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# House Committees on Economic & Small Business Development and Defense & Veterans' Affairs

*Study the economic impact of the aviation, aerospace, & defense manufacturing industry in Texas and the state's ability to facilitate industry job growth and investment. Review the relationship between the economic vitality of industry and military veterans transitioning into the workforce. Determine existing and potential barriers to the retention and expansion of the manufacturing industry in the state and the broader economic implications it may have on workforce readiness, as well as veteran employment and support services.*

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# Business Assessments of Texas

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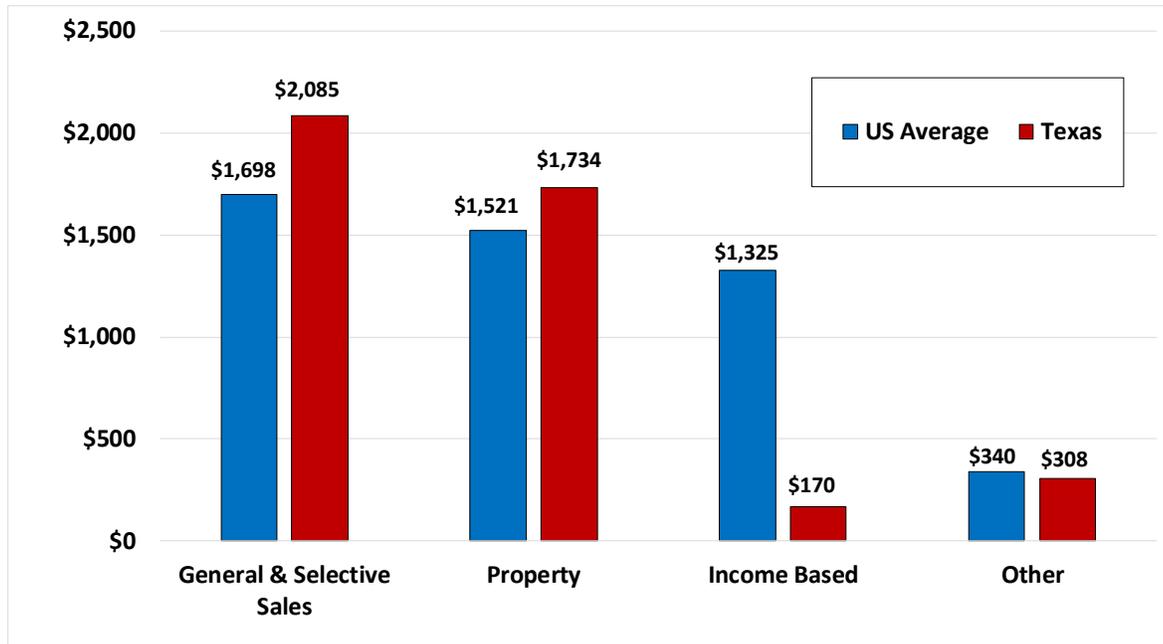
Pluses	Minuses
<ul style="list-style-type: none"><li>• A <i>Right-to-Work</i> State (i.e. one may not be compelled to join a labor union as a condition of employment)</li><li>• Quality institutions of higher education</li><li>• Available land at generally reasonable cost</li><li>• A growing state with a fair supply of labor</li><li>• Reasonable regulatory and judicial environment</li><li>• Stable and affordable energy resources</li><li>• Centrally located to both coasts</li><li>• Lack of a personal income tax</li></ul>	<ul style="list-style-type: none"><li>• Long term water availability is a concern—a problem that is being addressed</li><li>• Transportation networks are strained—a problem that is being addressed</li><li>• While labor is in fair supply, certain categories of skilled workers may be more limited; the lower the unemployment rate, the higher the cost of labor</li><li>• State and local taxes, particularly property and sales taxes, are <u>higher</u> than average and are particularly burdensome for capital intensive, goods producing industries</li></ul>

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# State & Local Taxes by Type of Tax

## Per Capita State and Local Taxes, 2015

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State and local tax systems are commonly viewed as a “three-legged stool,” balanced among sales, property and income taxes (personal and corporate).

