

## MINUTES OF THE HOUSE TAXATION COMMITTEE

The meeting was called to order by Chairman Richard Carlson at 9:00 a.m. on March 3, 2009, in Room 535-N of the Capitol.

All members were present.

## Committee staff present:

Gordon Self, Office of the Revisor of Statutes  
Scott Wells, Office of the Revisor of Statutes  
Hank Avila, Kansas Legislative Research Department  
Chris Courtwright, Kansas Legislative Research Department  
Kathy Beavers, Committee Assistant

## Conferees appearing before the committee:

Representative Virgil Peck  
Richard Cram, Kansas Department of Revenue  
Mark Tallman, Kansas Association of School Boards  
Larry Baer, League of Kansas Municipalities  
Representative Elaine Bowers

## Others attending:

See attached list.

Representative Carlson announced the names of the sub-committee appointed to study **HB 2150**. They are:

Representative Jeff King, Chair  
Representative Mario Goico  
Representative Sharon Schwartz  
Representative Melody McCray-Miller  
Representative Larry Powell

**HB 2328 - Sales tax holiday providing exemption for certain purchases of school supplies, computers and clothing.**

The Chairman opened the hearing on **HB 2328**.

Chris Courtwright, Legislative Research Department, briefed the committee on **HB 2328**. Chris Courtwright provided information to the members on states that have a tax holiday and stood for questions (Attachment 1).

Representative Virgil Peck testified in support of **HB 2328** (Attachment 2). He stated that Kansas businesses would benefit from the passage of this bill. Missouri has a Sales Tax Holiday and consumers from Kansas go to Missouri to purchase school items. He stood for questions.

Richard Cram, Kansas Department of Revenue, testified in opposition to **HB 2328** (Attachment 3). The Fiscal Note on **HB 2328** is estimated to result in the loss of \$5.7 million in fiscal year 2010. The Department of Revenue is required to send a 60 day notice to retailers prior to the first day of the calendar quarter in which the sales tax holiday commences. A guidebook on what purchases are exempt, how to report the exempt sales, and provide other sales tax holiday instructional material is needed. Mr Cram provided information on the administrative impact. Mr. Cram included a study titled, *Price Effects Around a Sales Tax Holiday: An Exploratory Study* which compared Total Gross Price, Total Sales Tax and Total Final Price between Pensacola, Florida and Mobile, Alabama during the Florida Sales Tax Holiday. He stood for questions.

Mark Tallman, Kansas Association of School Boards, testified in opposition to **HB 2328** (Attachment 4). He stated five reasons for opposing this bill. Those reasons are:

- ◆ Kansas is in the midst of the most serious budget crisis
- ◆ Granting further tax exemptions is the wrong direction to go
- ◆ Merchants will benefit without lowering their own prices
- ◆ Families are struggling to make ends meet

CONTINUATION SHEET

Minutes of the House Taxation Committee at 9:00 a.m. on March 3, 2009, in Room 535-N of the Capitol.

◆ Public education is funded by our taxes

He stated that the tax base will be narrowed and will worsen the state budget.

Larry Baer, League of Kansas Municipalities, testified in opposition to **HB 2328** (Attachment 5). He stated that the passage of **HB 2328** would reduce revenue generated by retail sales to those entities that are reliant upon it. Revenues lost by the sales tax holiday must be made up by other means-either by decreasing services or increasing other sources of revenue, including property taxes.

The Chairman closed the hearing on **HB 2328**.

**HB 2324 - Sales tax exemption requirements for certain retail businesses under Kansas enterprise.**

The Chairman opened the hearing on **HB 2324**.

Chris Courtwright briefed the committee on **HB 2324**.

Representative Elaine Bowers testified in support of **HB 2324** (Attachment 6). Representative Bowers shared the story of a constituent in her district that had applied to the Kansas Department of Revenue for a sales tax exemption for his business, only to be told he did not qualify because the population in the county he resided in didn't meet criteria. The population count used was from the US General Census and was an estimate. Representative Bowers wanted to ensure new businesses thinking about expanding or locating to her district would meet criteria based on population numbers certified by the Secretary of State. **HB 2324** would strike the use of the words *United States Federal Census* and change it to reflect the *Kansas Division of Budget revised population numbers that are certified to the Secretary of State*. This will enable a more accurate population count. She stood for questions.

The Chairman closed the hearing on **HB 2324**.

The next meeting is scheduled for March 4, 2009.

The meeting was adjourned at 10:50 a.m.



**2008 State Sales Tax Holidays**  
[2007 State Sales Tax Holidays]

State	Days	Items Included	Maximum Cost	1 <sup>st</sup> Year	2008 Dates	Information Links
Alabama	3	clothing - \$100 computers - \$750 school supplies - \$50 books - \$30		2006	August 1-3	<a href="http://www.ador.state.al.us/salestax/SalesTaxHol.htm">http://www.ador.state.al.us/salestax/SalesTaxHol.htm</a>
Connecticut	7	clothing and footwear - \$300		2001	August 17-23	<a href="http://www.ct.gov/">http://www.ct.gov/</a>
District of Columbia	9	clothing - \$100 school supplies - \$100		2004	August 2-10	<a href="http://otr.cfo.dc.gov/otr/">http://otr.cfo.dc.gov/otr/</a>
District of Columbia	17	clothing - \$100		2004	Nov. 28 - Dec. 7	<a href="http://otr.cfo.dc.gov/otr/">http://otr.cfo.dc.gov/otr/</a>
Georgia	4	clothing/footwear-\$100 school supplies - \$20 computers and accessories-\$1,500		2004	July 31 - Aug. 3	<a href="http://www.etax.dor.ga.gov">http://www.etax.dor.ga.gov</a>
Georgia	4	energy and water efficient products - \$1,500		2006	Oct. 2 - 5	<a href="http://www.etax.dor.ga.gov">http://www.etax.dor.ga.gov</a>
Iowa	2	clothing - \$100		2000	August 1-2	<a href="http://www.iowaccess.org/tax/">http://www.iowaccess.org/tax/</a>
Louisiana	2	all TPP - \$2,500		2007	August 1-2	<a href="http://www.rev.state.la.us/">http://www.rev.state.la.us/</a>
Louisiana	2	hurricane preparedness items - \$1,500		2008	May 24-25	<a href="http://www.rev.state.la.us/">http://www.rev.state.la.us/</a>
Massachusetts	2	TPP - \$2,500		2008	August 16-17	<a href="http://www.mass.gov/dor/">http://www.mass.gov/dor/</a>
Missouri	3	clothing - \$100 computers - \$3500 school supplies - \$50		2004	August 1-3	<a href="http://www.dor.mo.gov/tax/">http://www.dor.mo.gov/tax/</a>
New Mexico	3	clothing - \$100 computers - \$1,000 school supplies - \$15		2005	August 1-3	<a href="http://www.state.nm.us/tax/">http://www.state.nm.us/tax/</a>
North Carolina	3	clothing - \$100 school supplies - \$100 computers - \$3,500 other comp. - \$250 sports equip - \$50		2001	August 1-3	<a href="http://www.dor.state.nc.us/">http://www.dor.state.nc.us/</a>
Oklahoma	3	clothing - \$100		2007	August 1-3	<a href="http://www.tax.ok.gov/">http://www.tax.ok.gov/</a>
South Carolina	3	clothing school supplies computers other		2000	August 1-3	<a href="http://www.sctax.org/">http://www.sctax.org/</a> <a href="http://www.sctax.org/MR/rdonlyres/157662F0-B425-4018-AAFC-85118F14AC35/0/RR0510.pdf">http://www.sctax.org/MR/rdonlyres/157662F0-B425-4018-AAFC-85118F14AC35/0/RR0510.pdf</a>
Tennessee	3	clothing - \$100 school supplies - \$100 computers - \$1,500		2006	April 25-27	<a href="http://tn.gov/revenue/">http://tn.gov/revenue/</a>
Tennessee	3	clothing - \$100 school supplies - \$100 computers - \$1,500		2006	August 1-3	<a href="http://tn.gov/revenue/">http://tn.gov/revenue/</a>
Texas	3	clothing and backpacks - \$100		1999	August 15-17	<a href="http://www.window.state.tx.us/">http://www.window.state.tx.us/</a>
Texas	3	energy star products air conditioners - \$6,000; other - \$2,000		2008	May 24-26	<a href="http://www.window.state.tx.us/">http://www.window.state.tx.us/</a>
Vermont	2	non-business purchases of tangible personal property under \$2,000		2008	July 12-13	<a href="http://www.state.vt.us/tax">http://www.state.vt.us/tax</a>
Vermont	7	non-business purchases of Energy Star Appliances under \$2,000		2008	July 12-18	<a href="http://www.state.vt.us/tax">http://www.state.vt.us/tax</a>
Virginia	7	hurricane preparedness items - \$60 generators - \$1,000		2008	May 25-31	<a href="http://www.tax.virginia.gov/">http://www.tax.virginia.gov/</a>
Virginia	3	clothing - \$100 school supplies - \$20		2006	August 1-3	<a href="http://www.tax.virginia.gov/">http://www.tax.virginia.gov/</a>
Virginia	4	energy efficient products - \$2,500		2006	October 10-13	<a href="http://www.tax.virginia.gov/">http://www.tax.virginia.gov/</a>
West Virginia	7	energy efficient products - \$2,500		2008	September 1-7	<a href="http://www.state.wv.us/taxdiv/">http://www.state.wv.us/taxdiv/</a>

