
Tax Alternatives and School Finance

Presented to the Select Committee on Public School Finance Weights,
Allotments & Adjustments

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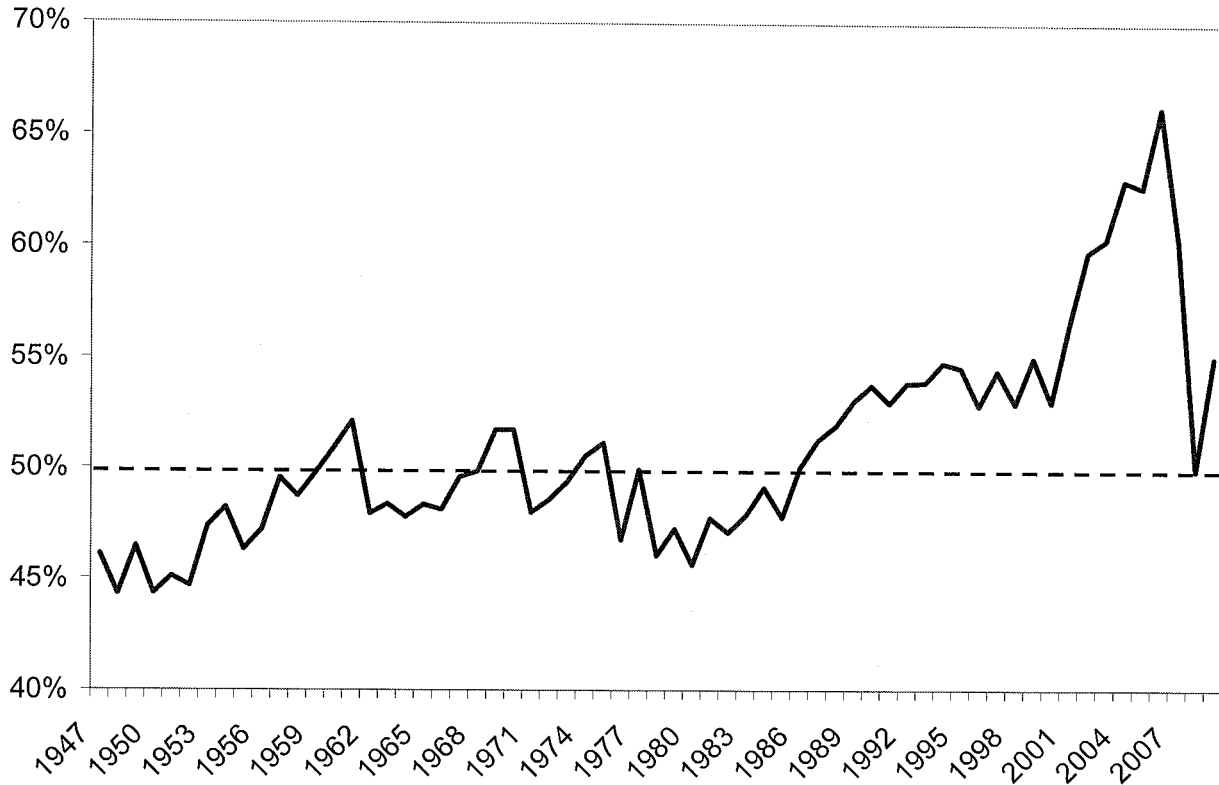
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School Property Tax Share of Public School Funding

