FINAL REPORT 02.19

TCCRI
Texas Conservative Coalition
Research Institute

STATE BUDGET & TAXATION TASK FORCE

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I. The State Budget in Perspective

Boosted by strong oil and gas, sales, and franchise tax collections, total tax collections for FY 2018 significantly exceeded the projections in the Comptroller's 2018-19 Biennial Revenue Estimate (BRE), as illustrated in the following table:

Texas Tax Collections, FY 2018 vs. 2018 Biennial Revenue Estimate ($ Thousands)

REVENUE SOURCE	FY2018 ACTUAL[i]	FY2018 BRE[ii]	FY 2018 BRE VS. ACTUAL
SALES TAX	$31,937,235	$28,067,335	$3,869,900
OIL PRODUCTION	$3,391,518	$2,248,715	$1,142,803
NAT GAS PRODUCTION	$1,431,106	$853,658	$577,448
MOTOR FUELS	$3,674,997	$3,600,605	$74,392
MOTOR VEHICLE SALES	$4,973,441	$4,842,924	$130,517
FRANCHISE	$3,685,940	$3,865,293	-$179,353
ALCOHOLIC BEVERAGE	$1,291,989	$1,284,786	$7,203
INSURANCE OCCUPATION	$2,508,434	$2,532,283	-$23,849
OTHER	$2,690,116	$1,673,366	$1,016,750
TOTAL	**$55,584,776**	**$48,968,965**	**$6,615,811**

Source of Underlying Data: Texas Comptroller of Public Accounts

Tax collections for the last five fiscal years indicate that Texas has rebounded from the slump seen in FYs 2016 and 2017. With its strong performance in FY 2018, Texas has seen its overall growth in tax collections exceed $4.5 billion since FY 2014.

Texas Tax Collections, FY 2014 – FY 2018

	FY2014	FY2015	FY2016	FY2017	FY2018
Sales Tax	$27,385,709	$28,910,857	$28,245,801	$28,900,035	$31,937,235
Oil Production	$3,874,071	$2,879,055	$1,704,283	$2,107,335	$3,391,518
Nat Gas Production	$1,899,582	$1,280,410	$578,799	$982,763	$1,431,106
Motor Fuels	$3,315,952	$3,446,157	$3,513,716	$3,583,734	$3,674,997
Motor Vehicle Sales	$4,209,953	$4,514,186	$4,616,082	$4,532,349	$4,973,441
Franchise	$4,732,262	$4,656,286	$3,881,176	$3,242,219	$3,685,940
Alcoholic Beverage	$1,053,231	$1,138,776	$1,182,549	$1,217,711	$1,291,989
Insurance Occupation	$1,947,908	$2,049,417	$2,226,725	$2,376,092	$2,508,434
Other	$2,573,894	$2,807,916	$2,527,095	$2,701,184	$2,690,116
TOTAL	$50,992,562	$51,683,060	$48,476,226	$49,643,422	$55,584,776

Source of Underlying Data: Texas Comptroller of Public Accounts (in thousands, rounded)

In the 2020-21 BRE, the Comptroller projected four percent growth in the Texas economy during FY 2019. Tax collections deposited to general revenue funds paint a different picture thus far, although there have been only four months of tax collections in FY 2019 to date.[iii] Sales tax collections from September through December of 2018 were down 6.75 percent compared to the prior year. Franchise tax collections over the same period declined by 13.5 percent compared to the prior year. Oil and natural gas tax collections during that same period, however, were up 50 percent and 35.9 percent year-over-year, respectively. While collections attributable to specific sources of revenue have seen significant fluctuation between September and December of 2018 compared to September and December of 2017, in the aggregate there has been virtually no year-over-year increase or decrease (a 0.05% decline).

Estimated total state revenue from all sources for the 2020-21 biennium is $265.6 billion, which is more than an 18 percent increase over the expected 2018-2019 figure of $224.8 billion. There will be $119.1 billion in general revenue-related funds available for certification for the 2020-2021 biennium, which is a healthy 13.5 percent increase over the corresponding $104.9 billion for the previous biennium. A comparison of key estimates in the 2018-2019 BRE and the 2020-2021 BRE in the table below makes clear how much the State's revenue picture is projected to have improved.

	2018-19	**2020-2021**	**Percent Change**
Taxes	$106.8	$122.1	14.3%
Federal Income	$74.9	$88.7	18.4%
Fees, Interest, & Other Income	$43.1	$54.8	27.1%
Total Revenue	$224.8	$265.6	18.1%
Dedicated Revenue	$118.3	$144.1	21.8%
GR-Related Revenue	$106.5	$121.5	14.1%
Net adjustment for carryover balance from previous biennium and transfers to ESF/SHF	-$1.6	-$2.4	n/a
GR-Related Funds Available for Certification	$104.9	$119.1	13.5%
ESF Balance (at end of biennium)	$11.8	$15.4	30.5%

Source: Texas Comptroller (figures in billions of dollars)

During a time of healthy state revenue growth, the Legislature should ensure that government remains confined to its proper role and that its spending adheres to an intellectually consistent standard rather than simply expanding to match whatever its available funds are. While the State had a strong FY 2018 and the outlook for the 2020-2021 biennium is encouraging, it is important not to use an unanticipated and perhaps temporary growth in tax revenue as an automatic justification to increase spending. If increased spending is justified on those grounds, then the new, increased level of spending becomes the new baseline by which spending in future years is measured, even if tax revenue in the future declines or plateaus and irrespective of whether future spending is consistent with the optimal role of government.

The budgets from the 2004-05 to the 2012-13 biennia are instructive. The 2004-05 budget appropriated $59.0 billion in general revenue[iv] – a 1.6 percent decrease from the previous biennium. This led the Legislature to make some necessary and sensible spending reductions. However, in 2006-07 many of these reductions were rolled back as the legislature enacted a $67.2 billion budget,[v] or a 14 percent increase over the 2004-05 level. Spending again significantly increased with the 2008-09 budget, which appropriated $81.6 billion in general revenue, a 21.4 percent increase.[vi] The corresponding appropriation in the 2010-2011 budget increased by only 1 percent to $81.9 billion.[vii] Finally, the budget for 2012-13 appropriated $86 billion in general revenue.[viii] That $86 billion caused consternation over alleged fiscal austerity[ix] but actually represented a 45.8 percent increase over the appropriations in general revenue in the 2004-2005 budget (equal to annual growth of 4.8 percent).

The Comptroller's estimates of funds available for general purpose spending from the 2004-2005 biennium to the 2012-2013 biennium illustrate the same phenomenon. Those estimates for the 2004-2005, 2006-07, 2008-09, 2010-2011, and 2012-13 biennia were $54.1 billion, $64.7 billion, $82.5 billion, $77.1 billion, and $72.2 billion, respectively.[x] Numerous articles were written upon the release of the 2012-13 biennial revenue estimate stating that the State faced a fiscal crisis,[xi] when in reality the estimates of funds available for general purpose spending had increased by 33 percent over that time frame (equivalent to 3.6 percent annual growth). The lesson that all Texas taxpayers should take from this is that spending freely during years of strong revenues sows the seeds of the next budgetary "crisis."

Rather than matching its spending to available funds, the Legislature should first ensure that the State is meeting its obligations. Funds in excess of whatever amount the State needs to fulfill those obligations should be applied towards tax relief. Providing tax relief using revenue *below* the spending limit must remain a focus for conservatives, since it is one way to permanently restrain the growth of government. That is especially true for a biennium in which strong revenue growth is expected, such as the 2020-21 biennium.

To ensure the ongoing fiscal strength of Texas, the 86th Legislature should strengthen the State's constitutional spending limit, continue to phase out the franchise tax, protect the Economic Stabilization (Rainy Day) Fund from being used for ongoing obligations, and provide much-needed property tax relief to homeowners and businesses that is still consistent with the State's obligation to contribute to the funding of public education. Taking these steps will ensure that government in Texas operates within its proper scope. Finally, to avoid future budget shortfalls, it is imperative that the 86th Legislature keeps Texas on a sound fiscal footing by keeping general revenue appropriations flat after adjusting for population growth and inflation.

A. The Constitutional Spending Limit

Texas' current constitutional spending limit, contained in Article VIII, Section 22 of the Texas Constitution, reads as follows:

> In no biennium shall the rate of growth of appropriations from state tax revenues not dedicated by this constitution exceed the estimated rate of growth of the state's economy. [Emphasis added].

The Texas Constitution grants the Legislature authority to provide statutory guidance to facilitate implementation of the spending limitation. Under this guidance, the "rate of growth of the state's economy" is calculated by the Legislative Budget Board (LBB) by "dividing the estimated Texas total personal income[xii] for the next biennium by the estimated Texas total personal income for the current biennium," per Government Code 316.002(b).[xiii]

The most important factors to consider in relation to Texas' constitutional spending limit are that:

1. The limit applies only to non-dedicated General Revenue (GR) spending, rather than *all* state spending.
2. The limit applies only to state spending, not local government spending.
3. The limit may be overridden by a simple majority vote of the Legislature.
4. Perhaps most importantly, the limit is based on an *estimate* of future personal income growth.

1. General Revenue versus All Funds

The first major weakness of the state's current constitutional spending limit is that it applies only to state tax revenues not dedicated by the Texas Constitution. There are numerous constitutional dedications of state tax revenue that are exempted from the current spending limit, including to the State Highway Fund and to the Foundation School Program. For the 2018-19 Biennium, an estimated 9.9 percent of all state appropriations- or more than $11 billion- is dedicated by the constitution.[xiv] For a constitutional spending limit to be effective, it is critical that it apply to at least both GR and GR-Dedicated state spending. Doing so would be a significant change that would enhance the state's spending limit. A spending limit that does not apply to all state funds can be circumvented and will always be a less than optimal restraint on the growth of state spending.

2. No Limit on Local Government Spending

Texas' current constitutional spending limit applies only to certain aspects of state spending; it does not impose any limit on local spending. The arguments for capping state spending by reference to population growth and inflation which are discussed below apply with equal force to local government spending.

An indication that spending at the local level in Texas has become problematic and that local governments are living beyond their means is the growing aggregate debt burden of local governments in Texas. In June 2015, the Comptroller released a 50 State Scorecard showing Texas's rankings in various categories; the State ranked 3rd worst in terms of local debt per capita.[xv] As of the end of the 2018 fiscal year, the combined local debt in Texas was $230 billion[xvi]-- a per capita burden of approximately $8,014 per resident.[xvii] Furthermore, these numbers do not take into account the interest that will be paid on that $230 billion in principal.

Texas Local Government Debt by Year

AS OF FISCAL YEAR END	LOCAL DEBT OUTSTANDING (IN BILLIONS)
2007	$141.4
2008	$160.3
2009	$174.6
2010	$183.8
2011	$192.7
2012	$195.8
2013	$200.3
2014	$205.3
2015	$212.4
2016	$218.5
2017	$218.0
2018	$230.0

Source: Texas Bond Review Board.

As the chart above shows, at the end of fiscal year 2007, the total debt held by Texas local governments was $141.4 billion. Thus, over an eleven-year period, local governments borrowed more than $88 billion. That figure is much greater than the State's total outstanding debt of $56.8 billion as of August 31, 2018.[xviii] This substantial increase in local government debt is striking because Texas's economy experienced solid growth during that period.[xix] Despite this growth, local governments still felt compelled to borrow to finance their spending.

The excessive borrowing of local governments in Texas is especially concerning given rapidly-escalating property taxes in Texas. While borrowing may allow local governments to temporarily prevent property taxes from rising at an even greater rate, paying down principal of $230 billion in addition to the interest on that amount inexorably puts upward pressure on property taxes.

Implementing a limit on spending by local governments could be accomplished by a simple statutory change. Recognizing the threat of excessive spending by local governments, SB 18 (85S1, 2017) proposed to limit local government spending by reference to population growth and inflation. Under the bill, a local government could have exceeded its spending limit only if the voters approved the excess spending or if the governor declared the area governed by the local government as a disaster area. Importantly, the spending limit would not have applied to funds raised by voter-approved bonds, or to a gift, donation, or grant to the local government. Although it was not enacted into law, the bill struck the correct balance between fiscal prudence and flexibility.

While critics of spending limits are sure to complain that they place local governments in desperate fiscal positions, there is ample evidence that voters are willing to provide authorization to spend. In November 2018, 86 local governments held 141 bond elections, 127 of which approved debt totaling $11.3 billion (a 90.1 percent passage rate.)[xx] If voters are willing to approve new local debt at such a high rate, local governments wishing to spend in excess of a spending limitation need only ask them.

3. Overriding the Spending Limit

As noted above, the Texas Constitution also authorizes the Legislature to override the current spending limitation by a simple majority vote. Although this provision has never been exercised, it effectively renders the existing spending limit a meaningless "safeguard" against higher spending. To address this shortcoming, the Texas Constitution should be amended to require a three-fifths vote requirement to override the spending limit. This change would require 90 affirmative votes in the House and 19 in the Senate to override the constitutional spending limit. A precedent for this is set by the constitutional requirements for appropriating funds from the Economic Stabilization Fund; the constitution establishes a three-fifths requirement (Art. III, 49-g, (k)) to appropriate ESF monies to address a current biennium shortfall.

