



# Testimony

## HB 59

### Replacing School District M&O Property Taxes in Texas

#### Testimony Submitted for HB 59 to Texas House Ways & Means Committee

by Vance Ginn, PhD, Chief Economist

Chairman Meyer and Members of the Committee:

My name is Dr. Vance Ginn. I am chief economist at the Texas Public Policy Foundation and am testifying in support of [HB 59](#). I provide insights on the costs of local property taxes in Texas, options for how to eliminate school districts’ maintenance and operations (M&O) property taxes, and benefits of this fundamental tax reform that include limiting government spending—the true burden of government.

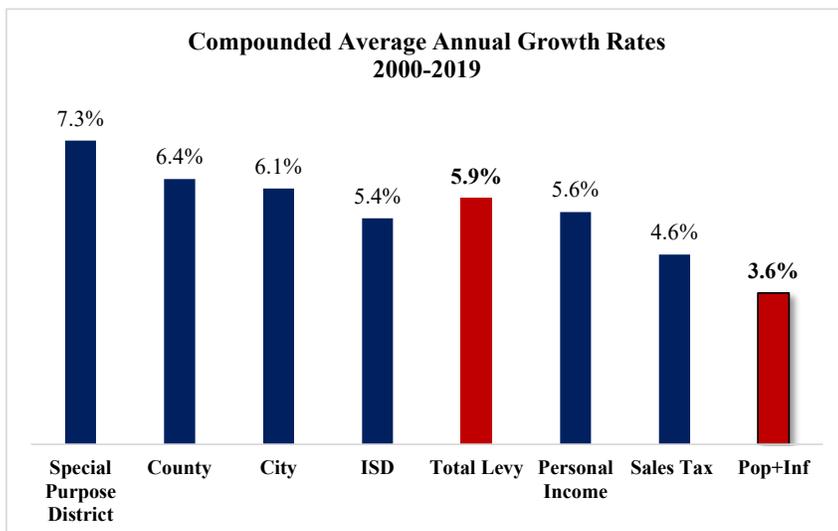
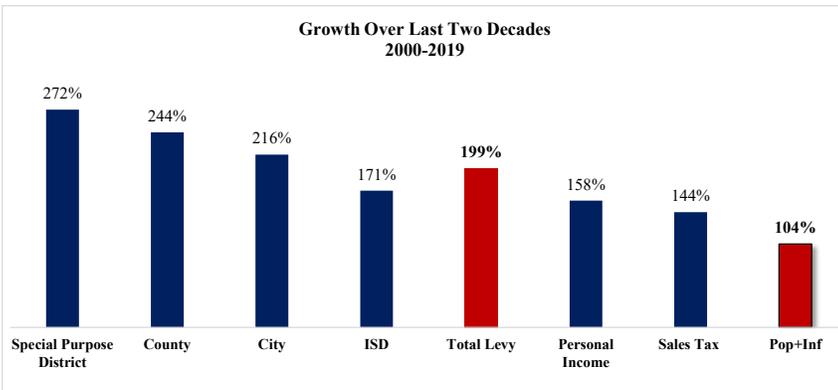
While there are several valuable bills and ideas available this session to achieve this goal, HB 59 helps start the discussion by eliminating the school district M&O property taxes on January 1, 2024, and by creating a legislative commission in

the interim to study how to replace them on that date. This bill would cut local property taxes nearly in half while adhering to the state’s constitutional responsibility of funding government schools. The key to achieving this is restraining government spending at the state and local government levels along with reforming sales taxes to a broader-based form of the current final sales and use tax without moving Texas to other new, excessively burdensome types of consumption tax such as a [value-added tax](#) (VAT) or a [carbon tax](#).

Despite the [economic success](#) of the [Texas Model](#) of fiscally conservative governance, the skyrocketing local property tax burden remains one of the state’s most pressing policy challenges. **Figure 1** shows that property taxes over the last 20 years have been growing faster than the average taxpayer’s ability to pay for them, as commonly measured by the change in population growth plus inflation, even with reforms and buydowns over time.

