The Consequences of Selected Potential Tax Reforms for Real Estate Performance and Business Activity in Texas

The Perryman Group
510 N. Valley Mills Dr., Suite 300
Waco, TX 76710
ph. 254.751.9595, fax 254.751.7855
info@perrymangroup.com
www.perrymangroup.com

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Executive Summary

Services provided by local governments are integral to quality of life. The need for adequate police and fire protection, for example, is obvious. Similarly, the need for a quality system of public education is beyond question. However, such services entail a price, and tax receipts from businesses and individuals are necessary to support these functions.

The issue becomes how to allocate the tax burden among various groups such that it is equitable, efficient, and minimally detrimental to the economy. If taxes result in a disincentive for businesses to invest, expand, and create jobs, all Texans lose. If individuals alter their patterns due to tax considerations, there can also be negative consequences for the economy.

The question of tax structure stands to be one of the central issues of the current session of the Texas Legislature. A key element of this discussion is the optimal method of funding the public schools of Texas. Because of problems such as an increasing reliance on local property taxes, a "Robin Hood" plan which results in transfers of resources among school districts, substantial litigation regarding the adequacy and equity of funds, a system approaching a ceiling on allowable rates, and widespread dissatisfaction among voters, there is currently intensive effort to reform the existing structure.

The Perryman Group (TPG) was recently asked to examine the impact of various alternative tax proposals on business activity in Texas and specific elements of the real estate sector. TPG is an economic research and analysis firm based in Waco, Texas. The firm has more than 20 years of experience in analyzing the Texas economy and assessing the economic impact of corporate expansions, regulatory changes, real estate developments, and myriad other types of events affecting business activity. The key model used in this study, the Texas Multi-Regional Impact Assessment System, was developed in the early 1980s and has been continually refined, updated, and expanded since that time.

The analysis involves examination of a proposal to

- ✓ impose a business activity tax (BAT),
- ✓ eliminate the current Texas franchise tax, and
- ✓ reduce property taxes by varying amounts.

The economic impact of these scenarios is evaluated, as is the economic development effect of the resulting tax structure. A focus on real estate development is also offered.

The Real Estate Industry in Texas

The real estate sector is a vital contributor to the Texas economy. Moreover, trends influencing the performance of the sector affect all Texans through their roles as property owners or renters. Key trends in the industry include the following.

- ✓ Rates of homeownership in Texas lag the US. Over the past two decades, Texas has ranked below the average US level of homeownership. This trend reflects shifting demographic patterns within the state relative to national norms which lead to somewhat lower per capita income in Texas than in the nation as a whole.

- ✓ Values and sales volumes have risen dramatically. In 1990, home sales topped 100,000 for the first time with dollar volume of $8.73 billion. Last year, Texas residential housing activity recorded 235,146 homes sold with a total dollar volume of $38.73 billion.

- ✓ Real estate is a key component of the Texas economy. The size of the real estate sector has grown notably over the past decades, from $33.969 billion in output (real gross state product or RGP in constant 1996 dollars) in 1980 to an estimated $64.856 billion last year.

- ✓ Real estate professionals often provide invaluable assistance to clients in navigating the complex process of buying or selling a home or other real estate asset.

Any proposal to change the tax structure should carefully weigh the effect on the real estate sector. Not only does this segment represent an important component of the Texas economy, it is also integral to the quality of life of all Texans. The affordability of housing is inextricably linked to property tax rates, as taxes are a notable component of the cost of homeownership.

Poorly conceived tax structures can decrease property values. Such outcomes have been observed in various geographic areas, and empirical studies indicate that high property taxes reduce demand for real estate. However, the inability of local governments to raise sufficient tax revenues to provide quality services (including education) also has a clear negative effect on property values and the real estate sector.

Problems with the Current Texas Tax Structure

Property taxes have been the mainstay of school finance for several decades, but it appears unlikely that they can continue to play this role effectively.

- ✓ The Texas **tax structure is typically ranked near or below the middle among all states in attractiveness for new business activity** and is not particularly well regarded by site selection consultants. Also, the state's heavy reliance on property taxes and the nature of the current franchise tax negatively affect both businesses and individuals.

- ✓ A major problem with Texas' reliance on property taxes is that the base of this levy, **the assessed value of taxable property, is an unstable source of growth for revenues**. The tax also suffers from the fact that increased property values often bear little relation to financial liquidity and, thus, ability to pay.

- ✓ From the perspective of those paying the levies, **property taxes have become a significant burden**. Individuals are affected through the higher cost of owning a house or other real estate, and businesses' profitability is decreased.

- ✓ One of the biggest problems with the state's tax structure is the fact that it places a **greater relative burden on capital-intensive firms** than those in competing areas. Almost half of the state and local taxes are based in some manner on the value of assets, with the burden thus being weighted toward firms with large, expensive facilities. Because of this situation, there are material tax disadvantages to locating a large facility in Texas.

- ✓ It is becomingly increasingly apparent that **local governments and school districts are overly reliant on property taxes**. This problem is at the root of the need to overhaul the Texas tax structure, particularly given specific problems in the area of school finance.

The fundamental problem with the overall Texas tax structure is that it is not reflective of expansion and demographic patterns and, thus, fiscal requirements. There are several potential alternatives; one of the most promising is a broad-based business activity tax.

Advantages of a Business Activity Tax

Business activity taxes (BATs) are a very common method of taxation used around the world, typically in the form of a value-added tax. Although no tax mechanism is perfect, it has generally proven to be a relatively equitable and efficient option for generating necessary revenue. Benefits of the BAT are as follows.

- ✓ The BAT is generally levied on businesses, not individuals. This characteristic of the tax helps define it as one that is **highly efficient from the standpoint of collections and compliance**.

- ✓ A BAT with a flat rate can **solve the problem of penalizing efficient companies** because all companies pay exactly the same rate. In addition, it is optimal for firms to make the same decisions with and without the BAT, thus leading to **greater efficiency and productivity**.

- ✓ It is also **relatively stable**, with little variation unless the underlying structure is changed. Even during the recent economic slowdown, the base of a comprehensive BAT would have risen modestly, thus alleviating some (but not all) of the budget crisis which confronted the state. Similarly, because its base clearly **corresponds to aggregate business activity**, it is **flexible in responding to future revenue needs**.

- ✓ A BAT system **does not differentiate between capital-intensive and labor-intensive industries**—both are taxed equally (except in the case of exemptions). Whether capital-

intensive manufacturing concerns or high-priced services firms operating in relatively small offices, the increment to value each company is responsible for is the driver for the amount of taxation.

Numerous industries which are vitally important to Texas (such as agriculture, chemicals, and petroleum refining) would be treated much more equitably in a system that replaced some segment of the property tax with a BAT, thus encouraging additional investment in the state.

Results of the Impact Assessment

The economic impacts of three alternative tax scenarios were examined. In each case, a business activity tax is implemented to eliminate the current franchise tax and reduce property taxes.

The results indicate that implementation of a BAT and reduction in other key taxes would have a modest effect that varies by indicator analyzed. The reason for these outcomes lies in the fact that the proposed changes reduce the relative tax burden away from capital-intensive sectors (such as manufacturing) which now pay a disproportionate share of property and franchise taxes (as noted in a prior section). Thus, overall production and efficiency sees a stimulus, as reflected in the increases in gross state product. On the other hand, there are slight losses in employment (which diminish as the magnitude of the property tax reduction expands). There is also a shift from lower-paying to higher-paying jobs, as indicated by the patterns in personal income. All of these short-

term “incidence effects,” however, are far less than the increasingly sizable outcomes resulting from a stimulus to economic development.

Net Estimated Effect of Proposed Changes in Tax Structure on Annual Business Activity in Texas			
	Elimination of Franchise Tax and $0.25 per $100 Valuation Property Tax Reduction Scenario	**Elimination of Franchise Tax and $0.50 per $100 Valuation Property Tax Reduction Scenario**	**Elimination of Franchise Tax and $0.75 per $100 Valuation Property Tax Reduction Scenario**
Total Expenditures	$716.035 mln	$1,646.893 mln	$2,577.751 mln
Gross Product	$39.338 mln	$269.080 mln	$498.823 mln
Personal Income	($50.336 mln)	$43.928 mln	$138.193 mln
Permanent Jobs	(1,825)	(1,021)	(217)

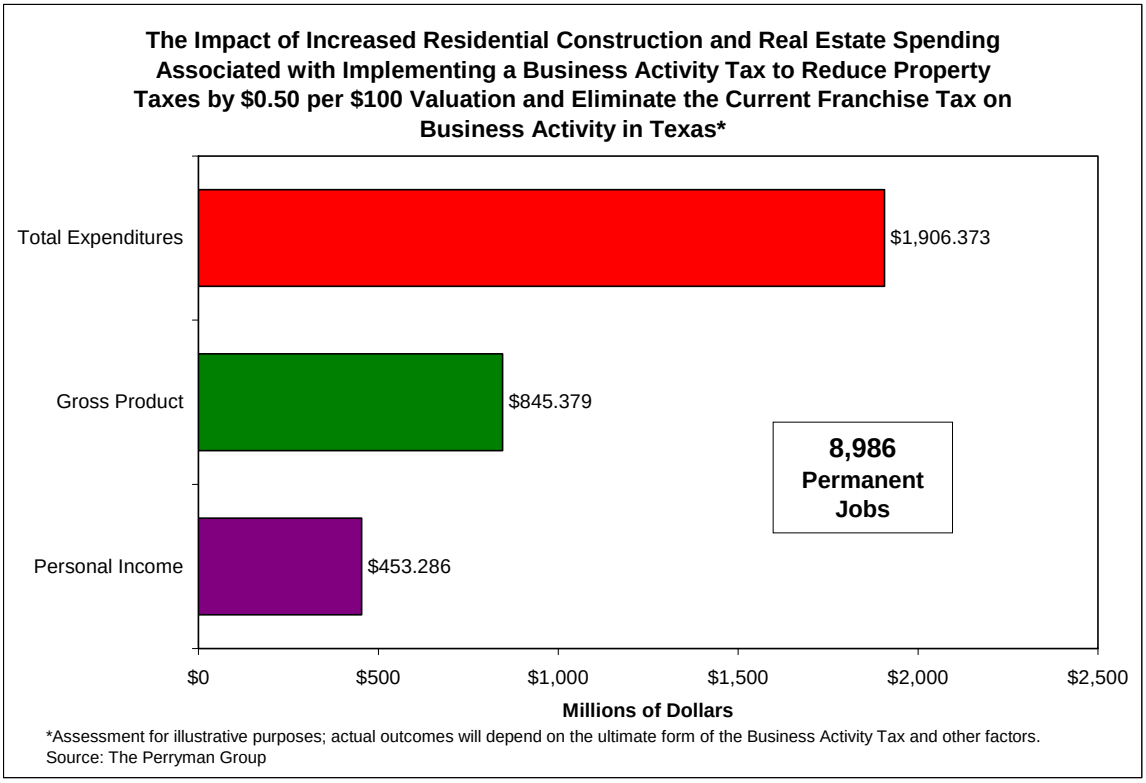
Note that all monetary values throughout this analysis are given in constant dollars for fiscal-year 2006, the first period in which any changes in the tax structure would occur.

As a part of these impacts, which largely stem from increased productivity and efficiency, a reduction in property taxes would also stimulate additional residential construction and real estate spending. As noted, taxes are an important determinant of real estate demand; as the tax rate decreases, houses and other properties become relatively more affordable and demand rises.

For example, the scenario in which property taxes decline by $0.50 per $100 valuation results in about 2,168 new housing starts and 2,973 additional sales of existing houses each year. The consequence of this activity is that homeownership rates in Texas increase, as does the opportunity for thousands of Texans to enjoy higher quality residences.