4. Shortcomings of Basing the Current Constitutional Limit on Personal Income Growth

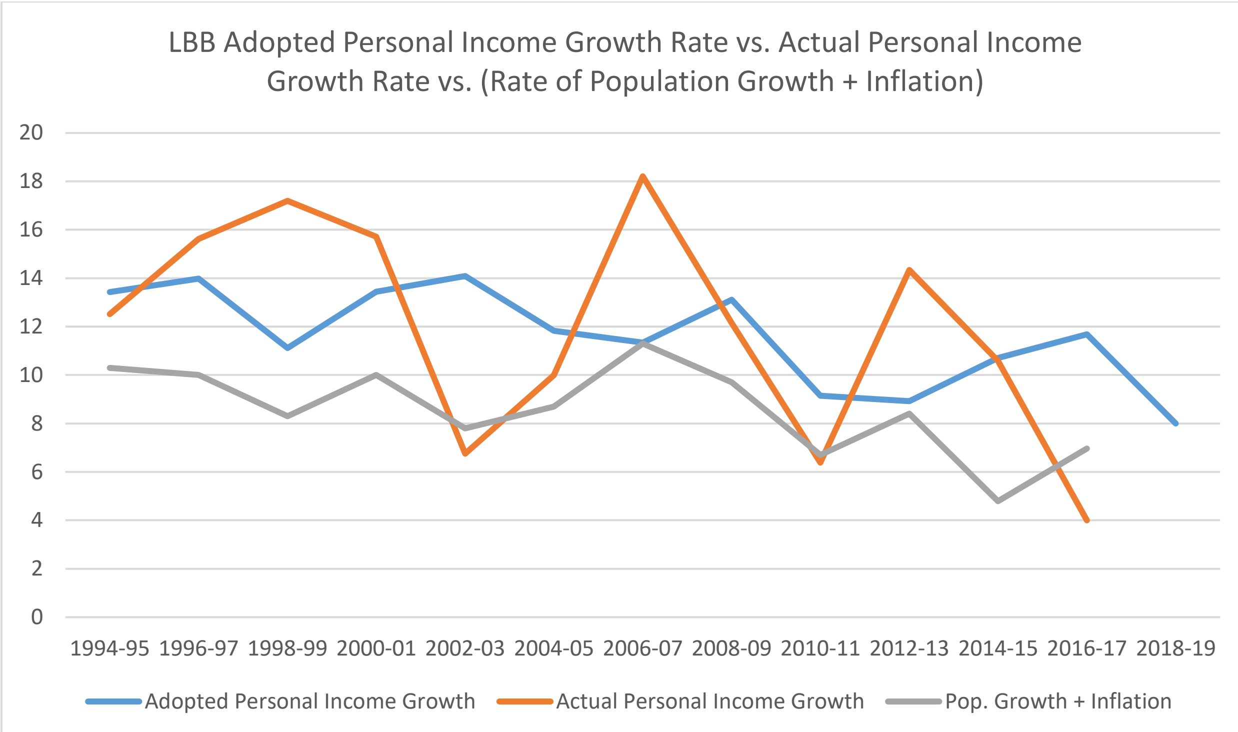
Perhaps the most critical flaw in the current constitutional limit on state spending is the manner in which it is calculated. Under current law, prior to a legislative session, the LBB adopts the constitutional spending limit that will be enforced for the upcoming biennium based on projections of personal income growth. It should be noted that the estimates of personal income growth frequently differ from actual income growth, and sometimes wildly so: most stark are the adopted rate of 14.1 percent for the 2002-03 biennium, when actual personal income growth only hit 6.8 percent, and the 2016-17 biennium adopted rate of 11.7 percent, when actual growth was only 4.0 percent.[xxi]

More broadly, it should be obvious that personal income is not a sensible basis for a state spending limit: as personal income (essentially wages, salaries, investment income, etc.) increases, the "need" for government services and assistance programs should decrease along with the spending on those programs. A spending limit that is functionally based on personal income growth assumes that state spending should continue to grow even as Texans become better-off. State spending and personal income should have an inverse relationship - not a direct one, as Texas' current spending limit does.

A far more reasonable approach to defining a constitutional spending limit is to base the limit on a population growth and inflation formula. At the simplest level, this would allow the state to continue to provide current services even as the state's population grows. Most importantly, in times of economic surplus, state spending could not exceed this "current services" standard. Conversely, whenever population growth slows (or even declines), state spending would have to be reigned-in accordingly. Notably, SB 9 (85R, 2017) would have based the spending limit in terms of population growth and inflation rather than personal income growth. Although the bill did not become law, it brought greater attention to a key flaw in the current calculation of the spending limit.

A comparison of Texas' population growth plus inflation against real and estimated personal income growth underscores the point that the population plus inflation measure is consistently the more conservative option and would therefore be the more effective type of spending limit.

Over the period from the 1994-95 biennium through the 2016-17 biennium (inclusive), a population and inflation limit averages 8.6 percent per biennium, while the average limit using estimated personal income growth is 11.9 percent per biennium- approximately 38 percent higher. The wide variation between the adopted spending limit and *actual* personal income growth (as reported by LBB) is also noteworthy. The data shows that actual personal income growth is very volatile, vacillating wildly from high of 18.2 percent to a low of 4.0 percent. Faced with this unpredictability, LBB frequently adopted spending limits both far below and far in excess of actual personal income growth. On the other hand, the population and inflation metric is considerably more stable, generally staying in a narrower band between 6 and 11 percent.



Source: Legislative Budget Board (except for population and inflation for 2014-15 and 2016-17, which is from the Texas State Library and Archives Commission (population growth, using U.S. Census estimates) and the Federal Reserve Bank of Minneapolis (inflation rate as measured by the Consumer Price Index)).

5. Exempting Tax Cuts

The Legislative Budget Board has made clear that, generally, tax cuts do not count toward the constitutional spending limit: "It is important to note that a piece of legislation resulting in a tax cut simply reduces revenue and is not an appropriation of any kind."[xxii] However, it is appropriations that are made to hold certain entities or funds harmless from the effects of such tax cuts that are currently subject to the spending limit. These types of appropriations are typically made in relation to property tax relief and would also have to be made in the event of significant franchise tax relief in the future, which, as LBB points out, "would reduce margins tax revenues deposited into and appropriations out of the Property Tax Relief Fund (PTRF). Current methods of finance for the Foundation School Program would shift that appropriation from the PTRF to GR. The resulting GR appropriation would count against the spending limit."[xxiii]

It may be appropriate to exempt these types of appropriations from the state's constitutional spending limit since they are only necessary in order to ensure that the Legislature can meet its obligations while also providing tax relief. In the case of the franchise tax, for example, taxpayers should not be penalized because the Legislature continues to meet its public education obligations, forestalling fundamental tax relief.

However, it is important to acknowledge that exempting such appropriations from the spending limit may create the impression that only funds collected in excess of the spending limit should be used for tax relief. Indeed, a provision of this type may invite the temptation to use all GR below the spending limit *only* on programs. There was a glimpse of this in the 83rd Session in the water debate. While the Legislature ultimately made the decision to tap the Economic Stabilization Fund to pay for water development projects, it remains true that there was ample revenue for water projects under the spending limit in the early stages of the budget process. Instead, revenue below the cap was used for other areas of the budget forcing the issue of using the ESF to fund water projects. The same pressures led to the passage of a constitutional amendment to partially fund transportation from revenue diverted before being deposited in the ESF rather than available general revenue.

6. Policy Recommendation and Conclusion: Reform the State's Constitutional Spending Limit

Texas' constitutional spending limit must be strengthened and supplemented in order to address its fundamental shortcomings. This requires four key reforms: (1) apply the spending limit to all general revenue and dedicated general revenue, (2) make statutory changes to implement a spending limit on local governments, (3) require a three-fifths vote of the legislature to override the state spending limit, and (4) use changes in population and inflation (rather than personal income growth) as the basis for both local and state spending limitations.

B. The Economic Stabilization Fund (The "Rainy Day" Fund)

The Economic Stabilization (Rainy Day) Fund (ESF) was created after its approval by voters in the November 1988 constitutional amendment election. Article III, Section 49-g of the Texas Constitution establishes four sources of revenue for the ESF:

- 50 percent of any unencumbered general revenue (GR) balances on the last day of a biennium;
- 37.5 percent of oil and natural gas production tax revenues in excess of what those taxes generated in the fiscal year ending August 31, 1987;
- Interest earned on the balance of the Fund; and
- Any additional amounts appropriated directly to the ESF by the Legislature.

The Constitution directs the Comptroller to calculate and deposit these revenues into the ESF. While there is no minimum required balance for the ESF, it is capped at no more than ten percent of deposits to general revenue the previous biennium. If any of the transfers outlined above would lead to the ESF exceeding the ten percent cap, the Comptroller is directed to reduce the transfers accordingly and to retain the remaining funds in GR.

1. Use of the Economic Stabilization Fund

Article III, Section 49-g, subsections (k), (l), and (m) outline the three situations in which the Legislature may appropriate funds from the ESF:

(k) *For the current biennium:* If the Comptroller certifies that appropriations from GR made by the preceding legislature exceed available GR and cash balances for the remainder of that biennium. This type of appropriation from the ESF requires a **three-fifths vote** in both the House and Senate.

(l) *For a succeeding biennium*: If the Comptroller estimates that anticipated revenues for the succeeding biennium will be less than the revenues that the Comptroller estimates to be available in the current biennium. This type of appropriation from the ESF requires a **three-fifths vote** in both the House and Senate.

(m) *For any purpose and at any time*: this type of appropriation requires a **two-thirds vote** in both the House and Senate.

2. Current Balance

The Comptroller's 2020-21 Biennial Revenue Estimate projects that the ESF will contain a balance of almost $15.4 billion at the end of the biennium, far short of the constitutional limit, which the Comptroller estimates to be $18.6 billion.

Details of Economic Stabilization Fund- Cash Basis Reporting (in thousands of dollars)

Year	**2019**	**2020**	**2021**
Beginning Balance	$11,043,415	$11,800,131	$13,527,198
Transfers and Interest Income			
Oil Production Tax Transfer	1,072,366	1,039,124	1,076,839
Natural Gas Production Tax	311,749	360,477	379,256
Interest Income	213,298	240,940	252,937
Investment Income	41,962	86,526	120,344
Total Transfers and Interest Income	1,639,375	1,727,067	1,829,376
Appropriations	882,659	0	0
Total Ending Balance	$11,800,131	$13,527,198	$15,356,575

It is worth pointing out that a constitutional amendment approved by voters in November 2014 authorized the transfer of certain oil and gas severance tax revenues to the State Highway Fund (SHF) that would otherwise be deposited to the ESF[xxiv]; such transfers have totaled $5.4 billion since the passage of the amendment.[xxv] In addition, the 83rd Legislature appropriated $2 billion from the ESF to water infrastructure projects under the purview of the Texas Water Development Board[xxvi] and transferred $1.75 billion from the ESF to the Foundation School Program (FSP).[xxvii] Without these three actions, the estimated balance of the ESF at the end of the 2020-21 biennium would be more than $24 billion, significantly in excess of the maximum balance permitted under the constitution.

3. The Importance of Maintaining a Healthy Balance in the ESF

Maintaining a healthy balance in the ESF is critical to ensuring that the state can meet future revenue shortfalls, and to retain Texas' strong bond ratings. In its 2018 annual report, the Texas Bond Review Board noted that *Moody's* latest action on Texas' general obligation bond debt rating was to affirm its Aaa rating and stable outlook. Moody's stated that "The Aaa rating reflects the size and strong fundamentals of the Texas economy; a strong budgetary cushion provided by the State's Economic Stabilization Fund; strong governance and fiscal management; and low bonded debt levels."[xxviii]

When voters endorsed the creation of the ESF in 1988, they approved a constitutional amendment "establishing an economic stabilization fund in the state treasury to be used to offset unforeseen shortfalls in revenue." Until the 83rd Legislature, with two narrow exceptions, the ESF had only been used to make supplemental appropriations related to revenue shortfalls: SB 7 (71S6, 1991), HB 7 (78R, 2003), HB 10 (79R, 2005), and HB 4 (82R, 2011). The two exceptions, SB 171 (73R, 1993) and SB 532 (73R, 1993), related to Texas Department of Criminal Justice (TDCJ) capacity issues and totaled less than $200 million.

However, as noted above, the Texas Constitution is clear that the ESF may be used for *any* purpose with the appropriate legislative approval. Article III, Section 49-g(m) states that "the Legislature may, by a two-thirds vote of the members present in each house, appropriate amounts from the economic stabilization fund at any time and for any purpose." It was under this constitutional provision that the 83rd Legislature passed legislation proposing a $2 billion appropriation from the ESF for water infrastructure and considered legislation appropriating ESF revenue for transportation infrastructure. The 83rd Legislature also used the ESF to undo the $1.75 billion deferral of the final Foundation School Program payment of the 2012-13 biennium, underscoring the beginnings of a troubling trend of the Legislature using the ESF for what should be core GR expenditures.

It is only through the defects of the original constitutional language creating the ESF that such expenditures from the Fund are permitted. As noted above, Article III, Section 49-g(m) of the Texas Constitution allows funds to be spent from the ESF *for any purpose* upon a two-thirds vote of the Legislature. In order to protect the balance of the ESF and promote fiscal restraint, this provision should be substantially narrowed.

4. **Policy Recommendation: Amend the Texas Constitution to narrow the permissible uses of the ESF to cover revenue shortfalls, state debt retirement, one-time infrastructure projects, and expenses related to a state of disaster**

Narrowing the uses of the ESF would achieve what is frequently considered a best practice in governance of state rainy day funds. For instance, the Institute on Taxation and Economic Policy argues that "rainy day funds should only be used to reduce the impact of budget shortfalls that arise from cyclical economic downturns—not to cope with long-term structural problems."[xxix] Similarly, the Mercatus Center at George Mason University suggests that states should "[e]nact rules governing the use of rainy day funds"[xxx]:

> State legislators can do more to ensure fiscal stability for their states by adopting requirements for deposits made to their rainy day funds and by setting strict rules about withdrawals. States that have already adopted such rules have, on average, lower spending volatility across years than states without such rules.

Amending Article III, Section 49-g(m) of the Texas Constitution to specify that other than in times of budget shortfall for a current biennium, the ESF may only be used for retirement of existing debt, one-time infrastructure payments, or to cover expenses related to a state disaster as declared by the Governor under the Texas Government Code §418.014 would achieve this goal. House Joint Resolution 94 (84R, Burkett) should be used as a model for future legislation. HJR 94 proposed amending Article III, Section 49-g(m) as follows:

> …the legislature may, by a two-thirds vote of the members present in each house, appropriate amounts from the economic stabilization fund to:
>
> (1) retire state debt;
>
> (2) pay costs associated with a state of disaster declared by the governor; or
>
> (3) pay nonrecurring costs of infrastructure projects
>
> ~~[at any time and for any purpose]~~.

It is important to note that legislation like HJR 94 would *still allow funds from the ESF to be used to address budget shortfalls*, since those situations are covered under Sections 49-g(k) and (l) of Article III of the Constitution.