STATE OF KANSAS

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VICE-CHAIRMAN: INSURANCE  
MEMBER: TAXATION  
TRANSPORTATION  
FINANCIAL INSTITUTIONS  
LEGISLATIVE POST AUDIT

HOUSE OF REPRESENTATIVES  
MAJORITY CAUCUS CHAIRMAN

**Testimony Regarding HB 2328**

**Chairman Carlson and members of the House Taxation Committee,**

Thank you for the opportunity to provide testimony regarding HB 2328.

A Back-to-school sales tax holiday is not a new idea to the Kansas Legislature, but when the economy suffers, as it currently is, it becomes even more important for legislators to stand up for Kansas families and businesses. HB 2328 is a proactive step in economic enhancement for our state.

An overwhelming majority of the Kansas population lives within a one hour drive of Missouri or Oklahoma. Both of these states have a back-to-school sales tax holiday. That causes Kansas businesses to be at a disadvantage during the back-to-school shopping season. Not only do they miss-out on selling exempted items, but they don't have the opportunity to sell other items that are not exempted. This reduces the revenue to businesses, communities and ultimately the State.

HB 2328 is not about what Kansas would **lose**, but about what we will **gain**. When money is spent in another state it benefits Kansas nothing. When consumers purchase goods in Kansas those dollars are reinvested in the Kansas economy. Not only does a sales tax holiday provide immediate, direct tax savings to consumers, it also spurs economic growth and development.

Without a back-to-school sales tax holiday in Kansas, many parents and grandparents will continue to drive across the state line, shop for clothing, school supplies, stop for lunch, fuel up their car and pick up extra items that aren't covered by the tax exemption.

Some have implied that a sales tax holiday causes businesses to avoid discounting their merchandise since the consumer will see a savings due to the sales tax exemption. I disagree. If you've ever been in a state (there are about 15 of them) that was conducting a sales tax holiday you know how busy the stores and malls are. That makes for competition, and a good business owner will want to be certain to capture their share, or more, of the market. That results in even bigger discounts.

Although I could say much more, I will close with this. When we discussed a sales tax holiday in 2006 a man named Mike Davis, who was a store manager with JC Penney's at Oak Park Mall in Johnson County, relayed his experience. He told us that on a usual day the Oak Park Mall Penney's sales volume was double that of the Metro North Penney's in Missouri. However, on the first day (Friday) of the sales tax holiday, the Missouri store had a 101% gain in sales while the Kansas store suffered a 2% loss for the day. Who won Kansas or Missouri?

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Testimony to the House Taxation Committee

Richard Cram

March 3, 2009

**Department Concerns with House Bill 2328**

Representative Carlson, Chair, and Members of the Committee:

House Bill 2328 amends K.S.A. 79-3606 to authorize a sales tax holiday. The proposal would allow for a sales tax holiday to occur during the period 12:01 am on the Thursday before the first Sunday in August and end at midnight on such Sunday. It would exempt from tax articles of clothing having a taxable value of \$300 or less, school supplies not to exceed \$100 per purchase, computer software with a taxable value of \$300 or less and personal computers or peripheral devices not to exceed \$2,000. The Act would be effective July 1, 2009.

The Department's fiscal note is attached. The fiscal impact of -\$5.7 million in lost sales tax revenue assumes that the first sales tax holiday would occur in August 2009. In order for that to happen, the Department must send notices to retailers of the holiday by May 1, 2009. Subsection 2(b) of the proposal requires the Department issue a notice to retailers 60 days prior to the first day of the calendar quarter in which the sales tax holiday commences. This is also a requirement in Section 322 A.2. of the Streamlined Sales and Use Tax Agreement (SSUTA). The Department cannot send notice to retailers until the bill has been passed by the Legislature and signed by the Governor, all of which must occur long enough prior to May 1, 2009 to give the Department time to prepare the notice to retailers with sufficient instructions on conducting the holiday. Otherwise, the sales tax holiday cannot be implemented until 2010. Any attempt to implement the sales tax holiday in August 2009 without meeting the statutory notice requirements would put Kansas out of compliance with the SSUTA, thereby jeopardizing Kansas' status as a Full Member State of the Governing Board.

Given the current fiscal situation, Kansas cannot afford a sales tax holiday. As our fiscal note outlines, the administrative costs of implementing a sales tax holiday are also significant.

Although sales tax holidays have grown in popularity in recently, they have been criticized as poor tax policy. Attached is a list published by the Federation of Tax Administrators of states with sales tax holidays, as of July 31, 2008. Our border states, Oklahoma and Missouri, currently have sales tax holidays. Colorado and Nebraska do not.

The obvious attraction of a sales tax holiday is that it supposedly encourages shoppers to make purchases in the state during the holiday period and provides a tax break to purchasers. New York was the first state to implement a sales tax holiday in 1997, in response to concerns that New York customers were shopping for their clothes in New Jersey. New York taxed clothing purchases, whereas New Jersey did not. Sales tax holidays have been spreading to other states ever since. However, studies conducted on New York and Florida sales tax holidays have shown that they do not to increase overall shopping volume in the state. The shopping volume is simply more concentrated in the sales tax holiday period, with corresponding decreases in volume before and after the holiday. Shoppers aware ahead of time of a sales tax holiday will plan their purchases accordingly, postponing them until the holiday arrives. (See 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," November 1997; Richard Harper, "Price Effects Around a Sales Tax Holiday: An Exploratory Study," *Public Budgeting & Finance*, Winter 2003, pp. 108-113 (attached); and Richard R. Hawkins and John L. Mikesell, "Six Reasons to Hate Your Sales Tax Holiday," *State Tax Notes* 20 (2001): 801-804 (attached).) (See comments of the Center on Budget and Policy Priorities dated November 6, 2001 on the New York study:

States that have implemented sales tax holidays have reported increases in sales during the holiday period. There is reason to suspect, however, that these increases in sales have not translated into overall improvements in state economies. Much of the reported increases can be attributed to consumers shifting the timing of their purchases from the weeks before or after the holiday 'window' to within it. The New York State Department of Taxation and Finance reported that the state's seven-day 1997 sales tax holiday on clothing did not increase quarterly clothing sales beyond what would have been expected even without the holiday; in other words, New York shoppers bought no more clothing in the winter of 1997 due to the holiday than they would have bought anyway.).

