
TEXAS PUBLIC POLICY FOUNDATION
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LEGISLATOR'S
GUIDE
to the issues
TEXAS PUBLIC POLICY
FOUNDATION

The Texas Public Policy Foundation is a 501(c)3 non-profit, non-partisan research institute.

The Foundation's mission is to promote and defend liberty, personal responsibility, and free enterprise in Texas and the nation by educating and affecting policymakers and the Texas public policy debate with academically sound research and outreach.

Funded by thousands of individuals, foundations, and corporations, the Foundation does not accept government funds or contributions to influence the outcomes of its research.

The public is demanding a different direction for their government, and the Texas Public Policy Foundation is providing the ideas that enable policymakers to chart that new course.

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Margins Tax

The Issue

No matter how you evaluate Texas' business franchise tax, commonly called the "margins tax," it fails the least-burdensome-tax test and fails to allow Texans the opportunity to flourish. This broad-based, gross-receipts-style margins tax is far more complex and unique among all taxes nationwide—with only Nevada having a similar gross-receipts-style tax. Eliminating this onerous tax would best serve Texans.

Businesses do not pay taxes; people do, in the form of higher prices, lower wages, and fewer jobs available. Given taxes exist to fund only the preservation of liberty, the least burdensome taxes should fund conservative budgets that grow, if at all, by no more than population growth plus inflation.

The margins tax is inherently complex with multiple calculations to determine the lowest tax liability, two tax rates depending on business type, and the $1 million gross revenue exemption. Complying with it is also markedly different from complying with the federal corporate income tax; as a consequence many firms must keep separate financial books. Because of these substantial costs, firms can spend more on compliance than their actual tax liability.

The 84th Texas Legislature cut the margins tax by $2.6 billion by reducing the rates by 25% and raising the ceiling to file with the E-Z computation to $20 million at a lower tax rate. This cut not only reduced the size of government, but employers also have more money to invest and hire workers.

Studies modeling the dynamic economic effects of phasing out or repealing the margins tax find substantial economic benefits, including thousands of net new private sector jobs and billions of dollars in net new personal income statewide.

The Foundation's research includes a dynamic economic model that accounts for burdens on the private sector of paying annual margins taxes and complying with the tax. The estimated results of full elimination of the margins tax within the first five years compared with the status quo include:

- More prosperity: Texas could gain $16 billion in new inflation-adjusted total personal income.
- More jobs: Net new private sector nonfarm employment in Texas could increase by 129,200 jobs.

While eliminating the margins tax will enhance Texans' prosperity, the stakes are much higher than just one state. This transformational policy would make Texas a leader for America—and even the world—in tax policy. For example, this would allow Texas to join just South Dakota and Wyoming without a general business tax or individual income tax.

Getting rid of the margins tax should be done no matter the budget situation. While cutting the tax may result in a short-run drop in tax revenue, the associated dynamic increase in economic activity will likely generate additional tax revenue through other taxes that could replace some, if not all, of the drop. In addition, spending restraint will ease the path to elimination.

If immediately eliminating the margins tax is not possible, phasing out the tax over a couple of budget cycles would be a valuable alternative. Of course, phasing it out reduces the potential full economic gains because of the compliance costs that remain. If the phase-out option is chosen, lowering the tax rates for all firms is preferable to raising the revenue exemption threshold that forces the burden on fewer firms.

The Facts

- Texas' margins tax is complex, costly, and difficult to comply with, giving rise to a less competitive business tax climate, for which the Tax Foundation ranks Texas 13th overall and second worst in the corporate tax ranking.
- Texas does not have a revenue problem. Between the 2004-05 to 2018-19 budgets, the state's estimated total tax collections increase is 97%, much faster than the 63% increase in population growth and inflation.
- The margins tax fails to be a least burdensome tax and to allow Texans the opportunity to prosper.

Recommendations

- Eliminate the business margins tax. Potential budget surpluses, more tax revenue from new economic growth, and spending restraint should fund this without imposing a new tax.
- Pass a bill requiring a supermajority (two-thirds) vote of each chamber to raise taxes or implement a new tax.

Resources

Texans Prosper from Eliminating Business Franchise Tax by Vance Ginn, Texas Public Policy Foundation (April 2017).

Failure of Texas' Business Margin Tax by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (Dec. 2015).

Economic Effects of Eliminating Texas' Business Margin Tax by Vance Ginn and Talmadge Heflin, Texas Public Policy Foundation (March 2015).

The Texas Margin Tax: A Failed Experiment by Scott Drenkard, Tax Foundation (Jan. 2015).

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