February 2016

FISCAL NOTES

Starting a New Business

by Maria Garnett

HOW TEXAS COMPARES

As noted in the last issue of *Fiscal Notes,* the rate of new business formation is declining both nationally and in Texas. In this issue, we consider some of the hurdles involved in starting a new business.

TEXAS STILL BUSINESS-FRIENDLY

A number of public and private entities rank the states on tax climate and other aspects of business "friendliness." One ranking, produced by the website Thumbtack.com, surveys small business owners on various aspects of business friendliness. The most recent survey, for 2015, is based on the responses of nearly 18,000 small business owners in 36 states.

In 2015, Texas ranked first among these states for small-business friendliness; of the 10 most populous states, only Texas and Georgia ranked in the top 10 (**Exhibit 1**).

The Thumbtack survey also ranks dozens of U.S. metropolitan areas, and all five of Texas' largest cities ranked among the top 15 included in the survey (**Exhibit 2**).

CONTINUED ON PAGE 3

EXHIBIT 1

OVERALL SMALL-BUSINESS FRIENDLINESS RANK AND GRADES, 10 MOST POPULOUS STATES: 2015

	OVERALL FRIENDLINESS RANK	OVERALL FRIENDLINESS GRADE	EASE OF STARTING A BUSINESS	EASE OF HIRING	OVERALL REGULATIONS	HEALTH & SAFETY	EMPLOYMENT, LABOR & HIRING	TAX CODE	LICENSING	ENVIRONMENTAL	ZONING	TRAINING & NETWORKING
TX	**1**	**A+**	**A+**	**B**	**A+**	**A**	**A+**	**A+**	**A+**	**A**	**A+**	**A**
GA	9	A	A	B	B+	B	B+	B+	B+	B+	B+	C+
OH	15	B	B	C-	B	B	B+	B-	B	B+	B+	A-
MI	20	B-	B-	B-	B-	C+	C+	C+	B-	B	B	B
FL	21	B-	C+	C	B	B	B	A	B-	B	B-	C
NC	23	B-	C+	B+	B	B-	B+	B-	B	B-	B+	B
PA	28	C-	C-	C-	D+	D+	C-	D	C	C-	D	D+
NY	32	D	F	B-	C	C+	C	C-	C	C+	C-	B-
CA	33	F	F	C	F	D+	F	F	F	F	D+	C-
IL	35	F	F	C-	D	D	F	F	F	C	C	D+

Note: 36 states participated in the 2015 survey.
Source: Thumbtack.com

A Message from the Comptroller

In the last issue of *Fiscal Notes*, we took a look at the decline of entrepreneurialism in Texas and the U.S. The plain fact is, new businesses just aren't being created at the same rates as in the past, and that's a trend with potentially serious consequences for our economy.

In this issue, we continue to examine this topic, with a focus on the Texas environment for would-be entrepreneurs. Our state has significant strengths — and some weaknesses, too. We'll tell you about the help and hurdles Texans can expect when they take their first steps into the arena of business ownership.

We're also offering another in our series of in-depth examinations of Texas' major taxes, in this case those on gasoline, diesel and other motor fuels.

All 50 states and the federal government levy various taxes and fees on motor fuels, and ours are the lowest among America's largest states. They're a vital source of funding for road and bridge projects as well as public education, but there are signs they're not keeping pace with the transportation demands of a vast and fast-growing state.

As always, I hope you enjoy this issue!

GLENN HEGAR
Texas Comptroller of Public Accounts

REGIONAL SNAPSHOT: HIGH PLAINS REGION

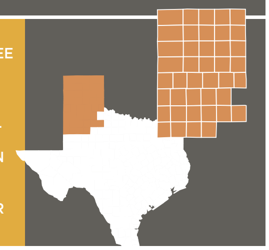
As the state's chief financial officer, I'm charged with monitoring the state's economic health. Therefore, it's vitally important that my office studies factors related to our regional economies.

The 41 counties comprising the High Plains Region have helped boost Texas' remarkable growth and resiliency over the past 10 years.

-GLENN HEGAR
Texas Comptroller of Public Accounts

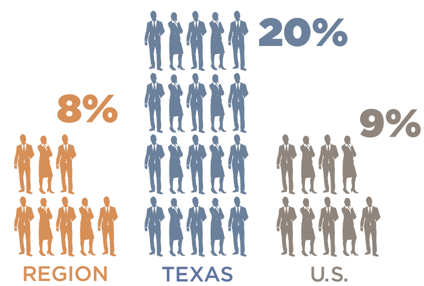
HIGH PLAINS REGION COUNTIES:

ARMSTRONG
BAILEY
BRISCOE
CARSON
CASTRO
CHILDRESS
COCHRAN
COLLINGSWORTH
CROSBY
DALLAM
DEAF SMITH
DICKENS
DONLEY
FLOYD
GARZA
GRAY
HALE
HALL
HANSFORD
HARTLEY
HEMPHILL
HOCKLEY
HUTCHINSON
KING
LAMB
LIPSCOMB
LUBBOCK
LYNN
MOORE
MOTLEY
OCHILTREE
OLDHAM
PARMER
POTTER
RANDALL
ROBERTS
SHERMAN
SWISHER
TERRY
WHEELER
YOAKUM



POPULATION GROWTH

HIGH PLAINS REGION VS. TEXAS AND U.S. / 2003-2013



Source: U.S. Bureau of Economic Analysis

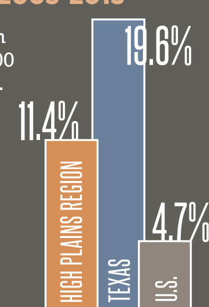
LUBBOCK, POTTER AND RANDALL COUNTIES HOUSE 63% OF THE REGION'S POPULATION.

Source: U.S. Census Bureau

JOBS & WAGES

JOB GROWTH 2003-2013

The High Plains Region added more than 38,500 jobs from 2003 to 2013. Lubbock and Randall counties led total job growth, accounting for more than 60 percent of net job increases.