Also, there is no guarantee that the consumer's bottom line savings will be the sales tax. What is to prevent a retailer from raising prices to at least partially offset the sales tax during the holiday period?

In a recent article (attached), the Tax Foundation articulates well the policy flaws of sales tax holidays. If the idea is to give the consumer a tax break, why not simply lower the sales tax rate, so all consumers benefit—not just those making purchases of the items included in the sales tax holiday? If the State cannot afford to lower the rate, then enacting a sales tax holiday is clearly ill-advised.

**MEMORANDUM**

**To:** Mr. Duane Goossen, Director  
Division of Budget

**From:** Kansas Department of Revenue

**Date:** 02/24/2009

**Subject:** House Bill 2328  
Introduced as a House Bill

**Brief of Bill**

House Bill 2328, as Introduced, amends K.S.A. 79-3606 to authorize a sales tax holiday. The proposal would allow for a sales tax holiday to occur during the period 12:01 am on the Thursday before the first Sunday in August and end at midnight on such Sunday. It would exempt from tax articles of clothing having a taxable value of \$300 or less, school supplies not to exceed \$100 per purchase, computer software with a taxable value of \$300 or less and personal computers or peripheral devices not to exceed \$2,000. The proposal defines the terms used in the exemption and provides rules for layaway, rainchecks and returned items.

The Act would be effective July 1, 2009.

**Fiscal Impact**

The sales tax holiday exemption is estimated to result in the loss of \$5.7 million in fiscal year 2010. The estimate was updated from research for a similar proposal in 2006. Consumer expenditure data from the US Dept of Labor shows that the average midwestern household spend \$1,750 on clothing and \$998 on education annually. It is estimated that 75% of the clothing and 50% of the education purchases would qualify for exempt status during the holiday. Data on computer related expenditures comes from the state sales tax collections reports, which shows collections of \$5.8 million from computer stores, which are estimated to represent 25% of the total sales tax from computer equipment, including software and of that total it is estimated 75% would qualify for exempt status during the holiday. Based on these assumptions, daily sales tax collections were computed. Data from other states indicate there is an increase in purchases during a holiday from a slight increase to a 5-fold increase in purchases. For the Kansas holiday, it is assumed that purchases during the 5-day period sales would be at least triple the normal purchases .

	Total	SGF	Hwy	Local
FY 2010	\$5.7	\$5.0	\$0.7	\$1.4
FY 2011	\$5.8	\$5.1	\$.07	\$1.4



FY 2012	\$5.9	\$5.2	\$0.7	\$1.5
FY 2013	\$6.0	\$5.3	\$0.7	\$1.5
FY 2014	\$6.1	\$5.3	\$0.8	\$1.6

The fiscal impact assumes the proposal will be amended to state that for the holiday to be held in 2009, that the notice be mailed to retailers by May 1, 2009. As currently written, there could not be a holiday in 2009 due to the requirements for issuance of a notice (see administrative problems).

The fiscal impact assumes the statute is, and remains, in compliance with the streamlined sales tax agreement. Should the act be determined to not meet the terms of SSTA, the state could lose an estimated \$42 million in state sales and use tax revenue in fiscal year 2010 from remote retailers currently remitting tax under SSTA.

### **Administrative Impact**

Administrative costs to implement the sales tax holiday is estimated at \$259,000. The costs include:

- revision to sales tax publications (\$19,000)
- development, publication, and mailing of a sales tax holiday handbook (\$210,000)
- itemized schedule as part of the August tax return to report the exemption (\$30,000)

No costs have been included for administering the sales tax holiday, although experiences from other states show it does create significant additional work for the department. There are a lot of questions from consumers and retailers as to what is exempt and how the holiday works, retailers have questions on how to file their tax returns, and there will be more errors in reporting for August.

### **Administrative Problems and Comments**

Subsection 2(b) of the proposal requires the department issue a notice to retailers 60 days prior to the first day of the calendar quarter in which the sales tax holiday commences. Even though the effective date of the bill is July 1, 2009, the notice for an August 2009 holiday would have to be mailed no later than May 1, 2009. This is also a requirement in Section 322 A.2. of the Streamlined Sales and Use Tax Agreement (SSUTA). The Department cannot send notice to retailers until the bill has been passed and signed by the Governor which would have to occur prior to May 1, 2009. Otherwise, attempts to implement the sales tax holiday in August 2009 without meeting the notice requirements would put Kansas out of compliance with the SSUTA, thereby jeopardizing Kansas' status as a Full Member State of the Governing Board.

Experiences from other states point to the need for an extensive guidebook on what purchases are exempt, how to report the exempt sales, and provide other sales tax holiday instructional material. The department anticipates there will be extensive questions and concerns from retailers that will result in allocation of available resources to administer the holiday vs. performing other duties.

**Taxpayer/Customer Impact**

Provide a sales tax holiday for school, clothing and computer purchases during a 4 day period in August.

**Legal Impact**

Approved By:

A handwritten signature in cursive script that reads "Joan Wagnon". The signature is written in black ink and is positioned below the "Approved By:" text.

Joan Wagnon  
Secretary of Revenue

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**2008 State Sales Tax Holidays**  
[2007 State Sales Tax Holidays]

State	Days	Items Included	Maximum Cost	1 <sup>st</sup> Year	2008 Dates	Information Links
Alabama	3	clothing - \$100 computers - \$750 school supplies - \$50 books - \$30		2006	August 1-3	<a href="http://www.ador.state.al.us/salestax/SalesTaxHol.htm">http://www.ador.state.al.us/salestax/SalesTaxHol.htm</a>
Connecticut	7	clothing and footwear - \$300		2001	August 17-23	<a href="http://www.ct.gov/">http://www.ct.gov/</a>
District of Columbia	9	clothing - \$100 school supplies - \$100		2004	August 2-10	<a href="http://otr.cfo.dc.gov/otr/">http://otr.cfo.dc.gov/otr/</a>
District of Columbia	17	clothing - \$100		2004	Nov. 28 - Dec. 7	<a href="http://otr.cfo.dc.gov/otr/">http://otr.cfo.dc.gov/otr/</a>
Georgia	4	clothing/footwear- \$100 school supplies - \$20 computers and accessories- \$1,500		2004	July 31 - Aug. 3	<a href="http://www.etax.dor.ga.gov">http://www.etax.dor.ga.gov</a>
Georgia	4	energy and water efficient products - \$1,500		2006	Oct. 2 - 5	<a href="http://www.etax.dor.ga.gov">http://www.etax.dor.ga.gov</a>
Iowa	2	clothing - \$100		2000	August 1-2	<a href="http://www.iowaccess.org/tax/">http://www.iowaccess.org/tax/</a>
Louisiana	2	all TPP - \$2,500		2007	August 1-2	<a href="http://www.rev.state.la.us/">http://www.rev.state.la.us/</a>
Louisiana	2	hurricane preparedness items - \$1,500		2008	May 24-25	<a href="http://www.rev.state.la.us/">http://www.rev.state.la.us/</a>
Massachusetts	2	TPP - \$2,500		2008	August 16-17	<a href="http://www.mass.gov/dor/">http://www.mass.gov/dor/</a>
Missouri	3	clothing - \$100 computers - \$3500 school supplies - \$50		2004	August 1-3	<a href="http://www.dor.mo.gov/tax/">http://www.dor.mo.gov/tax/</a>
New Mexico	3	clothing - \$100 computers - \$1,000 school supplies - \$15		2005	August 1-3	<a href="http://www.state.nm.us/tax/">http://www.state.nm.us/tax/</a>
North Carolina	3	clothing - \$100 school supplies - \$100  computers - \$3,500 other comp. - \$250 sports equip - \$50		2001	August 1-3	<a href="http://www.dor.state.nc.us/">http://www.dor.state.nc.us/</a>
Oklahoma	3	clothing - \$100		2007	August 1-3	<a href="http://www.tax.ok.gov/">http://www.tax.ok.gov/</a>
South	3	clothing		2000	August 1-	<a href="http://www.sctax.org/">http://www.sctax.org/</a>

