Texas Public Policy Foundation

Taxes

Legislator's Guide to the Issues 2017-18

Margin Tax

The Issue

Simply put, businesses don't pay taxes; consumers do in the form of higher prices, lower wages, and fewer jobs available. Given that taxes exist to fund essential government services, the least burdensome taxes should fund conservative budgets that grow by no more than population growth plus inflation.

No matter how you evaluate the margin tax, it fails the least burdensome tax test, fails to meet revenue expectations, and fails to allow Texans the opportunity to reach their full potential. Texans would be best served by eliminating this onerous tax.

The margin tax is inherently complex with multiple calculations to determine the lowest tax liability, two tax rates depending on business type, and the $1 million gross revenue exemption. Complying with it is also markedly different than complying with the federal corporate income tax, so many firms must keep separate financial books. Because of these substantial costs, firms can spend more on compliance than their actual tax liability.

This broad-based, gross receipts-style margin tax is far more complex and unique among all taxes nationwide—with only Nevada having a similar gross receipts-style tax. Since the margin tax's inception in January 2008, the Texas Comptroller's office has had difficulty accurately estimating its revenue, as noted by the cumulative $2.8 billion less in actual collections than estimated through FY 2015.

Fortunately, the 84th Texas Legislature made valiant steps to reducing the margin tax's burden. This was accomplished by cutting the tax rates by 25% and raising the ceiling to file with the E-Z computation to $20 million at a lower tax rate. These beneficial changes for a total value of $2.6 billion took effect on January 1, 2016. These cuts not only had the benefit of reducing the size of government, but employers also have more money to invest to boost the economy.

Studies modeling the dynamic economic effects of phasing out or repealing the margin tax find substantial economic benefits, including thousands of net new private sector jobs and billions in net new personal income statewide.

The Foundation's recent research includes a dynamic economic model that accounts for the private sector drain to pay for annual margin taxes and firms' cost of complying with the tax. The estimated results of full elimination before the margin tax changes made last session include:

- More prosperity: Texas could gain $16 billion in new real (inflation-adjusted) total personal income within five years compared with the baseline.
- More jobs: Net new private sector nonfarm employment could increase by 129,200 net new jobs five years after eliminating the margin tax compared with the status quo.

While eliminating the margin tax will enhance Texans' prosperity, the stakes are much higher than just one state. This transformational policy would make Texas a leader in America—and even the world—in tax policy. For example, this would allow Texas to join just three other states (i.e., Nevada, South Dakota, and Wyoming) without a corporate or individual income tax.

Slower economic growth statewide may leave a tight budget in the 2017 Legislature. However, this should not negate taking additional steps to achieve the ultimate goal of eliminating the margin tax. While cutting the tax results in a short-run drop in tax revenue, the associated dynamic increase in economic activity will likely generate additional tax revenue through other taxes that could replace some of the drop.

Depending on the fiscal and political environment, eliminating the margin tax in the next budget cycle may not be an option.

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Therefore, a valuable alternative is to pass legislation that would phase it out over the next two budget cycles. While phasing it out with certainty is a good option, it does reduce the potential economic gains, particularly by leaving in compliance costs. In addition, if the phase out path is chosen, it is preferable to lower the tax rates for everyone instead of raising the revenue exemption threshold that forces the burden on fewer firms.

The Facts

- Texas' margin tax is complex, costly, and difficult to comply with, giving rise to a less competitive business tax climate, for which the Tax Foundation ranks Texas 10th.
- The margin tax fails to be anything similar to a least burdensome tax, fails to meet revenue expectations, and fails to allow Texans the opportunity to reach their full potential.
- Texas does not have a revenue problem. From the 2004-05 to the 2016-17 budgets, the state's estimated total tax collections increase is 75%, much faster than the 51% growth rate of population plus inflation.

Recommendations

- Eliminate the business margin tax. An option is to phase it out over two biennia by cutting the rates. The combination of potential budget surpluses, increased tax revenue from economic growth, and modest spending restraint could fund this without imposing a new tax.
- Pass legislation requiring a supermajority (two-thirds) vote of each chamber to raise taxes or create a new tax.

Resources

Failure of Texas' Business Margin Tax by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (Dec. 2015).

Economic Effects of Eliminating Texas' Business Margin Tax by Vance Ginn and Talmadge Heflin, Texas Public Policy Foundation (March 2015).

The Texas Margin Tax: A Failed Experiment by Scott Drenkard, Tax Foundation (Jan. 2015).