To illustrate the potential magnitude of these effects, TPG assumed a hypothetical decrease in property tax rates of $0.50 per $100 valuation. **The impact on business activity stemming from increased residential construction and real estate spending was found to include**

- ✓ **$1,906.373 million in annual Total Expenditures;**
- ✓ **$845.379 million in annual Gross Product;**
- ✓ **$453.286 million in annual Personal Income; and**
- ✓ **8,986 Permanent Jobs.**



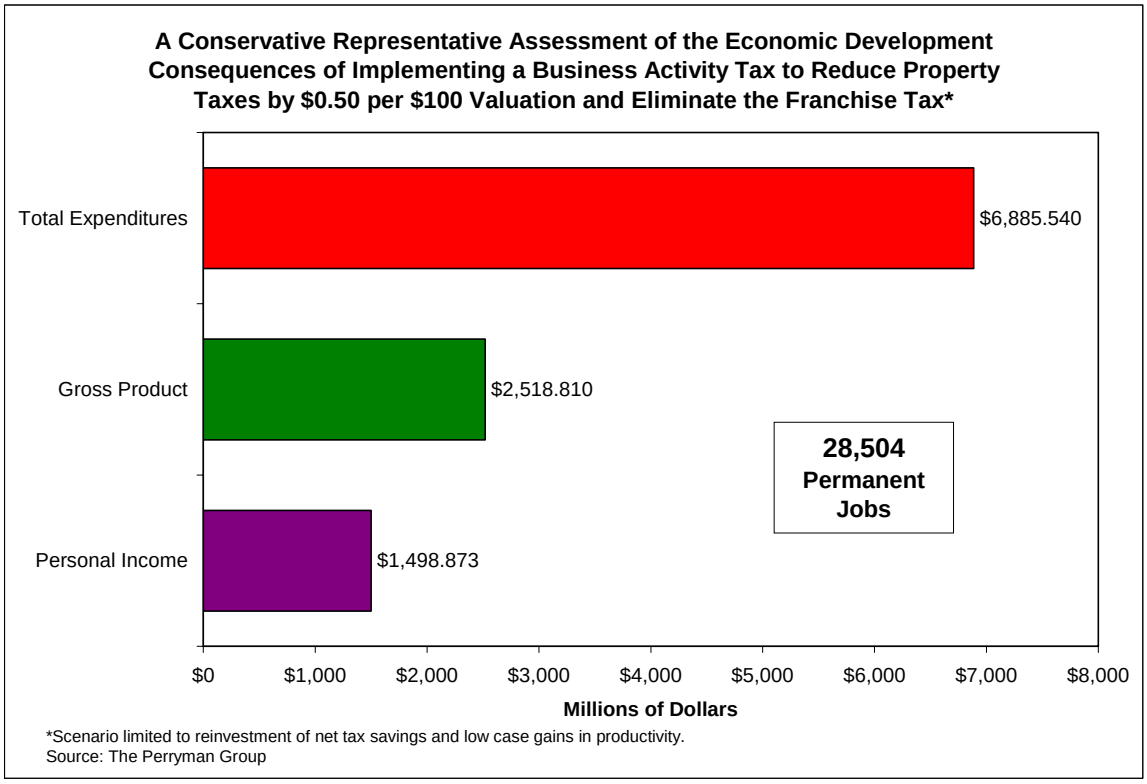
Effect of an Improving Tax Structure

In addition to the quantifiable effects of the proposed changes in the tax structure, the more responsible and equitable tax system will also improve the business climate of Texas. Gains in productivity should also be observed as firms have a greater incentive to achieve efficiencies without adjusting decisions for their tax consequences.

For purposes of illustrating the potential magnitude of these gains, TPG assumed reinvestment of net tax savings and low case increase in productivity (one percentage point enhancement to state output over 10 years). The increment in business activity in the state under these assumptions in the representative case of a

$0.50 property tax reduction for $100 valuation was found to include

- ✓ $6,885.540 million in annual Total Expenditures;
- ✓ $2,518.810 million in annual Gross Product;
- ✓ $1,498.873 million in annual Personal Income; and
- ✓ 28,504 Permanent Jobs.



These effects, while notable and well in excess of the direct consequences of the change in tax structure, will likely understate the actual gains. Texas will be a much more attractive state for the location, retention and expansion of major facilities, thus promoting greater levels of economic development.

Conclusion

The future success of the Texas economy is inextricably linked to the appropriateness of its tax structure. The current heavy reliance on property taxes is problematic in that (1) it fails to provide adequately for education and local government services and (2) it results in undesirably inequitable tax burdens.

By moving toward a more broad-based and equitable tax structure, such as a business activity tax, the state can enhance both current and future performance. A business activity tax is very straightforward to administer compared to the current franchise tax on business or the property tax. Moreover, the base is expected to grow in line with the general economy and slightly faster than many other non-property tax sources. One desirable characteristic of the tax is that it does not substantially alter economic decision-making; companies will generally try to maximize value-added irrespective of an "after-the-fact" tax.

Decreasing reliance on property taxes has several desirable outcomes. First, a significant deterrent for capital-intensive industries to locate or expand in Texas would be removed, thus enhancing economic development opportunities. The real estate market would benefit, as would current and potential homeowners and investors, in that a decrease in property taxes improves the affordability characteristics of such assets.

Even with the proposed reforms, property taxes would continue to be a significant portion of public school revenues and would remain a dominant funding source for cities, counties, and numerous special taxing districts. Nonetheless, a movement of this

magnitude toward a more stable, equitable, and responsive tax structure would clearly be a positive step for Texas over an extended time horizon and is worthy of serious consideration in the ongoing discussion of tax and educational reform.

The Consequences of Selected Potential Tax Reforms for Real Estate Performance and Business Activity in Texas

Introduction

Services provided by local governments are integral to quality of life. The need for adequate police and fire protection, for example, is obvious. Similarly, the need for a quality system of public education is beyond question. However, such services entail a price, and tax receipts from businesses and individuals are necessary to support these functions.

The issue becomes how to allocate the tax burden among various groups such that it is equitable, efficient, and minimally detrimental to the economy. If taxes result in a disincentive for businesses to invest, expand, and create jobs, all Texans lose. If individuals alter their patterns due to tax considerations, there can also be negative consequences for the economy.

The question of tax structure stands to be one of the central issues of the current session of the Texas Legislature. A key element of this discussion is the optimal method of funding the public schools of Texas. Because of problems such as an increasing reliance on local property taxes, a "Robin Hood" plan which results in transfers of resources among school districts, substantial litigation regarding the adequacy and equity of funds, a system approaching a ceiling on allowable rates, and widespread dissatisfaction among voters, there is currently intensive effort to reform the existing structure.

Although prior legislative sessions attempted to deal with the issue, significant structural changes in the Texas tax system will be required to improve the system. The sheer size of public education as an element of state and local activity precludes effective "band-aid" solutions. To date, although the topic has been the subject of intense debate, no sweeping action has been taken. Major efforts by then Governor George W. Bush in 1997, several Select Committees, and a special session in 2004 failed to produce notable results. However, the situation is worsening and may reach crisis proportions if fundamental reforms are not initiated. Even under the most favorable assumptions, the state economy clearly suffers due to the suboptimal taxation mechanisms now in place.

The level of tax receipts required to support a vibrant, sustainable business environment is obviously going to grow, even with prudent and efficient use of public resources. Moreover, the outlays needed for these crucial functions and others will inevitably rise in the future with growth in the state's population and the resulting demand for services. Careful consideration of the various methods available to ensure adequate tax revenues is essential to developing a viable plan.

Purpose of the Study

The Perryman Group (TPG) was recently asked to examine the impact of various alternative tax proposals on business activity in Texas and specific elements of the real estate sector. The analysis involves examination of a proposal to

- ✓ impose a business activity tax (BAT);
- ✓ eliminate the current Texas franchise tax, and
- ✓ reduce property taxes by varying amounts.

The economic impact of these scenarios is evaluated, as is the economic development effect of the resulting tax structure. A focus on real estate development is also offered.

The Perryman Group's Perspective

TPG is an economic research and analysis firm based in Waco, Texas. The firm has more than 20 years of experience in analyzing the Texas economy and assessing the economic impact of corporate expansions, regulatory changes, real estate developments, and myriad other types of events affecting business activity. The key model used in this study, the Texas Multi-Regional Impact Assessment System, was developed in the early 1980s and has been continually refined, updated, and expanded since that time.

This system has been used in hundreds of public and private sector applications and enjoys an excellent reputation for accuracy and reliability. In particular, the model has played a key role in numerous major policy initiatives in Texas (including, among others, judicial reforms, trucking deregulation, electric deregulation, tax policy, economic development incentives, telecommunication deregulation, and transportation funding mechanisms). Relative to the current task, these models have been used on a regular basis to analyze various taxation and public school finance issues for the Office of the Governor; the Lieutenant Governor; the Comptroller of

Public Accounts; the Speaker of the House; and numerous House, Senate, and Joint Committees and task forces. The firm also has extensive experience in evaluating the effects of various phenomena on real estate activity.

TPG has conducted hundreds of impact analyses for the US and Texas economies as well as all Texas metropolitan areas, regions, and counties. Impact studies have been performed for hundreds of clients including many of the largest corporations in the world, governmental entities at all levels, educational institutions, major health care systems, utilities, and economic development organizations.

The Real Estate Industry in Texas

The real estate sector is a vital contributor to the Texas economy. Moreover, trends influencing the performance of the sector affect all Texans through their roles as property owners or renters. In this section, key trends in the industry are highlighted in order to provide a framework for evaluating the effects of proposed tax law changes.

Rates of Homeownership in Texas Lag the US

In 2000, there were approximately 8.16 million housing units in Texas. Characteristically, with the growing mobility of American society, almost 25% of the occupants had lived in the same place for less than 15 months. Slightly over 30% had been in their home from two to five years; about another 30% had lived in their units more than a decade.

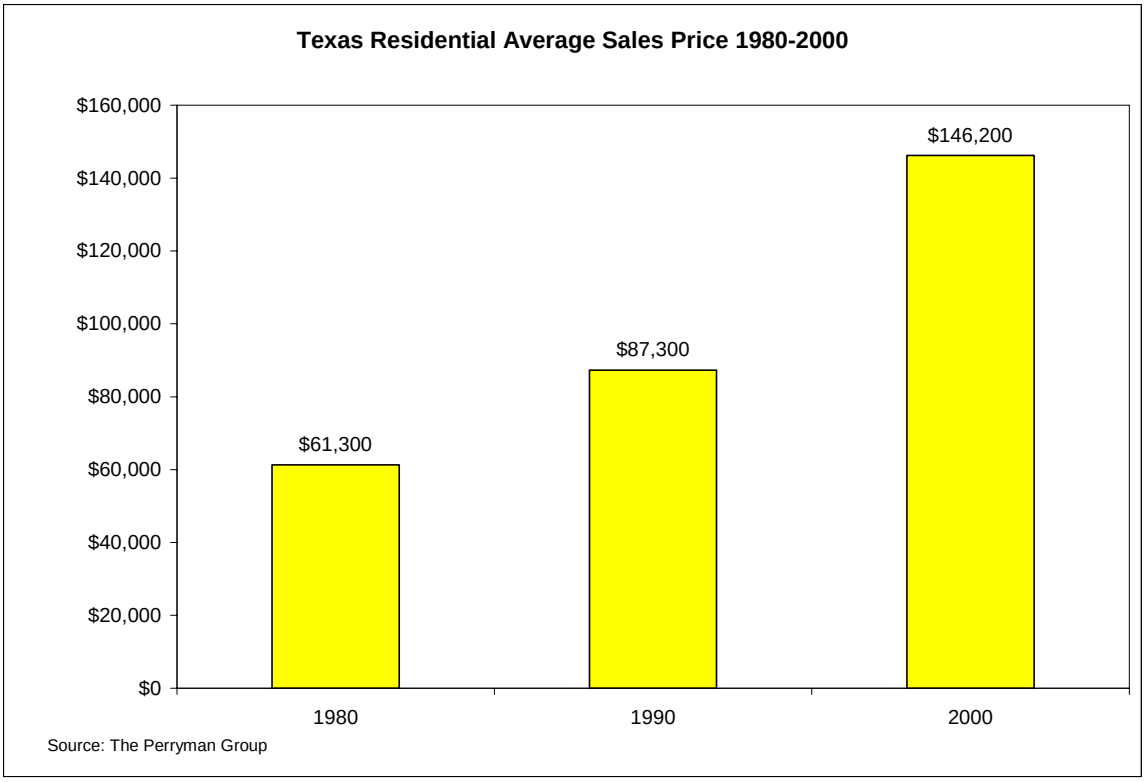
Over the past few years, mortgage interest rates in the US have been historically low, a phenomenon that has led to a substantial housing boom, both in construction of new homes and in purchasing of older ones. The drop in 30-year fixed mortgage rates from an average of 8.05% in 2000 to 5.87% last year has swelled the number of dwelling units being sold and purchased. The American dream of owning a house is now a reality for a large proportion of the population. Moreover, major policy initiatives, such as the Fair Credit Reporting Act, have opened the housing market to virtually all segments of society in a dramatic fashion.

Estimates by the US Census Bureau regarding homeownership indicate that about 64.5% of Texas households owned their homes in 2003. While this percentage is significant, it lags the national average of 68.3%. This pattern has not always been the case; in 1970, Texas homeownership was 64.7%, slightly higher than the US rate of 62.9%. Beginning in 1980, the Lone Star State dropped slightly below the national average, and over the past two decades Texas has ranked below the US levels. This trend reflects shifting demographic patterns within the state relative to national norms which lead to somewhat lower per capita income in Texas than in the nation as a whole.