<b>Carolina</b>		school supplies computers other	3		<a href="http://www.sctax.org/NR/rdonlyres/157662F0-B425-401B-AAFC-85119F14AC35/0/RR0510.pdf">http://www.sctax.org/NR/rdonlyres/157662F0-B425-401B-AAFC-85119F14AC35/0/RR0510.pdf</a>
<b>Tennessee</b>	3	clothing - \$100 school supplies - \$100 computers - \$1,500	2006	April 25-27	<a href="http://tn.gov/revenue/">http://tn.gov/revenue/</a>
<b>Tennessee</b>	3	clothing - \$100 school supplies - \$100 computers - \$1,500	2006	August 1-3	<a href="http://tn.gov/revenue/">http://tn.gov/revenue/</a>
<b>Texas</b>	3	clothing and backpacks - \$100	1999	August 15-17	<a href="http://www.window.state.tx.us/">http://www.window.state.tx.us/</a>
<b>Texas</b>	3	energy star products air conditioners - \$6,000; other - \$2,000	2008	May 24-26	<a href="http://www.window.state.tx.us/">http://www.window.state.tx.us/</a>
<b>Vermont</b>	2	non-business purchases of tangible personal property under \$2,000	2008	July 12-13	<a href="http://www.state.vt.us/tax">http://www.state.vt.us/tax</a>
<b>Vermont</b>	7	non-business purchases of Energy Star Appliances under \$2,000	2008	July 12-18	<a href="http://www.state.vt.us/tax">http://www.state.vt.us/tax</a>
<b>Virginia</b>	7	hurricane preparedness items - \$60 generators - \$1,000	2008	May 25-31	<a href="http://www.tax.virginia.gov/">http://www.tax.virginia.gov/</a>
<b>Virginia</b>	3	clothing - \$100 school supplies - \$20	2006	August 1-3	<a href="http://www.tax.virginia.gov/">http://www.tax.virginia.gov/</a>
<b>Virginia</b>	4	energy efficient products - \$2,500	2006	October 10-13	<a href="http://www.tax.virginia.gov/">http://www.tax.virginia.gov/</a>
<b>West Virginia</b>	7	energy efficient products - \$2,500	2008	September 1-7	<a href="http://www.state.wv.us/taxdiv/">http://www.state.wv.us/taxdiv/</a>

(updated July 31, 2008)

If you have any questions, please direct your inquiry to Ronald Alt.

## Price Effects Around a Sales Tax Holiday: An Exploratory Study

*Richard K. Harper, Richard R. Hawkins\*, Gregory S. Martin and Richard Sjolander  
Department of Marketing and Economics, University of West Florida, Pensacola, Florida 32514  
rhawkins@uwf.edu\*, (850) 474-2656 -v\*, (850) 474-3174 -f\**

Abstract: Tax relief from a sales tax holiday depends on lower final prices for the eligible goods. In this paper, prices are compared for 10 goods across several retail locations before, during and after the 2001 Florida sales tax holiday period. The comparison is also extended to the same items in a metropolitan statistical area just outside of Florida. The exploratory data indicate that before-tax prices are slightly higher in Florida retail establishments during the sales tax holiday, but it is not clear whether these prices reflect less generous markdowns by Florida managers or pricing decisions for much larger regions. Whichever is the case, the tax policy forces consumers to speculate on non-holiday prices and choose items where the final price is, in fact, lower during the holiday.

### Introduction

*Sales tax holiday* is the common term for a temporary sales tax exemption on selected items in a particular state. The history of tax holidays is not well-documented – New York promoted the first documented clothing holiday in 1997, but new vehicle holidays occurred in 1980 in Michigan and Ohio.<sup>1</sup> Recent holidays have targeted goods that have a broad appeal to the family market. Clothing has been the most frequent focus for these holidays (and a ‘back-to-school’ time period has been chosen in several states) but computers and school supplies are also frequently mentioned in holiday proposals.<sup>2</sup>

There is an interesting asymmetry in the popularity of sales tax holidays. The Hawkins and Mikesell study found growing popularity among state policymakers – 12 states (plus the District of Columbia) had used a holiday and 5 more were considering a holiday – and recent

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<sup>1</sup> Richard R. Hawkins and John L. Mikesell, “Six Reasons to Hate Your Sales Tax Holiday,” *State Tax Notes* 20 (2001): 801-804.

<sup>2</sup> Georgia enacted the first holiday of 2002 and included qualified clothing, computers and school supplies for a two-day holiday in March and a two-day holiday in August.

slowdowns in the growth of state revenues may slow growth in new holidays, but once enacted, the events appear to gain momentum.<sup>3</sup> Conversely, tax holidays appear to be very unpopular among academics. Brunori found, in a casual survey, that many academics view the tax policy as inefficient and unlikely to produce a measurable economic impact.<sup>4</sup>

Central to any proposal for a back-to-school sales tax holiday on clothing is the idea that the final price of the goods during the holiday will be lower and that voters will save money. This idea has been challenged, initially by Hawkins, with the proposition that if retailers believe the holiday period will be popular with shoppers markdowns will be less generous.<sup>5</sup> For example, if a good was initially going to be marked 20% off during the period in question, the retailer may decide to only reduce the price 10% and, in effect, claim some, all, or even more than all of the tax relief.

Price changes in tax holidays also increase impact-analysis complexity for state budget personnel. If markdowns are less generous, total exempt purchases can overstate the revenue loss.<sup>6</sup> In other words, if the revenue authority observes an exempt purchase of \$25, that may represent a revenue loss of the tax rate on a \$20 purchase later in the year.<sup>7</sup>

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<sup>3</sup> For example, Florida legislators were concerned about the state budget in 2001, but chose to limit the holiday – reducing the value of the maximum eligible clothing item from \$100 to \$50 – rather than cancel it.

<sup>4</sup> David Brunori, “Introducing Brunori’s Law,” *State Tax Notes* 22 (2001): 605-606.

<sup>5</sup> Richard R. Hawkins, “The Tax Cut a Mother Might Not Love: Short-run Incidence and Temporary Sales Tax Exemptions on Clothing,” *State Tax Notes* 17 (1999): 199-201.

<sup>6</sup> Total exempt purchases may also include new purchases by out-of-state residents and these also overstate the revenue loss.

<sup>7</sup> A more difficult issue is whether the \$5 difference represents a reduction in some other part of the tax base.

