Texas continues to grow, even in the face of a recession and the weak recovery. From 2008 to 2014, real gross domestic product per person in the United States did not grow, but in Texas, per capita GDP rose 4.7 percent. This has swelled public coffers and offers Texas the opportunity to eliminate the most counterproductive part of the tax code: the franchise tax.

Executive Summary

In 2013, the Beacon Hill Institute at Suffolk University modeled the economic benefits of eliminating Texas’s franchise tax. The franchise tax is a tax on capital. Instituted to raise revenue for school districts, the franchise tax is calculated in a number of different ways and has gone through a few iterations.

Beacon Hill researchers estimated that if Texas had eliminated the franchise tax in 2013:

- Investment would surge by $3.2 billion, growing to $3.4 billion by 2017.
- Texas would gain $6.4 billion in real disposable income in 2013 and, cumulatively, $9.8 billion by 2017.
- In the first year, private sector employment would grow 31,500, and the cumulative total in 2017 would be 41,500 additional jobs.

This study extends that analysis by examining how the economic benefits of franchise tax repeal would be distributed among households at various income levels. Some will be surprised that most of the benefits of repealing this tax on capital will flow to households that are not rich. Indeed, households with annual incomes of less than $100,000 a year would benefit most, measured as a percentage of their incomes and in absolute numbers of dollars. Even the poorest households would benefit disproportionately, compared to upper income households. Specifically:

- The poorest Texas households, with annual incomes of less than $10,000, earned only 3.34 percent of income in 2010, but would receive nearly 4 percent of the additional income over the 2013 to 2017 period.
- Households earning $50,000 or less annually received nearly one-third of income (30.2 percent) in 2010, but would receive more than one-third (35.58 percent) of the additional income.
- Nearly half (48.43 percent) of income was received by households with incomes of $75,000 or less in 2010, but they would receive more
Benefits to the Poor of Texas Franchise Tax Repeal

than one-half (56.31 percent) of the increase.

- Three-fourths of income in Texas was received by households with less than $150,000 in annual income in 2010, but they would receive more than four-fifths (83.29 percent) of the increase.

Over a five-year period, households making less than $35,000 per year would receive $2.2 billion in economic benefits if the tax were eliminated. Households under $100,000 per year would receive $6.9 billion.

Inequality has become a big topic in today’s political debates. Certain tax regimes may be economically beneficial, but will give rise to greater inequality. But it is important to distinguish between policies that may on average be good for households overall, but hurt the poor, and policies which help everyone, including the poor, but make official inequality statistics look worse. Even if the latter policies make Texas more unequal, they still benefit the poor, which is what we should really care about.

The elimination of taxes on capital, like Texas’s franchise tax, will yield genuine economic benefits for the poor, even though many benefits go to the wealthy. Taxes on capital are a not an efficient way of raising revenue for the government, which is why eliminating it can help everyone.

About the Author

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Introduction

Texas continues to grow, even in the face of a recession and weak recovery. From 2008 to 2012, real gross domestic product per person in the United States did not grow, but in Texas, per capita GDP rose 4.7 percent. This has swelled public coffers and offers Texas the opportunity to eliminate the most counterproductive part of the tax code: the franchise tax. This tax, colloquially known as the margin tax, directly discourages business and investment by taxing the difference between a business’s revenue and certain costs. In raising revenue to fund public services, whatever form of taxation the state chooses will cause some harm. But among all taxes imposed in Texas, the franchise tax causes the most harm for each dollar raised.

The franchise tax is a tax on capital. Instituted to raise revenue for school districts, the franchise tax is calculated in a number of different ways and has gone through a few iterations. For companies paying the tax, it typically works out to one percent of revenue after subtracting either the cost of goods sold or employee compensation. The state government wishes to pretend the tax is simply a fee, and, in some official capacities the government behaves as if it is a fee. But the practical economic consequences do not differ from any other tax on capital.

