TAX RELIEF AND THE SPENDING LIMIT

AN ISSUE BRIEF FROM LEGISLATIVE BUDGET BOARD STAFF

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OBJECTIVE

This brief explains the impact of certain tax cuts on the constitutional spending limit restricting the growth of appropriations funded with state tax revenues not dedicated by the Constitution.

KEY FACTS

- The spending limit restricts the growth of appropriations funded with state tax revenues not dedicated by the Constitution.
- Absent statutory changes, margins tax cuts would shift appropriations subject to the spending limit from the Property Tax Relief Fund to the General Revenue Fund and would not result in a significant change to spending capacity under the spending limit.
- Absent statutory changes, property tax cuts would trigger new General Revenue Fund appropriations which would count against the spending limit and reduce spending capacity under the spending limit.
- Appropriations funded with motor vehicle sales tax revenues count against the spending limit, regardless of the method of finance, unless the tax revenue is constitutionally dedicated for a specific purpose.

BUDGETARY IMPACT

GR appropriations in the House Bill 1 - Introduced are $8.1 billion below the spending limit. GR appropriations in the Senate Bill 2 -Introduced are $5.4 billion below the spending limit.

Tax cuts have implications not only for the overall level of appropriation but also for the constitutional spending limit. What follows is a discussion of the spending limit, tax cuts in general, and specific analysis with respect to school finance, the margins tax, local property tax, and the motor vehicle sales tax.

SPENDING LIMIT BACKGROUND

The spending limit is established in Article VIII, Section 22 of the Texas Constitution. The spending limit prohibits appropriations funded with state tax revenues not dedicated by the Constitution from growing faster than the estimated rate of growth of the state's economy.

The revenue source funding appropriations determines if the appropriations are restricted by the spending limit; the purpose and method of finance of the appropriation are not relevant. The spending limit does not apply to appropriations funded with non-tax revenues or appropriations funded with tax revenues if the Constitution requires the tax revenue to be spent for a specific purpose. For example, appropriations funded with sales taxes, motor vehicle sales taxes, and margins taxes are restricted by the spending limit. Appropriations funded with constitutionally dedicated tax revenues, such as motor fuel taxes or the 25 percent of oil and gas taxes dedicated to education, are not restricted by the spending limit. Other appropriations funded with non-tax revenues such as licenses, fees, fines, penalties, interest, and investment income are similarly not restricted by the spending limit.

The spending limit restricts growth of all appropriations from state tax revenue not dedicated by the Constitution regardless of method of finance. This includes appropriations from General Revenue (GR), General Revenue–Dedicated, and Other Funds that are funded with state tax revenue not dedicated by the Constitution.

TAX CUTS IN GENERAL

Changes in revenue may have varying affects on the level of state appropriations. In simplest terms, a reduction to state revenues, regardless of mechanism, means less revenue available for appropriation. It is important to note, however, that absent constitutional or statutory direction to the contrary, tax cuts in isolation do not affect appropriation amounts. At the same time, changes in the amount and type of revenue collections do impact the levels of appropriations funded with tax revenues subject to the spending limit and revenues not subject to the spending limit. For example, cutting sales tax revenues would reduce the percentage of tax revenue subject to the spending limit in the General Revenue Fund compared to non-tax revenue. As a result, a smaller portion of existing General Revenue Fund appropriations would be funded with revenue subject to the spending limit, resulting in additional spending capacity under the spending limit. However, the entire sales tax cut would cost the Article III, Section 49-a pay-as-you-go limit.

SCHOOL FUNDING FORMULAS

Current school funding formulas direct that total revenue to which school districts are entitled is a mix of state and local revenue. Any reduction to local revenue, regardless of the reason, is generally made up with state aid. This state aid increase primarily begins in the second year after the initial loss of local revenue. Legislation may also provide for additional state funding to fully compensate school districts for portions of local revenue loss that are not completely offset by current formulas. The FSP is the principal vehicle for distributing state aid to school districts, which use state funds and local property tax revenue, to provide educational services. Directing local school districts to cut property taxes would reduce local school district property tax revenue and trigger additional GR appropriations to the FSP to cover the shortfall.

The Property Tax Relief Fund (PTRF) is a fund outside of GR that serves as one of several methods of financing for the FSP. The PTRF is funded with revenues resulting from a package of legislation passed by Seventy-ninth Legislature, Third Called to provide property tax rate reductions. The amounts deposited to the PTRF are essentially the amounts generated by the change in those taxes authorized by the Legislature, with the greatest contributions coming from the margins tax. Any shortfall of revenue in the PTRF would trigger additional GR appropriations to cover the shortfall to the FSP.

MARGINS TAX CUTS

The PTRF (classified as an Other Fund, not GR) includes deposits of certain motor vehicle sales taxes, margins taxes, and tobacco taxes. Because those revenues are statutorily dedicated, not constitutionally dedicated, appropriations from the PTRF funded with those tax revenues count against the spending limit.

A margins tax cut would reduce margins tax revenues deposited into and appropriations out of the PTRF. Current methods of finance for the FSP would shift that appropriation from the PTRF to GR. The resulting GR appropriation would count against the spending limit to the extent it is financed with tax revenue not dedicated by the Constitution. In sum, a margins tax cut would result in a spending limit savings to the PTRF and a spending limit cost to GR. The overall change in appropriations subject to the spending limit would not be significant.

PROPERTY TAX CUTS

The state of Texas does not levy property taxes. All property taxes are levied by local taxing jurisdictions. Consequently, the state cannot simply cut property taxes. The state must require local taxing jurisdictions to cut property taxes. Current school funding formulas require the state to increase GR appropriations for the FSP to offset property tax revenue that would otherwise be lost to school districts. These new GR appropriations are subject to the spending limit to the extent they are funded with tax revenue not dedicated by the Constitution.

It is important to note that a piece of legislation resulting in a tax cut simply reduces revenue and is not an appropriation of any kind. It is not the property tax cut itself that is subject to the spending limit; it is the additional appropriations required by current law, or a hold harmless mechanism to replace lost school district revenues, which are subject to the limit.

MOTOR VEHICLE SALES TAX

Motor vehicle sales taxes are not dedicated by the Constitution and count against the spending limit when funding appropriations, regardless of which fund the appropriations are made from. If motor vehicle sales taxes were deposited in the State Highway Fund, appropriations from the SHF und financed with the motor vehicle sales taxes would count against the spending limit unless the tax revenue was dedicated by the Constitution.

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