Sources of State Revenue in Texas

As the 82nd Legislature writes the state budget, it will have $177.8 billion in revenue available to spend for fiscal 2012-13, according to the comptroller’s January 2011 Biennial Revenue Estimate. This includes $76.9 billion from all state taxes, $70.2 billion in federal funds, and $30.8 billion in fees, interest, and other income. Dedicated funds make up $100.5 billion of the $177.8 billion total, and general revenue funds make up $77.3 billion. This report examines the major sources of state tax revenue and surveys proposals to generate more.

Sales and use taxes
Sales taxes are applied at the final point of sale to a consumer of a taxable good or service. Use taxes are applied to goods and services purchased outside of Texas but used within the state. Sales and use taxes made up 56 percent of all state tax revenue in Texas in fiscal 2010.

In fiscal 2010, Texas collected $19.5 billion in state sales taxes. The state sales-tax rate is 6.25 percent. The Texas Legislature last raised the sales-tax rate in 1990, increasing it from 6 to 6.25 percent. Cities, counties, transit systems, and certain other districts in the state may impose local sales taxes of up to another 2 percent. Most Texans pay a total sales tax of 8.25 percent.

The Comptroller’s Office, in its February 2011 Tax Exemptions and Tax Incidence report, estimates that sales-tax exemptions, exclusions, and discounts amount to a total of $30.8 billion in potential revenue in fiscal 2011. Many goods and services exempt from the sales tax, including crude oil, motor vehicles, mixed drinks, aviation fuel, and insurance premiums, are taxed under other laws. The single largest sales-tax exemption for fiscal 2011 is projected to be for materials used in manufacturing. The exemption is projected to cost the state $9.6 billion in tax revenue that otherwise would have been collected. See page 2 for several of the larger sales and use tax exemptions.
Most state efforts to increase sales-tax revenue focus on improving collections or removing exemptions. Efforts to improve collections include closer scrutiny of sales-tax refunds, eligibility for exemptions, and applications for refunds on taxes collected on items meant for tax-free exports.

**Internet sales.** Under federal law, a state cannot require a company to collect sales taxes on the goods and services it sells unless the company has a physical presence, or nexus, in the state. States are examining this issue, which has become increasingly complex as internet purchases increase. According to the comptroller, Texas loses a total of about $600 million a year in uncollected sales taxes from internet sales.

States are considering proposals, such as the Streamlined Sales and Use Tax Agreement, to improve sales tax collections on these on-line transactions. In response to the growth of internet sales in the late 1990s, a group of states formed the Streamlined Sales Tax Project in 2000. Its goal is to establish common rules for collecting sales taxes on sales outside of member states where the good or service is used within the state. Nineteen states are full members of the agreement. According to the comptroller, if Texas joined the Streamlined Sales Tax Project and Congress authorized states to require sellers to collect taxes on remote sales, the state could collect another $500 million annually.

Last year, the Comptroller’s Office sued Amazon, an on-line retailer, for $269 million for sales taxes it

### Major Sales and Use Tax Exemptions
**Estimated loss of sales tax revenue for fiscal 2011-12***

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<td>Materials used in manufacturing</td>
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claimed the company never paid on transactions with its Texas customers. Other states are considering similar lawsuits or agreements with large on-line retailers or changing the definition of nexus to expand the jurisdiction in which they could collect sales taxes.

**Retail sales tax remittance.** According to the LBB’s *Texas State Government Effectiveness and Efficiency* report, Texas could save $81.2 million in general revenue funds in fiscal 2012-13 by increasing from .05 to .75 the percentage of sales taxes retailers may retain in return for timely filing their taxes, while limiting the total amount a business may retain to $3,750 per tax year. The LBB also calculates that the state could receive an additional $70.8 million by limiting the amount of tax a retailer may retain in exchange for remitting sales taxes to the state in advance. Under current law, retailers are eligible for a 1.25 percent prepayment discount if they pay their estimated sales taxes in advance. The LBB proposes lowering the discount to the lesser of 1.25 percent or the rate that produces an annualized rate of return equal to 4 percent over the prime rate.

