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Hold on to your wallets: Legislature looking for more revenue

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AUSTIN -- Haircuts, children's day care, dental work and bottled water are among the everyday goods and services now exempt from the state sales tax.

But Texas lawmakers are preparing to tackle a projected budget shortfall of at least \$11 billion, and removing some sales tax exemptions is going to get serious consideration as the state seeks to boost revenue.

Tax exemptions overall -- there are also property tax exemptions -- are an attractive potential revenue source because there are scores of them totaling billions of dollars each year.

By far the largest assortment of exemptions -- what Senate Finance Committee Chairman Steve Ogden, R-Bryan, describes as the "enchilada" -- are those for the state sales tax, the largest source of state tax revenue.

In the 2009 fiscal year that ended Aug. 31, sales tax exemptions on items ranging from tattoos and pedicures to basic essentials like food and water totaled \$30 billion, according to the Texas Comptroller's Office. That total easily surpassed the \$21 billion that the state tax generated in revenue that year, though about \$8.1 billion in sales tax exemptions are on items taxed under other laws.

Other exemptions are granted for the franchise tax, gasoline tax, the natural gas tax and the motor vehicles sales tax. Exemptions to property taxes for local school districts, which influence the amount of aid provided by the state, totaled \$5.5 billion in the 2009 fiscal year, according to the comptroller's office.

At the request of House Speaker Joe Straus, the House Ways and Means Committee has been conducting hearings to take a fresh look at the many sales tax exemptions, some of which have been in place since the sales tax was enacted nearly 50 years ago. "We are looking at every single thing," Committee Chairman Rene Oliveira, D-Brownsville, told the *Star-Telegram*.

At a hearing of his Finance Committee last week, Ogden raised concerns that exemptions have become so numerous that they may be resulting in wholesale violations of the state constitution's guarantee that taxes be fair, equal and uniform.

"I personally feel that the state of Texas has made a big mistake over the last 30 years or so of carving out exemptions and constitutional provisions that identify one or another special interest for different tax treatment," he said in a telephone interview. "We've gone way beyond what most people would have imagined as a fair, uniform and equitable tax system."

Jitters among lobbyists

The renewed look at tax breaks has generated a widespread case of jitters among lobbyists and interest groups, who are scrambling to build a case for their particular exemptions before next year's legislative session. Many of the exemptions have powerful constituencies that would strongly resist any change.

"Any business or industry that benefits from such exemptions or exclusions would be well-advised to watch the interim hearings and be very involved in the session, because there won't be many exclusions or exemptions that won't be on the table," said Gaylord Armstrong, a senior partner at the law firm of McGinnis, Lochridge & Kilgore and a veteran lobbyist who represents a variety of business, industry and trade associations.

Senior lawmakers and lobbyists predict that exemptions on the essentials of life -- such as food and healthcare -- are likely to stay in place, saying that any attempt to remove them would ignite a political backlash.

But other tax breaks could be more vulnerable as lawmakers struggle to craft a new two-year budget in the state's tight economic climate.

"There are some sacred cows out there that we're not likely to touch," said Oliveira, citing food, medicine and healthcare as examples. "But to me there shouldn't be a whole lot of sacred cows."

Oliveira said his committee is gathering information and may not have a firm picture until January of which exemptions if any should be lifted. But he said that virtually everything is on the table, including exclusions for a diverse range of services, such as barbers and hairdressers, accountants, day care, physicians, carwashes, dentists, lawyers and architects. The service exclusions total \$5.3 billion, making them an inviting target for those eyeing new sources of revenue.

The committee chairman said he has some thoughts about which exemptions warrant a close look, but he declined to specify them.

"I'm carrying around a list in my pocket. There are probably about a dozen of them that we should debate, and as we go along there should probably be more," he said, adding that it would be "irresponsible" not to consider exemptions that may be obsolete.

But Oliveira said that "there's a lot that needs to be done before we can turn this into a piece of successful legislation" and acknowledged that a possible rollback on even some exemptions would face stiff resistance.

"The political will hasn't been tested or determined, and I would need to see and hear bipartisan support for this," he said. "I'm not going to ask my Democratic colleagues to vote for this when Republicans are not going to vote for it."

