



TEXAS RESEARCH LEAGUE

BULLETIN

on Texas State Finance

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- Jared E. Hazleton, President

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EXPANDING THE SALES TAX

Broadening the sales tax base and revising the corporation franchise tax are the two major elements of Comptroller Bob Bullock's tax restructuring proposal. Bulletin No. 7 described the franchise tax recommendations; this Bulletin summarizes the main features of the sales tax plan.

BACKGROUND

The sales tax was intended to be a "limited" tax when first enacted in 1961, and has changed very little in character since then. Consequently, it primarily applies to the final sale of tangible personal property; very few services are taxable. As a result, the Comptroller estimates that only 5% of state sales tax revenue now comes from taxing services, although service industries account for over half of all consumer purchases and have accounted for more than half of the new jobs created over the past five years.

By including most services in the tax base, the Comptroller's plan is to change the sales tax to reflect the state's emerging economy based on sales and trade. Doing so would bring the services share of total sales tax receipts to an estimated 16%.

SERVICES INCLUDED

Under the proposal all services, unless specifically exempted, would be subject to the sales tax. Services would be very broadly defined as "any activity or conduct engaged in for another person for a consideration." In addition, financial, transportation, and information services would be specifically defined and taxed.

Professional services also would be specifically included and would be defined as those provided by a person required to hold a state or federal license for which an examination was taken. This definition is only added for emphasis since all services, professional or otherwise, would be included under the general definition.

Service providers would be treated just like retailers. They would be required to hold a sales tax permit, get resale and exemption

certificates when necessary, and collect and remit taxes on their taxable services. Similarly, just like retail merchants do now, they could choose to add the tax to their bills or bill their customers on a tax included basis without stating the taxes separately.

Services also would be treated just like tangible personal property for purposes of taxation. Most importantly, services performed in Texas for use out-of-state would be exempt, just as out-of-state sales of goods are now. Conversely, services performed out-of-state but used in Texas would be taxable here. Use would be defined as "the derivation in this state of direct or indirect benefit from the service."

EXEMPTIONS

The current exemptions for groceries, prescription drugs, residential and industrial utilities, agricultural items, sales to nonprofit organizations, components of manufactured products, and sales for resale would be retained.

A number of new exemptions would be created for some services: medical and dental care, licensed child care, veterinary services, advertising, construction services, insurance premiums and commissions, newspaper and magazine sales, tuition and fees for public and private nonprofit schools, motor vehicle inspection fees, and fees charged by government agencies for certain services.

The proposal also would exempt intercorporate sales of services between members of the same corporate family - defined generally to include those that file a single consolidated federal income tax return. In addition, such exempted services could not be purchased for resale by the providing company and the exemption would not extend to any services that are taxable under current law.

A significant new exemption would be provided for purchases of manufacturing machinery, equipment, and replacement parts or accessories. This would take the form of a credit against taxes paid each year on such purchases, phased in over a five year period at 20% a year until such purchases become fully exempt in 1992.

OTHER TAXES

Under the proposed plan several relatively minor taxes would be repealed and the items to which they now apply would become subject to sales taxation. These include the telephone gross receipts tax, well servicing tax, hotel-motel tax, and the boxing and wrestling gross receipts tax. In addition, the crude oil pipeline regulatory tax would be repealed and the motor vehicle sales tax rate would be set at the same rate as the general sales tax.

REVENUE IMPACT

The new taxing scheme would take effect on January 1st of next year; until then, the temporary 5.25% sales tax rate (up from 4.125%), scheduled to expire at the end of August, would be maintained. At a rate of 4.5% on the proposed expanded base, the sales tax is estimated to produce an additional \$1.9 billion for the 1988-1989 biennium -- approximately the same amount as would be gained by extending the 5.25% rate on the current base. Each additional .25% added to the proposed 4.5% rate would produce about another \$.5 billion in state tax revenue.