Source: Economic Modeling Specialists Intl.

MORE THAN 75 VARIETIES OF WINE GRAPES GROW IN THE HIGH PLAINS REGION.

Source: High Plains Winegrowers

PER CAPITA PERSONAL INCOME GROWTH 2003-2013

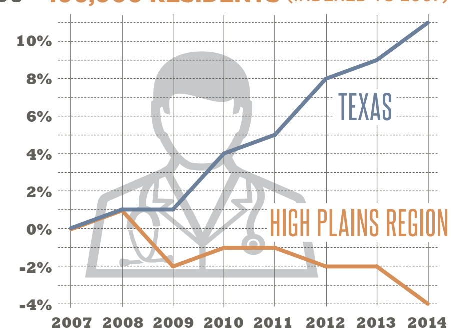
REGION 53%
46% TEXAS
U.S. 37%

Source: U.S. Bureau of Economic Analysis and Texas Comptroller of Public Accounts

HEALTH CARE ACCESS

PERCENTAGE OF PHYSICIANS PER 100,000 RESIDENTS (INDEXED TO 2007)

Physicians in the High Plains Region must care for an aging population across a vast and sparsely inhabited area. Providers are largely clustered in the region's two metropolitan centers, Amarillo and Lubbock. The region includes 43 percent of the state's counties without doctors.



Source: Texas Medical Board, Texas Department of State Health Services and Texas Comptroller of Public Accounts

FOR A COMPLETE LIST OF REGIONAL SNAPSHOTS, VISIT:
TEXASAHEAD.ORG/REGIONALRPTS

If you would like to receive paper copies of *Fiscal Notes*, contact us at
fiscal.notes@cpa.texas.gov

EXHIBIT 2

SMALL-BUSINESS FRIENDLINESS OF TEXAS CITIES: 2015

	OVERALL FRIENDLINESS RANK	OVERALL FRIENDLINESS GRADE	EASE OF STARTING A BUSINESS	EASE OF HIRING	OVERALL REGULATIONS	HEALTH & SAFETY	EMPLOYMENT, LABOR & HIRING	TAX CODE	LICENSING	ENVIRONMENTAL	ZONING	TRAINING & NETWORKING
Dallas	2	A+	A+	B+	A+	A+	A+	A+	A+	A+	A+	A-
Austin	4	A+	A+	B-	B	B-	B-	A-	B	B	B-	A+
Houston	7	A+	A+	B+	A+	A	A	A+	A+	A-	A+	B+
San Antonio	10	A	A-	B-	A	A-	A+	A+	A	A	A+	A+
Fort Worth	12	A-	A-	B-	B+	B	B+	A	A	B	B	C

Note: the 2015 survey included 95 U.S. metropolitan areas.
Source: Thumbtack.com

Other surveys and rankings paint a similar picture for Texas.

- ***Forbes*** magazine, for instance, ranks the Best States for Business each year, most recently in October 2015. Its rankings are based on scores in six core business areas – costs, labor supply, regulatory environment, current economic climate, growth prospects and quality of life. Texas' most recent overall rating within *Forbes'* methodology places it sixth, although the state received the highest ranking in the area of economic climate.
- ***Forbes*** also publishes annual rankings of the Best Places for Business based on costs, job growth and educational quality in America's metropolitan areas. In the July 2015 ranking, no Texas metro area placed in the top 10, but Dallas came in at no.15. This represents a decline from the previous year's rankings, when four major Texas metro areas (Dallas, Houston, San Antonio and Austin) appeared in the top 20.
- **The Tax Foundation** publishes a State Business Tax Climate Index each year based on scores in the areas of corporate taxes, individual income taxes, sales taxes, unemployment insurance taxes and property taxes. In 2015, Texas occupied the 10th spot among all states.
- The **Small Business & Entrepreneurship Council** annually publishes a Small Business Tax Index based on 23 tax-related measures. Most recently, and for the second year running, Texas ranked third overall.
- The website **Nerdwallet** produces a list of the Best Places to Start a Business, most recently released in late April 2015. Nerdwallet emphasizes measures such as business revenues and annual median housing costs. Based on its analysis of American Community Survey data, the Beaumont-Port Arthur area is Texas' best place to start a business. (Indeed, the Beaumont metropolitan area is the only Texas location in the top 20.)

Several factors contribute to Texas' consistently high rankings for small-business friendliness, including a relatively low tax burden, superior bankruptcy protections and recent entrepreneur-friendly regulatory reforms.

LOW TAX BURDEN

Texas is consistently lauded for its business-friendly tax framework, particularly for new and small businesses. Texas does not have a personal income tax, and sole proprietorships, the state's most common form of new business, are completely exempt from the franchise tax, its main business tax.

Texas is among only five states that do not levy *any* business tax, personal income tax or fee on sole proprietors, allowing them to invest more of their profits back into their businesses. (The others are Alaska, Florida, South Dakota and Wyoming.)

Texas also exempts many other small businesses from any tax obligation. For 2015, all businesses with total revenues of less than $1.08 million or total tax liabilities of less than $1,000 owed no franchise tax. These provisions saved Texas businesses about $256.6 million in fiscal 2015. Many other states, including California, New York and Florida, have minimum tax requirements.

Furthermore, taxable entities with less than $10 million in total revenue are eligible for a reduced franchise tax rate (the "E-Z" rate). This saved Texas

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EXHIBIT 3

HOMESTEAD EXEMPTIONS IN THE FIVE MOST POPULOUS STATES

STATE	MAXIMUM HOMESTEAD EXEMPTION
Texas	**Dollar amount unlimited in most cases, but limited as to land area**
New York	$75,000 - $150,000 (married couples may double, based on county in which homestead is located)
California*	$75,000 - $100,000
Florida	Dollar amount unlimited in most cases, but limited as to land area
Illinois	$15,000 (married couples may double)

Note: This exhibit reflects state bankruptcy laws. Debtors in some states including Texas may choose to file under the federal bankruptcy system.
*California has two distinct statutory schemes under which its residents can exempt property. Exhibit shows maximum available under either scheme.
Source: Texas Comptroller of Public Accounts

businesses an estimated $27.9 million in fiscal 2015. And most recently, the 2015 Texas Legislature approved a 25 percent reduction in the state franchise tax rate.

