenue from other sources including utility sales, fees, fines and other charges. Counties and some special districts may also adopt a limited sales tax, but property taxes are their main tax revenue.

State Level Tax Structure

The outline in Table 1 shows the major taxes from which the state government receives revenues, with details of the type of tax, tax rate, tax base, collecting entity, and major exemptions. Tax rates are typically expressed as a percentage or dollar amount that is multiplied by the tax base to determine the dollar amount of the tax levy paid to the state.

Texas is one of few states that has neither a corporate nor personal income tax. This has been a selling point for the state in attracting businesses and people looking for a place to live. However, maintaining this position is not without certain costs to taxpayers.

An important facet of any state tax structure is the way it interacts with federal tax structures. Business taxes can be deducted from income on the federal tax form. This lowers the effective tax rate for business. The story is different for individual tax payers who itemize deductions on federal income tax forms. None of the Texas state-level taxes are deductible from federal taxable income. (The property tax, a local tax, is deductible.) The state inheritance tax can be taken as a tax credit on the federal estate tax.

Table 1: Characteristics of major state level taxes, 1995.

Type of tax	Tax rate	Tax base	Exemptions
Sales and Use	6.25%	Retail price of tangible goods and selected services	Unprepared food, prescription drugs, purchases for farm and ranch use
Motor Vehicles Sales and Rentals	6.25% 10% less than 30 days; 6.25% more than 30; interstate carriers 6.25%	Sales: Sale price less trade-in value Rentals: Rental rate	
Corporate Franchises	$2.50 or 4.5%	Per $1,000 of taxable capital or earned surplus, whichever is greater.	
Motor Fuels	20¢ 20¢ 15¢	Gasoline: per gallon Diesel: per gallon Liquefied gas: per gallon	Fuel for farm, ranch and other off-road uses
Cigarette and Tobacco	41¢ 0.1¢ - 1.5¢ 35.213%	Per package of cigarettes Per cigar based on weight List price of smokeless tobacco	
Natural Gas	7.5%	Market value of gas produced in the state	
Oil Production Oil Production Regulation	4.6% 3/16 of 1¢	Production: Market value Regulation: Per barrel	
Alcoholic Beverages Beer Liquor Wine Malt Liquor Mixed Drinks Passenger Drinks	 $6.00 $2.40 20.4¢ - 51.6¢ 19.8¢ 14% 5¢	 Per barrel Per barrel Per gallon, based on alcohol content Per gallon Receipt value (price) Per serving	
Insurance Companies: Life, Accident & Health Property & Casualty Title Unauthorized and surplus lives	 1.75% 1.6 - 3.5% 1.3 - 2.0% 4.85%	 Texas investments Texas investments Texas investments Texas investments	
Inheritance Tax	1-16% tax credit on federal tax	Federal taxable estate value	$600,000
Utilities Tax Public Utilities Gas, Water & Electric Gas Utility Administration	 1/6% .581 - 12.99% 1/2%	 Gross receipts Gross receipts based on population Gross receipts	
Hotel/Motel	6%	Price paid	

Adapted from: Comptroller of Public Accounts in Report of the Staff Work Group.

General Sales and Motor Vehicles Taxes

The state general sales tax, an ad valorem tax, is collected at a rate of 6.25 percent of the retail value of taxable goods and services. This rate also applies to the excise tax on motor vehicles and manufactured homes. Hence, 6.25 percent, or 6.25 cents of each dollar, of taxable sales is collected from the consumer by the seller at the point of retail sale. The retailer, or final service provider, then remits the tax to the Texas Comptroller of Public Accounts.

The sales tax is levied on most goods (including the purchased value of tangible personal property), unless specifically exempted. The tax base for services is much narrower than for goods; only specifically included services are subject to sales tax.

Goods exempt from sales tax include: unprepared foods for home consumption; prescription drugs; utilities; motor fuels (subject to a special fuels tax); purchases for farm and ranch use; raw materials, machinery and equipment used in manufacturing; and items sold for out-of-state use. Services taxed include: non-automotive repair services; laundry and dry cleaning; amusements; cable television; garbage collection; exterminating; data processing; non-residential repair and remodeling; custom software; and security and information services.

Other state taxes for which the tax rate is a percentage of some dollar value (an ad valorem tax) include: the oil and gas severance taxes; insurance occupation taxes; utility taxes; hotel/motel taxes; one of the alternatives of the corporate franchise tax; and the inheritance tax. The inheritance tax rate ranges from 1 percent to 16 percent, depending upon the value of the taxable estate. This tax is taken as a credit on the federal inheritance tax.