C. Unfunded Mandates

An increasingly important issue is the concern over "unfunded mandates." Ostensibly, an unfunded mandate is a requirement created at the state level and imposed on local levels of government (e.g.

counties, municipalities, school districts) requiring the expenditure of funds in order to comply. But the issue is not so simple. Unfunded mandates are not formally defined anywhere, local governments often complain about mandates that are, indeed, funded, or that they lobbied the legislature to enact. Furthermore, most local governments have the power of taxation, which makes “unfunded mandate” a bit of a misnomer. Indeed, given this power of taxation, the argument that there is no such thing as an unfunded mandate is valid and legitimate. All of this takes place within the context of the state government and the Legislature having the legitimate authority to set and define the responsibilities and powers of the very local governments objecting to what they call “unfunded mandates.”

1. Legislative Attempts to Address Unfunded Mandates

There is an impulse in the Legislature to address the perceived issue of unfunded mandates, and while there is arguably merit to a conversation about so-called “unfunded mandates,” the Legislature should address this issue—to the extent it should address it at all—with a clear understanding of the answers to the following:

1. What is the definition of an unfunded mandate?
2. Should the legislature repeal an unfunded mandate instead of increasing funding?
3. What are the criteria for determining funds that might be owed to local governments in relation to unfunded mandate?
4. What is the mechanism by which local governments obtain funds for mandates that are not funded?

Past attempts at legislation have not taken these questions into proper account, using instead an excessively broad approach. For instance, House Joint Resolution 73 (85R), which passed the House with 127 Yeas and only 18 Nays on 3rd Reading, would have codified the following passage in the Texas Constitution:

> A law enacted by the legislature on or after January 1, 2018, that requires a municipality or county to **establish, expand, or modify** a duty or activity that requires the expenditure of revenue by the municipality or county is not effective unless the legislature appropriates or otherwise provides, from a source other than the revenue of the municipality or county, for the payment or reimbursement of the costs incurred for the biennium by the municipality or county in complying with the requirement.

The key words emphasized above are “establish, expand or modify.” That language touches on every possible piece of legislation that affects local governments. Entire House committees (e.g. County Affairs, Urban Affairs, Public Education) are dedicated to the activities of local governments. Entire committees (e.g. Elections, Corrections, Judiciary and Civil Jurisprudence) are dedicated to issues that change the way local governments operate. Under the language of HJR 73, every piece of legislation that passes through these committees would be on the table for local governments to make a constitutional challenge, ultimately requiring the Legislature to create or increase funding streams to accompany these changes. Would the Legislature have to adjust appropriations for every future reform to property tax appraisals, collections, and rate changes? Every future proposal that touches county jails or county hospital districts? Would bills that require reporting be an unfunded mandate even if that reporting were necessary to adjust policies and appropriations? What about changes to traffic laws that must be enforced by city or county law enforcement officers?

Two bills passed during the 85th Legislative Session highlighted these questions. House Bill 62 (Craddick) created a state-level offense for using a wireless electronic device while driving. The bill forces local governments that did not have ordinances on using such a device while driving to enforce the state law on that issue. And most cities that did have such an ordinance had to modify their approach in order to comply and enforce the state law. Under the language of HJR 73, the state is responsible for funding the cost of these changes, whatever they may be.

The other example from the 85th Legislative Session is Senate Bill 2190 (Huffman | Companion to HB 43, Flynn), which made significant changes to Houston's municipal pension system. Interestingly, the pension crisis addressed by SB 2190 was the product of local mismanagement. The city, through its "meet and confer" authority, could have enacted budget cuts, reduced benefits, or asked for more from city employees, yet it did not do so to any meaningful degree and ultimately turned to the Legislature for assistance. With the state's changes to Houston's pension system, should the state be held financially liable for fixing the problem the city created? Under HJR 73's approach, it would be.

None of this is to say that there is no place for a policy on so-called "unfunded mandates," but the parameters must be much narrower than proposals in the past, and the mechanisms through which an unfunded mandate becomes either funded (or no longer mandated) should be defined.

2. What is an Unfunded Mandate?

While numerous local governments and their associations bemoan unfunded mandates, such mandates are not clearly defined. Indeed, an unfunded mandate is in the eye of the beholder, and the beholder is typically a local government pursuing more state funding.

3. The Term "Unfunded Mandate" Is Abused in Service of Arguments for More Funding

The Texas Association of Counties (TAC), for example, states on its website that the Legislature "regularly requires that counties enact expensive new policies and programs, known as unfunded mandates, expecting local property tax payers to pick up the tab."[xxxi] The Texas Association of School Administrators (TASA) and the Texas Association of School Boards (TASB) issues a "Report on School District Mandates," yet the report does not clearly and specifically define its criteria for an unfunded mandate.[xxxii] Despite that fact, the report endeavors to identify "the most significant unfunded or underfunded mandates" and to help assist school leaders "in calculating the cost of implementing those mandates in their districts."[xxxiii] Note the inclusion of "underfunded," which broadens an already loose interpretation, essentially boiling it down to an entirely subjective determination.

And the TASA/TASB report takes advantage of the subjective groundwork laid out at its outset. Laying out nine different broad categories of unfunded mandates, each with numerous specific items identified:

Category	Number of "Unfunded Mandates" Identified
Instructional Programs	25
Assessment and Accountability	8
Human Resources and Employee Relations	13
Safe Schools	9
Special Education	5
Governance and General Administration	16
Reporting Requirements	8
Public Notices	8
Parental/Student Notifications	11
TOTAL:	**103**

Setting aside the subjectivity of "unfunded mandates," the items listed in the TASA/TASB report are identified as "significant" cost drivers. These include things like ensuring that counselors are able to explain the "Top 10% Rule" to students and parents,[xxxiv] holding one meeting to discuss school and campus performance,[xxxv] ensuring that personnel know how to properly administer an examination,[xxxvi] and notifying parents of a school's low accreditation status,[xxxvii] to name a few examples. To put it mildly, many of these examples identified as significant cost drivers and unfunded mandates are quite absurd, and they distract from the few items in the report that may actually qualify to the standard person as a costly mandate. Moreover, the TASA/TASB report does not identify the cost for a single item in its list of 103 unfunded mandates. Of course, to put a dollar amount on ensuring that a high school counselor can explain the Top 10% rule would illuminate a point at odds with calling it a costly mandate, thus distracting from the larger argument for more funding.

4. Mandates Identified as Unfunded are Often Times Funded

If it was not clear from the TASA/TASB use of "unfunded or underfunded" that the goal is simply to identify reasons to argue for more funding, some of the recommendations make clear that the state does, in fact, pay for these things. For example, the TASA/TASB report identifies a 2006 pay increase for teachers, nurses, counselors, and librarians of $2,500, and points out that the legislature actually funded these increases. The mandate, as the report complains, was that more funds were not appropriated for corresponding increases to TRS, Medicare, unemployment compensation, and other similar programs. The fact that the Legislature appropriated $2,500 across the board for pay increases becomes a secondary consideration to the now 13-year old complaint that more funding was not given at the time to pay for benefits as well.

Similarly, the Texas Association of Counties (TAC) cites "more than $265 million for court-appointed criminal lawyers in 2017 with minimal reimbursement from the state,"[xxxviii] yet directly within the statement is a concession that the state spends money on the item, which hardly makes it "unfunded."

5. Local Governments Often Lobby and Advocate in Favor of the Policies they Identify as Unfunded Mandates.

The aforementioned "unfunded mandate" of criminal indigent defense through court-appointed lawyers is the number one item listed by TAC in its materials bemoaning unfunded mandates. In a Legislative Brief from August 2018, TAC identifies the Fair Defense Act (Senate Bill 7, 77R) as a costly unfunded mandate of criminal indigent defense. And yet, the County Judges & Commissioners Association of Texas lobbied before the 77th Legislature in favor of its passage.[xxxix] Similarly, in 2009, officials for public entities including the City of Houston testified in favor of a requirement that backup generators are required at all water plants. Two years later, the Governor's Task Force on Unfunded Mandates, which included the Mayor of Houston, complained that the mandate was inflexible and that it could cost up to $92.5 million more than necessary.[xl]

6. Policy Recommendation: In Any Legislation Crafted to Address "Unfunded Mandates," Provide a Clear and Narrow Definition of What Counts as an Unfunded Mandate.

Given the subjective nature of how unfunded mandates are identified, there should be a clear definition. That becomes even more important should the Legislature again pursue a policy of prohibiting unfunded mandates. The following points should be factored into such a definition:

> An unfunded mandate is a statutory requirement imposed on a county, municipality, or school district that:
>
> 1. Cannot be satisfied using existing resources at the local level;
> 2. Requires the expenditure of an objectively identifiable sum of money;
> 3. Is not within the purview of a program or expenditure already funded by the Legislature; and
> 4. The affected local government did not lobby or advocate in favor of.

If the Legislature is to be held financially responsible for defining the activities of local levels of government—something that is entirely within its purview—beyond the scope of funds available through appropriation or existing local taxation, then the scope of that responsibility should be clearly defined. Responsibilities that can be satisfied using existing resources, like many of those identified in the TASA/TASB report would fall outside the scope of this definition not only because of the ease of absorption, but also because of their lack of identified cost.

7. Policy Recommendation: Any Passage of Legislation Prohibiting "Unfunded Mandates" Should be Secondary to the Requirement That Local Revenue and Taxation Growth Be Limited.

A prerequisite to Texas enacting any sort of prohibition on unfunded mandates must be a clear and decisive restriction on the growth of local property taxes.

In 1980, Missouri voters approved an amendment to the state's constitution that reined in local government spending. Indeed, the "Hancock Amendment," as it was called, prohibited the Missouri General Assembly from imposing "taxes of any kind which, together with all other revenues of the state, federal funds excluded," exceed an amount established by a formula that takes things into account such as the personal income of the state. Section 22 of the Hancock Amendment restricted counties and other political subdivisions from "levying any tax, license, or fee" without local voter approval. It also prevented the total amount of property tax revenue received by counties and political subdivisions from increasing faster than a measure tied to the consumer price index.

It was only with the reforms of the Hancock Amendment's strict tax and expenditure limitations that Missouri passed a restriction on unfunded mandates. This is of particular importance to Texas in the current debate over rapidly rising property tax collections. Like Missouri, Texas should pass important restrictions on taxation, revenue, and spending at the local level (e.g. property tax revenue caps, spending caps tied to population and inflation, etc.) as a prerequisite to any discussion of the state obligating itself to pay more money for local government functions that it has every authority to direct.

8. Policy Recommendation: Repeal So-Called "Unfunded Mandates" Where Agreement Can be Found.

The term "unfunded mandate" is a term that implies opposition to the policy at issue. The 103 "unfunded mandates" identified in the TASA/TASB report provide ample opportunity for identifying policies that could be repealed. For example, the TASA/TASB report identifies the 22:1 student-teacher ratio of 22:1 (grades K-4) as a costly mandate.[xli] This has long been identified as an inefficient mandate by conservative reformers because it reduces flexibility in personnel hiring. Perhaps a more skilled teacher could educate 25 students and be better compensated for it while at the same time allowing the same school to have smaller classes elsewhere.

Any other areas where local governments and school districts complain of unfunded mandates on policies that could conceivably be repealed should be explored as repeal candidates.

II. Tax Reform, Reduction, and Relief

Texas has an opportunity to show that more government is not the way forward. Rather than creating new government programs, expanding or growing existing programs, or hiring more public employees, Texas can underscore its faith in the free market by permanently lowering taxes and setting itself on a private sector path to prosperity.

Currently, the Texas Constitution permits the Legislature to enact an income tax on individuals if the voters approve of such a tax in a referendum. To minimize the possibility that Texas will ever adopt an economically destructive income tax, the Constitution should be amended to require the consent of the voters and two-thirds of each of the House and Senate.

The state's franchise tax and local school district maintenance and operations property taxes are both unnecessarily burdensome, and should be the focus of any legislative efforts to provide tax relief. It is also evident (as this report will make clear) that the benefits of providing tax relief in terms of dynamic revenue increases, as well as improvements in job creation, investment, and disposable income go a long way toward mitigating the short-term revenue losses to state coffers.

The sales and use tax is not only the largest single revenue generator[xlii], but it is one of the least onerous and most efficient and transparent forms of taxation. Consumption taxes in general (of which Texas' sales and use tax is an example) are a superior form of taxation because they do not penalize work, savings or investment. In 2005, then-Federal Reserve Board Chairman Greenspan testified to the following economic benefits of consumption taxes: "…many economists believe that a consumption tax would be best from the perspective of promoting economic growth… because a consumption tax is likely to encourage saving and capital formation." [xliii]

Contrast the sales and use tax with Texas's second and fifth largest revenue generators – school district M&O property taxes[xliv] [xlv] and the franchise tax,[xlvi] respectively– and it is evident that property taxes and the franchise tax are where lawmakers should focus their tax relief efforts. These two taxes are especially punitive toward businesses, job creation, capital investment, and, in the case of the property tax, home ownership.

Reforming these taxes to put the state on a path to greater economic prosperity demands bold action. Targeted tax incentive programs are always more politically viable than eliminating taxes entirely or reducing rates, but better fiscal policy requires the political will to realize the substantial economic benefits of broad-based tax reduction and elimination.

At the same time as the state levies the franchise tax and school districts levy M&O property taxes, there are numerous tax breaks offered to businesses: property tax abatements under Chapter 313 of the Tax Code, the franchise tax small business exemption, the Texas Enterprise Fund, the Moving Image

Industry Incentive Program, and the High Cost Natural Gas Production Tax exemption to name just a handful.

Implicit in each of these programs is the notion that low taxes encourage economic growth. Tax incentives are based on the concept that if a business gets to pay lower net taxes because the state gives it a tax break, it will relocate to Texas, remain in Texas, or expand its operations in Texas. Each of these outcomes would boost the state's economy and create jobs. This raises an obvious question: if targeted tax reductions boost narrow sectors of the economy, why not simply cut tax rates in order to spur economic growth in all sectors? Instead, an interminable amount of effort is put into tinkering with the state's tax system by making minor changes to existing taxes and creating a multitude of "targeted" incentives.

The time has come to cease making piecemeal reforms and incentive programs at the behest of one special interest or another. This is the failed course charted in Washington that gave us such examples of policy failures as the Wind Production Tax Credit and federal corn subsidies. Instead, Texas must be bold and visionary, setting itself aside from the rest of the nation.