According to the Tax Foundation, Texas has the [7th most burdensome property tax](#) on homeowners and the [15th worst property tax burden](#) on businesses in the nation. Too many property holders have been forced out of their homes and businesses because of skyrocketing property taxes. There is an argument to eliminate all property taxes, which

**Figure 1**  
*Increases in Taxes and Economic Measures Over the Last 20 Years*



Note. Data are from Texas Comptroller and author’s calculations.

hurt lower-income earners the most, so Texans can stop effectively renting from the government forever. A good start in that process would be to eliminate school district M&O property taxes which account for nearly half of the total property tax burden on Texans. Eliminating just the school district M&O property taxes is rather straightforward because the state determines the funding formulas for the school finance system, and it [represents nearly half](#) of the [property tax levy](#) across the state. State sales taxes have grown far less than property taxes, less than personal income, and more closely with population growth plus inflation. This indicates that moving to a system based on the sales tax better aligns with the average taxpayer's ability to pay for these taxes that fund government spending over time.

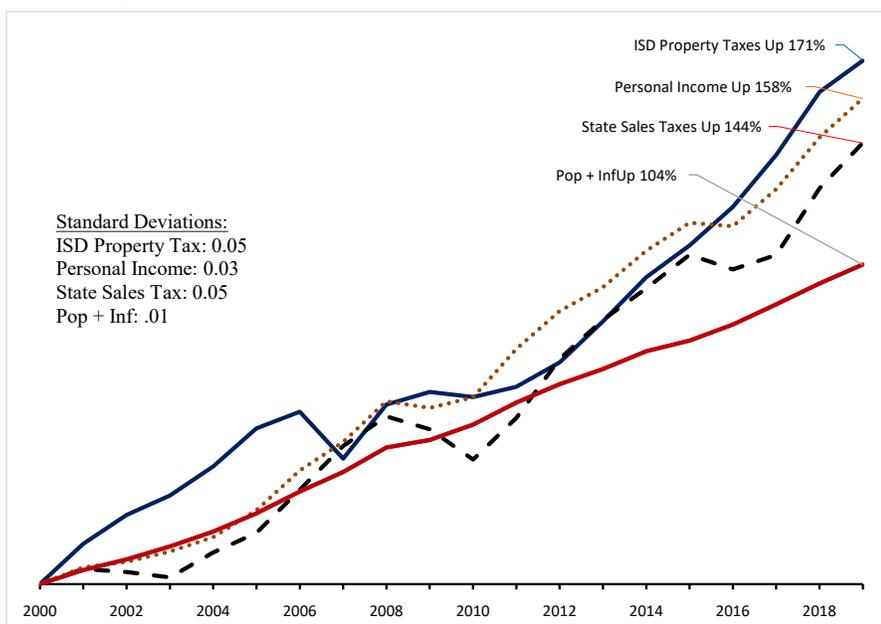
**Figure 2** illustrates that ISD property taxes have outpaced state sales taxes while also having similar measures of volatility (0.05). This demonstrates that a sales tax could replace school district M&O property taxes with little to no change in how consumers are affected by its volatility.

There are multiple options for eliminating school district M&O property taxes:

1. Replace them with a more efficient, slower-growing final sales and use tax based on objective market transactions, excluding real estate ([as long as there is a property tax](#)). This would help remove taxes on capital (i.e., property), which would help grow the economy because capital formation and accumulation drive growth. Combining this option with government spending restraint that is tied to a buydown would create surplus dollars of sales taxes and other taxes over time that would provide a substantially improved fiscal situation in Texas immediately and even better over time.
2. Limit government spending growth so that state surplus dollars could buy down the M&O property taxes over time.

No matter the option chosen, the option must include spending restraint and elimination of taxes.