Motor Fuels and Alcohol and Tobacco Taxes

Excise taxes are levied on a specific product (e.g., cigarettes, beer, motor fuel). Excise taxes can be a dollar amount per unit of the good (e.g., gallon, ton, etc.), or ad valorem (i.e., some percentage of value, such as the motor vehicle sales tax). Excise taxes are frequently used to recover governmental costs associated with the sale of some product (e.g., motor fuels taxes used for road construction and maintenance) or, in some cases, to discourage consumption (alcohol and tobacco). These taxes are also used because they provide a fairly stable source of revenue. The motor fuels tax rate is 20 cents per gallon for gasoline and diesel and 15 cents per gallon for liquefied gas, regardless of the price of the fuels. The so-called "sin taxes" on alcoholic beverages and tobacco products are excise taxes of a dollar amount per barrel, gallon, package, etc., regardless of the price of the good (see Table 1).

Corporate Franchise Tax

The corporate franchise tax applies only to corporations and limited-liability companies. Businesses organized under any other form of ownership are not subject to this tax. The tax has two tax bases, and a separate tax rate applies to each base. A tax rate of $2.50 per $1,000 applies to taxable capital (roughly, company net worth). A tax rate of 4.5 percent applies to earned surplus (profits plus executives' pay). Firms must calculate the tax by both methods and pay the higher of the two levies.

Local Tax Structure

The four local taxes in Texas—property, sales, hotel/motel, and mixed drinks—are all ad valorem taxes (see Table 2). The property tax base is the market value of all real estate and business personal property. While the property tax in Texas is uniquely local, taxing jurisdictions operate under a complex system of enabling legislation and regulations that are created and revised at the state level.

The market value of real estate and business personal property is assessed in each county by a chief appraiser, the chief executive officer of the county central appraisal district (CAD). Once the jurisdiction's tax base is determined for a tax year, the tax rate is set by the elected governing board of the local taxing jurisdiction—city council, county commissioners, school board, etc. Tax payers then pay a tax levy, which is the product of the assessed value of the taxable property they own times the tax rate.

In theory, the property tax could apply to the market value of all valuable property. However, in Texas, a large amount of property escapes taxation because of exemptions, exclusions, and special treatment in determining taxable value. Major types of property to which the property tax does not apply include intangible personal assets such as stocks, bonds, and other non-real estate investments; cash in the bank; and individual personal property such as vehicles, furniture, jewelry, and other personal tangibles. While some of these have been exempted by law in Texas, they typically are exempted de facto because of the difficulty and expense of assessment and collection.

Table 2: Characteristics of major local taxes in Texas, 1995.

Type of tax	Tax rate	Tax base	Taxing entity	State imposed rate limits
Property	set by taxing jurisdiction elected officials (rate applies per $100 of value)	market value of all real estate and business personal property	all property taxes are collected locally by cities, counties, school districts, special districts	**Cities:** $2.50 per $100 of value; $1.50 for general law cities **Counties:** $0.80 per $100 of value for general purposes; $0.15 for special roads and bridges; $0.30 for optimal road or flood control **School Districts:** $1.50 for operation and maintenance **Special Districts:** variable; hospitals and airports - $0.75; rural fire prevention - $0.03; community colleges - $1.00
Sales	2% maximum of local sales taxes	retail price of tangible personal property and selected services (same as state)	cities, counties and transit authorities; tax is collected by the state and remitted to local jurisdictions	Local sales taxes may not exceed a total of 2%; cities—optional, generally 1%, but an additional 1% may be levied for special purposes; counties—1% under special circumstances; transit authorities—up to 1%
Hotel/Motel	Cities: 9% maximum Counties: 7% maximum	room receipts (same as state) same as city and state	cities and counties collect the tax locally	**Cities:** limit varies, maximum is 9% **Counties:** limit varies, maximum is 7%
Mixed Drinks	3.0% divided equally between cities and counties	mixed drink receipts	tax collected by the state and remitted to cities and counties allowing sales of "liquor by the drink"	

Adapted from: Governor's Office of Budget and Planning in Report of the Staff Work Group.

Several legal exemptions and special valuation rules for the property tax have been adopted by the Texas legislature. These give tax relief to some categories of property or taxpayers and either reduce tax revenue to local jurisdictions or shift the tax burden to other categories of property and taxpayers. Major exemptions and special treatments include: limited value exemptions for homesteads; a freeze on the tax levy for homeowners more than 65 years of age (see Table 3); industrial tax abatements granted by local jurisdictions; productivity valuation of agricultural and timber land; land for wildlife habitat; free port; and other exemptions.

In total, legal exemptions and special treatments in property valuation amount to about 15 percent of the total assessed value of property statewide (Report of the Staff Work Group). The productivity valuation of agricultural and forestry land, as specified in Article VIII, section 1-d-1 of the Texas Constitution, accounts for about one-half of the property tax revenue reduction in local jurisdictions (Report of the Staff Work Group).

Cities, counties, and some special districts may collect a sales tax. The base for the local sales tax is the same as that of the state. However, local sales tax rates are lower and maximums are set for local jurisdictions. An overall local sales tax maximum of 2 percent is dictated by the state. Incorporated cities may levy a 1 percent sales tax for general revenue and have the option of an additional 1 percent for special purposes, such as reducing property taxes.

