Testimony before the House Committee on Ways and Means

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TEXAS TAXPAYERS
TTARA
AND RESEARCH ASSOCIATION

Business Assessments of Texas

Viewed Positively

- Reasonable regulatory and judicial environment
- A Right-to-Work State (i.e. one may not be compelled to join a labor union as a condition of employment)
- World-class port facilities
- Available land at generally reasonable cost
- A growing state with a relatively good supply of labor
- Affordable energy resources
- Centrally-located to both coasts
- Lack of a personal income tax—a boon to small business and to corporate headquarters

Viewed Negatively

- Recent electrical grid problems invite concerns about current stability and future cost of power
- Long term water availability has been a concern, but is being addressed
- Transportation networks have been strained, but are being addressed
- While labor is in relatively good supply, certain categories of skilled workers may be more limited
- State and local taxes, particularly property and sales taxes, are higher than average and are particularly burdensome for capital-intensive industries

Tax Incidence

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.

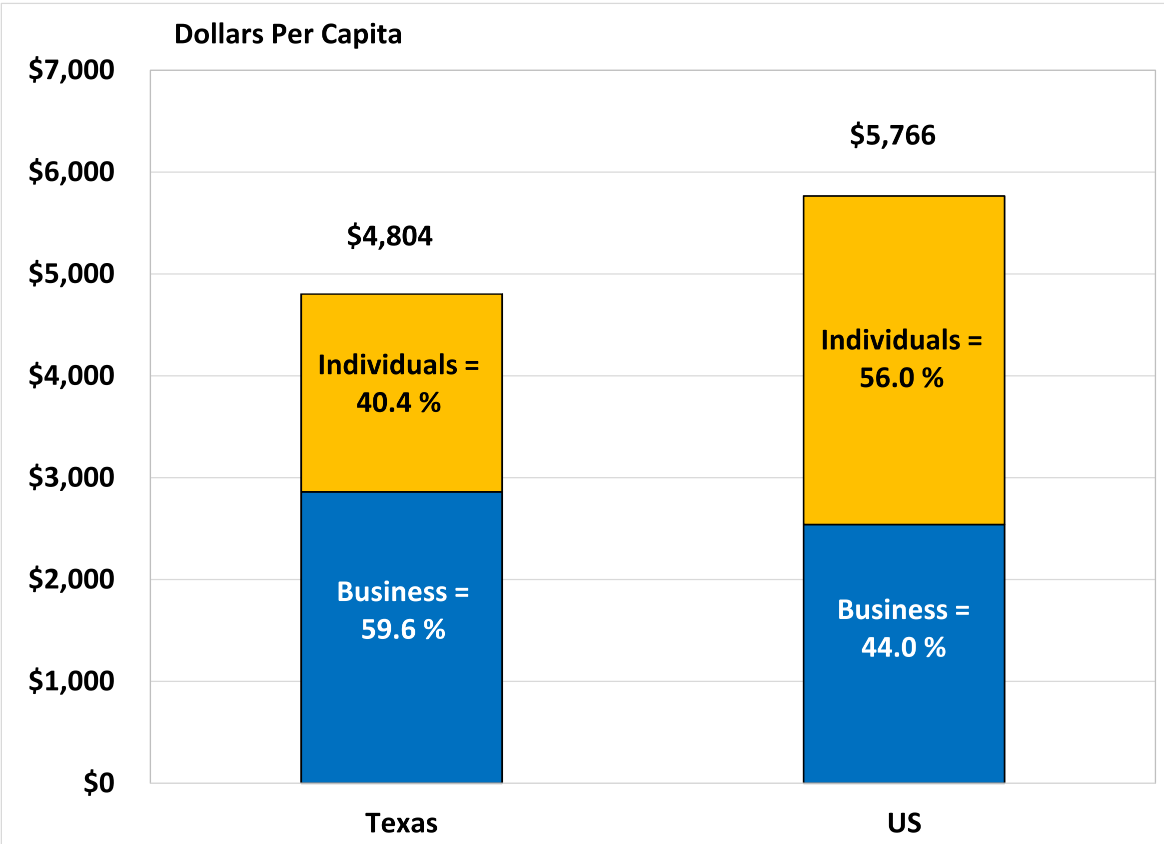
Businesses may incur taxes on their purchases (e.g. sales tax, fuels taxes), their real estate and personal assets (e.g. property tax), and be subject to special industry taxes on gross receipts (e.g. utilities, insurance). Businesses respond to taxes in one of three ways:

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.

Note about the initial incidence assignments in this analysis…

- Sales and motor vehicle sales taxes: tax due is on the sale of a taxable item and is paid by the *purchaser*. For example, while a retailer collects the tax and remits it to the state, the tax is paid by the purchaser of the item.
- Property tax is paid by the *owner* of the property, whether an individual or a business.
- Franchise tax is paid by the business entity.
- Severance taxes and industry-specific gross receipts (e.g., insurance, utility) taxes are paid by the business.

Who Pays State and Local Taxes?