Maintenance and Operations and Facilities



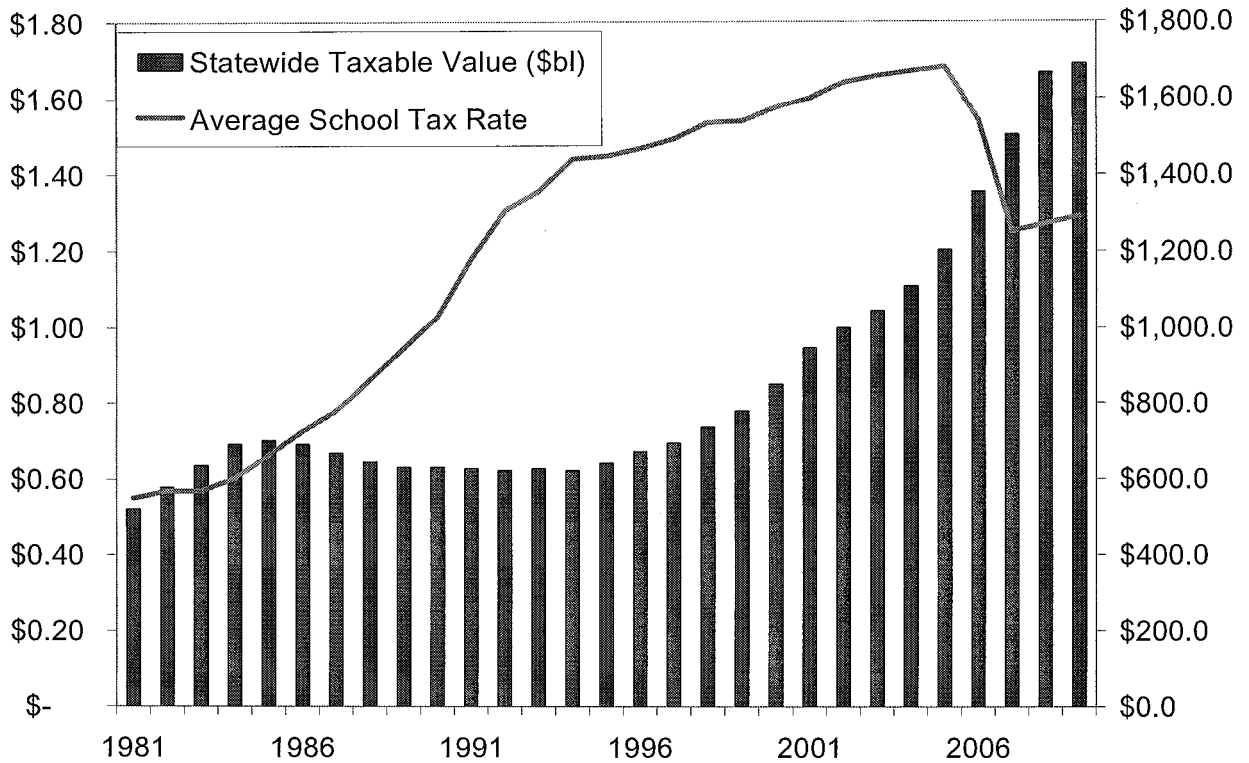
Source: LBB Fiscal Size Up and author's data.

- From 1947 (the year of Gilmer-Aikin) through the mid 1980s, local property taxes comprised 45 to 52 percent of general school program and facilities costs, with state aid accounting for the remainder.
- In the mid 1980s the state embarked on an effort to equalize disparities in taxable property wealth across districts. With the advent of recapture in 1991, the state was able to tap this wealth and equalize tax disparities.
- With a more equalized finance system, state aid was tied to property wealth. As property values increased with normal growth, the demands on state aid lessened, resulting in the property tax bearing a greater portion of school finance costs.



