

Sales Tax Holidays: Politically Expedient but Poor Tax Policy 2015

By Scott Drenkard & Joseph Henchman
Director of State Projects Vice President,
Legal & State Projects

Key Findings

- 18 states, primarily in the southeastern U.S., will hold a sales tax holiday in 2015, down from a peak of 19 states in 2010.
- Sales tax holidays do not promote economic growth or significantly increase consumer purchases; the evidence shows that they simply shift the timing of purchases. Some retailers raise prices during the holiday, reducing consumer savings.
- Sales tax holidays create complexities for tax code compliance, efficient labor allocation, and inventory management. However, free advertising for what is effectively a paltry 4 to 7 percent sale leads many larger businesses to lobby for the holidays.
- Most sales tax holidays involve politicians picking products and industries to favor with exemptions, arbitrarily discriminating between products and across time, and distorting consumer decisions.
- While sales taxes are somewhat regressive, this does not make sales tax holidays an effective tool for providing relief to low-income individuals. In order to give a small amount of tax savings to those with lower incomes, holidays give a large amount of savings to higher income groups as well.
- Political gimmicks like sales tax holidays distract policymakers and taxpayers from genuine, permanent tax relief. If a state must offer a “holiday” from its tax system, it is a sign that the state’s tax system is uncompetitive. If policymakers want to save money for consumers, then they should cut the sales tax rate year-round.

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Editor, Melodie Bowler
Designer, Dan Carvajal

Tax Foundation
1325 G Street, NW, Suite 950
Washington, DC 20005

202.464.6200

taxfoundation.org

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Executive Summary

Sales tax holidays are periods of time when selected goods are exempted from state (and sometimes local) sales taxes. Such holidays have become an annual event in many states, with exemptions for such targeted products as back-to-school supplies, clothing, computers, hurricane preparedness supplies, products bearing the U.S. government's Energy Star label, and even guns. High-tax New York State sparked the trend in 1997 as a way to discourage border shopping. In 2015, 18 states will conduct sales tax holidays, down from a peak of 19 states in 2010 (see Table 1).

At first glance, sales tax holidays seem like great policy. They enjoy broad political support, with backers arguing that holidays are a highly visible form of tax cut and provide benefits to low-income consumers. Politicians and other supporters routinely claim that sales tax holidays improve sales for retailers, create jobs, and promote economic growth.

Table 1

2015 Sales Tax Holidays & Price Caps

State	Dates	Clothing	School Supplies	Computers	Energy Star	Miscellaneous
Alabama	February 20-22					Generators \$1,000; Hurricane supplies \$60
	August 7-9	\$100	\$50	\$750		Books - \$30
Arkansas	August 1-2	\$100	No Cap			Clothing accessories \$50
Connecticut	August 16-22	\$100				
Florida	August 1-3	\$100	\$15	\$750		
Georgia	July 31-August 1	\$100	\$20	\$1,000		
	October 2-4				\$1,500	
Iowa	August 7-8	\$100				
Louisiana	May 30-31					Hurricane supplies \$1,500
	August 7-8					All purchases of tangible personal property up to \$2,500
	September 4-6					Firearms, ammunition, and hunting supplies (no cap)
Maryland	February 14-16				No Cap	
	August 9-15	\$100				
Massachusetts	August 15-16					All purchases of tangible personal property up to \$2,500
Mississippi	July 31-August 1	\$100				
	September 4-6					Firearms, ammunition, and hunting supplies (no cap)
Missouri	April 19-25				\$1,500	
	August 7-9	\$100	\$50	\$3,500		Computer software: \$350
New Mexico	August 7-9	\$100	\$30	\$1,000		Other Computer Hard-ware: \$500
	November 1-3				No Cap	
Ohio	August 7-9	\$75	\$20			School instructional material up to \$20
Oklahoma	August 7-9	\$100				
South Carolina	August 7-9	No Cap	No Cap	No Cap		Towels and Bedding - No Cap
Tennessee	August 7-9	\$100	\$100	\$1,500		
Texas	May 23-25				(a)	
	August 7-9	\$100	\$100			
Virginia	August 7-9	\$100	\$20		\$2,500	Generators \$1,000; Hurricane supplies \$60

Source: Tax Foundation review of state statutes and revenue department websites.

Note: Massachusetts in 2011, 2012, and 2013 passed legislation for its August sales tax holiday in early August each of those years. As of press time, the House had approved an August 16-17 holiday and the Senate had approved an August 9-10 holiday, but a final bill had not been enacted.

(a) Air conditioners up to \$6,000; refrigerators up to \$2,000; other Energy Star products no cap.

Despite their political popularity, sales tax holidays are based on poor tax policy and distract policymakers and taxpayers from real, permanent, and economically beneficial tax reform. Sales tax holidays introduce unjustifiable government distortions into the economy without providing any significant boost to the economy. They represent a real cost for businesses without providing substantial benefits. They are also an inefficient means of helping low-income consumers and an ineffective means of providing savings to consumers.

Principles of Sales Taxation

Sales taxes are a type of consumption tax, or a tax on spending on goods and services purchased by the end user. The principle underlying the use of sales taxes to fund government is that individuals should pay taxes in proportion to the benefit they receive from government spending; this idea is known as the benefit principle. Personal consumption is considered an appropriate proxy for the amount of government services consumed by an individual.

Thus, a tax on consumption is considered an equitable method of “paying” for government services.¹ Consumption also has the advantage of being relatively easy to track, measure, and tax. Many economists also prefer a consumption tax over an income tax because the former does not tax (and thereby discourage) savings.

Sales taxes in the United States are consumption taxes, but they largely exempt certain transactions such as higher education, housing, and health care. A properly structured sales tax, however, would tax all consumption by end users including services that are currently excluded.

Broadening the sales tax base while lowering the sales tax rate will mitigate both volatility in revenue collections and the economic harm caused by a high tax rate. A high tax rate increases distortions in the market and can inhibit growth by making a state less attractive for individuals and businesses.

Another important feature of good sales taxes is that they tax consumption once and only once. Business inputs, or business-to-business purchases that are used to create other products or services, should be excluded from the sales tax base. Otherwise, final products will be taxed multiple times: once (or more) during production and again when purchased by the end user. In practice, this multiple taxation unfortunately occurs in many states.