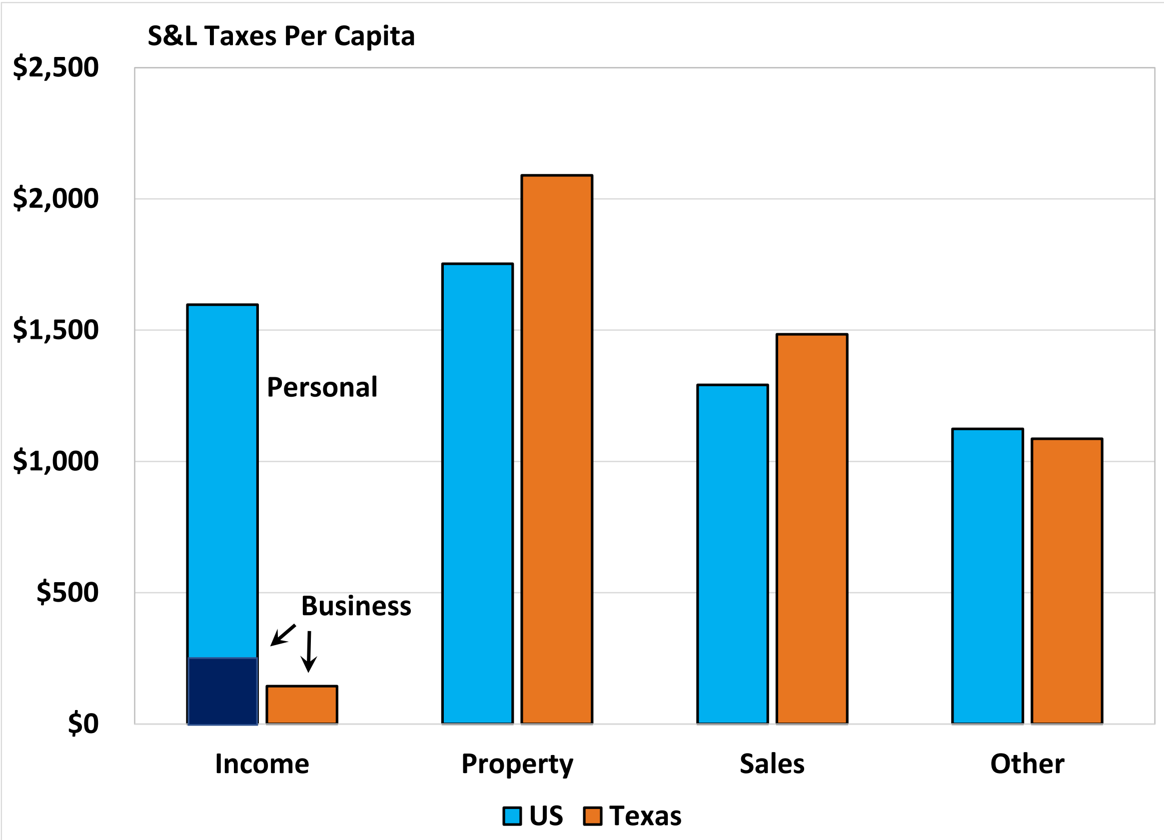
Source: Council on State Taxation, *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2019*.

By many measures, Texas' overall state and local tax burden is well below the national average. Texas state and local taxes totaled $4,884 per capita in 2019, or 17 percent below the national average of $5,766.

However, it is important to note there are two types of taxpayers: individuals and businesses.

Lacking a personal income tax, Texas relies on business to pay 59.6% of our state and local tax load—far above the 50-state average of 44.0%. Though Texas state and local taxes on individuals are low, taxes on business are actually quite high.

Texas State and Local Taxes Compared to 50-State Averages



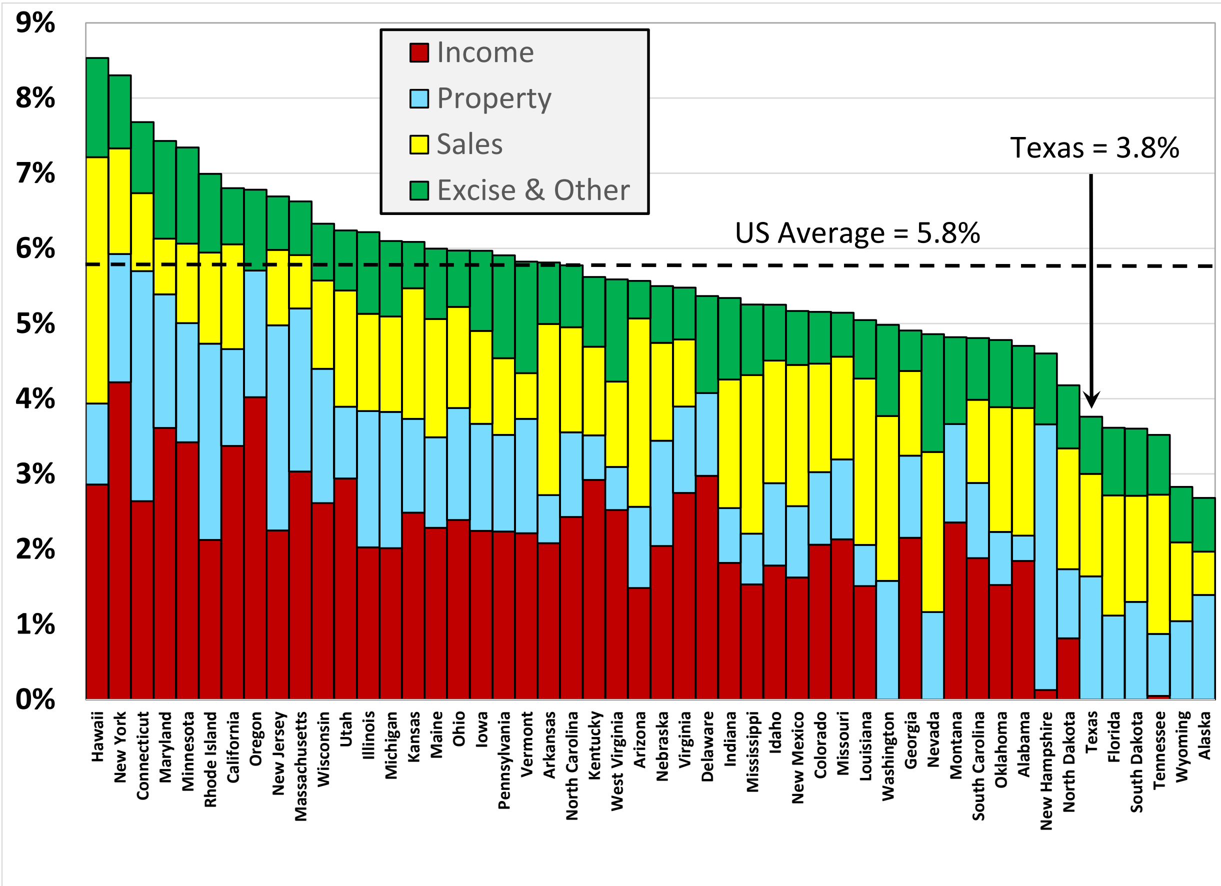
Source: Council on State Taxation, *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2019*.

