



## **Phasing Out the Texas Business Franchise Tax: The Impact on Private Sector Employment**

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### **Introduction**

This brief report discusses economic simulation results of a phase-out of the Texas business franchise tax modeled on the language contained in S.B. No. 179 of the 83<sup>rd</sup> legislature, originally introduced by Senators Ken Paxton and Dan Patrick. The TX business franchise tax is a privilege tax imposed on each taxable entity formed or organized in Texas or doing business in Texas. The tax is based on taxable margin<sup>1</sup> for most taxpayers and applies to certain partnerships, corporations, LLCs, business trusts, professional associations, business associations, joint ventures, incorporated political committees, and other legal entities. Currently, the rate of the franchise tax is 0.5 percent of taxable margin for taxable entities primarily engaged in retail or wholesale trade<sup>2</sup>, and one percent of taxable margin for all other taxable entities. S.B. No. 179 would reduce the franchise tax rate over years 2014 to 2016 according to the following schedule in **Table 1**. This analysis assumes that the phase-out schedule for years 2014 to 2016 continues in year 2017, resulting in the complete repeal of the TX business franchise tax in that year.

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<sup>1</sup> Unless a taxable entity qualifies and elects to file using E-Z computation, the tax base is a taxable entity's margin, which equals the lowest of (a) total revenue minus cost of goods sold, (b) total revenue minus compensation, or (c) total revenue times 70 percent.

<sup>2</sup> According to the Office of the Texas Comptroller, a taxable entity is primarily engaged in retail or wholesale trade only if (1) the total revenue from its activities in retail or wholesale trade is greater than the total revenue from its activities in trades other than the retail and wholesale trade; and (2) less than 50% of the total revenue from activities in retail or wholesale trade comes from the sale of products it produces or products produced by an entity that is part of an affiliated group to which the taxable entity also belongs, except for those businesses under Major Group 58 (eating and drinking establishments); and (3) the taxable entity does not provide retail or wholesale utilities, including telecommunication services, electricity, or gas.

**Table 1: Texas Franchise Tax Rate Phase-Out Schedule**

Year	Wholesale/Retail Trade Rate	Non-Wholesale/Retail Trade Rate
2014	0.38 percent (of taxable margin)	0.75 percent (of taxable margin)
2015	0.25 percent	0.50 percent
2016	0.13 percent	0.25 percent
2017	0.00 percent	0.00 percent

**Methodology**

To estimate the impact such a phase-out of the tax might have on private sector employment, the NFIB Research Foundation employed PI+, a dynamic, multi-region model based on the Regional Economic Models, Inc. (REMI) structural economic forecasting and policy analysis model which integrates input-output, computable general equilibrium, econometric, and economic geography methodologies. For this analysis, the Texas module was utilized to obtain state-level economic effects. Forecast variables include future levels of private sector employment. By comparing simulation results for scenarios which include proposed or yet-to-be-implemented policy changes with the model's baseline forecast, PI+ is able to obtain estimates of how these policy changes might impact businesses and their workers.

Originally, the franchise tax was intended to produce approximately \$6 billion per year. The tax has historically failed to generate the targeted revenue level. **Table 2** provides annual revenue figures produced by the franchise tax for years 2008 to 2012.<sup>3</sup> The revenue totals range from a low of \$3.9 billion, achieved in 2010 and 2011, to a high of \$4.6 billion, achieved in 2012. The five-year revenue average is \$4.2 billion which, for this analysis, is assumed to be the annual amount the tax would bring in in the absence of a phase-out.

**Table 2: Texas Franchise Tax Revenue, 2008-2012**

Year	Franchise Tax Revenue (\$Billions)
2008	\$4.5
2009	\$4.3
2010	\$3.9
2011	\$3.9
2012	\$4.6
5-Year Average	\$4.2

Given the separate rates applied to margins for taxable entities primarily engaged in wholesale or retail trade and all other industries, franchise tax revenue streams for these two categories were forecast separately. **Table 3** provides estimates of the amount of franchise tax revenue attributable to taxable entities primarily engaged in wholesale or retail trade and those that are not, based on industry-specific data provided by the Office of the Comptroller for year 2011. **Table 4** provides the schedule of forecasted franchise tax revenue flows for years 2013 to

<sup>3</sup> Combs, Susan, *The Business Tax Advisory Committee Report to the 83<sup>rd</sup> Texas Legislature*, January 2013.

2022, a ten-year forecast window, based upon the phase-out schedule and the revenue assumption above.

**Table 3: Franchise Tax Attributable to Wholesale/Retail Trade and Other Industries**

<b>Year</b>	<b>Estimated Franchise Tax Revenue from Wholesale or Retail Trade (\$Billions)</b>	<b>Estimated Franchise Tax Revenue Not from Wholesale or Retail Trade (\$Billions)</b>	<b>Total Franchise Tax Revenue (\$Billions)</b>
2008	\$0.50	\$3.78	\$4.5
2009	\$0.72	\$3.61	\$4.3
2010	\$0.69	\$3.27	\$3.9
2011	\$0.63	\$3.27	\$3.9
2012	\$0.74	\$3.86	\$4.6