Sales taxes tend to be inherently regressive with regard to income, as low-income individuals tend to spend a greater percentage of their income in taxable sales than high-income individuals. In an effort to reduce this regressivity, items viewed as basic necessities, such as groceries, utilities, clothing, and prescription drugs, are often exempted from sales taxes

¹ See generally Nicolas Kaldor, *An Expenditure Tax*, Allen and Unwin, London, 1955.

in the United States. But these exemptions also benefit high-income taxpayers, while narrowing the base and necessitating a higher tax rate.

Ideally, sales tax reform would broaden sales tax bases while lowering sales tax rates, to produce a system that collects stable revenue with minimal economic distortion. Sales tax holidays are an example of the opposite—base narrowing—in that they carve out exemptions for certain transactions during certain time periods.

The History of Sales Tax Holidays

Ohio and Michigan enacted the first sales tax holidays in 1980 when they offered tax holidays for automobile purchases. But it was New York that sparked the modern trend, with the first sales tax holiday for clothing in 1997. New York's objective was to tackle border shopping, the phenomenon of residents traveling to nearby states to take advantage of lower sales tax rates (particularly clothing purchases in New Jersey). The sales tax holiday gave hope of reducing border shopping without the need of actually having to reduce the state's sales tax rate.

While sales tax holidays are often defended on grounds of economic benefits, in reality, a key motivation has been attempting to stop cross-border shopping, and perhaps even lure shoppers from other states. In 2005, Massachusetts adopted an extremely generous weekend sales tax holiday applying to all goods up to \$2,500, attempting to stop Bay State residents from shopping in next-door New Hampshire, which has no sales tax.² In 2009, Massachusetts temporarily abandoned the holiday as it raised its sales tax even further, from 5 percent to 6.25 percent.

Since the inception of sales tax holidays, many states have created them around certain products and industries.³ In 2015, 18 states will hold clothing sales tax holidays, 11 states will have school supplies sales tax holidays, seven states will have computer sales tax holidays, and six states will have Energy Star products sales tax holidays. Altogether 18 states will conduct a holiday, one fewer than in 2010. (See Tables 2 and 3 for a chronicle of sales tax holidays.)

2 In response, New Hampshire launched a \$40,000 ad campaign emphasizing the number of days each state has with no sales tax ("New Hampshire: 365, Massachusetts: 2"). See Alicia Hansen, *New Hampshire's 365-Day Sales Tax Holiday*, TAX FOUNDATION TAX POLICY BLOG, Aug. 4, 2005, <http://www.taxfoundation.org/blog/show/998.html>.

3 Not included in our list are Ohio and Michigan's 1980 sales tax holiday for car purchases, nor four gas tax holidays adopted between 2000 and 2005 (Florida, Georgia, Illinois, and Indiana). For information on state gas tax holidays, see Jonathan Williams, *Paying at the Pump: Gasoline Taxes in America*, TAX FOUNDATION BACKGROUND PAPER No. 56, at 14-16, Oct. 2007.

Table. 2
State Sales Tax Holidays, 1997–Present

State	Items	Days	Date	Years
Alabama	Hurricane supplies	3	Early February (2013), July (2012)	2012-2015
	Clothing, computers, school supplies books	3	Early August	2006-2015
Arkansas	Clothing, school supplies	2	Early August	2011-2015
Connecticut	Clothing, footwear	7	Mid August	2000-2015
	Energy Star appliances	3 months	June-September	2007
Florida	Clothing, footwear, books and school supplies (beginning in 2004)	7-9 (2004-2009), 2 (2010-2011)	End July (2004-2009) Mid/early August (2010) 2004-2007	1998-2001, 2010-2015
	Emergency supplies	12	Late May/early June	2005-2007 2014
	Energy Star appliances	7	Early October	2006, 2014
Georgia	Clothing, footwear, books, school supplies, and computers	4	Late March (2002), early August	2002 (twice), 2003-2009, 2012-2015
	Energy Star appliances	4	Early/mid October	2005, 2007-2009, 2012-2015
Illinois	Clothing, footwear and school supplies	10	Early/mid August	2010
Iowa	Clothing, protective equipment, select sports equipment	2	Early August	2000-2015
Louisiana	Tangible personal property, first \$2,500	2	Mid December, Early August in 2010	2005, 2007-2015
	Hurricane supplies	2	Late May	2008-2015
	Firearms	3	Early September	2009-2015
Maryland	Clothing, footwear	7-May	Mid/late August	2001, 2006, 2010-2015
	Energy Star appliances	3	Mid February	2011-2015
Massachusetts	Tangible personal property under \$2,500	2-Jan	Mid August	2004-2008, 2010-2015
Mississippi	Clothing, footwear	2	Late July/early August	2009-2015
	Firearms	3	Early September	2014-2015
Missouri	Energy Star appliances	7	Late April	2009-2015
	School supplies, computer software and hardware, clothing and footwear (beginning in 2005)	3	Early/mid August	2004-2015
New Mexico	Clothing, footwear, computers, school supplies	3	Early August	2005-2015
North Carolina	Clothing, school supplies, computers, educational, software, sports equipment	3	Early August	2002-2013
	Energy Star appliances	3	Early November	2009-2013
New York	Clothing, footwear	7	Mid January	1997-2000, 2004-2006
	Clothing, and footwear (beginning in 1998)	7	September, first week	1997-1999, 2003-2005
Oklahoma	Clothing, footwear	3	Early August	2007-2015
Ohio	Clothing, school supplies	3	Early August	2015
Pennsylvania	Personal computers	8	Mid August (2000, 2001), mid February (2001, 2002)	2000, 2001 (twice), 2002
South Carolina	Clothing, footwear, school supplies, computers, printers, software, various bath supplies and bed linens	3	Early August	2000-2015
	Most purchases	2	Late November	2006
	Firearms	2	Late November	2008-2010
Tennessee	Clothing, school supplies, computers	3	Early August	2006-2015
	Clothing, school supplies, computers	3	Late April	2006-2008
Texas	Clothing, footwear	3	Early/Mid August	1999-2015
	Energy Star appliances	3	Late May	2008-2015
Vermont	Computers	3	Mid August (2003, 2004), mid October (2004)	2003, 2004 (twice)
	Tangible personal property	2-Jan	Mid July (2008), late August (2009), Early March (2010)	2008-2010
	Energy Star appliances	7	Mid July	2009
Virginia	School supplies, clothing, footwear	3	Early August	2006-2015