State and local tax systems are often described as a "three-legged stool," reflecting roughly equal legs of 1) income (both business and personal), 2) sales, and 3) property taxes (although other taxes—such as severance and excise taxes can be substantial).

By comparison, given our lack of a state personal income tax, Texas's system lacks a source of revenue that is substantial to many other states.

There is a trade-off for not having a personal income tax, though: Texas has much higher-than-average sales and property taxes—taxes that fall heavily on business.

Individual Tax Burden Relative to Personal Income, 2019



Source: Council on State Taxation, *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2019*.

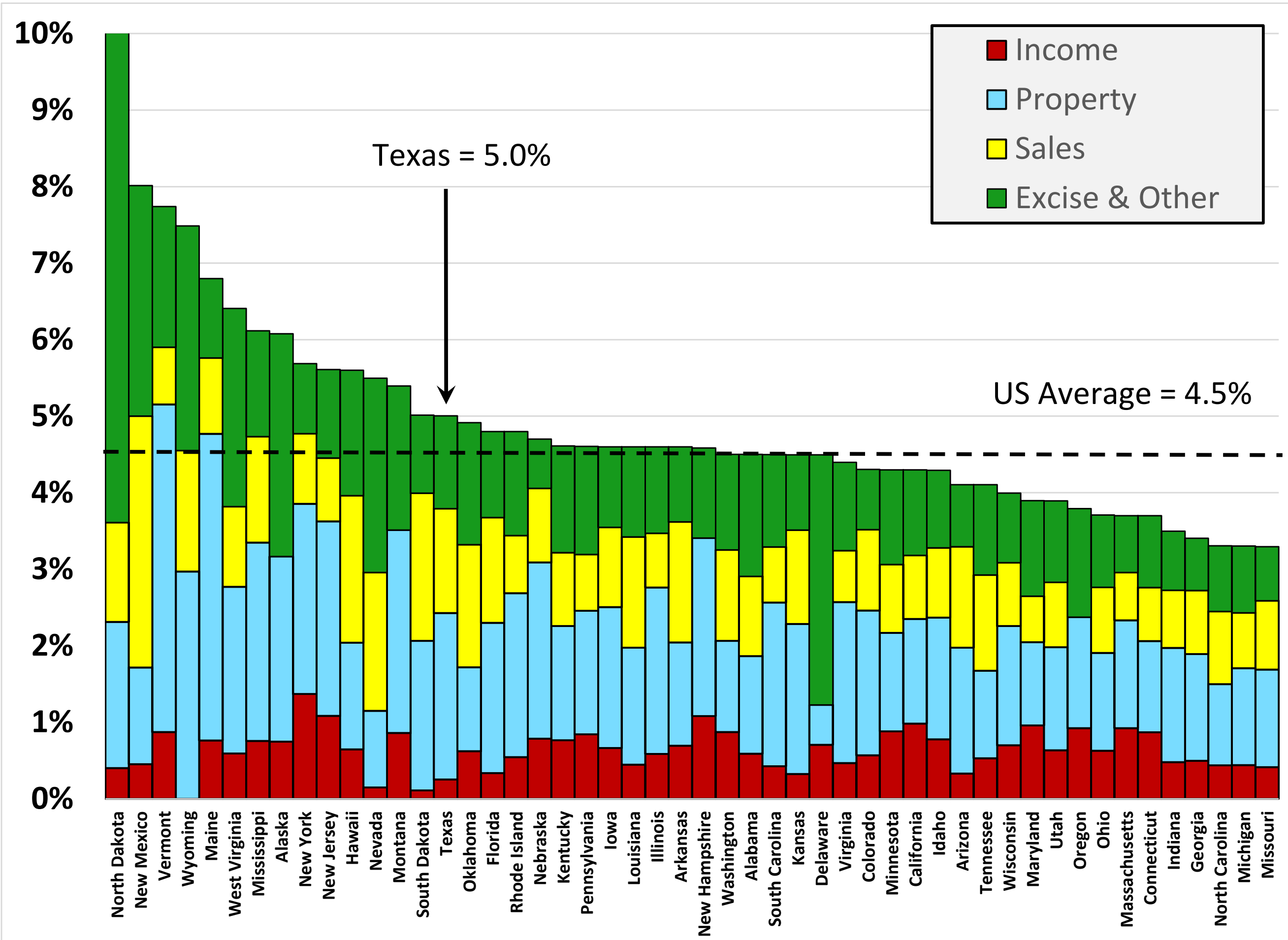
The above chart compares the average state and local tax burden of the portion of state and local taxes paid by individuals as a percent of personal income.