The literature on sales tax incidence is not helpful in predicting the price effect. For example, Besley and Rosen found over-shifting of the sales tax rate in the final price for more than half of the 12 commodities tested, indicating that the before-tax price of clothing could fall if the items are exempted.<sup>8</sup> Such results – including the Kotlikoff and Summers finding that incidence should depend on market structure – are important in analyzing permanent exemptions, but should be less useful for short-term holidays where a new equilibrium probably will not be reached.<sup>9</sup>

To this point, there has been no quantified evidence on before-tax prices during a sales tax holiday. This study represents an initial attempt to examine the proposition that consumers do not receive the full benefit of a sales tax holiday. Pensacola, Florida was chosen as an important border metropolitan area for price examination during the 2001 Florida holiday. For the analysis, clothing items were priced at several retailers in the Pensacola MSA and the same items were priced at the same retailers for the neighboring Mobile MSA in Alabama.<sup>10</sup> The price data were gathered before, during and after the Florida holiday.

The paper is organized as follows. In the second section, the clothing and retailer sets are discussed. The findings on final prices are found in the third section. The fourth section includes a brief conclusion.

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<sup>8</sup> Timothy J. Besley and Harvey S. Rosen, “Sales Taxes and Prices: An Empirical Analysis,” *National Tax Journal* 52 (1999): 157-178.

<sup>9</sup> Laurence Kotlikoff and Lawrence Summers. “Tax Incidence,” in *Handbook of Public Economics, Volume II*, ed. Alan Auerbach and Martin Feldstein (Amsterdam: North Holland, 1987): 1043-1092.

<sup>10</sup> To this point, Alabama has not enacted a sales tax holiday.

## Shopping Method

Clothing represents one of the more difficult goods for price comparisons.<sup>11</sup> Given the heterogeneity of apparel, the items for this study are an expansion of the three items used in calculating ACCRA price indexes.<sup>12</sup> The ten items are listed in Table 1 and represent three basic clothing articles for women, three for children and four for men.<sup>13</sup> The sizes generally follow the ACCRA instructions.

A team of trained student shoppers gathered price data in Mobile on Wednesdays and in Pensacola on Thursdays. As mentioned, the data were collected over a three-week period, covering the week before, during and after the Florida holiday. Five large Department store chains have Mobile and Pensacola locations – Dillard's, Parisian's, Sears, JC Penney and McRae's – and price data were collected at each. Four specialty stores – Gap (and Gap Kids), Limited, Structure and Eddie Bauer – were also chosen. One discounter, Wal-Mart, was sampled to complete the retailer set. Each specialty store did not offer all ten items, but shoppers did find a subset of the items on all six visits and complete data exist for 74 stock-keeping units (SKU).<sup>14</sup>

## Price Effects

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<sup>11</sup> In fact, the U.S. Bureau of Labor Statistics uses a hedonic approach for calculating changing apparel prices in the Consumer Price Index.

<sup>12</sup> ACCRA, *Cost of Living Index Manual* (Arlington, VA: Author, 2001).

<sup>13</sup> The additional item is a better brand of a man's dress shirt. This item is frequently marked down and is under the \$50 gross-price ceiling.

<sup>14</sup> The authors note, however, that only one item, the women's cotton oxford shirt, was found at the Limited (a women's specialty store) on all six visits.



Based on the prices observed in Pensacola before the sales tax holiday, it was expected that the shoppers would save \$125.58 during the holiday (Table 2). They did not. With changing markdowns over time, savings during the holiday were \$100.06 (the difference between the total final price in the first and second row).<sup>15</sup> Under the assumption that total price should remain constant between the first and second period, the reduction indicates that retailers were able to claim roughly 20% of the holiday. With this perspective -- comparing final prices in Pensacola during the holiday to the same prices before the holiday -- customers only received 80% of the tax relief during this sales tax holiday.

The Mobile data indicate the area is a relatively expensive place to shop. Before tax prices were between 4 to 7% higher and Mobile shoppers pay a 9% combined state and local sales tax rate as opposed to the 7 ½% combined tax in the larger county within the Pensacola MSA.<sup>16</sup> Most importantly, one can observe an increase in Mobile pre-tax prices during the Florida sales tax holiday. If Mobile prices reflect regional (or even national) managerial decisions, the Mobile increase would indicate that Pensacola retailers did not strategically claim a share of the tax holiday. Under this regional price scenario, the holiday coincided with a high-price period in the market for clothing.

One piece of evidence – the degree of markdown independence – casts doubt on the strength of the regional price scenario. For 117 of the 444 price measures, shoppers found an

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<sup>15</sup> This is somewhat consistent with the claim by Brunori that some New York City retailers increased before-tax prices during a New York holiday. See David Brunori, *The Politics of State Taxation: Welcome to the Club?*, *State Tax Notes* 20 (2001): 265-268.

<sup>16</sup> The relative Mobile prices are consistent with the over-shifting found by Besley and Rosen (1999), but could also be explained by other factors, including higher prices for inputs.

item marked “on sale”. Slightly less than half – 54 of the 117 – represented a symmetric markdown in both markets for the same SKU at the same time. In other words, sizable spatial price variation exists and the cause for the Mobile price increase during the holiday is unclear.

The “on sale” totals for both areas and all three periods indicate that shoppers were more likely to find an item on sale after the sales tax holiday. The sale likelihood from the before period into the holiday remained about the same, e.g. 18 SKU’s in Pensacola before the holiday and 18 SKU’s during the holiday, meaning the before-tax price increase during the holiday reflected less generous reductions. This can occur when the lowest-priced items are marked down or the markdown percentage is low. Shoppers for this study found a mix of both.

The markdown variation is also reflected in the lowest final price for each SKU. For the man’s house brand dress shirt, the item was least expensive in the holiday for 3 of the 9 observations. For the boy’s underwear pack, the item was least expensive for all 7 observations.

### **Conclusions**

In this paper, the after-tax price effect from the Florida sales tax holiday has been analyzed for ten clothing items across ten retailers and three time periods. These goods were least expensive when purchased during the holiday, but not as inexpensive as expected before the holiday. This could indicate the use of less generous markdowns by Florida retailers to claim 20% of the tax relief, but higher prices in Mobile, Alabama could mean the holiday was scheduled during an intrinsically high-price period.

Several issues should be addressed in future research. First, an independent control city would help establish whether the timing of the Florida holiday is an issue in the pre-tax prices.

Second, independent retailers do not have centralized markdowns and may be a greater source of strategic pricing during sales tax holidays. Finally, a more extensive list of clothing items may shed more light on specific types of price effects around sales tax holidays.

The ultimate impact of a sales tax holiday is the introduction of a new type of taxpayer uncertainty. The current research questions the assumption that every shopper benefits from a sales tax holiday, but does not give a definitive answer. Ultimately, policymakers will have to decide whether tax relief should include a nebulous cloud of final-price uncertainty or be constructed to more conclusively benefit the intended recipients.

Table 1  
Items Used to Examine Price Effects Around a Sales Tax Holiday

Item	Number of Complete Observations	Before-Tax Price Statistics		
		Average Price	Minimum Price	Maximum Price
Man's Dress Shirt (House Brand)	9	\$28.87	\$11.96	\$45.00
Man's Dress Shirt (Better Brand)	5	38.51	19.99	59.50
Man's Slacks (Dockers or Equivalent)	9	35.54	11.97	69.50
Man's Underwear (Least Expensive Multi-Pack)	9	15.63	3.80	29.50
Boy's Knit Shirt (Better Brand)	7	15.75	6.28	25.00
Boy's Slacks (Dockers or Equivalent)	7	20.84	11.88	38.00
Boy's Underwear (Least Expensive Multi-Pack)	7	6.93	3.88	10.50
Women's Denim Jeans (Levi or Equivalent)	8	26.97	16.88	36.00
Women's Cotton Oxford Shirt	7	30.64	18.00	38.00
Women's Underwear (Least Expensive Multi-Pack)	6	12.37	5.86	16.00

Table 2  
Price Effects Around the Florida Sales Tax Holiday

Period (Relative to the Tax Holiday)	Total Gross Price	Total Sales Tax	Total Final Price
<u>Pensacola, Florida</u>			
Before	\$1674.41	\$125.58	\$1799.99
During	1691.34	8.59 <sup>1</sup>	1699.93
After	1663.82	124.79	1788.61
<u>Mobile, Alabama</u>			
Before	\$1749.47	\$157.45	\$1906.92
During	1814.60	163.31	1977.91
After	1738.08	156.43	1894.51

<sup>1</sup> Three items had a before-tax price between \$50 and \$60 and, at that price, would not qualify for the tax holiday. One of the items was sale priced below \$50 in the Pensacola market during the holiday.

