

- SUBJECT:** Sales tax exemption for children’s non-prescription medications
- 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 exempts from the sales tax prescription drugs dispensed for human or animal use, insulin, hypodermic syringes, and a variety of prescribed items related to health care. Over-the-counter medicines are exempt only if they are prescribed.
- DIGEST:** CSHB 2372 would exempt from the sales tax over-the-counter drugs and medicines specifically formulated and labeled for children 12 years of age or younger, regardless of whether those drugs and medicines were prescribed. Only drugs and medicines labeled with a national drug code issued by the

federal Food and Drug Administration (FDA) would qualify for the exemption.

CSHB 2372 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, it would take effect October 1, 1999.

**SUPPORTERS
SAY:**

CSHB 2372 would help Texas families by eliminating the sales tax on essential medications that all families buy for their younger children. 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.

Families hardest hit by the sales tax are also the least likely to have adequate health insurance. Taxes on children's medicines are a burden to lower-income families who cannot easily obtain prescription drugs, which are exempt from the sales tax under current law. Because their children often are able to take only non-prescription drugs, these families must pay sales taxes on every medication they buy for their children.

This bill reflects trends in health care to rely increasingly on non-prescription medications to treat routine illnesses. The sales tax exemption for prescription medications has been in place since the inception of the sales tax in 1961. At that time, medications were dispensed predominantly in pharmacies on the orders of a physician.

This tax exemption would cost the state an estimated \$51 million in general revenue-related funds through fiscal 2001 if the bill took effect July 1, 1999. CSHB 2372 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 has substantial unmet needs in all of those areas.

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:

All over-the-counter medications bought without a prescription should be exempt from the sales tax, or else none should be. CSHB 2372 would create a confusing distinction between medications that are exempt and others that are not. Not all medications used by children age 12 and younger would qualify, because many drugs are not labeled or formulated specifically for the exclusive use of these children. Consumers would have to choose carefully among a dizzying array of products to find only those labeled for children to qualify for the exemption. Many common-cold and pain-relief medicines can be used by younger children but are not labeled specifically for them.

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 original bill would have allowed the comptroller to define by rule which drugs or medicines would be exempt from the sales tax, using categories established by the FDA. The committee substitute defined which over-the-counter drugs would be exempt by limiting them to drugs with a national drug code specifically formulated and labeled for children 12 years old and

younger. The effect of the committee substitute was to reduce the fiscal note by \$180 million.

SB 441 by Ellis would provide an identical exemption for over-the-counter drugs and medicines aimed at people 12 years of age and younger. It also would exempt certain clothing and footwear from the sales tax, a provision similar to that of CSHB 2280 by Dutton. 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.