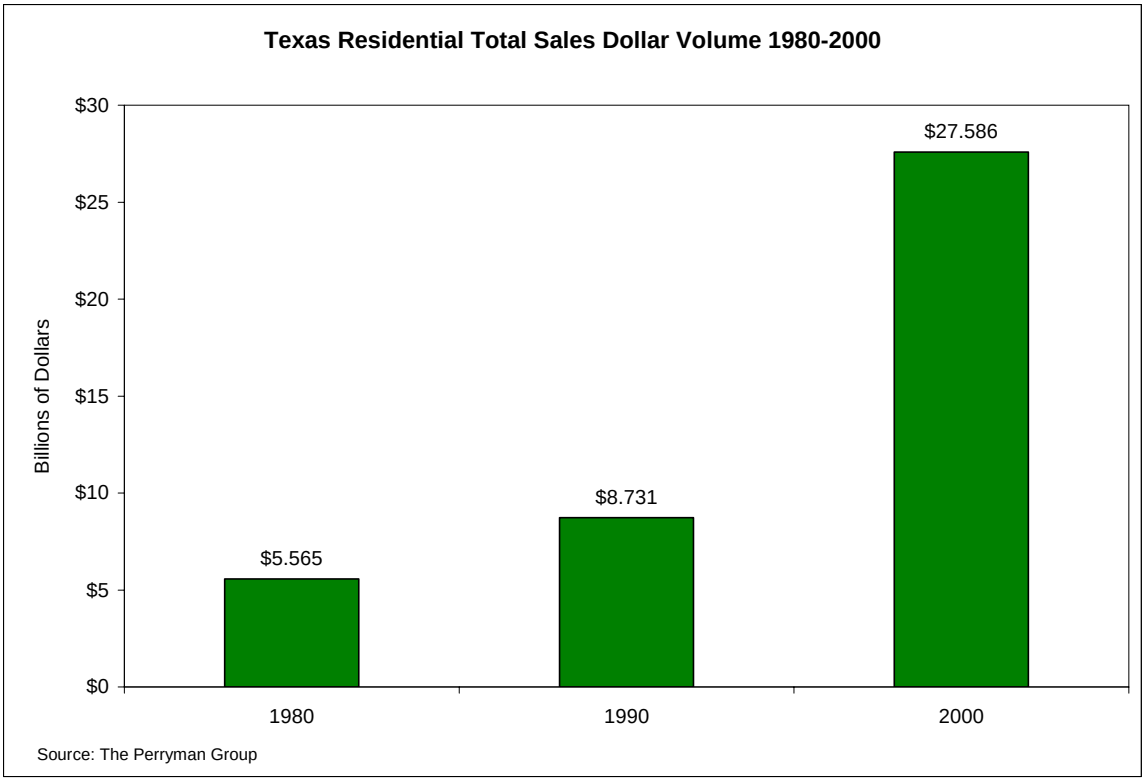
Values and Sales Volumes Have Risen Dramatically

Prior to World War II, the average value of a single-family residence in the US was $30,600 (adjusted to 2000 dollars). Median value in Texas was $17,600. Prices have dramatically escalated since that time, just as square footage and amenities have been expanded and enhanced.

In 1980, the median home value in the US was $93,400 while the value of one in Texas was $77,400, a difference of some $16,000. In 2000, the variation was significantly larger, as the US median price was $119,600 and Texas homes were valued at $82,500. Some 63.3% of the houses were valued less than $99,999, and 1.3% of Texas residents were in facilities costing more than $500,000.

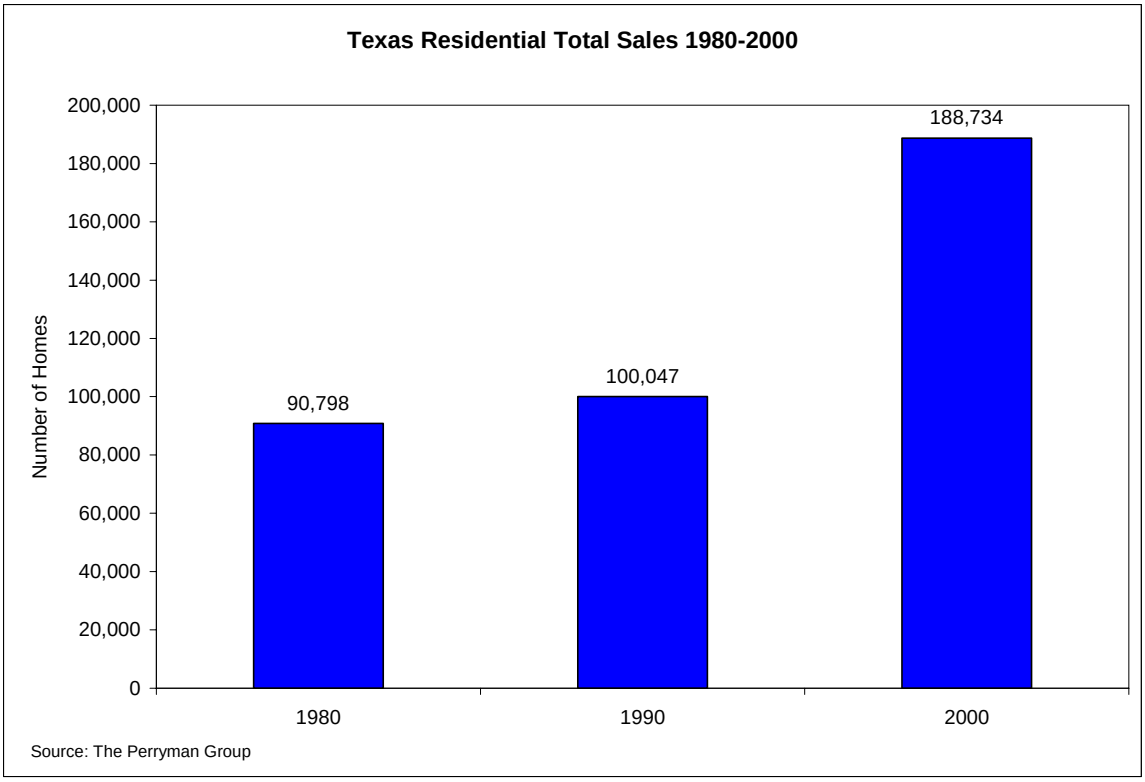


The volume of home sales has grown substantially over the past 25 years. In 1980, there were 90,798 sales of homes in Texas with an average price of $61,300. In 1990, home sales topped 100,000 for the first time with total dollar volume of $8.73 billion. The 200,000 mark in sales was reached in 2002 with an average price of $155,800 thereby amassing a total dollar volume of $31.28 billion. Last year, Texas residential housing activity recorded 235,146 homes sold with a total dollar volume of $38.73 billion.



In 2000, homes took an average of 4.5 months to change owners. Last year, some six months was required on the average for the sale of a home. At the beginning of this year, more than 113,700 houses were on the market.

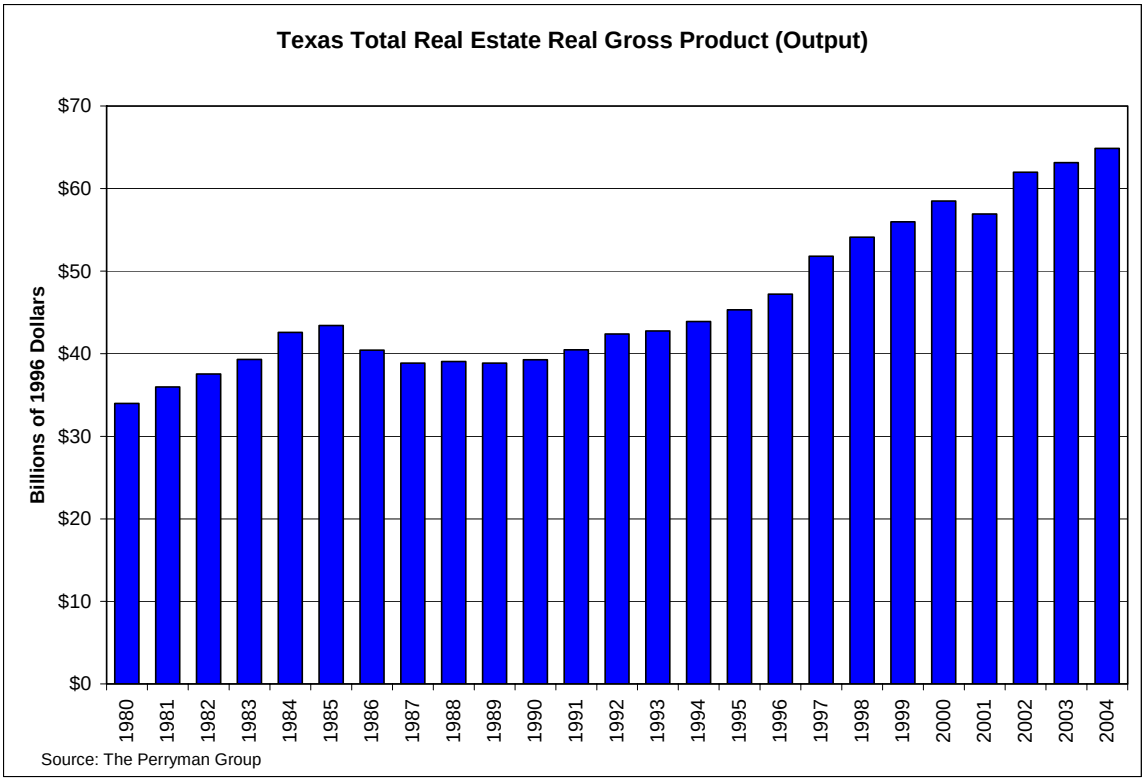
The market for new construction is also exhibiting a strong upward trend. In 1994, the number of building permits issued in Texas for single-family housing units was some 67,260. Last year, the number of permits was more than double that amount as 143,982 were authorized across the state. The average value for a new single dwelling unit 10 years ago was about $100,600, whereas the average value in 2004 was $136,500.



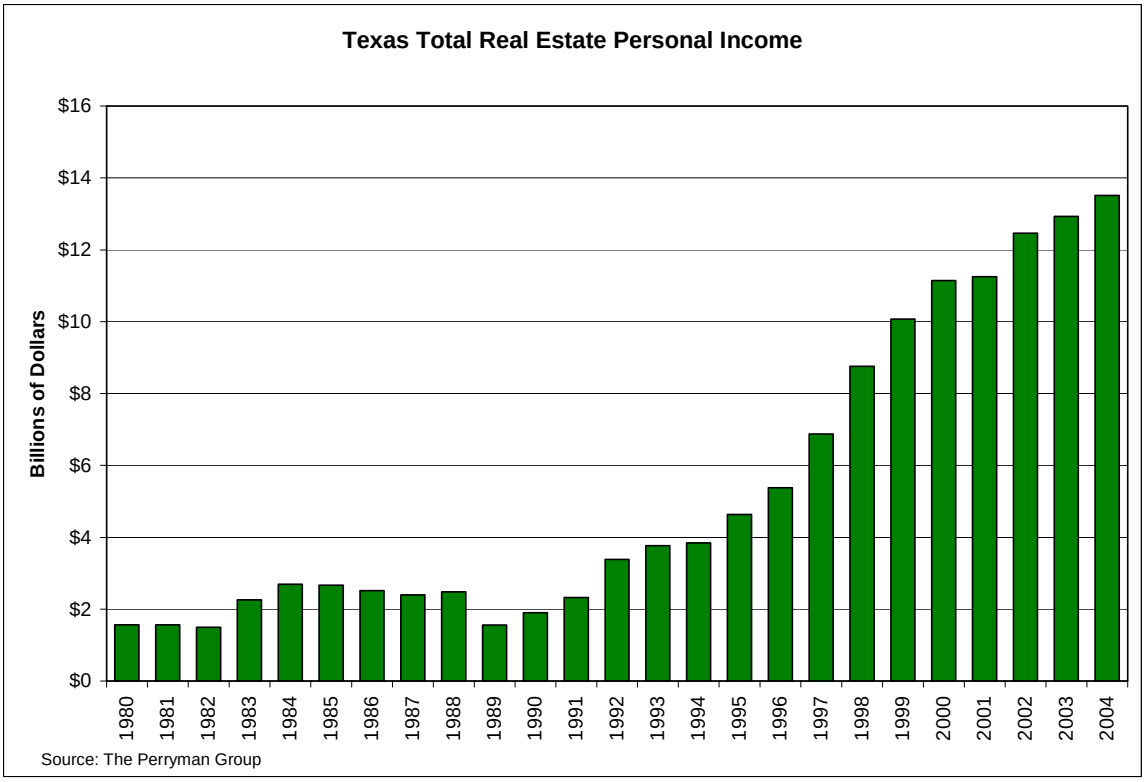
Permits for multi-family construction in Texas are also somewhat higher than a decade ago, with 1,676 issued in 1994 for two to four family dwellings and 29,849 for five or more units. In 2004, corresponding numbers were 6,476 and 31,460, respectively.

Real Estate is a Key Component of the Texas Economy

The size of the real estate sector has grown notably over the past decades, from $33.969 billion in output (real gross state product or RGP constant 1996 dollars) in 1980 to an estimated $64.856 billion last year.



Total personal income within the real estate industry in Texas has also risen markedly, from $1.568 billion in 1980 to an estimated $13.515 billion last year. A significant portion of these gains were due to the boost in the number of homes sold, both new and old, as well as the increase in the number of individuals entering the industry.



Real Estate Professionals Play a Vital Role

Since 1920, the Texas Association of REALTORS® has provided guidance and assistance to individuals and organizations throughout the Lone Star State seeking investments in housing as well as other facilities and properties. The overarching goal of the more than 73,000 members is to fulfill the needs of clients and help ensure satisfaction with their decisions.

The Texas Association of REALTORS® has created several avenues to enhance homeownership such as educational and communications programs designed to inform homebuyers about options and opportunities. In addition, the group has undertaken

special endeavors that support affordable housing and provide assistance in securing appropriate financing.