Lawmakers must break with the past and phase out the Texas franchise tax and transition away from property taxes to fund public schools. The state must stop trying to pick winners and losers: the free market is perfectly capable of fulfilling that role. Repealing the franchise tax would make Texas one of three states in the nation without a form of broad corporate or business taxation.[xlvii] If such a policy were pursued, serious consideration would have to be given to ending the array of tax incentive programs that currently litter the Tax Code and the Government Code. Being one of a very few states without a business tax is the ultimate incentive program, while reducing the property tax burden would attract business investment, create jobs, increase disposable income, and make home ownership more affordable. Finally, Texas should amend its constitution to require the consent of a super-majority of legislators to impose an income tax on individuals, thereby sending a signal to the rest of the country that Texas intends to keep its low-tax policies for the long term.

A. The Franchise Tax

1. Background

Since the current iteration of the Texas franchise tax was first collected in 2008 (and even before it was enacted), the tax has been controversial and a source of much criticism. Many of these criticisms stem from the fact that the franchise tax is a form of (gross) margins taxation, which is generally acknowledged to be an inefficient form of taxation with high compliance costs for businesses that are subjected to it.[xlviii]

Understanding these issues and the negative impact that the franchise tax is having on the state's business climate,[xlix] the Texas legislature has already set itself on the path toward elimination of the franchise tax. In the 2015 legislative session, House Bill 32 reduced the rates of the tax by one-quarter, increased the annual maximum revenue threshold for filing an "EZ" franchise tax return from $10 million to $20 million, and lowered the EZ filing rate by 42 percent. HB 32 (84R, 2015) also directed the Comptroller of Public Accounts to study the future fiscal and economic effects of repealing the franchise tax. Per the Legislative Budget Board (LBB), the cuts to the franchise tax enacted in HB 32 amounted to a $2.6 billion tax reduction over the course of the 2016-17 biennium. If the franchise tax remains in place, it is expected to raise $8.19 billion throughout the 2020-21 biennium, an increase of $0.6 billion or 8% over 2018-19.[l]

During the 2017 legislative session, several excellent bills regarding the franchise tax were proposed but not enacted into law. For example, SB 17 (Senator Nelson) would have phased out the franchise tax gradually in the following manner: if a BRE for a given biennium shows general revenue-related funds available for certification by the Comptroller that are more than five percent greater than the same figure for the preceding biennium, half of the excess funds would be used to lower franchise tax rates. The process would be repeated each subsequent biennium. Over time, this mechanism would result in an elimination of the franchise tax.

HB 28 (Representative Bonnen) would have accomplished a phaseout of the franchise tax in a different manner. The phaseout would be accomplished by first identifying the lesser of $3.5 billion or the ending balance of general revenue-related funds available for certification for the preceding biennium. Franchise tax rates would then be set to generate franchise tax savings equal to this amount. The process would be repeated each biennium. When the franchise tax so adjusted would be less than 15 percent of the franchise tax rate effective on September 1, 2017, the franchise tax would be eliminated entirely.

HB 388 (Representative Murphy) differed from SB 17 and HB 28 in that its repeal of the franchise tax would have occurred on a definite date. It would have phased out the franchise tax by reducing it incrementally each year for four years, then keeping the tax rate constant for one more year before eliminating the tax entirely.

Although these bills were not enacted into law, the Legislature should continue to pursue the idea behind them and phase out the franchise tax.

2. The Fiscal and Economic Imperative of Eliminating the Franchise Tax

Phasing out the franchise tax is an approach that the legislature must continue to pursue. Beyond the basic deficiencies of margins taxation, the franchise tax has failed on two other fronts: it has failed to help keep down property taxes, and it failed to keep the state out of court. It was only five years from the implementation of the franchise tax to the school finance lawsuit that was recently decided by the Supreme Court of Texas.[li]

Although the franchise tax is the state's primary business tax, it generated only 3.1 percent of all state revenues in FY 2018, partly as a result of the reductions enacted via HB 32 (84R).[lii] Incrementally reducing or slowing the growth of state outlays by one or two percent for each of the next two or three biennia could see the tax phased out five or six years from now. Alternatively, the tax could be entirely eliminated in the 86th Legislature.

Repealing or phasing-out the franchise tax would have substantial economic benefits for the entire Texas economy. The Beacon Hill Institute at Suffolk University (BHI) has modeled the dynamic fiscal and economic effects of both of these policy proposals. BHI's economic model shows 31,500 net new jobs created across the entire Texas economy, as well as $3.2 billion in net new investment in the state, and $6 billion in new personal disposable income.[liii]

By the fourth year of repeal, BHI projects that the economic gains accruing from repeal of the franchise tax will have increased significantly: 10,000 additional new jobs will be created (taking the total net new jobs to 41,500), while new net investment will rise to $3.4 billion, and new personal disposable income to $9.8 billion. Analyzing the results of their model, BHI notes that:

> The elimination of the franchise tax leads to a reduction in the after-tax burden on income derived from capital investments. This provides a powerful incentive for business owners inside Texas to invest in their businesses. Investment projects that may not have been profitable enough to justify the investment when taking into account property taxes, now become more profitable on an after tax basis. Moreover, firms looking to locate new facilities in the United States would find Texas an even more attractive location in the absence of the franchise tax.[liv]

BHI's results are summarized in the following table:

Economic Effects of Repealing the Texas Franchise Tax:

Year of Repeal	**Private Employment**	**Investment**	**Real Disposable Income**
	(Jobs)	($ billion)	($ billion)
1	31,500	3.2	6
4	41,500	3.4	10

Source: Beacon Hill Institute

Another recent analysis by John Merrifield and Corey DeAngelis of University of Texas at San Antonio looks backward to show how the Texas economy would have grown assuming the new franchise tax had never been put in place. Their analysis shows that cumulative disposable personal income would have grown by $30.5 billion to $46.3 billion between 2006 and 2013. This is as much as a 0.57 percent increase over how personal income actually grew over this period. This economic growth would also have created somewhere between $1.4 and $2.2 billion in additional tax revenues.[lv]

The scale of these economic and fiscal gains that result from eliminating the franchise tax underscore that the legislature must eliminate the tax. Indeed, Americans for Tax Reform has argued that "the margins tax has significantly diminished the competitive advantage that Texas companies have over their out-of-state competitors. Worse, for all the economic harm the margins tax does, it generates relatively little revenue for state government coffers."[lvi] Professor John Mikesell of Indiana University described the franchise tax as follows:

> [The franchise tax is] a badly designed business profits tax, like those that emerged in the newly independent states of the former Soviet Union...combin[ing] all the problems of minimum income taxation in general—excess compliance and administrative cost, penalization of the unsuccessful business, undesirable incentive impacts, doubtful equity basis—with those of taxation according to gross receipts.[lvii]

By eliminating the franchise tax, Texas would join states such as New Jersey, Kentucky, and Michigan, all of which repealed their gross receipts taxes within a few years of adopting them after realizing the flaws of that manner of taxation.

3. <u>Policy Recommendation</u>: Eliminate the Franchise Tax Through a Phaseout.

Like all forms of margin-based taxation (where tax liability is based on the top-line revenue of a business, rather than some calculation of net income) the Texas franchise tax has serious flaws. The tax is complex, with businesses having a multitude of ways to calculate their liability, unclear rules pertaining to what can be excluded from "total revenue" in adjusting their gross revenue, as well as what items can be included in the deductions for either "cost of goods sold" or "compensation." Margins taxation is also especially punitive for businesses that have narrow margins and can create situations in which businesses owe tax to the state despite having recorded a loss. The Tax Foundation summarized problems with the tax thusly:

> With the Texas margin tax collecting far less in revenue than expected, causing significant confusion and compliance costs, resulting in significant litigation and controversy over "cost of goods sold" definitions, and facing calls for substantial overhaul and even repeal, <u>it should not be used as a model tax reform for any other state</u>.[lviii]

Eliminating the franchise tax – which again, accounts for only 3.1 percent of all state revenues as of FY 2018– would make Texas one of only three states without a corporate income tax or gross receipts-style business tax[lix], which would be a boon for investment, job creation, and economic growth. That the margins tax "should not be used as a model for tax reform"[lx] is perhaps the best reason it ought to be abolished.

The Legislature should continue its phaseout of the franchise tax. To avoid a situation in which repeal of the tax exacerbates an unanticipated shortfall in state revenue, the Legislature could eliminate the franchise tax over time by using as a template legislation from last session, such as HB 28 by Representative Bonnen or Senate Bill 17 by Senator Nelson. Using either of these bills as a model would ensure that the phaseout of the franchise tax goes smoothly.

B. Property Taxes

1. Background

A common complaint among Texans concerns the amount of their property tax bills. From 1995 to 2015, annual property tax collections in Texas soared more than $36 billion—an increase of 227 percent.[lxi] In recent years, property taxes have played an increasingly prominent part of the overall tax burden on Texas residents. The property tax system should be a concern for conservatives everywhere for two reasons. First, as a practical matter, property taxes are particularly onerous because of a liquidity problem they pose for taxpayers. That is, the tax burden on a taxpayer rises as the value of his or her property appreciates even there is no readily available means for the taxpayer to use the increased value of his or property to pay the increased tax.

For example, assume a taxpayer who earns $60,000 a year pays property taxes of 2.5 percent a year on a house and land worth $180,000, or $4,500 a year. If the taxpayer's property appreciates at an annual rate of 5 percent, the taxpayer cannot readily pay the increased taxes out of the increase in the property value. In contrast, a taxpayer who is unable to pay sales tax on an item will not purchase the item in the first place and thus does not have to pay sales tax. But taxpayers who are faced with increasing property tax bills that exceed their ability to pay are sometimes forced to borrow from a property tax lender to keep their homes.[lxii] One trade group representing property tax lenders claims that over $175 million in property tax loans were made in Texas in 2016.[lxiii] A 2012 survey by the Texas Finance Commission indicated that the average rate on property tax loans exceeded 14 percent.[lxiv] Healthy demand for loans at high interest rates suggests that a great many property owners are struggling to pay their property tax bills. Owners who wish to avoid loans with such high rates, or who do not qualify for such loans, might be pressured into selling their homes to "downsize" and reduce their property tax bills.

The above liquidity problem does not affect only taxpayers whose property values are increasing faster than their salaries. Property owners who become unemployed- whether due to a layoff, medical emergency, or other cause- can face a situation in which property taxes force them to sell their homes.

More fundamentally, property taxes are concerning to conservatives because they limit the value of private property rights. A person who labors for income owns that income outright after paying taxes on it. In contrast, if a person uses that income to purchase land or a residence, he or she must pay property taxes each year to the government or forfeit the property. Functionally, there is a strong similarity between a property tax system and a system in which taxpayers lease property from the government for an annual fee. If taxpayers must pay government on an ongoing basis for the use of their own property, they cannot be said to have true ownership of that property. Such a lease-like arrangement is difficult to reconcile with a high regard for private property rights.

Respect for private property rights and recognition of the liquidity problems property taxes pose for taxpayers argue against raising revenue through a property tax system. If a property tax system cannot realistically be abolished, conservatives should focus on limiting property taxes and raising necessary revenue through more efficient and equitable means.

2. Recent Reforms

Prior to 2015, school districts in Texas were required to offer a $15,000 property tax exemption on the appraised value of residential homesteads. Senate Bill 1 and Senate Joint Resolution 1 (84R) raised the homestead exemption from $15,000 of the appraised value of the residence homestead to $25,000. SB 1 also provided for additional state aid to help make up the difference between revenue that would have been available to school districts before this change and revenue that districts actually receive after the bill's enactment. The amount of additional state aid will be determined by the lesser of the school district's currently adopted maintenance and operations tax rate, or the adopted maintenance and operations tax rate for the 2014 tax year.

In addition to the constitutional amendments required to enact SB 1, SJR 1 also prohibited the imposition of a transfer tax on a transaction that conveys fee simple title to real property. SJR 1 and SB 1 must also be considered in the context of SB 1760 (84R), which, among other provisions, requires that any increase in an effective property tax rate must be approved by at least 60 percent of the members of the governing body of a political subdivision. This was in addition to current law provisions that require an increase in an effective tax rate to be approved via a record vote of the governing body in question.

Taken together, SJR 1, SB 1, and SB 1760 represent a comprehensive effort to provide lasting property tax relief for Texans by increasing the homestead exemption and establishing a higher standard that must be met in order for a taxing entity to raise an effective tax rate.

At the time SB 1 and SJR 1 were passed by the legislature, the Legislative Budget Board (LBB) projected that it would cost the state $1.2 billion to hold school districts harmless against the loss of property tax revenue.[lxv] This estimate was confirmed in the LBB's Fiscal Size-up 2016-2017[lxvi], although LBB noted the following:

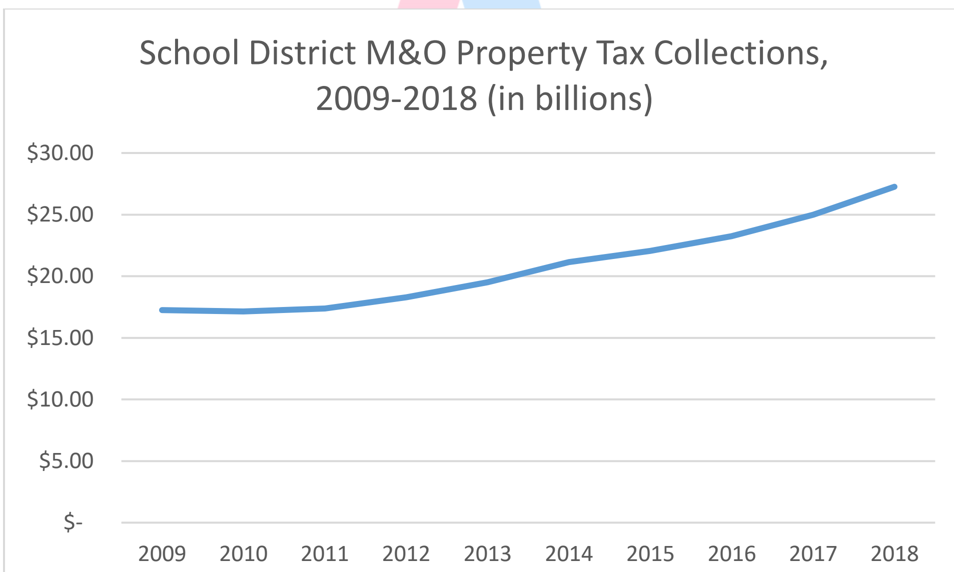
> Despite increases in FSP entitlement in the 2014–15 and 2016–17 biennia, and property tax relief through a homestead exemption increase in fiscal year 2016, the state share of the FSP is projected to decrease primarily due to moderate to robust property value growth.[lxvii]

In its 2018-2019 Fiscal Size-Up, the LBB echoed this statement:

Increases in local revenue typically decrease state obligations to fund FSP [Foundation School Program] entitlement, and growth in local property values is projected to result in a decrease in state cost of about $3.5 billion for the 2018–19 biennium.