Texas, however, is a state that does not levy a personal income tax, and its general business tax, the franchise (commonly referred to as the “margin” tax) is something of a hybrid income tax. Consequently, Texas’ stool essentially has only two legs—sales and property taxes.

The absence of a personal income tax is offset in roughly equal parts by:

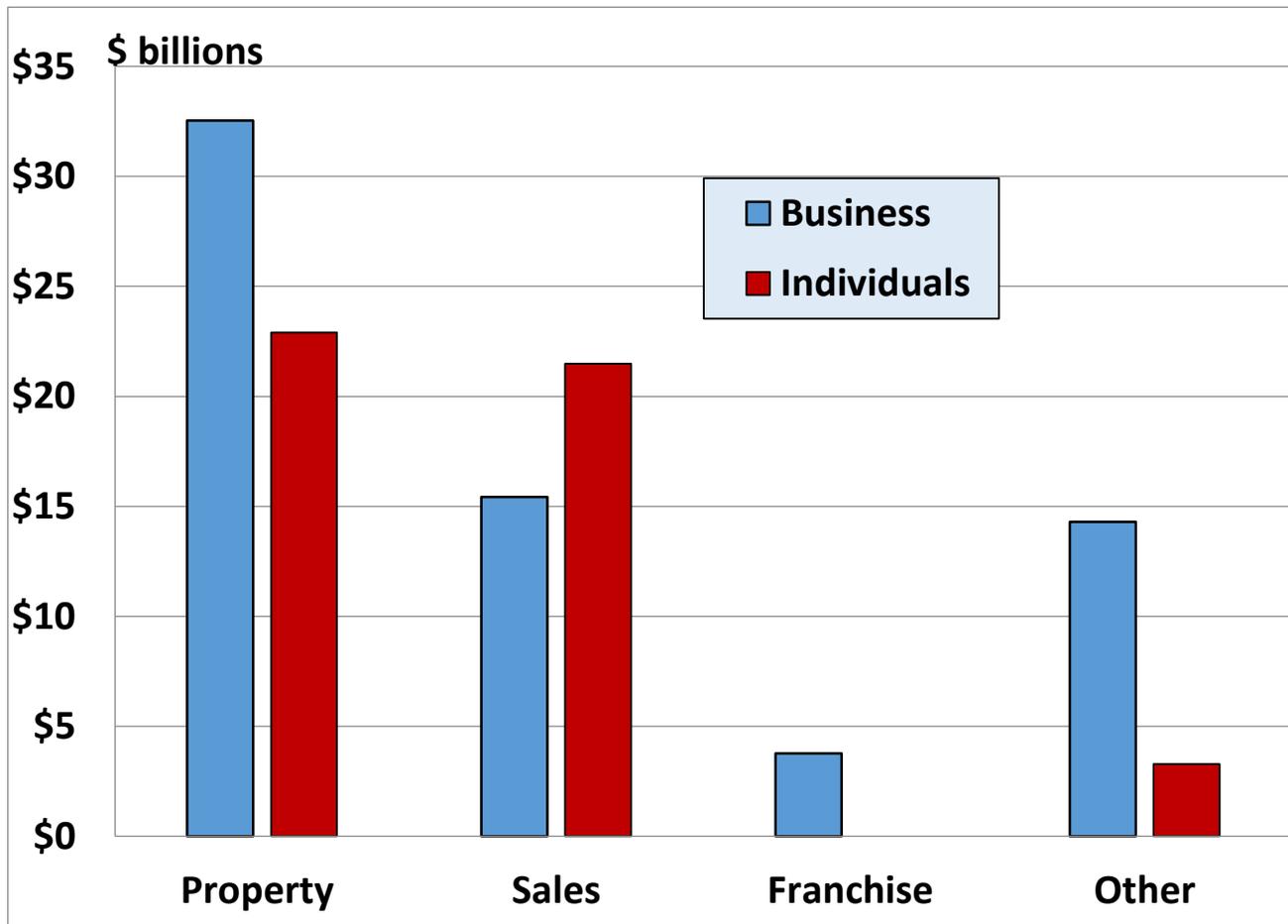
1. higher than average sales and property taxes, and a
2. lower than average level of state and local spending.

