



# Testimony

## Improving Texas' Public School Finance System through Property Tax Reform: *Testimony before the Joint Committee on Public School Finance System*

by The Honorable Talmadge Heflin

Chairman Shapiro, Chairman Aycock, and Members of the Committee:

My name is Talmadge Heflin and I am the Director of the Center for Fiscal Policy at the Texas Public Policy Foundation, a non-profit, non-partisan free market think tank based here in Austin. Thank you for taking the time today to investigate such an important policy matter: improving Texas' public school finance system by reforming the Tax Code.

My remarks today will focus on improving Texas' public school finance system by eliminating part or all of the local property tax and replacing the lost revenues with a reformed sales tax.

Most of us are aware that property taxes constitute a major revenue source for local school districts.\* But what some of you may not realize is that funding public education in this way—with a hefty local property tax<sup>†</sup>—is inefficient and leaves much to be desired from a policy perspective. That is because the property tax:

- Discourages capital investment in residential, commercial and industrial properties;
- Creates large economic distortions, or causes individuals and businesses to meaningfully alter their behavior in an attempt to reduce their tax burden;
- Bears little relation to taxpayers' ability to pay; and
- Is costlier and more complicated to administer than other simpler taxes, like the sales tax.

The combination of these attributes makes the property tax a less-than-ideal way to generate revenue. Because of this, policy-makers should consider alternative methods to raise necessary funds—ideally one(s) that do not create large economic distortions or disincentivize private sector investment to the degree that the property tax does. One possibility worthy of consideration is a proposal to eliminate the property tax system, either in toto or in part, and replace the lost revenues with a reformed sales tax.

### Full Replacement: The Laffer Plan

As the Foundation details in its August 2012 report, *Enhancing Texas' Economic Growth Through Tax Reform*, prepared by Dr. Arthur Laffer and associates, the Legislature could, with some modest revisions to the Tax Code, transition out of the property tax system completely and replace the revenues with an expanded sales tax. In order to make this transition revenue neutral, the newly re-worked state-local sales tax rate and base would have to closely resemble the following:

- 15.7 percent if the current sales tax base is used and includes the sale of property; or
- 11.0 percent if all services that are taxed in at least one state are taxed in Texas and includes the sale of property.

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\* According to the Texas Comptroller of Public Accounts' latest Annual Property Tax Report, local school districts in Texas collected a total of nearly \$21.8 billion from the property tax in fiscal 2009.

† According to the Tax Foundation's most recent estimates, Texas' per capita property tax collections for fiscal 2009 ranked as the 14th highest in the nation.

Under either of these scenarios, the Legislature could completely eliminate Texas' onerous property tax system—which would be a first among the states\*—while leaving revenues unaffected. By making such a transition, this would have the dual benefit of sparking additional job growth and wealth creation. More specifically, the Foundation estimates that as a result of this reform personal income and employment should respond accordingly:

- An increase in personal income in the range of \$3.6 to \$3.68 billion in the first year. Over a five year period if the property tax burden were replaced dollar for dollar with a higher sales tax burden it is estimated that personal income could, on a cumulative basis, increase between \$22.85 billion and \$63 billion; or an increase of 1.8 percent to 4.7 percent higher than it would have been otherwise.
- A net gain of new jobs, over a five year horizon, is estimated at between 124.9 thousand and 337.4 thousand over the job growth Texas would have had if no tax reform were implemented.

It is not entirely unreasonable to assume that the additional economic activity and growth that occurs under this proposal will help bolster state-local revenues across the board as people and businesses consume and invest more, thereby also proving to be a benefit for the public school finance system.

### **Partial Replacement: Eliminating M&O**

In the event that the proposal to eliminate property taxes in their entirety proves to be too much, the Foundation strongly recommends that the Legislature consider a scaled-down version of this proposal that focuses on eliminating only the school district maintenance and operations (M&O) tax.

Currently, school district M&O taxes, which help pay for day-to-day operations, constitute the bulk of the local property tax burden, and eliminating this select tax would do much to provide meaningful relief to Texas homeowners and businesses.

To give you a better idea of how much M&O property tax relief I might be talking about, let me direct you to House Bill 3176, a bill filed during the 81st Regular Session relating “to the abolition of school district maintenance and operation *ad valorem* taxes.”†

At the time, the Legislative Budget Board's Fiscal Note for HB 3176 estimated that “M&O taxes levied by school districts will be approximately \$21.6 billion in FY 2015.”<sup>1</sup> Assuming that amount is still accurate, or close to it, eliminating the M&O tax could reduce Texas' property tax burden by approximately \$1,000 per capita.<sup>‡</sup>

At this time, the Foundation is working diligently on different combinations of the state-local sales tax rate and base to determine the most plausible alternatives to eliminate the M&O. If so desired, the Foundation will brief the committee when these results are finalized.

In closing, there are better ways to fund government, and public schools, than the property tax. Alternatives like those proposed above would not only strengthen Texas' economy and jobs picture but would, in all likelihood, also result in more revenues coming into the coffers of Texas governments without a tax increase.

Thank you for your time and I look forward to answering any questions that you may have.

\* Property taxes are currently levied in all 50 states, according to the [Tax Foundation](#).

† To view the bill in its entirety, please [click here](#).

‡ Estimate based on \$26.1 billion tax levy divided by the Census Bureau's most recent population estimate for Texas, 25,674,681.

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<sup>1</sup> [Fiscal Note](#) for House Bill 3176 filed by State Representative Phil King during the 81st Regular Legislative Session.