Rising local property taxes are a key reason the state's share of public education funding has fallen from 37.6 percent to an estimated 35 percent from 2010 to 2019, while the local property owners' share of the burden has increased from 46.1 percent to an estimated 55.5 percent.[lxviii]

This point underscores the pernicious nature of the property tax system and why the relief provided through SB 1 and SJR 1 was necessary. Over a period of more than three decades, efforts have been made to provide property tax relief. The Legislature has tried to reform the appraisal process, lower the appraisal cap, lower the maximum allowable tax rate, improve the accountability and transparency of school districts, and increase public participation in school district decisions. While some of these efforts have been successful around the edges, the system is structured in a way that will always work against property owners, as evidenced by the 58 percent growth in school district maintenance and operations (M&O) property tax collections from 2009-2018 alone:



Source: Texas Education Agency. Years are school years ("2009" refers to the 2009-2010 academic year, and so on). Numbers for 2018 are estimates.

Adjusting the homestead exemption for school districts will not solve this long-term problem, but it has provided valuable relief.

3. Policy Recommendation: Permanently curb the growth of property taxes by enacting a 2.5 percent revenue cap, or by reducing the rollback rate to 2.5 percent.

As noted above, despite various attempts by the Legislature in previous years to slow the growth of property taxes, the decade from 2009-2018 nevertheless saw 58 percent growth in school district maintenance and operations (M&O) property tax collections. Similarly, local tax revenue directed towards public education has increased an estimated 51 percent from 2010-2019.[lxix] To effectively and permanently curb the burden of growth of property taxes on Texans, the Legislature should consider one of two options: either cap annual increases in local property tax revenue, or reduce the rollback rate.

A revenue cap of 2.5 percent would provide the genuine property tax relief that previous attempted cures failed to provide. As long as local voters consent, local taxing units could exceed the cap. This would provide local taxing districts the flexibility necessary to address unusual circumstances, such as unusually large growth in the local school-age population.

The approach adopted by Massachusetts more than thirty years ago demonstrates the effectiveness of a 2.5 percent cap on property tax revenue. In 1980, Massachusetts voters overwhelmingly approved "Proposition 2.5" by a margin of twenty points. The proposition has two components: (1) "a community cannot levy more than 2.5 percent of the total full and fair cash value of all taxable real and personal property in the community" (the levy ceiling), and (2) a community's tax levy is constrained and can grow by no more than 2.5 percent per year (the levy limit).[lxx]

The law also contains provisions exempting new growth (defined as developments or improvements to existing property, exempt real property returning to the tax rolls, and new subdivision parcels, but *not including* the results of reappraisal of existing properties)[lxxi], and allows voters to override either the levy ceiling or the levy limit on a majority vote of both its elected officials and the entire electorate.[lxxii] In short, without a voter override, total property tax collections in a community may not exceed 2.5 percent of the total assessed property value in the community, and total property tax collections may not increase by more than 2.5 percent from one year to the next.

The results of Proposition 2.5 have been undeniably positive for property owners in Massachusetts:

> Over the two and a half decades Proposition 2 ½ has been in effect, Massachusetts' level of property taxation has declined. Between 1980 and 1985, property taxes as a percentage of income fell from 76 percent above the national average to 13 percent above the national average, where it stands today.[lxxiii]

In contrast, Texas had the sixth-highest property tax burden in the nation in 2016, according to the Tax Foundation.[lxxiv] Other measurements place Texas behind only New Jersey, Illinois, and Vermont in terms of effective property tax rates.[lxxv]

The Beacon Hill Institute (BHI) also modeled the effects of a 2.5 percent *revenue* growth cap applied to all property taxes. BHI notes that property tax revenue growth in Texas has averaged 3.7 percent over the past decade, so a 2.5 percent cap would equate to a one-third reduction in property tax revenue growth. (Comptroller data shows an even higher rate of property tax revenue growth, averaging over 6.1 percent per year between 1998 and 2017.[lxxvi]) The economic and fiscal effects of enacting such a cap, modeled by BHI, follow:

Fiscal Effects of Limiting the Growth of Property Taxes:

State Taxes ($ millions)	**Yr. 1**	**Yr. 4**
Franchise Tax	20	110
Sales Tax	42	271
Other Revenue	95	315
Subtotal	157	696
Local Taxes ($ millions)		
Sales Tax	15	99
Residential Property Tax	-647	-3,837
Business Property Tax	-498	-2,990
Other Revenue	32	199
Subtotal	-1,098	-6,529
Total	**-941**	**-5,833**

It should be noted that the tax revenue "losses" indicated in the table above are relative to what would have been collected in the absence of a revenue or appraisal cap: *they are not a reduction in tax collections.* Property tax collections will still increase over time, but at a slower rate than under current law.

Economic Effects of Limiting the Growth of Property Taxes:

Year	**Private Employment**	**Investment**	**Real Disposable Income**
	(Jobs)	($ million)	($ billion)
Year 1	14,000	819	2
Year 4	80,200	4,256	14

The economic effects of a revenue cap are impressive. More than 80,000 new jobs created by year four of the simulation are just 7,700 jobs fewer than transitioning away from school district property taxes altogether.

As an alternative to adopting a 2.5 percent cap on property taxes, the Texas Legislature could lower the rollback rate. Under current law, the rollback rate is a key figure because proposed tax rates exceeding it are at least potentially subject to voter approval. If a school district proposes a tax increase which exceeds the

rollback rate, voter approval is required.[lxxvii] If a taxing unit other than a school district proposes a tax increase in excess of the rollback rate, voter approval is required only if a petition by local residents gathers enough signatures. The calculation of the rollback rate confuses many Texas residents,[lxxviii] and this confusion is exacerbated by the fact that the calculation varies depending on whether the local taxing unit is a school district. Understanding the calculation requires an explanation of some property tax-related terms.
Taxing units in Texas can charge maintenance and operations ("M&O") taxes, irrespective of whether they are school districts. The terminology can be confusing; because school district M&O taxes often account for a large portion of a taxpayer's property tax bill, people often informally refer to M&O taxes as school taxes.

A taxing unit's "effective M&O rate" is the tax rate that would raise the same amount of M&O revenue that it raised the previous year, considering only property that is taxed in both of those years (i.e., new property is excluded). If property values rise while tax rates stay constant, the effective rate decreases. Similarly, if property values decrease while tax rates stay constant, the effective rate increases. A taxing unit's debt rate is the rate that raises the revenue necessary for the local taxing authority to make the required interest and principal payments on its debt for that year.

If a taxing unit is a non-school district, the rollback rate is calculated according to the following formula:[lxxix]

Rollback rate = (the taxing unit's effective M&O rate * 1.08) + the debt rate

For school districts, calculating the rollback rate is more complex. The calculation depends in part on the "State Compression Percentage (SCP)," which is currently 0.6667. The rollback rate in the school district context is the lesser of:

A) (SCP * $1.50) + (0.04) + (debt rate) + (adjustment for any previously adopted rate in excess of the rollback rate for that school district); or
B) (the school district's effective M&O rate) + (SCP * 0.06) + (debt rate).

If a school district had an M&O tax rate for 2005 that was greater than $1.50 per $100 of taxable value, that figure is used in place of $1.50 in the above computation.

Lowering the rollback rate would be functionally almost identical to a cap on property taxes. In each case, a local taxing authority would need the consent of local voters before it could increase taxes beyond a certain amount. The one important difference is that the rollback rate under current law does not provide a true cap because the debt rate component of the rollback rate is uncapped.

Amending the rollback rules with respect to local taxing units other than school districts is especially important. These local taxing units have a greater ability to raise taxes than school districts do for two reasons. First, as the formulas above suggest, they are generally able to propose tax rates higher than school districts can before they face the possibility of a rollback election. Second, as noted above, these local taxing units face a rollback election only if they propose a rate in excess of the rollback rate *and* enough residents petition for a rollback election. School districts, in contrast, must hold rollback elections if they propose a tax rate higher than the rollback rate; no petition by residents is required.

The Legislature should curb the greater ability of local taxing units other than school districts to raise property taxes by lowering the rollback rate for these local taxing units from the current 8 percent to 2.5 percent. In addition, if that change to the law is made, the 2.5 percent threshold should apply to all local taxing units (including school districts). Finally, the Legislature should make the automatic election procedures currently in place for school districts which propose a rate in excess of the rollback rate applicable to all local taxing units which proposed such tax increases. This change would relieve residents of the burden of gathering signatures to file a petition and ensure that voters approve every tax rate increase in excess of the 2.5 percent rollback rate.

Senate Bill 2 (Bettencourt) and House Bill 2 (Burrows) filed in the 86th Legislature capture each of the key components described above and would represent a significant protection for property tax payers.

4. Policy Recommendation: Cease holding school districts harmless against the effects of property tax relief.

As noted above, SB 1 contained provisions that hold school districts harmless against the lost revenue resulting from a higher homestead exemption. As LBB notes, this is expected to cost the State more than $1.3 billion in general revenue over the course of the 2018-19 biennium.[lxxx] However, given the tremendous growth of revenue to school districts from consistent increases in property values over time, it is not always necessary to make up reductions in revenue. Since the purpose of legislation like SB 1 is to provide tax relief, replacing "lost revenue" merely shifts the burden from one group of taxpayers to another. In this case, residential property owners received a tax reduction that was funded by all other taxpayers who contribute to the state's GR account through sales taxes, the franchise tax and other sources of revenue deposited to GR.

True tax relief is about both cutting taxes and reducing the size of government. Hold harmless provisions may make tax relief more politically palatable, but they create ongoing financial burdens for the state. There is no better example of this than the creation of the new franchise tax and the Property Tax Relief Fund (PTRF) in 2007. The current iteration of the franchise tax was created in order to raise the additional revenue that was necessary for the legislature to fund the reduction of school district property tax rates.

In order to hold school districts harmless from the revenue loss when they lowered their tax rates, the Legislature enacted the new franchise tax (HB 3, 79S3) and reformed the motor vehicle sales and use tax and cigarette and tobacco taxes (HB 4 & HB 5, 79S3). All additional revenues generated by these reforms are dedicated to the PTRF, and are statutorily directed to pay for property tax relief (HB 2, 79S3). Since that time, the state has made more than $23 billion in hold harmless payments to school districts.[lxxxi] In the 2016-2017 biennium alone, approximately $3.6 billion was appropriated to the Texas Education Agency (TEA) from the PTRF in order to hold school districts harmless from the property tax rate reductions enacted in 2007.[lxxxii] This underscores how expensive a proposition it is to hold school districts harmless from the effects of efforts to provide property tax relief. Furthermore, “hold harmless” provisions do harm to the state budget process. For example, the $2.95 billion used for hold harmless in the current biennium comfortably exceeds the $2 billion that was appropriated from the Economic Stabilization Fund for critical water development projects in 2013.[lxxxiii] Similarly, the $2.95 billion is almost exactly equal to the additional revenue that will deposited into the State Highway Fund for transportation projects in 2020 as a result of SJR 5 (84R, 2015),[lxxxiv] and ten times larger than the $290 million supplemental appropriations bill passed by the 84th Legislature.[lxxxv] All of which is to say that hold harmless provisions place a great strain on the state budget as they lay claim to funds that could be used on urgent state priorities such as transportation infrastructure, water infrastructure, and supplemental appropriations.

With Additional State Aid for Tax Reduction (ASATR) having expired on September 1, 2017[lxxxvi], and with the State making a serious effort to phase-out the franchise tax, the era of holding districts harmless against the effects of the 2007 property tax buy-down should be over. It would be a mistake for the legislature to rekindle these or other hold harmless efforts as part of any future property tax relief initiative, and particularly efforts to impose revenue caps or lower the rollback rate. Any future efforts to provide school district property tax relief should not continue the practice of holding the districts financially harmless, especially when there are identified inefficiencies in school district spending and given the inexorable rise in property values that spins off new revenue to the districts (and other property-tax dependent subdivisions).

5. Policy Recommendation: Make locally-elected officials directly responsible for the appraisal process and increase the allowable margin of error in the Comptroller’s Property Value Study.

Direct accountability must be brought to the appraisal process, which is a cause of rising property taxes. Specifically, composition of County Appraisal Districts (CADs) aggravates taxpayer frustration with the property tax. A CAD is comprised of directors appointed by taxing units within the county. These unelected directors then appoint a chief appraiser who, despite being several steps removed from any elected official, has a direct impact on the tax bills property owners receive. This lack of accountability for appraisal increases must be addressed.

Indeed, the continued rise in appraisals and property tax revenues demonstrates that directors of the appraisal boards are not responsive to the concerns, complaints and comments of property owners when they demand fair and equitable appraisals. Instead, appraisal district directors serve the taxing entities, leading to the unreasonable and unsustainable rise in appraisals.

Accountability for appraisals could be achieved by having the elected heads of the various taxing entities serve as directors of the CAD and directly approve appraisals in lieu of directors appointed by taxing entities. By not only electing appraisal board directors, but by making the already-elected taxing entity officials serve, real and long overdue accountability and responsiveness would be injected into the administration of the property tax. Since these officials are already elected, voters will not have to educate themselves about another set of candidates, but will benefit because the appraisal process would become a subject for debate during election campaigns, with the members of appraisal boards having to defend their records.