While Texas has relatively high property and sales taxes the absence of a personal income tax makes Texas a very low tax state for individuals. The absence of a personal income tax saves the average Texas family roughly $3,600 annually.

In terms of state and local taxes levied on individuals relative to personal income, Texas ranks 45th highest among the states (or 6th lowest). Texas state and local taxes equate to 3.8 percent of total personal income — well below the 50-state average of 5.8%. Our state and local tax burden on individuals is 35% below the national average.

All states lacking a personal income tax have effective tax burdens on individuals that are well below the 50-state average.

The Taxes Business Pays in Texas, 2019



Source: Council on State Taxation, *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2019*.

The above chart compares the average state and local tax burden on those state and local taxes paid by business as a percent of private sector gross domestic product.

Texas state and local taxes on business are equivalent to 5.0% of gross state product — 11% above the 50-state average. That makes Texas a relatively high tax state for business— tied for 14th place among the 50 states.

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

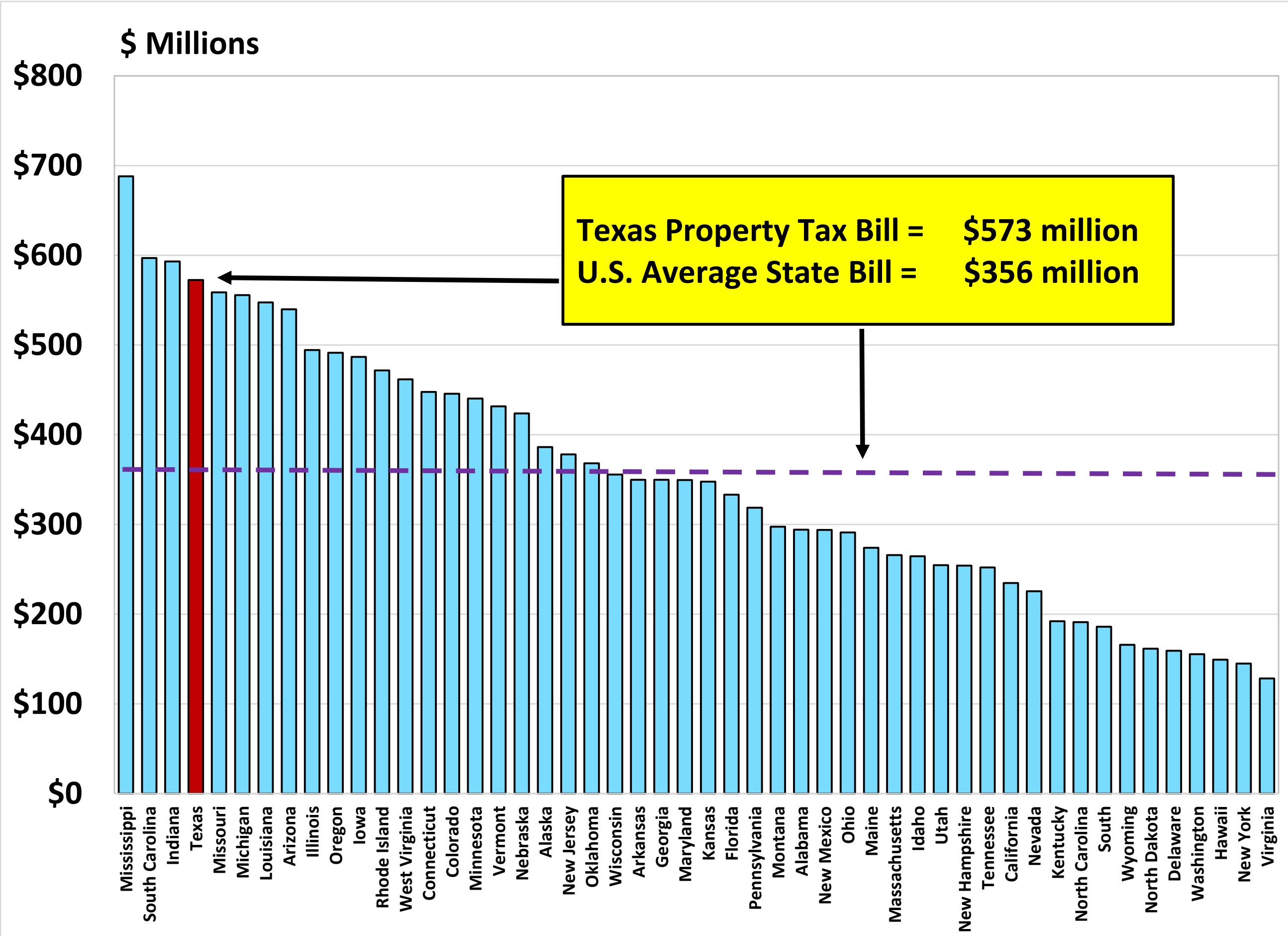
Texas' heavy reliance on property and sales taxes particularly impact both capital-intensive and goods-producing industries. Especially for capital-intensive industries, Texas is a very high tax state because of our high rates and broad-base property taxes.

