



SPRING 2019

# PERCSPECTIVES ON POLICY

## TEXAS TAXES

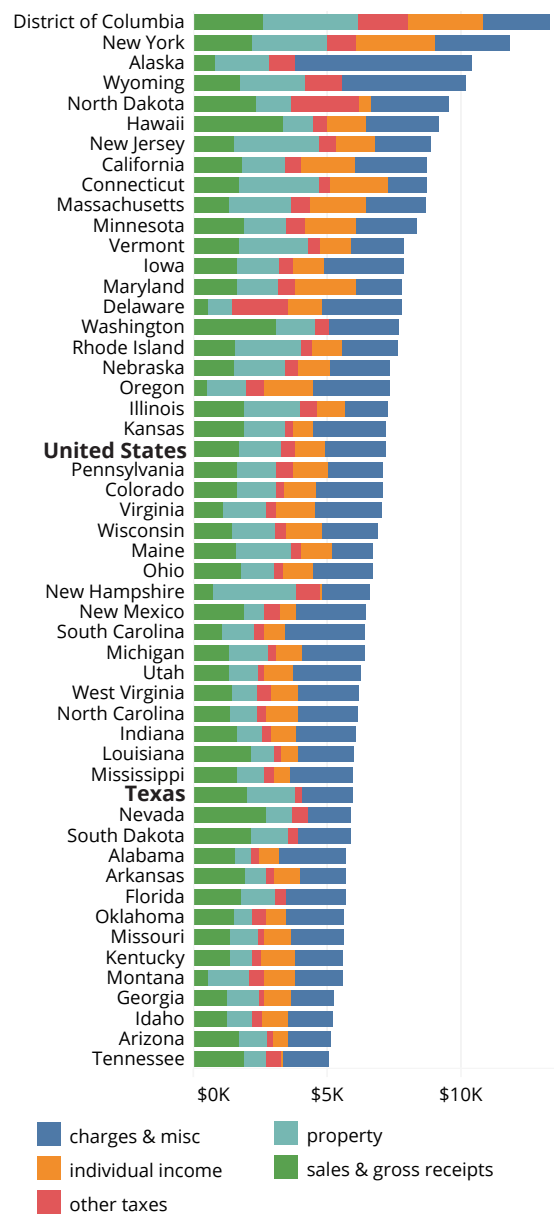
Dennis W. Jansen, Carlos Navarro, and Andrew J. Rettenmaier

Texas prides itself as a low tax state. It does not have an income tax, and the state and local revenues place it in the lowest third of all the states in terms of state revenues per person. A constitutional restriction limits the rate of growth in appropriations to the growth rate in the state's economy, interpreted as the growth rate of personal income, and spending is largely limited to the available state revenues. Importantly, these constraints do not apply to property taxes, which are collected at the local level, not the state level. Local property tax collections are rising faster than other Texas taxes, and this rise has produced an initiative in the current session of the Texas legislature to curb the growth in property taxes.

Before we look into the rising property taxes, let's first consider how Texas ranks among other states based on taxes per person. Figure 1 shows taxes and other revenues per person for all states. These amounts explicitly exclude revenues from the federal government, an important source of revenue for states. The data are from the U.S. Census Bureau's 2016 Annual Surveys of State and Local Government Finances. Texas is 14<sup>th</sup> lowest among the states in taxes and other revenues per person. If we look at state and local taxes relative to personal income, Texas is 13<sup>th</sup> lowest. Sales and gross receipt taxes (a broader category than just sales taxes) account for 34% of all revenues in Texas, property taxes account for another 30% of revenues, charges and miscellaneous account for another 32% and other taxes round out the remaining 4%.<sup>1</sup> Across all the states, sales and gross receipts taxes account for 24% of revenues, property taxes account for 22%, income taxes account for 16%, charges and miscellaneous account for 31% and other taxes make up the remaining 4%.

Figure 2 presents the inflation adjusted per person tax and other revenues collected by the state of Texas from 2005 to 2018. Total state revenues per

FIGURE 1. STATE AND LOCAL TAXES PER PERSON IN 2016



Source: United States Census Bureau

person rose prior to the great recession, fell during the recession, and have rebounded somewhat since then; however, total inflation-adjusted state government revenue per person was lower in 2018 than in 2008.

Inflation-adjusted sales taxes per person rose at an annualized rate of 0.7% between 2005 and 2018. Meanwhile state inflation-adjusted per capita personal income has risen at an annualized rate of 1.0% over this same period, indicating a decline in sales tax revenue as a fraction of personal income.

It seems clear from this figure that the constitutional restrictions limiting the growth in state revenues have worked. Between 2005 and 2017, these revenues have ranged from 4% to 5% of the state's GDP, and currently are 4.4%.