Accountability can also be brought to the appraisal process by moving appraisal authority back to the tax assessor-collector. In 1979, the Legislature enacted Senate Bill 621 (66R) – the so-called "Peveto Bill" sponsored by State Rep. Wayne Peveto – which created the Property Tax Code. Before these reforms, county tax assessor-collectors had been responsible for property tax appraisals. However, the new Property Tax Code gave appraisal authority to newly-created County Appraisal Districts which were phased in during the early 1980s.[lxxxvii]

Since these reforms, the property tax burden in Texas has risen significantly. Statistics from the Comptroller show that property tax revenues have increased by about 650 percent since 1982: around $6 billion in local property tax revenues were collected in 1982 while $45 billion was collected in 2013.[lxxxviii] The vast majority of this revenue increase can be attributed to school district property taxes, which, according to the Texas Association of Counties is a result of school boards' influence within appraisal districts:

> [T]he average school share of appraisal district budgets is about 60 percent. Typically, that number also reflects the school board dominance of appraisal district boards, as required by state law. If school property taxes drop, school district representation on the board will decrease also.[lxxxix]

Removing appraisal authority from elected tax assessor-collectors to appointed appraisal districts can be linked directly to the increase in the property tax burden that has occurred over the past two decades or more. Because they are unelected, appraisal districts lack accountability to taxpayers and have little incentive to restrain appraisal increases. In contrast, the willingness of elected tax assessor-collectors to continually increase appraised values would be constrained by their accountability to voters.

Putting appraisal authority in the hands of elected tax assessor-collectors would bring genuine accountability back to the appraisal process and would likely result smaller and less-frequent appraisal increases. At the same time, state law must grant local appraisers greater flexibility and discretion than they are currently afforded. Under current law, appraisal districts' taxable value determination must come within five percent of the taxable value as determined by the Comptroller's annual Property Value Study.[xc] This is to ensure conformity across the state for the purposes of public school funding, which relies heavily on local property taxation. However, this push for conformity places pressure on appraisal districts to assign property values that are at least 95 percent of market value for the property in their district. If a school district's valuation falls outside the allowable margin of error, it is determined to be "invalid," which triggers an appraisal standards review for the district. Ultimately, if aggregate property values in a particular district are not at or above 95 percent of the Comptroller's valuation in the third year of an appraisal standards review, a school district could receive a reduction in funding.

Raising the permissible margin of error to ten percent would relieve pressure on local appraisers and property tax payers because it would allow local appraisers greater leeway to appraise properties at what they believe to be appropriate for their local communities. This reform should go hand in hand with returning the responsibility for the appraisal system to locally-elected officials. This type of local control requires genuine local discretion and flexibility in order for it to be exercised effectively.

6. Policy Recommendation: Exempt the first $50,000 of tangible business personal property from property tax.

The final element of property tax relief that the Legislature should consider concerns the property taxes which businesses pay on their tangible personal property. Under current Texas law, a business must pay property taxes on the tangible personal property it holds for the production of income, including inventory and equipment. Intangible property, however, is generally exempt. This dichotomy is poor tax policy because it treats businesses differently based on the sector in which they operate. A retailer, for example, is likely to face a significant burden under current law in that its inventory is subject to property tax. Similarly, a manufacturing business may face high taxes as a result of the equipment it uses in the manufacturing process. In contrast, service occupations- such as software programmers, lawyers, and accountants- are far less likely to face significant property taxes on their property because the property they have is often intangible.

There is no sound tax policy justification for effectively subsidizing service-oriented industries over retailers and manufacturers; which companies thrive, and which fail should be determined by consumers and the free market process. The law provides companies with an incentive to minimize their equipment and inventory holdings rather than to expand their operations. In addition, the tax is poor policy because, similar to a gross margins tax, it can force a business to pay tax even when the business has incurred a loss. The rationale for the franchise tax exemption amount (currently $1.13 million) applies with equal force to property taxes on tangible personal property used in the production of income, although the exemption amount need not be identical.

It is difficult to estimate the fiscal cost of such an exemption. In the 84th Legislative Session, SB 763 would have exempted the first $50,000 of business tangible personal property from property taxes. Although the bill did not pass, its accompanying fiscal note estimated that the exemption would result in an aggregate cost to the state of approximately $175 million per year in Foundation School Program costs.

C. Chapter 313 Property Tax Abatements

1. Background

In 2001, the Legislature enacted The Texas Economic Development Act (TEDA[xci]), codified as Chapter 313 of the Tax Code. TEDA allows a school district's board of trustees to attract investment and jobs by offering entering into a valuation limitation agreement with a business. These agreements provide for a 10-year limitation on the appraised value of a property for the M&O portion of the school district property tax. Under prior law, TEDA provided for tax credits and an 8-year limitation period. Crucially, the tax revenue foregone by the school district under these agreements is substantially replaced for the school district by the Texas Education Agency.[xcii] According to data from the Comptroller in its 2019 report, these payments in relation to current projects will provide businesses participating in Chapter 313 with $9.68 billion in gross tax benefits over the lifetime of those agreements, with some of that cost already having been incurred.[xciii]

Property qualifying for incentives under TEDA must be used in one of ten fields: manufacturing, research and development, clean coal projects, advanced clean energy projects, renewable electric generation (wind), renewable electric generation (non-wind), electric power generation (integrated gasification combined cycle), nuclear electric power generation, computer centers used in connection with the preceding fields, and "Texas priority projects," the last of which requires qualifying capital investments of at least $1 billion. Several of the ten categories are unrepresented among the current TEDA projects, and as discussed below, wind and manufacturing projects account for the vast majority.

In addition to receiving compensation from the State for the revenue forgone as a result of the Chapter 313 tax incentive, school districts participating in Chapter 313 agreements often receive "supplemental payments" or "payments in lieu of taxes" (PILTs) which are payments from businesses which equal a percentage of their tax savings under TEDA. The size of PILTs is negotiated between the school district and the business and varies from project to project. Notably, PILTs are excluded from the school funding formula.

TEDA's purposes are as follows:[xciv]

(1) encourage large scale capital investments in this state;
(2) create new, high paying jobs in this state;
(3) attract to Texas new, large scale businesses that are exploring opportunities to locate in other states or other countries;
(4) enable local government officials and economic development professionals to compete with other states;
(5) strengthen and improve the overall performance of the economy of Texas;
(6) expand and enlarge the ad valorem property tax base of Texas; and
(7) enhance this state's economic development efforts by providing school districts with an effective local economic development option.

The legislative intent behind the enactment of the statute was that school districts would approve only those projects which among other things created new, high-paying jobs. In other words, the Legislature intended job creation meeting a certain threshold to be a requirement for a business to claim Chapter 313 incentives. That threshold was 25 "qualifying jobs," or in the case of rural areas, 10 such jobs.

Qualifying jobs are full-time jobs which entail at least 1,600 hours annually, offer health insurance, and pay 110 percent of the county's average manufacturing wage. A subsequent amendment to the statute clarified that qualifying jobs need not be employees of the business; for example, employees of third parties who contract with the business might be qualifying employees.

In addition to the job creation requirement, the Legislature imposed a type of net benefit test. Under this test, approval for Chapter 313 agreements was conditioned on total state and local tax revenue collected from the project being "reasonably likely" over a 25-year period to exceed the amount of tax revenue forgone as a result of the incentive. A subsequent amendment to the statute, however, provided that the Comptroller may still approve a project even if it fails to make the "reasonably likely" determination if it finds that the project still provides a net benefit to the State.

The State Auditor's Office periodically performs an audit of the Chapter 313 program by examining at least three of the school districts which are parties to value limitation agreements. Compliance with Chapter 313's requirements has improved in the last five years; this is due in part to a provision in HB 3390 (83R, 2013) which required the Comptroller to conduct an annual review of businesses receiving Chapter 313 benefits. To further improve transparency and accountability, the Comptroller recommends that each school district have a policy in place which requires board members to submit a statement that he or she has no conflict of interest regarding a value limitation agreement before any such agreement is approved.[xcv] In addition, the Comptroller recommends that each school district have a document retention policy in place so that it may verify information it has reported to the Comptroller previously.[xcvi]

2. Analysis

The Comptroller of Public Account periodically publishes updates on the status of TEDA. These reports highlight some of the positive effects of TEDA. The 2019 update[xcvii] indicates that TEDA has succeeded in attracting almost $120 billion in capital investment to Texas since its enactment, with 389 active current agreements. Even with the property tax limitation, TEDA has boosted the property tax base throughout the State by more than $14 billion, and that number may increase in the future as the value limitation agreements made pursuant to TEDA expire. In addition, TEDA has created an estimated 66,400 jobs. The Comptroller reports strong growth in applications for TEDA. In 2016, 2017, and 2018, there were 44, 68, and 90 TEDA applicants, respectively.

There are other considerations, however, which raise concerns about the wisdom of TEDA. First, the subsidies granted under TEDA are quite large: the total gross tax benefit provided to companies with TEDA agreements through 2017 is estimated to be more than $9.6 billion over the lifetime of those agreements, with more than $1.8 billion of that having been provided through 2017. Such a massive subsidy calls for an examination into whether TEDA is accomplishing the goals set forth by the Legislature, particularly at a time when families and businesses statewide are seeing significant property tax increases.

Second, considerable data indicates that the job creation attributed to TEDA is less than impressive. As noted above, the Comptroller estimates that 66,400 jobs, "direct and otherwise" have been created by TEDA, but that number is far from certain. Due to an amendment to the statute, the Comptroller has relied upon economic multipliers published by the Department of Commerce in reaching its estimate. Although using multipliers is in accord with the amended statute, they unfortunately are not precise, and their accuracy is impossible to verify. However, TEDA requires companies who benefit from TEDA to report the number of *actual* qualifying jobs they have directly created. The significant discrepancy between the qualifying jobs directly created and the estimated jobs created is illustrated by the Comptroller's 2019 report, which listed those figures as 12,498 and 66,400, respectively. Thus, as the chart below illustrates, for every qualifying job directly created under TEDA through 2017, a gross tax subsidy of more than $148,000 was "spent" (importantly, this number has the potential to increase dramatically in the future[xcviii]). The subsidies are even more striking after taking into account that just four of the 389 projects in the Comptroller's 2019 report accounted for 44 percent of those 12,498 jobs.[xcix]

The job numbers are particularly unimpressive for wind companies, which through 2017 accounted for 48 percent of companies with agreements pursuant to TEDA. With only 1,127 qualifying jobs directly created through 2017, the wind industry has received approximately $662,000 for every qualifying job directly created through 2017.

Category	# of Active Projects	# of Qualifying Jobs Directly Created Through 2017	Estimated Gross Tax Benefit Received Through 2017	Reported Investment Through 2017	Estimated Total Gross Tax Benefit Over Length of Agreement	Dollars per Qualifying Job Directly Created through 2017	Dollars per Qualifying Job Directly Created Over Length of Agreement*
Manufacturing	163	11,080	$1,065,379,000	$87,901,829,000	$7,137,551,000	$96,153	$644,183
Research & Development	4	205	$15,179,000	$773,141,000	$17,270,000	$74,044	$84,244
Renewable Energy Electric Generation (Wind)	188	1,127	$746,060,000	$28,605,367,000	$2,225,727,000	$661,988	$1,974,913
Renewable Energy Electric Generation (Non-Wind)	34	86	$27,455,000	$2,657,209,000	$297,817,000	$319,244	$3,462,988
Total	**389**	**12,498**	**$1,854,073,000**	**$119,937,546,000**	**$9,678,365,000**	**$148,350**	**$774,393**

*Shows the gross subsidy per qualifying job directly created assuming there is no future net job creation.

Categories with no active projects (e.g., nuclear power and clean coal) are not shown.

Furthermore, there is no guarantee that companies with agreements under TEDA will create more qualifying jobs in the future. But it is certain that they will continue to receive tax benefits under TEDA for years to come. If wind companies with TEDA agreements as of August 31, 2018 create a net total of zero jobs beyond 2017 for the duration of their TEDA agreements, those wind companies will have received a staggering subsidy of more than $1.97 million for each qualifying job directly created.

As discussed above, TEDA contains a statement of legislative intent that school districts should approve only those TEDA applicants who, among other things, "create high-paying jobs." Crucially, however, TEDA was amended in 2007 to allow a school district to waive the job creation requirement if it finds that the statutory job creation requirements that would otherwise apply exceed the number of employees needed to operate the facilities on the property which is the subject of TEDA incentives. Since then, waivers have become so common that the number of companies receiving them exceeds the number of companies satisfying the job creation requirements of the original statute. Among renewable energy companies, requesting the waivers has since become the rule. In a 2013 report, the Comptroller discussed the proliferation of waiver requests in light of the statute being amended:

> Of 95 projects initiated since the job waiver was authorized, 52 have had the minimum job creation requirement waived. Of this number, 45 (87 percent) are in the renewable energy industry. So, while the program continues to succeed in attracting large scale capital investment, projects are committing to fewer new, high-paying jobs in their Chapter 313 contracts.[c]

An April 2016 report by the Comptroller had similar findings: TEDA "allows [the] minimum number of jobs to be waived in certain circumstances, however, and more than half of applicants in fact receive such waivers."[ci] This waiver provision contributes to the poor aggregated job creation numbers of companies benefitting from TEDA. TEDA was intended to serve as an economic development tool by providing property tax benefits in return for companies making large-scale investments *and* creating new, high-paying jobs, but it is increasingly used to incentivize projects that create few or no jobs.

Third, while TEDA has thus far expanded the property tax base throughout Texas to some extent, its potential to do so in the future is unclear. The hope is that when TEDA agreements expire, businesses will then pay property taxes at normal rates on their property in Texas. Projecting the size of this benefit is difficult, however, because property can depreciate and companies can fail. Speaking of the difficulty in projecting future revenue gains due to TEDA, the Comptroller has said:

> As noted above, state law requires the Comptroller's office to determine whether a proposed Chapter 313 project is reasonably likely to generate enough tax revenue to offset the loss due to the tax limitation within 25 years. Yet economic projections over such a long period are uncertain at best. Economic conditions change; companies and industries rise and fall. Some Chapter 313 projects fail to produce the predicted rise in property values. Among the 13 projects with tax limitations that ended from 2013 to 2015, actual market values in the last year of the limitation period ranged from 28 percent to 125 percent of the initial market value. While most were within 20 percent of their

initial projections, the wide range of values shows the volatility of assumptions made about as-yet-unbuilt projects.[cii]

Thus, under current law, it is possible for a business to benefit from subsidies during a 10-year value limitation agreement, and then pay taxes on the greatly-reduced value of its property after the agreement expires. Such an arrangement creates significant risk that the tax benefits received by the business will outnumber the taxes paid by the business. To guard against this possibility, Representative Springer proposed a recapture provision in HB 1987 (84R, 2015). That bill provided for recapture of forgone property tax revenue under a TEDA agreement if, in the first tax year after the agreement expires, the market value of the property in question is less than 80 percent of its market value when the project was approved.