Table 2
State Sales Tax Holidays, 1997–Present *Continued*

State	Items	Days	Date	Years
	Energy Star appliances	4	Early October, Early August (2015)	2007-2015
	Hurricane supplies	7	Late May, Early August (2015)	2008-2015
West Virginia	Clothing, footwear, school supplies, computers, educational software	3	Early August	2002-2004
	Energy Star appliances	7; 3 months in 2009 and 2010	Early September; September 1 - November 30, 2009-2010	2008-2010
District of Columbia	School supplies, clothing, footwear	10-Sep	Early/mid August	2001-2002, 2004-2008
	Clothing and shoes	10-Sep	Late November	2001, 2004-2008

Source: Federation of Tax Administrators; Adam J. Cole, *Sales Tax Holidays, 1997-2007: A History*, 47 STATE TAX NOTES 1001 (March 2008); ALA. CODE § 40-23-210 et seq.; ARK. CODE § 26-52-444; CONN. GEN. STAT. § 12-407E; GA. CODE § 48-8-3(75); IOWA CODE § 423.3(68); LA. REV. STAT. § 47:305.54; MD. CODE, TAX-GEN. § 11-228; MISS. CODE § 27-65-111(Bb); MO. REV. STAT. § 144.049; N.M. STAT. § 7-9-95; N.Y. TAX LAW § 1115(30) (Repealed); N.C. GEN. STAT. § 105-164.13C; OKLA. STAT. tit. 68, § 1357.10; 72 PA. CONS. STAT. § 7204(58) (Repealed); S.C. CODE § 12-36-2120(57); TENN. CODE § 67-6-393; TEX. TAX CODE § 151.326, 151.327; VA. CODE § 58.1-611.2; W. VA. CODE § 11-15-9G; DC CODE § 47-2005(32A) (Repealed). Florida did not codify its 2011 sales tax holiday. See H.b. 143, 2011 Leg. (Fla. 2011).

*Massachusetts enacted its 2013 sales tax holiday after press time, bringing the total number of sales tax holiday states in 2013 to 18.

Table 3
Summary of States with a Sales Tax Holiday

1980	2 (MI, OH)
1981-1996	None
1997	1 (NY)
1998	2 (FL, NY)
1999	3 (FL, NY, TX)
2000	7 (CT, FL, IA, NY, PA, SC, TX)
2001	7+DC (CT, DC, FL, IA, MD, PA, SC, TX)
2002	8+DC (CT, DC, GA, IA, NC, PA, SC, TX, WV)
2003	9 (CT, GA, IA, NY, NC, SC, TX, VT, WV)
2004	12+DC (CT, DC, FL, GA, IA, MA, MO, NY, NC, SC, TX, VT, WV)
2005	12+DC (CT, DC, FL, GA, IA, LA, MA, MO, NM, NY, NC, SC, TX)
2006	15+DC (AL, CT, DC, FL, GA, IA, MD, MA, MO, NM, NY, NC, SC, TN, TX, VA)
2007	15+DC (AL, CT, DC, FL, GA, IA, LA, MA, MO, NM, NC, OK, SC, TN, TX, VA)
2008	16+DC (AL, CT, DC, GA, IA, LA, MA, MO, NM, NC, OK, SC, TN, TX, VT, VA, WV)
2009	16 (AL, CT, GA, IA, LA, MS, MO, NM, NC, OK, SC, TN, TX, VT, VA, WV)
2010	19 (AL, CT, FL, IL, IA, LA, MD, MA, MS, MO, NM, NC, OK, SC, TN, TX, VT, VA, WV)
2011	17 (AL, AR, CT, FL, IA, LA, MD, MA, MS, MO, NM, NC, OK, SC, TN, TX, VA)
2012	18 (AL, AR, CT, FL, GA, IA, LA, MD, MA, MS, MO, NM, NC, OK, SC, TN, TX, VA)
2013	18 (AL, AR, CT, FL, GA, IA, LA, MD, MA, MS, MO, NM, NC, OK, SC, TN, TX, VA)
2014	17 (AL, AR, CT, FL, GA, IA, LA, MD, MA, MS, MO, NM, OK, SC, TN, TX, VA)
2015	18 (AL, AR, CT, FL, GA, IA, LA, MD, MA, MS, MO, NM, OH, OK, SC, TN, TX, VA)

Source: Tax Foundation; Federation of Tax Administrators; state websites.

A number of states have tried sales tax holidays and then canceled them, a trend that has accelerated during the current recession and related state government revenue downturn. Florida and Maryland canceled their holidays after 2007 (but have reinstated them since). Massachusetts canceled its 2009 holiday after it hiked its sales tax, but reinstated it at the last minute almost every year since. In 2009, the District of Columbia, faced with declining revenue and a widening budget shortfall, announced the one-year suspension of its August sales tax holiday only weeks before it was scheduled to occur, later repealing it permanently. Meanwhile, Florida, having skipped holidays in 2008 and 2009, returned to having a tax holiday starting in 2010. North Carolina, in July 2013, approved legislation ending future sales tax holidays, using the revenue instead for broad-based tax relief.

Many other localities, counties, towns, and even individual vendors, have opted out of their state's sales tax holidays.⁴ As noted tax scholar John Mikesell has put it, "State lawmakers are in the position of making a politically attractive decision with the cost of that decision being borne by someone else (local lawmakers), [a] condition[] ripe for poor policy choices."⁵

Sales Tax Holidays Do Not Promote Economic Growth

Supporters claim that sales tax holidays stimulate the economy. They argue that, first, individuals will purchase more of the exempted goods than they would have in the absence of a holiday, and second, consumers will increase their consumption of non-exempt goods through "impulse" purchases, paying taxes that would otherwise not have been collected.

