ITEP Institute on Taxation and Economic Policy

TALKING TAXES

Sales Tax Holidays: Boon or Boondoggle?

Sales taxes are among the most important—and most unfair—taxes levied by state governments. In recent years, lawmakers have sought to relieve the burden of these taxes by enacting "sales tax holidays" that provide temporary sales tax breaks for purchases of clothing, computers and other items. This policy brief looks at the advantages and disadvantages of sales tax holidays as a tax relief device.

How Sales Tax Holidays Work

Sales tax holidays are basically temporary sales tax exemptions, applying to a small number of taxable items for a very limited period of time. These holidays are usually timed to take place in August, during the traditional "back to school" shopping season. The first sales tax holiday, enacted by New York in 1996, was a one-week sales tax exemption for articles of clothing and footwear priced under $500. Since then, almost a dozen other states have passed similar legislation. As the chart at right shows, states enacting sales tax holidays in recent years have typically focused on sales of clothing, but sometimes include computers, school supplies, and other "back to school" expenses. Most sales tax holidays last only three days.

Recent Sales Tax Holidays

State	Items Exempted	Duration
Connecticut	Clothing	7 days
Georgia	Clothing, School Supplies, Computers	4 days
Iowa	Clothing	2 days
Missouri	School Related Items	3 days
New York	Clothing	14 days
North Carolina	Clothing, School Supplies, Computers	3 days
South Carolina	Clothing, School Supplies, Computers	3 days
Texas	Clothing & Footwear	3 days
Vermont	Portion of Computer Costs	3 days
West Virginia	Clothing, School Supplies, Computers	3 days

Problems with the Sales Tax Holiday Approach

Advocates of sales tax holidays usually justify these tax breaks as a way of reducing the tax burden on low-income families with children—and sales tax reductions are among the most effective ways of achieving this goal. Sales taxes are regressive, requiring low- and middle- income taxpayers to pay a larger share of their income in tax than the wealthiest taxpayers. Virtually any sales tax cut will therefore provide larger benefits, as a share of income, to low-income taxpayers than to the wealthy. But sales tax holidays are a problematic way of achieving low-income sales tax relief, for several reasons:

- A one-week sales tax holiday for selected items still imposes a burden on low-income taxpayers when they purchase these items in the other fifty-one weeks of the year. In the long run, sales tax holidays leave a regressive tax system basically unchanged.
- Sales tax exemptions create administrative difficulties for state governments, and for the retailers who must collect the tax. For examples, 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

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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.

- If the goal is to provide tax relief to the low-income families for whom sales taxes are most burdensome, sales tax holidays are poorly targeted, providing tax breaks to even the wealthiest taxpayers. In addition, the benefits of sales tax holidays are not limited to state residents, but also extend to consumers visiting from other states. For states struggling with continuing budget deficits, sales tax holidays offer less "bang for the buck" than more targeted tax breaks such as low-income sales tax credits (described in ITEP Policy Brief #14).
- 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. These taxpayers may not have the luxury of shifting the timing of their consumption to coincide with week-long sales tax holidays. By contrast, wealthier taxpayers are more likely to be able to time their purchases to coincide with the sales tax holiday without throwing their finances out of kilter.
- Retailers know that many consumers will shift their spending toward sales tax holidays to take advantage of the temporary tax exemption. Unscrupulous retailers can take advantage of this shift in consumer behavior by increasing their prices (or failing to reduce them by the full amount of the sales tax break) during the tax holiday. There is some evidence that Florida retailers did exactly that during a recent sales tax holiday there: one study found that up to 20 percent of the potential benefits from that state's sales tax holiday were reclaimed by retailers in the form of higher prices.
- Perhaps most important for cash-strapped lawmakers, sales tax holidays are costly. Revenue lost through sales tax holidays will ultimately have to be made up somewhere else, either through painful spending cuts or increasing other 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 tax breaks.

Sales tax holidays are poorly targeted, temporary, and costly–and may ultimately force lawmakers to increase tax rates on other consumer purchases.

Advantages of Sales Tax Holidays

Sales tax holidays do have advantages, of course. As previously noted, the biggest beneficiaries from any sales tax cut will be the low- and middle-income families for whom these taxes are most burdensome. In states that rely heavily on sales taxes, a sales tax holiday slightly reduces the overall collections from this unfair tax. And the heavily-publicized manner in which sales tax holidays are typically administered means that taxpayers will be very aware of the tax cut they receive—and will know that state lawmakers are responsible for it.

But in the long run, sales tax holidays are simply too insignificant (and too temporary) to change the regressive nature of a state's tax system—and may lull lawmakers into believing that they have resolved the unfairness of sales taxes. Policymakers seeking to achieve greater tax equity would do better to shift the overall tax burden away from low-income taxpayers by scaling back sales taxes permanently, or by providing a permanent low-income sales tax credit.

To find out more about this issue, contact ITEP at (202) 626-3780