**Sales tax holiday.** The LBB also recommends making the August state sales-tax holiday conditional on budget conditions. Sales-tax holidays exempt certain goods, such as clothing and certain school supplies, from the state sales tax for a certain period. In Texas the sales-tax holiday takes place in August to ease the cost of outfitting children as they prepare for the start of a new school year. The LBB recommends suspending the August holiday in fiscal 2011 and fiscal 2012. Three states and the District of Columbia cancelled their annual sales tax holidays in 2009, and one state cancelled its holiday in 2010. Suspending the August sales tax holiday would be expected to provide Texas with $14.4 million in fiscal 2011 and $97.3 million in fiscal 2012-13.

**Tax amnesty.** To increase sales-tax revenue, Texas also has used amnesty programs, which allow taxpayers who owe delinquent taxes but whose tax debts have not yet been discovered by the comptroller to declare and pay their back taxes. In return, the comptroller waives the accrued penalty and interest. In 2007, Texas implemented an amnesty program on all delinquent state taxes, which generated $100 million in collections. Tax amnesties generate different amounts of revenue depending on several factors, including how long tax payers have to apply and the types of taxes for which amnesty is granted, such as sales or business taxes, among others. One proposal being considered for the fiscal 2012-13 budget would direct the comptroller to implement a tax amnesty program during the upcoming biennium that would be expected to raise $75 million.

Other proposals to increase sales-tax revenue that may be considered by the 82nd Legislature include:

- implementing a temporary one-cent increase of the sales tax, which would raise an estimated $2.5 billion a year;
- removing the sales-tax exemption from certain goods and services where the exemption may no longer be warranted because of changed market conditions or developments in the industry; and
- allowing local-option sales taxes that would enable local governments to levy local sales taxes on gasoline to fund transportation projects.

**Motor vehicle taxes and fees**

The state collects a tax of 6.25 percent on the purchase price of new and used motor vehicles, collects other fees associated with the transfer of a motor vehicle, and levies taxes on motor vehicle rentals. The comptroller expects motor vehicle sales and rental taxes to generate $5.8 billion in fiscal 2012-13, 8.8 percent more than the $5.3 billion the state collected from those taxes in fiscal 2010-11.

**Surcharge on vehicle sales.** The LBB, in its *Efficiency* report, proposed a fuel inefficiency surcharge of $100 on the sale of a vehicle with high emissions as determined by federal fuel economy standards. Imposing this surcharge, the LBB estimates, would raise $115.3 million in general revenue funds during fiscal 2012–13. The LBB says the additional surcharge would help offset the increased costs associated with inefficient vehicles. The additional revenue could be placed in the state’s emissions reduction fund or the General Revenue Fund.

**Motor fuels tax.** The state collects a motor fuels tax of 20 cents per gallon on diesel and gasoline and 15 cents per gallon on liquefied gas. The Texas
Constitution, Art. 8, sec. 7-a, dedicates one-fourth of state motor fuels tax revenue to the Available School Fund, with the remaining three-fourths dedicated to highway-related purposes. One percent of motor fuels tax revenue is deducted to enforce state motor fuels tax laws before the remainder is deposited into the State Highway Fund (Fund 6). The comptroller estimates motor fuels taxes will generate $6.3 billion in all funds in fiscal 2012-13, an increase of 3.5 percent from $6.1 billion in fiscal 2010-11. The motor fuels tax rates were last raised in 1991.

The Legislature has considered, but not enacted, several proposals to increase motor fuels taxes in recent years. The 81st Legislature in 2009 considered a measure, SB 855 by Carona, to allow a county the option to impose and collect a tax of 10 cents per gallon on the sale of gasoline and diesel fuel if such a measure were approved by a majority of voters in the county. The measure died in the House Calendars Committee.

One proposal would increase the 20-cent tax on gas and diesel fuel, contingent upon a Constitutional amendment dedicating a certain portion of any increase to pay off debt service for previously issued highway bonds.

