

SHOULD TAX-FREE HOLIDAYS BE ELIMINATED? A PRELIMINARY INVESTIGATION

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ABSTRACT

This paper examines the question on whether or not tax-free holidays should be eliminated. During any downturn in the economy, governments must investigate ways to increase revenue from taxes or decrease services offered the public. Eliminating or continuing tax-free holidays is a question that state legislatures offering the holiday must grapple with yearly. In answering this question, states must carefully examine how each of the stakeholders—government, retailers, and consumer—will be impacted. Based on preliminary findings, the researcher suggests that there is too much pressure from segments of all three stakeholder groups to eliminate tax-free holidays. Suggestions are made in the paper for further quantitative research that would provide more data in making this decision.

INTRODUCTION

A tax-free holiday is a temporary reduction or elimination of a tax, primarily the sales tax. Governments usually create tax holidays for one weekend, but some have been for a week or more, and they usually occur during a major shopping period for necessities, such as back-to-school. During that time, sales taxes are not collected on selected items, such as clothing and school supplies. There may also be other limitations, such as a maximum retail price on the exempt items. A statewide sales tax holiday was first enacted by the New York Legislature in January, 1997. Since then, nineteen states and the District of Columbia have participated in tax-free holidays.

How Do Tax-Holidays Differ from State to State?

Tax-Free holidays differ widely across the country. Florida has run its sales tax-free event for nine days—compared to three days in most states. Florida also had more restrictions, including a \$50 limit on tax-free items. One state, South Carolina, has had no dollar limit [31]. South Carolina's list of exempt items is also less restrictive than most states. North Carolina has specified that clothing with a price of \$100 or less and sports or recreational equipment with a price of \$50 or less are exempt. North Carolina limits computer purchases, including hard drives, monitors, keyboards, printers, scanners and software to \$3,500. In Florida, baseball cleats have been exempt, but catchers' mitts were not. Swim trunks were exempt, but underwater goggles were not. Sports uniforms were eligible to be tax exempt, but sports helmets were not [5].

What specifically makes the list of exempt items, and what does not, is a yearly debate in all states that have a tax-free holiday? Typically, that responsibility falls to a committee within the state's revenue department [2].

Other Types of Tax-Free Holidays

The tax-free holiday phenomenon has also expanded beyond back-to-school sales. The most popular new category, reflecting concerns about the high cost of energy and the state of the environment, are tax-free holidays for energy-efficient products. Vermont, West Virginia, Georgia, Virginia, North Carolina, Texas and Missouri have held sales-tax holidays for energy-efficient products [16] [23] [24].

In recent years, Louisiana, Florida and Virginia have held tax-free holidays for hurricane preparedness [13]. In Virginia, items exempted included portable generators up to \$1,000 and other hurricane preparedness supplies and equipment including blue ice, carbon monoxide detectors, cell phone batteries and chargers, non-electric storage coolers, portable self-powered light sources, portable self-powered radios, two-way radios, weather bank radios, storm shutter devices, tarpaulins, tie down kits, and packages of batteries. These supplies had to be priced at \$60 or less each [1].

Benefits of Tax-Free Holidays

Evidence indicates that generally, tax-free holidays have been a “hit” with consumers. Shoppers feel that keeping more of their dollars is always a good thing. Besides benefiting consumers, sales-tax holidays are also touted as being good for the economy. Consumers eat in mall food courts and other restaurants during their shopping day, purchase gas, and may even spend money on lodging if coming from out of town [19] [30].

The Department of Revenue Services in Connecticut has suggested that tax-free holidays help the state economy overall by having a positive impact on business [28]. In that state, the tax-free holiday has become one of the busiest of the year for purchasing clothing and shoes, which state leaders say boosts the bottom line for retailers and improves the general economy [29]. In Oklahoma, legislators there also tout the benefits of tax-free holidays [33]. The Retailers Association of Massachusetts has also reported year-over-year sales gains ranging from 50 to 500 percent [10] for that state’s first tax-free holiday.

