

SUBJECT: Sales tax exemption for clothing and footwear during a limited period

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 8 ayes — Oliveira, McCall, Bonnen, Craddick, Keffer, T. King, Ramsay, Sadler

1 nay — Heflin

2 absent — Y. Davis, Hilbert

WITNESSES: None

BACKGROUND: The state sales tax is the largest source of tax revenue for Texas, accounting for about 55 percent of state tax receipts. The tax is applied on certain transactions, typically on the final sale or rental of tangible personal property and on some services. The sales tax was enacted in 1961, and the state sales tax rate has been 6.25 percent since 1990. Local taxing entities may add local sales taxes that collectively may not exceed 2 percent.

Tax Code, sec. 151.301 et seq. exempts various tangible items and services from imposition of the tax and exempts certain purchasers from paying the tax. Some basic necessities are exempted, including groceries, prescription medications, and other health-care needs, residential natural gas and electric utility service, and water. Currently, all state sales tax exemptions apply year-round. State sales tax exemptions also apply to local sales taxes, as provided by Tax Code, sec. 321.208.

Current law does not exempt clothing or footwear from the sales tax, except for specialized footwear designed for rehabilitation or medical treatments. Current law does not authorize local governments to prevent or repeal the application of state sales tax exemptions to their local sales taxes.

DIGEST: CSHB 2280 would exempt from the state sales tax certain footwear and clothing for a nine-day period in August. It would allow local governments to repeal the application of the exemption to the local sales tax in their areas beginning January 1, 2000.

The exemption would apply to shoes and clothing costing less than \$75 and sold between the first Saturday in August and the second Sunday after the first Saturday in August. The exemption would *not* apply to any clothing or footwear designed primarily for athletic activity or protective use; accessories such as jewelry, handbags, and watches; or the rental of clothing or footwear. The bill would exempt tailoring or other services applied to exempted clothing and footwear.

The bill would add chapter 326 to the Tax Code to authorize local taxing authorities to repeal the application of a sales tax exemption to their local sales taxes. The new chapter would enable local governments, by a majority vote after a public hearing, to repeal the local tax exemption provided by CSHB 2280 for clothing and shoes. Local governments could not repeal any other application of a state sales tax exemption to their local taxes unless Tax Code, chapter 151 specifically authorized them to do so. A local taxing authority could reinstate the local tax exemption in the same manner.

The bill would authorize the comptroller to adopt emergency rules to implement its provisions.

CSHB 2280 would take effect on the first day of the first calendar quarter beginning on or after the date that it could take effect under the state constitution. If the bill were finally passed by a two-thirds record vote of the membership of each house, the exemption would take effect on July 1, 1999. Otherwise, the bill would take effect October 1, 1999.

**SUPPORTERS
SAY:**

CSHB 2280 would help Texas families by providing a sales tax “holiday” immediately before the start of a school year for moderately priced clothing and footwear. Despite a growing economy, many families are struggling to make ends meet. This bill would help poorer families in particular, because sales taxes take a higher percentage of their household income. Sales taxes consume about 7 percent of the income earned by the poorest 20 percent of families in Texas.

The state currently exempts from the sales tax necessities such as groceries, health-care needs, and utilities. All Texans need clothing and footwear. Growing children need new clothes and shoes every year, and most parents take them “back to school” shopping right before the new school year begins. For a family with two school-age children, the sales tax holiday provided by

this bill would mean a savings of about \$20, about the price of a pair of blue jeans.

The bill would limit the exemption by excluding apparel and shoes primarily used for athletic activities, accessories such as jewelry and handbags, and the rental of clothing. Maintaining the sales tax on these items and capping the sale price at \$75 would keep the fiscal note down and allow tax relief to be given only to essential items.

This tax exemption would cost the state an estimated \$158 million in general revenue-related funds through fiscal 2001 if the bill took effect July 1, 1999, or \$93 million if it took effect October 1, 1999. Unlike property or franchise tax cuts, 100 percent of the tax exemption provided by CSHB 2280 would go directly to consumers. This bill would be an effective way to give money back to families who need it most, and its cost would be relatively small compared with that of other, broader proposals.

The sales tax holidays in New York and Florida have been highly successful for consumers and retailers. Most retailers run promotions to coincide with the sales tax holiday, lowering costs to consumers even more and allowing retailers to clear their seasonal inventories. Many items priced just beyond the maximum price qualifying for an exemption are put on sale, creating an even bigger savings for consumers. Retailers have experienced strong sales growth during the tax holidays, and any expense incurred by retailers to implement the holiday is made up by increased sales. Sales tax holidays in New York and Florida have attracted consumers from other states, bringing more money into local economies.

CSHB 2280 would allow local governments to retain their sales tax revenues, lessening the potential for this exemption to harm local finances. Beginning in 2000, local taxing authorities could opt to reinstate their local sales tax rates on clothing and footwear sold during the state sales tax holiday.

**OPPONENTS
SAY:**

Taxes should not be reduced until schools, health care, and human service programs are fully funded. Teacher salaries are well below the national average. Texas ranks 35th nationally in per-capita elementary and secondary education spending and 40th in per-capita health and human services spending, despite the fact that one-fifth of the state's population lives in

poverty. More than one million Texas children are without health insurance. Because of these substantial unmet needs, taxes should not be reduced now.

If the Legislature determines that a tax cut is desirable, broad-based tax-rate reductions would produce more benefits for the state economy in terms of job creation and capital formation in relation to the revenue the state would lose. Narrow exceptions to taxation do help some Texans, but they produce little in terms of overall economic benefit. All Texans have contributed to the state through higher taxes, and all Texans should share fairly in a tax cut. Texas families would be served better by a reduction in the sales tax rate than by a series of specific exemptions aimed at limited numbers of families.

OTHER
OPPONENTS
SAY:

Appropriations are justified and reviewed biennially. Tax exemptions ought to be reviewed periodically as well. The Legislature should require the comptroller to prepare a report on the effectiveness and economic benefit of tax incentives. Such a report would provide the Legislature with sufficient quantitative evidence to determine whether these incentives should be extended, modified, or eliminated.

NOTES:

SB 441 by Ellis would provide a sales tax exemption for clothing and footwear costing less than \$200 and sold during a two-week period beginning the first Saturday of August. It would also exempt over-the-counter drugs and medicines aimed at people 12 years of age and younger in a manner identical to CSHB 2372 by Gutierrez. SB 441 also would exempt diapers from the sales tax, a provision similar to that of CSHB 2371 by Gutierrez. SB 441 passed the Senate on April 8 and has been referred to the House Ways and Means Committee.