Real estate professionals often provide invaluable assistance to clients in navigating the complex process of buying or selling a home or other real estate asset.

Implications for Real Estate are an Important Consideration in Tax Reform

Any proposal to change the tax structure should carefully weigh the effect on the real estate sector. Not only does this segment represent an important component of the Texas economy, it is also integral to the quality of life of all Texans. The affordability of housing is inextricably linked to property tax rates, as taxes are a notable component of the cost of homeownership. Moreover, ongoing costs are often a major factor in decision-making relative to commercial and industrial expansion.

Poorly conceived tax structures can decrease property values. Such outcomes have been observed in various geographic areas, and empirical studies indicate that high property taxes reduce demand for real estate. However, the inability of local governments to raise sufficient tax revenues to provide quality services (including education) also has a clear negative effect on property values and the real estate sector.

Problems with the Current Texas Tax Structure

Texas has a relatively low per capita tax burden, and the absence of a personal income tax is at times viewed positively by firms seeking new locations, particularly those involving high-wage employees.[1] Even so, the state's heavy reliance on property taxes and the nature of the current franchise tax negatively affect both businesses and individuals. The Texas tax structure is typically ranked near or below the middle among all states in attractiveness for new business activity and is not particularly well regarded by site selection consultants.

One particular problem is the tax structure's inability to adequately provide the resources needed by local governments and school districts. It is crucial to ensure sufficient tax receipts to meet the needs of a growing economy through funding methods that expand in accordance with requirements and respond to changes in the underlying economic base. Demographic trends also affect the need for services paid for through tax levies. The Texas population is expected to grow from approximately 22.5 million now to 35.8 million in 2040 (assuming migration into the state at a rate half that of the 1990s). In addition, the school-age population is expected to grow rapidly in many areas of the state (such as the Texas-Mexico border region), increasing the need for public education funding. At present, enrollment typically expands by 75,000-80,000 per year, with an increasing percentage in categories with more extensive educational requirements.

[1] The information in this section is partially adapted from numerous past studies of related issues by The Perryman Group.

Texas currently relies on such mechanisms as (1) a property tax, (2) a sales tax that applies primarily to goods at a time when consumption is shifting more toward services (and Internet purchases on which taxation is often avoided), (3) a franchise tax partially based on the capital stock of firms, and (4) an oil and gas severance tax in an era of gradually declining production. Thus, the current tax structure is not well suited to increase in line with either the expansion of the economy or the accompanying revenue requirements.

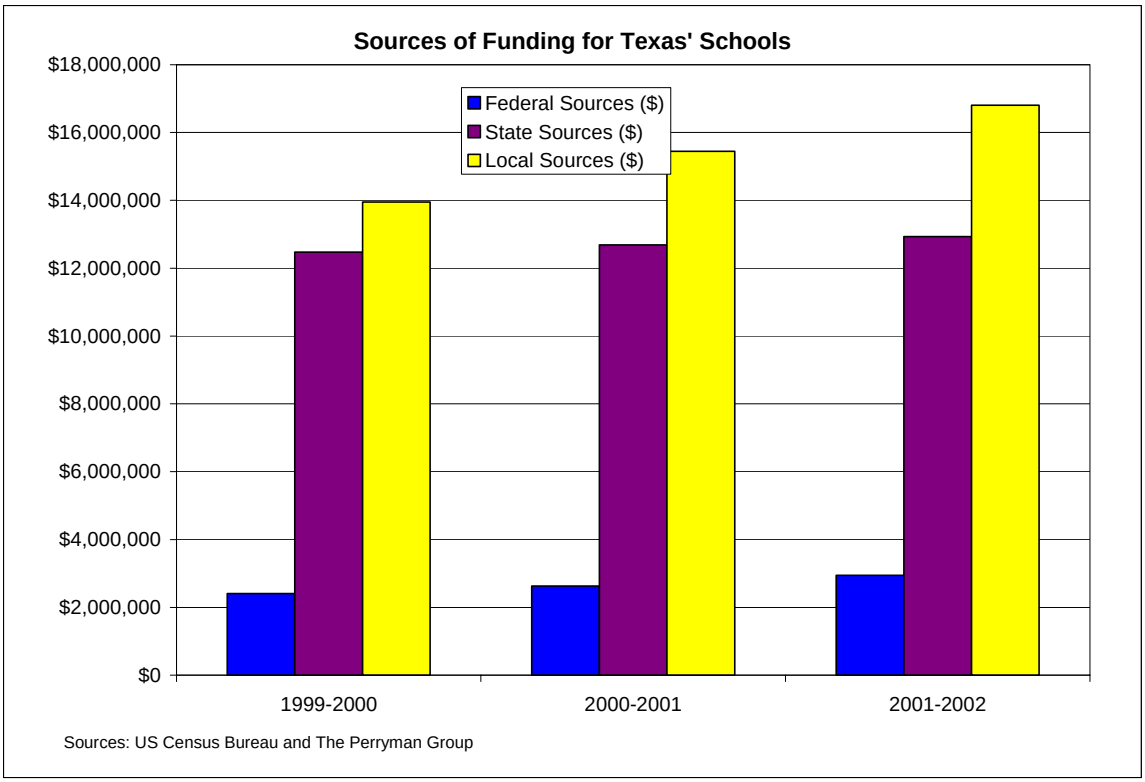
Problems with the Texas Method of Funding Public Education

Property taxes have been the mainstay of school finance for several decades, but it appears unlikely that they can continue to play this role effectively. A brief overview is useful as a backdrop to the empirical analysis

Shortcomings of Property Taxes

A major problem is that the base of this levy, the assessed value of taxable property, is an unstable source of growth for revenues. While long-term increases have occurred and are anticipated for the future, the pace lags well behind that of alternative measures of economic activity which could serve as mechanisms for tax collections. Over the past 20 years, the property tax base has risen by 72% as compared with gains of over 250% in other fiscal sources (such as expenditures, sales, business activity (output), or income). In fact, during an extended period from 1985 to 1995, the property tax base actually fell, while other measures rose in excess

of 60%. Over this same period, average property tax rates more than doubled. Although values have recovered in recent years, the rate of growth remains only about 60% as high as alternative bases. As a result, rates have increased dramatically to meet local fiscal needs. In particular, the nature of school funding mechanisms and formulas compelled many school districts to substantially increase their rate for maintenance and operations. The tax also suffers from the fact that increased property values often bear little relation to financial liquidity and, thus, ability to pay.



The Perryman Group is presently projecting that property values will continue to expand in the future, but at a pace below that of overall business activity. Moreover, while it is unlikely that another 10-year stagnation will occur, property values are subject to less predictability and more prolonged cycles than the economy as a whole. The timing of property value fluctuations also shows little

correlation with revenue requirements. Similarly, the rate of appreciation varies markedly across areas, thus adding uncertainty, complexity, and instability to a funding process which relies on local levies and collection with subsequent disbursement.

From the perspective of those paying the levies, property taxes have become a significant burden. Calls for reductions in total taxes, limits on changes in appraised values, and other measures to reduce the burden of property taxes are increasingly strident. Individuals are affected through the higher cost of owning a house or other real estate, and businesses' profitability is decreased. While there are numerous problems associated with appraisal caps (as indicated by the ongoing fiscal crisis in California), rate reductions and corresponding shifts to more equitable and efficient funding mechanisms will notably improve the fiscal structure of the state.

One of the biggest problems with the state's tax structure is the fact that it places a greater relative burden on capital-intensive firms than those in competing areas. Approximately 60% of state and local taxes in Texas are paid by businesses (in terms of direct incidence), whereas most competing states have roughly an equal division between businesses and households. Among the 10 most populous states in the US, only Florida (which, like Texas, has lagged in new corporate locations over the past 10 years) collects a comparably disproportionate percentage of taxes from the corporate sector. As a further complication, the Texas franchise tax is partially levied on the capital assets of a company, thus creating substantial tax liabilities for capital-intensive enterprises irrespective of their economic performance. Moreover, it is relatively easy to

avoid, thus making it an unreliable source of funds to meet long-term public needs.

The most significant segment of this imbalance occurs as a result of the heavy reliance on property taxes to fund much of the county, municipal, and (especially) school district activity. Almost half of the state and local taxes are based in some manner on the value of assets, with the burden thus being weighted toward firms with large, expensive facilities. Although manufacturing and utilities represent only about 26% of the gross state product, these sectors pay well over half of all business property taxes and a disproportionate share (almost 40%) of franchise levies.

Because of this situation, there are material tax disadvantages to locating a large facility in Texas. This phenomenon has been documented in several studies and is widely known in the economic development and site selection community. Although some strides have been made to partially offset the increased tax costs of a Texas location, including reducing property taxes for qualifying large facilities in the 2001 legislative session (House Bill 1200) and establishing the Texas Enterprise Fund in the 2003 session, there is still a need to address the underlying problems.

It is becomingly increasingly apparent that local governments and school districts are overly reliant on property taxes. This problem is at the root of the need to overhaul the Texas tax structure, particularly given specific problems in the area of school finance.

Problems with Robin Hood

For more than two decades, Texas has faced an ongoing struggle regarding school finance. In 1984, the constitutionality of the school finance program was challenged. Five years after several school districts filed suit, tried their case, and embarked on a whirlwind of appeals, the Texas Supreme Court ruled the method by which Texas funded its public school system was unconstitutional. Essentially, less wealthy districts were not able to fund their schools as adequately as wealthier ones could because of the differences inherent in their taxable property values.

The first attempt at remedy came in the summer of 1990, when the Texas Legislature sought reform by providing more funds in an effort to achieve parity. When this attempt failed to achieve the desired result, the Legislature made further radical changes by aggregating the tax bases of individual districts, capping property wealth per student at $280,000, and attempting a redistribution of excess funds to cash-strapped schools. This mechanism was again challenged and it became clear that further change was necessary.

Finally, in 1993, the Legislature was able to produce a school finance plan deemed constitutional. Through SB 7, the Legislature created a “recapture” provision, which allows locally raised property taxes from property-rich areas to be distributed to property-poor areas. Districts with more than $280,000 wealth per student (as measured by weighted average daily attendance—WADA) would be required to redistribute the excess funds in one of four ways, and the Robin Hood system was born.

In the past 10 years, the amount of money redistributed through the mechanism has grown exponentially. During the first school year the new finance program was in effect, 1994-1995, revenue redistribution totaled $135.6 million. By 2004, it was $1.2 billion from 134 school districts. Although the dollar amount of the property tax base per student has increased several times since this plan's inception, the basic structure has remained in force. Robin Hood was intended to be a temporary solution from the outset, with judicial rulings making it clear that it would no longer be constitutional once the ceiling rate for maintenance and operations ($1.50 per $100 valuation) was widely implemented (the Texas Constitution currently prohibits a statewide property tax).

Most school districts now see themselves taxing property at or near the maximum cap of $1.50 in order to simply keep up with the need for funds. In fact, the average rate is now over $1.48. Also at issue is the increasing difficulty faced by all school districts as state dollars allocated for public education continue to shrink each biennium. In 1981, the State accounted for 52% of all public school funding whereas now, State funding comprises only 38%. In essence, before and during the Robin Hood era, there has been a systematic, formula-driven shift of the school finance burden to the local level, a fact which has played a substantial role in driving rates to current levels.

Districts have once again banded together in order to charge that the school finance plan is an unconstitutional tax on property. Through the years, they argue, the $30 billion-a-year system has essentially evolved into a State ad valorem tax because districts must tax at maximum levels in order to achieve parity. In September 2004, a judge ruled that by October 1, 2005, Texas

would have to have a new school finance system or face an injunction effectively ending all State funding for public schools. While the appellate process continues, it is widely accepted that a new approach must be adopted.

In short, Robin Hood did not significantly solve the original problem of helping property-poor districts raise revenue for their schools. It essentially redistributed available funds, often compelling districts to raise taxes of little if any benefit to local constituencies. The most recent judicial ruling and public concern have likely signaled the beginning of the end for Robin Hood as the dominant factor of the school finance system.

Alternatives to the Property Tax

Given the difficulties with the current system, it is desirable to explore various options for alternative taxes. A complete discussion of these (except for the business activity tax, which is integral to the scenarios analyzed in this report) is beyond the scope of this project. However, a brief overview is offered as background to the present discussion. As noted earlier, the fundamental problem with the overall Texas tax structure is that it is not reflective of expansion and demographic patterns and, thus, fiscal requirements. Therefore, some type of broad-based tax with a relatively low rate is needed.

One option would be to broaden the applicability and increase the rate of the state's existing sales tax. Some argue that this type of tax is efficient, transparent, and fair. However, the downside of an increase in sales taxes includes avoidance and the inherently regressive nature of such taxes.

There also have been occasional proposals for implementing an income tax in Texas. However, opposition to this type of tax is strong, and there is at least some indication that the absence of a personal income tax in Texas has contributed to Texas' prosperity in recent years. Other broad tax bases include business activity, gross receipts, payrolls, and transactions. All of these have their benefits and drawbacks and all create "winners" and "losers" relative to the current system. Therein lies the basic dilemma of far-reaching tax reform.