Counties also have an option of collecting up to 1 percent to reduce property taxes. One-half percent may be levied by cities and counties for economic development. Transit authorities may collect up to 1 percent. Crime prevention districts may enact up to a 1 percent sales tax, and counties with populations of fewer than 50,000 may enact a one-half percent sales tax for health or hospital services. However, the combination of all local sales taxes in a given area may not exceed 2 percent.

Other local taxes include hotel/motel taxes and mixed drink taxes for cities and counties. Local hotel/motel taxes apply to the same base as the state tax—the amount paid for room rental. The state tax rate is 6 percent. Maximum rates are set at 9 percent for cities and 7 percent for counties. Local hotel/motel taxes are collected locally by cities and counties, the only local jurisdictions authorized by the legislature to use the tax. Mixed drink taxes are collected by the state and remitted to those counties and cities permitting sale of liquor by the drink.

Criteria for Evaluation of Taxes

Individuals need and want many items and services that cannot be provided profitably by the private sector. One function of government is to provide these goods and services—police, courts, education, roads, economic security, etc. In order to do so, the government must tax the citizens to pay for these services. A state or society can tax virtually anything that it chooses. The objective is to develop taxes and tax systems that serve the broad needs of society in an efficient, fair and impartial way. Several attributes of taxes are widely accepted as criteria for evaluating the impacts of taxes on society and the economy (Stiglitz). These are described in this section and then used to evaluate the major revenue producing taxes in Texas. No tax is ideal with respect to all these criteria, and each criterion has a different importance to different groups of citizens because the taxes they pay and the benefits they receive vary. Consequently, selecting taxes and designing a tax system for state and local revenues is a process of trade-off and compromise.

Table 3: Property tax exemptions.

Constitutionally mandated

- Basic $5,000 residential homestead exemption
- Tax freeze for persons 65 or older, so long as the person lives in the home and does not add significant improvements

1997 Constitutional Amendment

- Increase homestead exemption by $10,000 to $15,000
- Tax freeze for homeowners over 65 can be transferred, with adjustments, to the new home

Constitutionally allowed with legislative approval

- Additional homestead exemption for persons over 65 or disabled (Legislature may exercise option to specify the amount and condition of eligibility based on economic need.)
- $3000 homestead exemption for disabled veterans
- "Freeport" optional exemption instituted in 1992, waiving tax on certain goods, wares, ores, merchandise, and tangible personal property used in the repair and maintenance of aircraft operated by a certified air carrier, if the aircraft are in the state for 175 days or fewer (oil, natural gas, and petroleum products do not qualify)
- Pollution control exemption, begun in 1995, for property used to control pollution

Local option

- Additional exemptions of up to 20 percent of a residence's appraised value
- Additional exemption of at least $3,000 for the disabled or persons 65 or older

Source: House Research Organization, Texas House of Representatives. "The Tax System and Public School Financing in Texas." *Session Focus*, March 24, 1997. p. 5.

1. **Economic efficiency:** An efficient tax system does not interfere with the efficient allocation of resources and consumer choices. A broad-based tax causes fewer inefficiencies than a tax with a narrow base.
2. **Economic competitiveness:** A competitive tax system does not negatively affect the ability of firms within the state to compete with those outside the state, nor the ability of the state to attract new business.
3. **Administrative simplicity:** A simple tax system is easy for the taxpayer to understand and relatively easy and inexpensive for the taxpayer to comply with and the public sector to administer (that is, assess and collect).
4. **Adequacy:** An adequate tax system is able to generate sufficient revenue to meet public needs as the economy grows or declines. For example, as population and demand increase the tax base will grow sufficiently for revenue to meet public demands.
5. **Equity or fairness:** The tax system is fair in its relative treatment of different individuals. That is, the tax system bears equally on people in similar circumstances (horizontal equity) and differentially on people in dissimilar circumstances (vertical equity). There are two ways to compare the circumstances of people and determine whether the tax system treats them fairly—by the benefits they receive and by their ability to pay. Each is discussed below.

Benefits received: Individuals contribute to the support of the government through taxes in proportion to the benefits that they receive from public services. People who receive the same benefits pay the same taxes. If individuals contribute in this manner, there is horizontal equity. This principle does not include vertical equity. In order to evaluate the fairness of any individual tax or fee using this principle, the revenue from the tax must be tied to the provision of a related good or service. Because most tax dollars paid to Texas' state government go to general revenue, this indicator of equity has only limited usefulness.

This principle can be used to evaluate the equity of what are called licenses and fees, such as a driver's license, car registration fee, hunting license, road toll, etc., although many people do not even consider these to be taxes. The equity of the motor fuels tax can also be evaluated by the benefits received because the tax is used mainly to pay for roads. The person who uses the roads more buys more gasoline, and, therefore, pays more tax. Nevertheless, the motor fuels tax is, instead, thought of as a tax (not a license or fee) by the general public.

Theoretically, the fairness of the overall tax system can be evaluated by calculating the total taxes paid and total benefits received by citizens. The difficulties of this approach are in identifying the beneficiaries of a given public expenditure and in putting a value on the benefits of public goods, such as police protection, clean air, etc.