**Registration and other fees.** The state collects various fees associated with operating a motor vehicle. The largest of these revenue sources is motor vehicle registration fees and permits for special vehicles, such as those of excess size or weight. The comptroller estimates that motor vehicle registration fees, which are deposited into Fund 6, will generate $2.4 billion in fiscal 2012-13.

The 82nd Legislature may consider proposals to increase motor vehicle registration fees. According to an estimate from the Texas Transportation Institute (TTI), a $25 annual increase in the vehicle registration fee would generate another $623 million in annual revenue, which could be leveraged to secure about $8.3 billion in transportation bonds. A $35 increase in the fee would bring another $873 million, and an increase of $50, another $1.2 billion.

In its *Efficiency* report, the LBB proposed restructuring the highway maintenance fee that the state levies — in addition to the special vehicle registration fee — on oversize and overweight vehicles. The LBB suggests these fees could be restructured to generate an additional $6 million in revenue, a 10 percent increase.

Other motor vehicle-related revenue comes from fees for:

- vehicle inspections, driver’s licenses, certificate of title fees, and driver record information;
- citations for traffic violations, from which the state receives the first $30;
- surcharges for violations under the Driver’s Responsibility Program, including for DUI and driving without a license or insurance;
- special license plates; and
- penalties on certain commercial motor vehicles.

Many of these fees are deposited in the Texas Mobility Fund, where they are used to secure bond debt for transportation projects.

**Traffic fines.** In its *Efficiency* report, the LBB proposed increasing the state traffic fine from $30 to $45 for each person found guilty of committing a traffic violation. The LBB estimates this would generate $85 million in general revenue and general revenue-dedicated funds for fiscal 2012-13, while positively affecting driver behavior and helping fund traffic enforcement and safety programs. Revenue from traffic fines goes, in part, to a state fund for trauma centers and, in part, to the General Revenue Fund.

**Business margins tax**

The margins tax is Texas’ tax on businesses with some level of liability protection. It is expected to generate $5.3 billion in fiscal 2010-11 and $5.8 billion in fiscal 2012-13. The tax is 1 percent of a business entity’s taxable margin. It is .5 percent for retail businesses. The taxable margin is calculated in one of three ways:

- 70 percent of total revenue;
- total revenue less the cost of goods sold; or
- total revenue less employee compensation.

Taxpayers with less than $10 million in revenue may also use an “EZ” calculation of 0.575 percent of applicable revenue. In 2009, the 81st Legislature enacted HB 4765 by Oliveira, which temporarily increased the small business exemption from the margins tax from
$300,000 to $1 million in revenue. The exemption level will decrease to $600,000 in 2012.

The margins tax replaced the franchise tax in 2006, when the 79th Legislature, in its third called session, enacted HB 3 by J. Keffer. The margins tax was designed to generate more revenue by applying to a broader base of businesses. According to the comptroller, the new tax applied to 180,000 more business entities and lowered the tax rate that taxable businesses would pay. It was created to help generate revenue for the Property Tax Relief Fund, which helps the state pay for reductions in local school district property taxes.

In fiscal 2008-09, the margins tax generated $8.7 billion. In fiscal 2010-11, it is expected to generate $5.8 billion, and in fiscal 2012-13, $5.3 billion. According to studies by the comptroller’s business tax advisory commission, the tax is bringing in less revenue because more businesses than anticipated are calculating it using total revenue minus cost of goods sold.

Proposals to change the margins tax include clarifying what can and cannot be claimed under the various exemptions, increasing the rates on which the margin is taxed, and expanding the types of business entities required to pay the tax.

Tobacco and alcohol

Excise taxes on tobacco products and alcoholic beverages are among the oldest and most common taxes in the world. Texas has taxed liquor since the days of the republic and cigarettes since the Great Depression. All 50 states and the federal government impose these so-called “sin” taxes.