Retailers lobby for these holidays as an economic stimulus that boosts their bottom lines. In 2000, Pennsylvania’s weeklong tax-free holiday boosted sales by an average of 60 percent, according to the Pennsylvania Retailers Association [22]. In Texas, statistics compiled by Telecheck Services Inc., found that same-store sales jumped by 4.8 percent over sales figures for the previous year during the first year of that state’s tax-free holiday [25]. Tourism advocates also suggest that the sales-tax breaks lure residents of neighboring states, which do not have a tax-free holiday, to take advantage of the savings [3] [4] [9].

Cost of Tax-Free Holidays

It is difficult to determine how many dollars a state relinquishes each time that it holds a tax-free holiday. Most states are unable to determine exactly how much tax revenue they lose because retail sales figures are only tabulated monthly. Typically, specific day-by-day figures or even week-by-week figures are not available to states from retailers.

Most states rely on estimates when determining the cost of tax-free holidays. For example, in North Carolina, initial estimates were that the loss would top \$8 million a year [20]. In 2006, the Texas

comptroller's office estimated the cost at \$52.1 million in sales taxes during the tax holiday in 2007 [7] [21].

In 2007, Florida lost tax revenues of about \$38 million during the state's tax holiday [18]. Loss of sales tax revenue in Georgia was \$11.98 million for the state and \$8.9 million for local governments in 2007 [27]. In neighboring South Carolina, the cost was approximately \$3 million in 2006, a 15 percent increase from the \$2.6 million cost in 2005 [8] [12].

In New Mexico, the state Taxation and Revenue Department estimated that there was a loss of between \$1.9 million and \$3 million and a local government loss of \$1.3 million to \$2.1 million in 2006 when that state held a tax-free holiday [26]. While in Maryland, the cost was \$5.1 million during 2001 and \$5.5 million in 2006 [6]. Connecticut relinquished about \$3.3 million in sales tax revenue during the state's tax holiday, according to the Connecticut Department of Revenue Services [17] [29].

Opposition to Tax-Free Holidays

There are some critics, however, that question the value of tax-free holidays. They argue that the events are popular because they look good politically. Politicians are able to say they are cutting taxes for the poor and working families [6] [11] [14]. The Washington, DC-based Tax Foundation released a report that was critical of the states that offered sales tax holidays. Their report called tax-free holidays a *gimmick* that has distracted policymakers and taxpayers from real, permanent, and economically beneficial tax reform. The study suggested that sales-tax holidays do not promote economic growth or significantly increase consumer purchases. The report further stated that experience shows the claim of economic stimulus, increased revenue and consumer savings are greatly exaggerated [32].

Shoppers should probably be less enthusiastic about tax-free holidays. How often would a promotion by a retailer be effective if it offered less than an eight percent discount (the amount of a sales tax)? Are customers who shop during a tax-free holiday getting the best deals from retailers? A report on the tax-free week in Florida found shoppers saved less than expected during the event because retailers offered less generous markdowns and promotional sales during the week of the tax-free holiday than they did immediately after the event. While there were savings during the tax-free time, shoppers could have saved more money the week after the holiday—many items that did not sell during the tax-free period were marked down further. The report also suggested that a tax holiday is a form of tax relief that generates more headlines than final price savings [31].

RESEARCH QUESTIONS AND PROCEDURES

Should tax-free holidays be eliminated? This is the question facing state legislatures during these difficult economic times as they search for new sources of revenue or programs to cut. This paper hopefully adds input into that decision.

First, a search was made to locate any previous academic studies related to the question. Little previous research existed in the literature. Next, an exhaustive search of newspaper articles appearing over the last eleven years (the span of time that tax-free holidays have been held) was conducted to locate information about what was occurring in the states that hold or have held tax-free holidays. Seven hundred and forty three newspaper articles were identified and tabulated. This paper is based on a synthesis of that data.

FINDINGS

The news articles were examined for general themes and conclusions. Eighty-five percent of them were positive about tax-free holidays. Only a limited number of the articles discussed any negative issues associated with the holidays. In fact, many of the articles were almost cheerleaders for the holidays—alerting shoppers to the fact that the tax-free holiday was approaching and detailing what products were exempt from a sales tax during that time. Many of the articles were written while the tax-free holiday was occurring and were based on interviews with shoppers in the stores. Again, mostly positive feelings were reported. One interesting finding was that a majority of the news articles discussed “how much shoppers saved” with the tax-free holiday. Only a few of them discussed “how much the events cost state and local governments. Only five of the articles called for a repeal of the event.

