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2017 Joint Committee on Finance Paper #310

Sales Tax Holiday (General Fund Taxes -- Sales and Excise Taxes)

[LFB 2017-19 Budget Summary: Page 188, #1]

CURRENT LAW

In general, a 5.0% sales tax is imposed on the purchase price from the sale, lease, or rental of tangible personal property and services identified by state law. A companion 5.0% use tax is imposed on the storage, use, or other consumption of the property or services purchased from out-of-state retailers if the sale would have been taxable had the property or services had been purchased in the state. In addition, counties may impose local sales and use tax of up to 0.5% on the purchase price. In limited circumstances other taxes may apply (such as stadium district tax).

GOVERNOR

The bill would create an exemption from the state and local sales tax for certain school supplies purchased during the two-day period beginning on the first Saturday in August and ending on the following Sunday (the holiday).

The following products would be eligible for the exemption: (a) clothing, but not clothing accessories or equipment, if the sales price is no more than $75; (b) computers purchased for personal use if the sales price is no more than $750; (c) school computer supplies if the sales price is no more than $250; and (d) school supplies if the sales price of any single item is no more than $75. School art supplies and school instructional materials would not be eligible for the exemption.

For purposes of determining eligibility, any single item having a sales price greater than the eligibility limit would not be entitled to the exemption. Items normally sold as a single unit could not be divided into multiple parts in order to obtain the exemption. Discounts and coupons would apply to the sales price for purposes of determining eligibility, so long as the seller is not reimbursed for the decrease in price (such as via a manufacturer's rebate) and the discount is proportionally applied to all purchased items where the discount is not specific to the purchase of an eligible item. Layaway sales of eligible items would qualify for the tax exemption if the buyer selects and the retailer sets aside the product during the holiday or if the final payment is made during the holiday. Eligible items purchased via rain check during the holiday would qualify; however, items purchased after the holiday via a rain check issued during the holiday would not.

The bill would provide definitions for the terms used above. However, the bill would not define "computer." Under the current sales tax statute, a "computer" means an electronic device that accepts information in digital or similar form and that manipulates such information to achieve a result based on a sequence of instructions.

The effective date of the provision would be May 1, 2017, unless the date of the bill's publication is after that date, in which case the effective date would be January 1, 2018. The tax holiday would sunset after 2018. The administration estimated that the sales tax holiday would reduce state sales and use tax collections by $11,000,000 in 2017-18 and 2018-19.

Substantially similar provisions for a sales tax holiday have been included into separate legislation in 2017 Assembly Bill 232 and Senate Bill 163. Assembly Bill 232 has been referred to the Committee on Ways and Means, but no action has yet been taken on the bill. Senate Bill 163 was referred to the Committee on Revenue, Financial Institutions and Rural Issues. No action has yet been taken by the Senate Committee.

DISCUSSION POINTS

Fiscal Analysis of the Bill

1. The administration estimated that the sales tax holiday under the bill would reduce sales tax collections by $11,000,000 in each year of the 2017-19 biennium. Of this amount, it was estimated that the exemption for school supplies would reduce revenues by $1.2 million, the exemption for computers and school computer supplies would reduce revenues by $1.5 million, and the exemption for clothing would reduce revenues by $8.3 million.

2. Subsequent to the introduction of the bill, the Department of Revenue (DOR) issued a fiscal estimate for the substantially similar sales tax holiday in Assembly Bill 232. According to DOR, the sales tax holiday would reduce state sales and use tax collections by $17.3 million annually. Of this amount, DOR estimated that the exemption for school supplies would reduce revenues by $1.3 million, the exemption for computers and school computer supplies would reduce revenues by $7.7 million, and the exemption for clothing would reduce revenues by $8.3 million. DOR indicates that that local sales and use tax collections would decrease by approximately $1.3 million annually.

3. DOR's estimate differs from the estimated reduction in revenues under the budget bill primarily because DOR's interpretation of which products would qualify as computers is larger than assumed under the administration's estimate for the budget provisions. DOR states that the

definition of computer under current law could technically include other products that have computer chips, such as televisions, cellular phones, and video game consoles.

4. DOR indicated that if the definition of computer were modified to items similar to laptops, desktops, and tablets, then the estimated annual cost of the temporary exemption for computers would be similar to that estimated by the administration under the bill (approximately $1.5 million).

5. The Committee could modify the bill to limit the temporary exemption for computers to personal computers such as laptops, desktops, and tablets (Alternative 2).

6. It must be noted that the administration assumed that the holiday would occur in both 2017 and 2018. However, pursuant to the effective date of the bill, the holiday would only be held in August, 2018. This is because the date of publication of the bill will necessarily occur after May 1, 2017. Thus, there is no estimated fiscal effect for 2017-18.