Ability to pay: Taxes are distributed according to the capacity of taxpayers to pay taxes. Ability to pay is typically measured by income (Stiglitz). To determine if the tax has been distributed according to ability to pay, the criteria of horizontal and vertical equity are applied. Horizontal equity in ability to pay means that individuals with the same income pay the same tax levy. Vertical equity in ability to pay compares the percentage of income paid in taxes by persons of varying incomes (Davis and Meyer). If persons of lower incomes pay higher percentages of their incomes in taxes than do persons with higher incomes, the tax is regressive. If persons of increasingly higher incomes pay an increasingly higher percentage of their incomes in taxes, the tax is progressive. If persons of all income levels pay the same percentage of their incomes in taxes, the tax is proportional. The vertical equity criterion does not give guidance on how large a difference in income is considered a different ability to pay, nor on how different the percentages should be between income levels. These matters are left to public opinion or to the political process.

It is a subject of debate which of the two characteristics of taxpayers—benefits received or ability to pay—is appropriate for evaluating the equity of a given tax. Often public opinion determines which principle is appropriate in a given case. In the following sections, each tax will be evaluated using both characteristics, if possible.

Evaluation of Major State and Local Taxes in Texas

The criteria discussed above can be used to evaluate the state's various taxes. The taxes evaluated here account for 90 percent of tax revenues (see Figure 3).

Sales Tax and Motor Vehicle Sales Tax

Economic efficiency: The sales tax is broadly based on consumer goods (exempting unprepared foods for home use and prescription medicines). However, the tax is not broad-based on services. A narrow-based sales tax might lead consumers to substitute services without tax for those with tax, and to substitute untaxed services for taxed goods. Businesses also pay sales tax on purchases, except for raw materials and machinery and equipment used in farming, manufacturing, and residential utilities. Businesses may react in a similar manner as consumers; they might substitute non-taxed goods and services for taxed goods and services.

Economic competitiveness: Texas has one of the highest sales taxes in the nation. However, except along the state borders, individuals generally do not cross state lines to make purchases outside of Texas so as to avoid the higher Texas sales taxes. Moreover, most personal services do not compete with businesses in other states. Thus, the economic competitiveness of businesses that sell directly to consumers generally is not adversely affected.

Sales taxes paid by consumers are not deductible on their federal tax form. Consequently, Texas taxpayers suffer a loss in real income in the amount that would be saved under a deductible tax.

Businesses in Texas, because they pay higher sales taxes than do businesses in most other states, face higher costs than those in other states; some of these costs are passed on to consumers through higher product prices. Exempting sales taxes on raw materials and machinery and equipment used in farming and manufacturing helps to keep those industries competitive with those in other states.

Administrative simplicity: Consumers understand the sales tax, are readily aware of the tax on any given purchase, and invest no additional time and resources to pay the tax. Consumers, however, are not aware of the annual sales tax levy that they pay because it would be time consuming to keep track of the tax on each transaction. Businesses often complain about having to be tax collectors. Administration is becoming more complex, for both business and the public sector, as local governments exercise various local sales tax options. The state's collection and remittance of local sales taxes is complex because of the wide variance in local rates across the state.

Adequacy: The sales tax has generally provided adequate revenue throughout business cycles. Revenues have grown as the economy has grown. In economic hard times, consumers may change their purchases of goods (e.g., fewer new cars) and perform more services for themselves (e.g., doing their own laundry instead of taking it to commercial cleaners). With the exception of 1983, revenues have increased even in downturns, but less rapidly than during growth periods (Report of the Staff Work Group). The recent addition of some services to the tax base has helped keep the sales tax in line with the growing importance of services in the state's economy. The sales tax rate is changed only by an act of the legislature, which can cause revenue lags in times of rapid economic adjustment.

Equity or fairness: The *benefits-received* measure cannot be applied to the sales tax because sales tax revenues go into the general revenue fund and are not directed to a specific use. However, *ability to pay* can be used to evaluate the sales tax. *Horizontal equity*: People with the same income generally have similar consumption patterns and probably pay similar levies. As people consume more they pay a higher levy (see Table 4). *Vertical equity*: People with higher incomes pay a lower percentage of their income in sales tax (see Table 4). They also consume more of the services (e.g., physicians, dental, legal, architectural) that are not subject to the sales tax. Hence, the sales tax is regressive with regard to income.

Property Tax

Economic efficiency: The property tax on land, a commodity with a fixed supply, generally does not cause inefficiencies in the land market. However, the 1966 and 1979 constitutional amendments allowing differential treatment of farm land may cause inefficiencies in the land market, particularly near urban areas. Property tax inefficiencies also arise primarily because not all types of property are taxed, resulting in changes in investment patterns. Individual personal property is not taxed. An even larger part of the potential base, intangible property held as financial instruments (bonds, stocks, cash, savings, etc.), is not taxed. This is an efficiency issue because it changes investment patterns, shifting the holding of property away from real property and toward financial instruments.