ASSET PROTECTION

Texas' asset protections are among the nation's most generous, protecting certain assets from seizure by creditors regardless of whether an individual files for bankruptcy protection. It's an important consideration for those facing the financial risks of entrepreneurship.

Texas, moreover, is one of only a few states that allow most individuals filing for bankruptcy under state law to protect the entirety of their homesteads (**Exhibit 3**).

Texas' statutes also include significant protection limits for personal property that frequently allow debtors to protect their equity in one motor vehicle per licensed driver in their families. Among the five largest states, only Texas usually allows debtors to protect a considerable amount of their equity in their homes and cars.

And Texas offers the choice of filing for bankruptcy under state or federal exemption laws, an option some other large states such as California, Florida and Illinois do not provide.

EQUITY CROWDFUNDING

Recent statutory changes in Texas could further encourage entrepreneurship. For example, Texas was among the first states to approve an "equity crowdfunding" exemption to its securities regulations.

The growing popularity of crowdfunding sites, such as Kickstarter and Indiegogo, has encouraged many new and prospective businesses to make appeals for funding through these services. Until recently, however, those making these appeals could offer various awards in exchange for contributions — but not equity in the company itself, as with a traditional business investment. Only "accredited investors" (those above a certain level of net worth) were permitted to receive equity in a company in exchange for investment.

Since November 2014, however, Texas startups can offer equity in their ventures to any in-state investors, regardless of their resources. While there are some restrictions on the total amount such individuals can invest, equity crowdfunding could become another important tool for small businesses seeking capital.

ASSET FORMATION

Despite its business-friendly reputation, some factors undoubtedly discourage potential entrepreneurs in Texas. Whether or not these have contributed to the slowdown in business entry rates, they certainly influence decisions on whether to start new ventures.

Texas trails many other states in some important measures of financial ability.

Nearly half of all U.S. startup businesses rely on personal or family assets to finance some portion of their initial costs. In a recent Gallup poll, 68 percent of potential entrepreneurs cited a lack of sufficient personal savings as a barrier to starting a business.

Texas, unfortunately, is well below national averages for some measures related to assets. Its rates of "unbanked" or "underbanked" households — those that lack bank accounts entirely, or lack access to the basic financial services, such as personal loans, that banks provide — are among the nation's highest (**Exhibit 4**).

Texans who lack such basic advantages will find it much harder to engage in nearly every type of entrepreneurial activity. Simply participating in the traditional banking system can have tangible benefits. The Brookings Institution has estimated that an average full-time worker who banks at a traditional financial institution can save more than $40,000 during his or her working life.

Texas also has one of the nation's lowest homeownership rates. According to an analysis of recent

EXHIBIT 4

UNBANKED AND UNDERBANKED HOUSEHOLDS

Five Most Populous States and U.S. Average, 2013

STATE	UNBANKED RATE	UNDERBANKED RATE
Texas	**10.4%**	**27.4%**
California	8.0%	17.0%
Florida	6.2%	19.1%
Illinois	7.4%	14.6%
New York	8.5%	19.6%
U.S. Average	7.7%	20.0%

Source: Federal Deposit Insurance Corporation

In fiscal 2014, Texas businesses accounted for only 3 percent of all venture capital investments, while California's received 56 percent.

Census data (2013), just 61.8 percent of Texas' housing is owner-occupied, a lower rate than in all but seven other states. Not owning a home, most people's most important asset, presents another roadblock for prospective entrepreneurs seeking capital.

Texas does, however, provide some tools at the local level to help low- and moderate-income families save and buy homes.

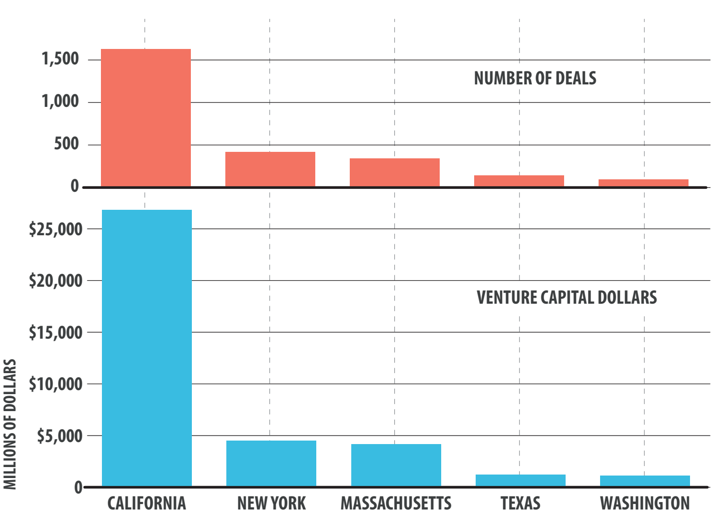
Individual development accounts (IDAs), for example, are matched savings accounts that can be used for starting a small business or for other personal transactions, such as purchasing a home or attending college. In exchange for meeting requirements such as attending financial education classes and committing to saving on a regular basis, participants in IDA programs are granted a match for every dollar they save. Some IDA programs in Texas are federally funded, while others are supported by nonprofit organizations, local governments, community colleges and private businesses.

Taxpayers can search for IDA programs and other asset-building aids in their areas through an online tool offered by Raise Texas, a statewide network of nonprofits, businesses and public institutions that supports asset-building initiatives.

