

Is Texas really a leader in low taxes?

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One in an occasional series examining the state's economic record under Gov. Rick Perry.

On national television and in stump speeches nationwide, Gov. Rick Perry is touting Texas as a model for the U.S. economy, notably the state's tax structure.

At a Republican debate this month in Florida, Perry said scores of people are moving to Texas "because they know there's still a land of freedom in America, freedom from overtaxation, freedom from overlitigation and freedom from overregulation, and it's called Texas. We need to do the same thing for America."

When many politicians and pundits proclaim Texas a low-tax state, they're referring to the fact that there's no personal income tax and that direct taxes on businesses are relatively low.

What draws less attention is that sales, property and wireless service taxes are higher in Texas than in most other states.

Which approach best serves the state's residents remains a matter of debate.

"If you don't have taxes on income, you're going to have to make it up in other higher taxes or lower spending, and it looks like Texas might split the difference," said Mark Robyn, an economist with the nonpartisan Tax Foundation.

At the state level, Texas draws most of its revenue from federal funding and sales taxes. At the local level, property taxes play a major role.

"If you look at the total system ... nearly half of taxes are property taxes, and another almost third is sales tax," said Dick Lavine, a fiscal analyst with the liberal Center for Public Policy Priorities in Austin.

While most local governments in the states levy property taxes, the approaches to state taxes vary widely, including no income or sales tax (New Hampshire), an income tax but

no sales tax (Oregon) and, most common, a mix of both. Many economists say the best approach depends on a state's characteristics, such as natural resources, quality of workforce and level of tourism.

Combining state and local rates, Texas has the 14th-highest sales tax rates in the country and the 22nd-highest property tax rates, according to the Tax Foundation.

'Medium-to-high taxes'

Texas Republican pollster David Hill recently highlighted the state's sales and property tax rates in a column for *The Hill*, a Washington-based political newspaper.

He said he worries that those touting the Texas model for economic growth don't understand the full picture.

Among the stats he finds most eye-opening: Texas ranks near the top in property taxes as a percentage of home value.

"Once you start adding it all up and writing the check, you see there is no free lunch," Hill said. "Texas is a nice state with medium-to-high taxes."

A weakness with the Texas approach to taxes is that the state looks less attractive to businesses that need a lot of land and equipment and can pay lower sales and property taxes elsewhere, said Dale Craymer, president of the pro-business Texas Taxpayers and Research Association.

"For service-oriented businesses, for research operations, for corporate headquarters, Texas is clearly a low-tax state," Craymer said. To lure capital-intensive businesses, Craymer said Perry has effectively used tax incentives and subsidies.

The Texas Association of Business has largely cheered the state's approach to taxes, but President Bill Hammond said he would prefer it if the state relied less on property or business taxes.

"The ideal is not to tax savings and investment but to tax consumption. We think the sales tax is the fairest way to fund the state," Hammond said.

Lavine said such an approach ignores how sales taxes are tougher on poorer families. Texas has the fifth-most-regressive tax system in the country, according to a 2009 study by the Institute on Taxation & Economic Policy.

"People who are trying to move up to the middle class, you're essentially pushing them back by giving them the highest tax rate," said Lavine, who believes that an income tax could make the state's tax system fairer.

Perry's changes

Since 2006, Texas' competitiveness on business taxes has dropped compared with other states, according to the Tax Foundation's annual ranking. Five years ago, Texas had the seventh-most-favorable business tax climate in the country. In the latest rankings, Texas is 13th.

Part of the drop is due to other states lowering their tax burden on businesses, Robyn said. Another cause is likely a controversial tax overhaul Perry approved in 2006.

That legislation was prompted by the state Supreme Court declaring Texas' education funding system unconstitutional. After years of wrangling, lawmakers ultimately lowered property taxes by billions and covered the loss through raising cigarette taxes from 41 cents to \$1.41 per pack and converting the franchise tax to a broader margins tax that focused more on gross revenue instead of profit.

The margins tax has drawn criticism ever since. Some businesses have said it hits certain companies more than others. A host of others say the overhaul created a structural deficit in the state budget, as the tax has never drawn as much revenue as originally forecast.

Hammond said the Texas Association of Business supported the margin tax as the "least worst alternative" of what could pass in Austin and lower property taxes.

"If businesses have to be taxed, an income tax is better than the current margin tax," Hammond said, though he stressed that consumption taxes are far preferable to either option.

On his presidential campaign website, Perry touts the 2006 deal as a "historic property tax cut" and more recent expansions of the businesses exempt from the margins tax as a tax cut for small businesses.

Whether those adjustments had a major effect on Texas' economic prowess in recent years is less clear. While Perry says they did, many economists are skeptical.

Bob Ward, director of fiscal studies at the University of Albany's Rockefeller Institute of Government, said Perry's tax changes "may have affected some individual businesses in important ways but are unlikely to have had any broad impact, for better or worse, on the state's economic growth."

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