

## **THE HEARTLAND INSTITUTE**

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### **Texas Legislators Solve the State's School Finance Problems, At Last**

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A package of five bills drafted to satisfy the November 2005 Texas Supreme Court ruling that required the state to reduce its reliance on property taxes to fund public education has received the state comptroller's certification and was signed into law on May 24 by Gov. Rick Perry (R).

The bills resulted from a 29-day special session of the Texas Legislature--its third since last November--to satisfy the court's June 1 deadline to solve the school funding issue.

#### **Canvassing the State**

A bipartisan Tax Reform Commission began meeting in November 2005 with former Texas Comptroller John Sharp (D) as chairman and 24 business leaders who represented various Texas industries. The commission conducted 16 public hearings statewide, taking oral and written testimony, the effort aimed at reducing local property taxes and closing loopholes in the current state business tax system, under which only one in every 16 Texas businesses pays any business taxes.

In a March 29 open letter to the governor, Sharp said the commission's recommendations agree with opinions voiced during testimony.

"The school property tax must be brought down," Sharp wrote. "Replacement revenue must be from a broad-based, low-rate source. The state budget must put school children first."

#### **Rallying in Austin**

On April 17, thousands of realtors and property owners joined the governor to kick off the special session on the Capitol steps.

Dennis Patillo, board chairman of the Texas Association of Realtors, described the rally in an open letter to realtors dated May 16, saying, "Realtors converged on the Texas Capitol with one loud and clear voice demanding lower property taxes for all Texans.

"I am certain that this special session would not have ended the way it did without the involvement of our realtor family," Patillo concluded. "Realtors engaged in a way that we never had engaged before."

#### **Broadening Business Tax**

The tandem bills will reduce Texans' net tax burden by \$6.9 billion over the next three years and will create a broad-based business tax on gross receipts for companies that earn more than \$300,000 annually. Businesses will pay a 1 percent tax on gross receipts; retailers and wholesalers will pay 0.5 percent, due to their smaller profit margins.

Michael Sullivan, media director of the Texas Public Policy Foundation, a free-market think tank in Austin,

appreciates the property tax reduction.

"The Legislature was able to decrease property taxes, and that means Texas really does have a net tax burden decrease," Sullivan said, "and that's a good thing."

### **Increasing Business' Burden**

Sullivan, however, saw red flags with the business tax.

"A lot of us are going to have to carefully monitor this new business tax," Sullivan said. "That the revenues are dedicated to future tax relief is good. Business taxes can, however, become cash cows--[these taxes] are hidden and are bad for open government."

Pete Sepp, vice president of communications at the National Taxpayers Union, a watchdog group based in Alexandria, Virginia, agreed. "There is more than a little uncertainty about the impact of the new reform package," Sepp said. "On the plus side is the prospect of substantial property tax relief in two or three years, tighter voter control over the future growth of property taxes, and some worthy educational reforms. On the negative side, costly new sops are being thrown to teacher unions, and counterproductive cigarette taxes will be on the rise.

"The big question remains over the impact of the restructured business tax," Sepp noted. "Will a simpler base and a flatter rate trump the fact that more businesses and, by inference, their customers will be forced to pay higher burdens? The answer will depend not only on what this year's legislature has just done, but also on what the next legislature does to correct any flaws in the new system and keep delivering for taxpayers."

### **Finding More Funds**

Additional income to fund education also will come from increased sales taxes on cigarettes--up from 40 cents per pack to \$1.41. Also, used car purchasers will pay sales tax on at least 80 percent of the car's blue book value; currently the tax is based on a buyer's claimed value.

Perry said in a May 18 statement the business tax package will provide "reliable funding for our school classrooms" and "help deliver a record \$15.7 billion property tax cut for the people of Texas."

### **Adding Other Reforms**

At the start of the special session the governor called on legislators to focus solely on school finance, but lawmakers found time to make several other reforms as well. Sen. Florence Shapiro (R-Plano), chairman of the Senate Education Reform & Public School Finance Committee, accepted testimony from educators, citizens, and policy organizations. In 29 days, the legislature approved:

- \$1.8 billion in teacher pay increases and incentive pay;
- \$1 billion in local property tax revenues that will remain in local districts instead of being given to other areas of the state;
- local property tax reductions of 17 cents per taxable \$100 of value at the \$1.50 level in the 2007 tax year and an additional 33 cents in 2008;
- \$2,000 across-the-board pay raises for teachers, school nurses, counselors, and librarians;
- tax-free health spending accounts as an option for all education employees;
- higher accountability standards and more transparency of expenditures for school districts;
- locally designed incentive-pay plans that will reward educators who improve student achievement;

- an allotment fund that will provide incentives to school districts to decrease dropout rates, increase graduation rates, and better prepare students for post-secondary education;
- a requirement, effective in 2011, that students take math and science courses in all four years of high school; currently, the minimum graduation requirement is two years of each;
- loosening unrealistic zero-tolerance drug policies by permitting students to self-administer prescription asthma or anaphylaxis medicine;
- setting a uniform election date for board trustees, which must coincide with county and state elections in a common polling place; and
- prohibiting school districts from beginning instruction for students before the fourth Monday of August, starting with the 2007-08 school year.

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**For more information ...**

The report of the Texas Tax Reform Commission can be found at [http://www.ttrc.state.tx.us/files/TTRC\\_report.pdf](http://www.ttrc.state.tx.us/files/TTRC_report.pdf).

A Microsoft PowerPoint presentation of the Tax Commission's findings is available at [http://www.governor.state.tx.us/priorities/tax\\_reform/TTRC\\_report/files/synopsis.ppt](http://www.governor.state.tx.us/priorities/tax_reform/TTRC_report/files/synopsis.ppt).

Materials relating to HB1-HB5, including complete text, audio, fiscal notes, news releases, and written testimony of the 3rd Called Session of the 79th Texas Legislature, are available at <http://www.capitol.state.tx.us>.

Tax rates for cigarettes by state are available at <http://www.taxadmin.org/FTA/rate/cigarette.html>.