Rather than stimulating new sales, sales tax holidays simply shift the timing of sales. In 1997, the New York Department of Taxation and Finance studied its clothing sales tax holiday and found that while sales of exempt goods rose during the holiday, overall retail sales for the year did not increase.⁶ On the contrary, shoppers waited until the holiday to purchase exempted goods, thereby slowing down sales in the weeks prior to and following the holiday. A University of Michigan study looking at computer purchases during sales tax holidays found that timing shifts "account[] for between 37 and 90 percent of the increase

4 See, e.g., Alabama Department of Revenue, *Local Governments That Have Notified the Department Regarding Participation*, <http://www.ador.state.al.us/salestax/STholiday.htm> (listing 59 localities that have opted out of the state sales tax holiday); Missouri Department of Revenue, *Back to School Sales Tax Holiday—Cities Opting Out*, <http://dor.mo.gov/tax/business/sales/taxholiday/school/cities.php> (listing 172 cities that opted out of the state sales tax holiday); Larayne Brown, *Shoppers throng to state's sales tax holiday*, Jackson Clarion-Ledger, Aug. 1, 2009. ("Kathy Waterbury, spokeswoman for the [Mississippi] State Tax Commission, has gotten reports that some retailers weren't participating in the event."). However, in most states with sales tax holidays, retailer participation is not optional.

5 John L. Mikesell, *State Sales Tax Holidays: The Continuing Triumph Of Politics Over Policy*, 41 State Tax Notes 107, 112, July 10, 2006.

6 New York Department of Taxation and Finance, *The Temporary Clothing Exemption*, at 23, Nov. 1997, http://www.tax.ny.gov/pdf/stats/policy_special/clothing/1997/1997_temporary_clothing_exemption.pdf.



in purchases in the tax holiday states over [a] 30-week horizon,” depending on price caps and particular products.⁷ Anecdotal evidence from other states supports these conclusions.⁸

Other evidence suggests that sales tax holidays attracted cross-border sales only when other states did not have their own holidays, which is no longer the case. Peter Morici, an economist with the University of Maryland, told the *Washington Examiner* in 2006 that a sales tax holiday “has to be a novelty to be a measurable success and it’s no longer.”⁹ As the costs of squeezing a disproportionate number of sales into a short period of time have become clear, evidence suggests that fewer shoppers participate.¹⁰ For the vast majority of those who shop during sales tax holidays, the holiday simply provides a modest windfall, or unexpected benefit, for doing something they would have done anyway.

“Impulse” purchases occur whenever consumers shop, and if consumers merely shift their purchases into a tax-free period, as the evidence suggests, their “impulse” purchases during a sales tax holiday are likewise shifted from other time periods. The increase in tax revenue would be far outweighed by the lost revenue from the much larger amount of tax-free purchases. It is therefore unlikely there is a net revenue gain from additional “impulse” purchases. And even if the “impulse” argument were true and consumers are essentially tricked into making extra unnecessary taxable purchases, that would contradict the argument that sales tax holidays are designed to provide a tax cut for consumers.

Job creation is a frequent argument in support of sales tax holidays. But this argument suffers from the same problems as the argument based on general economic growth. Any increase in employment will be modest and temporary, limiting the benefits. Temporary increases in labor associated with sales tax holidays are costly for businesses, more so than an equivalent increase spread over the whole year, because of the fixed cost associated with

7 Adam J. Cole, *Christmas in August: Prices and Quantities During Sales Tax Holidays*, at 23, May 2009. In a separate paper, Cole suggests the shifts are short-term ones, finding “no evidence that purchases are shifted across months to exploit the tax holiday in sufficient amounts to impact tax collections in months preceding or succeeding the month of a tax holiday.” Adam J. Cole, *The Fiscal Impact of Sales Tax Holidays*, at 3, May 2009.

8 See, e.g., Jenny Kincaid Boone, *Virginia’s Sales Tax Holiday: Just The Icing On The Cake*, *Roanoke Times*, Aug. 5, 2009 (“Larie Thompson...decided to get a head start on the sales tax holiday. She took her two daughters to the Bonsack Wal-Mart to scout out school deals, but she planned to wait until the tax-free weekend to buy them.”); Emilie Bahr, *New Orleans Merchants Hope Sales Tax Holiday Brings Boost*, *New Orleans Citybusiness*, Aug. 3, 2009 (“At The Garden Gate on Old Metairie Road, for example, manager Sara Draper said some customers will select a fancy fountain or bench but wait to swipe their credit cards until they can get the item during the tax-exemption period.”); Louis Llovio, *Sales-Tax Holiday On School Supplies Starts Friday*, *Richmond Times-Dispatch*, Aug. 2, 2009 (“Diane Parnell, who was shopping with Reason at the Target on Midlothian Turnpike last week, said she will do some shopping before the tax holiday begins, but will wait until the weekend to buy most of the supplies on her children’s list.”); LaTina Emerson, *Georgia’s Sales Tax Holiday Starts Thursday*, *Augusta Chronicle*, Jul. 29, 2009 (“Robyn Linen of Grovetown was shopping at Target.... She usually waits until the holiday so she can save money, she said.”); Emma Brown, *Shoppers Go For The Gold On Tax Holiday*, *Boston Globe*, Aug. 17, 2008 (“We’re going to come back again tomorrow’ for a stove, said Mariam Haddad of Somerville, who waited until this weekend to buy a crib for her day-care business and a digital camera for her 14-year-old daughter.”). The Tax Foundation has also received calls from individuals asking about the likelihood of their state conducting a sales tax holiday, with the caller’s intent being to postpone purchases if a holiday occurs. See, e.g., Josh Barro, *Even Proposing a Sales Tax Holiday Creates Instability*, *Tax Foundation Tax Policy Blog*, Oct. 21, 2008, <http://www.taxfoundation.org/blog/show/23803.html>.