**Figure 2**  
Comparing Economic Variable Growth and Taxation Over the Last 20 Years



Note. Data are from Texas Comptroller and author's calculations.

## Problems With Texas's Property Taxes

Research highlights how property taxes are more burdensome than sales taxes in Texas.

### Property Taxes Are Less Efficient Than Sales Taxes

Property taxes in Texas are [based primarily on subjective valuations](#) by appraisal review boards and tax rates determined by local tax entities with little to no feedback from citizens, creating a [highly inefficient collection mechanism](#). They can force people out of their homes and businesses if not paid, meaning Texans never truly own their property, even if they pay off their mortgage, because taxes will be owed annually forever.

### ***Property Taxes Are More Regressive Than Sales Taxes***

A Texas Comptroller's recent report notes that both Texas's sales taxes and property taxes are regressive but [suggests property taxes are less regressive](#). However, this static analysis does not account for the fact that sales taxes are paid once at purchase, yet property taxes are paid annually, [hurting low- and fixed-income Texans the most](#) because the costs compound over time. A high property tax also prevents many low-income earners from purchasing their first home and forces many others who do purchase to struggle to keep their home—they may even lose it. Neither of these outcomes are considered in analyses. Appropriately accounting for these dynamic cumulative costs, the property tax would be more regressive than a sales tax, which tends to grow at a similar rate as personal income growth and population growth plus inflation over time. Lastly, during recessions, lower-income earners tend to face the highest levels of unemployment and are least able to shoulder a tax burden. Their property tax burden, however, would increase relative to their income, while their sales tax burden would fall more proportionately with their income.

### ***Property Taxes Are Less Connected With Economic Activity Than Sales Taxes***

The idea of a [three-legged stool](#) of taxation implies that taxation rests upon a sales tax, a property tax, and a personal income tax. Because Texas appropriately does not have the latter, helping to [improve our economic competitiveness and individual freedom](#), the argument is that there is a need for the other two. But the focus should be on government spending, which determines the level of taxation, and taxation should be the least obtrusive to growth. When considering the states without a personal income tax compared to states with the highest income taxes, [states without a personal income tax perform much better](#) in terms of growth in population, employment, and personal income over most 10-year periods. Texas should move toward a single-legged barstool with a broad-based final sales tax.

A final sales tax is money that comes directly from the choices of consumers. It ensures that all financial power remains within their control, whereas property taxes are a burden that is forced upon all taxpayers with little means of working around it. If we observe **Figure 2**, it should be noted that during periods of recession (the early 2000s and the Great Recession), the state sales taxes stagnate and drop below population growth plus inflation, whereas ISD property taxes do not. This is to say that sales taxes are more indicative of the economic activity within private markets, as a final sales tax can only grow as much as people are participating. In addition, the sales tax growth rate is always near or below personal income and only increases once personal income has attained a steady growth itself. The same cannot be said for ISD property taxes where it not only always remains above population and inflation growth but also grows at a faster rate than personal income despite periods of economic strain.

### ***People Prefer Sales Taxes Over Property Taxes***

[Analysis of domestic migration](#) over the last decade shows that people are leaving states with high property and income taxes in exchange for states with sales taxes, even relatively high sales taxes. This is true on both a percentage basis and in terms of total tax burden. In other words, a person would prefer to pay \$1 in sales tax than \$1 in property tax, and he or she also prefers the economic prosperity in a state with a less burdensome consumption tax instead of a property tax. These facts help explain why people have been leaving states like Illinois, California, and New York in droves to states like Florida, Tennessee, and Texas, all three of which have no personal income tax and relatively low overall tax burdens. Texas could accelerate this

trend through reducing and eliminating property tax burdens, thereby supporting more economic prosperity with more productive people and capital.