Taxes on specific products such as gasoline, tobacco, wine, beer, liquor have been used in the past to raise additional tax revenue. As a practical matter, “sin” tax increases may well be a part of the ultimate funding package. Nonetheless, they are unlikely to provide sufficient funds to significantly affect the underlying need for restructuring the tax system. Similarly, other sources of revenue, including various forms of gaming activity, will also likely be a part of the discussion. In terms of achieving certain beneficial outcomes, however, a business activity tax offers several advantages as a method of taxation for the portion of funds to be generated from the production of goods and services. The nature of this levy is presently explored.

Other types of taxes have been proposed in the past and are likely to surface again as efforts to find a workable solution to the problem of school finance continue. They may even be appropriately utilized to some degree. Even so, none of these can compare to the equity characteristics of a business activity tax.

The Business Activity Tax

Business activity taxes are a very common method of taxation used around the world, typically in the form of a value-added tax (VAT). Although no tax mechanism is perfect, it has generally proven to be a relatively equitable and efficient option for generating necessary revenue. Because it is structurally similar to the proposed business activity tax, it is instructive to briefly explore the properties of the VAT as a preamble to the empirical analysis.

History and Prevalence of the VAT

More than 90 countries levy some form of a business activity tax. In fact, the United States is among the few industrialized, Organization for Economic Cooperation and Development (OECD) countries that do not. Since 1967, The European Union (EU—formerly the European Community or EC) has used a VAT. The United Kingdom (UK) has used a value-added tax system since 1973 with the original rate being 10%; many countries in the EU also implemented 10% rates. Since then, the minimum rate for the UK has risen to 17.5%, and the minimum rate for the EU is now 15%. Other member states have rates ranging from 15% to 25%.

The State of Michigan utilized a modified VAT system, then called the Business Activity Tax or BAT, beginning in the early 1950s. Michigan repealed its VAT system, by then known as the single business tax (SBT), in 1999; its rate of 2.3% is scheduled to be phased out over 23 years, although fiscal exigencies may well postpone or eliminate this possibility. The major problems with the Michigan system stemmed from its initial inception, when numerous small businesses were added to the tax rolls. Even though they were subsequently exempted, their opposition remained strong (essentially a reflection of the adage that "the only good tax is an old tax"). The levy was also made needlessly complex with regard to compliance, and it faced the expected opposition from labor-intensive firms (much as many other forms of taxation that penalize capital-intensive firms). It should be noted, however, that Michigan has over the past decade consistently been ranked among the top states in attracting new corporate locations and manufacturing enterprises.

Benefits of a VAT or BAT System

The value-added tax is commonly considered a consumption tax, one that is determined based on the "value added" to a good or service during the various stages of production. There are several variations, but the general premise is to tax a portion of the differential between (1) the selling price of a good or service and (2) the cost of purchased inputs needed to create that good or service. When treated as a state-level business activity tax, it is typical that capital purchases are counted as deductible input expenses at the time of purchase (rather than through depreciation) thus encouraging investment.

The BAT is generally levied on businesses, not individuals. This characteristic of the tax helps define it as one that is highly efficient from the standpoint of collections and compliance. Moreover, a BAT eliminates many of the problems associated with other forms of business taxation. It is self-enforcing to some extent, as purchasers of intermediate goods and services have an incentive to ensure that their suppliers have paid the tax.

As a point of contrast, a corporate income tax or a business profit tax (much like one aspect of the current Texas franchise tax) can lead to inefficient allocations of resources through encouraging excessive debt financing, discouraging saving and investing, penalizing efficient firms, and favoring certain methods of production and structures over others. A BAT with a flat rate can solve the problem of penalizing efficient companies because all companies pay exactly the same rate. It is also relatively stable, with little variation unless the underlying structure is changed. From an economic perspective, it is optimal for firms to make the

same decisions with and without the BAT, thus leading to greater efficiency and productivity. Even during the recent economic slowdown, the base of a comprehensive BAT would have risen modestly, thus alleviating some (but not all) of the budget crisis which confronted the state. Similarly, because its base clearly corresponds to aggregate business activity, it is flexible in responding to future revenue needs.

Another desirable property of the BAT is that it does not result in significant reallocation of resources in order to avoid taxation. Thus, economic activity is more consistently directed toward productive purposes. The primary difficulties are (1) it will face substantial opposition from those presently avoiding significant taxation, and (2) it can discourage outsourcing, a common mechanism used to achieve cost savings. The former will be the case with the "losers" in any new funding methods, while mechanisms (such as joint ventures) can be designed to mitigate the latter. The BAT also faces a few complications at the state level, such as the absence of a simple border "true up" across countries and difficulties establishing the correct origin of taxable activity. Such problems can be overcome, however, through effective collection mechanisms. If a truly comprehensive business activity tax were enacted, it would likely generate more than $5 billion per rate percentage point (thus permitting relatively low rates).

Industries and the BAT

One could argue that the best thing about a BAT system is that it does not differentiate between capital-intensive and labor-intensive

industries—both are taxed equally (except in the case of exemptions). It is the moneymaking potential, or ability to add value, of the business that determines its tax burden. Because it exempts capital purchases and not labor from the tax, however, it does have some resemblance to a payroll tax. This fact is sometimes a source of criticism, as many services firms view labor as an input in much the same sense that manufacturers view intermediate goods.

Given that the economy has been shifting toward a services orientation for decades, it is particularly important to note that the BAT is a much better mechanism for equitably taxing various types of firms than current approaches. Whether capital-intensive manufacturing concerns or high-priced services firms operating in relatively small offices, the increment to value each company is responsible for is the driver for the amount of taxation. Moreover, such a structure naturally evolves with the economy, as emerging sectors will similarly be taxed in accordance with their relative contributions.

As the subsequent empirical analysis will clearly demonstrate, numerous industries which are vitally important to Texas (such as agriculture, chemicals, and petroleum refining) would be treated much more equitably in a system that replaced some segment of the property tax with a BAT, thus encouraging additional investment in the state. The methodology used in the evaluation is presently described.

Methodology for Assessing the Impact of Various Plans

The basic modeling technique employed in assessing the economic impact of the proposed changes in the Texas tax system is known as dynamic input-output analysis. This methodology essentially uses extensive survey data, industry information, and a variety of corroborative source materials to create a matrix describing the various goods and services (known as resources or inputs) required to produce one unit (a dollar's worth) of output for a given sector. Once the base information is compiled, it can be mathematically simulated to generate evaluations of the magnitude of successive rounds of activity involved in the overall production process.

There are two essential steps in conducting an input-output analysis once the system is operational. The first major endeavor is to accurately define the levels of direct activity to be evaluated. In the present instance, the direct effects were estimated utilizing the hypothetical tax reform scenarios previously described.

The initial task undertaken in this investigation is a comparison of the current property and franchise taxes in Texas with the proposed business activity tax with regard to direct incidence. The direct property tax outlays are allocated across various industries (more than 500 separate categories) based on the best available estimates of the present tax burden. In order to provide a comparable sector-by-sector comparison, the residential segment of the tax is treated as foregone consumer spending and allocated based on standard spending patterns (as described in more detail below). The franchise tax is allocated based on an expansion of a

recent aggregate analysis from the Comptroller of Public Accounts. The 500-sector detail was estimated by allocating the levies across a broad industry level in accordance with relative proportions of the underlying base. The BAT is calculated based on estimated valued added by industry (in nominal terms to reflect actual payments) as defined in current proposals. The estimates of value added are derived from the direct requirement tables of the Texas Multi-Regional Impact Assessment System (TXMRIAS), which is fully discussed below and appropriately modified to account for the structure of a state-level BAT. Note also that this analysis fully adjusts for the stimulus to the real estate market resulting from the property tax reduction.

One of the key elements of the net effect of the property tax reductions is due to a stimulus to construction and real estate activity. This process occurs through many channels, such as the decrease in escrow requirements for home mortgages, which has a practical effect similar to a reduction in interest rates. These types of patterns are fully reflected in the dynamic linkages of the model with the Texas Econometric Model, a large-scale structural system maintained by The Perryman Group. For purposes of illustration, the impact of residential construction and sales activity is isolated and reported separately under one scenario (a $0.50 reduction in school maintenance and operations fees per $100 valuation).

As a final component of this investigation, a brief illustration of the potential of this type of tax reform for economic development is provided. This analysis assumes (1) direct reinvestment of the net savings from efficiency gains from the reallocation of the tax burden and (2) a one percentage point enhancement to overall productivity as a result of the more rational economic decision making

encouraged by a BAT over the next 10 years (measured in fiscal-year 2006 dollars, the first year in which any reform would likely be implemented). This stimulus is likely to significantly understate potential increases in economic performance, as the improved tax climate will be a substantial catalyst to business relocations and expansions.

Once the direct input values were determined, the present study was conducted within the context of the Texas Multi-Regional Impact Assessment System which was developed and is maintained by The Perryman Group. This model has been used in hundreds of diverse applications across the country and has an excellent reputation for accuracy and credibility. In addition, the model has been in operation and continually updated for over two decades. The system used in the current simulations reflects the unique industrial structure of the Texas economy.

The TXMRIAS is somewhat similar in format to the Input-Output Model of the United States and the Regional Input-Output Modeling System, both of which are maintained by the US Department of Commerce. The model developed by TPG, however, incorporates several important enhancements and refinements. Specifically, the expanded system includes (1) comprehensive 500-sector coverage for any county, multi-county, or urban region; (2) calculation of both total expenditures and value-added by industry and region; (3) direct estimation of expenditures for multiple basic input choices (expenditures, output, income, or employment); (4) extensive parameter localization; (5) price adjustments for real and nominal assessments by sectors and areas; (6) measurement of the induced impacts associated with payrolls and consumer spending; (7) embedded modules to estimate multi-sectoral direct spending

effects; (8) estimation of retail spending activity by consumers; and (9) comprehensive linkage and integration capabilities with a wide variety of econometric, real estate, occupational, and fiscal impact models. The models used for the present investigation have been thoroughly tested for reasonableness and historical reliability.

As noted earlier, the impact assessment (input-output) process essentially estimates the amounts of all types of goods and services required to produce one unit (a dollar's worth) of a specific type of output. For purposes of illustrating the nature of the system, it is useful to think of inputs and outputs in dollar (rather than physical) terms. As an example, the construction of a new building will require specific dollar amounts of lumber, glass, concrete, hand tools, architectural services, interior design services, paint, plumbing, and numerous other elements. Each of these suppliers must, in turn, purchase additional dollar amounts of inputs. This process continues through multiple rounds of production, thus generating subsequent increments to business activity. The initial process of building the facility is known as the *direct effect*. The ensuing transactions in the output chain constitute the *indirect effect*.

Another pattern that arises in response to any direct economic activity comes from the payroll dollars received by employees at each stage of the production cycle. As workers are compensated, they use some of their income for taxes, savings, and purchases from external markets. A substantial portion, however, is spent locally on food, clothing, health care services, utilities, housing, recreation, and other items. Typical purchasing patterns in the relevant areas are obtained from the *ACCRA Cost of Living Index*, a privately compiled inter-regional measure which has been widely

used for several decades, and the *Consumer Expenditure Survey* of the US Department of Labor. These initial outlays by area residents generate further secondary activity as local providers acquire inputs to meet this consumer demand. These consumer spending impacts are known as the *induced effect*. The TXMRIAS is designed to provide realistic, yet conservative, estimates of these phenomena.

Sources for information used in this process include the Bureau of the Census, the Bureau of Labor Statistics, the Regional Economic Information System of the US Department of Commerce, and other public and private sources. The pricing data are compiled from the US Department of Labor and the US Department of Commerce. The verification and testing procedures make use of extensive public and private sources. Note that all monetary values, unless otherwise noted, are given in fiscal-year 2006 dollars to eliminate the effects of inflation.

The TXMRIAS generates estimates of the effect on several measures of business activity. The most comprehensive measure of economic activity used in this study is **Total Expenditures**. This measure incorporates every dollar that changes hands in any transaction. For example, suppose a farmer sells wheat to a miller for $0.50; the miller then sells flour to a baker for $0.75; the baker, in turn, sells bread to a customer for $1.25. The Total Expenditures recorded in this instance would be $2.50, that is, $0.50 + $0.75 + $1.25. This measure is quite broad, but is useful in that (1) it reflects the overall interplay of all industries in the economy, and (2) some key fiscal variables such as sales taxes are linked to aggregate spending.

A second measure of business activity frequently employed in this analysis is that of **Gross Product**. This indicator represents the regional equivalent of Gross Domestic Product, the most commonly reported statistic regarding national economic performance. In other words, the Gross Product of, say, Amarillo is the amount of US output that is produced in that area. It is defined as the value of all final goods produced in a given region for a specific period of time. Stated differently, it captures the amount of value-added (gross area product) over intermediate goods and services at each stage of the production process, that is, it eliminates the double counting in the Total Expenditures concept. Using the example above, the Gross Product is $1.25 (the value of the bread) rather than $2.50. Alternatively, it may be viewed as the sum of the value-added by the farmer, $0.50; the miller, $0.25 ($0.75 - $0.50); and the baker, $0.50 ($1.25 - $0.75). The total value-added is, therefore, $1.25, which is equivalent to the final value of the bread. In many industries, the primary component of value-added is the wage and salary payments to employees.

