
**HOUSE COMMITTEE ON WAYS AND MEANS
TEXAS HOUSE OF REPRESENTATIVES
INTERIM REPORT 2004**

**A REPORT TO THE
HOUSE OF REPRESENTATIVES
79TH TEXAS LEGISLATURE**

**REPRESENTATIVE BRIAN MCCALL
CHAIRMAN**

**COMMITTEE CLERK
SHERRI WALKER**



Committee On
Ways and Means

November 22, 2004

Rep. Brian McCall
Chairman

P.O. Box 2910
Austin, Texas 78768-2910

The Honorable Tom Craddick
Speaker, Texas House of Representatives
Members of the Texas House of Representatives
Texas State Capitol, Rm. 2W.13
Austin, Texas 78701

Dear Mr. Speaker and Fellow Members:

The Committee on Ways & Means of the Seventy-Eighth Legislature hereby submits its interim report including recommendations and drafted legislation for consideration by the Seventy-ninth Legislature.

Respectfully submitted,

Handwritten signature of Rep. Brian McCall in black ink.

Rep. Brian McCall

Handwritten signature of Rep. Ken Paxton in black ink.

Rep. Ken Paxton

Handwritten signature of Rep. Allan Ritter in black ink.

Rep. Allan Ritter

Handwritten signature of Rep. Beverly Woolley in black ink.

Rep. Beverly Woolley

Handwritten signature of Rep. Harvey Hilderbran in black ink.

Rep. Harvey Hilderbran

Handwritten signature of Rep. Jim Pitts in black ink.

Rep. Jim Pitts

Handwritten signature of Rep. Jim Keffer in black ink.

Rep. Jim Keffer

Handwritten signature of Rep. Vilma Luna in black ink.

Rep. Vilma Luna

Rep. Ken Paxton
Vice-Chairman

Members: Rep. Jim Pitts, Rep. Allan Ritter, Rep. Jim Keffer, Rep. Beverly Woolley, Rep. Vilma Luna, Rep. Harvey Hilderbran

TABLE OF CONTENTS

INTRODUCTION 4

INTERIM STUDY CHARGES AND SUBCOMMITTEE ASSIGNMENTS..... 5

STREAMLINE SALES TAX PROJECT 6

 BACKGROUND 7

BRIEF ON FEDERAL TAX LEGISLATION 8

AFFECTING TEXAS..... 8

 BACKGROUND 9

 ACTUAL FEDERAL LEGISLATION 9

 FEDERAL DEDUCTION OF SALES TAX..... 11

 RECOMMENDATION 12

INTRODUCTION

In March of 2004, the Honorable Tom Craddick, Speaker of the House of Representatives, appointed Brain McCall as Chairman and Rep. Ken Paxton as Vice-Chairman of the House Committee on Ways and Means. The other members appointed to the committee included the following: Representative Allan Ritter, Representative Jim Pitts, Representative Jim Keffer, Representative Beverly Woolley, Representative Vilma Luna and Representative Harvey Hilderbran.

During the interim the committee received four charges issued by the Speaker. The Chairman appointed subcommittees to study the charges. The subcommittees have completed their research, and has adopted and approved all subcommittee reports which are incorporated as the following final report for the entire House Committee on Ways and Means.

Finally, the committee wishes to express appreciate to the Comptroller of Public Accounts, Carole Keeton Strayhorn and her staff for their valuable time and efforts on behalf of the committee.

We also extend our sincere thanks to the House of Representative legislative staff members who assisted the committee with this report.

HOUSE COMMITTEE ON WAYS AND MEANS
INTERIM STUDY CHARGES AND SUBCOMMITTEE ASSIGNMENTS

CHARGE 1

Monitor the fiscal impact to the state due to interstate sales and monitor Texas' involvement and implementation of the Streamlined Sales Tax Project.

CHARGE 2

Monitor federal tax policy changes that will affect Texas, specifically the permanent elimination of the inheritance tax and the deductibility of state sales taxes against federal income tax.

Subcommittee members:

Rep. Ken Paxton, Chairman
Rep. Jim Pitts
Rep. Vilma Luna
Rep. Jim Keffer

CHARGE 3

Actively support the Select Committee on Public School Finance in their deliberations on developing an alternative system of public school finance.

CHARGE 4

Monitor the agencies and programs under the committee's jurisdiction

STREAMLINE SALES TAX PROJECT

TEXAS INVOLVEMENT AND IMPLEMENTATION OF THE STREAMLINES SALES TAX PROJECT

BACKGROUND

Currently, 42 states and the District of Columbia are participating in the Streamlined Sales Tax Project (SSTP). Twenty states, including Texas, have moved forward and enacted all or part of the conforming legislation. The State of Texas has taken a cautious and more considered approach in regards to legislation and passed House Bill 2425 in the 78th Regular Session to enact several, but not all, provisions of the SSTP agreement.