Fourth, a fundamental and currently unanswered question about TEDA is whether it is truly attracting companies to Texas as a result of its subsidies, or whether companies that would have done business in Texas in the absence of TEDA are happily taking “free money.” Texas consistently ranks high in terms of attracting business for a variety of reasons. Thus, it is reasonable to suppose that at least some of the investments made and some of the jobs created under TEDA agreements would have been made and created even in the absence of TEDA. Currently, the Comptroller must certify that the Chapter 313 incentives were “a determining factor” in a company doing business in Texas before value limitation agreement is approved.[ciii] There is no statutory guidance, however, on how the Comptroller should determine this. Anecdotal evidence suggests that a company’s claim that Chapter 313 is a determining factor in its desire to do business in Texas is accepted at face value.

This conclusion is bolstered by the PILTs made pursuant to TEDA. The PILTs that most businesses with TEDA agreements make to school districts indicate that TEDA is providing property tax incentives greater than needed to entice business. For example, a business which receives a $100 gross tax benefit and then repays $20 of that to the local school district evidently did not need a $100 tax benefit to seal its decision to do business in Texas; an $80 benefit would have been sufficient. Although PILTs are subject to a cap, the Comptroller in its 2017 report indicated that “Renewable energy projects are returning 20 percent of their tax benefits back to the school districts through PILTs, while R&D and manufacturing projects are paying 14 percent and 11 percent.” Because the State compensates school districts for any local revenue “lost” as a result of TEDA, and because PILTs school districts receive are outside the public education funding formula, districts have an incentive to push for PILTs. As the Comptroller noted back in 2010, this arrangement may provide an incentive for districts to enter into agreements which are not beneficial to the State.[civ]

Reviewing the goals the Legislature set for TEDA, it appears that there has been significant investment by the targeted industries since its enactment. How much of this investment is directly attributable to TEDA is unclear. As a result of this investment, the state’s property tax base has grown, and it is quite possible that it will grow considerably more when the TEDA agreements expire.

Weighing against those benefits are the sheer size of the tax benefits under TEDA, which appear to be greater than necessary to attract investment to Texas. Perhaps more importantly, the number of jobs created under TEDA relative to the tax benefits granted appears quite underwhelming unless one is willing to rely on projections based on an unverified multiplier. Even if the multiplier were assumed to be accurate, one can still question why only certain industries are eligible to apply for TEDA's benefit. Alternatively, the tax benefits similar to those under TEDA could be applied to all businesses and individuals statewide through broad-based property tax relief, rather than being concentrated in a specific industry. Not only would such an arrangement be more equitable, but it might have its own multiplier effect.

Notably, Governor Abbot has expressed serious reservations about TEDA. HB 2826 (84R, 2017) provided that an entity seeking a TEDA agreement for a project that covers more than one school district, the entity must seek separate approval for the project from each of those school districts. As the bill analysis for HB 2868 noted:

> [W]hen determining the eligibility of school district property in more than one district for a limitation on appraised value under the Texas Economic Development Act, single projects extending across multiple school districts are evaluated by each portion of the project, and each portion must separately qualify for a limitation agreement, sometimes posing a significant burden.

In essence, the job creation and investment requirements imposed by the TEDA requirements must generally be met in *each* school district from which a project is seeking a tax exemption or reduction. This creates a higher burden for a project than if it happened to be located in just one school district. HB 2826 sought to amend these requirements such that the necessary job and investment requirements would be based on the entirety of the project, regardless of whether portions of the project are located within multiple school districts. However, in vetoing the legislation (which passed the House 131-12 and the Senate 25-6), Governor Abbott wrote that:

> Chapter 313 of the Tax Code allows for certain businesses to negotiate with school districts for lower appraisal valuations and, as a result, lower school property taxes. While the program may sometimes have a positive impact on local economic development, serious concerns exist about its oversight, its transparency, and its value to the taxpayers. According to a 2013 report by the Comptroller's Office, Chapter 313 cost the taxpayers $341,363 for every new job created by the program. The Comptroller estimates that House Bill 2826 will ultimately cost State taxpayers $100 million per biennium. I cannot support expansion of an incentive program that has not been proven to deliver the value taxpayers deserve.[cv]

The shortcomings of Chapter 313 are evident when comparing it to a similar program set forth in Chapter 312 of the Tax Code. Chapter 312 is similar to Chapter 313 but it applies only to local taxing units other than school districts, such as cities and counties. Under Chapter 312, these taxing units offer property tax abatements to businesses expanding their operations, with the abatement applying to the value of property in excess of the value as of the date the abatement agreement is executed. In contrast to Chapter 313, the State does not compensate the local taxing units for forgone revenue. Thus, there is no potential for a local taxing unit to seek a windfall at the expense of the state. A corollary to the State not being involved is that there is no purpose in having PILTs under Chapter 312. Under Chapter 312, each local taxing unit (other than school districts) can weigh the wisdom of offering property tax abatements and bears the fiscal and political consequences if the abatements ultimately turn out to be a poor decision.

The Legislature should make significant changes to TEDA given the consistent failure of businesses receiving its benefits to create the jobs envisioned despite very generous tax incentives. The Legislature could direct the savings to a much larger number of individuals and businesses by using them for general property tax relief and franchise tax relief. At a minimum the Legislature should take the following reforms applicable to value limitation agreements entered into after September 1, 2019:

3. Policy Recommendations

1) Provide that the State will no longer compensate school districts for forgone revenue. By removing the financial involvement of the State, this change would virtually merge Chapter 313 into Chapter 312.
2) Eliminate waivers of the job creation requirement.
3) Alternatively, if a job waiver is permitted, reduce the tax incentive provided to the applicant proportionately.
4) Provide for recapture of forgone property tax revenue under a TEDA agreement if, in the first tax year after the agreement expires, the market value of the property in question is less than 80 percent of its market value when the project was approved.
5) Eliminate PILTs. These payments are simply proof that State subsidies are greater than necessary to attract investment to Texas. Furthermore, they provide incentives for school districts to obtain windfalls at the expense of the State.
6) Implement the transparency recommendations by the State Auditor's Office.

D. Strengthening Constitutional Language on a State Income Tax

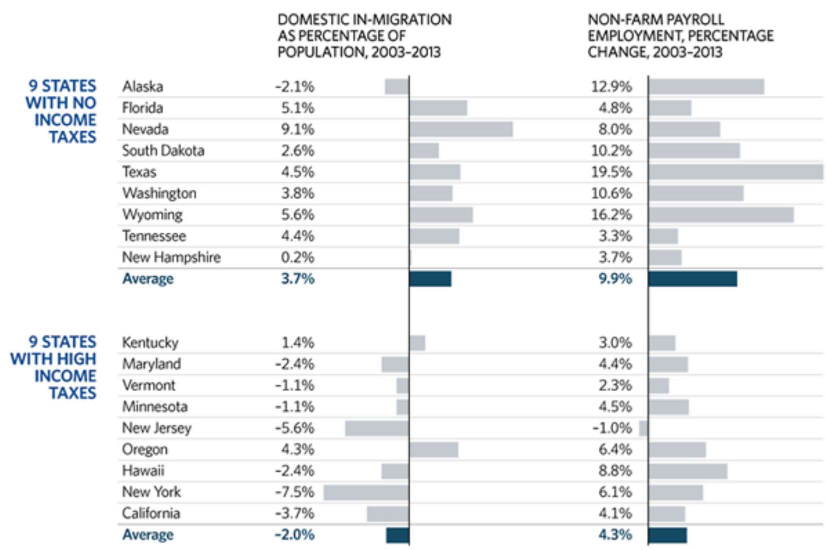
Rather than providing targeted tax breaks to certain special interests, Texas should strive to treat all individuals equally while attempting to keep the tax burden on them at the lowest level that is consistent with fulfilling its obligations. One meaningful step towards this goal would be to strengthen Texas's constitutional language regarding the enactment of an income tax. Contrary to what many believe, Texas's constitution does not prohibit an income tax on individuals, although it does provide a hurdle to the imposition of such a tax. In 1993, the state constitution was amended[cvi] to provide that a bill imposing an income tax on individuals could not take effect unless a majority of voters approved the proposed income tax.[cvii] In addition, any revenue raised by such an income tax would be dedicated exclusively to property tax relief and funding public education.[cviii]

It is axiomatic that people respond to financial incentives. By strengthening the constitutional language on a state income tax, Texas could send a message to voters not only in Texas but across the country, making clear that people working in Texas can count on retaining more of their paychecks, not just today but in the future. Texas continues to be a popular choice for people re-locating from other states: from April 1, 2010 to July 1, 2016, the State's estimated net domestic migration was a healthy 866,933.[cix]

While determining the various motivations of domestic migrants is difficult, the Heritage Foundation compared the nine states with the highest income tax rates to those with the lowest income tax rates (or no income tax at all). Over a 10-year period, the states with the highest income tax rates underperformed the states with the lowest rates in terms of domestic migration. As the study stated: "In terms of raw population, the nine zero-income-tax states in total gained an average of 830 people per day from domestic migration throughout 2004–2013; meanwhile, the nine highest personal income tax states in total lost an average of 944 people per day from domestic migration. The flow of families from high-tax to low-tax states is unmistakable."[cx] Furthermore, the nine zero-income tax states outperformed the nine highest-tax states in terms of employment growth:

CHART 1

States with No Income Taxes Outperform High-Income-Tax States in Population Growth and Job Growth



Note: U.S. averages are weighted for all 50 states.
Source: Arthur B. Laffer, Stephen Moore, and Jonathan Williams, *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index*, 7th ed., American Legislative Exchange Council, 2014, p. 39, Table 6, http://alec.org/docs/RSPS_7th_Edition.pdf (accessed November 17, 2014).

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TABLE 5 | The Nine States with the Lowest and Highest Marginal Personal Income Tax (PIT) Rates (10-Year Economic Performance)

	1/1/2016	Growth in 2005-2015			In 2004-2014	In 2004-2013
State	Top Marginal PIT Rate†	Population	Payroll Employment	Personal Income	Gross State Product‡	State & Local Tax Revenue§
Average of 9 Zero Earned Income Tax Rate States*	0.00%	12.9%	8.7%	50.1%	50.8%	57.3%
50-State Average*	5.74%	8.8%	5.6%	44.4%	41.2%	44.0%
Average of 9 Highest Earned Income Tax Rate States*	10.09%	6.6%	3.7%	43.2%	39.3%	49.9%

** Averages are equal-weighted.*
† Top Marginal PIT Rate is the top marginal rate on personal earned income imposed as of 1/1/2016 using the tax rate of each state's largest city as a proxy for the local tax. The deductibility of federal taxes from state tax liability is included where applicable.
‡ Gross State Product growth data are 2004 to 2014 because of data release lag.
§ State & Local Tax Revenue is the growth in state and local tax revenue from the Census Bureau's State & Local Government Finances survey. Because the U.S. Census Bureau did not release state & local finance data for 2003 and due to data release lag, these data are 2004 to 2013.

Source: Laffer Associates, U.S. Census Bureau, Bureau of Labor Statistics and Bureau of Economic Analysis

The recent federal tax reform legislation signed into law in December 2017 makes Texas's lack of income tax even more attractive. Under the new federal law, deductions for state and local taxes, which previously were uncapped, are now limited to $10,000 per taxpayer. Consequently, some taxpayers in high-tax states who itemize deductions—primarily higher-income taxpayers- will face higher federal tax bills in the future.

The effects of the new federal tax law on domestic migration are speculative at this point because the first tax returns which taxpayers will file under the new tax law are not due until April of 2019. However, a simple example illustrates the adverse effect of the recent federal tax will have on a high-earning software consultant in California. Assume this person earned $1 million in taxable income in 2018. He or she is young and unmarried and paid $5,000 in state and local taxes other than state income tax. The California income tax on $1 million of taxable income is $108,221.[cxi] Under prior federal law, paying state income tax of $108,221 would generate the same deduction on the taxpayer's federal tax return. But because of the limits the recent federal tax law imposes on deductions for state income taxes, this consultant will now be able to claim a state income tax deduction of only $5,000. As a result, he or she will pay $42,114 more in federal tax.[cxii]

Given this increased tax burden that residents of high-tax states will face in the future, it is not surprising that there are already reports of such people looking to move to lower-tax states.[cxiii] A recent study from the Cato Institute concluded that, as a result of the 2017 federal tax legislation, "Millions of households will feel a larger bite from state and local taxes and will thus become more sensitive to tax differences between the states. The tax law may prompt an outflow of mainly higher-earning households from higher-tax states to lower-tax states."[cxiv]

1. **Policy Recommendation: Amend the state constitution to provide that no income tax may be imposed on individuals.**

It is clear that the Texas Constitution does not prohibit a state income tax on individuals. One of the major implications of the current constitutional language is that the Legislature can vote to create an income tax with a simple majority vote in each of the House and Senate. The tax would then have to be approved by a simple majority of voters in a statewide referendum. In contrast, if there were a section of the Constitution that simply prohibited an income tax on individuals, it would require a two-thirds vote in each of the House and Senate to repeal that section and to allow for the creation of the tax. The legislation repealing the prohibition would then also have to be approved by a simple majority of voters in a statewide constitutional amendment election. This language would all but prohibit enactment of a personal income tax by setting the high bar of a two-thirds vote in each of the House and the Senate, as well as a majority vote of registered voters in a constitutional amendment election.

In the 85th Legislature, Representative Schofield offered House Joint Resolution 58, Representative Klick offered House Joint Resolution 79, and Senator Bettencourt offered Senate Joint Resolution 45, each of which proposed the constitutional amendment described above, but none were enacted into law. In the 86th Legislature, Representative Leach has filed House Joint Resolution 38 and Senator Fallon has filed Senate Joint Resolution 23, each of which would constitutionally prohibit the enactment of a personal income tax in Texas. This legislation should be advanced.

