BILL # SB 1147 **TITLE:** sales and use tax holiday

SPONSOR: Miranda **STATUS:** As Amended by Senate Finance

PREPARED BY: Brian Cary

FISCAL ANALYSIS

Description

As amended, the bill would exempt from the state and municipal Transaction Privilege Tax (TPT): clothing and footwear priced less than $100, computers priced less than $1,000, and school supplies priced less than $50 that are purchased during a 3-day period beginning the first Friday of August each year. The bill would require that municipal taxes also be incorporated in the sales tax holiday. The bill includes an emergency clause; as a result, this analysis assumes the first holiday would occur in August 2007 and affect FY 2008 tax collections.

Estimated Impact

Beginning in FY 2008, the bill is estimated to reduce General Fund revenues by $(2.8) million to $(6.0) million annually, depending on the extent to which consumers take advantage of the holiday.

The Arizona Department of Revenue (DOR) did not provide an estimate of the bill's fiscal impact.

Analysis

Consumer expenditure statistics from the U.S. Department of Commerce's Bureau of Economic Analysis (BEA) for the nation as a whole can be used to estimate sales of the exempt items in Arizona. Nationwide, BEA reported that purchases of items that would become exempt under the bill totaled $459 billion in 2005, including $55.4 billion for computers, $61.8 billion for school supplies, and $341.8 billion for footwear and clothing. Using the national figures to project Arizona sales of exempt items during the proposed 3-day holiday, total sales of exempt items are estimated to be $75.7 million, including $9.1 million for computers, $10.2 million for school supplies, and $56.4 million for footwear and clothing. These estimates are based on the assumption that purchases in Arizona would be proportionate to the state's share of the U.S. population. Based on the $75.7 million level of sales, the total annual General Fund revenue loss would be $(2.8) million. This estimate assumes that all of the exempt items purchased would be priced below the maximum prices specified by the bill.

This estimate is based on anticipated sales of the exempt items during the 3-day holiday period. However, it does not take into account two significant factors.

First, an undetermined amount of planned purchases would shift from other time periods to take advantage of the opportunity to avoid sales taxes. If the 5.6% state sales tax is avoided, along with city and county levies ranging from 2% to 4% or more, the exempt items would cost approximately 8% less during the tax holiday in most of the state's retail shopping centers. After the first sales tax holidays were introduced in New York, Texas and Florida, the estimated impact was to increase sales of exempt items by 70% to 100% during the holiday period. In other words, approximately 1.7 to 2 times the normal sales of exempt items would occur during the holiday.

Second, the reduced cost of exempt items may encourage consumers to purchase more of them than they would have otherwise. While this would benefit retailers, the exempt sales taxes would represent foregone revenue rather than lost revenue and would not have a significant impact on sales tax collections.

In order to project the impact of the bill, the experiences of two states with similar sales tax holidays were examined. South Carolina has an existing 3-day sales tax holiday which is annually held over the first weekend in August. The time period and the items exempt from state sales tax are similar to those exempted by SB 1147. The South Carolina Department of Revenue, which collects information from businesses on sales of exempt items during the holiday, reports that the revenue loss from the August tax holiday is approximately $(3.0) million per year. This figure does not include the additional impact of the November sales tax holiday that South Carolina introduced in 2006. Applying the South Carolina revenue loss to Arizona and adjusting for differences in population and the tax rate, the total expected revenue loss in Arizona would be $(4.8) million, of which $(3.2) million would be from the General Fund. There would be a greater incentive, however, for Arizona consumers to take advantage of a holiday as the combined state and local sales tax rates are higher in Arizona than in South Carolina.

Tennessee enacted a state tax holiday in 2006 that also is similar to the one proposed by the bill. It spans the same time period and exempts similar items by similar dollar amounts. The Tennessee Department of Revenue estimated that the state sales tax holiday reduced taxes collected for the state by $(11.1) million in September 2006. After adjusting for differences in population and the tax rate, Arizona's expected state revenue loss would be $(9.1) million, of which $(6.0) million would be from the General Fund.

In addition to its impact on the General Fund, the sales tax holiday would reduce funding for Proposition 301 education initiatives. The total annual revenue loss for these initiatives is estimated to be between $(450,000) and $(970,000).

Local Government Impact

TPT revenues are shared with local governments and any reduction in these collections would result in decreased funding for local governments. The proposal would reduce the city and county share of the state sales tax by between $(990,000) and $(2.1) million per year.

Besides the tax at the state level, the cities and counties assess their own individual sales taxes, resulting in additional losses of local revenues. Arizona's combined city and county sales tax rates range widely throughout the state, from 2% to 5.1%. Most of the communities with significant concentrations of retailers have a total sales tax levy of approximately 2.4%. Assuming a combined sales tax rate of 8% (5.6% state plus 2.4% local), the bill would reduce city and county sales tax revenue by between $(1.8) million and $(3.9) million.

2/8/07