EXHIBIT 5

STATES WITH THE MOST VENTURE CAPITAL DEALS

2014



Source: CB Insights, *The 2014 U.S. Venture Capital Year in Review*

VENTURE CAPITAL

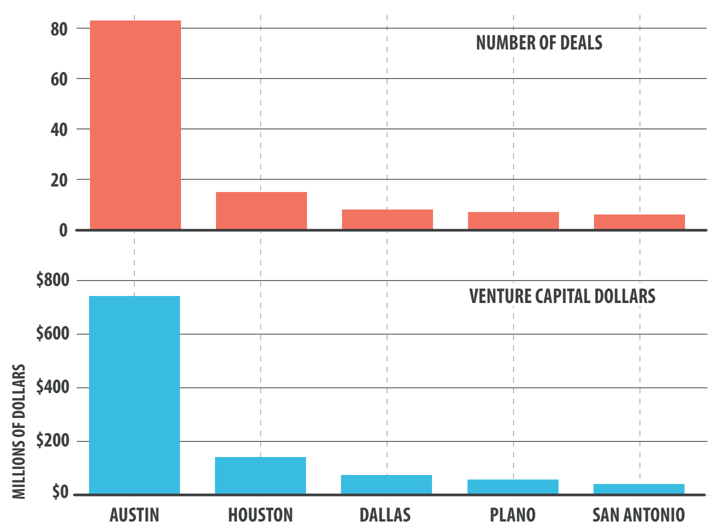
Access to venture capital represents another problem for entrepreneurial Texans. While Texas' venture capital activity is strong, it is far less robust than that seen in other large states such as California and New York (**Exhibit 5**). In fiscal 2014, Texas businesses accounted for only *3 percent* of all venture capital investments in the U.S., while California's received 56 percent. No Texas companies were among 2014's 25 most active venture capital firms.

Texas' venture capital investments are focused primarily in the Austin area, implying significant opportunities for growth in other areas of the state (**Exhibit 6**).

EXHIBIT 6

TEXAS CITIES WITH THE MOST VENTURE CAPITAL DEALS

2014



Source: CB Insights, *The 2014 U.S. Venture Capital Year in Review*

Texas' state government has focused much of its economic development efforts on direct grants to companies through the recently abolished Emerging Technology Fund and other programs. One challenge facing such programs thus far has been the inherent risk and controversy involved in using taxpayer dollars to directly fund young companies that may end up failing.

There's an alternative model, however, often called "funds of funds," which generally involves loaning bond revenues to proven, expert investors who then combine the funds with privately raised capital to make equity investments in qualifying small businesses. The profits from the businesses' eventual acquisition or public offerings, if any, are split between the state and the investment fund, resulting in a self-perpetuating program.

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Such efforts have seen some success. For example, the Ohio Capital Fund has attracted $939 million in private investments — more than eight times the state's own investment — to early-stage companies in Ohio. This funding has generated an estimated 2,600 jobs with average salaries of $73,569.

Texas has a similar program, called Jobs for Texas (J4T), administered by the Department of Agriculture. J4T, however, relies entirely on a one-time $46.5 million award from the federal government. Its investments have attracted nearly $395 million in outside private financing and led to the creation or retention of an estimated 1,150 jobs.

INTERNET PRESENCE

According to the latest Census data, Texas also ranks below average in computer ownership and high-speed Internet usage. Communities near the U.S.-Mexico border have particularly low rates, with McAllen, Brownsville and Laredo reporting some of the lowest rates among all U.S. cities.

Yet online commerce has become enormously important to the state and national economies. A recent Boston Consulting Group report estimated that the Internet now accounts for *$14.5 trillion* in annual U.S. economic output, or about 4.7 percent of the nation's total gross domestic product.

Furthermore, the report suggests that a business' use of the Internet has a direct impact on its growth. Small- and medium-sized enterprises in the U.S. that reported extensive Web use saw their sales grow by 10 percent in a recent three-year period. Similarly sized businesses reporting little or no Web activity saw sales *shrink* by 5 percent in the same period.

Texans without access to, and familiarity with, computers and the Internet are poorly equipped to start new businesses and remain competitive in an increasingly digital economy.

OCCUPATIONAL LICENSING

The need for occupational licenses is receiving increased attention from business and government alike. A July 2015 White House report found that about a quarter of all U.S. workers now require a license to do their jobs, and that the share of state-licensed occupations has risen *fivefold* since the 1950s.

The 2014 Thumbtack survey of small business owners stated:

> The complexity, time-cost, and monetary expenditure of obtaining and keeping licenses and permits was the most important issue for small businesses when rating the friendliness of their states.

Texas has fewer licensing requirements than many other states. An often-cited 2007 survey conducted by the Reason Foundation found that Texas had 78 licensed job categories versus a national average of 92.

According to a 2012 study by the Institute for Justice, however, while Texas licenses fewer lower-income occupations than most states, it places more burdensome requirements on those it *does* license, posing a substantial barrier to some aspiring entrepreneurs.

Texas ranked 38th among states for its number of licensed occupations, but 17th for the average *burden* of its licensing requirements, a measure accounting for factors such as average fees, minimum educational requirements and the average number of required exams. According to the Institute for Justice, in 2012 Texas' licensing requirements imposed "an average of $304 in fees, 326 days of training and two exams on those wishing to enter licensed occupations."

Occupational licensing is a continuing area of regulatory concern for Texas policymakers. The 2015 Legislature, for example, removed a requirement for operators of braiding businesses to hold barber or cosmetology licenses.

The sheer number of Texas license oversight entities — currently 42, according to the Texas Legislative Council — is not the only source of complications for entrepreneurs. Texas' regulatory agencies have very broad authority to set licensing rules and fees.

Section 2001.039 of the Texas Government Code requires state agencies to review each established rule at least once every four years after its effective date, to determine whether it should remain, be changed in some way or be eliminated. The state, however, lacks an official mechanism to oversee this rule review, so licensing entities are self-governing in this regard.

GETTING STARTED

With all its advantages — and despite its challenges — Texas remains one of the nation's best places to launch a new business.

For many entrepreneurs, the most difficult part of starting a new business is learning where to start. Many national, state and local resources are available to help them, however, including the Comptroller's own Texas Business Advisor page, at comptroller.texas.gov/tba. The Raise Texas online tool can be accessed at raisetexas.org/assets_building_db/search. **FN**

Texas' Motor Fuels Taxes

by John Heleman and Bruce Wright

ESSENTIAL LEVIES SUPPORT ROADS, EDUCATION

Unless you're filling up, you probably don't give much thought to motor fuels — and even less to the taxes assessed on them. Yet these indispensable products are an important source of revenue for the federal and state governments.