Notes: Each total is based on 74 SKU's. The items were purchased at 10 retail establishments, each with at least one Mobile and Pensacola location.



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For a recent column in the series "The Politics of State Taxation" that comments on sales tax holidays, see State Tax Notes, Jan 22, 2001, p. 265; 2001 STT 14-26; or Doc 2001-2034 (3 original pages).

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3-17

by Richard R. Hawkins and John L. Mikesell

Holiday season is back again! Not Christmas, not New Year's, which have come and gone, but sales tax holiday season -- one of the great new bad ideas made popular at the end of the 20th century. With state legislatures in session, new holidays will be in the air.

California Gov. Gray Davis (D) has made a sales tax holiday part of his budget proposals for the new year; the District of Columbia has just approved one; the Washington State Legislature has a holiday bill in the committee process, as does Hawaii; Nebraska appears to have such a proposal under consideration, a holiday bill was prefiled by legislators in Arkansas; and there likely will be more. Only disappointing state revenue growth, as the economic expansion cools, promises to slow the spread of the holiday virus.

These holidays grant a short tax exemption period for particular items, generally clothing, and have considerable political popularity. This is not surprising -- no rational human being enjoys taxes and any relief, no matter how small or how short, is nice. Holidays also promise local retailers the advantage of a final price reduction without actually having to reduce the prices they charge. But political popularity ought not substitute for reasonable tax policy; government services have to be paid for somehow. Thus, the issue is how to distribute the cost of government across the private economy, not how to make taxes disappear. By the cold light of day, sales tax holidays simply are not part of good tax policy -- even though at least 12 states, plus the District of Columbia, have offered at least one holiday or have one approved for the future. /1/ Indeed, some of these states have legislated them into annual events -- a Soviet-style state-directed price reduction on items selected by the state, with the state treasury, not the stores, losing revenue. This short report explains why ordinary taxpayers -- not just tax policy fanatics -- should have deep suspicions about sales tax holidays, particularly in comparison with other forms of tax reduction.

As promised, here they are: **Six reasons to hate** your sales tax holiday.

#### 1. You Cannot Trust Your Retail Manager

The fundamental assumption in designing a sales tax holiday is that the policy will reduce final prices. If price tag amounts are fixed, this is an acceptable assumption.

Hawkins (1999) considered the length of the holiday and the nature of apparel retailers to question the incidence of the tax holiday. When retailers determine markdown (sale) percentages, inventories and expected demand are important. In strong markets, expected demand will be large enough that many items will not be marked down as generously, and the final price will include the tax rate exemption and a less generous markdown. /2/ The latter allows the seller to capture some of the benefits of the tax relief. In essence, the behavior of retail managers introduces a tax policy dilemma. Is the intent to give relief to those buying, for example, school supplies just before the start of the school year or to increase the profits of certain retail merchants?

In weak markets, markdowns will probably be unaffected and consumers will genuinely save on their purchases, but total tax relief to the resident population will be limited. When markets are strong, markdowns will be affected and many consumers will not save on their purchases. Customers should [\*802] beware -- their savings from a holiday may be considerably less than advertised.

#### 2. You Cannot Trust Your Retail Cashier

Mikesell (1997) identified a significant compliance cost for a clothing tax holiday. The typical clothing retailer monitors inventory and applies the sales tax with an automated cash register. For the holiday, either the cash register must be correctly programmed for every exempt item or the cashier must remove the sales tax when the cash register does not. This is especially complicated for purchases of apparel accessories. For every scarf, glove, necktie, hat, pair of football shoulder pads (and other athletic equipment), the consumer must monitor the transaction for whether the exemption applies, and whether the sales tax is removed. Each holiday spawns its own set of regulations, and there are always narrow distinctions between the taxed and the exempt, particularly when there are price limits on the exemption.

Retailers may have an incentive to err on the side of taxation. If a store manager exempts goods that do not qualify for the holiday, the revenue authority in that state may impose taxes (that were not collected) and penalties. Of course, the correction requires an audit of sales records that must be tracked to dates of the holiday -- an extra cost for both the retailer and the tax authorities. However, if the manager taxes goods that qualify for an exemption, one wonders if the typical revenue authority will impose any financial

punishment or even find the error, given the very low audit rates in most states. At the cash register, customers should bring a list of exempt items, perhaps printed from the state tax department's Web site.

### 3. You Will Be Burdened

The "excess burden" argument is relatively straightforward. If a tax change alters behavior, the revenue goal has been achieved at an efficiency cost. For a tax increase, this extra cost is commonly called the excess burden. For a tax cut, the concept is the same -- tax cuts that do not induce us to change our consumption, work, and savings habits are socially cheaper than tax cuts that do.

In the typical sales tax system, however, one finds numerous statutory sources for excess burdens. The food exemption is a popular example; the tax structure induces households to buy more grocery food than they would otherwise. /3/ Because analysts appear to be unable to convince policymakers that these excess burdens matter, we offer some hypothetical examples of the real excess burden of a clothing tax holiday for a working-poor family.

Mrs. Adams saves for the sales tax holiday in order to buy her children new winter coats. The tax holiday, however, is scheduled for August and she faces a limited selection of cold-weather apparel. The Adams children wear the light jackets that were available in August during the following winter.

The Robinson family is not aware of the tax holiday until the week before. Mrs. Robinson buys clothing for each of the children, but the family car breaks down the following week. With large clothing expenditures during the tax holiday, the price of the automobile repair includes a 19.9 percent interest charge on the family credit card.

In both cases, the limited span of the tax holiday changed household behavior and put a family in an undesirable situation. In hindsight, each household would have been willing to pay a few dollars to receive a check for the tax cut rather than participate in a government policy that prodded them to buy when they would not have otherwise. This payment is the excess burden of the sales tax holiday. Would customers/taxpayers prefer a \$ 12 tax cut delivered by a check in the mail or to have to spend roughly \$ 200 (assuming a 6 percent tax rate) during a particular week of the year on the specifically exempted goods to receive the same financial benefit? And the saving from the specific exemption may be even lower, depending on what retailers do with their normal markup percentages.

### 4. Your Favorite Online Vendor (of Affected Goods) Will Suffer

For select online vendors, the tax holiday removes an important price advantage and punishes the online seller (relative to the local seller). If you believe that online sales should not be subject to the sales tax, you will not want your state government to remove this competitive advantage for some of the online vendors.

Other online vendors, however, try to accurately collect and remit state and local use taxes for remote jurisdictions, sometimes voluntarily and sometimes because their physical presence requires them to do so. /4/ The tax holiday is extremely difficult for these vendors; they may be unaware of the event, they may be unsure of what is exempt, or they may have a difficult time adjusting their transaction system for the short-term holiday that only affects some of their customers. If you join the authors in believing that remote vendors' sales ought to be treated like sales by local vendors, a holiday treats remote vendors (and their customers) cruelly. Online vendors will reasonably see this as another sales tax complication, a violation of the alleged drive to sales tax simplification, and will have yet another reason to fight against the requirement that they register as use tax collectors.

