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Temporary Gasoline Tax Holidays: Relief for Motorists or Poor Tax Policy?

by Jonathan Williams and Andrew Chamberlain

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As gas prices have risen in recent years, gasoline tax holidays have grown in popularity with lawmakers as a means of temporarily lowering retail gas prices for consumers. The phrase “tax holiday” generally describes any temporary repeal of a tax—in this case, any temporary repeal of local, state or federal sales or excise taxes on gasoline.

The most recent experiment with gas tax holidays was in the State of Georgia, when lawmakers temporarily repealed the state’s portion of the sales and excise taxes on gas during the period of abnormally high gas prices in the wake of Hurricane Katrina in 2005. Since 2000, three other states have also enacted gas tax holidays (see Table 1), and 41 states and the District of Columbia have considered or enacted similar proposals to suspend, cap, or otherwise freeze gasoline taxes.

Table 1. States Enacting Temporary Gas Tax Holidays Since 2000

State	Effective Dates	Description
Georgia	September 2005	Suspended state’s 7.5 cents-per-gallon excise tax and 4 percent sales tax on gasoline.
Florida	August 2004	Suspended 8 cents of the state’s 14.3 cents-per-gallon excise tax on gasoline.
Illinois	July-December 2000	Suspended the state’s portion of the sales tax on gasoline (5 percent).
Indiana	July-October 2000	Suspended the state's sales tax on gasoline (5 percent).

Source: *State Tax Notes*; Tax Foundation

While gas tax holidays are popular with lawmakers, they are generally poor economic policy. Tax holidays appear to provide a simple way to offer tax relief to consumers during times of high prices at the pump. However, not all forms of tax relief are created equal.

Some types of tax relief—including gas tax holidays—introduce costly economic distortions into the economy in the process of lowering tax burdens because they favor some industries and products over others. In contrast, broadly based and permanent tax relief does not favor particular industries or buying behavior, providing tax relief without harming the overall efficiency of the economy.[1] There is a growing body of research that suggests tax holidays are a costly and inefficient way to offer tax relief to consumers compared with more broadly based and permanent types of tax relief.[2]

Prices May Not Fall by the Full Tax Amount

Gas tax holidays are intended to lower gas prices at the pump. However, they may be a less efficient tool for achieving this than is widely believed by lawmakers.

Most gas taxes are imposed on wholesalers or retailers. When taxes are temporarily cut, there is uncertainty about whether tax savings will actually be passed on to consumers in the form of lower prices, or whether producers will absorb the savings. The question of whether consumers or business owners will benefit most from tax holidays depends crucially on whether buyers or sellers bear what economists call the “economic incidence” of gas taxes.

Economists make a distinction between the “legal incidence” of a tax—that is, who is legally obligated to remit tax payments to the government—and the “economic incidence,” which is the true economic burden of a tax.[3] Most economists agree that in the long run the economic burden of gas taxes falls on consumers. But in the short run when temporary gas tax holidays take effect, there is considerable disagreement about which portion of gas taxes is borne by buyers and sellers.

Past economic studies have found the economic burden of gas taxes can fluctuate depending on location, tax structure, and the length of the time period being analyzed.[4] As a result, it is likely that business owners bear at least some of the economic burden of gas taxes in the short run, causing retail gas prices to fall by less than the full amount of a temporary tax holiday—a point that is often ignored by lawmakers.

In general, a 1-cent temporary gas tax holiday will not lead to a 1-cent decrease in retail gas prices unless accompanied by price controls that artificially force down prices. Instead, the actual relief to consumers will often be smaller, making holidays an ineffective way to reduce retail gas prices.

Increased Administrative Costs of the Tax System

Like other types of temporary tax changes, gas tax holidays increase the administrative and enforcement costs of the tax system. Ultimately these costs must be made up for by higher taxes or spending cuts elsewhere in the economy.

As discussed above, in many cases gas prices will not fall by the full amount of a temporary gas tax cut. In an effort to force retailers to pass along tax savings to consumers, lawmakers often enact gas tax holidays with complex accompanying rules and regulations requiring gas stations to lower retail prices by the full amount of the tax cut—effectively levying a price ceiling on the retail price of gas.