Ogden also acknowledged that tackling exemptions would be a test of the Legislature's political will, but he said that many taxpayers are growing angry with the perception that some Texans "don't have to pay a dang thing."

Other Republicans, including Rep. Phil King of Weatherford, are pushing the idea of broadening the sales tax to replace overburdened school property taxes.

But King said he would oppose removing sales tax exemptions as a way to boost revenue, saying any expansion of the sales tax should be "revenue neutral" and used only to bring about a proportionate decrease in property taxes.

Groups prepare to fight

Oliveira's hearings constitute the first broad-based review of sales tax exemptions in years and have generated a buzz about which are likely targets. Bottled water, which currently isn't taxed, is mentioned as a possible new revenue source, but retailers are gearing up to defend those exemptions.

"We are watching those hearings very closely," said Ronnie Volkening, president of the Texas Retailers Association, saying that bottled water should be considered in the same category as food. "Water is essential to life," he said. "Any time there is a natural disaster, one of the greatest needs is to get bottled water to people."

As far as other drinks, Volkening said it would be "very difficult to administer the difference" in the food value of different products, raising the prospect of inadvertent errors.

The state's medical community is prepared to fend off a possible tax on cosmetic surgery. "Medical practices are really not traditional businesses, and we don't think the patients of Texas should be taxed for their healthcare," said Dr. Susan Bailey, a Fort Worth allergist who will become president of the Texas Medical Association on May 1.

In many instances, she said, cosmetic surgery is often used for reconstructive purposes, such as for patients who have undergone surgery for breast cancer. "It's difficult to take any one medical procedure and say that it's not medically necessary," she said.

Fort Worth-based American Airlines is teaming with the other three Texas-based air carriers -- Southwest Airlines, Continental Airlines and Express Jet, a regional carrier -- to deflect possible taxes on aircraft sales, spare parts, maintenance services and jet fuel.

"We think the state has benefited hugely from not having a tax on these things," said Dan Hagan, American's managing director for state and community affairs, who wrote Oliveira last month to spell out the airlines' concerns.

Spreading the burden

Many Republican lawmakers, free-market advocates and business groups argue that removing exemptions constitutes a tax increase that would impose further misery on consumers who have already endured personal hardships during the recession. Gov. Rick Perry has vowed to get through the budget crunch without a tax increase, raising the prospect that he would veto anything perceived as a tax increase.

"Removing tax exemptions simply to enable more government spending would reduce Texas' economic advantage," said Justin Keener, vice president of policy and communications for the Texas Public Policy Foundation, which supports policies that promote private property rights and limited government.

"The high unemployment rates and chronic budget problems suffered by those other states are strong arguments against becoming like them," Keener said.

But others contend that lifting exemptions is not a tax increase and instead would more fairly spread the tax burden, generating revenue needed to avert a drastic cut in services such as healthcare and overdue improvements in the state's transportation system.

"Either we're going to have to shut down some of these exemptions, or we're going to have to shut down programs for school kids, sick children or drivers who want to get to work on time in the morning," said Dick Lavine of the Center for Public Policy Priorities, which advocates programs and policies that help low-income Texans.

Sales tax history

The sales tax was enacted in 1961 and quickly claimed a high-profile casualty. Then-Gov. Price Daniel opposed a sales tax but allowed the law to go into effect without his signature to keep the state from going broke, according to the Handbook of Texas. He was defeated for re-election to an unprecedented fourth two-year term, in part because voters blamed him for the new tax.

Many exemptions were included with original law, including oil, sulfur and motor vehicle sales that are taxed under other laws. Exemptions on healthcare and food for human consumption have also been in place since 1961. Others were added over the years to stoke or protect various aspects of the state's socioeconomic structure.

Exemptions for film production were added in 1999, reflecting the state's emerging film industry. An exemption on certain timber items was added in 2001, becoming fully effective in 2008.

The tax is imposed on retail sales, leases and rentals as well as designated services. Cities, counties, transit authorities and special purpose districts have the option of imposing additional local sales taxes for a combined total of 8 1/4 percent. The state's tax is 6 1/4 percent.

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