Texas Public
POLICY FOUNDATION

BUSINESS FRANCHISE TAX OVERVIEW

WRITTEN BY **John Bonura,** Policy Analyst, Taxpayer Protection Project
DECEMBER 2024

KEY POINTS

- Because of the substantial costs, firms can often spend more on compliance than on paying the franchise tax itself.
- Phasing out or repealing the business franchise tax can create thousands of jobs and add billions of dollars in new personal income.
- In 2023, Texas state lawmakers passed legislation that doubled the amount of revenue exempt from the franchise tax—greatly expanding the number of businesses exempt altogether.

ISSUE

Texas' business franchise tax hinders the ability of consumers, employees, jobseekers, shareholders, and suppliers to flourish. This broad-based, gross-receipts-style tax is complex and unique among all taxes nationwide, with only Nevada having a similar gross-receipts-style tax (Texas Public Policy Foundation, 2020). Eliminating this onerous tax would best serve the small and medium sized businesses in Texas.

The franchise tax is inherently complex, with multiple calculations required to determine the taxable entity's margin. According to the Texas Comptroller of Public Accounts (n.d.), those computational methods include establishing "total revenue times 70 percent; total revenue minus cost of goods sold (COGS); total revenue minus compensation; or total revenue minus $1 million (effective Jan. 1, 2014)." Complying with franchise tax procedure is also markedly different than acceding to 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 often spend more on compliance than the tax itself.

In 2023, the 88th Texas Legislature passed SB 3, amending Chapter 171 of the Tax Code which increased the no-tax-due threshold and discontinued certain reporting requirements (SB 3 Fiscal Note, 2023). SB 3 doubled the amount of total revenue exempt from the franchise tax from $1.24 million to $2.47 million (SB 3 Bill Analysis, 2023). As a result, the number of small- to medium-sized businesses fully exempt from franchise taxes has increased by 67,000 (SB 3 Bill Analysis, 2023). SB 3 also exempts taxable entities that do not owe franchise

continued

taxes from having to file a No Tax Due Franchise tax return (SB 3 Bill Analysis, 2023). By exempting business from the franchise tax and eliminating the time and effort it takes to file tax returns, money will be put back into the pockets of businesses and in turn stimulate the economy through growth instead of for government projects.

Studies modeling the dynamic economic effects of fully phasing out or repealing the franchise tax find further economic benefits, including thousands of net new private sector jobs and billions of dollars in net new personal income statewide. Texas Public Policy Foundation (TPPF) created a dynamic economic model that accounts for burdens on the private sector of paying and complying with the annual franchise tax.

TPPF economists used a 3- variable recursive vector autoregressive (VAR) model to estimate the impact of a margins tax on income and employment. The three variables measured in the model are the percent changes of real (adjusted for inflation) personal income (PI), total private sector nonfarm employment, and real margin tax revenue (Ginn and Heflin, 2015). The results of the study found that beginning in 2008 when the margins tax was implemented real income and private sector employment were substantially negatively affected. When the margins tax revenue was at its peak personal income and employment were significantly depressed (Ginn and Heflin, 2015). This conforms to economic theory literature which finds that taxes on capital have a negative effect on investment. Higher costs of doing business can prevent business expansion which slows employment and wage growth (Ginn and Heflin, 2015). Based on the model, estimated five-year results of the full elimination of the franchise tax include at least $16 billion in new inflation-adjusted total personal income and more than 130,000 new jobs (Ginn and Heflin, 2015).

Moving in the direction of elimination would make Texas a leader in America—and the rest of 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 raising the amount of revenue exempted from the franchise tax is a step in the right direction, there are still better options available. Phasing out the franchise tax would be a valuable alternative. To create an environment that is more conducive to economic growth, lowering the tax rates for all firms is preferable to raising the revenue exemption threshold.

FAST FACTS

- Franchise tax collections represent 7.1% of all tax revenue generated in the 2022-23 biennium (Legislative Budget Board, 2022, p. 31).
- During the 2022-23 biennium, the franchise tax generated $9.7 billion for the state, an increase of approximately $800 million over the previous period (Legislative Budget Board, 2022, p. 31).
- Of the $9.7 billion in estimated revenues, $6.8 billion was allocated to the General Revenue fund and $2.9 billion was directed to the Property Tax Relief Fund (Legislative Budget Board, 2022, p. 34). ■

REFERENCES

Ginn, V., & Heflin, T. (2015). *Economic effects of eliminating Texas' business margin tax.* Texas Public Policy Foundation. https://www.texaspolicy.com/wp-content/uploads/2018/08/MarginTax-CFP.pdf

Legislative Budget Board. (2022). *Fiscal size-up: 2022-23 biennium*. https://www.lbb.texas.gov/Documents/Publications/Fiscal_SizeUp/Fiscal_SizeUp_2022-23.pdf

SB 3 Bill Analysis. Senate Research Center. 88th Legislative Session. 2nd Called Session. (2023). https://capitol.texas.gov/tlodocs/882/analysis/pdf/SB00003F.pdf

SB 3 Fiscal Note. Legislative Budget Board. 88th Legislative Session. 2nd Called Session. (2023). https://capitol.texas.gov/tlodocs/882/fiscalnotes/pdf/SB00003I.pdf

Texas Comptroller of Public Accounts. (n.d.). *Franchise tax overview*. Retrieved July 24, 2024, from https://comptroller.texas.gov/taxes/publications/98-806.php

Texas Public Policy Foundation. (2020, September 22). *Business margins tax.* https://www.texaspolicy.com/legebusinessmarginstax/

ABOUT THE AUTHOR

John Bonura is a Policy Analyst for the Taxpayer Protection Project with Texas Public Policy Foundation.

Prior to joining TPPF John served in the University system as a Graduate Assistant until he was given the opportunity to teach Principles of American Government. John holds a Master of Arts in Political Science from Texas State University and a Bachelor of Arts in Political Science from Sam Houston State University.

As a proud Eagle Scout John is an avid camper and enjoys spending time in the outdoors as well as at home with his wife.