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Sales Tax Holidays: Politically Expedient but Poor Tax Policy

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Sales tax holidays, the temporary suspension of state and local sales taxes levied on certain goods, have become an annual event in many states. Lawmakers advertise them as a generous tax cut on back-to-school shopping items, particularly for low-income residents, but overall sales tax holidays amount to poor tax policy.

Sales tax holidays have been a feature of state and local tax systems for more than a quarter century, and continue to rapidly spread throughout the country. Ohio and Michigan began the trend in 1980 when they offered tax holidays for automobile purchases. In 2006, 15 states and the District of Columbia will conduct sales tax holidays (see Table 1).

Table 1: Number of Sales Tax Holidays Reaches 15 in 2006

State	Dates	Length	Included Items
Alabama	Aug. 4-6	3 Days	Clothing under \$100 Computers, school supplies under \$750
Connecticut	Aug. 20-26	7 Days	Clothing and footwear under \$300
District of Columbia	Aug. 5-13	9 Days	School supplies and clothing under \$100
Florida	July 22-30	9 Days	Clothing and books under \$50 School supplies under \$10
	Oct. 5-11	7 Days	Energy-efficient products under \$1,500
	May 21-June 1	12 Days	Hurricane supplies
Georgia	Oct. 6-9	4 Days	Energy efficient products under \$1,500
	Aug. 3-6	4 Days	Clothing and footwear under \$100
Iowa	Aug. 4-5	2 Days	Clothing under \$100
Maryland	Aug. 23-27	5 Days	Clothing and footwear under \$100
Massachusetts	Aug. 13-14	2 Days	All sales under \$2,500
Missouri	Aug. 4-6	3 Days	Clothing under \$100 School supplies under \$50 Computer software under \$350 Computers under \$3,500
New Mexico	Aug. 4-6	3 Days	Clothing and footwear under \$100

			Computers under \$1,000
North Carolina	Aug. 4-6	3 Days	Clothing and school supplies under \$100 Computers under \$3,500
South Carolina	Aug. 4-6	3 Days	Clothing, computers/accessories, bedding, bath items
Tennessee	Aug. 4-6	3 Days	Clothing and school supplies under \$100 Computers under \$1,500
Texas	Aug. 4-6	3 Days	Clothing, accessories
Virginia	Aug. 4-6	3 Days	Clothing and footwear under \$100 School supplies under \$50

Source: Tax Foundation, CCH, Inc.

As sales tax holidays gain popularity among lawmakers, it becomes more important to point to their faults, which have been widely recognized by state tax experts in the past.^{[1](#)}

Sales Tax Holidays Discriminate Between Products

Sales tax holidays distort consumers' shopping decisions in an arbitrary way, pushing them to buy items chosen for a tax exemption by lawmakers, and away from items they would normally buy. Since it is impossible to compose a complete list of items deemed necessary for consumers, and because consumers' needs change over time, the list of tax-exempt items is commonly determined by political factors rather than economic considerations.

For example, a student shopping for back-to-school products may be forced to decide between a backpack, covered under a sales tax holiday, and a satchel, which is not covered under the holiday. The student may prefer the satchel, but because the backpack has preferential tax treatment, she ends up with the backpack instead.

Economists generally recommend against political efforts to manipulate the market, such as sales tax holidays, because they make markets less efficient, causing manufacturers to produce more of a product even though consumers would prefer something else. An efficient tax system should be neutral with regard to products: all end-user goods and services should be subject to the same sales tax.

Sales Tax Holidays Discriminate Over Time

Tax holidays not only single out certain products for special treatment, but also discriminate across time periods. When tax holidays are enacted, some consumers may be out of town or unable to shop, making them ineligible for tax relief for no good reason. Ideally, consumers should be left free to make purchases based on personal preferences and economic considerations, not tax considerations.

Sales Tax Holidays Introduce Unnecessary Complexity to the Tax Code

The tax system should generally be as simple as possible. Sales tax holidays add considerable complexity to already complex state sales tax systems.^{[2](#)} States typically limit sales tax holidays to only certain goods, such as "back-to-school purchases," and

most states also limit the dollar value of items that qualify. These requirements significantly add to the complexity and administrative burden of tax holidays.