### 5. You Will Love and Hate Visitor Spending During the Holiday

One topic that is frequently addressed in press coverage of a tax holiday is whether it will be good for the economy. In all probability, the short-run exemption will affect the timing of [\*803] clothing purchases, despite the markdown issue mentioned above, but it should have little effect on total household purchases for the year. This is consistent with the finding from a New York State Department of Taxation and Finance (1997) analysis of the effect of the first New York holiday: clothing sales during the holiday week were considerably higher, but clothing sales for the quarter that contained the holiday showed only a modest increase, roughly equal to normal growth. Any net effect on a jurisdiction's economy will depend on new purchases by visitors and the retention of resident purchases that would have been made elsewhere.

Empirical research has shown that border shopping is influenced by sales tax rates and that tax holidays



probably benefit shopping areas near state boundaries. /5/ These sales represent real gains for border retailers and help explain the popularity of the holiday; these retailers have a financial opportunity in both new visitor spending and retained local spending.

A sales tax holiday, however, is a weak instrument for boosting retail sales. Every state has visitors throughout the year, and many will benefit on spending that would have occurred without the holiday. /6/ Thus, the policy brings some additional spending to your area, but also rewards some of the visitors who would have contributed tax revenue anyway.

#### 6. You Will Know Some of the Tax-Relief Losers

Narrowly based tax cuts neglect some of the population. For example, many don't directly purchase gasoline and cannot directly benefit from any reduction of the sales tax that applies to it. Others purchase the commodity, but in relatively small quantities, and this limits their potential relief. For the popular clothing holiday, the elderly fall below the average household in clothing expenditures; therefore, they probably receive a disproportionately small amount of tax relief from a clothing exemption. /7/ The characteristics of these tax-cut losers will depend on the specific tax that is cut, but some neighbors, coworkers, and relatives - including many who would qualify for tax relief under normal criteria -- will be largely excluded from holiday relief. /8/

#### Conclusion

Tax holidays have soared in popularity since the New York policy on clothing in 1997. They have generated considerable headlines, and considerable tax exemptions, through purchases of targeted commodities during the specified periods. However, the holidays also violate most tax policy norms. They require vendors to segregate sales by date of sale and type of merchandise, thus increasing the cost of administration and compliance. The items selected for temporary exemption could add to the regressivity of the tax depending on the shopping behavior within the holiday. Much of the total relief will accrue to higher-income taxpayers or to local retailers instead of their customers. Furthermore, the timing and limited scope of the cut means that economic activity will be distorted.

In this article, we deviated from the usual academic objections -- regarding the social costs and benefits of the policy -- and developed six simple arguments to show why holidays are not the most desirable format for a buyer's tax reduction. If policymakers prefer policies that avoid the issues of trust for the retail manager, trust for the cashier, excess burden, unequal treatment of online vendors, love-hate toward visiting shoppers, and tax-relief losers, they will consider another type of tax cut. Permanently reducing the sales tax rate -- or even refunding unneeded tax revenues directly to the public, as Minnesota has done -- represent far more efficient, equitable, and effective approaches than a holiday.

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## FOOTNOTES

/1/ The laundry list of tax holidays includes Michigan (June 27 to July 31, 1980, reduced rate for certain motor vehicles); Ohio (September 19 to November 18, 1980, reduced rate for certain motor vehicles); New York (six holidays, the first from January 18-24, 1997, for clothing); Florida (August 15-21, 1998; July 13 to August 8, 1999; and July 29 to August 6, 2000, for clothing and accessories); Texas (August 6-8, 1999, and August 4-6, 2000, legislated as an annual event, for clothing and footwear); Connecticut (August 20-26, 2000, legislated as an annual event, for clothing and footwear); South Carolina (August 4-6, 2000, legislated as an annual event, for clothing, computers, and supplies); Pennsylvania (August 6-13, 2000, and February 18-25, 2001, for computers); Iowa (August 4-5, 2000, and August 3-4, 2001, legislated as an annual event for the first Friday and Saturday of August, for clothing and footwear); Maryland (August 10-16, 2001, for clothing); Indiana (July 1 to October 25, 2000, for gasoline); Illinois (July 1 to December 31, 2000, for gasoline); and the District of Columbia (August 3-12, 2001, for clothing, footwear, and school supplies).

/2/ In fact, Brunori (2001) found evidence of price markups during the holiday period in a casual survey of New York retailers.

/3/ Iorwerth and Whalley (1998) demonstrated a production-based inefficiency here, under which the exemption shifts households from restaurant meals to home meals.

/4/ Because the transaction does not take place in the local jurisdiction, use tax is generally owed by the purchaser but can be collected by the remote vendor.

/5/ Mikesell (1997) summarizes numerous studies on this effect. In general, a 1 percent difference in the sales tax rate will reduce per capita retail sales by roughly 7 percent in the high-tax-rate area compared with an adjacent low-tax area.

/6/ The Florida Legislature tried to avoid this by not extending the exemption to sales at a theme park, an entertainment complex, within a public lodging establishment, or within an airport.

/7/ In the published tables for the 1998 Consumer Expenditure Survey, all households report spending 4 percent of income on apparel and apparel services. For households with a reference person over 65, this spending accounts for 3.4 percent of income. Many studies have examined the relationship between spending and income to determine the vertical equity of the general sales tax; this relationship between spending and age is one of the horizontal inequities of a clothing exemption.

/8/ Other losers include the locally provided services you are forgoing if your local government joined the state in the tax holiday, as well as the revenues to companies and governments in jurisdictions across the state line.

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August 3, 2006

## Sales Tax Holidays: Politically Expedient but Poor Tax Policy

by Jonathan Williams, Curtis S. Dubay and Johanna Mausolf

### Fiscal Fact No. 63

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.<sup>1</sup>

### **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.<sup>2</sup> 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.<sup>3</sup> 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.<sup>4</sup> 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.<sup>5</sup> 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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August 20, 2008

## Sales Tax Holidays: Small Gains Are Outweighed By Serious Harms

by Joseph Henchman

I'll be appearing on Fox Business Network at 2:00 PM to talk about sales tax holidays. These one- or two-day breaks from sales taxes for specific items are increasingly popular; 16 states had or are having one this year. The holiday in D.C. is representative: school supplies, clothing, and shoes under \$100 were temporarily exempt from the 5.75% sales tax from August 2 to 10.

Everyone seems to win with these holidays. Consumers save some hard-earned money, retailers get free advertising, and politicians get to take credit for cutting taxes. What's the harm with sales tax holidays?

*They put politicians in charge of deciding what qualifies for tax-free status.* Tax systems should be neutral; taxes should be used to raise revenue, not encourage or discourage certain behaviors. But most sales tax holidays apply only to specific products under certain prices. Sales tax holidays essentially allow government to artificially shape what products are purchased and when. By doing so, the government places itself in the business of deciding economic winners and losers - a function that should always be the sole responsibility of the free market.

*They have heavy administrative and compliance costs.* Sales tax holidays are also non-neutral across time, since the tax treatment of many things will differ depending on when it is purchased. Anecdotal evidence suggests that purchases are merely shifted in time to the holiday, requiring retailers to have more inventory on hand but without increasing overall sales. Tracking which purchases are exempt and which aren't can be a headache for business owners. Tax holidays create unstable tax codes that force businesses to develop new administrative and compliance strategies every time a tax holiday is enacted.