**Table 4: Forecast Franchise Tax Revenue According to S.B. No. 179 Phase-Out Schedule**

<b>Year</b>	<b>Forecast Franchise Tax Revenue from Wholesale or Retail Trade (\$Billions)</b>	<b>Forecast Franchise Tax Revenue Not from Wholesale or Retail Trade (\$Billions)</b>	<b>Total Franchise Tax Revenue (\$Billions)</b>
2013	\$0.68	\$3.56	\$4.24
2014	\$0.51	\$2.70	\$3.22
2015	\$0.34	\$1.78	\$2.12
2016	\$0.17	\$0.92	\$1.10
2017	\$0.00	\$0.00	\$0.00
2018	\$0.00	\$0.00	\$0.00
2019	\$0.00	\$0.00	\$0.00
2020	\$0.00	\$0.00	\$0.00
2021	\$0.00	\$0.00	\$0.00
2022	\$0.00	\$0.00	\$0.00

The principal benefit of phasing out the franchise tax is that it will allow taxable business entities to retain more of their pre-tax income to finance business expansion, build cash reserves, enhance worker compensation, and provide better returns to shareholders. In practice, certain of these events entail the reinvestment of retained revenue into the economy in the forms of additional consumer expenditure or business investment. For this analysis, *additional demand* for private sector goods and services was modeled by increasing consumer spending and fixed investment in proportions determined by historical ratios derived from the National Income and Product Accounts (NIPA) tables.<sup>4</sup>

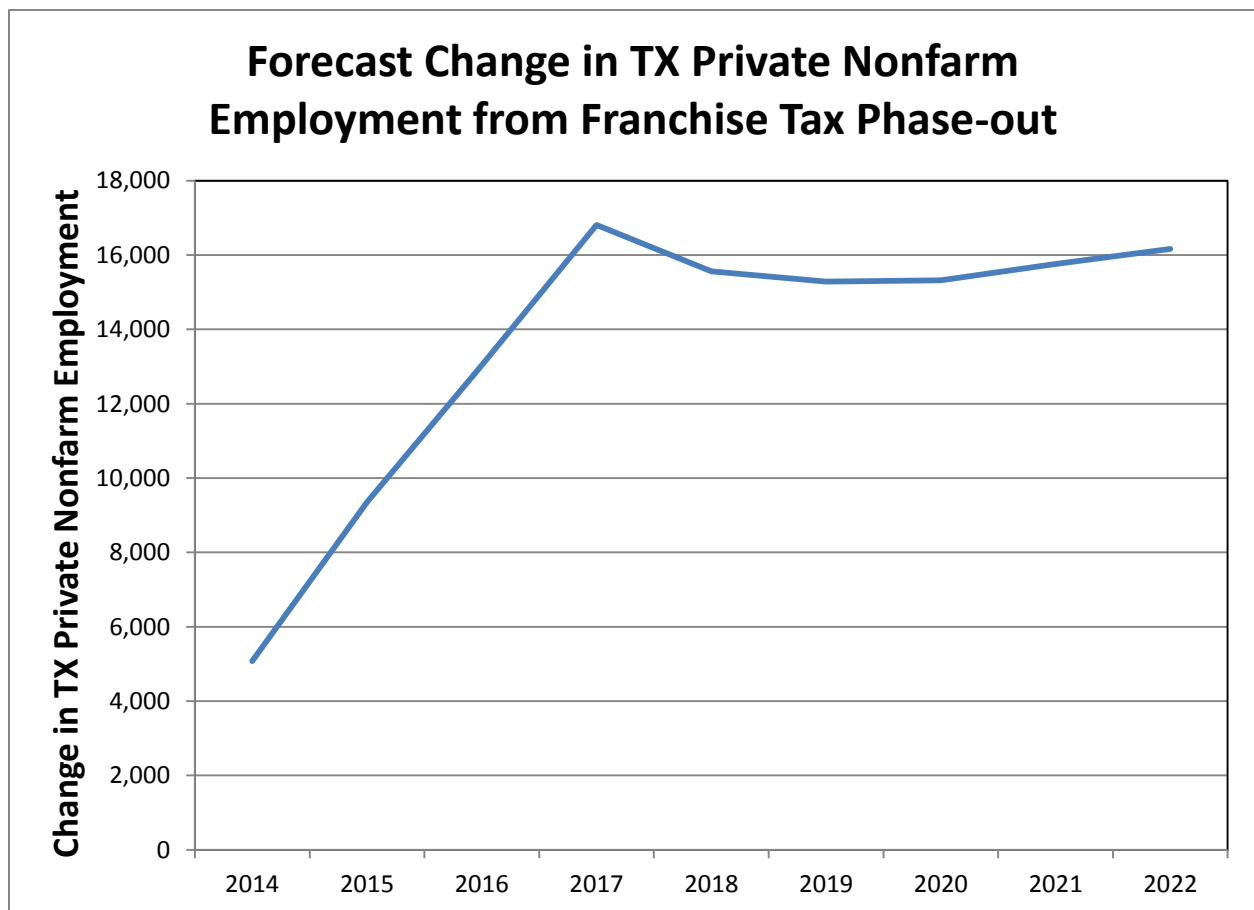
<sup>4</sup> Table 1.5.6 accessible at [www.bea.gov](http://www.bea.gov).

## **Results**

The PI+ simulation results indicate that a phase-out of franchise tax revenue commensurate with the schedule provided in Table 4, along with additional private sector demand according to the ratios described above, would result in an increase of approximately 16,000 private sector jobs in Texas in the long run. Complete forecast employment differentials from the baseline forecast are given in **Table 5** and are charted in **Figure 1**.

**Table 5: PI+ Forecasted Employment Differences from Baseline (Units)**

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Change in TX Private Nonfarm Employment	0	+5,073	+9,357	+13,030	+16,806	+15,561	+15,289	+15,323	+15,762	+16,166



**Figure 1**