The third gauge of economic activity used in this evaluation is **Personal Income**. As the name implies, Personal Income is simply the income received by individuals, whether in the form of wages, salaries, interest, dividends, proprietors' profits, or other sources. It may thus be viewed as the segment of overall impacts which flows directly to the citizenry.

The fourth measure, **Retail Sales**, represents the component of Total Expenditures which occurs in retail outlets (general merchandise stores, automobile dealers and service stations, building materials stores, food stores, drugstores, restaurants, and

so forth). Retail Sales is a commonly used measure of consumer activity.

The final aggregate used is **Permanent Jobs**. This measure reveals the full-time equivalent jobs generated by an activity, excluding those which are temporary in nature. It should be noted that, unlike the dollar values described above, Permanent Jobs is a "stock" rather than a "flow." In other words, if an area produces $1 million in output in 1999 and $1 million in 2000, it is appropriate to say that $2 million was achieved in the 1999-2000 period. If the same area has 100 people working in 1999 and 100 in 2000, it only has 100 Permanent Jobs.

Results of the Impact Assessment

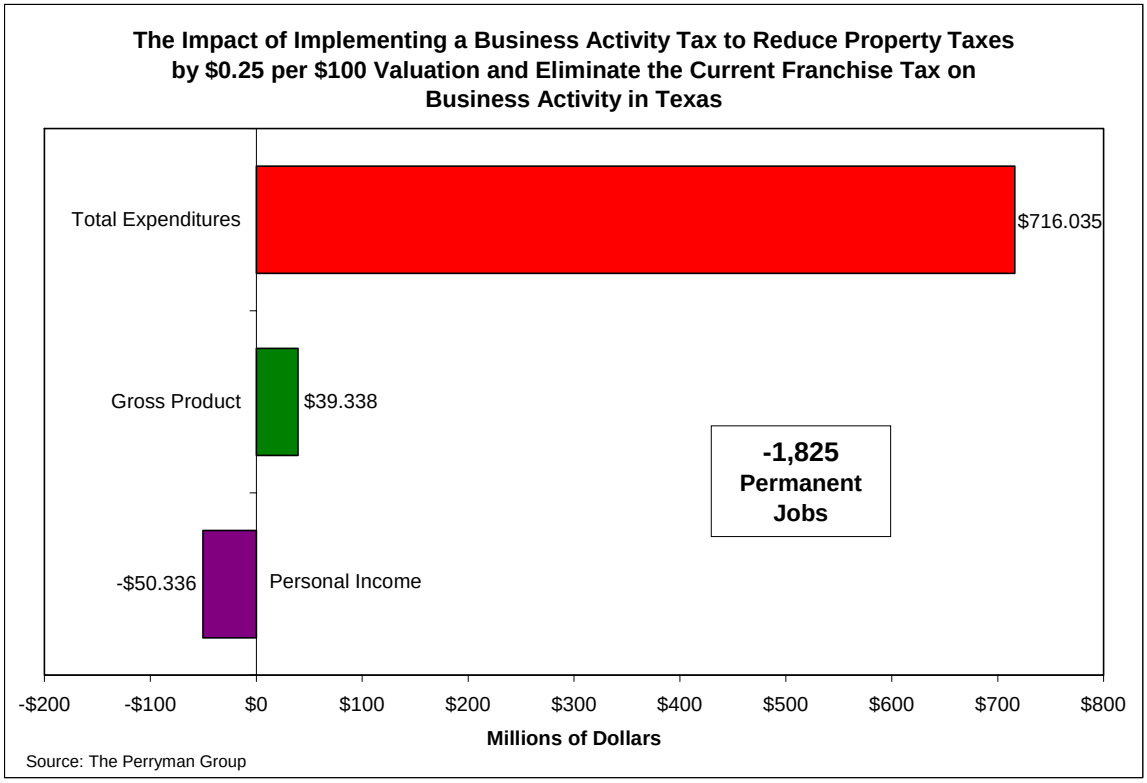
The economic impacts of three alternative tax scenarios were examined. In each case, a business activity tax is implemented to eliminate the current franchise tax and reduce property taxes.

The results indicate that implementation of a BAT and reduction in other key taxes would have a modest effect that varies by indicator analyzed. The reason for these outcomes lies in the fact that the proposed changes reduce the relative tax burden away from capital-intensive sectors (such as manufacturing) which now pay a disproportionate share of property and franchise taxes (as noted in a prior section). Thus, overall production and efficiency sees a stimulus, as reflected in the increases in gross state product. On the other hand, there are slight losses in employment (which diminish as the magnitude of the property tax reduction expands). There is also a shift from lower-paying to higher-paying jobs, as indicated by the patterns in personal income. All of these short-term "incidence effects," however, are far less than the sizable outcomes resulting from a stimulus to economic development.

$0.25 per $100 Valuation Property Tax Reduction Scenario

In this scenario, it is assumed that the BAT levy is sufficient to allow for a reduction in property taxes of $0.25 per $100 valuation (in addition to eliminating the franchise tax). The effect on business activity in Texas was measured to be

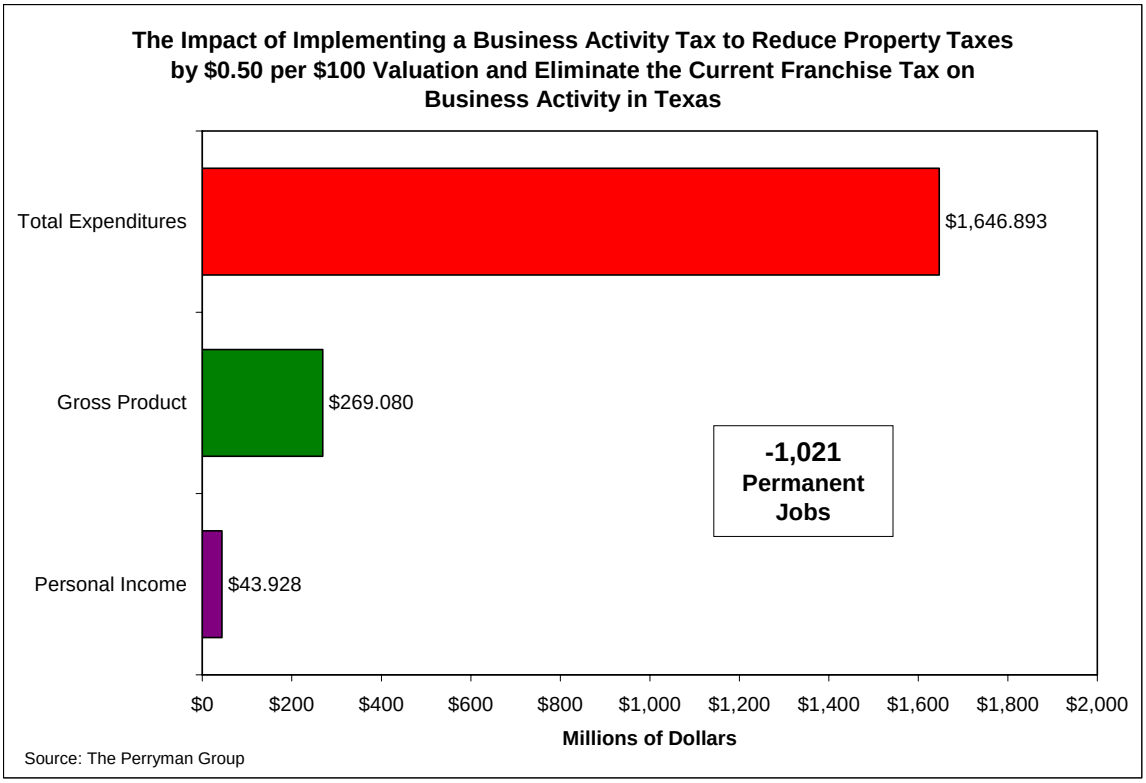
- ✓ $716.035 million in annual Total Expenditures;
- ✓ $39.338 million in annual Gross Product;
- ✓ -$50.336 million in annual Personal Income; and
- ✓ -1,825 Permanent Jobs.



$0.50 per $100 Valuation Property Tax Reduction Scenario

Under the assumption of a $0.50 per $100 valuation reduction, the effect on business activity was calculated to include

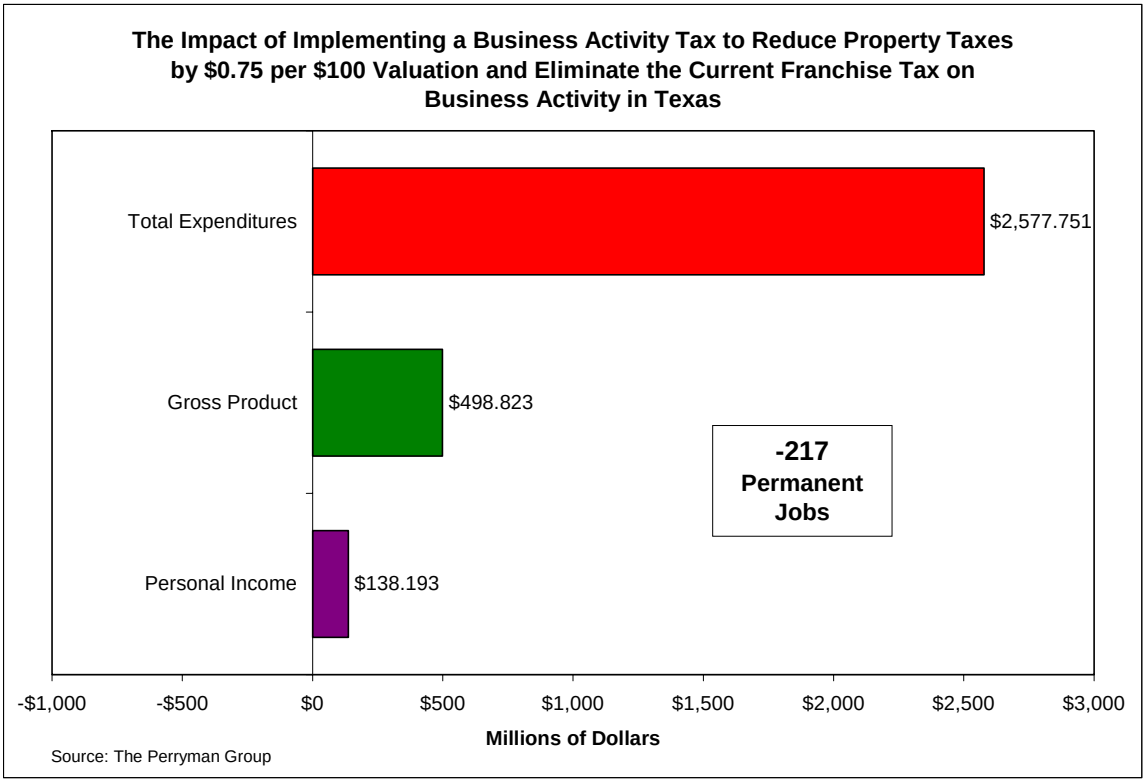
- ✓ $1,646.893 million in annual Total Expenditures;
- ✓ $269.080 million in annual Gross Product;
- ✓ $43.928 million in annual Personal Income; and
- ✓ -1,021 Permanent Jobs.



$0.75 per $100 Valuation Property Tax Reduction Scenario

If a BAT sufficient to eliminate the franchise tax and allow for reduction in property tax rates of $0.75 per $100 valuation is implemented, the effect on business activity in Texas is likely to total

- ✓ $2,577.751 million in annual Total Expenditures;
- ✓ $498.823 million in annual Gross Product;
- ✓ $138.193 million in annual Personal Income; and
- ✓ -217 Permanent Jobs.



Note that all dollar values are presented in fiscal-year 2006 dollars. Detailed sectoral results, which illustrate the shifting of the tax burden among industries, are summarized for the three scenarios in Tables 1-3 of the Appendix.

