



WHO PAYS TEXAS TAXES?

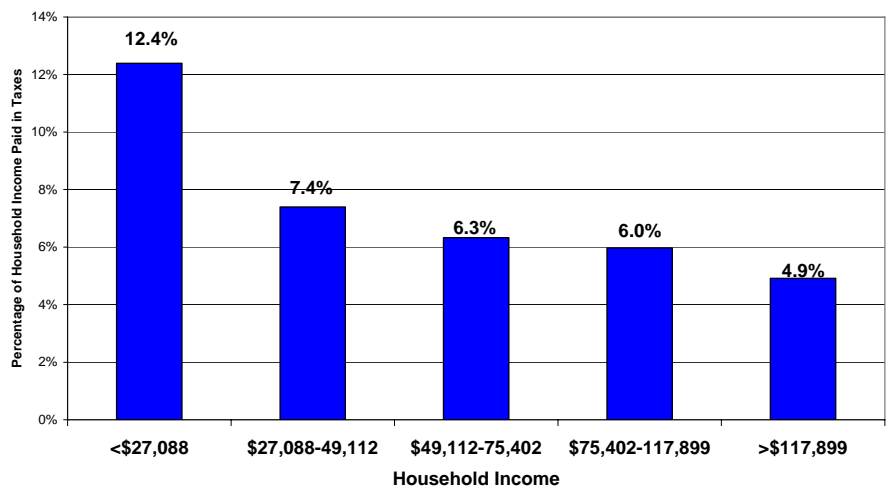
Our quality of life in Texas depends on our public structures—including public education, child health services, and transportation infrastructure—maintained by Texas tax dollars. A good tax system would not only provide adequate revenue to maintain these structures, but would also **match the share of taxes paid with the share of income earned by each Texas family**. However, the Comptroller’s newly released biennial study of the fairness of the Texas tax system, *Texas Exemptions and Tax Incidence*,¹ demonstrates conclusively that low- and moderate-income Texas families bear a disproportionate share of state and local taxes. We need a fairer system to fund public structures so can improve and maintain Texas families’ quality of life.

- **A good tax system would match the share of taxes paid with the share of income earned by each Texas family.**
- **Texas’ tax system is regressive, meaning low- and moderate-income Texans bear a disproportionate share of taxes.**
- **The school property tax is one of the fairest taxes paid by Texans. Reductions in school property taxes mandated in 2006 caused budget holes that must be filled with general revenue.**
- **Filling these budget holes with general revenue redistributes income from the vast majority of Texas families to the one-fifth of families with the highest income.**

Tax Fairness

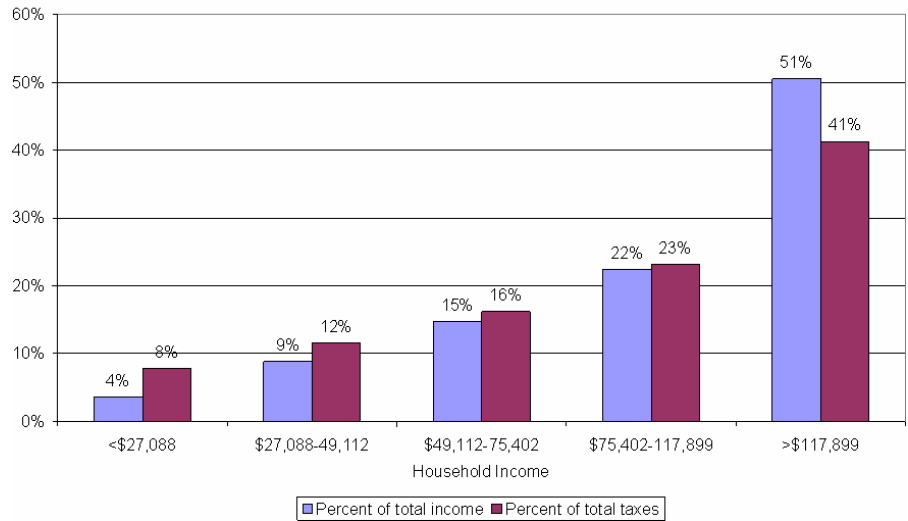
Fairness of a tax system can be judged by comparing the percentage of income different households pay in taxes. In a state with a fair tax system, households with higher incomes, who can afford to pay a larger percentage of their income in taxes, pay more. In Texas, the households with the lowest incomes pay the highest percentage of their income in taxes; the households with the highest incomes pay the lowest percentage of their income in taxes. In other words, those who can least afford it pay the most. A system that takes a higher percentage of the income of a lower-income family is called “regressive.” Texas has the fifth most regressive state and local tax system of the 50 states.²

Households With the Lowest Income Pay the Highest Percentage in State and Local Taxes



The Top One-Fifth of Texas Households Pay Less Than Their Fair Share of Taxes

The graph on page 1, derived from the information in the comptroller’s report, shows the average income of households in each income group, the average amount of major state and local taxes paid by households in the income group, and the average percentage of total household income paid in taxes. Each income group contains one-fifth (20 percent) of all Texas households—1.8 million households.



