Business Margins Tax

The Issue

Businesses do not pay taxes; people do. Whether in the form of higher prices, lower wages, or fewer jobs available, Texans ultimately pay for taxes.

No matter how you evaluate Texas's business franchise tax, commonly called the "margins tax," it hinders Texans in their attempts to flourish. This broad-based, gross-receipts-style margins tax is complex and unique among all taxes nationwide—with only Nevada having a similar gross-receipts-style tax. Eliminating this onerous tax would best serve Texans.

The margins tax is inherently complex with multiple calculations to determine the lowest tax liability, two tax rates depending on business type, and the $1 million gross revenue exemption. Complying with it is also markedly different than complying with the federal corporate income tax, so many firms must keep two separate financial books just to follow the law. Because of these substantial costs, firms can often spend more on compliance than on paying the tax itself.

The Texas Legislature in 2015 cut the margins tax by cutting the rates by 25% and raising the ceiling to file with the E-Z computation to $20 million at a lower tax rate. This cut not only reduced the size of government by reducing taxpayer dollars available for spending, but employers also have more money to invest and hire workers.

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

The Foundation has created a dynamic economic model that accounts for burdens on the private sector of paying and complying with the annual margins tax. The estimated 5-year results of the full elimination of the margins tax include at least $16 billion in new inflation-adjusted total personal income and at least 130,000 new jobs.

This transformational policy would make Texas a leader for America—and even the world—in tax policy. Texas would join South Dakota and Wyoming as the only states without either a general business tax or personal income tax.

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

The Facts

- Texas's margins tax is complex, costly, and difficult to calculate, giving rise to a less competitive business tax climate, for which the Tax Foundation ranks Texas 13th overall and 4th worst in the corporate tax ranking.
- The margins tax fails to be a least burdensome tax and fails to allow Texans the best opportunity to prosper.

Recommendations

- Eliminate the business margins tax. This could be accomplished at one time or phased out over time by cutting the rates. Potential budget surpluses from more tax receipts from new economic growth and spending restraint can fund this tax cut without imposing a new tax.
- Pass a bill requiring a supermajority (two-thirds) vote of each chamber to raise taxes or create a tax.

Resources

Texans Prosper from Eliminating Business Franchise Tax by Vance Ginn, Texas Public Policy Foundation (April 4, 2017).

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

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

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

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