## Options for Eliminating School Districts' M&O Property Taxes

### 1. Replacing School District M&O Property Taxes with Sales Taxes Immediately

For this option, a version of which could be provided in the enabling legislation to [HJR 154](#), broadening the sales tax base would be best because it would provide both a more efficient tax that limits the number of exemptions, which effectively pick winners and losers, and the lowest tax rate possible. This would help [keep the rate competitive with nearby states](#) with the total state and average local tax rates being 9.52% in Louisiana (second highest in nation), 9.51% in Arkansas (third highest), 8.95% in Oklahoma (sixth highest), and 7.83% in New Mexico (15th highest).

**Table 1** shows that Texans paid a total of \$72 billion to [school district M&O property taxes](#), [local sales tax](#), and [state sales tax](#) in 2019 (latest year with data available for our calculations and before the COVID-19 pandemic to reflect a typical year).

**Table 2** shows data using a static analysis for a range of sales tax bases and sales tax rates for FY 2019. Let us start with total private industries that can be taxed, given the government sector is not taxed, and then subtract multiple industries to determine different gross state product bases and tax rates needed to cover state and local sales taxes and school district M&O property, taxes while attempting to avoid a more burdensome value-added tax.

The GSP base that collected the \$43.5 billion in state and local sales taxes in 2019 is about \$527.1 billion (\$43.5 billion divided by the highest rate of 8.25%). The tax base of the \$34 billion in state sales taxes is about \$544.6 billion (\$34 billion divided by 6.25%). The Texas Comptroller's [2018 report](#) notes that Texas would provide an estimated \$43 billion in exemptions, exclusions, and discounts to the sales tax base in 2019, which is effectively picking winners and losers within the Tax Code. This tax bias in the code contributes to a higher sales tax rate and should be eliminated as much as possible to practice sound tax policy of the broadest base and lowest rate possible to fund limited roles for government. Broadening the sales tax base would also influence local government jurisdictions' sales tax collections. This should be addressed by lowering their rates to make it revenue-neutral along with strict local spending limits.

### Replacing Property Taxes With Slightly Reformed Sales Taxes

**Table 2** notes in the second row that the total sales tax rate in Texas

would be only 0.25 percentage point higher than the current maximum rate of 8.25%, which would help the state's Tax Code remain competitive while cutting the total local property tax levy by nearly half. The reformed sales tax base should not include items that are already taxed or items whose taxation would create a system that resembles a destructive

**Table 1**  
*Tax Collections by Source, FY 2019*

<u>Tax Revenue Sources (Millions of \$)</u>	<u>2019</u>
School District M&O Property Taxes	\$28,457
Local Sales Taxes	\$9,449
State Sales Taxes	\$34,040
<b>School M&amp;O Property Taxes Plus Local and State Sales Taxes</b>	<b>\$71,949</b>

Note. Data are from Texas Comptroller.

**Table 2**  
*Sales Tax Rates Needed to Replace School District M&O Property Taxes, 2019*

<u>Replacement Tax Base Options</u>	<u>Gross State Product Base (Millions of \$)</u>	<u>State Tax Rate</u>	<u>Local Tax Rate Max</u>	<u>Total Tax Rate</u>
Tax Base Needed With No Change in Tax Rate	\$872,110	6.25%	2.00%	8.25%
Reformed Gross State Product Base	\$845,192	7.40%	1.10%	8.50%
Tax Rate Needed With No Change in Tax Base	\$527,140	11.86%	1.79%	13.65%

Note. Sources are [U.S. Bureau of Economic Analysis](#) and author's calculations. Reformed GSP base is total private industries excluding real estate, healthcare, manufacturing, mining, management, and construction industries.

value-added tax. The reformed base should remove sales tax exemptions on items like most services, over-the-counter drugs, containers, and more, but continue to exclude things taxed by other taxes, unprocessed food, physician services, new residential and non-residential construction, and more. While the base expansion means some sectors not currently under the sales tax would be taxed, like many professional services such as lawyers and accountants, under the reformed sales tax, the total tax burden of Texans would decrease and would be distributed more equitably. For those paying rent, reduced property taxes will result in lower rent payments through competition in the marketplace, as well as slower growth in rental prices over time. By combining this with government spending restraint, such as limiting spending to [less than population growth plus inflation](#) and using 90% of the state surplus dollars to buy down the sales tax rate each biennium thereafter, the state could quickly lower the sales tax rate to where it was before the tax replacement occurred and possibly even lower thereafter.