**Tobacco and alcohol taxes.** Texas levies two separate tobacco taxes — one on cigarettes and another on cigars and other tobacco products, including chewing tobacco, smoking tobacco, and snuff. Taxes on cigarettes are levied per package. Taxes on cigars and other tobacco products are set by weight. The state levies separate taxes on package sales of liquor (distilled spirits), beer, malt liquor, and wine and on by-the-drink sales of mixed drinks.

Most tobacco and alcohol tax revenue goes into the General Revenue Fund. Some tobacco tax revenues are dedicated to special purposes, such as to property tax relief or to the Physician Education Loan Repayment Program. The program provides loan repayment funds to physicians who agree to practice in a Health Professional Shortage Area, usually an underserved rural area, for at least four years.

The alcoholic beverage tax is expected to generate $1.6 billion in fiscal 2010-11 and $1.7 billion in fiscal 2012-13, according to the comptroller. Tobacco taxes are expected to generate $1.2 billion in fiscal 2010-11 and $1.1 billion in fiscal 2012-13.

**Tobacco settlement.** Texas also receives tobacco-related revenue through payments from the settlement of a lawsuit brought by Texas and other states in 1998. Under the settlement agreement, big tobacco companies are paying Texas $17.3 billion over 25 years and will make further payments after that based on tobacco sales. Actual payments by the industry are subject to adjustment formulas related to tobacco sales, inflation, and industry profitability. Under Texas’ settlement terms, payments from the industry rise or fall in proportion to U.S. consumption of cigarettes each year as compared to consumption in 1997. According to the comptroller, in fiscal 2012-13, Texas tobacco settlement receipts are expected to total $867 million, an 8.7 percent decline from the $950 million expected in fiscal 2010-11.

According to the Comptroller’s Office, consumption of tobacco and alcohol has either declined or held steady over the past three decades, largely because of health concerns, limiting revenue growth from these taxes. Because alcohol and tobacco are not essential items, their consumption generally declines during economic recessions.

**Oil and gas taxes**

Texas has three main oil and gas taxes: a 4.6 percent oil production tax, a 7.5 percent natural gas production tax, and a 3/16th-of-one-cent tax per barrel of oil produced in Texas. Oil production and regulation taxes are expected to generate $2 billion in fiscal 2010-11 and $1.9 billion in fiscal 2012-13, according to the comptroller. Natural gas taxes are expected to generate
$1.3 billion in fiscal 2010-11 and $1.5 billion in fiscal 2012-13.

One proposal to increase natural gas tax revenue is to repeal or limit the tax rate reduction for high-cost gas extraction. According to the LBB, the exemption will cost $962.5 million in revenue in fiscal 2011. The exemption applies to natural gas wells that are certified by the Railroad Commission as high cost because of high operating expenses or the type of drilling technology used.

Property taxes

Property is subject only to local taxation in Texas. The state has oversight chiefly through rate limits, exemptions, exclusions, and performance reviews of local collection efforts. A state-level property tax existed from the beginning of the republic until voters abolished it through amendment to the Texas Constitution in 1982. The statewide tax applied to all property, although assessment was inconsistent and enforcement uneven.

Since 1979, real and business personal property has been taxed on the basis of appraised value, which cannot exceed the property’s fair cash market value (Texas Constitution, Art. 8, sec. 20). County-based central appraisal districts assign values to taxable property, which is subject to review, appeal, and litigation. The governing bodies of local taxing entities set property-tax rates.

Local property taxes affect the state through agreements it has made with school districts to ensure certain revenue levels. Under the school finance formulas, if property taxes underperform, the state makes up the lost revenue.

Proposals to abolish refunds and exemptions. One proposal would abolish a refund that was established in 1995 to reimburse companies after the state repealed property tax abatements the companies were receiving from local school districts. The Legislature never ended the refund program, and many companies continue to apply for and receive the refund even though they never received the original school property-tax abatement. This change would save the state an estimated $20 million in avoided property tax refund payments to businesses.

Selling or leasing state assets

Buildings. Some states and cities around the country are selling or leasing public assets to augment decreased tax revenues. Both the House and the Senate base budget proposals and the governor’s proposed budget assume the sale of the Texas Department of Criminal Justice’s Central Unit in Sugarland to private developers for about $33.5 million.

