AN ECONOMIC ANALYSIS OF GOVERNOR PERRY'S TAX REFORM PROPOSAL

For

The Lone Star Foundation

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By

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EXECUTIVE SUMMARY

Governor Perry appointed a Texas Tax Reform Commission to study the Texas tax system and to recommend tax reforms that will adequately address the school finance system problem identified in a recent the Texas Supreme Court ruling. The Court found that the Texas school finance system is unconstitutional. The Commission has recommended a significant change in the tax system known as Governor Perry's Plan (Plan).

The Plan has three major components. It would reduce the O&M portion of the local school property tax from the current $1.48 per $100 valuation to $1.00, replace the State's business franchise tax with a new margins tax and raise the tobacco tax by $1.00 per pack. Individual home owners will experience a significant decrease in their property taxes and businesses will face a new margins tax but also experience a major decline in school property taxes and the elimination of the franchise tax.

The Plan will stimulate economic growth both because families will have more after-tax income to spend, and because the shift in tax burden to a more equitable distribution of initial tax burden among industries will spur investment. The significant reduction in the taxation of capital assets in the business community amounts to a significant economic stimulus. The Plan will produce the following **annual** economic growth impacts in the **beginning of the period** after full implementation:

GDP	+ $2.2 Billion
Personal Income	+ $1.6 Billion
Employment	+33 Thousand Jobs
Industry Production	+$4.0 Billion
Business Investment	+$12.5 Billion
Additional State Tax Revenues	+$301 Million

Over the first ten years of the Plan these economic benefits will grow to $4.0 billion in GDP, $3.3 in personal income and 40 thousand in employment.

Business sectors that now avoid the Texas franchise tax by organizing under one of several types of partnerships rather than as a corporation, will experience a modest increase in tax burden under the proposed margins tax. The margins tax rate is small, however, so the tax burden on any given firm will be small. Small businesses ($300,000 per year in gross revenue) will be exempt. Firms will have the option of minimizing their tax burden under the margins tax by choosing to deduct either total compensation or the cost of goods sold. The final result of the economic effects of the Plan are to expand all major sectors of the economy as the stimulus works its way through the economy.

The analysis also shows that when tax burden calculations are made for various industry classes it is important to recognize that one can not get a tax decrease in situations when no tax is being paid now. That is, the status quo is much of the problem that the Plan is designed to address. One must not just think of tax changes based off of what is now being paid, but also based on what one would have been paying had they not skillfully avoided taxation.

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