### **Replacing Property Taxes With Sales Taxes Would Boost Growth**

Economists of the Baker Institute at Rice University studied the [economic effects of replacing property taxes with sales taxes over time](#). They found that a 3.6% decrease in school district M&O property taxes could contribute to a \$14.3 billion (0.8%) increase in economic output and 217,000 new jobs after just the first year of reforms and more thereafter. These results occur because of the economic gains of such a transition to a more efficient economic system based more on sales taxes. Extrapolating to a complete elimination of these property taxes would support substantially more gains in prosperity through a more efficient and competitive economic framework based more on a sales tax system. While they did not model it, this option should be combined with strict spending limitations at the state and local levels to avoid rising tax bills, and the state surplus should be used to provide tax relief, [supporting even more economic gains](#). The full replacement is a conservative reform because sales taxes tend to grow at a slower rate than property taxes and are based on objective metrics from mutually beneficial exchanges rather than the guesswork of appraisal districts. They are also more visible to the taxpayer, especially renters, because their costs are not “hidden” in other payments, such as rent. The other appeal of the complete replacement of school M&O property taxes by sales taxes is that it eliminates the possibility that the tax relief experienced by a replacement would only be temporary. This has been one of the [failures of property tax relief efforts of the past](#).

### **Alternative Considerations to an Increased Sales Tax: Value-Added Tax**

The Value-Added Tax (VAT), otherwise known as the goods and services tax, is a tax at every stage of the supply chain where a product gains value. The main argument in favor of this tax is that it incentivizes businesses to control costs, encourages savings, and simplifies administration. It is also lauded as less regressive since the burden does not exclusively fall on the consumer. For example, Andrew Yang, a 2020 presidential candidate, promoted the idea of a [10% national VAT](#) with the notion that “if you want to do business in America, you have to pay into America.” Similarly in Texas, [HB 3770](#) was filed this session in favor of a state VAT of 6.72% that would replace the ad valorem tax. In addition, under the bill, local governments may impose VATs that, combined, may not exceed 2% and school districts cannot levy a VAT above half a percent. The bill would create VAT exemptions for small businesses, government entities, and religious, educational, and public service organizations. Despite HB 3770 adding nuances that make it better than Yang’s VAT, there are still aspects missing when considering the detriments of a VAT.

While the supply chain is taxed and no final tax given to the consumer with a VAT, the consumer still must bear the burden of the added cost of production. This is because in order for a product to remain profitable through these stages of taxation, the cost of the product must be passed along according to the size of the VAT so that firms may continue to operate. Alternatively, firms would have to cut costs to remain competitive within the market, with a high likelihood that they would start by cutting worker wages or firing employees depending on the relative costs of labor and capital. This makes workers and employers worse off and slows economic growth. Moreover, a [VAT distorts each stage or production](#), thereby creating a more inefficient and costly production process that reduces economic activity and slows economic growth too. No VAT is imposed by any level of government in the U.S. because of the destructive nature of this tax system. Countries in Europe impose VATs, but that has contributed to less economic growth and much larger government spending over time, unlike a prosperous Texas Model of relatively less spending, taxing, and regulating.

In short, there is a cost to any tax system, which is why it is so important to limit the roles of government so spending and therefore taxing can be less than otherwise. The VAT, carbon taxes, income taxes, and property taxes all have their own problems and are much more inefficient and costly and distort economic activity more than a final sales and use tax. Given these costs of any tax system, the least burdensome, fair, and efficient form of taxation is a final sales tax that would help to limit government's growth over time and would be based on market exchanges in the private sector that better reflect the average taxpayer's ability to pay over time while giving Texans the freedom to choose whether to save and pay no state tax or spend and pay taxes.