Texas is a big state, and getting around it burns a lot of fuel. Texans use about 13 billion gallons of gasoline and 4.5 billion gallons of diesel fuel each year, as well as much smaller amounts of various alternative fuels such as compressed and liquefied natural gas. According to federal statistics, only eight *nations* used more gasoline and diesel than Texas in 2012.

That adds up to significant revenue for the state. Texas motor fuels taxes generated more than $3.4 billion in fiscal 2015, making them the fourth-largest source of state tax revenue.

Nearly all states including Texas use the bulk of this revenue for transportation projects. Under the Texas Constitution, after refunds and collection costs are subtracted, three-quarters of the state's motor fuels tax revenue is used to build and maintain public roadways. The remainder goes to the state's Available School Fund, which supports public education.

HOW IT BEGAN: THE AUTO ERA

In 1917, the first year of Texas' annual auto registration, the state already had nearly 188,000 cars and about 5,000 trucks, providing a testament to the explosive growth of the automotive era in the 20th century. Similar growth occurred across the nation, as reflected in production figures for Ford's ubiquitous Model T; the company turned out 10,666 in 1909, 308,162 in 1915 — and more than *2 million* in 1923.

The need for more and better roads inevitably led to taxation to fund them. According to the Federal Highway Administration, just four states — Colorado, New Mexico, North Dakota and Oregon— had a motor fuel excise tax in 1919. A decade later, every state had some form of the tax. The federal government adopted its own motor fuels tax, at one cent per gallon, in 1932.

Texas enacted its tax on gasoline in 1923, also at a cent per gallon. The Legislature increased the rate to 3 cents per gallon in 1927 and 4 cents in 1929.

In 1931, the state defined the term "gasoline" to include any other product that could be used to power a motor vehicle on Texas highways. A decade later, Texas adopted separate tax rates for the three primary types of motor fuel we still recognize today: gasoline, diesel fuel and liquified gases. The initial diesel rate was set at 8 cents per gallon, while liquefied gases were taxed at 4 cents. Gasoline remained at 4 cents (**Exhibit 1**).

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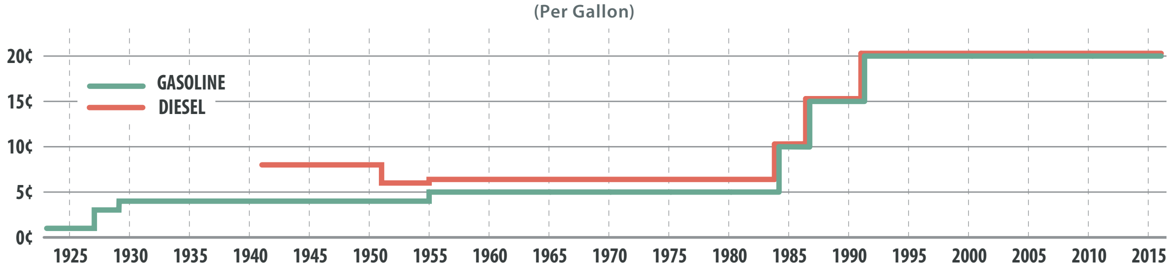
EXHIBIT 1

TEXAS MOTOR FUELS TAX RATES: 1923 TO PRESENT

(Per Gallon)



Source: Texas Comptroller of Public Accounts

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In Texas, motor fuel is taxed as it is withdrawn from a storage facility, commonly called a "terminal rack" or rack, which is usually its first stop after leaving the refinery. From the rack, the fuel either is trucked directly to gas stations and convenience stores, or shipped by truck or pipeline to a wholesale distributor.

As **Exhibit 1** illustrates, Texas' tax rates on gasoline and diesel have been remarkably stable in recent years, remaining at 20 cents per gallon since 1991.

Long periods of unchanging rates have been common. Gasoline stayed at 4 cents per gallon for 26 years and 5 cents for 29 years. In the latter 1980s, however — an economically turbulent period in Texas due to an oil bust — gas tax rates rose sharply, from 5 cents per gallon in 1984 to 20 cents in 1991. Diesel rates more than tripled in the same period, from 6.5 cents to 20 cents per gallon.

UNTAXED FUELS

Texas law provides a variety of exemptions from gasoline and diesel taxes. Federal agencies and Texas public school districts, or their bus contractors, are exempted. Another broad provision provides tax refunds for gasoline used "off-road" — in motorboats, lawnmowers, agricultural equipment and other non-vehicular, gasoline-powered devices.

Federal law requires the use of red dye, added at the rack, to maintain the distinction between taxable and nontaxable diesel. Red dye signifies that the fuel is intended for off-road uses, such as the powering of farm and construction equipment — a bulldozer, say. The only diesel fuel appropriate for on-road use is undyed, clear diesel.

Diesel, like gasoline, is taxed when first withdrawn from the rack, but state law places more limits on statutory refunds of the diesel fuel tax. For this reason, in Texas tax-free withdrawals of diesel from storage are more common than refunds on diesel taxes. Even so, such refunds are issued as needed; for example, a public school bus may be obliged to use clear diesel on a school trip. The school district would be eligible to receive a refund after purchasing the fuel.

EXHIBIT 2

MOTOR FUELS TAX RATES: FEDERAL AND 10 LARGEST STATES

2015
(In Cents per Gallon)

GASOLINE		DIESEL	
Florida	4.0	Florida	4.0
New York	8.0	New York	8.0
Federal Rate	**18.3**	California	13.0
Illinois	19.0	Michigan	15.0*
Michigan	19.0*	**TEXAS**	**20.0**
TEXAS	**20.0**	Illinois	21.5
Georgia	26.0	**Federal Rate**	**24.3**
Ohio	28.0	Ohio	28.0
California	30.0	Georgia	29.0
North Carolina	36.0**	North Carolina	36.0**
Pennsylvania	50.5***	Pennsylvania	64.2***

* State gasoline and diesel taxes will increase to 26.3 cents per gallon on Jan. 1, 2017.

