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THE BUSINESS TAX

THE ISSUE

Businesses don't pay taxes, people do. For every tax government levies on a business, entrepreneurs lose the ability to hire additional employees; managers have less money to give their workers; customers pay higher prices for products; and investors see their returns disappear. In short, everyone is made poorer.

In a perfect world, no one would have to pay taxes and everyone would be free to keep what they earn, but such a world does not exist and taxes are a necessary evil. Therefore, government's challenge is to devise a tax structure that harms the economy the least while still generating needed revenues. This is easier said than done as not all taxes are created equal.

Some taxes discourage wage growth like the income tax, while others like the property tax punish the upkeep of property. The business tax, however, is especially harmful because it penalizes economic activity.

Economic activity is the key to creating wealth. Prosperity comes when jobs are plentiful, investments are being made, businesses are expanding, and people are striving to earn higher wages; but when government levies a tax against economic activity, it puts up a barrier to productivity and the fruits that come along with it.

Here in Texas, legislators have long recognized the importance of a business-friendly tax system—that is until recently. The state's new margins tax—a 1 percent levy on a business's gross receipts—hit many small businesses and entrepreneurs hard in 2008. According to the National Federation of Independent Business (NFIB), many small businesses reported seeing their tax bills increase by 200, 400, and even 1,000 percent. As a result, many businesses have been left shell-shocked and are unable to hire more workers, make investments, etc. Some have even had to take out loans simply to pay off their tax bills.

This higher tax burden on businesses has also dulled Texas' economic competitiveness. According to the Tax Foundation, Texas' business climate fell to 8th nationally in 2008—down two positions from 2007. In today's worsening national economy, the state can ill afford to lose its business-friendly reputation. Instead, policymakers should be looking for ways to re-emphasize Texas' low tax, pro-growth policies such as ridding the state of the margins tax and the economic harm it has caused.

THE FACTS

- ★ All taxes are bad, but some are worse than others.
- ★ Business taxes are among the worst because individuals are penalized in the form of higher prices, lost jobs, lost wages, and slower economic growth.
- ★ Texas' new margins tax has tarnished the state's image as a business-friendly state.

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- ★ Despite the underperformance of tax revenue collected by the margins tax, some businesses and entrepreneurs are seeing their taxes increase by a factor of 2x, 4x, and 10x, according to the NFIB.
- ★ As a result of the margins tax, Texas' economic edge has dulled slightly. The Tax Foundation now ranks Texas' business climate as 8th nationally—down two spots from 2007.
- ★ The margins tax is not performing as expected. The tax is only expected to collect \$4.7 billion of the anticipated \$5.9 billion promised; yet it is disproportionately hurting small businesses in the state which employ the majority of Texas workers.
- ★ No other state has a margins tax equivalent.

RECOMMENDATIONS

- ★ The margins tax should be eliminated.
- ★ “Lost” state revenue should be replenished by making changes to the sales tax base and reducing spending.
- ★ If not eliminated, the Legislature should continue to use any revenues from the margins tax above that of the old franchise tax to provide property tax relief.

RESOURCES

- *Tax Pyramiding: The Economic Consequences of Gross Receipts Taxes* by Andrew Chamberlain and Patrick Fleenor, The Tax Foundation (Dec. 2006) <http://www.taxfoundation.org/files/sr147.pdf>.
- *All Taxes are Not Created Equal* by Byron Schломach, Texas Public Policy Foundation (Feb. 2006) <http://www.texaspolicy.com/pdf/2006-02-PP-consumptiontax-BS.pdf>.
- *2008 State Business Tax Climate Index (Fifth Edition)* by Chris Atkins and Curtis S. Dubay, The Tax Foundation (Oct. 2007) <http://www.taxfoundation.org/research/show/22658.html>.
- *Phone Company Sends Message: Remit Payment for Services and Taxes* by William Ahern and Curtis S. Dubay, The Tax Foundation (Feb. 2007) <http://www.taxfoundation.org/commentary/show/2208.html>.

