SUBJECT: Classifying apparel rental companies as retail for franchise tax purposes

COMMITTEE: Ways and Means — favorable, without amendment

VOTE: 9 ayes — Hilderbran, Otto, Christian, Elkins, Gonzalez, Lyne, Murphy, Villarreal, Woolley

0 nays

2 absent — Martinez Fischer, Ritter

WITNESSES: For — Stuart Gaylor, Al's Formal Wear; (*Registered, but did not testify:* Brad Shields, Al's Formal Wear; Ronnie Volkening, Texas Retailers Association)

Against — None

BACKGROUND: Tax Code, sec. 171.002, imposes a franchise tax on businesses engaged in retail trade at 0.5 percent of taxable margin. Other businesses are taxed at 1 percent of taxable margin under sec. 171.001.

Tax Code, sec. 171.0001(12) defines "retail trade" as the activities described in Division G of the 1987 Standard Industrial Classification Manual published by the federal Office of Management and Budget. According to the U.S. Department of Labor, Division G includes establishments engaged in selling merchandise for personal or household consumption and rendering services incidental to the sale of the goods. A retail trade establishment usually buys or receives merchandise in addition to selling it. The establishment may process its products, but such processing is incidental or subordinate to selling. The establishment is considered retail in the trade, since the establishment sells to customers for personal or household use.

DIGEST: HB 3326 would add apparel rental activities to the definition of retail trade for franchise tax purposes. The bill would define "apparel rental activities" as those apparel rental activities classified as Industry 5999 or 7299 of the 1987 Standard Industrial Classification Manual published by the federal Office of Management and Budget.

The bill would take effect on January 1, 2012, and would only apply to franchise taxes due on or after that date.

SUPPORTERS SAY:

Companies that sell and rent apparel should be taxed as retailers. HB 3326 would classify apparel rental businesses as retail businesses for franchise tax purposes. The franchise tax defines retail businesses through references to federal classifications. While this largely works well, it can lead to some businesses being left out of the definition of retail trade when they should be included. The U.S. Department of Labor lumps apparel rental businesses together with babysitting bureaus, dating services, diet workshops, marriage bureaus, locker rentals, tanning salons, Turkish baths, tattoo parlors, wedding chapels, and others as "Not Elsewhere Classified." Under current Texas law, Not Elsewhere Classified does not fall under the franchise tax definition of retail business. HB 3326 would properly include apparel rental with retail where it belongs.

Businesses that engage in apparel rental activities are part of the retail community and should be taxed as such. These companies sell products as well as rent certain items. They also have a business model similar to traditional retail businesses: they operate from storefronts, run on small margins, have high employee costs, and collect and remit sales taxes. These were the same characteristics defined by the Legislature when it assigned a 0.5-percent tax rate rather than the 1-percent tax rate when it created the new franchise tax in 2006.

OPPONENTS SAY:

HB 3326 will cause a loss to needed state revenue. Every dollar lost to a tax break is a dollar less to help those who cannot help themselves or a dollar less to make investments in our future through education and health care. The Legislature should hold the line and protect the revenue it has left.

NOTES:

According to the LBB's fiscal note, HB 3326 would result in a loss of $243,000 during fiscal 2012-13.