Property taxes in Texas are another matter; they are local taxes not governed by the constitutional restrictions on state revenues. Property taxes have been growing on a real per person basis and when compared to the state's overall economy. Figure 3 depicts real per person property tax levies for four Metropolitan Statistical Areas (MSAs) in Texas and for the state as a whole. The series for the major MSAs are labeled in the figure. Of the major metropolitan areas, Austin has the highest property taxes, and over the past four years its real per capita property taxes have grown at an annual rate of 5.1%. Houston's and San Antonio's real per capita property taxes also grew 5.1% annually over the last four years, while in Dallas they grew at a real annual rate of 4.2%. Across the entire state per capita real property taxes grew at an annual rate of 3.9%. Meanwhile per capita real personal income statewide grew at an

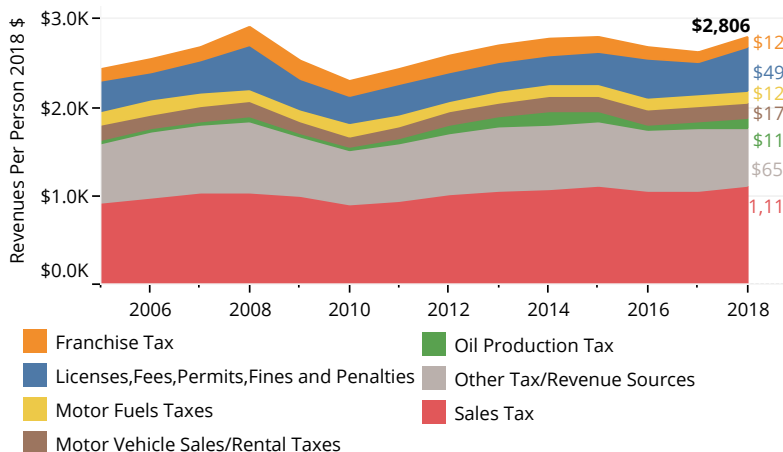
annual rate of 0.7% over this same period. Citizens are responding to increases in property tax bills that are outstripping their income growth.

The most recent data on property tax levies per person in metropolitan statistical areas are presented in Figure 4. Midland and Austin-Round Rock lead the list, with Austin levying \$2,900 per person in 2017 (converted to 2018 dollars). Houston-The Woodlands-Sugar Land comes in third at \$2,531, and Dallas-Fort Worth-Arlington fourth. All are above the overall Texas average of \$2,149 per person. College Station-Bryan is relatively high on the list for a small MSA, with property taxes in the MSA averaging \$1,887 per person in 2018 dollars. Waco, another small MSA in the middle of the triangle, has property taxes of \$1,644 per person. Lubbock, another small MSA with a large student population, has per capita property tax levies of \$1,497. The lowest per person property taxes are levied in the Rio Grande Valley, with Brownsville-Harlingen at \$967 per person, about one-third the rate of Austin-Round Rock. These taxes per person are very highly correlated with the underlying property values per person, 91% in 2017, although this falls a bit, to 77%, when school district tax levies are excluded.

There are several mechanisms already in place in Texas that constrain the growth in property taxes, but nonetheless property taxes per capita are rising with the underlying rise in property values. The first mechanism is a limitation on annual increases in the appraised value of a homestead. The general limit is an increase of 10% of the previous year's appraised value plus any improvements. The second limiting mechanism is a pure rate limit of the tax rates counties, cities, and school districts can apply. For example, across all school districts the average tax rate for maintenance and operations is about 1.1%, and there is an upper limit of 1.17%. However, the actual total tax rate including interest and sinking taxes averages 1.3%.

A final limit applies to the tax rates school districts, cities and counties apply to the assessed property values. Each taxing entity goes through a budgeting process for the coming year to determine the tax rate that would cover the budgeted amount based on the the current assessed property values. If the

**FIGURE 2. REAL PER CAPITA REVENUES TO THE STATE**



Last reported data point: 2018 (annual). Sources: Texas Comptroller of Public Accounts, US Census Bureau, and Bureau of Labor Statistics.

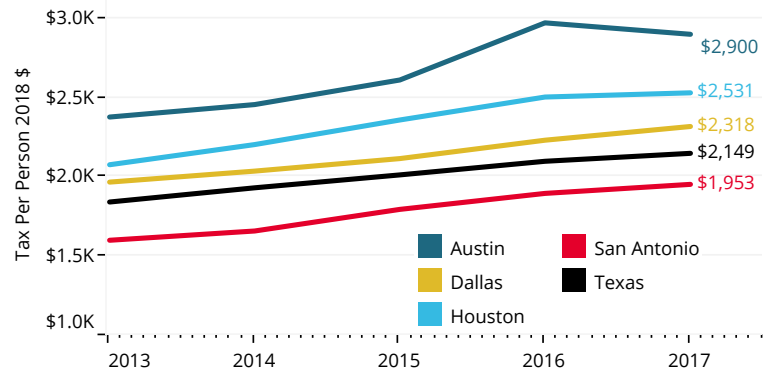
proposed tax rate to cover budgeted spending would raise more than an additional 8% of tax revenue, then the taxing entity must seek voter approval.