Texas' Key Taxes Compared to Other States

Tax	Current Rate and Base	Comparison
Sales Tax Rate[1]	State Tax Rate: 6.25% Local Taxes: Generally capped at 2.0 %; average is 1.94% Average Combined Rate: 8.19%	State Rate: 13th highest Combined Rate: 14th highest
Sales Tax Base[2]	Generally applies to all sales of tangible personal property excluding food, medicine and residential or industrial utilities; and a number of 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)
Property Tax Rates[3]	Residential property: average effective tax rate in 2019 was 1.71 percent of market value Commercial property: average effective tax rate in 2019 was 2.29 percent of market value Industrial property: average effective tax rate in 2019 was 2.29% of market value	Residential property: Texas' effective tax rates rank us 14th highest nationally, 23 percent above the national average Commercial property: 18th highest nationally, 17 percent above the national average (this does not include business personal property or inventories) Industrial property: Texas' effective tax rates rank us 4th highest nationally, or 61 percent above the national average
Property Tax Base[4]	Texas taxes all real estate plus 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 10 states (4 states partially tax inventories).
Business Franchise Tax[5]	Texas' franchise tax is unlike the net business income tax levied by most other states; Texas' effective tax rate relative to economic output was 0.25% in 2019.	Relative to economic output, Texas' franchise tax ranks 47th highest among the states, about 60 percent *below* the national average; however, Texas' franchise tax is far more complex than business taxes in other states, resulting in a much higher compliance cost.

[1] Rate comparisons are from the Tax Foundation, *State and Local Sales Tax Rates 2021*.
[2] Federation of State Tax Administrators, *Sales Taxation of Services, 2017 Update*.
[3] Rate comparisons are drawn from Lincoln Institute of Land Policy and the Minnesota Center for Fiscal Excellence, *50-State Property Tax Comparison Study, for taxes paid in 2019*.
[4] From the Tax Foundation, *States Moving Away from Taxes on Tangible Personal Property* and *Does Your State Tax Business Inventory?*
[5] From the Council on State Taxation, *FY19 State and Local Business Tax Burden Study*.

Property Taxes on a $1 Billion-Valued Industrial Project (25 Year Life)



Based on *50 State Property Tax Comparison Study, For Taxes Paid in 2019* by the Minnesota Center for Fiscal Excellence and the Lincoln Institute of Land Policy.

The above chart illustrates the total property taxes a billion-dollar industrial facility would pay over a 25-year lifespan in Texas compared to other states.

The average state and local property taxes paid over the life of the facility nationwide is $356 million. In Texas, the facility, if it received no city/county property tax abatements or Chapter 313 school tax limitations, would pay $573 million in property taxes — 61 percent higher than the national average.

If the facility received a 10-year city/county property tax abatement and a ten-year 313 value limitation of $80 million, the project's lifetime property tax bill would be about $380 million— still higher than the average of other states — assuming those states did not offer any incentives of their own.

How Texas Evaluates Economic Incentives

Vacant Lots

Taxable Value	$5.3 ml
Gross School Tax Bill	$0.7 ml
School Tax Discount	n.a.
Net School Property Taxes Paid	$0.7 ml
Other Local Property Taxes	$0.3 ml
Sales, Franchise, Other Taxes	$0.0 ml
Total Taxes Paid	$1.0 ml
Direct Jobs	0
Total Jobs	0
Annual Personal Income	$0.0 ml

Austin (Del Valle) Tesla Plant

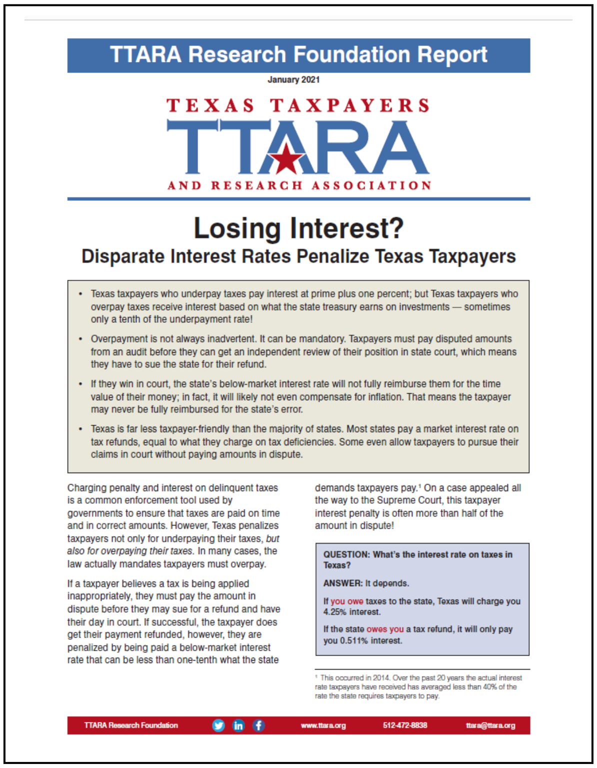
Taxable Value (Limit on/off)	$80/395 ml
Gross School M&O Tax Bill (25 yrs)	$117.2 ml
School Tax Discount	$50.4 ml
Net School M&O Taxes Paid	$66.8 ml
Other Local Property Taxes	$98.1 ml
Sales, Franchise, Other Taxes	$56.1 ml
Total Taxes Paid	$221 ml
Direct Project Jobs	5,025
Total Jobs (direct/indirect/induced)	14,634
Annual Personal Income	~$2.0 bl

Recently, Tesla announced it would build a new truck manufacturing plant in the Austin area. Del Valle ISD, where the plant is to be built, granted the company a temporary property tax discount, agreeing to exempt qualified value at the site in excess of $80 million for the next ten years.

The vacant land was generating a $1 million annual property tax bill. Del Valle ISD offered the project a temporary exemption, which will save the project $50.4 million in school M&O taxes over the next ten years – a figure widely reported in the press. However, even after the school tax discount and a tax abatement from Travis County, the facility will actually pay, at a minimum, $164.9 million in property taxes over the next 25 years, plus more than $50 million in other state taxes. It will also employ 5,025 workers and stimulate roughly another 10,000 jobs in the state, for a total near 15,000 new jobs.