9 Dena Levitz, *Sales tax holiday returns to Maryland*, *Washington Examiner*, Aug. 23, 2006.

10 See, e.g., Mary Worrell, *Sales Tax Holiday A Bust For Some Retailers*, *Hampton Roads Business Journal*, Aug. 13, 2007 (“Zenisek spent money advertising the tax-free weekend in area publications and had more employees in-store anticipating an influx of traffic, which she never saw.”); Mark Albright, *Sales Tax Holiday’s Appeal May Be Slipping*, *Tampa Bay Times*, Aug. 2, 2007 (“I’m done,’ proclaimed the Largo nurse and mother of three during a recent outing at Target, ‘I shop the sales year round for real deals. I’m trying to be more practical. I won’t be fighting crowds for the small savings during the sales tax holiday.”); Jenny Munro, *Budget-Conscious Shoppers Welcome Sales Tax Holiday*, *Greeneville News*, Aug. 5, 2009 (“Mel Lester, who was shopping for summer shorts for her two children, said she probably wouldn’t shop on the sales tax holiday weekend. ‘You don’t save enough to make it worth fighting the crowds,’ she said.”); Christel Phillips, *Many East Texans Not Waiting For Tax Free Weekend To Shop*, *KTRE (Lufkin, TX)* (“Parents tend to do it two weeks in advance,’ said Maria Hernandez, a JC Penny store manager. She says many parents don’t want to take a risk when school is just around the corner.... Some store managers recommend shopping before the tax free weekend to avoid missing out on items that could be out of stock.”).

hiring and training multiple temporary employees. By focusing on encouraging a few days of temporary employment during sales tax holidays, lawmakers lose sight of and undermine policies that promote long-term economic growth and job creation.

Recent budget difficulties have prompted some states and localities to cancel or opt out of their sales tax holidays. The District of Columbia Office of Taxation and Revenue estimated that it would save \$640,000 in tax revenue by canceling its sales tax holiday in 2009.¹¹ After eight years of sales tax holidays, District tax officials found the holiday did not spur enough economic growth to offset the costs. Other states would be wise to follow DC's lead and re-evaluate the costs and benefits of sales tax holidays.

Sales tax experts and economists widely agree that there is little evidence of increased economic activity as a result of sales tax holidays.¹² Politicians claim that sales tax holidays largely pay for themselves through increased economic activity and new collections. But experience shows that the claims of economic stimulus, increased revenue, and consumer savings are greatly exaggerated. States see little net economic activity as a result of sales tax holidays; the holidays instead represent a costly-to-administer revenue loss for the government.

Sales Tax Holidays Discriminate Arbitrarily Between Products

Sales tax holidays usually only apply to a specific list of products, such as school supplies, sports equipment, clothing, or computers. The number of categories has expanded in recent years to specific appliances, hurricane preparedness supplies, and even firearms. Restaurant owners in Massachusetts have even pushed for a prepared food sales tax holiday.¹³ These lists are a product of political forces. Politicians single out specific populations or industries and bestow targeted tax breaks on them. Such discrimination between products distorts consumer spending and reduces market efficiency by favoring certain products over others.

For example, the New Mexico sales tax holiday exempts computer microphones but not headsets, blank painting canvases but not dry erase boards, and backpacks but not duffel bags. Many states exempt backpacks during their "back to school" sales tax holidays even though a student may prefer to purchase a comparably priced messenger-style bag or duffel bag which accomplish the same functional goal but are not tax-exempt. The sales tax holiday raises the price of these items relative to the backpack and so the student is influenced to purchase the backpack. Though she saves a little money on the purchase, she ends up with a less suitable product that she would not have purchased in the absence of the holiday.

11 See, e.g., Micah Cohen, *A True Cause for Celebration: DC Cancels Sales Tax Holiday*, TAX FOUNDATION TAX POLICY BLOG, July 22, 2009, <http://www.taxfoundation.org/blog/show/24902.html>.

12 See, e.g., David Brunori, *The Politics of State Taxation: Dumber Than a Bag of Hammers*, 2001 STATE TAX NOTES 48-63, Mar. 12, 2001. After listing many of the flaws of sales tax holidays and citing scholars on left and right, Brunori colorfully writes that sales tax holidays are "dumber than a bag of hammers."

13 See Kendall Hatch, *Restaurants Seek Their Own Tax Holiday*, TAUNTON GAZETTE, Feb. 7, 2011. See also S.B. 1528, 2011 Leg. (Mass. 2011).

Likewise, a low-income elderly or childless couple may not have a need for school supplies, a computer, or sports equipment, but presumably they are as deserving of tax cuts as a consumer purchasing any of the exempt products. Using the tax code to discriminate between products can easily translate into discrimination between certain types of consumers, driving sales taxes further away from the ideal policy based on the benefit principle.

While it is true that consumers always face these cost-benefit tradeoffs in the market, tax policy should avoid adding unnecessary and discriminatory market distortions. In general, political efforts to manipulate the economy make markets less efficient by influencing consumers, retailers, and manufacturers to consume, sell, and produce more or less of a product than they otherwise would. While the economic costs of these distortions may be difficult to measure, they are real and economically damaging.

The fact that most sales tax holidays impose a price limit on the goods that are exempt only worsens the economic distortions. This encourages consumers to purchase cheaper goods over more expensive goods during sales tax holidays, even if they would prefer an item of better quality or suitability. Consumers should make consumption decisions for economic reasons, not tax reasons.

Sales Tax Holidays Can Mislead Consumers about Savings

Large retailers are often the biggest supporters of sales tax holidays. Given that they are the beneficiaries of free marketing for what is essentially a modest 4 to 7 percent sale, and that the mad customer rush in a short time allows them to raise prices, this is not surprising. Policymakers should not be convinced that a sales tax holiday is a good idea just because retailers support it.¹⁴

As weeks or months of sales cram into a weekend or a week, demand rises dramatically during sales tax holidays. Because the amount of inventory a retailer can have on hand is finite, many retailers understandably respond by raising prices rather than running out of stock too quickly. When lawmakers create sales tax holidays, the assumption is that the benefit will be passed on to consumers in the form of lower prices. In reality, retailers often absorb those benefits for themselves.

