



The Business Of Taxing Business

By Byron Schlomach, Ph.D., Chief Economist

Texas Business Taxes: Looking Good Despite Fourth Highest Burden?

Texas likes to bill itself “the friendly state.” Texans are, by and large, friendly people. But, this friendliness extends beyond just saying “howdy” and being helpful with directions when someone is lost. Texans are also pretty friendly when it comes to charging themselves and others to live in the state.

Overall, Texas’ tax burden is one of the lowest in the country. In fact, the U.S. Census Bureau ranks Texas as having the lowest per capita state tax burden in the country.¹ As a percentage of total state personal income, Texas’ state tax burden still ranks low at 48th of the 50 states.² This sounds like Texas is the place to live in order to enjoy low taxes.

Of course, such a conclusion would be a result of not quite taking everything into account. State governments throughout the nation do not all take on the same responsibilities. Texas is notable among the states, for example, in its relatively heavy dependence on local funding for the support of public schools. So leaving out local government tax revenue in determining tax burden in Texas would be a mistake.

When local taxes are thrown into the mix, Texas’ low-tax ranking drops from first or third to eighth among the 50 states (43rd highest state and local tax burden), according to the Tax Foundation.³ This is still a respectable position with respect to tax burden. A low tax burden is an invitation to enterprising individuals ready to work hard and prosper.¹

The low tax burden, in no small part, factors into subjective evaluations of Texas’ business environment. One poll of 458 corporate leaders asked them to evaluate states according to how good it is to do business in them. Factors on which the states were to be evaluated included the executives’ assessment of states’ quality of life issues, work force attitudes, growth rates, regulatory environment, and tax burden. Texas was ranked the *best* state in which to do business. Nevada was a distant second.⁴

Interestingly, in that poll of 458 corporate leaders, thirteen rated Texas as the *worst* state in which to do business. However, this is an extraordinarily subjective evaluation of the state. A somewhat more objective evaluation is conducted by the Tax Foundation. Each state is scored on a composite of five indexes that are each constructed using measurable criteria, all evaluated on the same basis across the states. The Tax Foundation ranks Texas as having the *fourth best* business tax climate among the states.⁵

A Deeper Look: Texas’ Business Taxes

While Texans arguably deserve a pat on the back for having a low tax burden, three percent of corporate leaders polled did rate Texas as having the *worst* business climate. While the Tax Foundation rates the state among the top ten percent of states, a Texas Public Policy Foundation study conducted by economists Stephen Moore, Arthur Laffer, and Donna Arduin ranked Texas 19th among the states in economic outlook. Texas’ ranking was brought down by,

¹It should be noted that when the federal tax burden is included, Texas has only the 29th lowest (22nd highest) overall tax burden according to the Tax Foundation.

among other things, an overdependence on property taxes—a local tax—in the state.⁶ This suggests that the Tax Foundation’s rating for Texas would be lower if it took property taxes into account—something it does not currently do.

A truly wet blanket is a report published by COST (Council On State Taxation). The authors asked—what are for Texas—some uncomfortable questions about business taxation in the states. For example, of all state and local taxes, what percentage is directly paid by business? It turns out Texas businesses pay just over 60 percent of all state and local taxes, the fourth *highest* business tax burden in the nation by this measure. The U.S. average is 43 percent. Even California depends less on business taxation for its state and local revenues at 41.4 percent.⁷

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Well, one might reason, maybe a lot of Texas’ tax revenue comes from business but Texas is still a low tax state, so that does not necessarily mean Texas businesses face that high of a burden. The authors of the COST report thought of that. So they asked, what percentage of the state’s output (gross state product or GSP) is taken up by business taxes? The effective business tax rate on a GSP basis, it turns out, is 5.8 percent in Texas—the seventh *highest* rate among the states. Once again, Texas comes in higher even than California’s 4.5 percent; the U.S. average is 4.7 percent.⁸

The COST report’s authors asked one more question. What share of state and local tax revenue *growth* from 2000 to 2004 comes from business? Only Alaska’s state and local revenues failed to grow during the four-year period. Texas’ total state and local tax revenues increased some 26.6 percent. It turns out that 63 percent of the new revenues resulted from direct business taxation. Only 11 other states saw business cover a bigger share of their revenue increases. On this statistic (finally!), California was

higher at 73 percent. The U.S. average was 52 percent.⁹

Then, as if to add insult to injury, COST has also evaluated the states on the basis of their tax administration. Such issues as whether the state and taxpayer are on an equal footing with regard to late refund/payment interest and deadlines, whether the taxpayer must remit tax before having a right to appeal, how long a taxpayer has to protest a ruling, and the independence of the settler of tax disputes are considered. When tax administration systems and statutes were compared across the states, Texas earned a grand total of 4 out of a possible 16 points. That is the *lowest* score of the fifty states *and* the District of Columbia. (California earned 8 points, double Texas’ score but still only half the possible points.)¹⁰

Texas Business: Paying More Than Its Fair Share

According to the Comptroller’s office, business directly pays 43.9 percent of the sales tax, 100 percent of the franchise tax (naturally, since it is specifically a business tax), 100 percent of the natural gas tax, 18.6 percent of the gasoline tax, 34.4 percent of the motor vehicle sales tax, and more than half—53.3 percent—of the school property tax.¹¹ These are only the six major taxes included in the Comptroller’s tax incidence study. Many taxes are not included making the incidence study an imperfect barometer of tax effects. For example, over 40 percent of all property taxes are non-school (i.e., county, city, and special district) taxes that are not included in the incidence study.