7. The effective date stated in the bill is due in part to the provisions of the Streamlined Sales and Use Tax Agreement (SSUTA), of which Wisconsin is a member. Under SSUTA, a holiday may be held only if notice of the holiday is provided to retailers at least 60 days prior to the first day of the calendar quarter in which the proposed holiday will begin. As a result, in order for a holiday in August, 2017, to be in compliance with the provisions of SSUTA, the proposal needed to have been enacted with notice to retailers on or before May 1, 2017.

8. It is unclear what penalty the state would face if the bill were modified to hold a holiday in August, 2017, in violation of SSUTA. DOR reports that the state collects approximately $10.1 million in 2016 from retailers who voluntarily remit use tax to the state (and other SSUTA member states) even though those retailers do not have a physical presence in Wisconsin. If the state were to be found out of compliance, it is possible that those retailers would no longer remit tax to the state and the bill could reduce state revenues by an additional $10.1 million annually.

Sales Tax Holidays

9. In 2016, 17 states held 25 sales tax holidays. The most common sales tax holidays apply to clothing and footwear (16 states), school supplies (10 states), computers (six states), and energy efficiency products (five states).

10. Proponents argue that sales tax holidays stimulate the economy by drawing in residents from other states for cross-border sales and by generating in-state consumer interest. For example, retailers may publicize and drive consumer interest through marketing and discounting during the holiday. Research into sales tax holidays held in other jurisdictions indicates that sales of exempted items do increase during the holiday period. Such increased activity may be taxable in other ways such as under the income tax or through increased sales tax collections from purchases of non-eligible items during the holiday.

11. Opponents, on the other hand, contend that sales tax holidays do not stimulate the overall economy on an annual basis because they shift the timing of purchases rather than generate

new ones. Further, cross-border sales may be minimal without significantly large reductions in sales tax (and assuming, of course, that nonresidents would not owe use tax to their local jurisdiction). As a result, critics argue that sales tax holidays reduce revenues without measurable increases in economic activity.

12. Proponents also emphasize that sales tax holidays provide a simple method for returning money back to specific taxpayers without creating permanent exemptions. A one-time or annual tax holiday may provide tax relief for a favored activity, such as retail sales related to education.

13. However, the tax relief benefits of sales tax holidays may be limited due to poor targeting. First, sellers may capture the tax relief meant for consumers by raising prices during the sales tax holiday. Second, tax holidays cannot provide tax relief to consumers unless they spend money within a certain time frame. Because wealthy consumers are more likely able to time their purchases than lower-income consumers, wealthy consumers may be more likely to receive tax relief. Further, consumers need to purchase goods and services throughout the year and will not receive any tax relief for purchases made outside of the holiday. Third, tax holidays generally suffer from ill-defined or arbitrary product inclusion. For example, some students may need or prefer products which do not qualify as school supplies and many senior citizens have no need for school supplies. As a result, such persons would not receive tax relief from a back-to-school sales tax holiday. Fourth, it may not be possible to exclude purchases by persons outside of the population intended to receive the tax relief. For example, a tax holiday intended for families with children may also provide tax relief to other groups that purchase eligible items, such as businesses, out-of-state residents, and childless families that purchase clothing or computers during a back-to-school sales tax holiday.

14. As with other sales tax exemptions, sales tax holidays decrease the simplicity and administrative efficiency of a general sales tax. For a few days a year every retailer is required by law to change their accounting and collection methods on certain sales of products and delivery methods. The burden of administrative compliance may fall unequally upon large and small retailers depending on the resources available for retailers to prepare for the change in tax law.

15. The Committee could approve the Governor's recommendation with the revised cost estimate prepared by DOR (Alternative 1). The administration indicates that the purpose of the proposed sales tax holiday is to provide tax relief to families as they make necessary purchases in preparation for the school year. The resulting loss of tax revenues would be $17,300,000 in 2018-19.

16. Alternatively, the Committee could delete the Governor's proposal because the purported tax benefits are relatively minor relative to the overall loss of revenue (Alternative 7). According to the 2011-2015 American Community Survey (ACS) conducted by the U.S. Census Bureau, there were 2,299,107 households in Wisconsin in 2015. Assuming that all such households purchased eligible items and the holiday would provide $11.0 million of tax relief annually, then on average each household would receive less than $5 in tax relief.

17. For comparison, according to the ACS there are 630,382 households in Wisconsin

with children under the age of 18. Assuming that all such households made purchases of eligible items during the holiday and that no other persons did, the average tax relief would be approximately $17. It should be noted that businesses, childless families, and out-of-state residents also make purchases of items eligible for the sales tax holiday. As a result, the average tax relief would be lower for Wisconsin households with children. Although the proposed holiday would make purchases of computers for non-personal use ineligible, it is unclear how such a measure could effectively be enforced at the point of sale by retail employees.