School Tax Rates and Taxable Values

Maintenance and Operations and Facilities Tax Rates

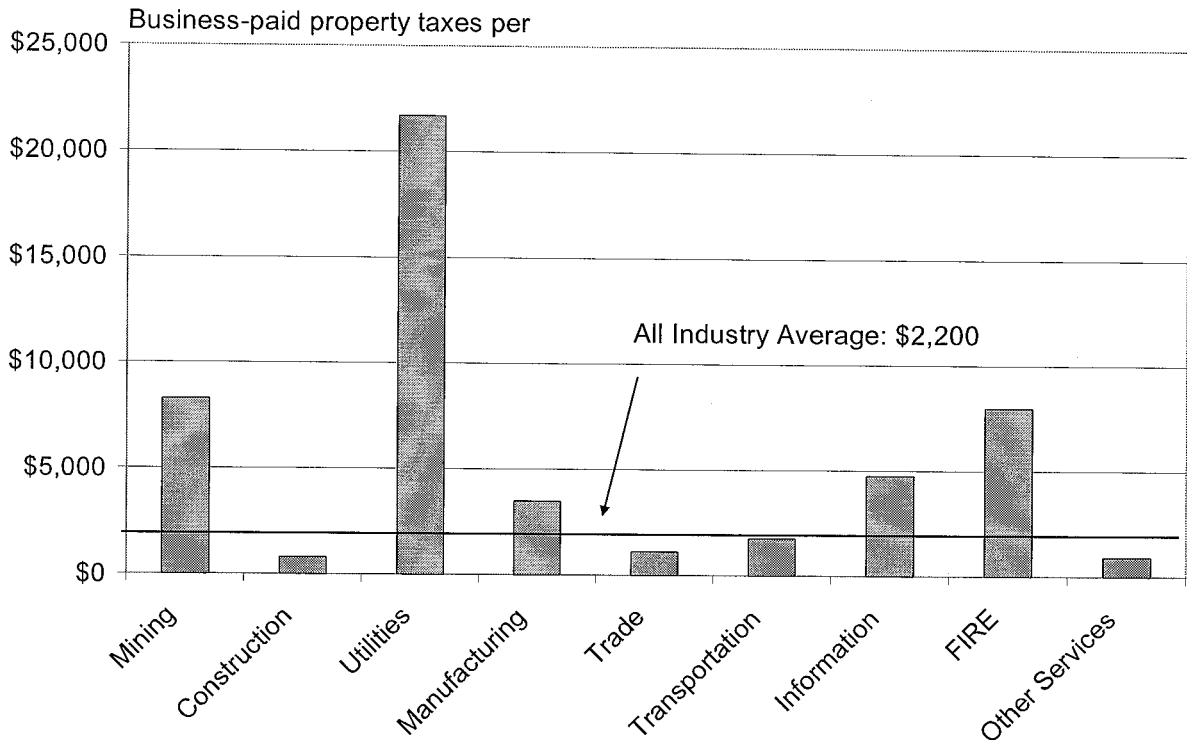


- Since the 1981 tax year, the average school property tax rate has increased from \$0.55 per \$100 of taxable value to a high of \$1.68 in 2005, and currently stands at \$1.29.
- Over that time, the taxable value available to school districts has more than tripled—increasing from \$521 billion to \$1.7 trillion today.
- The 2006 property tax relief effort reduced school maintenance and operations tax rates by a total of one third—phased in over two years.
- In 2009 tax rates continued their historical creep, as districts authorized additional taxes for debt and enrichment purposes.



Business Property Taxes and Jobs

School Taxes Paid Per Employee by Industry



Source: TTARA Research Foundation, *Who Really Pays: The Ultimate Incidence of the Property Tax*.

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- In 2008, 56.3 percent of the school property tax was paid by businesses on their property and 43.7 percent was paid by individuals (mostly on the homes they own and occupy).
 - On average, for each worker a business hires in Texas, the business pays roughly \$2,200 in property taxes (this does not include those taxes the worker pays directly on the property the worker owns).
 - The business share of the property tax is not evenly distributed. Not surprisingly, because the property tax is essentially a tax on capital, capital-intensive businesses pay high amounts of tax relative to the number of jobs they create.



Replacing the Property Tax: School Finance Issues

1. Replace or Reduce?

Should the property tax be replaced entirely, or should some alternative revenue be used to substantially reduce the tax?

2. State versus local tax

The school property tax is a local tax—imposed locally and collected locally, with revenues accruing directly to the district to which the tax is paid. Would the replacement tax be a state tax or a local tax? If the replacement tax is to be a local tax, there would likely be a substantial shift in tax wealth per student, with many property wealthy districts suddenly becoming poor and vice versa. This would require formula adjustments for recapture to ensure the state maintained an equitable finance system. If the replacement tax is to be a state tax, would there be a loss of connection between the taxpayers and the schools which their taxes support? Would the new tax completely eliminate school maintenance and operations taxes, or just some portion of them? Would the new tax allow for some degree of local financial control?

3. Access to enrichment

There would be need for local option enrichment to preserve "local control." Would access to enrichment be accomplished through the new tax, or would some portion of the school property tax remain on the books for enrichment purposes? If the school property tax is not completely eliminated, would there be protections in place to ensure that property taxes do not creep back up to previous levels?

4. Facilities Financing

Because of previous voter authorizations and bond covenants, existing debt would likely have to be financed through property taxes. Would future facilities be financed with a locally-imposed property tax?

5. Formula Implications/Hold Harmless

Would formulas be rewritten to solely reflect each district's unique educational costs or would they reflect historical revenue discrepancies as does the target revenue system? Is it more difficult to defend higher revenue levels for property-wealthy districts if that is a carry-over from a tax that no longer exists?