** State gasoline and diesel taxes fell to 35 cents as of Jan. 1, 2016.

*** Rates changed to 50.3 cents for gasoline and 64.0 cents for diesel as of Jan. 1, 2016.

Sources: U.S. Energy Information Agency, National Conference of State Legislatures and State of Pennsylvania

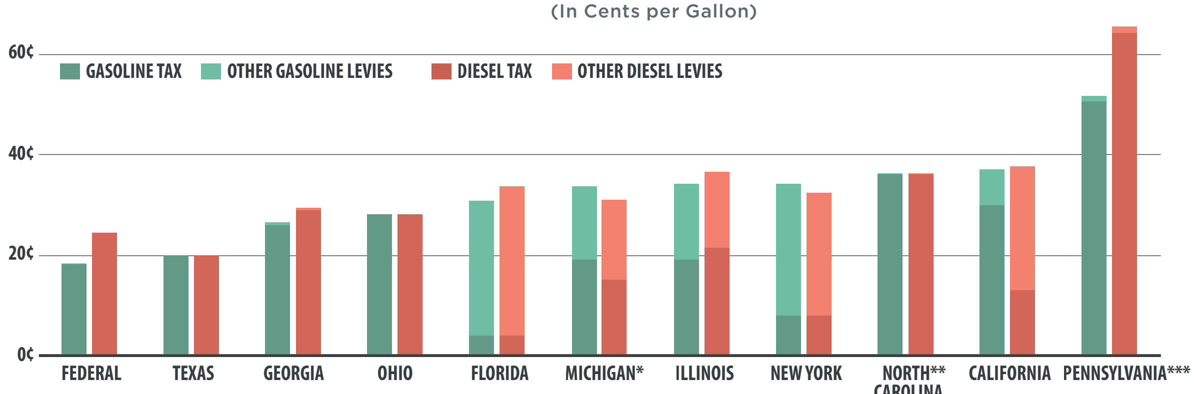
RATE COMPARISONS

Among the 10 most populous states, Texas ranks in the middle in terms of both its gasoline and diesel tax rates (**Exhibit 2**). Florida has the lowest rates, while Pennsylvania has the highest.

EXHIBIT 3

TOTAL LEVIES ON MOTOR FUELS: FEDERAL AND 10 LARGEST STATES

2015
(In Cents per Gallon)



* State gasoline and diesel taxes will increase to 26.3 cents per gallon on Jan. 1, 2017.

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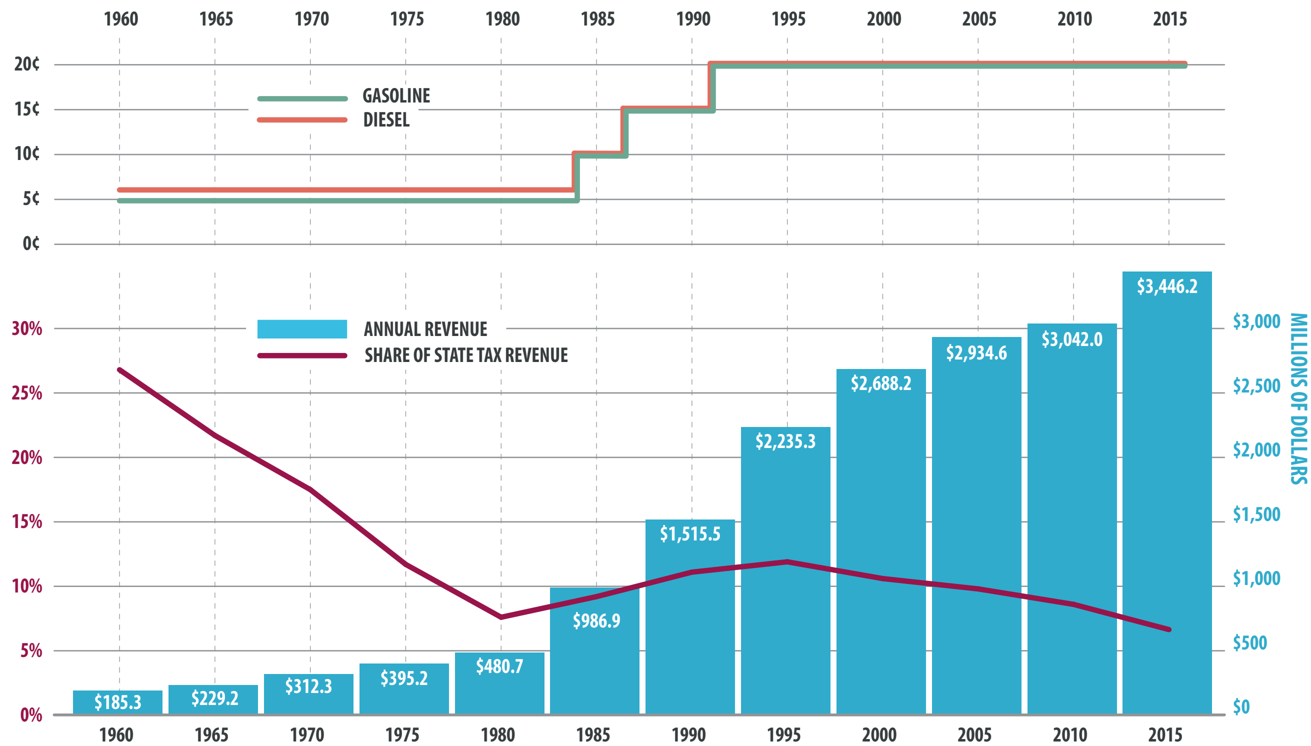
*** Rates changed to 50.3 cents for gasoline and 64.0 cents for diesel as of Jan. 1, 2016.

