HOUSE
RESEARCH
ORGANIZATION bill analysis 5/11/2009

HB 3131
Hartnett, Jackson
(CSHB 3131 by Hartnett)

SUBJECT: Margins tax exclusion for qualified destination management companies

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 9 ayes — Oliveira, Bohac, Hartnett, C. Howard, P. King, Paxton, Peña, Taylor, Villarreal

0 nays

2 absent — Otto, Hilderbran

WITNESSES: For — Laurie Sprouse, Ultimate Ventures, Association of Destination Management Executives; (*Registered, but did not testify:* Justin Bragiel, Texas Hotel and Lodging Association, Texas Association of Convention and Visitors Bureaus; Glen Ganey, Texas Restaurant Association; Lance Lively, Will Newton, National Federation of Independent Businesses - Texas; Shannon Noble, Texas Air Conditioning Contractors Association; Ryan Paylor, Texas Conservative Coalition; Michael Sullivan, Texans for Fiscal Responsibility)

Against — None

BACKGROUND: Under Tax Code, sec. 171.1011, a business must determine its tax liability under the margins tax by computing its total revenue. For most businesses, total revenue is the sum of gross receipts and other income such as dividends, interest, and rents. From this amount, the entity subtracts items such as bad debt, deductions allowed by the IRS, distributive income form partnerships, limited liability corporations, and "S" corporations, and certain other amounts. The margins tax also allows certain expenses and flow-through funds, or funds passed through a taxable business to another taxable business, to be exempted from total revenue. These include specific exclusions relevant to legal services entities and staff leasing entities.

DIGEST: CSHB 3131 would amend the Tax Code, sec. 171.1011, to a allow a qualified destination management company (DMC) to exclude from its total revenue certain amounts of payments made to other persons who provided services, labor, or materials in connection with the provision of destination management services.

The bill would define “destination management services” as:

- transportation management;
- booking and management of entertainers;
- coordination of tours or recreational activities;
- meeting, conference, or event registration;
- event management; and
- meal coordination.

A qualified DMC would be defined as a taxable business that:

- received at least 80 percent of its annual total revenue from its entire business from providing or arranging for the provision of a combination of at least four destination management services;
- maintained a permanent nonresidential office from which the destination management services were provided or arranged;
- had at least three full-time employees;
- spent at least one percent of the entity’s annual gross receipts from its entire business to market the destinations with respect to which destination management services were provided;
- had at least 80 percent of the clients with which the entity entered into destination management services contracts located outside of Texas;
- other than the office equipment used in the conduct of the entity’s business, did not own equipment used to directly provide destination management services, including motor coaches, limousines, sedans, dance floors, decorative props, lighting, podiums, sound or video equipment, or equipment for catered meals;
- was not doing business as a caterer;
- did not provide services for weddings;
- did not own a venue at which events or activities for which destination management services were provided occur; and
- was not a subsidiary of another entity and not a member of an affiliated group another member which was doing business as, or was owned or operated another entity that did business as, a caterer nor owned or operated a venue at which destination management services were provided.

The bill would take effect on January 1, 2010.

SUPPORTERS SAY:

CSHB 3131 would allow a DMC to exclude from its total revenue certain payments made to other persons who provided services, labor, or materials in connection with the provision of destination management services. These payments flow through the DMC from the client to the sub-contractor that provided a service. DMCs should not have to pay margins tax on these flow-through funds because the revenue is more appropriately taxed to the subcontractors that performed the services and were paid for it.

DMCs deserve this revenue exemption because they bring large meetings, conventions, and events from across the country and world to Texas. DMCs spend between one to three percent of their total revenue advertising Texas and all it has to offer. Their clients not only make payments to DMCs, they also stay in Texas hotels, and shop, eat, and sightsee while here. DMC industry standards prevent clients from paying service providers directly, and the clients hire DMCs to manage these details for them.

CSHB 3131 is a narrowly targeted bill and would grant this exemption to the only 20 or so DMCs that exist in Texas. Further, according to the LBB, exempting these flow-through payments would not have a significant cost to the state.

OPPONENTS SAY:

The margins tax was designed to be a broad-based tax that would be widely applicable to many different kinds of businesses. If the Legislature decided to reform the revenue exemption for flow-through funds, it should follow a more equitable approach and grant the exemption to all entities that have a business structure that involves widespread use of sub-contractors. CSHB 3131 would carve out an exemption for one small group of businesses. The Legislature should change the model, not grant exemptions.

NOTES:

The substitute differs from the bill as filed by tightening the caption to relate to the exclusion of certain payments from the total revenue of “a qualified destination management company” as opposed to “certain taxable entities.” The substitute would change the requirements for a destination management company to qualify for the revenue exemption. To qualify an entity would have to have:

- spent at least one percent of its annual gross receipts from its entire business to market the destinations with respect to which destination management services are provided; and
- at least 80 percent of its destination management clients be located outside of Texas;

The entity could not be a subsidiary of another entity that, and not a member of an affiliated group, another member of which:

- had done business as, or owned or operated another entity that did business as, a caterer; or
- owned or operated a venue at which events or activities for which destination management services were provided.

The companion bill, SB 818 by Van de Putte, has been referred to the Senate Finance Committee.