Endnotes

[i] "Revenue by Source for Fiscal Year 2018," *Texas Comptroller of Public Accounts*, https://comptroller.texas.gov/transparency/reports/revenue-by-source/ .
[ii] Comptroller, Biennial Revenue Estimate 2018-19, p. 35 (January 2017). Motor fuels tax and franchise tax numbers are adjusted in light of pages 31 and 33, respectively.
[iii] "Monthly State Revenue Watch," *Texas Comptroller of Public Accounts* (Feb. 2019), https://comptroller.texas.gov/transparency/revenue/watch/general-revenue/.
[iv] Legislative Budget Board, 2010-11 Fiscal Size-up, p. 9 (December 2009).
[v] *Ibid.*
[vi] *Ibid.*
[vii] Legislative Budget Board, 2018-19 Fiscal Size-up, p. 9. 24 (September 2018).
[viii] *Ibid.*
[ix] *See, e.g.*, Corrie MacLaggan, "Texas Lawmakers Approve Bill that Cuts School Funding," *Reuters* (June 28, 2011) (quotes from Representative Villarreal).
[x] Per the respective Biennial Revenue Estimates.
[xi] *See, e.g.*, Dave Montgomery, "Comptroller Estimates Texas Has $72.2 billion for Next Two-year Budget," *Fort Worth Star-Telegram* (Jan. 10, 2011).
[xii] The Legislative Budget Board relies on the U.S. Bureau of Economic Analysis' definition of "personal income", which reads as follows: "...the income received by persons from all sources, that is, from participation in production, from both government and business transfer payments, and from government interest. Personal income is the sum of wage and salary disbursements, supplements to wages and salaries, proprietors' income, rental income of persons, personal dividend income, personal interest income and transfer payments, less personal contributions for social insurance."
[xiii] "Tax Relief Amendment Implementation Limit on Growth of Certain State Appropriations," Legislative Budget Board, available at www.lbb.state.tx.us/Notice/Technical_Memo.pdf.
[xiv] Legislative Budget Board, Fiscal Size-Up 2018-19 Biennium (September 2018).
[xv] "The 50 State Scorecard," *Texas Comptroller of Public Accounts*, https://comptroller.texas.gov/about/media-center/infographics/2015/50-state.php.
[xvi] Texas Bond Review Board, Local Government Annual Report 2018 (January 2019). "Local government" as used here includes the following political subdivisions: cities, counties, health and hospital districts, water districts, community/junior college districts, and independent school districts.
[xvii] Using an estimated population of 28.7 million as of July 1, 2018 per the United States Census Bureau, see https://www.census.gov/newsroom/press-releases/2018/estimates-national-state.html.
[xviii] Texas Bond Review Board, http://www.brb.state.tx.us/state_debt.aspx.
[xix] Data from the Federal Reserve Board of St. Louis indicates that from January 1, 2007 to January 1, 2017, Texas' gross state product grew at a rate of 3.39 percent annually. See https://fred.stlouisfed.org/series/TXNGSP (data for 2018 unavailable).
[xx] Texas Bond Review Board Local Government Annual Report 2018 (January 2019).
[xxi] Legislative Budget Board memorandum (November 7, 2018), http://www.lbb.state.tx.us/LBB_Meetings/Memo_LBB_Growth_Rates_Tech_Memo_11-7-18.pdf.
[xxii] "Tax Relief and the Spending Limit," Legislative Budget Board, February 2015.
[xxiii] *Ibid.*
[xxiv] 2014-15 Certification Revenue Estimate, Texas Comptroller of Public Accounts (2013).

[xxv] Texas Department of Transportation, https://www.txdot.gov/government/legislative/state-affairs/ballot-proposition.html.
[xxvi] 2014-15 Certification Revenue Estimate, Texas Comptroller of Public Accounts (2013).
[xxvii] House Bill 1025 (83R, 2013).
[xxviii] Texas Bond Review Board 2018 Annual Report. (Emphasis Added)
[xxix] "A Primer on State Rainy Day Funds," *Institute on Taxation and Economic Policy*, Policy Brief #25 (2005).
[xxx] Erick M. Elder, "Weathering the Next Recession: How Prepared are the 50 States?" *Mercatus Center* (Jan. 6, 2016).
[xxxi] "Unfunded Mandates," *Texas Association of Counties* (Jan. 2019), https://www.county.org/Legislative/County-Legislative-Issues/Unfunded-Mandates.
[xxxii] "Report on School District Mandates," *Texas Association of School Administrators & Texas Association of School Boards* (Jan. 2017), https://www.tasb.org/Legislative/documents/170120Mandates.aspx.
[xxxiii] *Id.*
[xxxiv] *Id.* at 44.
[xxxv] *Id.* at 16.
[xxxvi] *Id.* at 15.
[xxxvii] *Id.* at 39.
[xxxviii] "Unfunded Mandates," *Texas Association of Counties* (Jan. 2019), https://www.county.org/Legislative/County-Legislative-Issues/Unfunded-Mandates.
[xxxix] *See* Witness List for Senate Bill 7 (77R, 2001), http://www.capitol.state.tx.us/tlodocs/77R/witlistbill/html/SB00007S.htm.
[xl] Governor's Office, Letter from the Task Force on Unfunded Mandates, May 6, 2011, http://governor.state.tx.us/files/press---office/5--- 6_Unfunded_Mandates_Narrative.pdf.
[xli] Texas Education Code, §§ 25.112, 42.005(c).
[xlii] Approximately $32 billion in FY 2018, https://comptroller.texas.gov/transparency/reports/revenue-by-source/.
[xliii] https://www.federalreserve.gov/boarddocs/Testimony/2005/20050303/default.htm.
[xliv] While school district M&O property taxes are not technically "state" taxes because they are set and levied at the local level, the nature of Texas' school finance system means that the state has an overriding interest in the taxes levied by school districts.
[xlv] The Texas Education Agency estimates M&O revenue for the 2018-19 school year as $27.3 billion, see https://tealprod.tea.state.tx.us/fsp/Reports/ReportSelection.aspx (last updated January 28, 2019). Per the same source, estimated Interest & Sinking property tax revenue ("I&S") for the same year is $6.4 billion.
[xlvi] *See* Texas Comptroller, "Revenue By Source for Fiscal Year 2018," https://comptroller.texas.gov/transparency/reports/revenue-by-source/. The franchise tax is the third-largest source of state tax revenue per that link; however, if M&O and I&S taxes are considered virtual "state" tax taxes in accordance with note 54 above, then the franchise tax was the fifth-largest revenue generator for Texas in FY 2018.
[xlvii] South Dakota and Wyoming are the others. *See* https://taxfoundation.org/state-corporate-income-tax-rates-brackets-2018/.
[xlviii] Ben Wilterdink, "Margin Tax is the Epitome of Bad Tax Policy," *American Legislative Exchange Council* (July 9, 2014).
[xlix] Scott Drenkard, "The Texas Margin Tax: A Failed Experiment," *The Tax Foundation* (2015).
[l] Texas Comptroller of Public Accounts, Biennial Revenue Estimate 2021-2021 (January 2019).

[li] *See* Andrea Zelinski, "Texas Supreme Court: school finance system constitutional, but needs improvement," *The Houston Chronicle* (May 13, v2016), https://www.houstonchronicle.com/news/politics/texas/article/Texas-Supreme-Court-school-finance-system-7467883.php (the trial at the lower court level began in October 2012).

[lii] "Revenue by Source for Fiscal Year 2018," *Texas Comptroller of Public Accounts*, https://comptroller.texas.gov/transparency/reports/revenue-by-source/.

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[liv] *Ibid.*

[lv] "Dynamic Scoring Analysis of Spending Restraint Alongside a Franchise Tax Repeal," By John Merrifield and Corey DeAngelis, April 14, 2014.

[lvi] "Time to Eliminate the Texas Margins Tax," *Americans for Tax Reform* (Jan. 16, 2013).

[lvii] John L. Mikesell, supra note 2, at 4 n.6, http://www.taxfoundation.org/legacy/show/2180.html.

[lviii] Joseph Henchman, "Texas Margin Tax Experiment Failing Due to Collection Shortfalls, Perceived Unfairness for Taxing Unprofitable and Small Businesses, and Confusing Rules," *The Tax Foundation* (2011) (Emphasis Added).

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[lx] *Ibid.*

[lxi] Legislative Budget Board, Fiscal Size-up 2018-2019 Biennium (September 2018).

[lxii] *See* "Property Tax Lenders," *Texas Office of Consumer Credit Commissioner*, https://occc.texas.gov/industry/property-tax-lenders.

[lxiii] "About Us," *Texas Property Tax Lienholders Association*, https://tptla.org/about.

[lxiv] "Legislative Report Property Tax Lending Study," *Finance Commission of Texas* (Aug. 2012), https://occc.texas.gov/sites/default/files/uploads/misc/ptl-2012.pdf.

[lxv] Legislative Budget Board Fiscal Note for SB 1 (84R).

[lxvi] Legislative Budget Board, Fiscal Size-Up 2016-17 (May 2016).

[lxvii] *Ibid.*

[lxviii] Legislative Budget Board, Fiscal Size-Up 2018-19 (September 2018).

[lxix] Legislative Budget Board, Fiscal Size-Up 2018-19 Biennium (September 2018).

[lxx] Levy Limits: A Primer on Proposition 2.5, Massachusetts Department of Revenue, http://www.mass.gov/dor/docs/dls/publ/misc/levylimits.pdf.

[lxxi] *Ibid.*

[lxxii] *Ibid.*

[lxxiii] "Hidden Consequences: Lessons from Massachusetts for States Considering a Property Tax Cap," *Center on Budget and Policy Priorities* (May 21, 2008).

[lxxiv] "Facts and Figures," *The Tax Foundation*, https://files.taxfoundation.org/20180411102900/Facts-Figures-2018-How-Does-Your-State-Compare.pdf (based on 2016 data).

[lxxv] Attom Data Solutions, "U.S. Property Taxes Levied on Single Family Homes in 2016 Total More Than $277 Billion," (April 3, 2018), https://www.attomdata.com/news/market-trends/home-sales-prices/attom-2017-property-tax-data-analysis/.

[lxxvi] Texas Comptroller of Public Accounts Biennial Property Tax Report, 2016-17 (December 2018).

[lxxvii] Since 2009, school districts have held 434 of these "tax ratification elections." Voters consented to the proposed tax rate in 355 of them- a passage rate of 81.8 percent. *See* Comptroller, "Fiscal Notes" (January 2019).

[lxxviii] *See, e.g.*, Dave Lieber, "This is how the state of Texas confuses you about the cost of your property taxes," *Dallas Morning News* (Aug. 25, 2018), https://www.dallasnews.com/news/watchdog/2018/08/23/state-texas-confuses-cost-property-taxes.

[lxxix] Tax Code Section 26.04(c)(2). This formula is what some commenters have in mind when they oversimplify and refer to Texas having an 8 percent rollback rate.

[lxxx] Fiscal Note for SB 1 (84R, 2015).
[lxxxi] The Facts About Additional State Aid for Tax Reduction (ASATR), The Texas School Coalition.
[lxxxii] Senate Bill 1, General Appropriations Act, 85R (2017).
[lxxxiii] Legislative Budget Board, Fiscal Note for HB 4 (83R, 2013).
[lxxxiv] Legislative Budget Board, Fiscal Note for SJR 5 (84R, 2015).
[lxxxv] Legislative Budget Board, Fiscal Note for HB 2 (84R, 2015).
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[lxxxvii] "Texas Property Taxes Past and Present," *Texas Taxpayers and Research Association*, May 2008.
[lxxxviii] *Ibid.*
[lxxxix] "Assessing the Appraisal Districts," *The Texas Association of Counties*, *County,* Volume 16, No. 2, March/April 2004.
[xc] Government Code 403.302 (c).
[xci] The terms "TEDA" and "Chapter 313" are used interchangeably in this Task Force Report.
[xcii] Texas Comptroller of Public Accounts, *Report of the Texas Economic Development Act* (2017) (compiling information on projects for which agreements were in place on or before August 31, 2018).
[xciii] *Ibid.*
[xciv] Tax Code, Sec. 313.003.
[xcv] State Auditor's Office, "Selected Major Agreements Under the Texas Economic Development Act" (July 2018).
[xcvi] *Ibid.*
[xcvii] Based on agreements in place on or before August 31, 2018.
[xcviii] The Comptroller's 2017 report states that a total of $7.82 billion in gross tax benefits would be provided over the life of all Chapter 313 agreements in place as of the end of 2017. The same report indicated that 12,498 jobs had been created, yielding a ratio of approximately $626,000 in lifetime gross tax benefits for every job created thus far. Consistent with the above discussion, the ratio is even greater for wind projects.
[xcix] Texas Comptroller of Public Accounts, Report of the Texas Economic Development Act (2019).
[c] Texas Comptroller of Public Accounts, Report of the Texas Economic Development Act (2013).
[ci] "Chapter 313: Attracting Jobs and Investment," *Fiscal Notes* (Apr. 2016), https://comptroller.texas.gov/economy/fiscal-notes/2016/april/chap313.php.
[cii] *Ibid.*
[ciii] Technically, the Comptroller may still approve a project even if the incentives were not a determining factor if it finds that the project still provides a net benefit to the State. Tex. Tax Code 313.026(f).
[civ] Comptroller, Texas Economic Development Act Report (2010).
[cv] Veto Proclamation for HB 2868 (84R, 2015).
[cvi] *See* SJR 49 (73R, 1993).
[cvii] Article VIII, Section 24 of the Texas Constitution.
[cviii] *Ibid.*
[cix] "Gone to Texas," *Texas Comptroller of Public Accounts*, https://comptroller.texas.gov/economy/fiscal-notes/2017/october/migration.php.
[cx] Joel Griffith, "1,000 People a Day: Why Red States Are Getting Richer and Blue States Poorer," *The Heritage Foundation* (May 5, 2015), https://www.heritage.org/government-regulation/report/1000-people-day-why-red-states-are-getting-richer-and-blue-states#_ftnref8.
[cxi] See California Franchise Tax Board, 2018 Calculator, available online at https://webapp.ftb.ca.gov/taxcalc/calculator.aspx.
[cxii] Assumes a 37 percent federal income tax rate and a 3.8 percent tax under the Patient Protection and Affordable Care Act.

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cxiv Chris Edwards, "Tax Reform and Interstate Migration," Cato Institute (September 6, 2018).