House Bill 2425 dealt with the issue of the sourcing of local sales taxes by taking a two-tier approach; one for taxable services and one for tangible personal property. Texas is one of the states, like California and others, with an origin-based system of sourcing local sales tax on transactions. For Texas, the location of the seller's place of business generally determines the local sales taxes that are due, except for transit taxes. The SSTP agreement calls for collection of local sales taxes on a destination-basis that looks to the location where the goods are delivered or where the taxable services are provided.

Effective July 1, 2004, Texas was to begin sourcing taxable services on a destination basis but implementation of this provision had to be delayed. Several members of the Texas Legislature as well as many business owners around the state have raised concerns about the significant and far-reaching effects of these changes. Because of these concerns, and at the request of key legislative leaders, the Comptroller's office has delayed implementing the new requirements. The Comptroller's office is studying the implications of these changes on local sales and use taxes, and developing various online and printed resources to help taxpayers understand the new requirements. This experience is not unique to Texas because other SSTP states with origin-based sourcing, such as Kansas, Utah, and Ohio, had to delay implementation of destination-based sourcing.

House Bill 2425 also called for the Comptroller to perform a study of the economic and other costs to local governments should sales, leases, and rentals of tangible personal property be sourced on a destination basis in conformance with the SSTP agreement. The Comptroller's economic analysis staff is in the process of developing this study with input from other states and local governments.

The Comptroller's staff continues to participate in the SSTP meetings and to work with other states, local governments, and with business interests in regards to issues of simplification of sales and use tax administration. The SSTP general meetings take place on a periodic basis about every other month.

**BRIEF ON FEDERAL TAX LEGISLATION
AFFECTING TEXAS**

FEDERAL TAX LEGISLATION BRIEF

BACKGROUND

1. The U.S. House of Representatives has passed six bills that could affect Texas taxpayers, including one that would eliminate the inheritance tax (H.R. 8, Death Tax Repeal Permanency Act of 2003), and another which would include the reinstatement of the deductibility of sales tax on personal federal income tax returns (H.R. 4520, American Jobs Creation Act of 2004). H.R. 4520 works to make our manufacturing, service, and high-technology businesses and workers more competitive and productive both at home and abroad. The House version also includes language reinstating the deductibility of sales tax. The U.S. Senate has passed only two of the companion bills to date. In the Senate version of H.R. 4520, the deductibility of state and local sales tax was removed. Additionally, the Senate passed S.R. 150, the Internet Access Tax Moratorium, which extended the moratorium on internet access taxes for four years. The House version would make the moratorium permanent. Both bills will be sent to conference committees. A more expanded discussion of the legislation is included below.
2. No legislation is expected to pass the Senate before the presidential election in November; thus the legislation passed by the House (including some of great interest to Texans) will likely not be acted on before then.

ACTUAL FEDERAL LEGISLATION

■ **H.R. 4181 -- Permanent Extension of the Marriage Penalty Relief Act --**

The U.S. House voted on April 28, 2004 to preserve fairness in the tax code for married couples by permanently eliminating the marriage penalty. H.R. 4181, which passed by a vote of 323-95, would provide permanent tax relief for millions of married couples. Unless marriage penalty tax relief is extended, 27 million married couples will face an average tax increase of \$300 next year—and 35 million will see a tax increase of over \$700 starting in 2011. Marriage penalty relief was first enacted in the 2001 tax relief package. Congress accelerated the full effect of this relief to couples as part of the 2003 tax relief package. Marriage penalty relief is achieved by doubling the standard deduction and the 15 percent tax bracket for couples so that these provisions are double those for individuals. The 2001 tax relief also reduced the marriage penalty as it relates to the Earned Income Credit by gradually increasing the income level at which the credit is phased out for married couples.

H.R. 4181 prevents all three relief measures from expiring after 2010. There has been no action by the U.S. Senate.

■ **H.R. 4227 -- Middle-Class Alternative Minimum Tax Relief Act --**

This bill was approved by the U.S. House on May 5, 2004, by a 333-89 vote and extends through 2005. Current income exemptions are subject to the alternative minimum tax at \$40,250 for individuals and \$58,000 for couples. Absent enactment

of the bill, the income exemptions are scheduled to revert to \$33,750 for individuals and \$45,000 for couples in 2005. There has been no action by the U.S. Senate.

- **H.R. 4275 -- The 10 Percent Tax Bracket Extension and Permanency Act --**

This bill was approved by the U.S. House by a 344-76 vote on May 13, 2004. The bill, sponsored by Texas Representative Pete Sessions, would preserve the benefits of the new 10 % tax bracket. The 10% bracket applies to the first \$7,000 in taxable income for single taxpayers and double that amount for married couples. The 2001 Bush Tax Cut created a new tax bracket at the 10% rate to help lower the burden on working Americans. This relief was expanded in 2003. If Congress fails to act, the 10% bracket will shrink by \$2,000 next year (\$1,000 for singles), affecting an estimated 73 million taxpayers, and will disappear in 2011. H.R. 4275 preserves the size of the 10% bracket and ensures that it is permanently preserved. This bill will provide Americans with \$218 billion in tax relief over 10 years, according to the Joint Committee on Taxation. There has been no action by the U.S. Senate.