¹⁴ In December 2008, as interest groups of all kinds sought a piece of federal stimulus proposals under consideration, a group of large retailers pushed Congress to adopt three nationwide sales tax holidays for 2009. See, e.g., Ann Zimmerman, *Retailers Want In on Stimulus Plan*, WALL STREET JOURNAL, DEC. 24, 2008. The group stated its proposal would be stimulative, and pointed to a survey that 82 percent of consumers favored a sales tax holiday and that 69 percent said they would make purchases they otherwise wouldn't make. That consumers support receiving benefits when no costs are explained to them shouldn't be surprising. The economic evidence from various studies provided in this report undermines the idea that many additional purchases would occur, especially in a recession.

For example, assume a pair of shoes costs \$50, and with tax the total comes to \$53. During a sales tax holiday, the shoes are exempt from the sales tax, so the consumer would expect to pay \$50. But if the shoes are in high demand due to crowds turning out for the sales tax holiday, a retailer may have to raise the price or risk running out of stock too quickly. If he raises the price to \$51 or \$52, he absorbs a large share of the savings that are intended to go to the consumer.

Researchers at the University of West Florida studied the price effect of Florida's sales tax holiday in 2001.¹⁵ Using ten different types of apparel across ten retail locations, data was collected over a three-week period to analyze whether before-tax prices were comparable before, during, and after the sales tax holiday. Based on the prices observed in Pensacola before the sales tax holiday, it was expected that shoppers would save \$125.58 during the holiday on a representative basket of \$1,674.41 worth of consumer goods. Due to changes in the before-tax price of the various products, actual savings observed during the holiday were \$100.06. In short, retailers absorbed up to 20% of the benefit of a sales tax holiday, significantly reducing the benefit that consumers received. Their study is not conclusive for all tax holidays, but it strongly suggests uncertainty about how much consumers actually benefit from sales tax holidays.¹⁶

There is even evidence that the prices consumers pay during holidays may exceed the prices during other times of the year, even after accounting for the tax savings. A reporter in Charlotte, North Carolina, found that consumer price savings were better at six large stores in the week before the 2009 tax holiday than during it.¹⁷

Indeed, this seems to be a perverse effect of sales tax holidays: the more consumers they turn out, the more demand goes up, and the more prices rise.

15 See Richard Harper, et al., *Price Effects Around a Sales Tax Holiday: An Exploratory Study*, 23 PUBLIC BUDGETING & FINANCE 108-113, 2003.

16 The University of Florida researchers noted that prices also rose in nearby Mobile, Alabama, suggesting that some of the price increase occurred for reasons other than the sales tax holiday. Cole found in his study of computer prices during sales tax holidays that the holiday induced retailers to raise prices of inexpensive laptop computers but lower prices of inexpensive desktop computers. See Cole, *Christmas in August*, *supra* note 6. Additionally, scholars Richard Hawkins and John Mikesell note that retailers' ability to raise prices are more constrained during recessions. See Richard R. Hawkins & John L. Mikesell, *Six Reasons to Hate Your Sales Tax Holiday*, 2001 STATE TAX NOTES 801-803, Mar. 7, 2001. Further research analyzing price effects before and during sales tax holidays would be valuable.

17 See, e.g., Michael Handy, *Sales Tax Holiday Not All It's Cracked Up To Be*, WBTV (Charlotte, NC), Aug. 3, 2009 ("If you looked at the fine print in Sunday's newspaper advertisements, you may have noticed some of the best sale prices will end several days before tax-free weekend. In fact, JC Penney started a huge sale on Sunday which ends Tuesday. For example, Levi Jeans are marked down to \$32.99 which is \$11 cheaper than the normal price. If you wait for the sales tax holiday, you will pay the full price of \$44 and save only \$3 in taxes. Belk is also offering some of its best prices from now until Tuesday, including an extra 15 percent off all home purchases. Remember, you will save only seven percent if you wait for tax-free weekend. Some retailers are honoring their discounts for at least part of the sales tax holiday. Office Depot, Best Buy, Target and Sports Authority are running their biggest sales from now through Saturday. In these cases, you are better off waiting until the weekend."). See also David Brunori, *The Politics of State Taxation: Welcome to the Club?* 2001 STATE TAX NOTES 265, Jan. 22, 2001, ("I talked to several retailers in New York, who said they raised prices considerably knowing that people thought they were saving money by shopping tax-free.").

Sales Tax Holidays Cause Costly Complexity and Instability

Tax codes should be as simple as possible. Tax complexity means additional tax compliance costs. Because of their impacts on labor allocation and inventory management, sales tax holidays add complexity to sales taxes and are accompanied by administrative costs which can place a large burden on businesses. This extra burden represents a real cost to businesses, particularly small businesses, as valuable resources are diverted to pay for compliance with and implementation of sales tax holidays.

Businesses must reprogram their registers and computers to ensure they are in compliance with the temporary tax changes. Most states, for instance, prohibit stores from advertising that they will pay the sales tax on a purchase for the consumer; during a sales tax holiday, what is normally prohibited becomes mandatory. Lawmakers are likely to be under strong political pressure to provide ever expansive exemptions, and businesses are required to track and comply with these year-to-year law changes. These costs are especially high for small businesses without the overhead to dedicate employees to tracking these changes and ensuring compliance.¹⁸

Sales tax holidays force businesses to operate under more than one set of sales tax laws each year. These include non-intuitive and sometimes absurdly minute regulations about the holiday's operation. For example, Mississippi's sales tax holiday regulations prohibit the sale of individual shoes (evidently done as a way to get under the holiday price cap), permit the use of coupons, prohibit layaway sales but permit rain checks, and exclude shipping costs from the holiday.¹⁹ Virginia's sales tax holiday permits layaway sales and rain checks, does not permit rebates to lower the sales price, and excludes shipping but includes handling.²⁰ South Carolina subjected layaway sales to tax during its holiday.²¹ Texas exempts layaway sales as well as shipping, handling, and even installation costs as part of its Energy Star product tax holiday.²²

Vermont's sales tax holiday for computer purchases in 2004 applied to keyboards and mice but not printers, unless purchased as part of a bundled package, with the enigmatic caveat that "(1) the package is sold for \$4,000 or less and (2) the most common selling price of items that would be taxed if charged separately is not more than \$250 or 15 percent of the selling price of the package, whichever is greater."²³ Pennsylvania's 2000 holiday taxed

18 See, e.g., Mary Worrell, *Sales Tax Holiday A Bust For Some Retailers*, HAMPTON ROADS BUSINESS JOURNAL, Aug. 13, 2007 ("Corprew said larger corporations and department stores have the luxury of big computer systems to calculate tax-free items, but for a small business like her clothing shops, she and her partner spend hours photocopying receipts and organizing sales information just to make sure everything is accurate and in order. 'We have to split all the details and it's a tremendous amount of work for us,' Corprew said.").