## **2. *Replacing School District M&O Property Taxes With General Revenue Over Time***

Another option is to [limit the increase of general revenue spending](#) per biennium and use 90% of the state surplus dollars generated to buy down school districts' M&O property taxes over time until they are eliminated. If revenue growth kept up with past trends and spending was limited to 4% per biennium, this process would take about a decade to eliminate districts' M&O property taxes. This option is available this session in [HB 958](#) and [HB 2074](#). Economists at the Baker Institute studied the [economic effects of this option as well](#). They found that a 3.4% decrease in school M&O property taxes could contribute to a \$12.5 billion (0.7%) increase in economic output and an increase in employment of 183,000 jobs in just the first year after the initial buydown, and more thereafter. A challenge with this option is that it allows the actions of local governments, including school districts, to diminish the property tax relief that would otherwise be experienced by property owners. Managing this is an important component of the replacement plan to eliminate the school district M&O property taxes. Under these options, the [maximum tax revenue growth](#) by local tax jurisdictions should be 2.5%, and school districts should no longer be able to increase their M&O property tax rates in the buydown option. Instead, the state would essentially set the school districts' rates, lowering them each year, until the tax is eliminated. And it is essential to limit the growth of property taxes by other local taxing entities.

In order to eliminate school district M&O property taxes, estimated to raise [\\$53.2 billion](#) during the state's 2018-19 fiscal biennium, Texas would need to restrain spending growth to generate a surplus of state revenue to be used to replace

these property taxes with state taxes over time. To reduce the time this elimination process would take, biennial increases in general-revenue-related (GRR) appropriations growth would be limited to 4%. Within this limit, the Legislature could appropriate additional funds for any purposes for which it can legally do so, including for increases in education funding to cover enrollment growth and other purposes. **Table 3** shows that the appropriations limit of 4% growth would create a surplus of state funds as it is substantially below the historical average of state GRR growth.

Thus, the spending restraint would create a surplus of state funds averaging 5.59% per biennium. Ninety percent of this surplus would be used to cut school district M&O property taxes. **Table 4** shows projected surpluses under an average revenue growth scenario for upcoming biennia that could be used to replace local property tax revenue.

**Table 4** shows that with average growth in GRR funds the \$53.2 billion in school district M&O property taxes could be eliminated in about a decade. Once the replacement is complete, there would be more than \$11 billion on the table annually to deal with contingencies or eliminate or reduce other taxes, such as the margins or sales taxes.

At the local level, each year school districts would set their M&O tax rate to reduce property tax revenue by the amount they received from the state's replacement funding. On average, property taxpayers in districts across the state would see the same percent reduction in their taxes, though that might vary from one district to another. At the end, though, every taxpayer's M&O property tax burden would be identical: zero. To the extent the reduction raises constitutional questions of equal tax revenue for equal effort, the amount of replacement funding for each district can be adjusted each biennium. Districts could only exceed the replacement rate with the approval of a majority of voters in an election with at least a 20% turnout. However, additional funds raised through a voter-approved tax increase would be fully recaptured by the state. So, increases in education funding each year would come from the state. The system would work much as it does today, with districts having the flexibility to set rates with much of the revenue being recaptured by the state.

An important component of the replacement plan is limiting the growth of property taxes by other local taxing entities. Counties, cities, and special purpose districts would be able to set their property tax rate to generate no more than a 2.5% annual increase over the previous year's revenue in property tax revenue. However, just as

**Table 3**  
*Biennial GRR Growth Rates from 2004-05 to 2018-19*

Biennium	GRR Growth Rate
2006-07	19.9%
2008-09	13.9%
2010-11	-11.1%
2012-13	19.0%
2014-15	22.3%
2016-17	-1.2%
2018-19	11.60%
<b>Average</b>	<b>9.59%</b>

*Note.* Data are from Texas Comptroller and author's calculations.