Sources: U.S. Energy Information Agency, National Conference of State Legislatures and State of Pennsylvania

EXHIBIT 4

TEXAS MOTOR FUELS TAX REVENUE AS A SHARE OF TOTAL STATE TAX REVENUE

Fiscal 1960-2015



Source: Texas Comptroller of Public Accounts

The primary tax rates, however, don't always tell the entire story. Many states add additional taxes, fees or charges to the main tax, significantly raising the final price of fuel at the pump. Texas doesn't. When *all* government levies on gasoline and diesel are considered, the ranking appears quite different (**Exhibit 3**).

In **Exhibit 2**, for example, Florida appears to have the lowest tax rates on gasoline and diesel. In fact, though, the state imposes *other* levies on motor fuel, including the state sales tax, a state transportation system tax and other assessments. These add-ons, according to the U.S. Energy Information Agency (EIA), equate to an additional 26.6 cents in levies per gallon of gasoline, and 29.7 cents per gallon for diesel.

Among the 10 largest states, five — California, Florida, Illinois, Michigan and New York — add sales tax to the price of fuel at the pump.

Florida also adjusts its tax rates to compensate for inflation. North Carolina plans to link its rate to population growth and the Consumer Price Index (CPI) in 2017. Michigan will link its rates to the CPI beginning in 2022.

Some states also have local-option taxes and/or fees, although these are not presented in the exhibits.

Finally, the federal government also adds a 0.1 cent per gallon fee to its motor fuels taxes to remediate leaking underground storage tanks.

While motor fuels taxes still comprise an important part of Texas tax collections, their share has declined sharply over the decades.

When *total* levies are considered, Texas' taxes on gasoline and diesel are the lowest among the 10 largest states. Adding in the federal tax, Texans pay 38.4 cents in taxes for every gallon of gasoline they buy, and 44.4 cents per gallon for diesel. Pennsylvanians, by contrast, paid roughly twice as much in 2015, at 70 cents and 89.7 cents per gallon, respectively.

GRAND TOTALS

Out of the $3.4 billion in state motor fuels taxes collected in fiscal 2015, net revenue from the gasoline tax totaled nearly $2.6 billion; diesel accounted for $860.9 million; and other motor fuels, such as liquefied and compressed natural gas, brought in the remaining $5.1 million. Gasoline and diesel thus made up more than 99.8 percent of all motor fuel receipts, with gasoline alone comprising about three-quarters of the entire amount.

While motor fuels taxes still comprise an important part of Texas tax collections, their share has declined sharply over the decades. In 1960 — prior to the enactment of the Texas sales tax — these taxes contributed

CONTINUED ON PAGE 10

more than a quarter of the state budget (**Exhibit 4**). Interestingly, this decline occurred even though the tax rates quadrupled, a pattern attributable to a variety of factors including increasing sales tax rates and the Legislature's extension of the tax to more goods and services.

A TROUBLED TAX?

In Texas and many other states, motor fuels tax collections have begun to fall behind in their ability to meet the ever-rising cost of the transportation projects they support. Federal motor fuels taxes face the same problem; a 2009 Congressional study found that, "Because it is not adjusted for inflation, the federal gas tax has experienced a cumulative loss in purchasing power of 33 percent since 1993."

Similarly, the Texas A&M Transportation Institute's (TTI's) 2016 publication *Gas Tax Facts* states that, "Because of inflation, we have less and less money available to pay for roads and bridges." In 2015, TTI reported to a Texas legislative committee that the actual purchasing power of the state's gasoline tax, set at 20 cents per gallon in 1991, had fallen to 6.8 cents by 2014 due to inflationary effects.

Meanwhile, transportation costs have accelerated dramatically. In the 10 years from fiscal 2003 to 2013, the state's motor fuels tax revenue rose by 13.5 percent. But according to Texas Department of Transportation data, the cost of building roads and bridges went up by *83.4 percent* over the same period (**Exhibit 5**). (Costs in road construction are rising much faster than the general inflation rate; according to the U.S. Bureau of Labor Statistics, the general rate as measured by the CPI amounted to 27 percent between 2003 and 2013.)

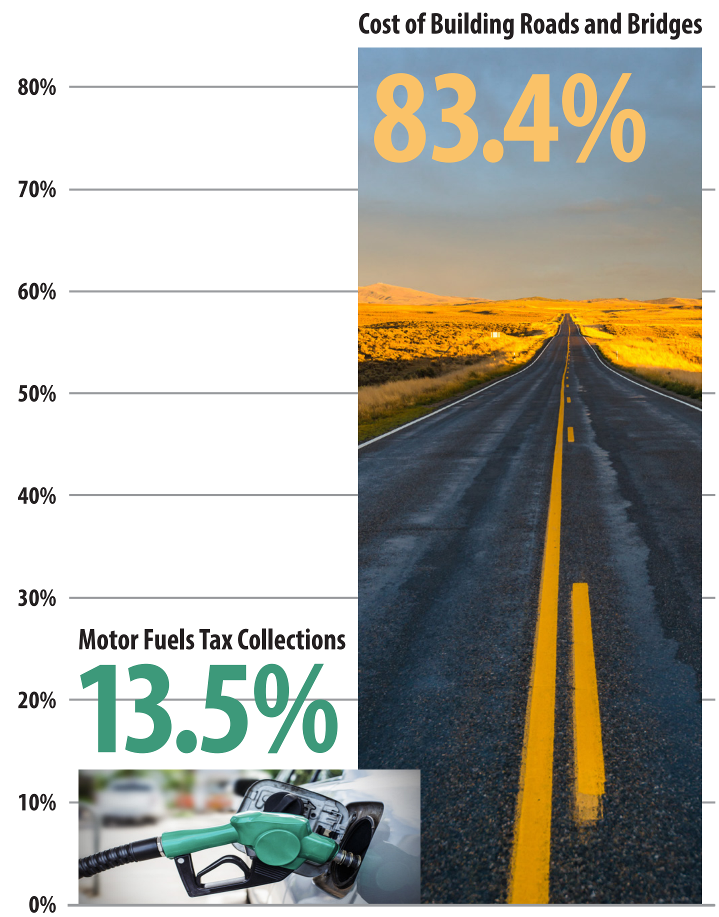
If the mismatch between the rate of growth in revenue collections and highway costs persists, motor fuels taxes will only be able to support an ever-declining amount of road and bridge construction and maintenance, even as the demand for transportation infrastructure increases.