Source: U.S. Bureau of the Census, *State and Local Finances, 2015*.

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# Texas State & Local Taxes by Type of Taxpayer

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Texas state and local taxes will total about \$114 billion in 2017, with business paying roughly 3/5 of all taxes—the reverse of most states because of the lack of a personal income tax.

The largest tax business (and individuals) pays is the local property tax, paid to schools, cities, counties, and various special districts.

The second largest tax business (and individuals) pays is the sales tax—paid primarily to the state, but also to cities and other local governments.

While thought of as the state’s “general business tax,” businesses will actually pay \$13 in property and sales taxes for every dollar they pay in franchise tax.

*Note: Rental property is included as business property.*

*Source: Estimates derived from Tax Exemptions and Tax Incidence, Texas Comptroller of Public Accounts, February 2017, and the Texas Taxpayers and Research Association.*

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# Texas' Key Taxes Compared to Other States

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Item	Business	Individuals
Percent of State and Local Taxes Paid, Texas	61.5 %	38.5 %
Percent of State and Local Taxes Paid, Average State	43.9 %	56.1 %
Burden Rank Among the States	20 <sup>th</sup> Highest	48 <sup>th</sup> Highest
Net Tax Burden Relative to Average State	8 % Higher	42 % Lower

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Property and sales taxes fall more heavily on business than do personal income taxes. Consequently, Texas' net tax burden on business is higher than average; however, Texas taxes on individuals are among the lowest of any state

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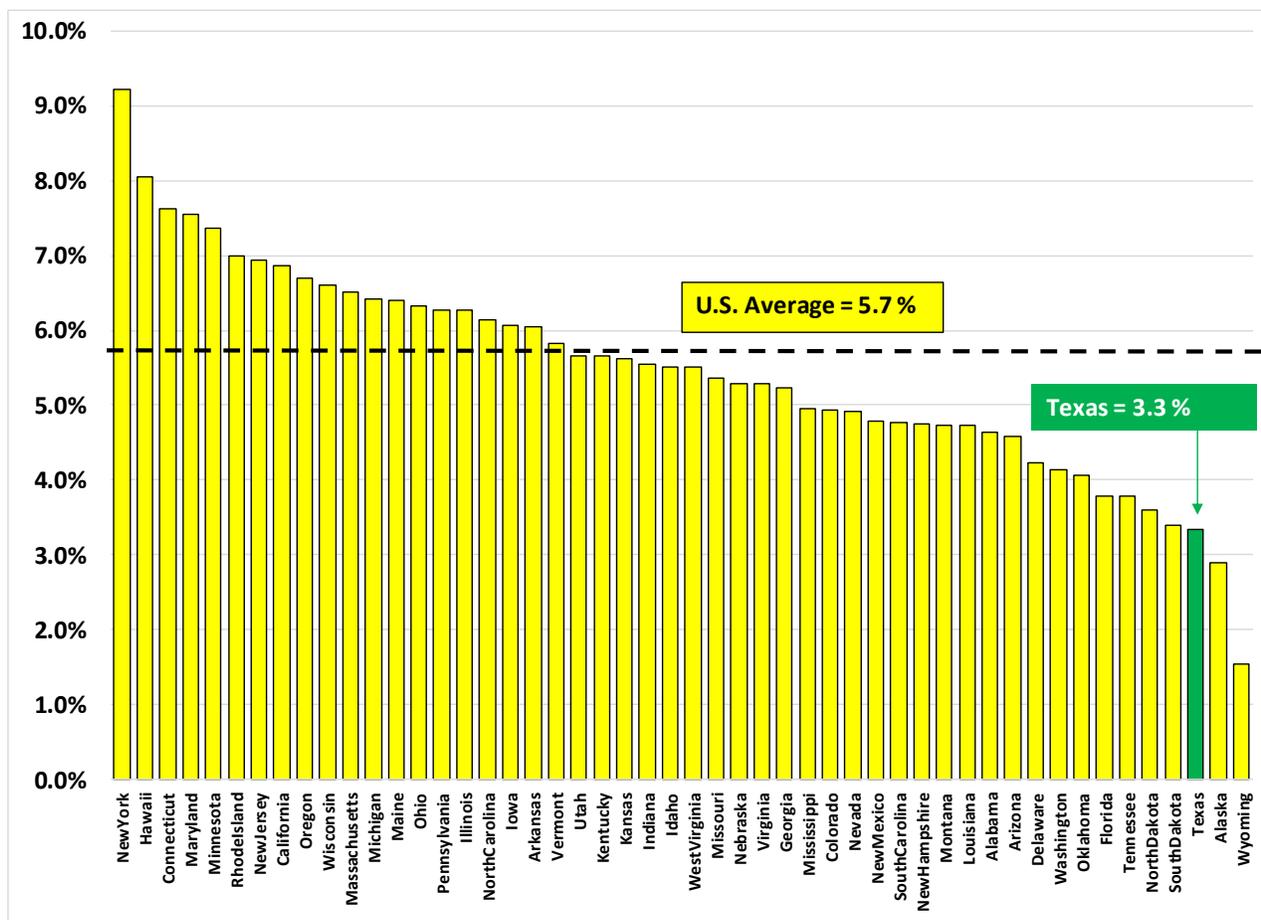
Note: There are two basic types of taxpayers: 1) *businesses*, and 2) *individuals*. In Texas, *individuals* incur direct taxes on many of their purchases and their real estate, but unlike most states, not on their income.

