

- SUBJECT:** Sales tax exemption for diapers
- 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.
- DIGEST:** CSHB 2371 would exempt diapers from the sales tax. Diapers purchased, sold, or used by a diaper service would not qualify for the exemption and would continue to be taxed.
- CSHB 2371 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 July 1, 1999. Otherwise, the bill would take effect October 1, 1999.

**SUPPORTERS
SAY:**

CSHB 2371 would help Texas families by eliminating the sales tax on diapers, an essential product for all families with an infant and for a number of elderly Texans. 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 tax exemption provided by CSHB 2371 would mean the equivalent of one month of free diapers, at an estimated cost to the state of \$64 million in general revenue-related funds through fiscal 2001. 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.

**OPPONENTS
SAY:**

Taxes should not be reduced until schools, health care, and human service programs are fully funded. Texas ranks 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 1 million Texas children are without health insurance.

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.

A more broad-based approach to tax reduction also would minimize the impacts on local governments. Once an item is exempted from the state sales tax, it also is exempted from all local sales taxes. Not all cities, counties, transportation authorities, and other taxing districts have large surpluses allowing them to exempt items from the sales tax.

**OTHER
OPPONENTS
SAY:**

The bill should not discriminate against families who use diaper services. Families from all income levels use diaper services because they are often less expensive than disposable diapers, and cloth diapers are better for the environment than disposable diapers. Most diaper services are small businesses providing essential services for families that use them. Since the

intent of CSHB 2371 is to provide tax relief to families facing the high costs of caring for an infant, it should exempt cloth diapers sold and used by diaper services, too. There would be no significant change to the fiscal note if diaper services were included in the exemption.

Appropriations are justified and reviewed biennially. Tax exemptions — which, like appropriations, involve the directing of state funds — 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:

The committee substitute amended the original bill by excluding diaper services from the exemption and restoring insulin to the list of exempted items. The original bill's removal of insulin from the list was not intended and would not have eliminated this exemption, as insulin would be covered under prescribed medications. However, to avoid potential misunderstanding, the substitute restored the explicit exemption for insulin.

SB 441 by Ellis would exempt all diapers from the state sales tax, including those related to diaper service. It also would exempt over-the-counter drugs and medicines aimed at people 12 years of age and younger, a provision identical to that of CSHB 2372 by Gutierrez. SB 441 also would exempt certain clothing and footwear from the sales tax, a provision similar to that of CSHB 2280 by Dutton. SB 441 passed the Senate on April 8 and has been referred to the House Ways and Means Committee.