Economic competitiveness: Texans spend more of their income on property taxes than the average of the U.S. Most of the burden is on real estate. This is detrimental to capital-intensive firms that are located in Texas and may serve as a deterrent to firms considering locating in Texas. (Firms will look at the total tax bill, including other business taxes.)

Administrative simplicity: The tax is relatively easy for taxpayers to understand. And it is relatively easy for them to be aware of the tax levy. The property tax is not simple to administer, however. Assessing values is time consuming and requires well trained appraisers. Local assessments are subject to review and may be legally challenged. A large data base is needed on all categories of property. Appraisal of complex properties, such as industries, utilities, and

Table 4: Average tax burden and relative burden by family income of selected state and local taxes, fiscal year 1994.

	Gross family income				
	$10,000	**$25,000**	**$35,000**	**$50,000**	**$100,000**
Sales tax					
Average $ paid	$416	$727	$900	$1,163	$1,800
% of income	4.16	2.91	2.57	2.33	1.80
Relative burden	2.31	1.62	1.43	1.29	1.00
Property tax					
Average $ paid	$205	$347	$568	$1,042	$2,881
% of income	2.05	1.39	1.62	2.08	2.88
Relative burden	0.71	0.48	0.56	0.72	1.00
Alcohol & tobacco taxes					
Average $ paid	$87	$143	$169	$165	$174
% of income	0.87	0.57	0.48	0.33	0.17
Relative burden	5.12	3.35	2.82	1.94	1.00
Motor vehicle sales tax					
Average $ paid	$50	$126	$152	$251	$270
% of income	0.51	0.35	0.30	0.25	0.14
Relative burden	1.85	1.85	1.63	1.85	1.00
Motor vehicle registration					
Average $ paid	$51	$89	$103	$126	$136
% of income	0.51	0.35	0.30	0.25	0.14
Relative burden	3.64	2.50	2.14	1.79	1.00
Motor fuels					
Average $ paid	$80	$141	$173	$201	$235
% of income	0.80	0.56	0.50	0.40	0.24
Relative burden	3.33	2.33	2.08	1.67	1.00
TOTAL					
Average $ paid	$889	$1,573	$2,065	$2,948	$5,496
% of income	8.89	6.28	5.91	5.89	5.50
Relative burden	1.61	1.14	1.07	1.07	1.00
% of families in income range**	12.75	27.04	16.46	19.10	22.02

Source: Adapted from Texas State Comptroller's Office.

*Relative burden expresses the percentage of income paid for the tax by each family income group as a ratio to the percentage of income paid for the tax by the $100,000 income group.

**Income ranges are: less than $10,000; between $10,000 and $25,000; between $25,000 and $35,000; between $35,000 and $50,000; and between $50,000 and $100,000. 2.63 percent of families have incomes of more than $100,000. Based on 1989 census data.

minerals, typically are contracted to professional appraisal companies. Assessing business personal property is particularly difficult because of items unique to the business. Some 253 central appraisal offices appraise property for more than 3,500 taxing jurisdictions in Texas.

Adequacy: The property tax base has not kept pace with economic growth in Texas, necessitating increases in tax rates in order to provide adequate revenues, especially for public schools. The base is not growing as fast as the economy because low-capital-investment service businesses have dominated economic growth in recent years. In addition, the value of oil, gas, and other mineral lands, once a major part of the tax base, has fallen. Although property values move up and down with the business cycles, there is no automatic mechanism for changing assessed values. Taxing jurisdictions must constantly readjust the base to market values and then adjust rates in order to provide adequate revenues.

Equity or fairness: *Benefits received* cannot be applied if revenues are going into the general funds of cities and counties. For school and other special taxing districts, the tax can be evaluated on the basis of whether those who pay the tax receive benefits from it in relation to the tax they pay. While all citizens receive benefits from the education of others (for example, a cashier who can correctly make change), families with children in public school receive higher direct benefits than families without. Even among families with children, the tax levy varies widely based on the value of the property owned.

Ability to pay can also be used to evaluate the property tax. *Horizontal equity:* Tax assessors attempt to evaluate similar properties similarly, and the same tax rate is applied to all property. Exemptions and special taxation provisions may provide for some inequities in the property tax (e.g., homeowners have the homestead exemption and renters do not). Families and businesses with similar incomes will pay a different levy depending on the value of the property they own. Firms with similar profits (and net worth) pay widely varying tax levies depending on capital investments. *Vertical equity:* Lowest income home owners pay a higher (or equal) percentage of their income in property taxes than all but the highest income group. The tax is regressive for the lowest income group (see Table 4). For all other family income groups the tax is progressive. Relative to income, the property tax is the least regressive of all Texas taxes.

Alcohol and Tobacco Taxes

Economic efficiency: Because alcohol and tobacco taxes are not broad-based taxes, they have the potential to distort consumer choices away from the taxed item and toward untaxed items. On the other hand, the demand for these products is inelastic (quantities sold do not decrease as rapidly as price increases), so that the substitution of other products is less than it would be in the case of other goods.