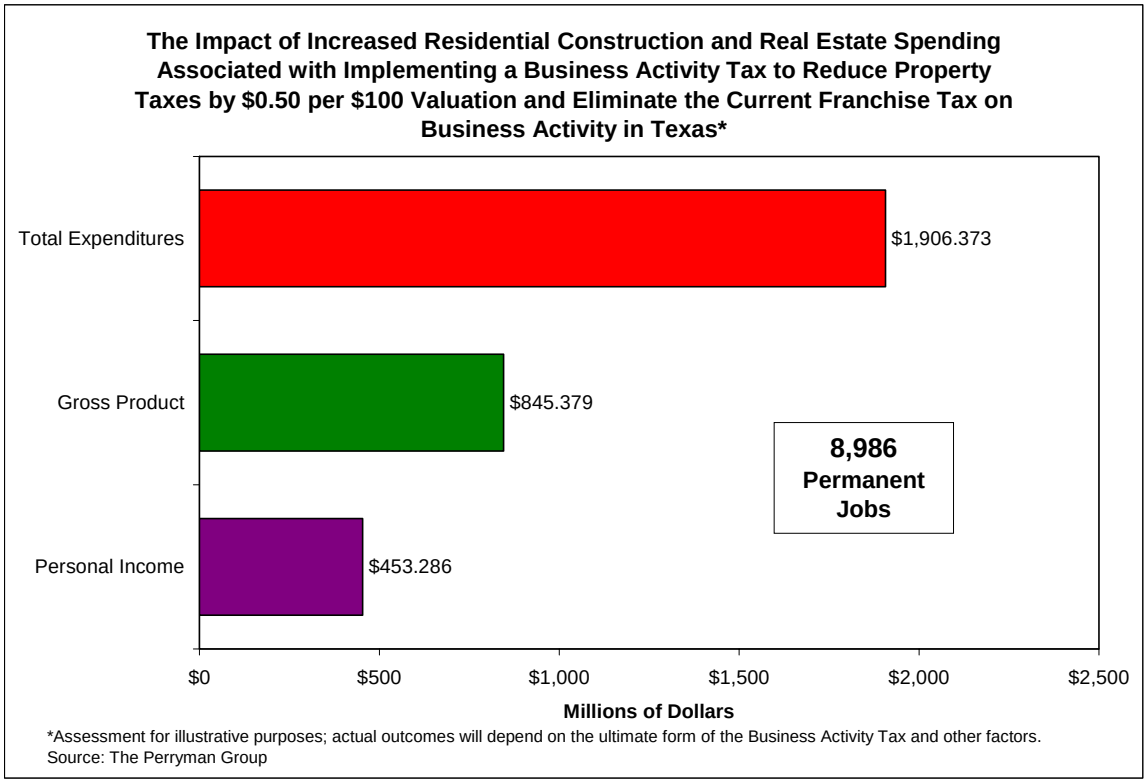
Effects on Increased Construction and Real Estate Spending

As a part of these impacts, which largely stem from increased productivity and efficiency, a reduction in property taxes would also stimulate additional residential construction and real estate spending. As noted, taxes are an important determinant of real estate demand; as the tax rate decreases, houses and other properties become relatively more affordable and demand rises. **For example, the scenario in which property taxes decline by**

$0.50 per $100 valuation results in about 2,168 new housing starts and 2,973 additional sales of existing houses each year. The consequence of this activity is that homeownership rates in Texas increase, as does the opportunity for thousands of Texans to enjoy higher quality residences.

To illustrate the potential magnitude of these effects, TPG assumed a hypothetical decrease in property tax rates of $0.50 per $100 valuation. The impact on business activity stemming from increased residential construction and real estate spending was found to include

- ✓ $1,906.373 million in annual Total Expenditures;
- ✓ $845.379 million in annual Gross Product;
- ✓ $453.286 million in annual Personal Income; and
- ✓ 8,986 Permanent Jobs.



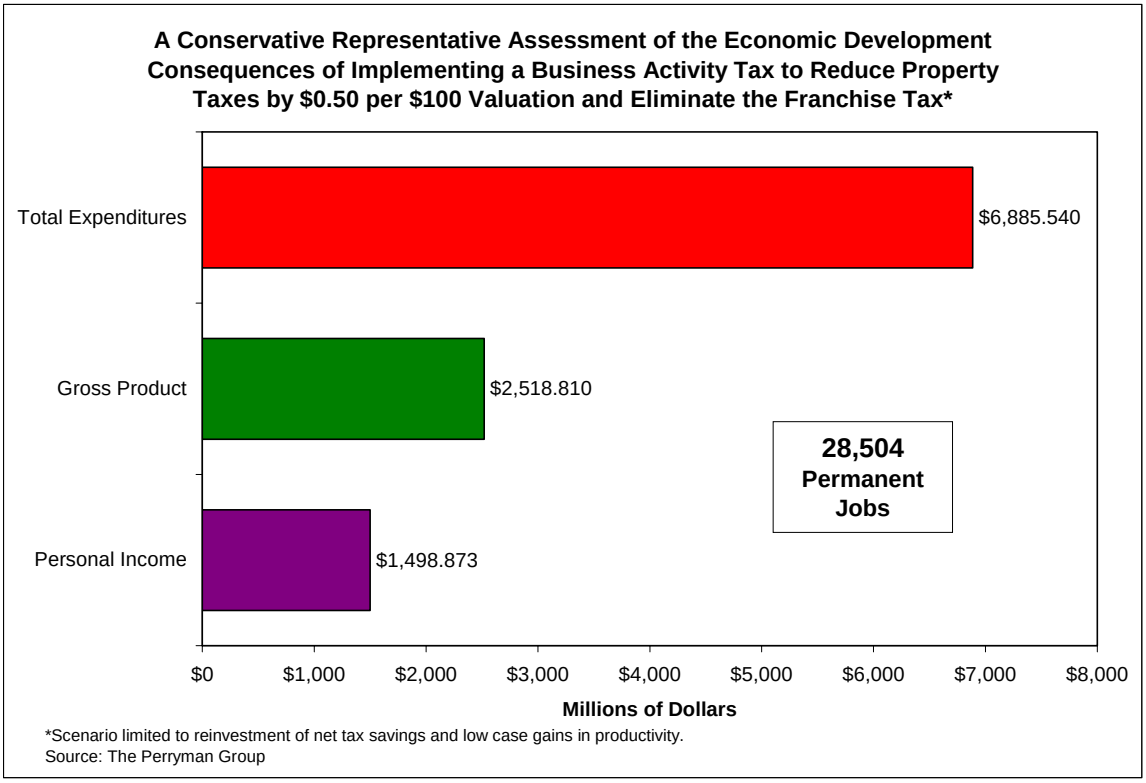
Results by industry are found in Table 4 of the Appendix.

Effect of an Improving Tax Structure

In addition to the quantifiable effects of the proposed changes in the tax structure, the more responsible and equitable tax system will also improve the business climate of Texas. Gains in productivity should also be observed as firms have a greater incentive to achieve efficiencies without adjusting decisions for their tax consequences.

For purposes of illustrating the potential magnitude of these gains, TPG assumed reinvestment of net tax savings and low case increase in productivity (one percentage point enhancement to state output over 10 years). The increment in business activity in the state under these assumptions in the representative case of a $0.50 property tax reduction on $100 valuation was found to include

- ✓ $6,885.540 million in annual Total Expenditures;
- ✓ $2,518.810 million in annual Gross Product;
- ✓ $1,498.873 million in annual Personal Income; and
- ✓ 28,504 Permanent Jobs.



These effects while notable and well in excess of the direct consequences of the change in tax structure, will likely understate the actual gains. Texas will be a much more attractive state for the location, retention and expansion of major facilities, thus promoting greater levels of economic development.

Conclusion

The future success of the Texas economy is inextricably linked to the appropriateness of its tax structure. The current heavy reliance on property taxes is problematic in that (1) it fails to provide adequately for education and local government services and (2) it results in undesirably inequitable tax burdens.

By moving toward a more broad-based and equitable tax structure, such as a business activity tax, the state can enhance both current and future performance. A business activity tax is very straightforward to administer compared to the current franchise tax on business or the property tax. Moreover, the base is expected to grow in line with the general economy and slightly faster than many other non-property tax sources. One desirable characteristic of the tax is that it does not substantially alter economic decision-making; companies will generally try to maximize value-added irrespective of an "after-the-fact" tax.

Decreasing reliance on property taxes has several desirable outcomes. First, a significant deterrent for capital-intensive industries to locate or expand in Texas would be removed, thus enhancing economic development opportunities. The real estate market would benefit, as would current and potential homeowners and investors, in that a decrease in property taxes improves the affordability characteristics of such assets.

Even with the proposed reforms, property taxes would continue to be a significant portion of public school revenues and would remain a dominant funding source for cities, counties, and numerous

special taxing districts. Nonetheless, a movement of this magnitude toward a more stable, equitable, and responsive tax structure would clearly be a positive step for Texas over an extended time horizon and is worthy of serious consideration in the ongoing discussion of tax and educational reform.

Respectfully submitted,

The Perryman Group
M. Ray Perryman, PhD, President

APPENDIX

Table 1
The Impact of Implementing a Business Activity Tax to Reduce Property Taxes by $0.25 per $100 Valuation and Eliminate the Current Franchise Tax on Business Activity in Texas -- Detailed Sectoral Results

Sector	Total Expenditures	Gross Product	Personal Income	Employment (Permanent Jobs)
Agricultural Products & Services	$183,615,137	$40,153,633	$27,346,887	503
Forestry & Fishery Products	$23,549,084	$5,723,746	$2,122,852	30
Coal Mining	$7,120,107	$2,047,386	$2,157,466	16
Crude Petroleum & Natural Gas	$193,666,421	$42,485,576	$19,594,239	111
Miscellaneous Mining	$1,560,253	$523,084	$307,475	5
New Construction	$138,643,379	$52,398,403	$43,179,542	710
Maintenance & Repair Construction	$3,828,360	$168,053	$138,447	-1
Food Products & Tobacco	$40,286,783	$4,753,577	$2,428,391	43
Textile Mill Products	$621,020	$163,422	$138,299	3
Apparel	($394,104)	($187,126)	($94,817)	-5
Paper & Allied Products	$286,393	($39,014)	($17,635)	-5
Printing & Publishing	($25,547,286)	($13,723,517)	($8,957,689)	-182
Chemicals & Petroleum Refining	$135,357,597	$28,173,913	$13,229,305	109
Rubber & Leather Products	$3,166,728	$1,195,057	$698,619	9
Lumber Products & Furniture	$20,608,141	$6,674,676	$4,758,690	112
Stone, Clay, & Glass Products	$5,115,635	$1,226,200	$641,383	10
Primary Metal	$11,883,323	$2,807,493	$2,089,783	27
Fabricated Metal Products	$4,427,498	$862,559	$556,807	9
Machinery, Except Electrical	$22,614,353	$8,490,326	$6,065,498	74
Electric & Electronic Equipment	$1,664,952	$328,924	$196,639	-4
Motor Vehicles & Equipment	($1,700,430)	($875,108)	($568,438)	-10
Transp. Equip., Exc. Motor Vehicles	($3,346,120)	($2,041,708)	($1,334,168)	-20
Instruments & Related Products	$3,655,486	$1,669,513	$1,269,095	18
Miscellaneous Manufacturing	$5,899,575	$2,202,706	$1,519,171	29
Transportation	$21,107,475	$6,484,000	$4,288,225	72
Communication	($29,283,930)	($18,077,949)	($7,718,080)	-85
Electric, Gas, Water, Sanitary Services	$260,353,845	$54,109,847	$23,612,142	114
Wholesale Trade	$68,989,698	$46,672,147	$26,911,520	353
Retail Trade	$24,452,638	$20,245,603	$12,106,162	372
Finance	($118,089,541)	($34,900,757)	($20,322,876)	-214
Insurance	($66,137,401)	($46,044,448)	($27,527,216)	-392
Real Estate	$149,307,626	$64,012,562	$10,313,863	104
Hotels, Lodging Places, Amusements	($13,225,464)	($7,276,282)	($4,773,515)	-139
Personal Services	($12,172,357)	($7,671,584)	($5,968,600)	-122
Business Services	($167,575,196)	($115,908,532)	($94,551,608)	-1,344
Eating & Drinking Places	($38,174,943)	($22,376,643)	($11,905,558)	-628
Health Services	($109,256,374)	($72,083,573)	($60,947,374)	-1,179
Miscellaneous Services	($30,629,887)	($12,814,714)	($11,109,325)	-312
Households	($213,784)	($213,784)	($209,280)	-17
Total	**$716,034,688**	**$39,337,669**	**($50,335,675)**	**-1,825**

SOURCE: US Multi-Regional Impact Assessment System, The Perryman Group

Table 2
The Impact of Implementing a Business Activity Tax to Reduce Property Taxes by $0.50 per $100 Valuation and Eliminate the Current Franchise Tax on Business Activity in Texas -- Detailed Sectoral Results

