The Franchise Tax:

AN IMPORTANT COMPONENT OF STATE REVENUE

Broad prosperity requires public investment in schools, colleges, affordable health care and other building blocks of job creation and economic growth. An important source for these investments is the state franchise tax, which the Texas Legislature dramatically reduced by 25 percent in 2015 and may consider eliminating entirely in future sessions.

The goal of a Texas where everyone is healthy, well-educated and financially secure will be harder to reach if the Legislature further reduces the franchise tax. Businesses benefit from state services and have a stake in the state's well-being.

CPPP RECOMMENDS

- Maintain the franchise tax rates at current levels so businesses pay their fair share toward a prosperous Texas.
- Require regular review of all state and local tax breaks to eliminate wasteful giveaways.
- Invest in schools, health care, and other services essential to making Texas the best state for hard-working families.

What is the franchise tax?

Only businesses pay the franchise tax. What they owe is based on their total revenue minus what they pay in compensation to employees or to purchase goods that are packaged or processed, then sold. The difference between revenue and these costs is called the "margin," which is why the tax is commonly known as the "margin tax."

The largest Texas tax paid solely by businesses, the franchise tax had been the second-largest source of state tax revenue, after only the state sales tax. But in 2015 the Texas Legislature reduced the franchise tax rate by one fourth, leading to a more than $1 billion drop in annual state revenues. Further cuts could be on the table in the 2017 session.

In 2006 legislators substantially revised the tax as part of their response to the Texas Supreme Court's decision directing the state to reform the school finance system. School districts were required to cut their local property taxes by one-third, and the state promised to make up the difference with increased state aid. The revised franchise tax was expected to supply a substantial portion of the necessary state revenue. The increase in

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revenue from the revisions was placed in a new "Property Tax Relief Fund," which helps supply the state's share of public school funding. Franchise tax receipts that would have been generated by the pre-2006-revision tax go to the state's General Revenue Fund, which is used to support public education, health and human services, and other state services.

Why should I care about the franchise tax?

The Property Tax Relief Fund received $1.8 billion in franchise tax revenue in 2015. Because of the 2015 tax cut and a weaker economy, the fund is expected to get only $888 million in 2017 — meaning businesses will contribute $900 million a year less to supporting our schools through this tax.

Further major cuts in the franchise tax would squeeze support for Texas schools, resulting in higher property taxes on Texas families and businesses or more crowded classrooms in districts with growing enrollment — or possibly both.

If the Legislature eliminated the franchise tax, the state would lose at least $7 billion per two-year budget. Here's what a $7 billion cut to General Revenue support for state services could mean: In health and human services, at least 20 percent could be slashed from health care, child protective services, and services for Texans with disabilities. And since most General Revenue spending on health and human services draws down a federal match, another $10 billion in federal support could be eliminated, too. Cuts like these could mean catastrophic cuts to nursing home care and services for children at risk, and longer waitlists for programs for Texans with disabilities.

For state-supported institutions of higher education, $7 billion is almost 50 percent of the General Revenue they currently receive. Additional tuition increases at public colleges to make up for the loss of state budget support would be very likely, which would further burden students struggling to pay for the significantly increasing cost of college.

The Department of Criminal Justice, which receives more than half of General Revenue spending on public safety and corrections, could implement massive cuts in its budget only by closing state prisons.

A $7 billion cut could also be achieved by completely eliminating General Revenue spending on all of the following, combined: general government functions; business and economic development; courts; parks and environmental protection; and consumer protection and other regulatory agencies.

The bottom line for Texans is that the state franchise tax generates resources that are very important to fulfilling the vision we all want of a healthy, prosperous, safe Texas. Cutting it further or eliminating it would seriously erode Texans' well-being.