Economic competitiveness: The tax rules apply to all alcohol and tobacco sold in the state. Few people cross state lines to purchase these items, so the tax has little effect on competitiveness.

Administrative simplicity: Consumers have a general awareness that there is a tax, but are unaware of the tax amount on an individual item because it is included in the price. In addition, the consumer is unaware of the yearly tax levy paid. The tax collection is relatively easy to administer.

Adequacy: Because demand is inelastic, consumption is relatively stable, even in an economic downturn. The tax rate is a fixed amount per unit, rather than a percentage of value, so revenues do not keep up with inflation. Raising the rate requires legislative action.

Equity or fairness: *Benefits received* does not apply because the taxes go into general revenues. *Ability to pay* can be used to evaluate these taxes. *Horizontal equity:* People with the same income pay different amounts depending on their use of these products. *Vertical equity:* Lower income groups pay a higher percentage of their income in cigarette and alcohol taxes. Alcohol and tobacco taxes are regressive relative to income (see Table 4).

Motor Fuels Tax

Economic efficiency: This tax applies to all businesses and individuals who use roads. Because alternatives to using fuel-burning vehicles for transportation are currently limited, the tax is not likely to distort economic decisions within the state. Also, individuals and businesses are not likely to cross state lines to avoid the tax. Increases in price due to taxes have little effect on fuel consumption in the short term. In the longer run people decrease fuel consumption by buying smaller or more fuel efficient cars. The higher fuel prices also create incentives for the development and use of alternative fuels. Thus the tax may have the indirect effect of reducing pollution from the use of fuels.

Economic competitiveness: The Texas tax rate of 20 cents per gallon on gasoline and diesel fuel is slightly above the national average of 18.5 cents per gallon (Report of the Staff Work Group). This difference is not likely to have a major competitive impact on Texas business and the Texas economy because other factors are more important in determining regional fuel prices.

Administrative simplicity: The consumer is aware of and understands the tax. Tax rates per gallon are frequently displayed on fuel pumps, but most consumers are not aware of their yearly levy. The tax is relatively easy to administer.

Adequacy: The tax rate is a fixed amount per gallon, so that it does not keep pace with inflation. In times of rapid growth or inflation, the revenues may not keep pace with the needs. The tax was raised several times during the 1980s. Seventy-five percent of the tax revenue is allocated to roads, and 25 percent to schools. Currently, the tax funds 100 percent of road maintenance in Texas (Report of the Staff Work Group).

Equity or fairness: *Benefits received* can be used because the majority of the tax revenue is allocated to roads. In general, the amount of gas that people buy is a reflection of their road use, so that benefits received are related to tax payments. *Ability to pay* can also be used to evaluate the motor fuels tax. *Horizontal equity:* People with the same income pay varying amounts of tax, depending on their road use. V*ertical equity:* In general, those with less income spend a higher percentage of their income on the motor fuels tax (see Table 4).

Corporate Franchise Tax

Economic efficiency: The corporate franchise tax is paid only by corporations and limited-liability companies. As a result, among firms providing the same product or service, some will pay this tax and others will not. This is a cost advantage to the firms that are not organized as corporations. Corporations must keep their prices competitive, so they may not be able to pass the full cost of the tax to customers.

Economic competitiveness: Businesses in many states pay a corporate income tax. Unincorporated Texas businesses have a competitive advantage. The competitive impact on incorporated Texas businesses depends on how the franchise tax compares with the corporate income tax in other states.

Administrative simplicity: The accounting is highly complex because the franchise tax is calculated in two ways, and each method has a different tax rate. The firm must calculate the tax by both methods and pay the higher of the two levies. The tax is difficult to administer and legal challenges have not been uncommon (Report of the Staff Work Group).

Adequacy: Corporate franchise tax revenues have not grown with the Texas economy in recent years without adjustments to the tax rates and the tax base. Most of Texas's growth has been in service industries that are not capital intensive, are frequently unincorporated, and are not reached by the franchise tax. The tax was modified in 1991 to increase revenues. Modification of the tax rate or base is not a routine decision. Frequent modification is an indication of inadequacy.

Equity or fairness: *Benefits received* cannot be applied because the tax goes into general revenues. *Ability to pay* can be used to evaluate this tax. *Horizontal equity:* Because the tax is based on the way a business is organized, firms with similar products, net worth, and net incomes receive very different tax treatment. *Vertical equity:* Firms with very different net incomes may pay the same percentage of that income in tax.

Summary

Tax revenues have declined from 64 percent of total state revenues in 1982 to 49 percent in 1996. The percentage of state revenues from federal funds and from fees and other sources has increased. The sales tax currently is the major source of state tax revenue. The property tax is the major source of revenue for all levels of local government.

Evaluation of the major state and local taxes shows that no tax is ideal with respect to all the criteria. The various state and local taxes have different effects on various groups of citizens. Thus, choosing a tax, or set of taxes, is part of the political process. It is hoped that the background material in this report will provide a common starting point for both citizens and state legislators as they debate the appropriate taxes for state and local government.

