

The Beacon Hill Institute



The Fiscal and Economic Impact of Franchise Tax Reform in Texas

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The evidence is clear: Changes in tax rates have measurable effects on taxable activities, directly, and on other economic activities, indirectly.¹ Yet, policymakers seldom consider these effects adequately when they contemplate tax changes, partly because of inadequate access to quality analysis of the effects rooted in real numbers.

BHI used its State Tax Analysis Modeling Program for Texas (TX- STAMP) to determine the effects of reform scenarios of the Texas franchise tax on the state economy.² The first would abolish the Texas franchise tax and the second would cut the franchise tax by 50%.

We assumed the franchise tax changes begin in 2013 and report the results for that year and 2017, five years after implementation. TX-STAMP allows us to calculate the dynamic revenue effects, as opposed to static effects, under the tax change.

Table 1 displays the results of abolishing the franchise tax against a baseline of no tax policy change.

Table 1: The Fiscal Effects of Eliminating the Texas Franchise Tax (\$ millions)

State Taxes	2013	2017
Franchise Tax	-4,210	-4,531
Sales Tax	133	189
Other Revenue	152	197
Subtotal	-3,925	-4,145
Local Taxes		
Sales Tax	47	69
Business Property Tax	358	462
Other Revenue	55	70
Subtotal	460	601
Total	-3,465	-3,544

Abolishing the franchise tax would generate significant dynamic revenue gains to state sales tax, motor vehicle, fuels tax and other taxes. Eliminating the franchise tax would reduce revenues by \$4.210 billion in 2013 and \$4.531 billion in 2017. However, these revenue losses would be partially offset by increases in the revenues of other state taxes revenues. These revenues would increase by \$285 million and \$386 million in 2013 and 2017 respectfully, with the state sales tax contributing the largest portion of the increase (\$133 million in 2013 and \$189 million in 2017).

¹Barry W. Poulson and Jules Gordon Kaplan, "State Income Taxes and Economic Growth," *Cato Journal* 28, no. 1 (Winter 2008: 53-71).

² For a description about the STAMP model see http://www.beaconhill.org/STAMP_Web_Brochure/STAMP_HowSTAMPworks.html.

In total, the loss of revenue increases over time because the state projects the franchise tax revenues will grow faster than the revenues for the other state taxes. In total, the state would lose \$3.925 billion in 2013, rising to \$4.145 billion in 2017.

Local sales taxes, property taxes and other revenues would increase by an additional \$460 million in 2013, growing to \$601 million in 2017. Combined state and local revenue would fall by \$3.465 billion in 2013 and \$3.544 billion in 2017.

Table 2: The Economic Effects of Eliminating the Texas Franchise Tax

Year	Private Employment (Jobs)	Investment (\$ billion)	Real Disposable Income (\$ billion)	Real Disposable Income Per Capita (\$ per capita)
2013	31,500	3.2	6.4	159
2017	41,500	3.4	9.8	209

In general, the elimination of the franchise tax leads a significant improvement in the state economy. The change would create 31,500 jobs and boost investment by \$3.2 billion in 2013. Real disposable income would rise by \$6.4 billion or \$159 per Texas resident.

Investment projects take time to plan and build, and thus the full amount of new investment, the not to mention the accompanied employment and income, spurred by abolishing the franchise tax, would take time to fully materialize. Therefore, we also report the effects for 2017 in the bottom half of Table 2. The change would create 41,500 jobs and boost investment by \$3.4 billion in 2017. Real disposable income would rise by \$9.8 billion or \$209 per Texas resident.

Table 3 displays the results of reducing the franchise tax by 50 percent also would generate significant dynamic revenue. Cutting the franchise tax would reduce state tax revenues by \$1.439 billion in 2013 and \$1.077 billion in 2017. However, these revenue losses would be partially offset by increases in the revenues of other state taxes revenues. Total state revenues would fall by \$1.302 billion in 2013 and \$940 million in 2017.

Local sales taxes, property taxes and other revenues would increase by an additional \$173 million in 2013 and \$164 million in 2017. Combined state and local revenue would fall by \$1.129 billion in 2013 and \$776 million in 2017.

Table 3: The Fiscal Effects of Reducing the Texas Franchise Tax (\$ millions)

State Taxes	2013	2017
Franchise Tax	-1,439	-1,077
Sales Tax	60	64
Other Revenue	77	73
Subtotal	-1,302	-940
Local Taxes		
Sales Tax	21	23
Business Property Tax	126	116
Other Revenue	26	25
Subtotal	173	164
Total	-1,129	-776

Similar to the scenario that eliminates the franchise tax, cutting the tax would provide a modest improvement to the state economy. The change would create 12,200 additional jobs and boost investment by \$1.8 billion in 2013. Real disposable income would rise by \$2.6 billion or \$63 per Texas resident. Table 4 displays the results.

Table 4: The Economic Effects of Reducing the Texas Franchise Tax

Year	Private Employment (Jobs)	Investment (\$ billion)	Real	Real
			Disposable Income (\$ billion)	Disposable Income Per Capita (\$ per capita)
2013	12,200	1.8	2.6	63
2017	16,200	1.9	4.0	83

We also report the effects for 2017 in the bottom half of Table 4. The change would create 16,200 jobs and boost investment by \$1.9 billion in 2017. Real disposable income would rise by \$4.0 billion or \$83 per capita.