

Who Pays Taxes in Texas?

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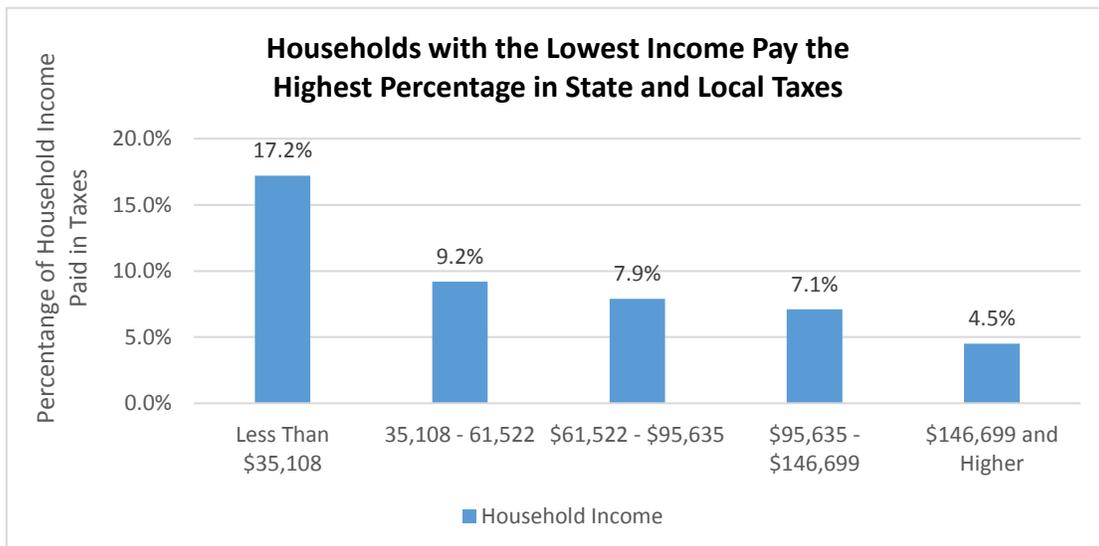
Our state’s tax system is upside down, asking the most from those with the least. In Texas, the wealthiest residents pay an average of only 4.5 percent of their income in state and local taxes, compared to 17.2 percent for residents with the lowest incomes.

For the state to invest in the building blocks of thriving communities -- 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 should provide adequate revenue to maintain these services and also apportion the responsibility for funding these services according to a household’s ability to pay. Unfortunately, our tax system fails in apportioning responsibility equitably. The unfairness of a tax system is measured by a “tax incidence analysis,” which measures the impact of various taxes on residents at different income levels. The Texas Comptroller is required to conduct that type of analysis every two years. The [2017 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

Tax Fairness

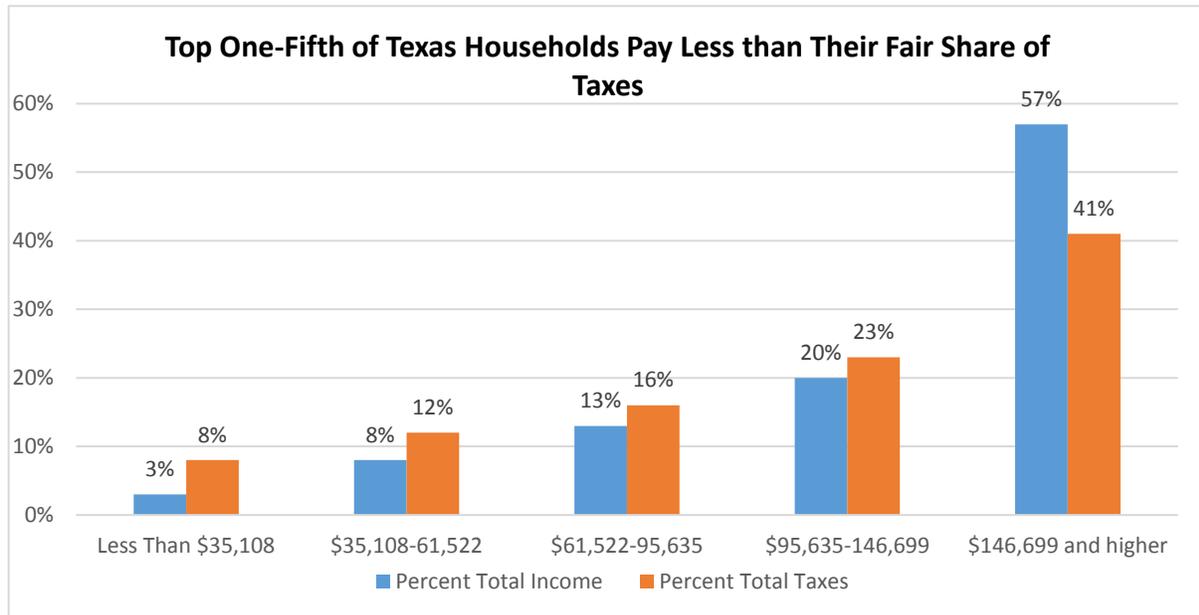
One way to judge the fairness of a tax system is to compare the percentage of their income that different households pay in taxes. The Comptroller’s study ranks Texas households according to income, from highest to lowest, then combines them into five groups (called “quintiles”), each of which contains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

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 \$35,108 pay almost four times more in taxes as a percentage of income than households with income over \$146,699.

Another way to measure the fairness of a tax system is to compare the income received by households in each income group to the taxes paid by these households. The graph below shows that, for each of the four income groups (80 percent of Texas households) earning less than \$146,699 per year, the share of taxes paid by that group is 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 they receive.



Tax Incidence

Although businesses and households may initially pay taxes, incidence studies reflect that businesses shift their tax cost onto workers through lower wages, onto consumers through higher prices, and 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 onto 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. When a tax code is upside down, asking more of those with the least, it's called "regressive." –The upside down taxes score less than zero on the Suits Index. All major Texas taxes score lower than zero; each puts more responsibility on those

with the least. The Texas state and local tax system is the [third](#) worst offender of the 50 states when it comes to putting more responsibility on those with the least

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. Meanwhile the gasoline and insurance premium taxes are the least fair.

Tax	Suits Index (from most fair to least fair)
Oil Production Tax	-0.029 (most fair)
Franchise Tax	-0.064
School Property Tax	-0.07
Motor Vehicle Sales Tax	-0.184
Sales Tax	-0.242
Gasoline Tax	-0.293
Insurance Premiums	-0.304 (least fair)

The table also demonstrates that the sales tax, which accounts for over half of all state tax revenue, is one of the most unfair taxes. The sales tax responsibility falls more on low-income families than on 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 takes 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 responsibility for business property taxes.

The homestead exemption, which is currently \$25,000, 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 responsible for 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 Non-Texans Pay Texas Taxes

Certain Texas taxes are passed on to non-Texans, primarily through higher prices. For instance, as shown below, close to two-thirds of the oil production tax is exported, so that the final incidence is not borne by in-state households. This is because 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
Oil Production Tax	62.4%
Franchise Tax	36.1%
Sales Tax	21.2%
School Property Tax	19.4%
Motor Vehicle Sales Tax	13.5%
Gasoline Tax	10.3%
Insurance Premiums	5.8%

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

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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