Some states and local governments are raising short-term revenue through leasebacks of public property. With these transactions, a government entity receives a large upfront payment from a private partner and, after a set term during which the government entity makes a certain number of payments to the private partner, the title is returned to the governmental entity. In 2010, Arizona leased its state Senate and House buildings, governor’s executive office tower, and several prisons and other buildings for a total of $1 billion. The city of Chicago leased its tollways, parking garages, and parking meters for $3 billion.

The Texas Facilities Commission has taken the opposite approach in the long term, with plans to invest in and expand state assets, such as state-owned office buildings and office parks. The commission is considering consolidating state offices into large office parks similar to the capitol complex, predicting the state would see large savings over time by avoiding rental and lease costs for office space.

Lottery. Some states also are considering selling or leasing their lotteries. During the 80th legislative session in 2007, Gov. Perry proposed that Texas sell or lease its lottery programs to a private company in exchange for a large up-front payment, but no legislation to do this was filed. Other states and countries continue debating similar proposals, including privatizing the operation of a lottery in hopes that a contractor can increase overall revenue. Texas has already done this, and Illinois is considering it. In fiscal 2010, the Texas lottery generated $3.7 billion in revenue. Of this, $2.4 billion was paid back to prize winners, and $1 billion was deposited in the Foundation School Fund. The lottery is expected to generate $2 billion for the Foundation School Fund in fiscal 2012-13.
Gambling

The amount of revenue the state could raise by legalizing and taxing casino gambling in Texas has become a focus of debate on the issue. Estimates of potential revenue range widely, depending on the number of gambling sites, the types of games authorized, the portion of gaming revenue going to the state, and when the gambling begins. Gambling revenue could come from new sources, such as fees for casino licenses and taxes on gambling, and from established taxes, such as the sales tax, business margins tax, alcohol taxes, hotel-motel taxes, and property taxes.

Both constitutional and statutory provisions restrict gambling in Texas. Art. 3, sec. 47(a) of the Texas Constitution requires the Legislature to prohibit lotteries and gift enterprises, and the Penal Code prohibits certain types of betting and gambling. Proposals to authorize casinos or slot machines usually take the form of constitutional amendments.

Casinos generally allow patrons to gamble on slot machines or video lottery machines, table games, such as blackjack or roulette, and other games. They sometimes are coupled with amenities such as hotels, restaurants, and shops. While potential revenue is often central to the debate on allowing casino gambling in Texas, other issues include potential economic development, social costs, and whether the issue should be decided by the voters.

Some proposals to legalize casino gambling in Texas concentrate on resort-type casinos, while other proposals are drafted more narrowly only to allow slot machines at Texas’ pari-mutuel race tracks. Allowing slot machines at the state’s bingo halls also has been proposed. Most proposals to legalize casino gambling or slot machines in Texas would limit the number of casinos or the placement of slot machines, designate or create a state entity to license and oversee the gaming, require state or local-option voter approval, impose a tax on the amount bet, and include authorization for Texas’ three federally recognized Native American tribes to conduct some type of gaming.

Destination casinos. One proposal would authorize up to eight destination resort casinos, eight more licenses for slot machines at Texas racetracks, and gaming facilities to be operated by Texas’ three Native American tribes. The plan would dedicate a portion of the revenue from gaming to the Property Tax Relief Fund and to the Texas Grant Program, the state’s primary financial aid program for financially needy Texas students who meet certain requirements. The Texas Gaming Association says the plan would result in at least a billion dollars in state revenue in the upcoming biennium, mostly from up-front fees from casino operators.

Gaming at tracks. Another proposal would allow video lottery terminals, which are gaming machines similar to a traditional slot machine, only at Texas racetracks and on the land of Texas’ three federally recognized Native American tribes. This proposal could generate about $825 million for the state in fiscal 2012-13, with about $225 million coming from up-front fees and $600 million from tax revenue, according to Win for Texas, a coalition of racing industry groups and others.
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