There are lots of taxes and fees at the state level that directly impact businesses’ bottom lines. Some are entirely derived from direct business payments. Others are only partially derived from direct business payments. Of the 60 taxes, fees, and assessments in the Comptroller’s *Sources of Revenue Growth* report, at least 39 are derived in whole or in part directly from Texas businesses. These include, to name a few, air pollution control fees, occupation taxes and fees, the beer tax, the cement production tax, the coastal protection fee, the diesel fuel tax, the gas utility pipeline tax, the hotel occupancy tax, insurance taxes, various oil extraction taxes, and the sulphur production tax.¹²

So it would seem that Texas’ state and local governments are extracting their pound of flesh from Texas

business. The Comptroller produces a tax incidence study that looks at each of the state's six major taxes (including the local *school* property tax, *not* city and county taxes) borne by each of the state's major industries. Calculations from that study show that business directly pays 50.1 percent—*over half*—of the six major taxes while personal consumption bears 49.9 percent. For anyone to claim that business does not pay “its fair share” begs the question of just what that fair share is.

While it can be argued that we tax various industries in Texas more heavily than others, the real question is why we directly tax business at all. For example, when we tax industries like oil and gas that mainly produce inputs for other production processes, it inevitably leads to oil and gas being taxed again at another stage of production. That leads to *pyramiding*, which is really a fancy way of saying that something is being double and even triple taxed. To some extent, that can—and does—happen in all industries.

Business taxation is also a convenient way to hide the true tax burden from taxpayers. We do not know, for example, that a significant amount of what we pay for manufactured goods in Texas is due to property taxation of the manufacturing industry. Nor do we know, very often, the extent to which the price we pay for phone service is affected by the various taxes the telecommunications industry pays long before it sends the bills that often reflect a host of additional taxes assessed directly on the consumer—taxes that are based on a percentage of a bill made higher by the hidden taxes.

The Business Tax: Is There Such Thing?

Fundamentally, there is no such thing as a business tax. As Joseph Crosby of COST puts it, “From an economic perspective, of course, all taxes eventually fall on individuals—as consumers in higher prices, as employees in lower wages (or less employment), or as capital owners in lower returns.”¹³

The same point is made in the Comptroller's *Tax Exemptions & Tax Incidence, 2005* report: “It should be recognized that any tax levied directly on a business will ultimately be paid by real, live people—if not consumers via higher prices, then business owners via reduced profits or employees via reduced wages.”¹⁴ The fact that only people pay taxes exposes the hol-

lowness of the slogan that “business needs to pay its fair share.” It is meaningless. Even if Archer Daniels Midland Company (ADM), a huge player in the agriculture industry, were assessed an entirely new tax in order to bear its “fair share” the ultimate effect of the tax would be to cause any combination of higher product prices, fewer jobs, lower income, and lower profit proceeds to investors. In fact, due to the worldwide competitive nature of the agriculture market and its inability to pass costs to consumers, ADM would most likely remove at least part of its operations from Texas, costing jobs more than anything else.

Policymakers should give pause regarding the possibility of constructing a tax system that “equitably,” “fairly,” or “efficiently” taxes business. It is very difficult to fully determine how any given industry or company is or should be affected by any given tax system. Policymakers should simply remember that businesses are just people in production mode. Taxes on businesses are taxes on human enterprise, human work, and human innovation. That means that when it comes to so-called business taxes, policymakers should simply not go there.

As was noted above, state and local business taxes in Texas constitute about 5.8 percent of Texas' GSP, a good bit more than the national average. Nationally, state and local business taxes constitute more than 30 percent of business profits.¹⁵ This means that in Texas, state and local business taxes likely constitute significantly more than 30 percent of business profits. Texas taxes business, and taxes it too highly.

And there is nothing economically justified—or certainly even friendly—about that. 

Byron Schlomach, Ph.D., is the chief economist at the Texas Public Policy Foundation.

The Center for Fiscal Policy studies was established to provide Texas policymakers with reliable information and champion restrained spending and taxation. Policymakers will be encouraged to use strict criteria to determine whether taxpayer funds are being expended efficiently, effectively, and for purposes that promote economic growth and prosperity.

Contact Byron Schlomach at:
bschlomach@texaspolicy.com

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