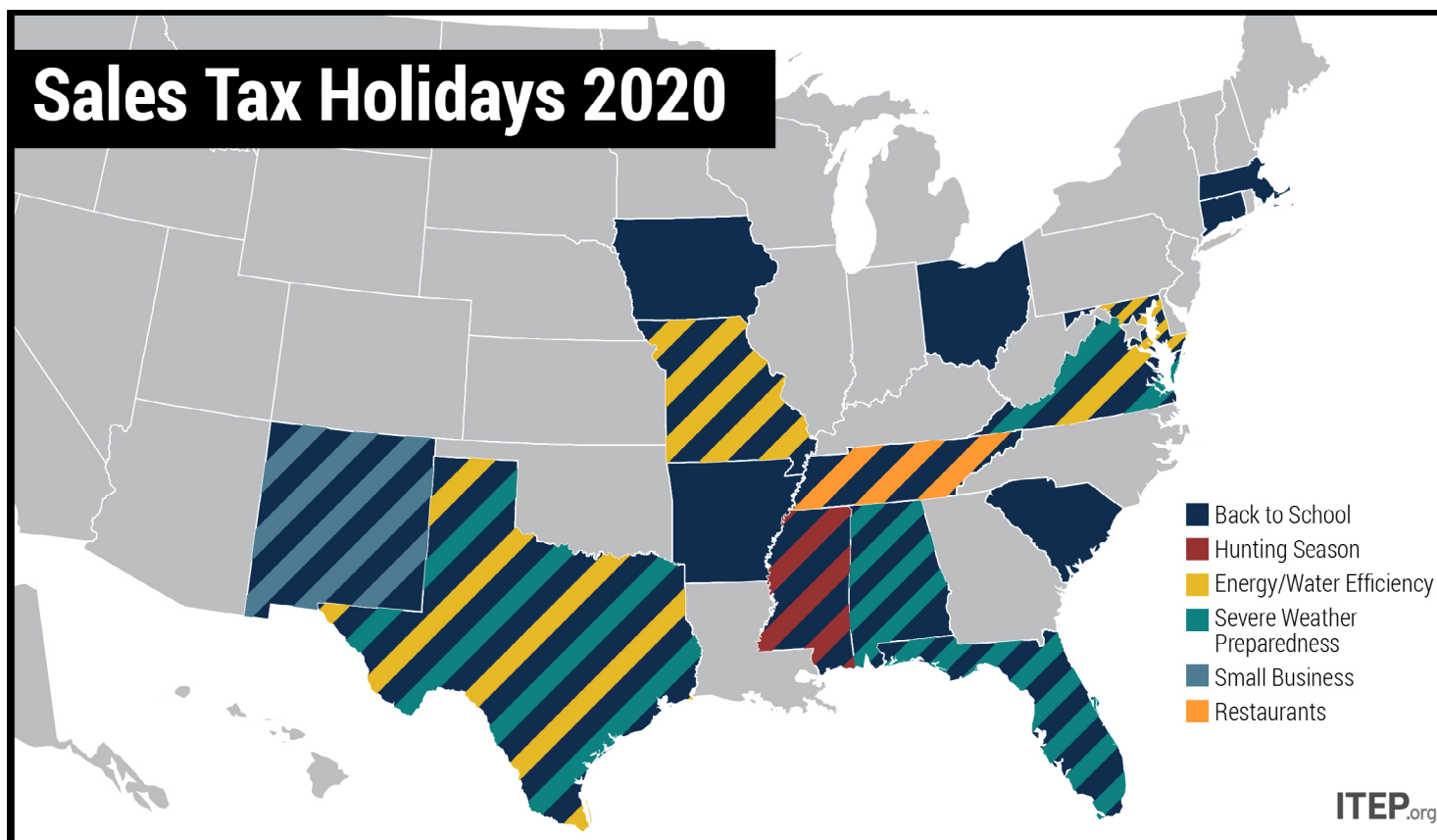


Sales Tax Holidays: An Ineffective Alternative to Real Sales Tax Reform

DYLAN GRUNDMAN

Sales taxes are an important revenue source, making up close to half of all state tax revenues.¹ But sales taxes are also inherently regressive because the lower a family's income, the more the family must spend on goods and services subject to the tax. Lawmakers in many states have enacted "sales tax holidays" (16 states will hold them in 2020) to provide a temporary break on paying the tax on purchases of clothing, school supplies, and other items. These holidays may seem to lessen the regressive impacts of the sales tax, but their benefits are minimal while their downsides are significant—and amplified in the context of the COVID-19 pandemic. This policy brief looks at sales tax holidays as a tax reduction device.