Alternative Tax Relief

18. If there is a desire to provide tax relief targeted to families with children, the Committee could consider alternatives to the Governor's proposal.

19. For example, the personal exemption for dependents under the individual income tax could be increased from $700 to $840, effective in tax year 2017 (Alternative 3). This would reduce income tax revenues by approximately $11.0 million in 2017-18 and 2018-19, the same amounts as estimated for the sales tax holiday by the administration. This alternative would ensure that all of the tax relief would be directed to families with children. The exemption amounts for non-dependent adults would not be changed. A drawback of this option is that families who do not earn enough income to pay state income taxes would not receive a benefit.

20. A more targeted approach would be to increase the state earned income tax credit (EITC). The state EITC is available to lower- and middle-income working parents, and is refundable, so that the full credit amount is provided even if the claimant does not have a state income tax liability. The current state credit is equal to 4% of the federal EITC for families with one child, 11% of the federal credit for families with two children, and 34% for families with three or more children. The credit is eliminated for families earning between approximately $40,000 and $55,000, depending on whether the claimant is a single individual or a married couple and how many qualifying children are in the family. Under current law, the state EITC is estimated to cost $101.9 million in 2017-18 and $104.3 million in 2018-19. If an additional $22 million were provided for the credit in the 2017-19 biennium, the credit amounts could be increased by 10.7% over current law (Alternative 5).

21. It should also be noted that the budget bill introduced by the Governor would provide $20.8 million in 2018-19 to increase the credit percentage for families with one child from 4% to 11% of the federal EITC, effective in tax year 2018. The budget bill would also enhance the credit for claimants who become married, and create a credit for noncustodial parents. Any additional increases in the credit could be enacted in conjunction with the Governor's proposals. Further, various options could be crafted regarding how the increases would apply to families of different sizes.

22. Either type of modification could be enacted on a temporary or permanent basis. As noted above, under the bill, the sales tax holiday would only be provided in 2017 and 2018, unless it were to be extended by subsequent legislation.

23. Finally, the state has reliable data regarding the number of dependents claimed for

income tax purposes and the number of claimants and costs of the EITC. Therefore, the actual fiscal impacts of the alternative approaches described above would likely be very close to the estimated amounts. By contrast, the estimated $11 million annual fiscal effect of the proposed sales tax holiday must be considered speculative. This is because the state has never conducted such a tax holiday, its fiscal impact would be significantly influenced by the behavior of retailers and purchasers, and the state does not collect data regarding sales tax paid on specific goods and services.

ALTERNATIVES

1. Approve the Governor's recommendation with the revised fiscal estimate projected by DOR for AB 232. Tax collections would decrease by $17,300,000 in 2018-19. As discussed, the fiscal impact differs from the amount estimated by the administration because more computers would be eligible than originally anticipated and because no holiday period would occur in 2017.

ALT 1	**Change to**	
	Base	**Bill**
GPR-Tax	- $17,300,000	$4,700,000

2. Modify the Governor's proposal to limit the definition of computers to personal computers such as laptops, desktops, and tablets (but not cellular phones).

ALT 2	**Change to**	
	Base	**Bill**
GPR-Tax	- $11,000,000	$11,000,000

3. Modify the Governor's proposal to delete the provisions relating to the sales tax holiday and instead permanently increase the personal exemption for dependents under the individual income tax from $700 to $840, effective in tax year 2017.

ALT 3	**Change to**	
	Base	**Bill**
GPR-Tax	- $22,000,000	$0

4. Adopt the modification under Alternative 3, but provide that the increased personal exemption amount would only be effective for tax years 2017 and 2018.

ALT 4	**Change to**	
	Base	**Bill**
GPR-Tax	- $22,000,000	$0

5. Modify the Governor's proposal to delete the provisions relating to the sales tax holiday and instead permanently increase credit amounts for the state earned income tax credit by 10.7% over current law.

ALT 5	Change to Base	Change to Bill
GPR	$22,000,000	$22,000,000
GPR-Tax	0	- 22,000,000

6. Adopt the modification under Alternative 5, but provide that the increase in the EITC would only be effective for tax years 2017 and 2018.

ALT 6	Change to Base	Change to Bill
GPR	$22,000,000	$22,000,000
GPR-Tax	0	- 22,000,000

7. Delete the Governor's proposal.

ALT 7	Change to Base	Change to Bill
GPR-Tax	$0	$22,000,000

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