



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

Sales taxes are an important revenue source, comprising close to half of all state revenues in 2013. But sales taxes are also inherently regressive because the lower a family's income, the more of its income the family must spend on things subject to the tax. Lawmakers in many states have enacted "sales tax holidays" (at least 17 states will hold them in 2014), providing a temporary break on paying the tax on purchases of clothing, computers and other items. While these holidays may seem to lessen the regressive impacts of the sales tax, in fact their benefits are minimal. This policy brief examines the many problems associated with using sales tax holidays as a tax reduction device and concludes that they have more political than policy benefits.

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. The notion of a holiday was first introduced in 1980 when Ohio and Michigan didn't tax sales of automobiles for a period of time.¹ New York experimented with the current concept of sales tax holidays in 1996 and since then well over a dozen other states have passed similar legislation (New York no longer offers a holiday). 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. Yet, 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. 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 worth over \$100 are generally not exempted).

2014 Sales Tax Holidays

"Back to School" Holidays

State	Description	Dates
Alabama	Books, Clothing, Computers, School Supplies	August 1-3
Arkansas	Clothing, School Supplies	August 2-3
Connecticut	Clothing, Shoes	August 17-23
Florida	Clothing, School Supplies	August 1-3
Georgia	Clothing, School Supplies	August 1-2
Iowa	Clothing	August 1-2
Louisiana	All Tangible Personal Property	August 1-2
Maryland	Clothing, Shoes	August 10-16
Massachusetts	Taxable Items Under \$2,500	August 16-17
Mississippi	Clothing, Shoes	July 25-26
Missouri	Clothing, Computers, School Supplies	August 1-3
New Mexico	Clothing, Computers, School Supplies	August 1-3
Oklahoma	Clothing	August 1-3
South Carolina	Clothing, Computers, School Supplies	August 1-3
Tennessee	Clothing, Computers, School Supplies	August 1-3
Texas	Backpacks, Clothing, School Supplies	August 8-10
Virginia	Clothing, School Supplies	August 1-3

"Energy Efficiency" Holidays

State	Description	Dates
Georgia	Energy Star Products	October 3-5
Florida	Energy Star Products	September 19-21
Maryland	Energy Star Products	February 15-17
Missouri	Energy Star Products	April 19-25
Texas	Energy Star Products	May 24-26
Virginia	Energy Star Products	October 10-13

Other Holidays

Alabama	Severe Weather Preparedness	February 21-23
Florida	Hurricane Preparedness	May 31-June 8
Louisiana	Firearms, Ammunition	September 5-7
Louisiana	Hurricane Preparedness	May 24-25
Mississippi	Firearms, Ammunition	September 5-7
Virginia	Hurricane Preparedness	May 25-31

Sources: Federation of Tax Administrators and individual state Department of Revenue websites

Problems with Sales Tax Holidays

Sales tax holidays are advertised as a way to give people a break from paying the sales tax. On the surface, this sounds good given that sales taxes are regressive, meaning they take a larger share of income from low- and middle-income families than from wealthy families. However, a two- to three- day sales tax holiday for selected items does nothing to provide relief to low- and moderate-income taxpayers during the other 362 days of the year. In the long run, sales tax holidays leave a regressive tax system basically unchanged. The benefits of sales tax holidays are minimal. Here are some other problems with these holidays.

Sales Tax Holidays are Poorly Targeted

- Because wealthier taxpayers can 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 have less disposable income than wealthier taxpayers to spend when the holiday arrives.
- One recent study found that while households with earners above \$30,000 were likely to shift the timing of their clothing purchases to coincide with a sales tax holiday, households earning less than \$30,000 were not.²
- 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.

Sales Tax Holidays Offer No Significant Retail Boost

- One popular rationale for sales tax holidays is that they increase local consumer spending and boost local retail, but this has not been demonstrated. Rather, increased sales during sales tax holidays have been shown to be primarily the result of consumers’ shifting the timing of their planned purchases.

Some Retailers Exploit Sales Tax Holidays

- Unscrupulous retailers can 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. One study of retailers’ behavior during a sales tax holiday in Florida found evidence of precisely 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.³

¹Janssen, C. B. (2012), (Un) Happy Holidays: The True Meaning of Sales Tax “Holiday” Policy, *Loyola Consumer Law Review*, 24: 411–440.

²Marwell, Nathan and Leslie McGranahan (2010), The Effect of Sales Tax Holidays on Household Consumption Patterns. Federal Reserve Bank of Chicago

³Harper, 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.

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.

Sales Tax Holidays Cost Revenue

- In 2014, these holidays will cost states at least \$300 million. Revenue lost through sales tax holidays will ultimately have to be made up somewhere else, either through painful spending cuts or increasing other taxes.

Growing Skepticism

Many states either repealed or temporarily suspended sales tax holidays during the recession. For example, lawmakers in Florida, Georgia, Maryland, Massachusetts and Washington DC all canceled holidays during the height of the recent economic recession (though all but DC have reinstated them in recent years). Sales tax holidays in the Illinois, New York, North Carolina, West Virginia and Vermont were either short-lived or repealed. Last year lawmakers in Arizona proposed a back to school sales tax holiday and Texas lawmakers proposed a holiday for firearms; this year lawmakers in Ohio and Wisconsin proposed back to school sales tax holidays. However none of these proposals became law. The *Milwaukee Journal Sentinel* opined, “The savings for individuals would be meager, the cost to the state would be about \$14.5 million and any boost to the economy would be minimal. Unless legislators can show that’s not the case, this is not an idea worth pursuing.”⁴

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 can not 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. Policy makers 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. 🚩

⁴ “Concentrate on tax reform, not tax gimmicks such as sales tax holidays.” *Milwaukee Journal Sentinel*, January 1, 2014. <http://www.jsonline.com/news/opinion/concentrate-on-tax-reform-not-tax-gimmicks-such-as-sales-tax-holidays-b99174246z1-238302141.html>