

HB 3: Payroll, sin and sales taxes lead the proposals

by **Christine DeLoma**

Volume 9, Issue 27

[View Issue](#)

The House Ways and Means Committee approved on March 2 a measure that would cut property taxes by one-third, create a new payroll tax on Texas businesses, increase cigarette taxes by \$1 and raise the state sales tax rate from 6.25 to 7.2 percent.

With the mission to reduce skyrocketing school property taxes for Texas homeowners and businesses, committee substitute HB 3, authored by Rep. **Jim Keffer** (R-Eastland), represents a major shift in the way the state raises its revenue.

Reducing property tax rates

Under the bill, the maintenance property tax rate levied by school districts would be lowered from \$1.50 to \$1 per \$100 valuation. Property tax relief under the plan is expected to cost \$5.4 billion a year.

Another measure in the bill calls for dedicating 15 percent of future state budget surpluses toward property tax reduction. For example, if the state has a \$10 billion surplus and the property tax rate is \$1 per \$100 valuation, then \$1.5 billion out of the surplus would be used to rollback the rate to 85 cents per \$100 valuation.

Effectively referred to as a “buydown,” the plan allows the state to distribute the surplus dollars to the local taxing units and requires that they lower their tax rate by a certain percentage.

Truth in taxation clause nixed

HB 3 originally included a “truth in taxation” clause that would have capped the amount of revenues a local taxing unit could raise without voter approval. The original taxpayer protections in HB 3 were modeled after Rep. **Carl Isett’s** (R-Lubbock) HB 1006. The clause would have forced local taxing entities to lower their tax rates when property values increased quickly or to seek voter approval of revenue increases larger than 3 percent. Isett noted that his taxpayer protection provisions most help low-income homeowners. Lower-end homes often grow in value less quickly than middle and upper class homes. A taxpayer protection bill that forces rates down when values rise would, Isett said, likely provide more tax cuts to low income families. Isett predicted the changes in the taxpayer protection provisions will provoke discussion when HB 3 hits the floor.

However, portions of the clause were stripped from the bill by an amendment offered by Vice Chairman **Mike Villarreal** (D-San Antonio), allowing local taxing entities to increase the tax rate without an automatic election. Districts only need to provide public notice and hold a public hearing.

Mandatory sales price disclosure

To help appraisal districts more accurately determine the value of properties, HB 3 includes mandatory sales price disclosure of homes when they are sold on the market.

Dick Lavine, of the Center for Public Policy Priorities (CPPP), who also serves as vice chairman of the Travis Central Appraisal District said, “Sales price disclosure will improve the operation of the district. It will improve the accuracy of the appraisals, and it may reduce the number of protests we have to handle every year...I think there’s greater public confidence for appraisals that are based on market values and market information.”

Shifting the tax burden

To pay for these cuts, the bill creates a “reformed franchise tax,” commonly referred to as a payroll tax on Texas businesses. The tax would effectively replace the current franchise tax. Businesses would pay a tax of 1.1 percent on wages of each employee earning up to \$80,000 a year. Nonprofit organizations, government entities and sole proprietorships would be exempt from the tax.

Given that the state Constitution forbids a state income tax, HB 3 specifies that businesses cannot deduct the payroll tax directly from an employee’s wages. The bill imposes criminal and civil penalties on violators.

However, **Byron Schломach**, chief economist of the Texas Public Policy Foundation, argued that the payroll tax was a hidden type of income tax.

“I think replacing the old franchise tax is a good idea,” said Schломach, “but in this particular case, I think it’s being replaced by something arguably worse. It is an income tax. It’s a tax on earnings. It’s just that you’re charging the [employers] paying the paycheck before the person who earned the money ever sees it.”

Legislators expressed their concern that the current franchise tax is so riddled with loopholes that only one in six businesses pay it. The new tax would cover nearly 90 percent of the businesses in the state and cost approximately \$1.6 billion per year.

Small business owners who testified at the hearing told legislators the payroll tax would hurt their businesses.

“I almost had a heart attack when I heard there would be a payroll tax because that is a tax on jobs,” said **Wanda Rohm**, owner of Presto Printing in San Antonio and member of the National Federation of Independent Business. “You need to consider the economic impact it’s going to have on small businesses. We are the ones who generate more jobs... yet you’re putting the heaviest burden on us.”

Certain health care providers would be offered tax relief in the form of a credit if 15 percent or more of the business’s revenue came from Medicaid and Medicare payments. Such providers would qualify for a 40 percent credit for every dollar received under Medicare and Medicaid.

Increasing sin taxes

The legislation also increases “sin taxes” on tobacco products. HB 3 raises the tax on cigarettes from 41 cents to \$1.41 per pack. The tax rate for smokeless tobacco products was increased from 35.2 percent to 40 percent. The bill also includes a complex tax formula for cigars. If HB 3 becomes law, Texas would join many states in recent years that have increased sin taxes to raise revenue.

According to the American Lung Association, 16 states and the District of Columbia raised cigarette taxes in 2003, increasing the average state cigarette tax by a dime to \$0.72 per pack. Rhode Island leads the nation with a state tax of \$2.46 per pack and Kentucky has the lowest tax at \$0.03. It is estimated the tax increase on tobacco products would generate an additional \$648.6 million. There is no new tax proposed for alcohol.

Increasing the sales tax rate

The state sales tax rate would increase from 6.25 to 7.2 percent. It is anticipated consumers will pay an additional \$2.02 billion per year in state sales taxes.

Along with the increase in the sales tax rate, the bill also expands the number of goods and services that can be taxed. Billboard advertising, bottled water, car wash services, and automotive maintenance and repair would now fall under the new sales tax.

Newspapers would be subject to the sales tax for the first time. Although there was no mention of it in the committee substitute bill that was voted out of committee Wednesday, legislative staffers indicated that Legislative Council inadvertently left the indicated language out of the bill. Legislators are expected to introduce a technical amendment to the bill on the House floor that makes newspapers taxable.

Sales taxes on motor vehicles and boats would increase from the current 6.25 to 7.35 percent under the bill.

Bill Walters, president of the Texas Automobile Dealerships Association, expressed his opposition to the increase in the sales tax on motor vehicles, the repeal of labor exemptions in the auto shop and the payroll tax.

“The motor vehicle sales tax increase to 7.35 percent is the equivalent of a \$440 million tax per year on Texas consumers.” He also emphasized that the increase in the motor vehicle sales tax would make Texas among one of the highest sales tax rates in the nation.

Others opposed the bill for different reasons. Lavine commented that the sales tax is a regressive tax that disproportionately hurts the working poor. He also stressed that CPPP would prefer a personal income tax over the increase in the sales tax.

“Our basic problem with the bill... is that the only reason it exists is to cut the property tax,” said Lavine. “We do not think that it is the most pressing need in the state of Texas... This bill does nothing to improve education infrastructure. It’s just a swap of one tax for another.”

The committee passed the bill, voting 6-2, with all Republicans voting for the bill. Only one Democrat, Villarreal, voted in favor of the amended HB 3. The bill will go to the House floor sometime next week.