

Who Pays Taxes in Texas?

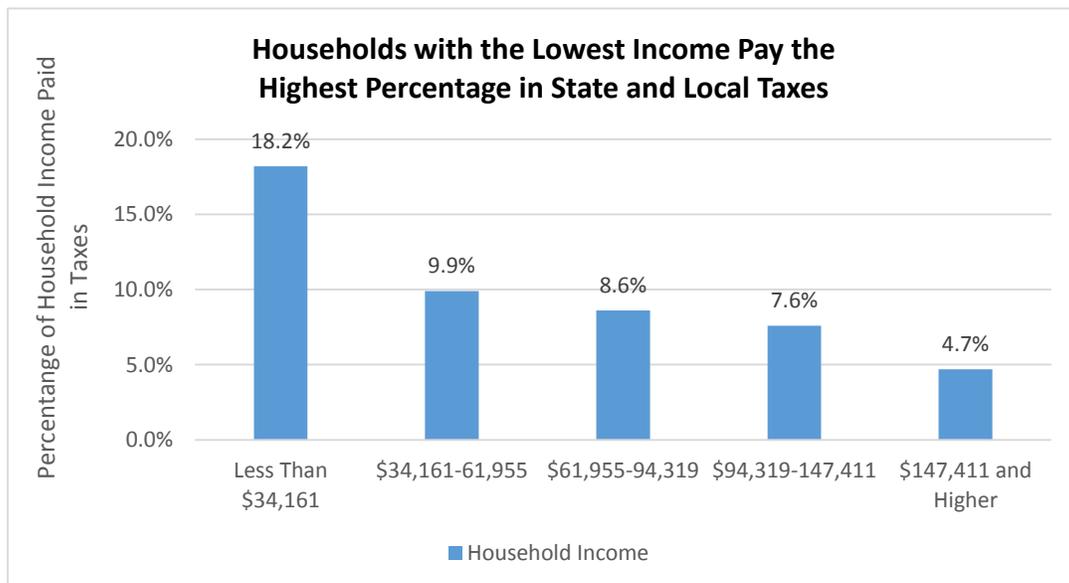
Brakeyshia Samms, samms@cPPP.org

For the state to invest in schools, public safety, roads, libraries, parks, and other public services, we need a fair and adequate tax system. The type of tax system we need would not only provide adequate revenue to maintain these public services, but would also apportion the responsibility for funding these services according to a household’s ability to pay. Unfortunately, our tax system does not meet our needs. One way to judge the unfairness of our tax system is to conduct a “tax incidence analysis,” which measures the impact of various taxes on residents at different income levels. Fortunately, the Comptroller’s office already conducts that type of analysis. Their 2015 Tax Exemption and Tax Incidence report demonstrates conclusively that low- and moderate-income Texas households bear a disproportionate share of state and local taxes.¹ This means that the Texas households that are least able to afford it pay the most in taxes as a percentage of their income, while the Texas households that can afford to pay more pay the least.