How Texas Compares By Tax

Tax	Rate	Base
Sales Tax	At a state rate of 6.25%, Texas is tied with Massachusetts for the 10 th highest rate; adding in local taxes ¹ Texas ranks 12 th highest in effective state and local tax rate combined ² ; 46 states levy a sales tax.	In general, Texas' tax base is somewhat broader than most states (ranking 23 rd broadest) ³ ; Texas taxes a greater number of services than most other states (83, compared to the average of 56) ⁴ , but does not tax food as some states do.
Property Tax	Texas' effective tax rates are among the nation's highest. Effective tax rates on industrial property rank us 4 th highest; homesteads 10 th highest. ⁵ All states have some form of a property tax—most commonly used by local governments.	Texas property tax applies to business personal property (9 states exempt business personalty), including inventories (33 states exempt inventories), as well as realty.
Personal Income Tax	Texas is one of 7 states without a tax on some form of personal income.	
Business Tax	Texas' franchise has a much lower rate and much higher base than direct business taxes of most other states. Relative to gross state product, Texas' franchise tax burden ranks roughly in the middle—23 rd highest.	

¹ Federation of Tax Administrators: <http://www.taxadmin.org/fta/rate/sales.pdf>

² Tax Foundation: <http://www.taxfoundation.org/taxdata/show/26269.html>; rate is weighted based on actual taxes in place.

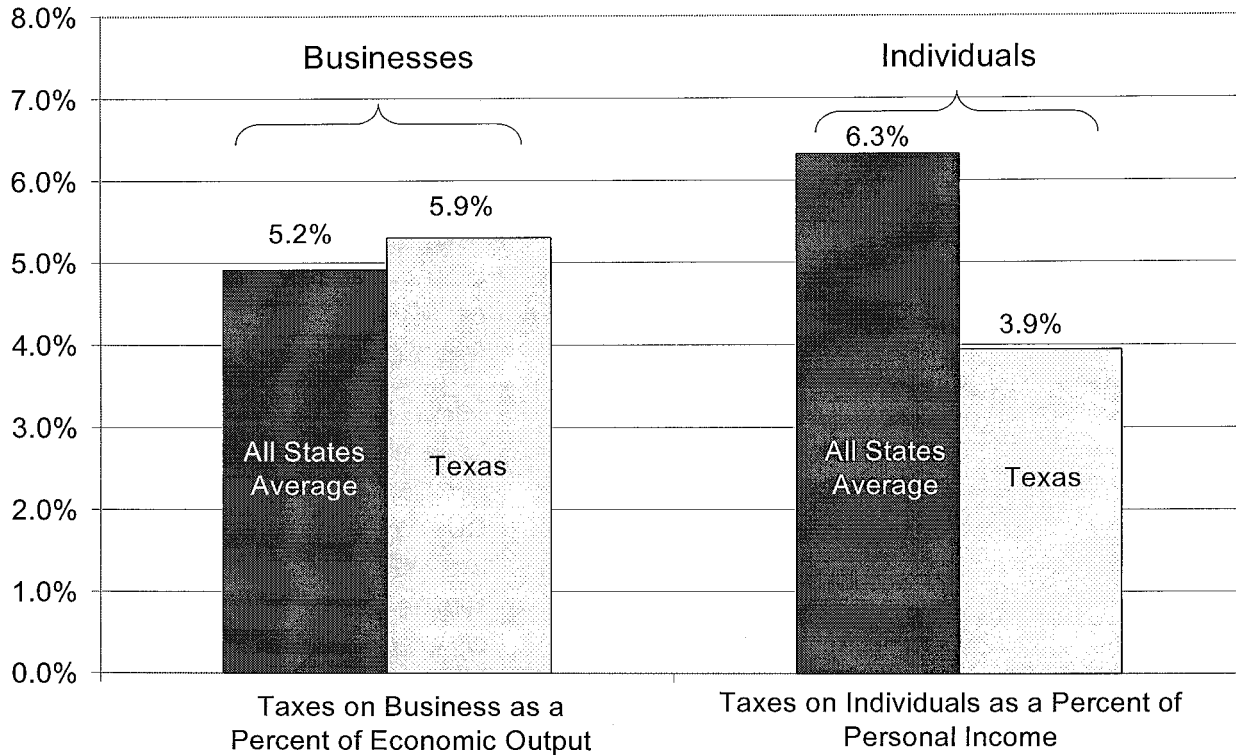
³ Derived by dividing revenue data for 2008 from the Census Bureau by the state tax rate reported by the Federation of Tax Administrators to determine the total tax base, then dividing by Gross Private Product for each state as reported by the U.S. Bureau of Economic Analysis.