HOW SALES TAX HOLIDAYS WORK

Sales tax holidays are temporary sales tax exemptions, usually applying to a small number of taxable items for a very limited period. These holidays are typically timed to take place in August during the traditional “back to school” shopping season and offer breaks on school-related items such as clothing, school supplies, and computers. However, a few states exempt all taxable goods during the holiday. Separate holidays for energy-efficient appliances and storm preparation materials are becoming increasingly common as well, and in 2020 New Mexico will hold a “Small Business Saturday” holiday, Mississippi will hold one for guns and hunting supplies, and Tennessee will hold a first-of-its-kind holiday for restaurants. Most sales tax holidays last only two or three days, and almost all holidays apply only to items below some specified price (e.g. clothing items priced over \$100 are generally not exempted).

HISTORY OF SALES TAX HOLIDAYS

The notion of a holiday was first introduced in 1980 when Ohio and Michigan opted to not tax the sale of automobiles for a period of time.² New York experimented with the current concept of sales tax holidays in 1996, but has since abandoned the policy. More than twenty states have enacted legislation at some point to provide holidays and proposals to extend the concept to more states and more types of purchases continue to appear each year.

Many states either repealed or temporarily suspended sales tax holidays when facing significant revenue gaps. For example, lawmakers in Florida, Georgia, Maryland, Massachusetts and the District of Columbia all canceled holidays during the height of the Great Recession; and although most of these reinstituted them afterward, Georgia and the District of Columbia’s holidays have not been revived and Florida’s has only returned in a scaled-back form. Louisiana, which once held three separate holidays for back-to-school shopping, hunting season, and hurricane preparedness, started paring them back due to budget woes in 2016 and has now cancelled all three.³ Holidays in Illinois, New York, North Carolina, Vermont, West Virginia, and Wisconsin were also either short-lived or repealed.

Despite pandemic-induced revenue shortfalls and public health guidance against large in-person gatherings, including restrictions on the capacity in retail stores, states have not made many changes to their scheduled holidays in 2020. Florida reduced its back-to-school holiday from 5 days to 3, while Tennessee doubled the value of qualifying purchases for its holiday and added a one-weekend holiday for restaurants.

PROBLEMS WITH SALES TAX HOLIDAYS

Policymakers tout sales tax holidays as a way for families to save money while shopping for “essential” goods. On the surface, this sounds good. However, a two- to three- day sales tax holiday for selected items does nothing to reduce taxes for low- and moderate-income taxpayers during the other 362 days of the year. Sales taxes are inherently regressive. In the long run, sales tax holidays leave a regressive tax system unchanged, and the benefits of these holidays for working families are minimal. Sales tax holidays also fall short because they are poorly targeted, cost revenue, can easily be exploited, and create administrative difficulties.



Sales Tax Holidays Are Poorly Targeted

Because wealthier taxpayers also benefit from sales tax holidays, they offer less “bang for the buck” from a fairness perspective than more targeted tax breaks such as low-income sales tax credits (described in ITEP Policy Brief, “Options for Progressive Sales Tax Relief”) or Earned Income Tax Credits (described in ITEP Policy Brief, “Rewarding Work Through Earned Income Tax Credits”).