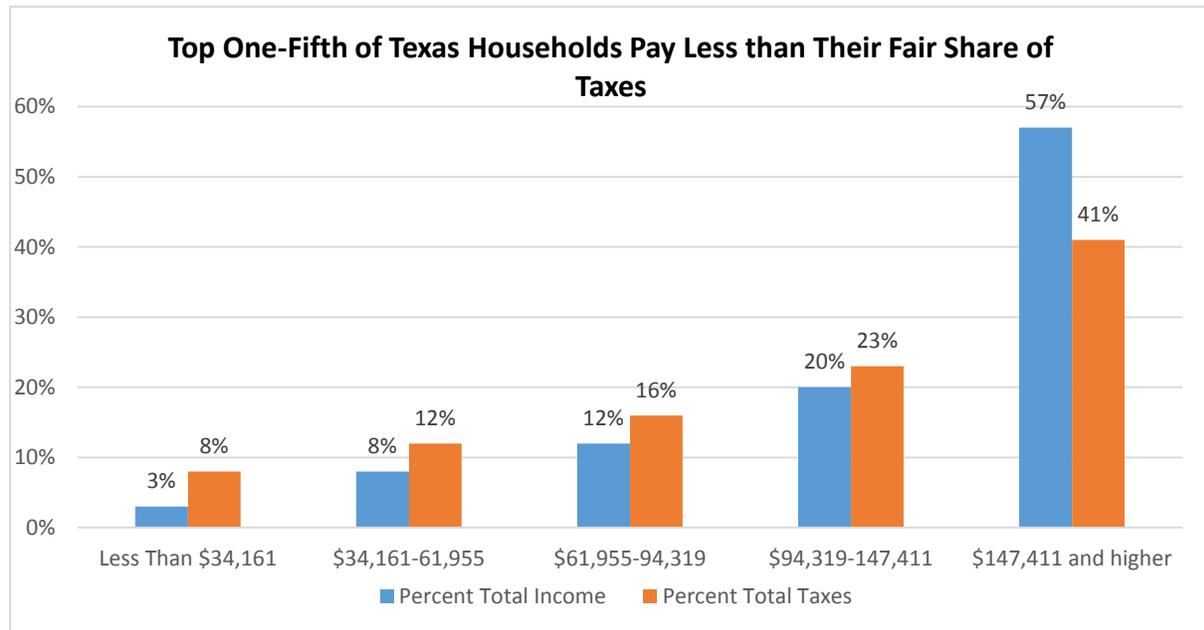
Tax Fairness

The way to judge the fairness of a tax system is to compare the percentage of income different households pay in taxes. The Comptroller’s study ranks Texas households according to income, then combines them into five groups (called “quintiles”), each of which contains the same number of households. In a state with a fair tax system, the taxes paid by each income group matches the income received by the households in that group. However, 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.

The graph below, derived from the information in the comptroller’s report, shows the range of incomes of households in each income group and the average percentage of total household income paid in state and local taxes. Each income group contains one-fifth (20 percent) of all Texas households or about 2 million households. The graph reveals that households with income less than \$34,161 pay almost four times more in taxes as a percentage of income than households with income over \$147,411.



The graph below shows that, for each of the four income groups (80 percent of Texas households) earning less than \$147,411 per year, the share of taxes paid by that group are higher than the share of income received by households in that group. This disparity enables the top one-fifth of Texas earners to pay a much smaller share of taxes than the share of income that they receive.



Tax Incidence

Although taxes may initially be paid by businesses, as well as by households, incidence studies reflect that businesses shift their tax cost 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 incidence of tax by household income.

For instance, all households pay property taxes. Homeowners pay their property taxes directly, while renters pay property taxes indirectly. Landlords initially pay the taxes on the property, and 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. A "regressive" tax system is one where a higher percentage of household income goes to taxes from a lower-income family than from a high-income family. All major Texas taxes score lower than zero; each is regressive. Texas has the [third](#) most regressive state and local tax system of the 50 states.

As shown in the table below, the regressivity of different taxes varies significantly. The oil production tax is actually the fairest tax paid by Texans, because it ranks closer to 0. Whereas, the cigarette tax is the least fair.

Tax	Suits Index (from least unfair to most unfair)
Oil Production Tax	-0.052
Natural Gas	-0.076
Franchise Tax	-0.08
School Property Tax	-0.084
Motor Vehicle Sales Tax	-0.202
Sales Tax	-0.254
Gasoline Tax	-0.261
Insurance Premiums	-0.316
Cigarette Tax	-0.442

The table also reveals that the sales tax, which accounts for over half of all state tax revenue, is one of the most unfair taxes. 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 goods 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 on sales-taxable items. Exemptions for groceries, residential utilities (gas, electric, and water), and prescription and over-the-counter medicines reduce the unfairness of the sales tax somewhat. 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 homestead exemption, which is currently \$15,000, and the 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 those 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 [Circuitbreakers: The Best Way to Control Property Taxes](#).)

Some Texas Taxes Are Paid By Non-Texans

Certain Texas taxes are passed on to non-Texans, primarily through higher prices. For instance, as shown below, more than two-thirds of the natural gas tax is exported, so that the final incidence is not borne by in-state households, since much of the gas produced in Texas is processed here but sold out-of-state. Similarly, nearly one-third of the franchise tax initially paid by Texas business is passed on to out-of-state consumers or shareholders.

Tax	Percent Paid By Non-Texans
Natural Gas	66.4%
Oil Production Tax	61.6%
Franchise Tax	33.2%
School Property Tax	21.3%
Sales Tax	20.9%
Motor Vehicle Sales Tax	13.9%
Gasoline Tax	10.2%
Insurance Premiums	7.6%
Cigarette Tax	1.9%

Increases in the rates of these taxes, or elimination of exemptions or deductions, could raise state revenue needed to maintain public services, but not proportionately increase taxes borne by Texas households.

Conclusion

This report highlights the fact that the Texas tax system remains unfair, since those who can pay more in taxes as a percentage of income do not pay more. Without a fair and adequate tax system, the state's ability to invest in schools, public safety, roads, and other public services will continually become more difficult.

ⁱ Per Section 403.0141 of the Texas Government Code, incidence analysis is conducted for taxes that generate more than 2.5% of state tax revenue in the previous fiscal year. More information here: <http://codes.lp.findlaw.com/txstatutes/GV/4/A/403/B/403.0141>

For more information or to request an interview, please contact Oliver Bernstein at bernstein@cphp.org or 512.823.2875.

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