

## Eliminating School M&O Property Taxes

### The Issue

Texas has the [seventh highest local property taxes](#) in the nation, with an effective property tax rate of 1.81% according to WalletHub.com. The Texas Constitution prohibits the state government from levying a property tax, so all Texas property taxes are levied at the local level. These local taxes have far outgrown the means of taxpayers, increasing the tax burden on them over time. Property taxes are an inefficient type of tax based on arbitrary appraisal determinations and high administrative costs. They can be more regressive than other forms of taxation: They punish the poor more because of the compounding of tax payments annually over time, and they can push them out of a home. They also keep Texas from being as competitive with other states as it could be. Therefore, [property taxes should be abolished](#), with the first step being to eliminate school districts' maintenance and operations (M&O) property taxes.

Texas's school M&O property taxes partially fund government schools based on school finance formulas determined by the Texas Legislature. These taxes amounted to \$25.6 billion in 2017, equal to 43% of all property taxes levied in Texas. This property tax has numerous problems, resulting in several school finance lawsuits over the last half century, with the current system still questionably constitutional.

Given the high burden this tax places on Texans' prosperity, we provide two options to eliminate school districts' M&O property taxes: Swapping property taxes for final sales taxes or buying down property taxes with surplus state funds.

Both options require spending restraint and a constitutional amendment prohibiting school districts from again imposing an M&O tax after its elimination.

- For the sales tax swap, we recommend replacing school M&O property taxes with final sales taxes by mostly broadening the sales tax base. This would allow Texas to increase the fairness of the Tax Code, to broaden the tax base to collect more final sales taxes, and to keep the maximum sales tax rate competitive with other states. In 2017, the last year for which data is available from the Texas Comptroller's website, Texas provided an estimated \$42 billion in exemptions, exclusions, and discounts to the final sales tax base, requiring a higher tax rate and higher burden on those taxed. When considering these excluded items for inclusion in the final sales tax base to eliminate nearly half of all property taxes in Texas, it is important to continue excluding items either taxed by other taxes, funded primarily by taxpayer dollars through government expenditures, or that would make the system similar to a value added tax. This would go a long way to replacing the school M&O property tax.

Another way to do this is to look at which sectors to tax in the state's gross state product using a similar approach of

what to exclude as for the exemptions, which could result in a combined state and local sales tax rate increase from 8.25% to 9.88% with a broadened base. Broadening the sales tax base would influence other local government jurisdictions' sales tax collections, which they should address by lowering their rates to make it revenue neutral along with enacting strict local spending limits. While this means payment of more sales taxes, Texans would pay only about half of what they paid in property taxes. Texans would benefit from this immediate swap because it brings permanent property tax relief, relies on slower-growing sales taxes, and bases collections on objective market exchanges rather than the subjective valuations by appraisal districts. This plan should go along with spending restraint to hold down or even use surplus state dollars to buy down the sales tax rate over time.

- For the buydown option, we recommend that the state limit the increase of general revenue-related funds per biennium and use 90% of the resulting surplus to buy down school districts' M&O property taxes over time until they are eliminated. This means that school M&O property taxes would be frozen as the state provides an increasing portion of government school funding. If state tax receipts kept up with past trends and spending was limited to 4% per biennium, this elimination process would take about a decade. This option would be dependent on legislatures sufficiently limiting spending every session until elimination of the school M&O property tax, and it shows that there is a clear tradeoff between providing property tax relief and increasing spending. With the property tax burdening Texans so heavily, legislators should do everything they can to achieve its elimination.

Economists at the Baker Institute at Rice University studied the economic effects of both options for M&O elimination and found that each plan would lead to increased economic output and more jobs created, but the benefits of both options could be negated if other property tax jurisdictions raise taxes too much. Fortunately, there were valuable reforms in Senate Bill 2 in the 2019 Legislature. This bill lowered the rollback rate trigger to call for an automatic voter election to 3.5% for local taxing entities other than school districts, whose rate was reduced to 2.5%. This reform must be maintained, and the rollback rate trigger even lowered, to protect taxpayers from skyrocketing tax bills.

High taxes are always and everywhere a spending problem, so any path to tax relief must be paired with limiting government spending. By doing so, Texas could shift to a more efficient and fairer sales tax-dominated system. In this way, Texans can be assured meaningful, lasting property tax relief and an improved Texas Model that will sustain prosperity for generations.

## **The Facts**

- Texas has one of the highest property tax burdens in the nation.
- Texas school districts' M&O property tax accounts for almost half of all local property taxes.
- Past attempts to provide relief to property taxpayers without limiting spending have failed.

## **Recommendations**

- Eliminate school M&O property taxes by replacing them either (a) immediately with a swap using sales taxes or (b) over time with a buydown using surplus state funds.
- Require spending restraint at the state and local levels to keep taxes from rising.
- Pass a constitutional amendment either upfront with the swap or at the end with the buydown that prohibits school districts from imposing an M&O tax.

## **Resources**

[\*Education and Property Taxes: A Texas-Sized Conundrum\*](#) by Austin Griesinger, Emily Sass, and Parker Stathatos, Texas Public Policy Foundation (Feb. 2020).

[\*Paths to Real Property Tax Cuts\*](#) by Vance Ginn, Texas Public Policy Foundation (April 2019).

[\*School Property Tax Reform: An Analysis of Options\*](#) by Jorge Barro and John W. Diamond, Texas Public Policy Foundation (Nov. 2018).

[\*Abolishing the "Robin Hood" School Property Tax\*](#) by Kara Belew, Emily Sass, Vance Ginn, and Bill Peacock, Texas Public Policy Foundation (June 2018).