Wealthier taxpayers are often best positioned to benefit from the holidays since they have more flexibility to shift the timing of their purchases to take advantage of the tax break—an option that isn’t available to families living paycheck to paycheck. Many low-income taxpayers spend most or all of their income just getting by, which means that they also have less disposable income than wealthier taxpayers to spend when the holiday arrives. One recent study found that households that earn more than \$30,000 were likely to shift the timing of their clothing purchases to coincide with a sales tax holiday, but households earning less than \$30,000 were not.⁴

Moreover, those same wealthier taxpayers are also most likely to be able to take advantage of the holidays safely during the COVID-19 pandemic by ordering online, arranging curbside pickup, and having items delivered to their homes. Lower-income households, on the other hand, may lack these conveniences and be forced to choose between keeping their families safe or going into a crowded store during peak hours to take advantage of the discount.

The benefits of sales tax holidays are not limited to state residents but instead extend to anybody who happens to be within the state’s borders at the time of the holidays, including tourists and individuals who live close to the border.

Though the holidays are often marketed as boons to local businesses, all of these holidays except New Mexico’s “Small Business Saturday” and Tennessee’s new restaurant weekend apply to online purchases, even those shipped from other states, giving no advantage to locally owned businesses.

In the two states—Florida and Missouri—that still fail to tax many online sales at any time of the year, the public health implications of holding a sales tax holiday during a pandemic are even starker, as the holidays serve purely to incentivize in-person shopping.

Sales Tax Holidays Reduce State and Local Revenue

In 2020, these holidays will cost states and local governments more than \$300 million.⁵ Revenue lost through sales tax holidays will ultimately have to be made up somewhere else, either through painful spending cuts or increasing other taxes. Such trade-offs are all the more painful at a time when funding for core priorities is already threatened by the COVID-19 pandemic. And local jurisdictions like cities and counties—which often have few revenue options and have to rely on sales taxes to fund important priorities like roads, parks and police and fire protection—rarely have a choice in the matter of sales tax holidays. Only Alabama, Mississippi and Missouri allow localities to opt out of the holidays.



Moreover, now that most online sales are subject to state and local sales taxes, the annual cost of holding these holidays will likely quickly grow far beyond the estimated \$300 million. Online purchases, which are tax-free under all but one of these holidays, are a large and growing share of retail sales, and it is also relatively easy for shoppers to time their online purchases to coincide with a tax holiday. This means that the true cost of holding a sales tax holiday in 2020 and beyond is unknown but certainly higher than in the past.

Some Retailers Exploit Sales Tax Holidays

Retailers can also take advantage of the shift in the timing of consumer purchases by increasing their prices or watering down their sales promotions during the tax holiday. The influx of shoppers gives them economic incentive to do so, and the evidence suggests that they often do.⁶ One study of retailers' behavior during a sales tax holiday in Florida, for example, found that up to 20 percent of the price cut consumers thought they were receiving from the state's sales tax holiday was actually reclaimed by retailers.⁷

Sales Tax Holidays Create Administrative Difficulties

Sales tax exemptions create administrative difficulties for state and local governments and for retailers who must collect the tax. For example, exempting groceries requires a sheaf of government regulations to police the border between non-taxable groceries and taxable snack food. A temporary exemption for clothing (or for any other back-to-school item) requires retailers and tax administrators to wade through a similar quantity of red tape for an exemption that lasts only a few days. Further complexity can arise in states with local sales taxes when some localities opt not to participate in the holiday and consumers unexpectedly end up paying local sales taxes on their purchases.

CONCLUSION

Sales tax holidays are poorly targeted and too temporary to meaningfully change the regressive nature of a state's tax system. Lawmakers must understand that they cannot resolve the unfairness of sales taxes simply by offering a short break from paying these taxes. If the long-term consequence of sales tax holidays is a higher sales tax rate, low-income taxpayers may ultimately be worse off as a result of these policies. Policymakers seeking to achieve greater tax fairness would do better to provide a permanent refundable low-income sales tax credit or Earned Income Tax Credit (EITC) to offset the impact of the sales tax on low- and moderate-income taxpayers.