The graph on the right shows that Texas households earning less than \$117,899 per year pay a higher percentage of total taxes than their percentage of total income earned in Texas. This disparity enables the top one-fifth of Texas earners to pay a percentage of total Texas taxes much smaller than the percentage of total Texas income that they receive.

Families eventually pay the taxes paid by businesses, such as the franchise tax or the natural gas tax. The final cost of the tax can be shifted onto workers through lower wages and onto consumers through higher prices, as well as onto shareholders through lower profits. The comptroller calculates both the initial distribution of tax by industry and the final distribution of tax by household income.

All households pay property taxes. Homeowners pay their property taxes directly, while renters pay property taxes indirectly. Their landlords initially pay the taxes on the property, then pass the cost of the taxes on to their tenants through higher rents. The degree to which these taxes can be passed on varies with the local rental market.

Which tax is the fairest?

The Suits Index measures the fairness of a tax system by mathematically comparing the percentage of taxes paid and the percentage of total income received for each taxpayer. If each family paid the same percentage of income in tax, the Suits Index for that tax would be zero. Regressive taxes

score less than zero on the Suits Index. All major Texas taxes score lower than zero; each is regressive.

Tax	Suits Index (listed from least unfair to most unfair)
Natural gas tax	0.005
School property tax	-0.06
Franchise tax	-0.11
Motor vehicle sales tax	-0.14
Sales tax	-0.17
Gasoline tax	-0.25

The regressivity of different taxes varies significantly. **The school property tax is actually among the fairest taxes paid by Texans. The sales tax is one of the least fair.**

The sales tax burdens low-income families more than higher-income families, since it is based on how much each family spends. Low-income families typically spend three-quarters of their income on things subject to the sales tax, middle-class families spend less than half of their income on items subject to sales tax, and the richest families spend one-quarter or less of their income of sales-taxable items. Exemptions for groceries, residential utilities (gas, electric, and water), and prescription and over-the-counter

medicines reduce somewhat the unfairness of the sales tax. Taxing business and professional services primarily used by higher-income families, but not currently taxed, could also reduce the regressivity of the sales tax.

The school property tax taxes a more equitable percentage of income from families at every income level. This may be because families at most income levels spend similar percentages of family income on housing. In addition, business owners—who generally make more income—frequently bear the burden of business property taxes.

The \$15,000 homestead exemption and over-65 tax freeze reduce school property taxes, particularly for lower-income homeowners. Another method of introducing consideration of a homeowner's ability to pay property taxes is a circuitbreaker program, which reduces property taxes that exceed a certain percentage of a taxpayer's income. Without a circuitbreaker, the property taxes owed on a home can rise, even when a homeowner's income does not. Circuitbreakers can be targeted to individual taxpayers most burdened by property taxes, reducing their tax liability to a manageable level. Because of this careful focus, circuitbreaker programs cost much less than across-the-board rate reductions or increases in exemptions. (For more information on circuitbreakers, see <http://www.cppp.org/research.php?aid=835>.)

Who wins when local property tax cuts are funded with state General Revenue?

Changes in the franchise, cigarette, and used car sales taxes made in 2006 only partially fund the school property tax cuts passed in the same year. The comptroller's biennial revenue estimate forecasts that the 2006 tax changes will generate \$5.5 billion in 2010-11. The property tax

revenue lost by school districts due to required rates reductions is expected to total nearly \$15 billion in 2010-11 – leaving a “structural deficit” of \$9.5 billion, which must be filled by general revenue.

Using state general revenue to replace local school property taxes redistributes income from the vast majority of Texas families to the one-fifth of families with the highest income—those earning more than \$117,900.

