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★ JANUARY 2009

## STRENGTHS OF THE SALES TAX

### THE ISSUE

All taxes are not created equal. Some taxes discourage productivity, like the income tax; while others depress investment, such as the property tax; while still others, like the sales tax, target consumption. Each tax penalizes a different activity and, therefore, affects an economy in different ways.

In a perfect world, taxes wouldn't be necessary and no one would be penalized for earning more income, improving their homes and businesses, or making everyday purchases; however, this is not a perfect world and taxes are a necessary evil. Since taxes are unavoidable, smart fiscal policy dictates that the best tax system is one that offers simplicity, transparency, and does the least amount of damage to an economy. The tax that best meets all of these criteria is the sales tax.

Conventional sales taxes charge only the end-user meaning that only the person consuming the final product bears the ultimate cost of the tax. Since only person/entity consuming the final product bears the cost, the tax can be administered in a relatively simple manner. The seller need only add the cost of the tax to the final product and collect it on the government's behalf. Such simplicity avoids the need for many of the big bureaucratic organizations associated with other forms of taxes—i.e., appraisal districts, appraisal review boards, income tax departments (in all their various incarnations), etc.—and the need for taxpayers to support them. The sales tax's simplicity also means that taxpayers are free from otherwise time-consuming paperwork meaning they are free to pursue other, more productive activities.

Transparency is another important feature of the sales tax. After each purchase, every consumer is provided with a receipt clearly showing the amount of sales tax paid in addition to the price of the actual good. Since the sales tax is acknowledged after every purchase, manipulating the tax rate without public knowledge is virtually impossible. This is an important safeguard against back-door tax hikes and other stealth maneuvers to raise taxes.

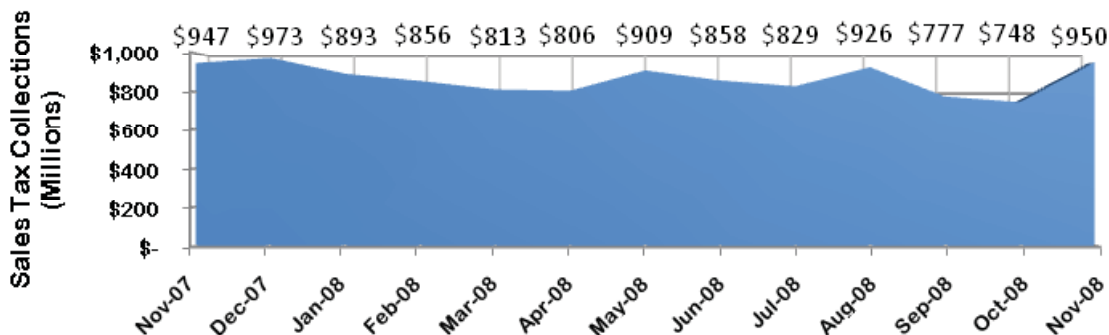
Sales taxes also cause the least amount of economic distortion of all the major taxes since they focus on consumption rather than income or investment. A tax structure based on sales taxes does away with preferential tax treatment of businesses and non-businesses that are taxed according to their legal status; the work disincentive of higher productivity; and the investments businesses make in equipment, infrastructure, and inventory. Albeit, the sales does distort the economy, but not nearly to the degree that other taxes do.

Critics will often argue that Texas' sales tax revenue has not kept pace with the growing needs of its citizens, but this is simply not the case as the graph illustrates (see back).

During arguably one of the most tumultuous years in recent memory, state sales tax collections from November 2007 to November 2008 have remained relatively steady and actually increased slightly over the last year, according to the Texas Comptroller.

## TEXAS PUBLIC POLICY FOUNDATION

### State Sales Tax Collections: November 2007 to November 2008



Source: Texas Comptroller of Public Accounts

While other taxes focus on investment and income to generate revenue, the sales tax focuses on consumption and that is where it draws its primary strength from. It encourages people and businesses to save and invest, promotes productivity, and doesn't penalize wage gains. But the sales tax also benefits from simplicity, transparency, and causes the least amount of economic damage as compared other tax structures.

### THE FACTS

- ★ Each type of tax penalizes a different activity: income taxes discourage productivity; property taxes affect investment; and sales taxes target consumption.
- ★ Since sales taxes only target consumption, other productive economic activities—i.e., labor income (wages and salaries), investment income (interest on savings, dividends, etc.) job creation, etc.—are not affected.
- ★ Sales taxes offer the most simplicity, the greatest level of transparency, and cause the least amount of economic disruption.
- ★ State sales tax collections have remained a stable source of revenue over the last year. From November 2007 to November 2008 the Texas Comptroller increased collections by 0.4 percent.
- ★ Texas has an above-average state sales tax rate at 6.25 percent and a local option of adding up to 2 percent.
- ★ Texas' active business climate has been bolstered by the state's reliance on the sales tax.

### RECOMMENDATIONS

- ★ Texas government should continue to rely on the sales tax as the main revenue generator. In the future, if the Legislature should decide to generate more revenue with the sales tax, they should consider broadening the base rather than increasing the rate.
- ★ Any increase in the sales tax base or the sales tax rate should be accompanied by reductions in other taxes.

### RESOURCES

- *The Case for Converting from Property Taxes to Sales Taxes* by Talmadge Heflin, Texas Public Policy Foundation (Mar. 2008) <http://www.texaspolicy.com/pdf/2008-03-PB04-propertytaxes-th.pdf>.
- *Tax Policy and Economic Growth in the States* by Barry W. Poulson and Jules G. Kaplan, Texas Public Policy Foundation (Oct. 2007) <http://www.texaspolicy.com/pdf/2007-10-PP26-poulson.pdf>.
- *All Taxes are Not Created Equal* by Byron Schlomach, Texas Public Policy Foundation (Mar. 2006) <http://www.texaspolicy.com/pdf/2006-02-PP-consumptiontax-BS.pdf>.