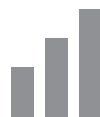
APPENDIX

2020 Sales Tax Holidays

State	Back to School	Energy and Water Efficiency	Severe Weather Preparedness	Other
Alabama	July 17-19 Clothing < \$100 Computers < \$750 School supplies < \$50 Books < \$30		February 21-23 Assorted items < \$60 per item Generators < \$1,000	
Arkansas	August 1-2 School supplies (no \$ limit) Clothing < \$100 Accessories & equipment < \$50			
Connecticut	August 16-22 Clothing < \$100			
Florida	August 7-9 School supplies < \$15 Clothing < \$60 Computers < \$1,000		May 29 - June 4 Generators < \$750 Radios, tarps, etc. < \$50 Batteries and coolers < \$30 Fuel containers < \$25 Lights < \$20 Ice packs < \$10	
Iowa	August 7-8 Clothing < \$100			
Maryland	August 9-15 Clothing < \$100 Backpacks < \$40	February 15-17 Energy Star items and solar water heaters (no \$ limit)		
Massachusetts	August 29-30 Most goods except vehicles < \$2,500			
Mississippi	July 31 - August 1 School supplies < \$100 Clothing < \$100			HUNTING SEASON August 28-30 Guns and certain hunting supplies (no \$ limit)
Missouri	July 31 - August 1 School supplies < \$50 Clothing < \$100 Software < \$350 Graphing calculators < \$150 Computers & peripherals < \$1,500	April 19-25 Certain Energy Star items < \$1,500		
New Mexico	August 7-9 School supplies < \$30 Clothing < \$100 Computers < \$1,000 Computer equipment < \$500			SMALL BUSINESSES November 28 Specified items < \$500 from businesses with 10 or fewer employees

2020 Sales Tax Holidays

State	Back to School	Energy and Water Efficiency	Severe Weather Preparedness	Other
Ohio	<u>August 7-9</u> School supplies < \$20 Instructional material < \$20 Clothing < \$75			
Oklahoma	<u>August 7-9</u> Clothing < \$100			
South Carolina	<u>August 7-9</u> School supplies Clothing & linens Computers & accessories (no \$ limits)			
Tennessee	<u>July 31 - August 2</u> School supplies < \$200 Clothing < \$200 Computers < \$3,000			RESTAURANTS <u>August 7-9</u> Food and drink sold at restaurants
Texas	<u>August 7-9</u> School supplies < \$100 Clothing < \$100 Backpacks < \$100	<u>May 23-25</u> Energy Star air conditioners < \$6,000 Energy Star refrigerators < \$2,000 Other Energy Star items (no \$ limit) WaterSense & similar items (no \$ limit)	<u>April 25-27</u> Batteries, flashlights, etc. < \$75 Hurricane shutters & ladders < \$300 Generators < \$3,000	
Virginia	<u>August 7-9</u> School supplies < \$20 Clothing < \$100	<u>August 7-9</u> Energy Star items < \$2,500 WaterSense items < \$2,500	<u>August 7-9</u> Generators < \$1,000 Chainsaws < \$350 Certain other items < \$60	



ENDNOTES

- 1 U.S. Census Bureau, U.S. Census Bureau, 2019 Annual Survey of State Government Tax Collections.
- 2 Janssen, C. B. (2012), (Un) Happy Holidays: The True Meaning of Sales Tax “Holiday” Policy, *Loyola Consumer Law Review*. 24: 411–440.
- 3 Some local jurisdictions in Louisiana still have hunting season exemptions from local sales taxes in place because the repeal of state-level holidays in 2018 did not extend to localities. Louisiana Department of Revenue, **Revenue Information Bulletin No. 18-020**.
- 4 Marwell, Nathan and Leslie McGranahan (2010), The Effect of Sales Tax Holidays on Household Consumption Patterns. Federal Reserve Bank of Chicago.
- 5 ITEP survey of cost estimates from state tax expenditure reports, fiscal notes, revenue departments, and academic studies.
- 6 Brunori, David (2017), Sales Tax Holiday: Great Politics, Poor Policy. D.C. Policy Center, <https://www.dcpolicycenter.org/publications/sales-tax-holidays-great-politics-poor-policy> .
- 7 Harper, R. K., Hawkins, R. R., Martin, G. S. and Sjolander, R. (2003), Price Effects around a Sales Tax Holiday: An Exploratory Study. *Public Budgeting & Finance*, 23: 108–113.