19 See Mississippi State Tax Commission, *Official Guide for 2009 Sales Tax Holiday*, <http://www.mstc.state.ms.us/taxareas/sales/06-03-09SalesTaxHolidayGuide.pdf>.

20 See Virginia Department of Taxation, *Sales Tax Holiday for Clothing and School Supplies Guidelines and Rules*, <http://www.tax.virginia.gov/Documents/School%20Supplies%20and%20Clothing%20Sales%20Tax%20Holiday%20Guidelines.pdf>.

21 See S.C. CODE § 12-36-2120(57)(a)(vi).

22 See Texas Comptroller of Public Accounts, *Energy Star Sales Tax Holiday*, http://www.window.state.tx.us/taxinfo/taxpubs/tx96_1331.

23 Vermont Department of Taxes, *Temporary Exemption for Computers August 7-9 and October 9-11, 2004*, <http://tax.vermont.gov/pdf/word/excel/legal/tb/TB30.pdf>.

computer accessories, but they became exempt for the 2001 holiday, even when not purchased with a computer.²⁴

Virginia's hurricane preparedness holiday is ostensibly to help consumers stockpile needed supplies, but the list there is arbitrary as well.²⁵ Cell phone chargers are exempt, but laptop chargers are not. Duct tape is exempt but not masking or electrical tape. What some states include is somewhat unusual. South Carolina included "bath wash clothes, blankets, bed spreads, bed linens, sheet sets, comforter sets, bath towels, shower curtains, bath rugs and mats, pillows, and pillow cases" in its general sales tax holiday.²⁶ Virginia includes "clerical vestments" in its definition of clothing, along with suspenders (listed twice).²⁷

Besides the complexities of preparing for the sales tax holiday, businesses will have to deal with a distortion in consumer spending as shoppers shift their buying patterns to coincide with sales tax holidays. The increased activity during sales tax holidays may be accompanied by the need to hire temporary workers or pay their employees overtime compensation, as previously noted. But because this increase in consumption is largely a result of consumers shifting the timing of purchases, the result is simply a loss in efficiency for businesses without an overall boost in sales.

One retail establishment respondent in a 2015 survey of Massachusetts Retailers Association members said, "The sales tax holiday has created more problems than benefits for us. Business is nonexistent three weeks before and two weeks after. As a result, five weeks of business are crammed into two days, and the total amount of sales does not come close to five normal weeks of summer business."²⁸

Instability in tax law is costly to the economy not only because of complexity but also because it disrupts the plans and expectations of consumers and businesses. Not every state codifies its sales tax holiday in law; some instead pass a new bill establishing it each year. Florida alternated between having a holiday, not having one, and now having one again.²⁹ New York did the same. Even states that have codified them can suspend them. Washington DC's last-minute cancellation of its 2009 sales tax holiday created more costs and left everyone involved uncertain.³⁰ The sudden change meant businesses had to change their pricing systems and registers yet again.

Lawmakers should avoid creating temporary tax laws like sales tax holidays. From the perspective of a business trying to operate at maximum efficiency, the extra administrative and labor costs associated with a sales tax holiday are an unjustifiable burden, considering

24 72 PA. CONS. STAT. § 7204(58) (repealed).

25 See Mark Robyn, *Virginia's Hurricane Sales Tax Holiday*, TAX FOUNDATION TAX POLICY BLOG, May 20, 2009, <http://www.taxfoundation.org/blog/show/24716.html>.

26 See S.C. CODE § 12-36-2120(57)(a)(vi).

27 See Kail Padgitt, *VA Sales Tax Holiday*, TAX FOUNDATION TAX POLICY BLOG, Aug. 5, 2009, <http://taxfoundation.org/blog/show/24977.html>.

28 David Tuerck, Paul Bachman, & Frank Conte, *The Effects of the Massachusetts Sales Tax Holiday on the State Economy*, Beacon Hill Institute of Suffolk University, June 2015. <https://retailersma.org/sites/default/files/BHISalesTaxHolidayReport2015.pdf>.

29 See, e.g., Pat Hatfield, *The Mystery Of Florida's Vanishing Sales Tax Holiday*, THE DELAND-DELTONA BEACON, July 8, 2008.

30 See, e.g., D.C. *Shoppers Fuming Over Canceled Holiday Tax Relief*, WJLA NEWS, July 20, 2009, <http://www.wjla.com/news/stories/0709/641909.html>.

the unlikelihood that sales tax holidays increase overall sales. Instead of creating a subset of tax laws that apply only temporarily and then creating ambiguity about whether those very laws will even be implemented on a year-to-year basis, lawmakers should focus on enacting real and permanent tax relief.

Sales Tax Holidays Discriminate across Time

There is little economic justification for why a product purchased during one time period should be tax exempt while the same product purchased in another time period should be taxable.³¹ Experience with sales tax holidays shows that consumers will wait until a holiday to purchase the same goods they would have purchased earlier in the year. But purchases in one time period are no more beneficial to the economy, all else being equal, than purchases in another time period.

Time discrimination also has serious negative consequences for some consumers and businesses. Some consumers may be unable to shop during the sales tax holiday because they're working, are out of town, or are between paychecks. Presumably they are no less deserving of a tax break than consumers who can shop during the holiday, but the nature of the timing leaves them out.