**Table 4**  
*10-Year School Property Tax Replacement Scenario (in Thousands of Dollars)*

	2020-21	2022-23	2024-25	2026-27	2028-29	2030-31
<b>GRR Revenue</b> (9.59% increase)	126,048,054	138,130,848	151,371,881	165,882,181	181,783,418	199,208,927
<b>New GRR Available for State Spending</b> (4% increase)	4,600,887	4,784,923	4,976,320	5,175,373	5,382,388	5,597,683
<b>New GRR Property Tax Replacement Payment</b>	5,782,483	7,146,331	8,152,875	9,216,722	10,388,637	11,683,906
<b>Property Tax Replacement %</b>	10.86	15.06	20.23	28.67	45.30	93.14
<b>School M&amp;O Property Taxes</b>	47,448,497	40,302,165	32,149,290	22,932,568	12,543,931	860,024

*Note.* Data from Texas Comptroller.

with the current rollback system, local governments could petition voters to increase total property tax revenue more than 2.5%. To approve the higher rate would require the approval of a majority of voters in an election with at least a 20% turnout. The limits on counties, cities, and special purpose districts does not directly affect the buydown of the school district M&O property taxes. Instead, it keeps other local governments from taking advantage of the lower school district property taxes by raising their tax rates. This is what they did in 2006, when school property taxes decreased by more than \$1 billion, but increases by counties, cities, and special districts wiped out over \$600 million of the school property tax cut.

## Recommendations to Strengthen the Texas Model

- **Eliminate school district M&O property taxes, which HB 59 would help achieve.**
- **Options to replace school district M&O property taxes include**
  - Broadening the sales tax base and slightly increasing the rate to immediately provide a revenue-neutral replacement so that the state rate is about 7.4% and the total sales tax rate, with a lower average local sales tax rate, is about 8.5%. This should be combined with a stronger state spending limit of population growth plus inflation and use surplus dollars to buy down the sales tax rate over time to return it to 8.25% or lower and then cut other state taxes.
  - Limiting state spending to 4% and using surplus dollars to buy down these property taxes over time until they are eliminated.
  - Passing a constitutional amendment prohibiting school districts from imposing another M&O property tax for any path forward, such as [HJR 154](#).
- **Regarding improvements to HB 59**
  - Require the legislative committee to receive feedback from external sources.
  - Calculate savings based on reductions in costs to provide school M&O property taxes.
  - Calculate positive economic gains using a dynamic economic analysis that accounts for the full regressive nature of property taxes highlighted above.
  - Calculate lower costs to safety net programs from increased economic growth and job creation.
  - Require the report be published online when completed.
  - Clarify that the consumption tax used to raise funds for the replacement must be a final sales and use tax so that it is not a destructive value-added tax, carbon tax, or any other form of taxation.
  - Add that there shall be consideration of tying the replacement with a buydown option of limiting government spending and using surplus dollars to buy down sales taxes and other taxes over time.

## Conclusion

School district M&O property taxes can be eliminated through a revenue-neutral, immediate replacement with a reformed sales tax combined with a spending restraint and buydown of sales taxes or other taxes over time, or through a buydown option with spending restraint over time. Given that high taxes are always and everywhere a spending problem, whichever path is chosen must be paired with limiting government spending at the state and local levels. By combining property tax reductions and reform with spending limitations, Texas could shift to a more efficient and fairer sales tax system. In this way, Texans can be assured of meaningful, lasting, property tax relief and an improved Texas Model that will sustain economic prosperity for generations. ★

## ABOUT THE AUTHOR

**Vance Ginn, PhD**, is chief economist at the Texas Public Policy Foundation, a 501(c)3 non-profit, non-partisan research institute in Austin. He served as associate director for economic policy at the White House's Office of Management and Budget, taught at several universities, and earned a doctorate in economics at Texas Tech University.

## About Texas Public Policy Foundation

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