⁴ Federation of Tax Administrators: <http://www.taxadmin.org/fta/pub/services/services.html>

⁵ 50 State Property Tax Comparison Study, Payable Year 2008, Minnesota Taxpayers Association.



Texas' Tax Burden and Who Pays It



- There are two types of taxpayers—businesses and individuals.
- Texas relies heavily on sales and property taxes to finance the costs of government—taxes shared by businesses and individuals alike.
- Lacking a personal income tax, Texas is a low tax state for individuals,
- Relying heavily on sales and property taxes—taxes paid by businesses as well as individuals—Texas is a relatively high tax state for businesses.



Property Tax Alternatives and Issues

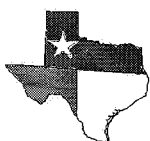
Tax/Option	Issues Involved
Property Tax (Wealth)⁶	
State property tax	Property would be removed from the local tax base and subjected to a state tax; with funding formula adjustments this could resolve school finance disparities but would not by itself reduce tax rates. Property tax tends to be more stable than other revenue sources.
Split the tax roll, subjecting business property to higher tax rates than homeowners	Shifts taxes from homeowners onto business, potentially eliminating high tax rates for one part of the economy by forcing higher tax rates on another; would worsen current problem of high property taxes on business; would increase recapture since business property is at the heart of school district wealth disparity; most current property wealthy districts would become property poor.
Expand the Tax Base	
<ul style="list-style-type: none"> • Repeal Agricultural Valuation 	Could raise taxes on agricultural property by a factor of 7; would imperil current owners of family farms and other agricultural properties.
<ul style="list-style-type: none"> • Tax Intangibles (stocks, bonds & financial assets) 	In theory these were subject to the property tax prior to the late 1970s though enforcement was non-existent; would convert the "property tax" to a "wealth" tax; many of these assets do not generate cash income and the tax could be difficult to pay.
<ul style="list-style-type: none"> • Repeal Existing Tax Exemptions 	Currently homesteads benefit the most from exemptions, as well as certain types of business property exempt for reasons of economic competitiveness or pollution control; because 84% of current exemptions are for homesteads, repeal could increase tax on homeowners by 25%; on the business side this would diminish Texas' ability to compete for new investment.
Sales Tax (Consumption)	
Expand the Tax Base	
Groceries/Home Utilities	14 states tax groceries in some form, 22 states tax residential utilities; though some offer tax rebates for low income families; would worsen the regressivity of the tax.
Services	Only three small states extensively subject services to the sales tax (South Dakota, New Mexico, Hawaii); administration is very complex and could violate interstate commerce protections unless done carefully; would be a substantial cost increase for services industries and could encourage tax avoidance through Internet and other sources; businesses are predominant consumer of most services, which could result in a shift of more taxes to business.

⁶ In general, these changes would require an amendment to the Texas Constitution.



Raise Tax Rate	At a total state and local rate of 8.25%, Texas currently has one of the highest effective sales tax rates in the nation (12 th); higher tax rates could increase non-compliance through Internet sales, further harming Texas storefront businesses.
Income Tax (Income)	
Impose Personal Income Tax⁷	An income tax would harm entrepreneurship and make Texas less attractive as a location for company headquarters. The Texas Constitution requires that 2/3 of income tax proceeds must be used to reduce school property taxes. Using a tax that falls predominately on individuals to reduce a tax shared by businesses and individuals alike would shift the overall tax burden more to individuals. Personal income tax is not regressive, but tends to be more volatile than other revenue sources.
Business Tax	
Gross Receipts Tax	Substantial revenue can be generated at low rates; unprofitable businesses could be subject to high tax bills; tax "pyramids" as goods move through the production chain. Only one state has a broad-based business gross receipts tax (Ohio). Using a tax that falls predominately on business to reduce a tax shared by businesses and individuals alike would shift the overall tax burden more to business.
Business Income Tax	In most states corporations are subject to corporate income tax and partnership owners are subject to personal income tax. Revenues tend to be highly volatile. Tax is widely understood. Using a tax that falls predominately on business to reduce a tax shared by businesses and individuals alike would shift the overall tax burden more to business.
Business Activity Tax	Applies to revenue less cost of raw materials. Michigan recently repealed unpopular similar tax. Tax base is essentially "net economic output," and tends to shift business tax more to labor-intensive services industries. Using a tax that falls predominately on business to reduce a tax shared by businesses and individuals alike would shift the overall tax burden more to business.