For example, Georgia's 2005 gas tax holiday required gasoline sellers and distributors to pass on the full value of the tax holiday in the form of artificially lower prices. Failure to do so constituted an "unfair or deceptive act or practice" punishable under the "Fair Business Practices Act," subjecting companies to intense legal scrutiny.[5]

These regulations often require the establishment of complex and costly enforcement bureaucracies to monitor gas prices and the behavior of companies, increasing the cost of tax compliance for many small and medium-sized businesses. They may also result in costly legal investigations and criminal prosecution of business owners who unwittingly violate price regulations. For example, if gas retailers faced a sudden rise in production costs while a gas tax holiday's price controls were in effect, they could be faced with the difficult decision of having to violate the law to sell profitably—possibly inducing some retailers to shut down altogether rather than sell at a loss during the tax holiday.

Temporary Tax Changes Lead to Costly Instability
Instability in tax law is inherently costly to the economy, because it upsets plans and expectations of individuals and companies.[6] By design, gas tax holidays introduce unnecessary instability in tax law. Tax holidays effectively create two parallel tax codes that operate in different time periods, each with distinct sets of rules, regulations and enforcement mechanisms.

This instability in tax law unnecessarily raises the cost of tax compliance for retailers and wholesalers, requiring them to revise tax collection procedures, become familiar with new rules and regulations, and track the timing of tax changes. Other things being equal, this inherent drawback of gas tax holidays makes them a poor alternative to other types of tax relief such as permanent, broad-based rate reductions.

Tax Holidays Distort Markets
In addition to increasing the instability and administrative costs of the tax system, gas tax holidays interfere with markets in economically harmful ways. To some extent, tax holidays encourage consumers to stock up on goods during holidays and cut back before and after, causing people to change buying decisions for tax reasons rather than economic reasons. By introducing arbitrary distortions into markets, tax holidays make the economy less efficient overall.

A basic principle of sound tax policy is that taxes should aim to minimize the economic harm caused by the tax system, and influence individual behavior as little as possible. Gas tax holidays are not consistent with that principle, and introduce unnecessary distortions into the marketplace that well-designed tax relief does not.[7]

Conclusion
Gas tax holidays offer lawmakers a politically appealing antidote to rising gas prices. However, they are inconsistent with widely accepted principles of tax policy. Compared

with other types of tax relief, tax holidays reduce the efficiency of the tax system and the overall economy. Lawmakers should not rely on gas tax holidays, and should focus instead on permanent, broad-based tax relief and other long-term solutions to high gas prices.

Footnotes

1. Patrick Fleenor, "Taxing More, Taking Less: How Broadening the Federal Tax Base Can Reduce Income Tax Rates," *Tax Foundation Special Report* No. 135 (October 2005).
2. Richard R. Hawkins and John L. Mikesell, "Six Reasons to Hate Your Sales Tax Holiday," *State Tax Notes* (March 5, 2001).
3. Gerald Prante and Andrew Chamberlain, "Economic vs. Legal Incidence: Comparing Census Bureau Figures with Tax Foundation Tax Burdens," *Tax Foundation Fiscal Fact* No. 59 (June 9, 2006).
4. Joseph J. Doyle and Krislert Samphantharak, "$2.00 Gas! Studying the Effects of a Gas Tax Moratorium," National Bureau of Economic Research Working Paper No. 12266 (May 2006). Also see Hayley Chouinard and Jeffrey Perloff, "Incidence of Federal and State Gasoline Taxes," *Economics Letters*, (April 2004).
5. See Karen Setze, "Georgia General Assembly Ratifies Governor's Suspension of Fuel Taxes," *State Tax Today* (September 13, 2005).
6. Arthur P. Hall, Ph.D., "The Cost of Unstable Tax Laws" *Tax Foundation Special Report* No. 41 (October 1994).
7. See Hawkins and Mikesell, supra note 2.

Tax Foundation
2001 L Street NW Suite 1050
Washington, DC 20036
Ph: (202) 464-6200
Fax: (202) 464-6201
www.taxfoundation.org