

Sales tax holiday spurs business, losses in tax collections

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Sales tax holidays for certain goods lead to significantly higher sales on the goods, but also substantially reduce tax collection revenue.

The findings appear in a new report by the Center for Local, State, and Urban Policy, which is in the University of Michigan's Gerald R. Ford School of Public Policy.

A sales tax holiday is a short window of time during which state and local taxes are eliminated or reduced for specific goods. Tax holidays are designed most often to reduce the tax burden on families with children and to encourage purchases of certain products in particular or to stimulate the economy more generally. They typically occur in August when many people do their back-to-school shopping.

As sales tax holidays have spread in popularity among other states—nearly 20 will participate this year—Michigan has not yet had one.

CLOSUP officials said given Michigan's severe budget problems it may be difficult for the state to consider enacting further tax cuts such as those implemented in other states.

"On the other hand, families across the state are suffering from the economic recession, and would surely welcome a tax break on back-to-school shopping," said Brian Jacob, who directs CLOSUP. "Retailers would likely also appreciate the boost in sales that would result."

The first sales tax holiday occurred in 1997 in New York, and the policy tool has been spreading to more states since then.

In its report, CLOSUP looked at the impact of tax holidays for computer purchases. In 2007, consumers purchased 161 percent more computers (total 58,600) during the tax holiday compared to the prior week.

Consumers who purchased a desktop computer priced \$250 to \$500 saved about \$29 during the sales tax holiday. While some purchases that would have been made anyway are simply shifted in time to take advantage of the tax break, these holidays also appear to induce purchases of computers that otherwise would not have been made in the absence of the holiday, particularly inexpensive desktops, Jacob said.

However, the study also found that sales and use tax collections decreased 4.2 percent during the months containing tax holidays. Nine states that had tax holidays in August 2007 collectively lost between \$3.3 million and \$5.1 million in sales tax revenue as a result of the week-long tax holiday on computer purchases.

Tax holidays also create opportunities for both noncompliance and tax evasion. Retailers face significant compliance costs when a tax holiday is implemented, providing some with an incentive to not comply with the tax holiday.

Provided by University of Michigan

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