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Sales Tax Holidays: A Boondoggle

Sales taxes are among the most important—and most unfair—taxes levied by state governments. Sales taxes accounted for close to half of all state revenues in 2010, but sales taxes fall far more heavily on low- and middle-income taxpayers than on the wealthy. In recent years, lawmakers have sought to lessen the impact 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 reduction device.

How Sales Tax Holidays Work

Sales tax holidays are 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. Since New York experimented with the first sales tax holiday in 1996, well over a dozen other states have passed similar legislation (See chart on next page for a list of 2011 sales tax holidays).

The majority of sales tax holidays include an exemption of clothing, though holidays for computers, school supplies, and other “back to school” expenses are also common. Separate holidays for energy efficient appliances 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).

Problems with the Sales Tax Holiday Approach

Advocates of sales tax holidays usually justify these tax breaks as a way of reducing taxes on low-income families with children—and sales tax reductions are among the most effective ways of achieving this goal. Because of the regressive nature of sales taxes, virtually any cut in sales tax rates will provide the largest benefits, as a share of income, to low income taxpayers.

But sales tax holidays are a problematic way of achieving low-income sales tax relief, for several reasons:

- A three-day sales tax holiday for selected items does nothing to provide relief to low-income taxpayers during the other 362 days of the year. In the long run, sales tax holidays leave a regressive tax system basically unchanged.
- Sales tax holidays are poorly targeted, providing tax breaks to even the wealthiest taxpayers.
- 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, “Options for Progressive Sales Tax Relief”).
- 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. On the other hand, 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 a three-day sales tax holiday.

- Unscrupulous retailers can take advantage of the shift in the timing of consumer purchases by increasing their prices 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 potential benefits from the state's sales tax holiday were reclaimed by retailers in the form of higher prices.
- The benefits of sales tax holidays are not limited to state residents, but also extend to consumers visiting from other states.
- Sales tax holidays do not stimulate the economy. Increased consumption during sales tax holidays has been shown to be primarily the result of consumers' shifting the timing of their purchases.
- Sales tax exemptions create administrative difficulties for state and local governments, and for the 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.
- Perhaps most importantly for cash-strapped states, 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. For example, lawmakers in Georgia decided against offering a holiday the past two years because of the economic consequences and the need for sales tax revenue. 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.

Conclusion

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 affected most by sales taxes. In states that rely heavily on sales taxes, a sales tax holiday slightly reduces the overall collections from this unfair tax.

But in the long run, sales tax holidays are simply too insignificant, poorly targeted and too temporary to meaningfully change the regressive nature of a state's tax system. Regrettably, these holidays 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 provide a permanent low-income sales tax credit. 🎯

2011 Sales Tax Holidays

"Back to School" Holidays

State	Description	Dates
Alabama	Books, Clothing, Computers, School Supplies	August 5-7
Arkansas	Clothing, School Supplies	August 6-7
Connecticut	Clothing, Shoes	August 21-27
Florida	Books, Clothing, School Supplies	August 12-14
Iowa	Clothing	August 5-6
Louisiana	All Tangible Personal Property	August 5-6
Maryland	Clothing, Shoes	August 14-20
Massachusetts	All taxable items under \$2,500 each	August 13-14
Mississippi	Clothing, Shoes	July 29-30
Missouri	Clothing, Computers, School Supplies	August 5-7
New Mexico	Clothing, Computers, School Supplies	August 5-7
North Carolina	Clothing, Computers, School Supplies, Sports Equip.	August 5-7
Oklahoma	Clothing	August 5-7
South Carolina	Clothing, Computers, School Supplies	August 5-7
Tennessee	Clothing, Computers, School Supplies	August 5-7
Texas	Backpacks, Clothing, School Supplies	August 19-21
Virginia	Clothing, School Supplies	August 5-7

"Energy Efficiency" Holidays

State	Description	Dates
Maryland	Energy Star Products	February 19-21
Missouri	Energy Star Products	April 19-25
North Carolina	Energy Star Products	November 4-6
Texas	Energy Star Products	May 28-30
Virginia	Energy Star Products	October 7-10

Other Holidays

Louisiana	Hurricane Preparedness	May 28-29
Virginia	Hurricane Preparedness	May 25-31
Louisiana	Ammunition, Firearms, an	September 2-4

Sources: Federation of Tax Administrators and Individual State Department of Revenue websites