- **H.R. 4359 -- \$1,000 Child Tax Credit --**

The U.S. House of Representatives voted May 20, 2004 (by a vote of 271-139) to prevent a tax hike on middle-class families by approving H.R. 4359, the Child Credit Preservation and Expansion Act of 2004. Without action by Congress, the child credit will drop by \$300 next year. This bill, introduced by Rep. Jon Porter, would insure the \$1,000 credit is available not only next year but permanently. The bill also increases the income level at which the credit begins to phase out from \$110,000 to \$250,000 for married couples and from \$75,000 to \$125,000 for single parents. Enacting H.R. 4359 would prevent a tax hike of \$610 next year on 30 million taxpayers with 49 million children, according to the Joint Committee on Taxation. There has been no action by the U.S. Senate.

H.R. 8 -- Death Tax Repeal Permanency Act of 2003 --

The House passed this measure on June 18, 2003 by a vote of 264-163. This bill provides that the sunset provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 shall not apply to the Estate, Gift, and Generation-skipping Transfer Tax Provisions. The repeal measure was part of the tax relief package that President Bush signed into law in June 2001, but will expire at the end of 2010 because of an arcane Senate rule. If it expires, the law would revert to having estates with assessed values of more than \$1,000,000 subject to the levy. Under this bill, the repeal of the death tax will become permanent after 2010. There has been no action by the U.S. Senate.

- **S.R. 150, H.R. 49 -- Internet Access Tax Moratorium --**

The House version of this bill (passed in 2003 by a voice vote) would extend the Internet Access Tax Moratorium permanently and eliminates the grandfather clause. The moratorium, which had been in place since 1998, prohibited taxes on Internet access and banned multiple and/or discriminatory taxes on goods or services ordered over the Internet. A grandfather clause permitted several states, including Texas, to continue to tax regular and DSL Internet access for an additional two years. The current moratorium on Internet taxation expired on November 1, 2003. In 2004, the Senate approved S.R. 150 (by a vote of 93-3) that would extend the moratorium for 4 years and provide for a 4-year phase out of the grandfather clause. The House has yet to act on Senate changes, and no conference committee has been appointed.

FEDERAL DEDUCTION OF SALES TAX

In 1986, Congress introduced legislation (presented by President Reagan) to simplify the tax system by eliminating most of the itemized deductions, including ALL deductions for state and local taxes - income, property and sales tax. By the end of the process, the only deductions eliminated were sales taxes (state and local). State and local property and state income tax deductions were untouched. It was argued by some that the deduction of sales tax was rarely used and outdated. The final legislation fell short of President Reagan's vision of a simplified system. Since then, there has been discrimination toward states which primarily fund state and local governments with sales tax (7 states in all - 2 do not have income taxes) refusing citizens in those states the right to reap the full benefit of deductions on their federal income tax returns.

At the beginning of June, our office began to receive information regarding the possibility of the reinstatement of the deduction of sales taxes. Congressman Brady and Majority Whip Delay worked to include the deduction of sales tax from federal personal income taxes in the American Jobs Creation Act of 2004 (H.R. 4520). Chairman of the Ways and Means Committee, Bill Thomas, negotiated with Congressman Brady and Whip Delay to come to a compromise regarding the level and scope of restoring that deductibility at the cost of \$4 billion to the federal government.

The Ways and Means Committee reached a compromise allowing two years of coverage with no cap on the deduction per year. Many supporters believe that it is worth seeking a complete deduction despite the two year limitation (one option was a cap on the deduction of \$1000, allowing the measure to last 3 years). Some saw the sales tax deduction as a sweetener added to garner more votes for the high-profile and controversial tax bill. Congressman Brady does not view the deductibility of sales tax as a sweetener, but rather a fundamental provision of the legislation, and considers the lack of a cap a victory for Texans.

The American Jobs Creation Act of 2004 (H.R. 4520) passed the full House on June 17, 2004 by a vote of 251-178. During the debate on H.R. 4520 in the Senate, an amendment was offered and adopted that struck everything under the enacting clause and replaced it with language from S. 1637 (Jumpstart Our Business Strength (JOBS) Act). The language in S. 1637 did not include the sales tax deductibility language. The Senate passed the amended H.R. 4520 on July 15th, 2004 by a voice vote. H.R. 4520 will be sent to conference committee to work out the differences. The Senate Conferees have been named, while the House Conferees have not.

RECOMMENDATION

Certain of these tax bills have major implications for the Ways and Means Committee and the State of Texas. We recommend that we continue to monitor the progress of various bills discussed above. Our committee may want to consider sending letters of support as a whole or individually to the authors of each bill.