Discussions of why taxes hurt the economy overall, and not just the rich, are polluted by caricatures of the theory. “Trickle-down economics,” as opponents refer to it derisively, does not at all describe the mechanism by which cutting taxes on capital will help the poor. In fact, the entire notion of trickle-down is an epithet fabricated by those who wish to keep taxes at their current levels.1

The real argument is simply that capital — machines, buildings, vehicles — makes workers more productive. One remarkably counterintuitive result is that, under standard economic assumptions, workers are best off if all revenue is raised with a tax on labor, and the tax on capital is set to zero. This is a well-known result.2 In the words of economist Garett Jones:3

“Under standard, pretty flexible assumptions, it’s impossible to tax capitalists, give the money to workers, and raise the total long-run income of workers. Not hard, not inefficient, not socially wasteful, not immoral: Impossible.”

Essentially, workers will realize higher pay when no one is discouraged by taxes from investing. When you tax something, you get less of it. Since capital is something we want more of, not less, it is ill-advised to tax it. Advanced economies have adopted economists’ recommendations regarding tax policy in many other ways, but eliminating taxes on capital is the notable exception.4 This suggests that, in contrast to other possible tax reforms, reducing the tax burden on capital is by far the lowest hanging fruit.

The Economic Benefits to Texas of Franchise Tax Repeal

In 2013, the Beacon Hill Institute at Suffolk University modeled the economic benefits of eliminating Texas’s franchise tax.5 To do so, Beacon Hill applied its State Tax Analysis Modeling Program for Texas (TX-STAMP), an effective vehicle for determining the economic impacts of numerous policy changes.6 STAMP is a computable general equilibrium (CGE) model that offers a way of utilizing state-level data to analyze how such policies affect the economic incentives of households and businesses.

Beacon Hill estimates that if Texas had eliminated the franchise tax in 2013:

■ Investment would surge by $3.2 billion, growing to $3.4 billion by 2017.
■ Texans would gain $6.4 billion in real disposable income in 2013 and, cumulatively, $9.8 billion by 2017.
■ In the first year, private sector employment would grow 31,500, and the cumulative total in 2017 would be 41,500 additional jobs.

Beacon Hill also estimated the effect on tax revenues of ending the franchise tax. Simply because taxes are cut, say by $100, does not mean the state will receive $100 less in revenue. Taxes like the franchise tax also reduce other taxable activities. Thus, if one cuts the franchise tax, some of it will be offset by an increase in sales tax revenues, without increasing the sales tax rate. As a result, while the state has raised $4.2 billion from the franchise tax, it would only lose an estimated $3.5 billion in revenue if it eliminates it. (Note: It is assumed throughout this analysis that the elimination of the franchise tax will be funded by a combination of these effects and the significant budget surpluses Texas now enjoys.)
The key numbers for our results are the increases in real disposable income. The theoretical link between these factors is clear. Taxes on capital like the franchise tax discourage investment. The removal of the franchise tax will cause a surge in investment, followed by more investment in each future year. More investment means more capital, which makes workers more productive and allows their wages to rise. Along with the higher returns for capital, this leads to $9.8 billion more in disposable income by 2017. As we will see, all income groups benefit from eliminating the tax, not just the rich.

### Table I

**Texas Households’ Share of Income**

<table>
<thead>
<tr>
<th>Income Bracket</th>
<th>Percentage of Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $10,000</td>
<td>3.34%</td>
</tr>
<tr>
<td>$10,000-$15,000</td>
<td>2.36%</td>
</tr>
<tr>
<td>$15,000-$25,000</td>
<td>5.76%</td>
</tr>
<tr>
<td>$25,000-$35,000</td>
<td>7.23%</td>
</tr>
<tr>
<td>$35,000-$50,000</td>
<td>11.59%</td>
</tr>
<tr>
<td>$50,000-$75,000</td>
<td>18.17%</td>
</tr>
<tr>
<td>$75,000-$100,000</td>
<td>12.59%</td>
</tr>
<tr>
<td>$100,000-$150,000</td>
<td>14.52%</td>
</tr>
<tr>
<td>$150,000+</td>
<td>24.46%</td>
</tr>
</tbody>
</table>

Source: Author's calculations.