The state's fiscal note on Chapter 313 is "static," rather than dynamic. It will only report the amount of the tax benefit received by the recipient ($50.4 million, highlighted above in green), and will not include any estimates of new economic activity stemming from the project – even though Tesla had to demonstrate to the Comptroller's satisfaction, that the project would not move forward without a 313 benefit.

TTARA Research Foundation Reports on Tax Administration



TTARA Research Foundation Report

January 2021

TEXAS TAXPAYERS TTARA AND RESEARCH ASSOCIATION

Losing Interest?

Disparate Interest Rates Penalize Texas Taxpayers

- Texas taxpayers who underpay taxes pay interest at prime plus one percent; but Texas taxpayers who overpay taxes receive interest based on what the state treasury earns on investments — sometimes only a tenth of the underpayment rate!
- Overpayment is not always inadvertent. It can be mandatory. Taxpayers must pay disputed amounts from an audit before they can get an independent review of their position in state court, which means they have to sue the state for their refund.
- If they win in court, the state's below-market interest rate will not fully reimburse them for the time value of their money; in fact, it will likely not even compensate for inflation. That means the taxpayer may never be fully reimbursed for the state's error.
- Texas is far less taxpayer-friendly than the majority of states. Most states pay a market interest rate on tax refunds, equal to what they charge on tax deficiencies. Some even allow taxpayers to pursue their claims in court without paying amounts in dispute.

Charging penalty and interest on delinquent taxes is a common enforcement tool used by governments to ensure that taxes are paid on time and in correct amounts. However, Texas penalizes taxpayers not only for underpaying their taxes, *but also for overpaying their taxes*. In many cases, the law actually mandates taxpayers must overpay.

If a taxpayer believes a tax is being applied inappropriately, they must pay the amount in dispute before they may sue for a refund and have their day in court. If successful, the taxpayer does get their payment refunded, however, they are penalized by being paid a below-market interest rate that can be less than one-tenth what the state demands taxpayers pay.[1] On a case appealed all the way to the Supreme Court, this taxpayer interest penalty is often more than half of the amount in dispute!

QUESTION: What's the interest rate on taxes in Texas?

ANSWER: It depends.

If you owe taxes to the state, Texas will charge you 4.25% interest.

If the state owes you a tax refund, it will only pay you 0.511% interest.

[1] This occurred in 2014. Over the past 20 years the actual interest rate taxpayers have received has averaged less than 40% of the rate the state requires taxpayers to pay.

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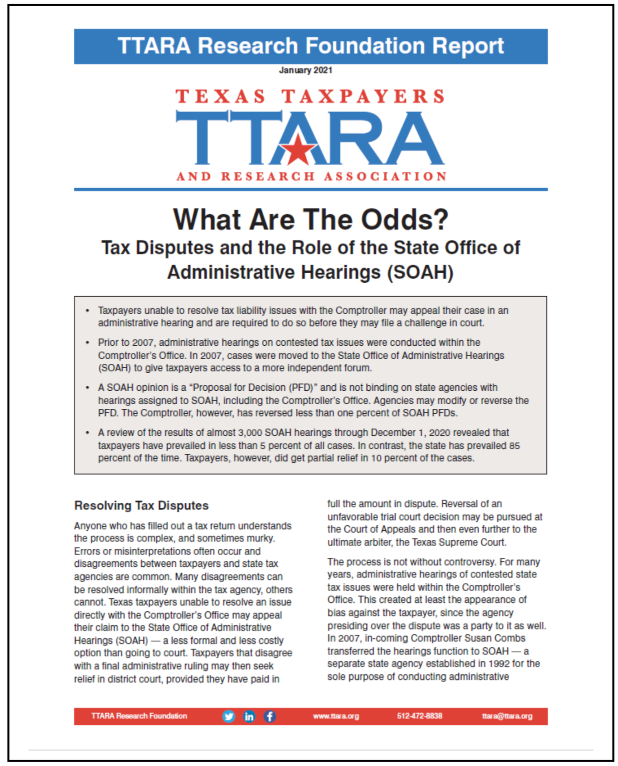

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What Are The Odds?

Tax Disputes and the Role of the State Office of Administrative Hearings (SOAH)

- Taxpayers unable to resolve tax liability issues with the Comptroller may appeal their case in an administrative hearing and are required to do so before they may file a challenge in court.
- Prior to 2007, administrative hearings on contested tax issues were conducted within the Comptroller's Office. In 2007, cases were moved to the State Office of Administrative Hearings (SOAH) to give taxpayers access to a more independent forum.
- A SOAH opinion is a "Proposal for Decision (PFD)" and is not binding on state agencies with hearings assigned to SOAH, including the Comptroller's Office. Agencies may modify or reverse the PFD. The Comptroller, however, has reversed less than one percent of SOAH PFDs.
- A review of the results of almost 3,000 SOAH hearings through December 1, 2020 revealed that taxpayers have prevailed in less than 5 percent of all cases. In contrast, the state has prevailed 85 percent of the time. Taxpayers, however, did get partial relief in 10 percent of the cases.