*Businesses* may incur taxes on their purchases (e.g. sales tax, fuels taxes), their real estate and personal assets (e.g. property tax) and be subject to special industry taxes on gross receipts (e.g. utilities, insurance). Businesses respond to taxes in one of three ways:

1. Pass the cost of the tax forward to individuals in the form of higher prices,
2. Pass the tax backward to owners in the form of lower profits, and/or
3. Pass the tax backward to individuals by reducing expenses, such as payroll or relocating or shifting investment to a lower cost location.

Source: Derived from Total State and Local Business Taxes, State-by-state estimates for fiscal year 2016, Council on State Taxation, Washington, D.C., August 2017 (Figures updated for final 2015 & 2016 gross state product and personal income).

# State and Local Taxes on Individuals, 2016



Relative to personal income, Texas state and local taxes directly paid by individuals are among the lowest in the nation. Relative to personal income, Texas' average state and local tax burden is 3.3 percent — 42 percent lower than the overall average for states.

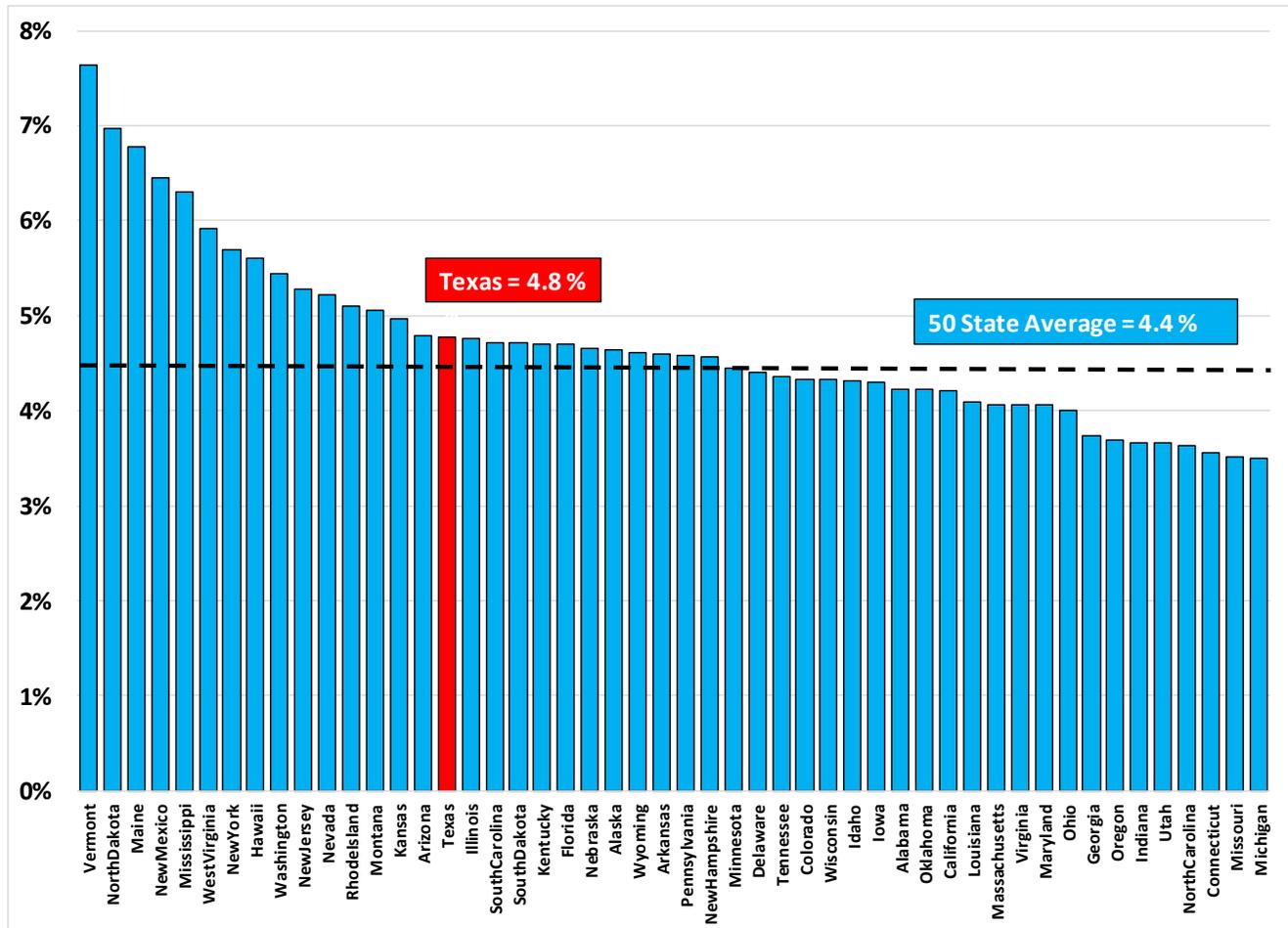
Texas ranks 48<sup>th</sup> among the 50 states in terms of individual tax burden (or, put another way, 3<sup>rd</sup> lowest).

The lack of a personal income tax in Texas saves the average Texas family of three roughly \$3,400 per year.

Source: Derived from Total State and Local Business Taxes, State-by-state estimates for fiscal year 2016, Council on State Taxation, Washington, D.C., August 2017 (Figures updated for final 2015 & 2016 gross state product and personal income).

# State and Local Taxes on Business

## Tax Burden Relative to Economic Output, 2016



Texas state and local taxes on business are equivalent to 4.8% of gross state product, a level ranking 8% above the average state. That makes Texas a relatively high tax state business—ranking 16<sup>th</sup> highest among the 50 states.

While the ranking is not extraordinarily high, by no means is Texas a low tax state for business.