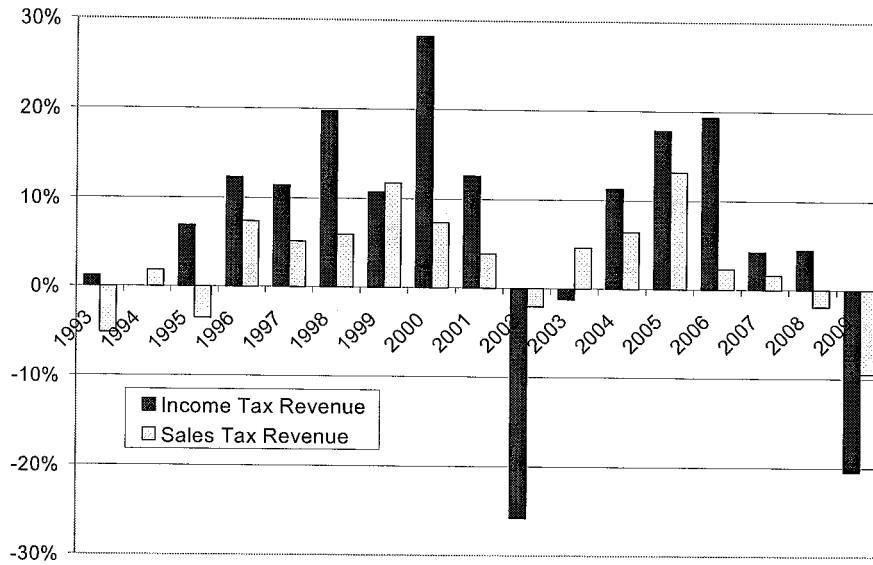
⁷ A personal income tax must be approved by Texas voters before it may take effect, and two-thirds of the revenue it raises must be used to reduce school property taxes, with the remaining one third available for any purpose supporting education.



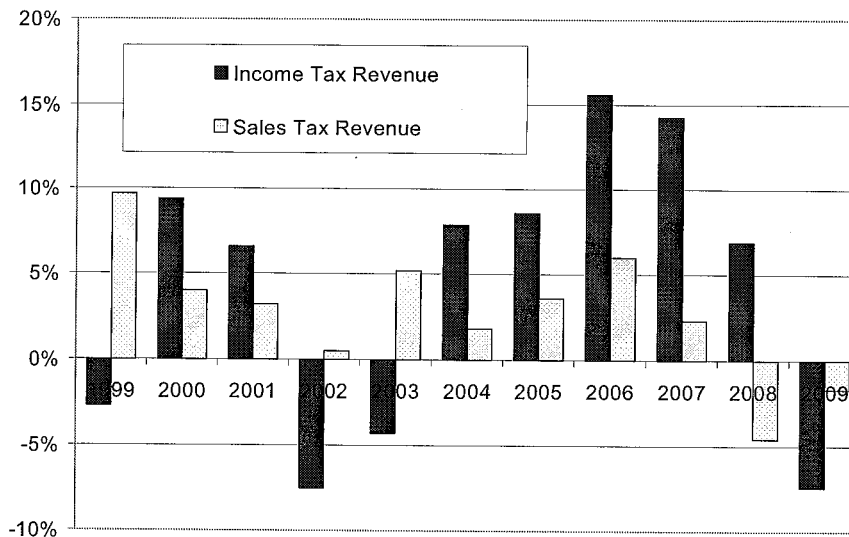
State Personal Income Tax Versus State Sales Tax

California and Kansas: Annual Percent Change

California



Kansas



General Tax Issues in Replacing the School Property Tax

- Tax policy is about doing the least harm.
- Any tax changes should not harm our competitive position relative to other states.
 - Any replacement tax should not worsen the current business/individual split. High business tax burdens make it more difficult to attract new businesses to Texas.
 - Current high property taxes are a disincentive to invest in Texas, but a school district can grant a temporary limit on the taxable value of new investment, providing a temporary buffer from the tax. Any replacement tax may need some type of similar feature in order to compete for new investment.
- Any replacement tax should not cause economic distortions such as pyramiding, or unduly affect economic decision-making.
- Any replacement tax should not overly burden one segment of the economy to the advantage of another—especially within the same line of business.
- A replacement tax may need to be accompanied by some type of reserve fund mechanism to protect against the volatility of revenue swings.
- If some portion of the property tax is to remain, some type of limiter will need to be in place to ensure that rates don't creep up over time, eliminating the benefit of the replacement tax initiative.