The researcher then identified the stakeholders that such a decision would impact. They were 1) state and local governments, 2) retailers, and 3) consumers. Positive and negative impacts for each group were identified. From a positive perspective, governments create goodwill among their constituents by sponsoring tax-free holidays. Legislators are able to campaign on a theme of cutting taxes for working people—individuals most impacted by regressive sales taxes. Many legislators also stress that additional tax revenues are created with tax-free holidays. They feel that shoppers who participate in tax-free holidays purchase many items that are not tax exempt, thus creating additional tax revenues—an economic stimulus. They also stress that these shoppers spend money on gas, eat at restaurants, and spend money on other activities during their shopping trips on tax-free holidays. From a negative perspective, tax-free holidays result in less revenue being collected, which means other taxes must be implemented or government services reduced. These tax reductions are especially critical during economic downturns.

From a positive perspective, for retailers, tax-free holidays generate customer traffic in stores. In fact, retailers are basically provided free advertising from the media to get shoppers into stores. Local TV, radio, and newspapers consistently run stories about tax-free holidays as they approach—they are almost reminding consumers to go out and shop. Tax-free items do not cost retailers; however, in recent years they have had to increase promotional deals in an attempt to attract even more customer. From a negative perspective, time is required to update computer pricing systems with exactly which products are tax-exempt. More employees must be hired; however, this expense can be offset if more sales are generated.

From a positive perspective, consumers view tax-free holidays as a savings, and any savings are important to them during economic downturns. Some items, such as some computers, may not be placed on sale until the end of the season. Tax-free holidays allow customers to save at the beginning of the season. For some customers, tax-free weekends may provide them with the internal satisfaction that they did not have to pay taxes on their purchases. From a negative perspective, tax-free weekends offer limited savings. Retailers offering less than an eight percent discount would probably not generate as much traffic; however, in recent years, retailers have begun offering additional promotions during this event. Moreover, a shopper’s savings is wiped out if they overspend on items that are not tax-exempt. Sometimes shoppers could save more after a tax-free holiday when some items may be discounted much more after the event.

SUGGESTIONS

There are proponents of tax-free holidays within each of the three stakeholder groups. They may be so entrenched that it would be difficult for governments to eliminate the event; nor does there seem to be any one of the stakeholder groups that are working for elimination of the tax-free holidays. However, in recent years, several states, that have held tax-free holidays in the past, have opted out of conducting them while the economic downturn continues. Many state legislators, however, have been reluctant to eliminate a government program that consumers and retailers view positively. Attempts to eliminate the tax-free holidays would probably cause an uproar from members of all three stakeholder groups.

During economic downturns, tax-free holidays should probably be eliminated. State and local governments need the additional tax revenues. Other types of tax relief would probably have a more beneficial impact on consumers who are negatively impacted by the regressive nature of sales taxes. And finally, the savings is relatively small for most shoppers making purchases during tax-free holidays. They possibly are being lured into stores to make purchases when retail prices are their highest.

FURTHER RESEARCH

This data synthesis found that additional research involving more quantitative data analysis is needed. Exact costs to state and local government due to exempted sales taxes are not known. Retailers report sales taxes on a monthly basis; therefore, only estimates are available as to actual revenue losses due to tax-free holidays. Research needs to examine retailers' sales figures for the period of the tax-free holiday and make comparisons to previous years. Most research efforts should be directed to learning more about consumer during tax-free holidays. Much of the consumer research related to tax-free holidays is anecdotal and not quantitative. Research also needs to be directed toward other consumer spending patterns during their shopping excursions on tax-free holidays. The amount of savings that shoppers are actually realizing during tax-free holidays also needs to be quantified. Could shoppers find better deals and more savings by waiting to make their purchases after the tax-free holiday?

Such quantitative research would provide better input into future decision-making efforts on this issue; however, tax-free holidays are currently a "hit" with shoppers, and that makes retailers happy. Happy constituents also make government politicians happy.

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