Glossary

Ability to pay is the tax equity principle that taxes be distributed according to the capacity of the taxpayer to pay them. Ability to pay is usually measured by income.

Ad valorem tax has a tax rate stated as a percentage of the value of the good or service. The tax levy is the tax rate multiplied by the value of the good or service. The sales tax, motor vehicle tax, and property tax are all ad valorem taxes. The Texas Constitution uses "ad valorem" to refer to the property tax.

Adequacy is the ability of a tax system to be flexible and generate sufficient revenues under changing economic circumstances.

Administrative simplicity occurs if a tax system is easy for the taxpayer to understand and relatively easy and inexpensive for the taxpayer to comply with and the public sector to administer.

Benefits received is the tax equity principle that taxpayers contribute to the support of the government in proportion to the benefits that they receive from public services.

Business activity tax is levied on business organizations and is a modification of a value-added tax (see below). The tax base of the Texas business activity tax, (proposed by Governor Bush in 1997) begins with net income (from IRS forms) and adds labor costs, employee benefits and depreciation. The firm pays a percentage of this amount as its tax levy (1.25 percent was proposed). The first $500,000 of tax base would be exempt from taxation, and firms would be allowed to deduct new capital investments (Jones, et. al).

Business gross receipts tax has a base of all revenues (all business and investment income) of all businesses. The tax rate is a percentage of gross revenues.

Capital gains (or losses) are the changes in value of an asset. Capital gains (or losses) are realized when an asset is actually sold. The base of a capital gains tax is the amount of capital appreciation (or loss) from time of purchase to time of sale or transfer of ownership through inheritance.

Capitalization is a financial method of converting the annual income from a perpetual investment (land) into the value of the asset. The formula is V=I/R. V is value, I is annual net income from the investment, and R is a capitalization rate (see below). In Texas, capitalization is used to estimate the productivity value of agricultural and forestry land for taxation purposes.

Capitalization rate is used to estimate the value of an asset by dividing the capitalization rate into an expected perpetual income stream from the asset (land). The capitalization rate is the market rate of interest plus an allowance for risk. In Texas, the capitalization rate used to estimate the productivity value of agricultural and forestry land is 10 percent, or the current Federal Land Bank interest rate on long-term loans plus 2 percent, whichever is greater.

Depreciation is the decline in value of durable equipment and buildings that occurs as they are used in the production process (i.e., as they wear out). The depreciation in value over the lifetime of the asset is equal to the total value of the asset.

Depreciation allowance is the portion of the cost of depreciable or durable assets that can be included in production expenses and deducted from income for tax purposes.

Double taxation occurs when the same activity is taxed more than once by different types of taxes or by different jurisdictions. For example, in the U.S., corporate profits are taxed twice—first by the corporate income tax and second by the personal income tax when corporate profits are distributed as dividends (Stein).

Economic competitiveness refers to the ability of firms within the state to compete with those in other states, and to the ability of the state to attract new business.

Economic efficiency occurs if the tax system does not distort choices made by consumers and firms among goods, services and investments. A broad-based tax causes fewer inefficiencies than a tax with a narrow base. How much the consumption of the taxed product will change depends on the elasticity (see below) of that product—that is, on how consumer purchases react to changes in the price of that good. Tax A is more efficient than tax B if it generates the same revenue with less loss of satisfaction to the consumer (Sandford).

Effective tax rate is actual taxes paid divided by the taxable base. The effective rate differs from the adopted rate because of exemptions and deductions. For example, Texas property law requires that both the adopted rate and effective rate be published. The effective rate is calculated as the levy from the previous year divided by the current year's base. If, for the current year, the property taxing district raises both the tax rate and reappraises property to a higher value, the effective tax rate is lower than the newly adopted rate. Another example: the property tax can be deducted from income on the federal income tax, so the effective tax rate for the individual property owner is lower by an amount that depends on his federal tax bracket.

Elasticity describes how consumer purchases react to a change in the price of a product or service. With inelastic demand, consumption will decrease proportionately less than the price increase. For example, if the price increases 5 percent and consumption declines less than 5 percent, demand is inelastic. With elastic demand, consumption decreases proportionately more than the increase in price.

Equity is the principle that the tax system be fair in its relative treatment of different individuals. If the tax system bears equally on people in similar circumstances there is horizontal equity (see below). If the tax system differentiates appropriately among people in dissimilar circumstances there is vertical equity (see below). There are two ways to compare the circumstances of people—the benefits received by the taxpayer (see above) or the taxpayer's ability to pay (see above).

Excise tax is a tax on the sale of a specific product or service. There are both per unit (see below) and ad valorem (see above) excise taxes. These taxes are used customarily to discourage consumption of particular goods (alcohol and tobacco) or to pay for government costs associated with private consumption (motor fuels for road construction).

Exemptions are special provisions in the tax code that reduce or eliminate the tax burden for qualifying business or individuals.