As noted above, some states have sought to supplement motor fuels tax revenues with supplemental levies, inflation indexing and other measures. These methods are not without risk, however, and not only from voter disapproval. Kentucky, for instance, attempted to take advantage of once-soaring energy prices by linking its gasoline tax rate to the average wholesale price. When prices plunged, so did the tax rate and revenues, forcing the state to establish a minimum "floor" for the tax in 2015. **FN**

EXHIBIT 5

INCREASE IN MOTOR FUELS TAX REVENUE vs. ROAD CONSTRUCTION COSTS

2003-2013



Source: Texas Department of Transportation

State Revenue Watch

This table presents data on net state revenue collections by source. It includes most recent monthly collections, year-to-date (YTD) totals for the current fiscal year and a comparison of current YTD totals with those in the equivalent period of the previous fiscal year.

These numbers were current at press time. For the most current data as well as downloadable files, visit **TexasTransparency.org**.

Note: Texas' fiscal year begins on Sept. 1 and ends on Aug. 31.

NET STATE REVENUE — All Funds Excluding Trust

(AMOUNTS IN THOUSANDS)

Monthly and Year-to-Date Collections: Percent Change From Previous Year

Tax Collections by Major Tax	DECEMBER 2015	YEAR TO DATE: TOTAL	YEAR TO DATE: CHANGE FROM PREVIOUS YEAR
SALES TAX	$2,330,433	$9,427,149	-2.12%
PERCENT CHANGE FROM DECEMBER 2014	-1.09%		
MOTOR VEHICLE SALES AND RENTAL TAXES	$361,509	$1,547,078	2.00%
PERCENT CHANGE FROM DECEMBER 2014	4.96%		
MOTOR FUEL TAXES	$269,261	$1,164,803	0.94%
PERCENT CHANGE FROM DECEMBER 2014	-4.14%		
FRANCHISE TAX	-$145,302	-$185,602	-58.23%
PERCENT CHANGE FROM DECEMBER 2014	-54.25%		
INSURANCE TAXES	$16,545	$70,144	-3.89%
PERCENT CHANGE FROM DECEMBER 2014	3.02%		
NATURAL GAS PRODUCTION TAX	$78,131	$308,991	-48.14%
PERCENT CHANGE FROM DECEMBER 2014	-47.71%		
CIGARETTE AND TOBACCO TAXES	$123,938	$433,790	-14.02%
PERCENT CHANGE FROM DECEMBER 2014	-13.23%		
ALCOHOLIC BEVERAGES TAXES	$90,134	$378,001	3.62%
PERCENT CHANGE FROM DECEMBER 2014	1.96%		
OIL PRODUCTION AND REGULATION TAXES	$160,971	$648,719	-48.91%
PERCENT CHANGE FROM DECEMBER 2014	-42.68%		
UTILITY TAXES[1]	$641	$117,877	-4.57%
PERCENT CHANGE FROM DECEMBER 2014	-69.75%		
HOTEL OCCUPANCY TAX	$37,915	$170,973	1.61%
PERCENT CHANGE FROM DECEMBER 2014	6.79%		
OTHER TAXES[2]	$9,502	$46,216	-43.72%
PERCENT CHANGE FROM DECEMBER 2014	-50.42%		
TOTAL TAX COLLECTIONS	$3,333,680	$14,128,139	-6.06%
PERCENT CHANGE FROM DECEMBER 2014	-1.90%		

Revenue By Source	DECEMBER 2015	YEAR TO DATE: TOTAL	YEAR TO DATE: CHANGE FROM PREVIOUS YEAR
TOTAL TAX COLLECTIONS	$3,333,680	$14,128,139	-6.06%
PERCENT CHANGE FROM DECEMBER 2014	-1.90%		
FEDERAL INCOME	$3,404,106	$13,155,053	3.84%
PERCENT CHANGE FROM DECEMBER 2014	-10.03%		
LICENSES, FEES, FINES AND PENALTIES	$935,147	$3,722,033	19.04%
PERCENT CHANGE FROM DECEMBER 2014	-12.15%		
INTEREST AND INVESTMENT INCOME	$43,305	$155,991	-39.20%
PERCENT CHANGE FROM DECEMBER 2014	-70.08%		
NET LOTTERY PROCEEDS[3]	$177,988	$640,720	2.63%
PERCENT CHANGE FROM DECEMBER 2014	4.05%		
SALES OF GOODS AND SERVICES	$34,448	$105,829	12.02%
PERCENT CHANGE FROM DECEMBER 2014	22.41%		
SETTLEMENTS OF CLAIMS	$501,879	514,406	7.55%
PERCENT CHANGE FROM DECEMBER 2014	7.01%		
LAND INCOME	$156,558	$422,322	-37.24%
PERCENT CHANGE FROM DECEMBER 2014	133.25%		
CONTRIBUTIONS TO EMPLOYEE BENEFITS	$5	$17	-20.41%
PERCENT CHANGE FROM DECEMBER 2014	-6.64%		
OTHER REVENUE	$347,211	$1,365,967	20.78%
PERCENT CHANGE FROM DECEMBER 2014	-3.98%		
TOTAL NET REVENUE	$8,934,325	$34,210,478	0.35%
PERCENT CHANGE FROM DECEMBER 2014	-5.83%		

[1] Includes public utility gross receipts assessment, gas, electric and water utility taxes and gas utility pipeline tax.

[2] Includes the cement and sulphur taxes and other occupation and gross receipts taxes not separately identified.

[3] Gross sales less retailer commissions and the smaller prizes paid by retailers.

Note: Totals may not add due to rounding.

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