This last mechanism is at play in the current debates in the state legislature. The current versions of the property tax bills would limit the growth factor for school districts (2.5% and 2.0% in the current Senate and House versions, respectively), but if the school district proposes a higher rate, then an election to approve or disapprove the rate increase is held.

This proposed limit on the rate of growth in tax levies has raised concerns about school districts' ability to fund their ongoing operations. As we have seen, property taxes per person have been rising with rising property values and school districts have come to expect increasing budgets. In response to these concerns is a proposed increase in the state sales tax rate, with the additional revenues directed to property tax relief.

Numerous issues arise with any change in how property taxes are allocated. The current school funding formula re-allocates revenues from districts with high property values to those with low property values. The top five amounts in re-allocated funds this academic year were the \$674 million from the

**FIGURE 3. REAL PER PERSON PROPERTY TAX**



Last reported data point: 2017 (annual). Sources: Texas Comptroller of Public Accounts, US Census Bureau, and Bureau of Labor Statistics.

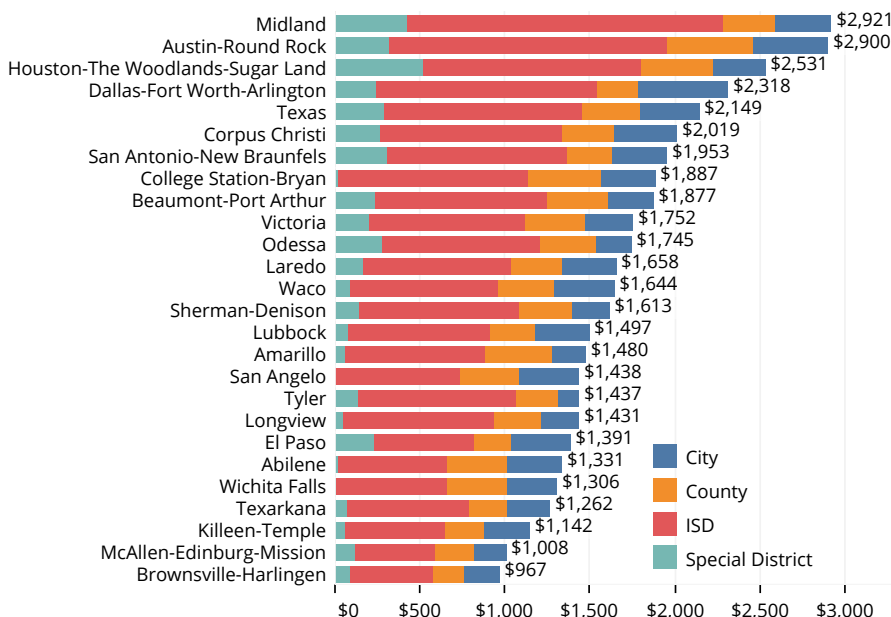
Austin ISD, \$274 million from the Houston ISD, \$211 million from the Plano ISD, \$103 million for the Highland Park ISD, and \$101 million for the Eanes ISD. These districts account for about 48% of the re-allocated revenues. As property values in these districts continue to rise, property taxes increase but the additional funds are in part used to support other ISDs. In effect the state relies on property taxes from these districts to cover spending it would otherwise have to provide to districts with less property wealth.

Limiting the growth rate in property taxes will necessitate a change in the school funding formula that is coupled with the allocation of any new revenues from an increase in the state sales tax. Also, the

growth in all government services that have been funded through the increasing property taxes revenues, should it continue, would require increasing sales tax rates, or a curtailment in the growth in these services.

Addressing the growth in property taxes in Texas is the focal point of this legislative session. The myriad details in limiting the growth rate in property taxes, redesigning the already complex school funding formula, and considering a higher state sales tax rate will keep many in Austin busy as the legislative session comes to a close.

**FIGURE 4. REAL TAX LEVIES PER CAPITA IN 2017**



Sources: Texas Comptroller of Public Accounts, US Census Bureau, and Bureau of Labor Statistics.

**Endnotes**

<sup>1</sup> In the Census survey data, the sales and gross receipts category includes fuel, alcohol and tobacco, public utility, and other sales taxes.



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