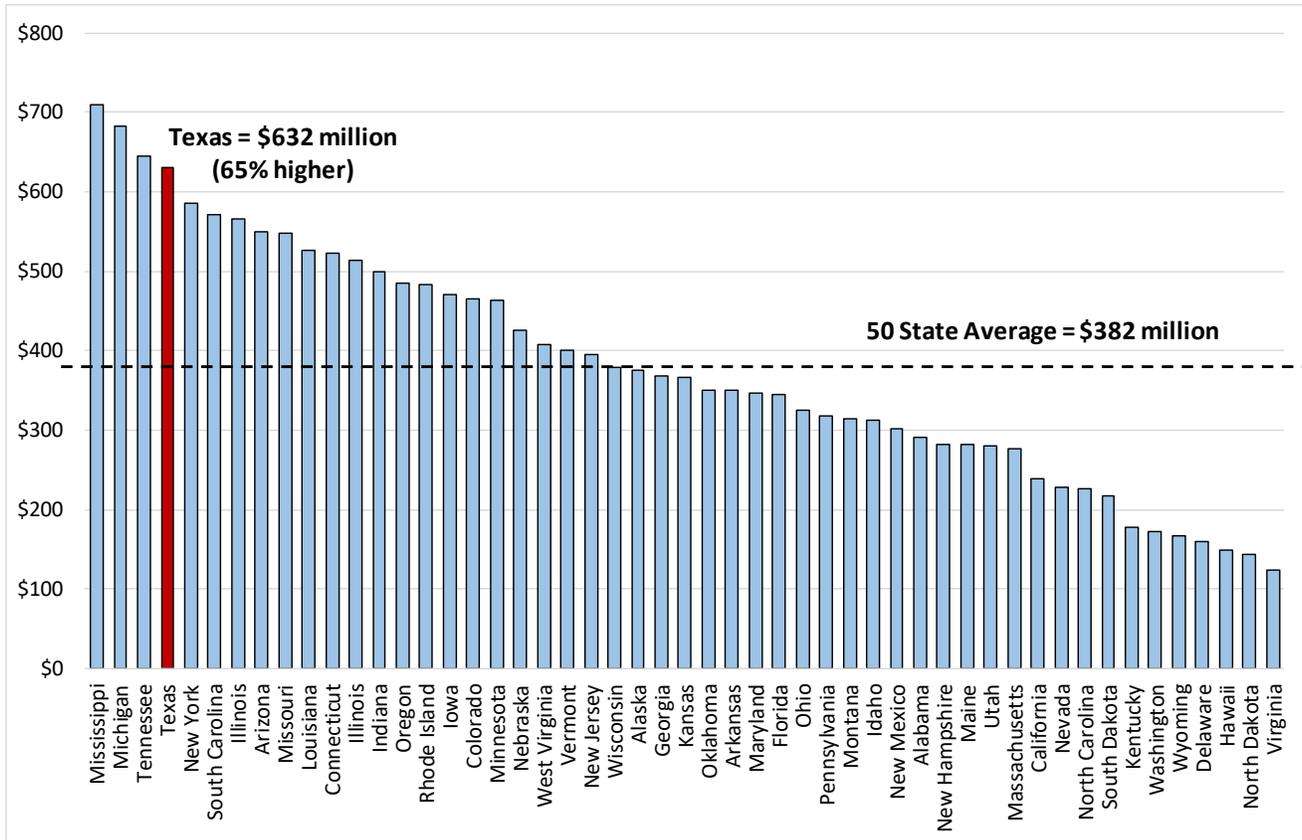
Texas' heavy reliance on property and sales taxes particularly impact both capital intensive and goods producing industries. In particular, for capital-intensive industries Texas is a very high tax state because of our high local property tax rates and the breadth of the tax base.

Source: Derived from Total State and Local Business Taxes, State-by-state estimates for fiscal year 2016, Council on State Taxation, Washington, D.C., August 2017 (Figures updated for final 2015 & 2016 gross state product and personal income).