Table I shows the distribution of household income in Texas. In 2010:

- The poorest households, with annual incomes of less than $10,000, earned only 3.34 percent of income;
- Households earning $50,000 or less annually received nearly one-third of income (30.2 percent);
- Nearly half (48.43 percent) of income was received by households with incomes of $75,000 or less;
- Three-fourths of income was received by households with less than $150,000 in annual income; and
- One-fourth of income (24.46 percent) was received by households with more than $150,000 in annual income.

Inequality has become a big topic in today’s political debates. Certain tax regimes may be economically beneficial, but will give rise to greater inequality. But it is important to distinguish between policies that may on average be good for households overall, but hurt the poor, and policies which help everyone, including the poor, though those policies make official inequality statistics look worse. Even if the latter policies make Texas more unequal, they still benefit the poor, which

### Table II

**Distribution of Economic Benefits from Elimination of the Franchise Tax**

<table>
<thead>
<tr>
<th>Income Bracket</th>
<th>Percent of Benefits</th>
<th>Benefits by 2013 ($millions)</th>
<th>Benefits by 2017 ($millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $10,000</td>
<td>3.94%</td>
<td>$252</td>
<td>$386</td>
</tr>
<tr>
<td>$10,000-$15,000</td>
<td>2.90%</td>
<td>$186</td>
<td>$284</td>
</tr>
<tr>
<td>$15,000-$25,000</td>
<td>6.91%</td>
<td>$442</td>
<td>$677</td>
</tr>
<tr>
<td>$25,000-$35,000</td>
<td>8.26%</td>
<td>$529</td>
<td>$810</td>
</tr>
<tr>
<td>$35,000-$50,000</td>
<td>13.57%</td>
<td>$869</td>
<td>$1,330</td>
</tr>
<tr>
<td>$50,000-$75,000</td>
<td>20.73%</td>
<td>$1,327</td>
<td>$2,032</td>
</tr>
<tr>
<td>$75,000-$100,000</td>
<td>13.63%</td>
<td>$872</td>
<td>$1,336</td>
</tr>
<tr>
<td>$100,000-$150,000</td>
<td>13.35%</td>
<td>$854</td>
<td>$1,308</td>
</tr>
<tr>
<td>$150,000+</td>
<td>16.71%</td>
<td>$1,069</td>
<td>$1,637</td>
</tr>
</tbody>
</table>

Source: Author's calculations.
is what we should really care about. Eliminating the tax on capital is one such policy that may not look great from the standpoint of inequality statistics, but will help the poor.

Like efficiency, equity is a reasonable goal of sound tax policy. The populist mindset is inclined to view these benefits as accruing solely to the rich. But there are good reasons to expect these benefits to help the poor. Moreover, eliminating the franchise tax would set Texas up for even more growth in the future.

This study estimates how much the elimination of the tax on capital will help the poor. To estimate the distribution of the benefits of the elimination of the franchise tax, we use 2010 data from MIG, Inc.’s Impact Analysis for Planning (IMPLAN) software. This data tells us how much money each income bracket spent on each industry in Texas that year. For instance, households with an income between $10,000 and $15,000 spent just over $1.4 billion on retail trade in 2010. This distribution informs our proxy for the distribution of benefits accruing to households.

Each industry pays a different share of the total tax revenue collected, depending on the size of the industry and how the various rules and exemptions affect them. Data on these shares have been summarized by the Texas Taxpayers and Research Association, drawing upon the Business Tax Advisory Committee Report. Combined with the IMPLAN data above, we can identify what percentage of each group’s expenditures went toward paying the tax. Applying this derived distribution to the economic benefits from Beacon Hill, the effects by household income were estimated. As shown in Table II and Figure I:

- Over a five-year period, households making less than $35,000 per year will receive $2.2 billion in additional income should the tax be eliminated.
- Households earning less than $35,000 per year should accrue 22 percent of the benefits.
- Households earning $35,000 to $100,000 per year should accrue nearly half (48 percent) $0
- Households under $100,000 per year will receive $6.9 billion.
- These results are presented graphically in Figure II.
- Households earning $35,000 to $100,000 per year should accrue 22 percent of the benefits.
- Households earning $100,000 to $150,000 per year should accrue nearly half (48 percent)

Figure I
Distributional Effects of Elimination of Franchise Tax by Annual Household Income
(in millions of dollars)

Figure II
Percentage Gains by Household Group

Source: Author's Calculations.
of the benefits.