Sales tax holidays result in government influencing consumers to change when they purchase goods, but in some cases, it might not be wise for consumers to put off the tax-free purchases until the holiday. (For example, it may not be the best idea to wait until the weekend before school begins to buy school supplies.) For others, it might be wiser to wait until after the holiday. For example, scholars Richard Hawkins and John Mikesell describe a working class family that puts off repairing its only car so that it can take advantage of the holiday, or a single, low-income mother who runs up her credit card during the August tax holiday to buy winter coats for her children.³²

Such government manipulation of consumer timing decisions is unwarranted and economically damaging. Experience shows that political decisions about holiday scheduling and product selection are often arbitrary and sometimes wholly unpredictable. Distorting consumer behavior with sales tax holidays is frequently not to consumers' benefit.

31 An exception would be where there is a negative externality, or societal cost, caused by consumers postponing their purchase. For instance, if an epidemic were raging and vaccines were available but too costly, immediately suspending governmental costs on vaccine purchases could encourage people to move up their vaccination, benefiting all society. In most such cases, however, other policy solutions such as subsidies or outright government provision would be more effective than a tax holiday. Another example would be a desire to move the timing of consumer spending, such as with stimulus packages. Whether this would be effective economic policy can depend on one's view about the effectiveness of stimulus packages, although sales tax holidays would likely be too small and too temporary for even a stimulative boost to aggregate demand. Similarly, stimulus proposals in 2009 for a federal payroll tax holiday were rejected in favor of direct government spending.

32 See Hawkins & Mikesell, *supra* note 16.

Sales Tax Holidays Are Not an Effective Means of Relief for Low-Income Consumers

Some supporters claim that sales tax holidays provide tax relief to the working poor. However, sales tax holidays are an inefficient way to achieve that purpose. Because sales tax holidays only provide a benefit for a short time, low-income consumers who may not be able to shop during the designated time for cost, mobility, or timing reasons cannot enjoy the benefits of the holiday.

Sales tax holidays provide savings to all income groups, not just low-income individuals. People of every income level can and do buy goods during sales tax holidays. If the purpose of sales tax holidays is to make school supplies and clothes cheaper for low-income individuals, then a 4 to 7 percent price reduction for all consumers, but only for a brief period, is an odd and ineffective way of achieving that. It's an example of politicians using a fire hose when a garden hose will do a better job.

If the citizens of a state determine that there truly is a legitimate need to help low-income consumers obtain particular products, a more targeted and effective approach could be a rebate or voucher program. Such a program would be administratively similar to existing food stamp programs and would only be available to the needy, avoiding a windfall for higher-income consumers. A rebate or voucher should make benefits available to low-income consumers regardless of when they shop. The poor would receive real benefits, while society avoids the economic distortions and burdens associated with sales tax holidays.

If policymakers genuinely want to save money for consumers, then they should cut the sales tax rate year-round. While the rate reduction may be modest, such a change would put the same money back in taxpayers' hands without the distortions and complications associated with a sales tax holiday. For example, applying the revenue loss from a 2008 New Jersey tax holiday proposal could reduce the state's sales tax rate from 7 percent to 6.6 percent year-round.³³ If tax relief for consumers looks good for a few days, why not give it to them all year long?

³³ See, e.g., Josh Barro, *New Jersey Republicans Propose Sales Tax Holiday*, TAX FOUNDATION TAX POLICY BLOG, Oct. 14, 2008, <http://www.taxfoundation.org/blog/show/23769.html>.

Sales Tax Holidays Are Not Real Tax Cuts and Distract Policymakers and Taxpayers from Tax Reform

Some sales tax holiday advocates support them as a way of giving revenue back to taxpayers. However, if the ultimate policy goal is reducing government involvement in individual and market decisions, sales tax holidays are a poor choice due to their complexity, administrative burdens, distortions, and arbitrary government micromanaging. As scholars Hawkins and Mikesell put it, sales tax holidays are highly intrusive, going so far as to call them “a Soviet-style state-directed price reduction on items selected by the state....”³⁴

Because states must balance their budgets, and because states rarely, if ever, cut spending to offset the revenue loss from sales tax holidays, the net result is that tax rates must rise elsewhere, now or in the future. Pushing for a sales tax holiday without associated spending cuts means that the government will have to raise revenue from other sources, creating even more complexity in the tax code.

Looking only at tax collections provides an incomplete picture of the economic damage caused by sales tax holidays. One must also look at the harmful effects of discrimination between different products and time periods, burdensome administrative and complexity costs on businesses, distortions of consumer behavior, and economically damaging uncertainty about tax policy. Real reform—broadening sales tax base and lowering sales tax rates—can achieve desired revenue collection levels without these costs. Going further to eliminate the sales tax year-round for all consumers is another option to reduce negative effects.³⁵

Tax holidays are a gimmick that distract policymakers and taxpayers from real, permanent, and economically beneficial tax reform. Their creation came about as a way to avoid addressing the negative effects of high sales taxes. Politicians often receive favorable media attention for pushing for these short-sighted policies, denigrating the hard work of those who support genuine tax relief.

³⁴ See Hawkins & Mikesell, *supra* note 16.

³⁵ Broadening the base and lowering the rate, or eliminating the sales tax, could find support on the left side of the political spectrum, where individuals often view sales taxes as harmful to the working poor. The four states with no state or local sales taxes are not all traditionally anti-tax states: Delaware, Montana, New Hampshire, and Oregon. The lack of a sales tax enjoys broad popular support in those states.

Sales tax holidays have enjoyed political success, but recently policymakers are reevaluating them. Rather than providing a valuable tax cut or a boost to the economy, sales tax holidays impose serious costs on consumers and businesses without providing offsetting benefits.

Taxes should raise revenue, not micromanage a complex economy by picking winners and losers in the market. Lawmakers should aim to raise the necessary revenue in the least economically distortionary and destructive way. To achieve this goal, sales taxes should be neutral toward products and timing decisions: all end-user goods and services should consistently be subject to the same sales tax. Narrowing the tax base, by contrast, is likely to lead to higher and more damaging taxes elsewhere.

Sales tax holidays neither promote economic growth nor increase purchases. They create complexities for all involved, while inserting the political process into consumer decisions. By distracting high-tax states from addressing real problems with their tax systems, holidays undermine efforts to provide legitimate relief to consumers in general and low-income individuals in particular. Sales tax holidays are no part of sound tax policy.