# Texas' Key Taxes Compared to Other States

Tax	Current Rate and Base	Comparison
<b>Sales Tax Rate</b>	<p>State Tax Rate: 6.25%</p> <p>Local Taxes: Generally capped at 2.0 %; average is 1.94%</p> <p>Average Combined Rate: 8.17%</p>	<p>State Rate: 13<sup>th</sup> highest</p> <p>Combined Rate: 12<sup>th</sup> highest</p>
<b>Sales Tax Base</b>	Generally applies to all sales of tangible personal property excluding food, medicine plus residential or commercial utilities; and a number of specifically itemized services.	Texas' base is generally broader than that of other states because we tend to tax more services than other states (only 7 states tax more services).
<b>Property Tax Rate</b>	<p><u>Residential property</u>: average effective tax rate in 2017 was 1.78 percent of market value (\$150,000 home)</p> <p><u>Commercial property</u>: average effective tax rate in 2017 was 2.36 percent of market value (\$25 million building)</p> <p><u>Industrial property</u>: average effective tax rate in 2017 was 2.53% of market value (\$25 million building with equal value of tangible personal property)</p>	<p><u>Residential property</u>: Texas' effective tax rates rank us 15<sup>th</sup> highest nationally, 22 percent above the national average</p> <p><u>Commercial property</u>: 19<sup>th</sup> highest nationally, 13 percent above the national average (excludes personal property).</p> <p><u>Industrial property</u>: Texas' effective tax rates rank us 4<sup>th</sup> highest nationally, or 65 percent above the national average</p>
<b>Property Tax Base</b>	Texas taxes all real estate <u>plus</u> any tangible personal property used for business purposes (equipment and inventory); goods in interstate commerce are exempted at local option (i.e. Freeport property)	Texas' base is generally broader than that of other states: 11 states exempt all business tangible personal property; inventories are generally exempt in all but 6 states (5 states partially tax inventories).
<b>Business Franchise Tax</b>	Texas' franchise tax is unlike the net business income tax levied by most other states—it has a much broader tax base than profits, but a much lower tax rate. Texas' effective franchise tax rate relative to economic output was 0.27% in 2016.	Relative to economic output, Texas' franchise tax ranks 27 <sup>th</sup> highest among the states, about 32 percent <i>below</i> the national average.

# Property Taxes on a \$1 Billion Industrial Investment Project (25 Year Life)



The above chart illustrates the total property taxes on an industrial facility valued at \$1 billion million over its 25-year lifespan across the various states.

The average state and local property taxes paid over the life of the facility nationwide is roughly \$400 million. In Texas, the facility, if it received no city/county property tax abatements or Chapter 313 school tax limitations, would pay over \$640 million in property taxes—60 percent higher than the national average.

If the facility received a ten-year city/county property tax abatement and a ten-year 313 value limitation of \$80 million, the project’s lifetime property tax bill would still be over \$400 million—roughly more in line with the average of other states, but excluding any incentives those states might offer.

Source: *Based on 50 State Property Tax Comparison Study* by the Lincoln Institute of Land Policy in conjunction with the Minnesota Center for Fiscal Excellence, Cambridge, Massachusetts, April 2018.

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# Calculating the Franchise Tax

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*Begin With:*

Total Revenues \$ \_\_\_\_\_

*Subtract the Higher of:*

- Cost of Goods Sold
  - Compensation
  - 30 % of Total Revenue; or
  - \$1 Million
- \$ \_\_\_\_\_

*Equals*

Gross Margin \$ \_\_\_\_\_

*Multiplied by:*

Percent of Business in Texas<sup>1</sup> \_\_\_\_\_ %

*Equals*

Texas Taxable Margin \$ \_\_\_\_\_

*Multiplied by*

Tax Rate<sup>2</sup> \_\_\_\_\_ %

*Equals*

Franchise Tax Due \$ \_\_\_\_\_

Notes:

<sup>1</sup> The percent of business in Texas is equal to the sum of goods sold in Texas and services performed here divided by the sum of goods sold everywhere and services performed everywhere.

<sup>2</sup> The tax rate is 0.375 percent for wholesalers and retailers and 0.75 percent for all other lines of business.