Resolving Tax Disputes

Anyone who has filled out a tax return understands the process is complex, and sometimes murky. Errors or misinterpretations often occur and disagreements between taxpayers and state tax agencies are common. Many disagreements can be resolved informally within the tax agency, others cannot. Texas taxpayers unable to resolve an issue directly with the Comptroller's Office may appeal their claim to the State Office of Administrative Hearings (SOAH) — a less formal and less costly option than going to court. Taxpayers that disagree with a final administrative ruling may then seek relief in district court, provided they have paid in full the amount in dispute. Reversal of an unfavorable trial court decision may be pursued at the Court of Appeals and then even further to the ultimate arbiter, the Texas Supreme Court.

The process is not without controversy. For many years, administrative hearings of contested state tax issues were held within the Comptroller's Office. This created at least the appearance of bias against the taxpayer, since the agency presiding over the dispute was a party to it as well. In 2007, in-coming Comptroller Susan Combs transferred the hearings function to SOAH — a separate state agency established in 1992 for the sole purpose of conducting administrative

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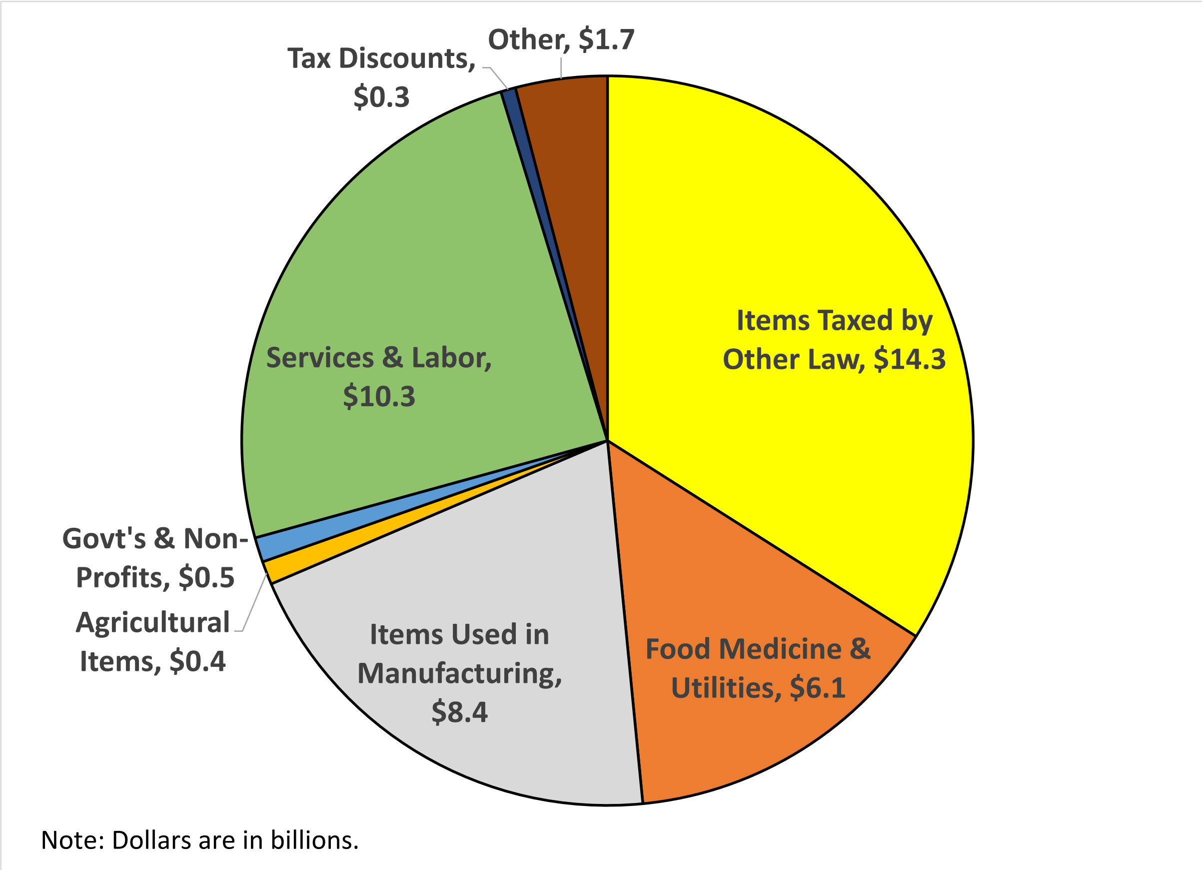
While comparative studies commonly focus on tax burdens from one state to the next, systems of state and local tax administration and the associated compliance costs can be a positive or negative aspect of state tax climates that businesses evaluate.

The TTARA Research Foundation recently published two reports dealing with aspects of Texas state tax administration in Texas that measure unfavorably relative to other states.

In *Losing Interest: Disparate Interest Rates Penalize Texas Taxpayers*, TTARA reported that Texas taxpayers are penalized when seeking refunds from the state by being paid a rate of interest well below the market rate, and well below the rate of interest the state charges on delinquent taxes (plus a ten percent penalty). Most states pay and charge taxpayers identical rates.

In *What Are the Odds? Tax Disputes and the Role of the State Office of Administrative Hearings (SOAH)*, TTARA evaluates the disposition of tax cases, finding that since hearings were moved from the Comptroller's Office to the State Office of Administrative Hearings, taxpayers have prevailed in only 5% of cases, with the state prevailing 85% of the time. Many taxpayers would benefit from bypassing the hearings process and pursuing their case directly in district court.

The Lure of Tax Exemptions, Exclusions, and Discounts ($ billions)



According to the Comptroller, exemptions, exclusions, and discounts reduced state sales tax collections by $42.0 billion in 2021. The Comptroller's report is often used as a guide to raise revenue—either to relieve other taxes or to fund new programs—however; many of the perceived revenue gains present certain challenges.