Households with incomes of more than $100,000 will receive less than one-third (30 percent) of the benefits.

Eliminating the franchise tax will tangibly help everyone in Texas, not just the upper income class. Furthermore, there is no reason to believe that benefits will not continue as time goes on; the elimination of the franchise tax increases Texas’s long-run economic growth rate beyond 2017. Finally, we must not forget that Beacon Hill’s model demonstrates that ending the franchise tax will create jobs, many of which will be jobs for individuals in lower income households.

Another way of looking at it is how much the end of the franchise tax will increase the incomes of households on a percentage basis. It is much easier to increase the incomes of the poor by 1 percent than it is to increase the incomes of the rich by 1 percent. By this measure, the poorer households do better than the rich households. As shown in Figure III, households making less than $10,000 per year will see their incomes increase by 0.78 percent, while those making more than $150,000 will see their incomes increase by 0.45 percent. Given fairly standard assumptions regarding how money maps into wellbeing, this is actually evidence that eliminating the franchise tax will benefit the poor more than the rich, even though higher income households gain more dollars per household.10

How do these results compare with other estimates? It is difficult to make an apples-to-apples comparison, but these results are consistent with the results of a recent study by the Brookings-Urban Tax Policy Center. That study modeled various assumptions regarding whether taxes on capital fall on labor or on capital. The findings here appear to be roughly between the Tax Policy Center results that assume that the tax is evenly split between labor and capital and those that assume it falls entirely on labor.11

Ultimately, the method used in this study offers evidence that while many of the benefits will find their way into the hands of the wealthy, poor and middle class Texans should anticipate benefits as well. Taxes like the franchise tax negatively impact not just the businesses they directly tax, but also third parties who do not own businesses, including the poor.

**Conclusion**

Certain reforms improve the economy without any direct benefits to the poor. Economists widely agree that a broad-based sales tax is a better way to raise revenue than an income tax, but its ultimate effect on the poor is unclear since such a tax is regressive. The elimination of taxes on capital, such as Texas’s franchise tax, will yield genuine economic benefits for the poor, even though many benefits go to the wealthy. Public policy is not a purely zero-sum game. There are good ways and bad ways of carrying out the essential functions of government. Taxes on capital are not an efficient way of raising revenue for the government, which is why eliminating it can help everyone.

Do we stop the poor and middle class from earning these benefits to spite the rich? Abstract inequality statistics don’t mean much for people who struggle to afford clothing or put money away for their child’s education. Eliminating the franchise tax will help them while encouraging investment, job creation and economic growth. Public policy in Texas can do much better and the place to start is the elimination of the franchise tax, which will benefit all, rich and poor alike.
Endnotes


6. For more on STAMP, see http://www.beaconhill.org/STAMP-Method/STAMP.pdf.

7. The industry sectors are Agriculture, Forestry, Fishing and Hunting, Mining, Utilities, Construction, Manufacturing, Wholesale Trade, Transportation and Warehousing, Retail Trade, Professional Services, Educational, Health and Recreation Services.

8. There is little hard data on which household groups will receive the benefits of cutting taxes on capital. Most attempts to look at the empirical incidence focus on the incidence on capital versus the incidence on labor. For a literature review and a numerical simulation, see Benjamin H. Harris, “Corporate Tax Incidence and its Implications for Progressivity,” Urban-Brookings Tax Policy Center, 2009. Available at http://www.urban.org/uploadedpdf/1001349_corporate_tax_incidence.pdf.


11. See Benjamin H. Harris, “Corporate Tax Incidence and its Implications for Progressivity.” The method here looks at income brackets while the Brookings-Urban study looked at income quintiles. In the absence of very granular data, various assumptions must be made to compare the results. Under reasonable assumptions, the distribution of benefits fits between two of their three results.
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