Franchise tax is a tax on corporations and limited-liability companies for the franchise, or privilege, of conducting business in a state. In Texas, the tax is on net worth or on earned surplus, whichever yields the higher tax levy for the individual firm. Earned surplus is profits plus executives' salaries and benefits.

Horizontal equity is the principle that the tax system bears equally on people in similar circumstances. Individuals with the same income pay the same tax levy.

Investment tax credit allows businesses to deduct a percentage of their new investment costs from their tax bill.

Motor fuels tax is a per gallon tax on the sale of gasoline, diesel and liquefied gas. The Texas tax rates are 20 cents per gallon on gasoline and diesel fuels and 15 cents on liquefied gas. The motor fuels tax is paid by the wholesaler. Twenty-five percent of the tax is allocated to the permanent school fund, and the rest is allocated to road construction and maintenance.

Net to land is the annual net returns after payments for purchased inputs, labor, capital use, and management. In Texas law, an average of net to land for the most recent 5-year period is calculated and then capitalized (see above) into a productivity value (see below) of land for purposes of property taxation.

Per unit tax is a tax of a specified dollar amount per unit of an item sold. Many excise taxes (see above) are per unit taxes. The alcohol and tobacco and the motor fuels taxes are per unit taxes.

Personal taxes are all taxes paid by individuals—income, payroll, sales, property tax, and other taxes.

Productivity value is a special way of calculating the tax base for qualified farm, timber, wildlife habitat, and other special-use land. This is the single-use value of land that arises from its ability to earn income in agricultural or timber production, ignoring other forces that contribute to market value. Productivity value is less than market value.

Progressive tax is one in which the ratio of tax to income is higher at higher income levels than at lower ones; i.e., the tax rate increases as income increases. An evaluation of a tax as progressive is based on applying the vertical equity (see below) criterion to the ability to pay.

Property tax is an ad valorem tax on real estate and business personal property. This tax is the major source of revenue for local governments, school districts and special districts in Texas.

Proportional tax is one in which the ratio of tax paid to income is the same for all income levels. An evaluation of a tax as proportional is based on applying the vertical equity criterion (see below) to the ability to pay (see above).

Rate limit is the maximum tax rate the state allows local jurisdictions to adopt. The State of Texas sets a rate limit of 2 percent for local sales taxes.

Regressive tax is one in which the ratio of tax paid to income is higher at lower income levels than at higher income levels. An evaluation of a tax as regressive is based on applying the vertical equity criterion (see below) to the ability to pay (see above).

Sales tax is a tax on purchases of goods and services. The tax is a percentage of the value of the purchase (ad valorem). It is paid to the seller at the time the taxable item is purchased. The seller is responsible for paying the tax to the state. There are several different types of sales taxes, those that apply to a large range of goods and services and those that apply to specific goods and services, such as motor vehicles.

Severance tax is a tax on the value of natural resources such as oil, gas, minerals or raw materials at the point of extraction. It is separate from the property tax on real estate, land or minerals.

Special valuation refers to different valuation criteria used for tax purposes. For example, land used for agriculture and forestry may be taxed on productivity value instead of the market value of the land.

Tax is a payment imposed by the government (federal, state, local or special taxing district) on personal or business income, on goods and services purchased, or on wealth. Taxes are used to raise revenues, to alter the distribution of income and wealth, to control the level and structure of consumption in the economy, and to alter consumption preferences.

Tax base is the taxable value to which the tax rate is applied. A wide variety of tax bases exist—sales, income, value-added, market value of land, value of capital, quantity sold, etc.

Tax burden is the amount of a tax paid by an individual. It can also be used to refer to the total revenue from a tax. In addition, the tax burden is sometimes defined as the effective tax rate or the percentage of income paid as taxes.

Taxing entity is the government agency or jurisdiction (state, county, city, special district) with the legal right to impose and collect the tax.

Tax incentive is a special provision of the tax code that promotes a particular activity such as investment or charitable giving. Among tax incentives are deductions, exemptions and tax credits.

Tax incidence is the ultimate distribution of the tax burden, which may differ from the point of collection. For example, the state collects the sales tax from retailers but the incidence is on consumers.

Tax levy is the actual dollar value of tax paid by an individual (usually in 1 year). It is the tax base multiplied by the tax rate.

Tax rate is a dollar amount per unit or a percentage of the value of the tax base that must be paid as a tax. The tax rate is multiplied by the tax base to obtain the actual amount of tax to be collected (the tax levy).

Tobacco and alcohol taxes are taxes on purchases of alcohol and tobacco products. In Texas these items are subject to per unit excise taxes. Sometimes taxes on these products are called “sin taxes.”

Transactions tax applies to each transaction as raw materials move from initial production, through processing, to final sale of the finished product. This tax applies to the total value of each transaction.

Value-added tax (VAT) is based on the value added during the production process. Value-added is the gross receipts, less expenses, for purchased inputs for production. It is a tax on the earnings of land, labor, owned capital, and management used in the business.

Vertical equity is the principal that the tax system differentiates appropriately among unequals. Individuals with different incomes pay different percentages of their incomes in taxes.

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