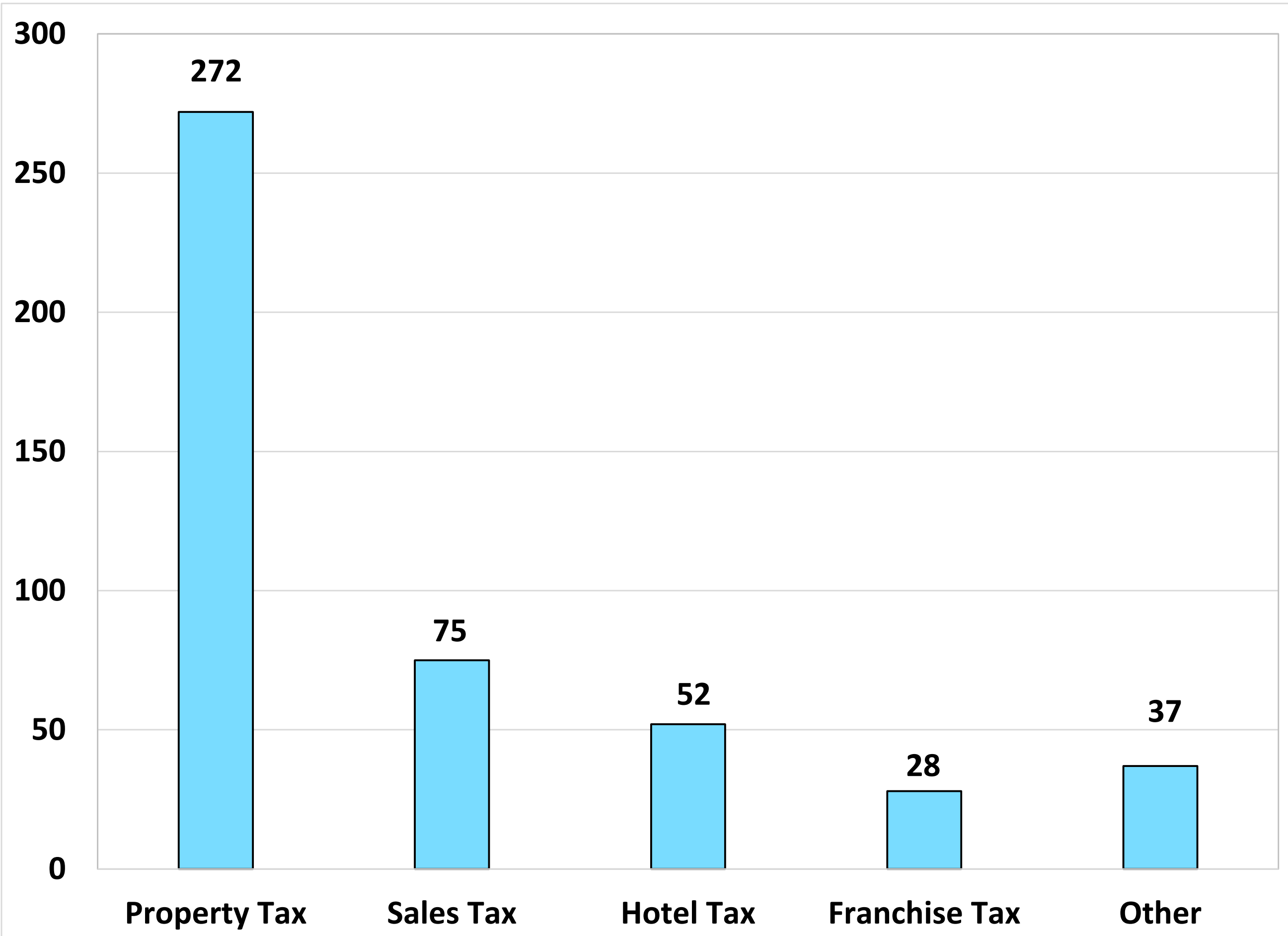
The largest category of sales tax exemptions are items taxed under another law ($14.3 billion). Extending the sales tax to these items (crude oil, motor vehicles, motor fuels, insurance premiums, etc.) would constitute double taxation unless the existing taxes were repealed, which would substantially reduce or negate any revenue gain.

The second largest category is items used in manufacturing ($8.4 billion) — mostly raw materials, which no other state taxes. Extending the sales tax to these items may increase the tax cost of manufacturing in Texas, even if the revenue were used to reduce property taxes.

Food, medicine, and consumer utilities—among the more popular exemptions—account for $6.1 billion, but may be politically difficult to repeal.

Services and labor—items excluded from the sales tax rather than specifically exempted—account for $10.3 billion. This revenue may not be achievable, as the taxation of services is fraught with administrative difficulties as many of these services are provided across state lines and are difficult to assign to Texas.

Bills Referred to Ways and Means Relative to Actual Taxes Paid, 2019



Numbers may not add to total of 438 because some bills dealt with multiple taxes.

In 2019, a total of 438 bills were filed and referred to the Ways and Means Committee (including Senate bills).

About 3/5, or 272, of those bills related to property tax (about the same proportion the property tax represents of all state and local taxes paid).

About 1/6, or 75, of those bills involved sales tax — proportionately less than the share the sales tax represents of state and local tax collections. This implies some degree of acceptance with the sales tax, or at least the perception that it is in less need of change.

Roughly 1/8, or 52, of bills referred to committee related to the hotel tax—a tax levied by both local governments and the state. Most of the bills dealt with provisions specific to local communities.

About six percent of bills referred to Ways and Means related to the franchise tax.

TTARA Policy Staff

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