TEXAS PUBLIC POLICY FOUNDATION
Testimony

March 2016
Center for Fiscal Policy

Eliminate the Margin Tax to Reach Texans' Full Potential

Presented to the Senate Finance Committee on the interim charge to phase out the franchise tax

by Dr. Vance Ginn, Economist in the Center for Fiscal Policy

Chair Nelson and Members of the Committee:

My name is Dr. Vance Ginn and I am an economist in the Center for Fiscal Policy at the Texas Public Policy Foundation, a non-profit, nonpartisan free-market think tank based here in Austin. Thank you for inviting me to speak today on the interim charge to study the benefits of continuing to phase out the franchise tax. My remarks will summarize the Foundation's research by Ginn and Heflin (2015a, 2015b) found at www.texaspolicy.com that studies the dynamic economic effects of eliminating the franchise tax, commonly called the margin tax.

Failures of the Margin Tax

Simply put, businesses don't pay taxes; people do in the form of higher prices, lower wages, and fewer jobs available. Given that taxes exist to fund essential government services, the least burdensome taxes should fund conservative budgets, which grow by no more than population growth plus inflation. No matter how you evaluate the margin tax, it fails to be anything similar to a least burdensome tax, fails to meet revenue expectations, and fails to allow Texans the opportunity to reach their full potential. Texans would be best served by eliminating this onerous tax.

The margin 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 than complying with the federal corporate income tax, so many firms must keep separate financial books. Because of these substantial costs, firms can spend more on compliance than on their actual tax liability.

This broad-based, gross receipts-style margin tax is far more complex and unique among all taxes nationwide, with only Nevada having a similar gross receipts-style tax. Since the margin tax's inception in January 2008, the Texas comptroller's office has had difficulty accurately estimating its revenue as noted by the cumulative $2.8 billion less in actual collections than estimated through FY 2015.

Economic Effects of Eliminating the Margin Tax

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

The Foundation's recent work by Ginn and Heflin (2015a) includes a dynamic economic model that accounts for the private sector drain to pay for annual margin taxes and firms' cost of complying with the tax. The model allows for estimates of potential gains in total personal income and private sector employment from eliminating the margin tax. These results include:

- More prosperity. Texas could gain $10.8 billion in new real (inflation-adjusted) total personal income after the first year and accumulate a total $16 billion increase within five years compared with the baseline.
- More jobs: Net new private sector nonfarm employment could increase by 67,800 after the first year and add a cumulative 129,200 net new jobs five years after eliminating the margin tax compared with the status quo.

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The costs imposed by the margin tax on firms do not harm just them but the entire economy. To put these results another way, the margin tax obstructs Texans of the opportunity to reach their full potential in terms of income, jobs, and prosperity.

While eliminating the margin 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 three other states (i.e. Nevada, South Dakota, and Wyoming) without a corporate or individual income tax.

Fortunately, the 84th Texas Legislature made valiant steps to reducing the margin tax's burden. This was accomplished by cutting the tax rates by 25 percent and raising the ceiling to file with the E-Z computation to $20 million at a lower tax rate. These beneficial changes for a total value of $2.6 billion took effect on January 1, 2016. These cuts not only had the benefit of reducing the size of government, but employers will also have more money to invest to boost the slowing job market from a slower global economy and low oil prices.

Path to Eliminating the Margin Tax

Slower economic growth statewide has contributed to recent tax revenue data indicating a tight budget next session. However, this should not negate taking additional steps to achieve the ultimate goal of eliminating the margin tax. While cutting the tax results 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 of the drop. In addition, modest restraint in spending would also ease the path of elimination.

Given the economic and fiscal uncertainty with the current state of the economy, eliminating the margin tax in the next budget cycle may not be an option. Therefore, depending on the revenue picture, a valuable alternative is to pass legislation that would phase it out over the next two biennia. The details could then be determined as the revenue picture becomes clearer. While phasing it out with certainty is a good option, it does reduce the potential economic gains, particularly by leaving in compliance costs. In addition, if the phase out path is chosen, it is preferable to lower the tax rates for everyone instead of raising the revenue exemption threshold that forces the burden on fewer firms.

For a more prosperous Texas, last session's progress should be continued by putting the margin tax on a path to elimination. Thank you for your time and I look forward to answering your questions.

References

Ginn, Vance, and Talmadge Heflin. 2015a. "Economic Effects of Eliminating Texas' Business Margin Tax." Texas Public Policy Foundation, March: 1-19.

Ginn, Vance, and Talmadge Heflin. 2015b. "Failure of Texas' Business Margin Tax." Texas Public Policy Foundation, March: 1-19.

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