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TEXAS BUSINESS TAX CLIMATE

BY CHARLES E. GILLILAND

Taxes frequently represent a sizable outlay for businesses, a cost they usually have little or no control over. Because of this, owners often search for locations that offer the best business potential while minimizing tax expenses.

The Tax Foundation, a tax-exempt, nonpartisan, educational organization, provides objective data on government finances. The foundation is perhaps best known for its calculation of "Tax Freedom Day" (the day when working Americans have earned enough to pay their total federal, state and local tax bills for the year). The group's mission is to analyze tax policies and data at all levels of government, determine how tax policy affects private citizens and businesses, and disseminate what they learn to help educate the public.

According to foundation researchers, sound tax policy has five characteristics. First, the tax system should be as simple as possible to minimize compliance costs, such as filing returns, appealing taxes and undergoing audits.

DEEP IN THE HEART OF TAXES

- In 2004, Texans had to work until April 7 to pay their total tax bills. By comparison, the national Tax Freedom Day was April 11.
- At 8.7 percent of state income, the Texas state and local tax burden falls well below the national average at 10 percent. That places Texas 46th among states nationally.
- The total state and local per capita tax tab was \$2,797. Texans had to work 31 days to earn that amount.
- With property taxes of \$950 per capita, Texas ranks 15th nationally.
- At 6.25 percent (well above the national median of 5 percent), Texas state sales tax per capita is \$690, ranking Texas 14th nationally.
- Texas receives 92 cents in federal spending for each tax dollar collected in Texas. That low return places Texas 37th nationally in funds received per federal tax dollar paid.

Source: Tax Foundation

STATE BUSINESS TAX CLIMATE INDEX 2004

	Total Score	Rank
South Dakota	7.37	1
Florida	6.92	2
Alaska	6.85	3
Texas	6.80	4
New Hampshire	6.63	5
Nevada	6.49	6
Wyoming	6.45	7
Colorado	6.35	8
Washington	6.25	9
Oregon	6.15	10
Missouri	5.84	11
Indiana	5.74	12
Virginia	5.74	12
Oklahoma	5.68	14
Tennessee	5.67	15
Alabama	5.66	16
Montana	5.63	17
Delaware	5.57	18
Arizona	5.49	19
Georgia	5.44	20
Maryland	5.42	21
Pennsylvania	5.31	22
Illinois	5.21	23
South Carolina	5.18	24
Mississippi	5.15	25
Utah	5.10	26
Louisiana	5.06	27
Iowa	5.03	28
Ohio	4.87	29
North Carolina	4.86	30
Idaho	4.85	31
Kansas	4.82	32
Massachusetts	4.80	33
New Jersey	4.78	34
Nebraska	4.77	35
Michigan	4.70	36
Connecticut	4.70	37
California	4.61	38
North Dakota	4.50	39
New Mexico	4.50	40
Wisconsin	4.46	41
Maine	4.44	42
Arkansas	4.44	43
Kentucky	4.34	44
Vermont	4.31	45
Rhode Island	4.25	46
West Virginia	4.24	47
Minnesota	4.06	48
New York	4.04	49
Hawaii	3.74	50
District of Columbia	3.70	-

Source: Tax Foundation
www.TaxFoundation.org

Second, it must make clear what and who is being taxed. Third, tax laws should rarely change so taxpayers can count on knowing their rights and remedies.

The tax system should be “neutral” to avoid distorting economic decision making (that is, business decisions should be made based on merit, not on tax implications). Finally, taxes should make up the smallest proportion of national income consistent with sound fiscal policy.

The foundation's state business tax climate index facilitates comparisons of state tax systems and indicates how “business-friendly” those systems are. The index focuses on corporate income taxes, individual income taxes, sales and gross receipts taxes, the state's fiscal balance, and the degree to which the state's tax structure conforms to the structure of other state tax systems and the federal tax system. The more a system conforms to a “typical” state tax system, the easier it is for businesses to comply with that tax.

In the competition between states trying to attract businesses, degree of “tax friendliness” can become a determining factor when other considerations are equal. Because Texas has no personal income tax, many would expect Texas to rank highly in this kind of comparison. With an overall index of 6.798, Texas ranks 4th (see table). South Dakota, Florida and Alaska rank higher.

Many states ranking in the top ten of the index forgo either sales taxes or personal income taxes. Colorado manages to rank eighth despite imposing both income and sales taxes. The simplicity of the Colorado tax system keeps rates and compliance costs low.

Notably, the index addresses state tax systems but does not include local property taxes. With high property tax rates and expanding compliance costs, Texas may well suffer by comparison with other states when property taxes are factored into business location decisions.

The state franchise tax on corporations operating in Texas functions as a corporate income tax. However, the impact of that tax on location decisions is likely mitigated by tax avoidance strategies focused on currently available tax exemptions for partnerships and similar business organizations.

In past decades, the Texas tax system depended heavily on taxes levied on the oil and gas industry. But as the Texas economy has shifted from mining oil and gas, that revenue source has begun to dry up.

In 1981, oil and gas production provided 28 percent of state tax revenues in Texas. According to Rice University Professor George Zodrow, that total had dwindled to 4.7 percent by 1995 and presumably has eroded further since then.

Income levels have risen faster in Texas than taxes in recent years. One of the biggest tax challenges facing the state is to find replacements for these declining revenues from oil and gas. ➔

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