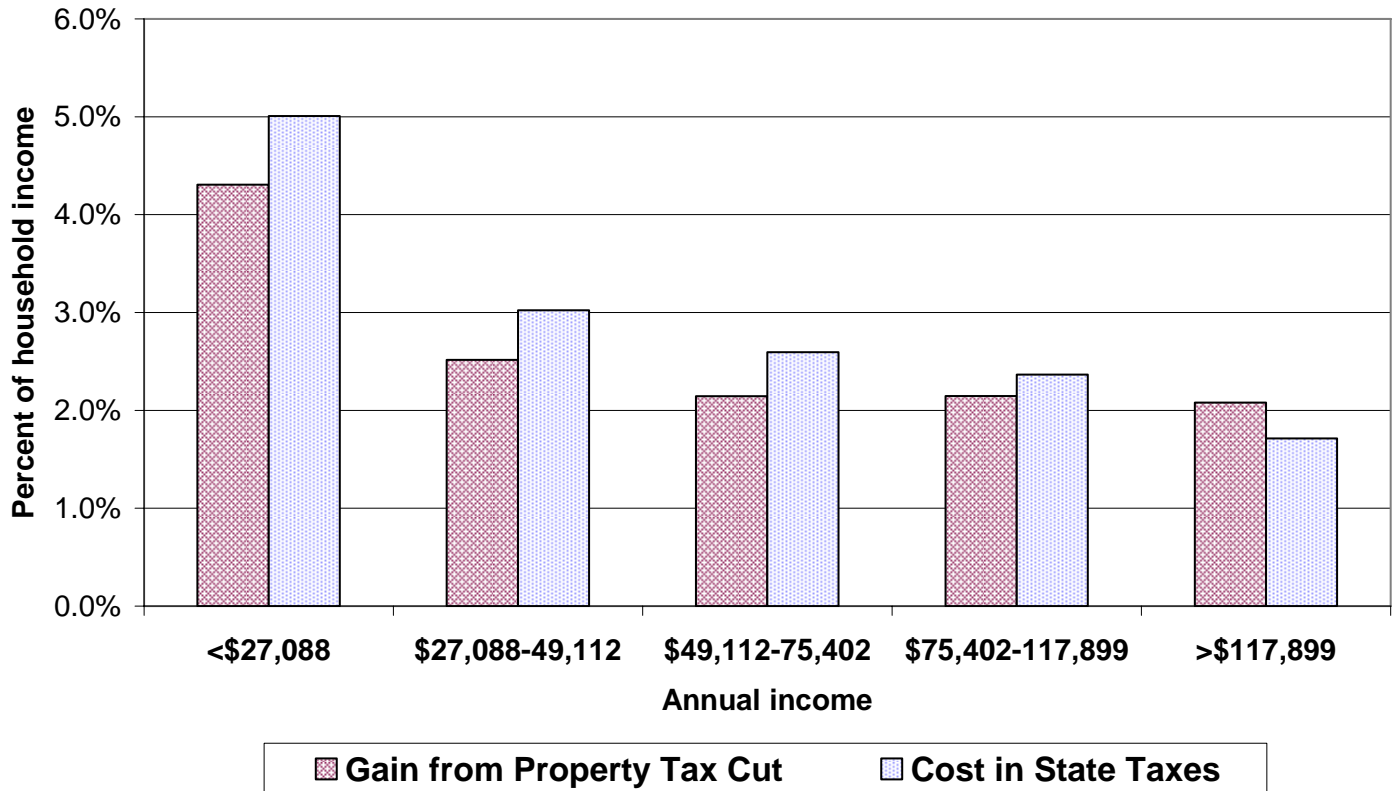
The chart on the next page shows the percentage of household income saved by a \$9.5 billion reduction in property taxes (the left-hand bar in each pair) and the percentage paid to raise the same amount of money statewide from the major states taxes—the sales tax, motor-vehicle sales tax, and natural gas tax (the right-hand bar). These three taxes account for nearly 80 percent of state tax revenue, so approximately demonstrate the resulting shift in tax incidence caused by using general revenue to pay for property tax cuts.

The average household in all four lower- and middle-income brackets pays more in state taxes than it gains in lower property taxes.

Conclusion

The comptroller's report shows conclusively that Texas' tax system is regressive and unfairly burdens Texas families that can least afford it. Texas should consider fairer tax systems that consider families' ability to pay. To learn more about fairer, more adequate tax systems, read CPPP's policy page, “The Best Choice for a Prosperous Texas: A Texas-Style Personal Income Tax,” available at: <http://www.cppp.org/research.php?aid=766&cid=7>.

Most Families Lose When Property Taxes Are Replaced with General Revenue



¹ Online at <http://www.window.state.tx.us/taxinfo/incidence09/>

² *Who Pays?* A Distributional Analysis of the Tax Systems in All 50 States, 2nd Edition (2003), Institute on Taxation & Economic Policy, <http://www.itepnet.org/whopays.htm>

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The Center for Public Policy Priorities is a nonpartisan, nonprofit policy institute committed to improving public policies to better the economic and social conditions of low- and moderate-income Texans.