

# Yes, Compression Is the Best Form of Tax Relief

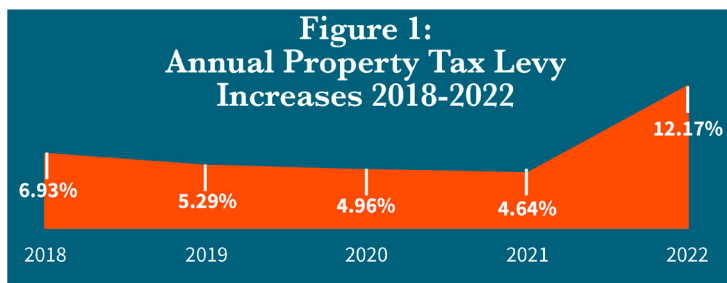
## Five Steps for Ending the Stalemate Over School Property Taxes

By Don Huffines and Bill Peacock

After failing to pass property tax relief during its regular 140-day session that ended on Memorial Day, the Texas Legislature began a special session on Tuesday after Governor Abbott called the legislators back together to address property tax relief. The situation quickly deteriorated into another stalemate.

The Texas Senate passed property tax legislation on Tuesday that, according to Gov. Abbott, did not conform with his call for reducing property tax rates through compression. The Senate then adjourned until Friday. A few hours later, the Texas House of Representatives passed bills that addressed both issues on the call from Governor Abbott—property tax reform through compression and human trafficking on the border, declared the Senate’s bill out of order, and then adjourned sine die—meaning that for the House, the special session is over.

Now, the only way for Texans to get property tax relief in this first special session is for the Senate to adopt the House bill and send them to Gov. Abbott. The Senate’s stance to this point, however, makes it unlikely that it will happen.



Source: Texas Comptroller of Public Accounts

Gov. Abbott’s call for the special session came in response to the Texas Legislature’s failure to pass property tax relief over the last five months. Abbott tasked legislators to pass “Legislation to cut property-tax rates solely by reducing the school district maximum compressed tax rate in order to provide lasting property-tax relief for Texas taxpayers.”

Many Texans likely do not understand what “compression” means when it comes to property taxes. Compression is the only form of property tax relief

that would help put Texas on the path to permanent reductions of property taxes. Compression is one of three ways that the Texas Legislature proposed over the last five months for reducing property taxes: the Texas Senate favors limited exemptions for homesteads from property taxes with some compression, while the Texas House favored compression along with appraisal caps.

The concept of compression is simple. In this case, it applies only to school property taxes. Let’s say in 2022 a property tax owner paid \$1.16 in school property taxes for every \$100 of property value for his home. A home with a taxable value of \$390,000 would result in a school property tax of \$4,524. But if the Legislature spent an additional \$12.3 billion on public schools and mandated that school districts reduce property tax rates by an amount to cut statewide property tax revenue by a total of \$12.3 billion, the property tax rate on the house would be “compressed” by about 16 cents. It thus would drop to about \$1 per \$100. At the new rate, the taxes on the \$390,000 home would decrease to \$3,900. One way to think of compression is to say that the state is “buying down” the property tax by reducing property tax rates. If taxpayers want to completely eliminate school property taxes, that is, to buy down the rate to \$0 per \$100, compression moves Texas in the right direction.

This is the scenario if the plan adopted on Tuesday in the Texas House in HB 1 becomes law. It put \$12.3 billion for property tax relief entirely into compression. The Senate plan in SB 1, passed on Tuesday, takes a somewhat different approach. It puts about \$8 billion into compression. Then, it spends another \$4.1 billion on public schools to pay for increasing the homestead exemption, i.e., owner-occupied housing, from \$40,000 to \$100,000.

The primary difference between the two bills is that the House plan provides equal property tax relief to all Texans affected by property taxes: homeowners, renters, and businesses. The Senate plan is skewed toward providing more relief to homeowners who

live in their homes.

For the home with a taxable value of \$390,000, the Senate's \$8 billion for compression would reduce its tax rate from \$1.16 to \$1.06, with the property tax bill decreasing to \$4,134. In addition, the increase in the homestead exemption would decrease the property's taxable value to \$330,000. The total effect of the Senate plan would be to decrease property taxes on the \$390,000 home from \$4,524 to \$3,498. Thus, the Senate's plan provides homeowners with a lower property tax bill because the homestead exemption concentrates \$4.1 billion only on properties with owner-occupied housing. While this is good for homeowners, it expands the bifurcated property tax system currently in place that pits homeowners, renters, and businesses against each other. It also does not move Texas as far along the path to eliminating school property taxes as the Abbott plan backed by the Texas House.

Whether the House plan or the Senate plan eventually becomes law, committing more than \$12 billion toward property tax relief is a significant step in the right direction. But more needs to be done. As Figure 1 shows, recent attempts to address the growth of property taxes have provided little relief. The reason for this, and the reason that the effort this year is insufficient—is two-fold.

First, the Texas Legislature has not committed enough money to property tax relief. Property taxes were \$80 billion last year; school districts accounted for \$44 billion of the total. Throwing a few billion dollars every few years is not enough to address the problem. And this year, using only \$12 billion of the state's historic \$32 billion surplus for property tax relief is also insufficient.

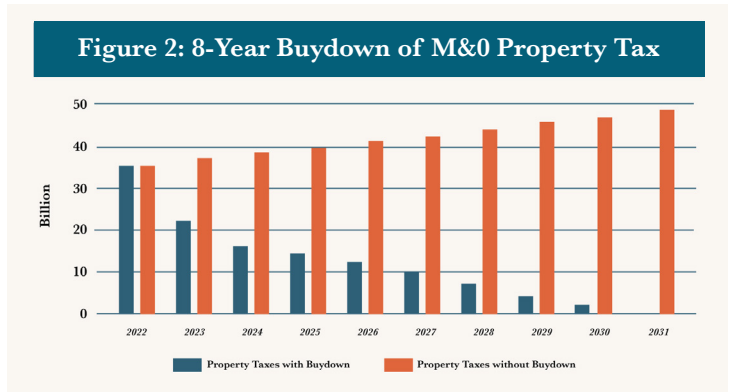
Second, the Texas Legislature has been unwilling to control spending growth at both the state and local levels. This is a problem because property taxes will increase as long as state and local spending increases.

### The Solution: Eliminating the School Property Maintenance and Operations Tax

The current divide over property taxes is in many ways unnecessary. Conflicts over homestead exemptions, abatements and exemptions for businesses,

and the property appraisal system would disappear if property taxes were eliminated.

The first step down that path is to eliminate school property taxes. If Texas leaders are going to get serious about eliminating Texas' school maintenance and operations property tax (M&O), here are five steps they must take to lock the state into a path to accomplish this within eight years:



**Limit State Spending Growth:** Limiting state spending growth to no more than 5.9% per biennium (2.9% annually) would provide budget surpluses that could be dedicated to property tax relief.

**Freeze School M&O Property Taxes:** Freezing school M&O property tax revenue at the current level stops school districts from undermining efforts to eliminate the M&O tax with constant increases.

**Use 90% of Texas' Budget Surpluses:** Using 90% of state funds budget surpluses will provide enough funds to eliminate the M&O property tax in 8 years (or less).

**Require Voter Approval to Exceed the No-New-Revenue Tax Rate:** Cities, counties, and special districts must ask voters for permission to Exceed the No-New-Revenue Tax Rate.

**Enshrine Property Tax Relief in the Texas Constitution:** Property tax relief must be made permanent by passing an amendment to the Texas Constitution.