Sector	Total Expenditures	Gross Product	Personal Income	Employment (Permanent Jobs)
Agricultural Products & Services	$370,265,808	$85,551,778	$58,265,576	1,072
Forestry & Fishery Products	$41,958,883	$10,935,827	$4,055,932	58
Coal Mining	$13,309,308	$3,831,469	$4,037,455	30
Crude Petroleum & Natural Gas	$232,554,583	$51,042,295	$23,540,554	132
Miscellaneous Mining	$2,979,710	$1,018,969	$598,954	8
New Construction	$272,010,689	$102,782,056	$84,698,802	1,392
Maintenance & Repair Construction	$14,934,688	$5,212,468	$4,295,334	66
Food Products & Tobacco	$88,689,220	$12,983,788	$6,632,796	123
Textile Mill Products	$1,503,133	$376,636	$318,721	7
Apparel	$4,197,742	$2,379,262	$1,205,612	33
Paper & Allied Products	$5,053,611	$2,062,155	$932,306	8
Printing & Publishing	($34,501,222)	($18,658,384)	($12,178,823)	-250
Chemicals & Petroleum Refining	$220,474,545	$51,846,884	$24,345,161	199
Rubber & Leather Products	$11,585,194	$4,655,818	$2,721,773	50
Lumber Products & Furniture	$44,439,931	$14,541,510	$10,367,302	245
Stone, Clay, & Glass Products	$16,389,996	$5,928,590	$3,100,802	56
Primary Metal	$24,903,302	$6,152,929	$4,579,965	63
Fabricated Metal Products	$18,039,489	$5,775,434	$3,728,534	70
Machinery, Except Electrical	$50,100,776	$19,321,157	$13,803,075	166
Electric & Electronic Equipment	$18,714,975	$9,950,025	$5,948,473	47
Motor Vehicles & Equipment	($1,781,385)	($1,133,129)	($736,046)	-14
Transp. Equip., Exc. Motor Vehicles	$1,172,951	$137,775	$90,034	-2
Instruments & Related Products	$9,385,393	$4,249,201	$3,229,966	46
Miscellaneous Manufacturing	$10,694,339	$4,030,742	$2,779,967	52
Transportation	$92,728,242	$46,557,423	$30,791,340	501
Communication	($11,823,620)	($7,318,756)	($3,124,663)	-44
Electric, Gas, Water, Sanitary Services	$487,704,233	$102,757,358	$44,840,654	217
Wholesale Trade	$37,678,373	$25,471,315	$14,686,903	196
Retail Trade	($3,946,906)	($3,311,580)	($1,980,334)	-56
Finance	($161,675,574)	($41,157,388)	($23,966,161)	-255
Insurance	($85,246,528)	($58,623,308)	($35,047,348)	-501
Real Estate	$354,455,742	$139,895,557	$22,540,281	228
Hotels, Lodging Places, Amusements	($20,284,856)	($10,932,469)	($7,172,124)	-210
Personal Services	($11,791,927)	($7,495,132)	($5,831,320)	-124
Business Services	($230,846,773)	($159,492,182)	($130,104,655)	-1,850
Eating & Drinking Places	($46,485,524)	($27,275,181)	($14,511,824)	-768
Health Services	($149,214,009)	($98,006,897)	($82,865,820)	-1,605
Miscellaneous Services	($41,589,691)	($17,119,834)	($14,841,520)	-417
Households	$156,144	$156,144	$152,796	13
Total	**$1,646,892,982**	**$269,080,325**	**$43,928,429**	**-1,021**

SOURCE: US Multi-Regional Impact Assessment System, The Perryman Group

Table 3
The Impact of Implementing a Business Activity Tax to Reduce Property Taxes by $0.75 per $100 Valuation and Eliminate the Current Franchise Tax on Business Activity in Texas -- Detailed Sectoral Results

Sector	Total Expenditures	Gross Product	Personal Income	Employment (Permanent Jobs)
Agricultural Products & Services	$556,916,478	$130,949,923	$89,184,265	1,642
Forestry & Fishery Products	$60,368,683	$16,147,909	$5,989,012	86
Coal Mining	$19,498,509	$5,615,552	$5,917,444	44
Crude Petroleum & Natural Gas	$271,442,745	$59,599,014	$27,486,869	153
Miscellaneous Mining	$4,399,167	$1,514,853	$890,432	12
New Construction	$405,377,999	$153,165,708	$126,218,062	2,074
Maintenance & Repair Construction	$26,041,015	$10,256,883	$8,452,220	132
Food Products & Tobacco	$137,091,658	$21,213,999	$10,837,200	202
Textile Mill Products	$2,385,246	$589,850	$499,142	10
Apparel	$8,789,589	$4,945,649	$2,506,041	70
Paper & Allied Products	$9,820,828	$4,163,324	$1,882,246	22
Printing & Publishing	($43,455,158)	($23,593,252)	($15,399,958)	-319
Chemicals & Petroleum Refining	$305,591,494	$75,519,855	$35,461,017	290
Rubber & Leather Products	$20,003,661	$8,116,580	$4,744,927	90
Lumber Products & Furniture	$68,271,720	$22,408,344	$15,975,914	378
Stone, Clay, & Glass Products	$27,664,356	$10,630,979	$5,560,222	102
Primary Metal	$37,923,281	$9,498,365	$7,070,146	99
Fabricated Metal Products	$31,651,479	$10,688,310	$6,900,261	131
Machinery, Except Electrical	$77,587,199	$30,151,989	$21,540,653	259
Electric & Electronic Equipment	$35,764,998	$19,571,126	$11,700,306	98
Motor Vehicles & Equipment	($1,862,340)	($1,391,150)	($903,655)	-18
Transp. Equip., Exc. Motor Vehicles	$5,692,022	$2,317,259	$1,514,237	16
Instruments & Related Products	$15,115,299	$6,828,888	$5,190,837	75
Miscellaneous Manufacturing	$15,489,103	$5,858,778	$4,040,762	75
Transportation	$164,349,009	$86,630,847	$57,294,454	929
Communication	$5,636,689	$3,440,437	$1,468,754	-3
Electric, Gas, Water, Sanitary Services	$715,054,620	$151,404,869	$66,069,166	319
Wholesale Trade	$6,367,048	$4,270,484	$2,462,286	38
Retail Trade	($32,346,449)	($26,868,763)	($16,066,831)	-484
Finance	($205,261,608)	($47,414,019)	($27,609,447)	-296
Insurance	($104,355,655)	($71,202,169)	($42,567,480)	-609
Real Estate	$559,603,859	$215,778,552	$34,766,699	352
Hotels, Lodging Places, Amusements	($27,344,248)	($14,588,655)	($9,570,733)	-282
Personal Services	($11,411,497)	($7,318,680)	($5,694,039)	-126
Business Services	($294,118,349)	($203,075,832)	($165,657,701)	-2,356
Eating & Drinking Places	($54,796,105)	($32,173,719)	($17,118,089)	-907
Health Services	($189,171,643)	($123,930,221)	($104,784,266)	-2,031
Miscellaneous Services	($52,549,496)	($21,424,954)	($18,573,715)	-522
Households	$526,071	$526,071	$514,873	42
Total	**$2,577,751,276**	**$498,822,981**	**$138,192,533**	**-217**

SOURCE: US Multi-Regional Impact Assessment System, The Perryman Group

Table 4
An Illustrative Assessment of the Impact of Increased Residential Construction and Real Estate Spending Associated with Implementing a Business Activity Tax to Reduce Property Taxes by $0.50 per $100 Valuation and Eliminate the Current Franchise Tax on Business Activity in Texas
Detailed Sectoral Results

Sector	Total Expenditures	Gross Product	Personal Income	Employment (Permanent Jobs)
Agricultural Products & Services	$20,981,282	$6,567,802	$4,473,042	83
Forestry & Fishery Products	$923,042	$573,444	$212,678	3
Coal Mining	$2,159,602	$615,492	$648,584	5
Crude Petroleum & Natural Gas	$16,645,400	$3,698,554	$1,705,768	9
Miscellaneous Mining	$2,310,788	$1,066,454	$626,910	8
New Construction	$303,506,000	$116,973,568	$96,393,506	1,582
Maintenance & Repair Construction	$49,709,378	$24,279,366	$20,007,706	328
Food Products & Tobacco	$41,264,414	$10,650,786	$5,440,926	106
Textile Mill Products	$709,574	$174,062	$147,278	4
Apparel	$9,403,796	$5,255,518	$2,663,056	84
Paper & Allied Products	$8,132,532	$3,624,936	$1,638,808	29
Printing & Publishing	$12,247,396	$6,177,666	$4,032,302	80
Chemicals & Petroleum Refining	$52,189,470	$9,158,392	$4,300,396	37
Rubber & Leather Products	$8,491,708	$3,583,958	$2,095,166	48
Lumber Products & Furniture	$37,427,426	$12,229,052	$8,718,636	211
Stone, Clay, & Glass Products	$27,535,074	$12,311,470	$6,438,954	121
Primary Metal	$8,692,984	$2,457,286	$1,829,084	32
Fabricated Metal Products	$22,806,908	$8,418,882	$5,435,238	108
Machinery, Except Electrical	$9,504,992	$3,499,062	$2,499,748	30
Electric & Electronic Equipment	$7,196,364	$3,786,424	$2,263,650	21
Motor Vehicles & Equipment	$3,315,140	$694,100	$450,932	7
Transp. Equip., Exc. Motor Vehicles	$1,699,460	$745,780	$487,336	7
Instruments & Related Products	$1,217,826	$482,768	$366,944	5
Miscellaneous Manufacturing	$3,076,636	$1,157,616	$798,420	14
Transportation	$44,005,200	$29,470,128	$19,490,482	314
Communication	$28,179,930	$17,387,360	$7,423,218	76
Electric, Gas, Water, Sanitary Services	$60,766,582	$13,637,540	$5,951,058	29
Wholesale Trade	$61,248,978	$41,412,948	$23,879,074	311
Retail Trade	$138,181,940	$114,475,614	$68,452,758	2,088
Finance	$22,130,148	$12,193,156	$7,100,112	73
Insurance	$27,602,838	$16,547,134	$9,892,520	139
Real Estate	$646,798,400	$227,682,710	$36,684,620	378
Hotels, Lodging Places, Amusements	$11,772,076	$6,189,346	$4,060,422	115
Personal Services	$23,669,136	$14,573,278	$11,338,244	223
Business Services	$59,140,648	$37,008,564	$30,189,504	428
Eating & Drinking Places	$55,574,618	$32,478,720	$17,280,412	909
Health Services	$39,976,874	$27,995,450	$23,670,414	455
Miscellaneous Services	$34,375,246	$14,341,820	$12,433,166	345
Households	$1,802,802	$1,802,802	$1,764,650	142
Total	**$1,906,372,608**	**$845,379,008**	**$453,285,722**	**8,986**

SOURCE: US Multi-Regional Impact Assessment System, The Perryman Group

Table 5
A Representative Assessment of the Economic Development Consequences of Implementing a Business Activity Tax to Reduce Property Taxes by $0.50 per $100 Valuation and Eliminating the Franchise Tax Under a Scenario Limited to Reinvestment of Net Tax Savings and Low Case Gains in Productivity
Detailed Sectoral Results

Sector	Total Expenditures	Gross Product	Personal Income	Employment (Permanent Jobs)
Agricultural Products & Services	$170,098,014	$39,544,965	$26,932,325	500
Forestry & Fishery Products	$3,246,429	$2,272,987	$843,018	12
Coal Mining	$10,364,011	$2,932,051	$3,089,695	23
Crude Petroleum & Natural Gas	$458,188,592	$100,467,157	$46,335,324	263
Miscellaneous Mining	$12,925,761	$5,137,584	$3,020,100	38
New Construction	$0	$0	$0	0
Maintenance & Repair Construction	$119,558,987	$64,731,581	$53,342,863	875
Food Products & Tobacco	$395,660,667	$95,983,862	$49,033,147	954
Textile Mill Products	$6,549,436	$1,595,449	$1,349,903	35
Apparel	$48,668,748	$26,869,612	$13,615,245	431
Paper & Allied Products	$99,497,643	$46,129,255	$20,854,699	368
Printing & Publishing	$144,974,694	$74,263,184	$48,473,251	957
Chemicals & Petroleum Refining	$1,754,217,157	$271,094,717	$127,294,713	1,095
Rubber & Leather Products	$93,060,749	$38,840,340	$22,705,885	525
Lumber Products & Furniture	$71,422,146	$24,993,038	$17,818,667	431
Stone, Clay, & Glass Products	$80,992,190	$41,491,760	$21,700,367	411
Primary Metal	$97,583,826	$25,964,975	$19,327,055	338
Fabricated Metal Products	$168,765,032	$65,718,086	$42,427,678	845
Machinery, Except Electrical	$168,850,157	$69,161,343	$49,409,145	612
Electric & Electronic Equipment	$178,811,817	$104,667,531	$62,573,813	604
Motor Vehicles & Equipment	$77,555,356	$19,056,487	$12,380,346	203
Transp. Equip., Exc. Motor Vehicles	$80,231,574	$41,113,738	$26,866,366	373
Instruments & Related Products	$35,295,160	$15,717,969	$11,947,093	177
Miscellaneous Manufacturing	$62,316,291	$24,306,470	$16,764,455	309
Transportation	$208,086,329	$124,930,743	$82,624,734	1,329
Communication	$93,925,528	$57,939,431	$24,736,203	254
Electric, Gas, Water, Sanitary Services	$261,307,233	$57,195,733	$24,958,698	123
Wholesale Trade	$225,440,284	$152,525,484	$87,947,547	1,144
Retail Trade	$387,511,037	$321,067,362	$191,988,015	5,856
Finance	$68,135,953	$37,427,046	$21,793,875	225
Insurance	$76,266,486	$45,631,137	$27,280,089	381
Real Estate	$478,945,793	$82,625,906	$13,312,823	137
Hotels, Lodging Places, Amusements	$41,265,881	$21,461,665	$14,079,595	399
Personal Services	$80,073,888	$49,192,867	$38,272,837	750
Business Services	$178,230,441	$106,925,734	$87,223,998	1,234
Eating & Drinking Places	$190,811,382	$111,645,003	$59,401,105	3,125
Health Services	$132,646,334	$92,838,309	$78,495,644	1,508
Miscellaneous Services	$118,081,925	$49,372,359	$42,801,720	1,189
Households	$5,977,344	$5,977,344	$5,850,858	471
Total	**$6,885,540,276**	**$2,518,810,265**	**$1,498,872,894**	**28,504**

SOURCE: US Multi-Regional Impact Assessment System, The Perryman Group