Typically, once a sales tax holiday has become well established, lawmakers tend to add additional items to the list of exempt goods, often for political reasons. For example, the State of Florida began with a single holiday for school supplies in 1998. Today the state operates two additional tax holidays, one for energy-efficient appliances and one for all goods that relate to hurricane preparedness.

Sales tax holidays create tax complexity by forcing retailers to operate under more than one set of sales tax rules during the year, and by forcing them to develop systems for clearly marking which goods are covered by the temporary tax exemption and which are not. This additional compliance burden caused by sales tax holidays can generate large up-front costs, which may impose an onerous burden on small businesses that lack resources to comply with temporary rules and regulations.³ Sales tax holidays give an unfortunate illustration of the cost of instability in tax law.

Tax Holidays Fail to Deliver on Promises

Putting aside the economic problems with tax holidays, an examination of the results of past sales tax holidays shows they often fail to deliver the benefits promised. Supporters of tax holidays argue that they will help both consumers and retailers, but the evidence does not support this claim.

Evidence from the State of New York shows that tax holidays do not increase overall sales of retail goods. Instead, they merely shift the timing of retail purchases to the tax-exempt period.⁴ So while retailers may sell more pencils and erasers during the tax holiday, total retail sales do not increase over the course of the year.

Why then do large retailers generally favor the idea of sales tax holidays? For retailers that sell items meeting the lawmakers' tax-free criteria, tax holidays are an effective marketing tool. State lawmakers are often eager to demonstrate their generosity toward their constituents, and by doing so, selected retailers receive a state-sponsored windfall of free publicity.

Moreover, previous studies have indicated retailers may in fact increase pre-tax prices during sales tax holidays.⁵ If those findings are accurate, and retailers in fact tend to increase profit margins during sales tax holidays, it may not be the case that consumers realize the full value of tax savings at the checkout counter.

Sound tax policy seldom results from policies being determined by political factors rather than sound economic reasoning. While sales tax holidays remain popular with lawmakers and some retailers, they are generally poor economic policy. It is true that tax holidays reduce overall sales tax collections, but they are generally inferior to other forms of more broad-based tax relief that are available.

With the same budget impact, lawmakers could easily make small reductions in the general sales tax rate. By doing so, all consumers would be eligible for tax savings—regardless of what products they choose to purchase and when they choose to purchase them.

Conclusion

The purpose of sound tax policy is to raise necessary revenue for programs while minimizing distortions in the economy, and interfering as little as possible with the choices of free individuals in the marketplace. Unfortunately, sales tax holidays fail this test of sound policy.

Not all forms of tax relief are created equal. Lawmakers have the ability to choose among many alternative forms of tax relief, and sales tax holidays are among the least desirable options. If lawmakers wish to reduce the burden of taxes on consumers, they should enact permanent, broad-based tax relief that avoids the costly economic distortions caused by tax holidays.

Footnotes

1. See David Brunori, "Oysters and Gumballs," *State Tax Notes*, July 17, 2006, p. 185 and John Mikesell, "State Sales Tax Holidays: The Continuing Triumph of Politics Over Policy," *State Tax Notes*, July 10, 2006, p. 107.
2. Richard R. Hawkins and John L. Mikesell, "Six Reasons to Hate Your Sales Tax Holiday," *State Tax Today*, March 7, 2001.
3. John L. Mikesell, "State Sales Tax Holidays: The Continuing Triumph of Politics Over Policy," *State Tax Today*, July 10, 2006.
4. New York State Department of Taxation and Finance, Office of Tax Policy Analysis. "The Temporary Clothing Exemption, Analysis of the Effects of the Exemption on Clothing Sales in New York State," Report to the Governor and the Legislature (November, 1997).
5. Richard Harper, "Price Effects Around a Sales Tax Holiday: An Exploratory Study," *Public Budgeting & Finance* 23 (Winter 2003): pp. 108-113. Also see David Brunori, "The Politics of State Taxation: Welcome to the Club?" *State Tax Notes*, Jan 22, 2001

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