

The Case for Converting from Property Taxes to Sales Taxes

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Although property taxes and tax reform have been a hot issue in Texas for the last five years, this is not a story or situation unique to Texas. Property taxpayers around the country have grown increasingly upset about rapid increases in their property tax bills—increases which many experts have chalked up to the rapid increases in property values in a strong real estate market. Others criticize local governments and school districts for spending money inefficiently, requiring further increases in property taxes to keep the coffers full. Both the real estate market and spendthrift local officials have been criticized in the Lone Star State as well.

A 2006 special session of the Texas Legislature was intended to deliver property tax relief to Texans around the state, and a brief glance at the recent trends in property taxes illustrates just why this was such an important issue to the state's taxpayers. For instance, according to the final report of the Texas Task Force on Appraisal Reform, the average increase in a single-family residential tax bill over a four year period was almost 46 percent.¹ According to the data, the average total tax bill in 2000 of \$2,151 climbed to \$3,138 by 2004.²

The Tax Foundation reports that the median property tax paid on Texas owner-occupied homes in 2006 was \$2,122, ranking as the 14th highest among the states.³ However Texas ranked first among the states when considering taxes paid as a percentage of home value, with a median home value of \$114,000 with 1.86 percent of the home's value paid in property taxes.⁴ Finally, the study also shows Texas ranking 10th in terms of property taxes paid as a percentage of income (3.7 percent).⁵

For the same year, the Tax Foundation's rankings found that seven Texas counties appear in the top 100 counties for median property taxes paid on

homes. Those seven counties also appear in the top 100 in terms of taxes paid as a percentage of home value (Fort Bend County is highest, ranking #5 at 2.5 percent of the home's value) and in terms of taxes paid as a percentage of income (Travis County ranks highest at number 54, with 5.1 percent of income paid in property taxes).⁶ The median property tax paid in Collin County, which ranked the highest among Texas counties at number 35, was \$4,345.⁷

Amazingly, in terms of taxes paid as a percentage of home value, Texas had 27 counties in the top 100.⁸

Texas' high property taxes are often argued to be reasonable given the fact that Texas has no state personal income tax, yet it seems that such an argument alone is an insufficient explanation for the state's high taxes given the rankings of other states in the study. High tax states like New Jersey, Connecticut, and New Hampshire make up the top three states in terms of median property taxes paid, just as they each appear in the top 10 states when it comes to property taxes as a percentage of home value. By the same token, Texas ranks 14th in terms of median property taxes, while other non-income tax states like Florida and Tennessee* rank 22nd and 41st, respectively. Considering these rankings, it seems that the level of a state's property taxes may be independent of a state's overall tax structure and instead more closely linked to spending. This gives some credence to the protests of taxpayer protection organizations who argue for limits on spending as a means for controlling the state's thirst for new revenue.

SWAPPING THE PROPERTY TAX FOR THE SALES TAX

As a matter of policy, the "best" tax is one that does the least possible harm to the economy and to its

* Tennessee does not have a personal income tax, though it does tax dividend and interest income.

citizens. As a matter of principle, taxes should be simple, transparent, treat similarly situated people in the same way, and they should not discourage work effort, job creation, or investment. On all counts the sales tax meets these goals.

By contrast, while the property tax may be transparent and simple, it fails on the other two counts: the property tax arguably discourages investment in one's property, and it fails to treat similarly situated people the same way given the wide fluctuations in appraised property values, not to mention other freezes for select categories of taxpayers.

In addition, the sales tax has done a good job keeping up with the Texas economy. From 1991-2003, the 5 percent average annual growth in sales tax revenues outpaced the combined increases in inflation and population growth of 4.5 percent.⁹ Importantly, this includes 2002 and 2003, when sales taxes declined in the slumping economy.¹⁰ Even with slowed sales tax revenue in those years, average growth still outperformed the most common

benchmark for growth with inflation and population. Furthermore, the sales tax is immediately responsive to the economy, as opposed to the property tax, which can lag from year-to-year, just as it can hit people hard as rapid increases in home values can stay with taxpayers even in slow economic times. This reality is potentially made worse given that Texas ranks 10th in terms of property taxes as a percentage of income.¹¹

Lawmakers should continue to focus on delivering tax relief, while shifting from property taxes to consumption-based taxes for the long term.

Finally, it is particularly important for state and local officials to keep an eye on spending to control the invariable and frequent pushes for new revenue. Ongoing efforts to pass a local-option sales tax increase of up to a full penny in the Dallas-Fort Worth area would increase the overall tax burden around the region, at a time when sales tax increases should only be permitted with commensurate reductions in property taxes. ★

ENDNOTES

¹ Texas Task Force On Appraisal Reform, "Texas Task Force on Appraisal Reform Findings and Recommendations" (8 Jan. 2006) 23, http://www.governor.state.tx.us/priorities/appraisal_reform/files/report.pdf.

² Ibid.

³ The Tax Foundation, "Property Taxes on Owner-Occupied Housing, by State, 2006," <http://www.taxfoundation.org/research/show/1913.html>.

⁴ Ibid.

⁵ Ibid.

⁶ The Tax Foundation, "Property Taxes on Owner-Occupied Housing by County, 2006" (12 Sept. 2007) <http://www.taxfoundation.org/research/show/1888.html>.

⁷ Ibid.

⁸ Ibid.

⁹ The Texas Public Policy Foundation, "The Virtues of a Consumption Tax, Testimony before the Texas Senate Finance Committee by Byron Schlomach" (15 Mar. 2006) <http://www.texaspolicy.com/pdf/2006-03-testimony-bs.pdf>.

¹⁰ Ibid.

¹¹ The Tax Foundation, "Property Taxes on Owner-Occupied Housing, by State, 2006," <http://www.taxfoundation.org/research/show/1913.html>.