*They divert attention from longer-term tax reforms.* It would be better tax policy (less distorting, more neutral) to drop the three-day tax holiday altogether and instead reduce the overall sales tax rate by 3/365ths (or more) all year long. Consumers would get the same benefit without all the headache and administrative mess of picking a date that everyone can agree on. But holidays allow politicians to take credit for cutting taxes when they really haven't.

*They mislead consumers.* State-funded advertising campaigns usually leave the fact that only some goods are exempt for the fine print. For the most part, consumers just buy what they were already planning on buying. According to the New York State Department of Taxation and Finance, while the Empire State's first sales tax holiday increased sales during the period of the holiday, sales for the year were virtually unchanged. In other words, shoppers didn't buy more; they just shifted the timing of their purchases. Other studies have indicated that retailers may raise their pre-tax prices during the tax holiday, leaving consumers out of the full tax savings. So consumers may not even save anything.

Politicians love enacting these holidays as a gimmicky way to appear to cut taxes without really cutting taxes. There are certainly easier ways to help poorer students get supplies and clothes for schools other than giving everyone in the state a weekend-long exemption. If taxes are too high, the best solution would be to lower the tax rate year-round, not just for one weekend.

KANSAS  
ASSOCIATION



OF  
SCHOOL  
BOARDS



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Testimony before the  
**House Committee on Taxation**

on  
**HB 2328**  
by

**Mark Tallman, Assistant Executive Director/Advocacy**  
Kansas Association of School Boards  
Also Representing  
**Kansas National Educational Association**

**March 2, 2009**

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear today as opponents of **HB 2328**, which would create a “school tax holiday” by expanding sales tax exemptions for certain school supplies. We oppose this bill for the following reasons.

First, Kansas is in the midst of the most serious budget crisis in modern times. The Governor and Legislature has been forced to make serious cuts in important state programs this year, including a reduction in the base budget per pupil for public education.

Although the Governor’s revised budget would use funding from the federal stimulus package to maintain the base budget and special education at their current levels for the next two years, these amounts are far below the levels indicated by legislative cost studies as required to meet educational outcomes established by the state, as well as the commitment to 92 percent funding for special education excess cost. Even minimal increases in salaries and fixed costs will require districts to make offsetting cuts in programs that have boosted student achievement and improved the performance of all student groups. Giving families a small tax cut for school supplies, when the state is cutting its support of those very schools, is completely counterproductive.

Other state programs have faced deeper cuts than public education, and local governments are facing declining state support. At such a time, additional tax cuts will only make it more difficult to sustain critical public services.

Second, we believe that granting further tax exemptions is absolutely the wrong direction to go. We believe the state should be seeking to reduce exemptions and broaden the tax base to allow lower rates and more stable revenue. This process of creating new tax breaks for limited purposes and benefiting selected groups is the fundamental reason our tax code appears broken. The problem is not that our taxes are too high in aggregate; it is the continual shifting of the tax burden to a smaller and smaller base. These exemptions are the reason other tax rates have to rise, including the property tax that was the focus of last week’s hearings.



Moreover, it is certainly contrary to the idea of free markets for the state to create special benefits and exemptions for apparently favored productions or transactions.

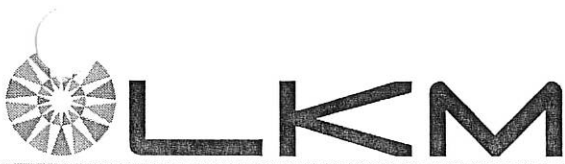
Third, it's hard to see who this proposal really helps, other than merchants who might be able to attract shoppers looking for lower costs without having to reduce their own prices. Presumably the lowest income families are the least able to save up for a tax holiday and are the least able to purchase computers, software and other more expensive items, while upper income families who can already afford to make these purchases would have the greatest ability take advantage of a tax holiday.

Fourth, we would certainly agree that many families are struggling to make ends meet and the cost of school supplies poses a financial difficulty. We suggest the fundamental reason is decades of stagnant wages for low-skilled workers and widening income inequality. Perhaps the biggest factor in this trend is educational disparity. The way to address this issues is not with tax gimmicks but to make sure *all* children develop the proficiencies they will need to compete in the future. With the help of increased state funding for public education, Kansas has made a great start. But the simple fact is the public school system was not designed to help every student reach high levels, and the cost of truly bringing every child to proficiency costs more than we have been spending. Tax cuts like **HB 2328** make achieving that vital goal more difficult.

Fifth, and finally, you can't have public education – or for that matter, vouchers or scholarships for private education – without public funding. Like it or not, public funding comes from taxes. Having a “school supply tax holiday” that invites people to reduce their support for the very schools they need is, at best, a mixed message.

In conclusion, we urge you not to adopt yet another base-narrowing tax exemption that will worsen the state budget crisis. Instead, we urge this committee to support the development of a broad, fair, economically responsive tax system that supports the public services our citizens want and need.

Thank you for your consideration.



League of Kansas Municipalities

Date: March 2, 2009  
To: House Committee on Taxation  
From: Larry R. Baer  
Assistant General Counsel  
Re: HB 2328  
Testimony in Opposition.

Thank you for allowing me to appear before you today and present testimony on House Bill 2328 on behalf of the League of Kansas Municipalities and its 627 member cities. HB 2328 proposes to establish a statewide sales tax holiday which would temporarily suspend the collection of all state and local sales taxes levied upon the goods specified within the bill.

The League stands in opposition to HB 2328 and sales tax holidays. A sales tax holiday is yet another intrusion on the sales tax base available to cities, counties and the State. Just as any other tax exemption, a sales tax holiday reduces revenue generated by retail sales to those entities that are reliant upon it. Lost revenues result in either erosion of quality of services or termination of services or tax increases to replace the lost revenue to allow service to continue at the level that taxpayers expect. If the intent is to give a tax break to low income tax payers, a more efficient and effective method is through the use of a low income sales tax credit or refund.

### History of Sales Tax Holidays

Sales tax holidays got their start in the United States during the boom years of the 1990s when there were large budget surpluses and they were used to provide tax relief. In more recent years, the justification has shifted to a way to help parents with back-to-school expenses and the like. Sixteen states presently have some form of a sales tax holiday. These states vary in the way in which they treat local option sales tax. Some lift all local taxes statewide. Some permit local option on the exemption of qualified sales from local sales tax (such as Missouri). At least one (Tennessee), suspends all local sales taxes during the holiday, but reimburses local government for lost revenue. Budget deficits occurring at the state level in recent years have impacted sales tax holidays in at least two states. Maryland took action in 2007 to suspend its sales tax holiday through at least 2009 and Florida cancelled both of its holidays in 2008.

### Study Results

Studies indicate that sales tax holidays do affect consumer behavior. Timing of purchases may be delayed to take advantage of the holiday. Lower cost goods may be purchased to permit the consumer to stay under the price caps established by the holiday legislation.

A sales tax holiday is one of those things that on the surface sounds like a good idea. However, when studied it becomes clear that it is not sound tax policy and results in adverse fiscal impact upon state and local governments. In an article published in 2005 by the Institute on Taxation and Economic Policy, *Talking Taxes*, Policy Brief #17) it is stated: "...sales tax holidays are a problematic way of achieving low-income sales tax relief, for several reasons." A number of reasons are then listed, including:

- **Sales tax remains a burden on the low income tax payer:** A one-week sales tax

holiday for selected items still imposes a burden on low income taxpayers when they purchase these items in the other fifty-one weeks of the year. In the long run, sales tax holidays leave a regressive tax system basically unchanged.

- **Creates administrative difficulties:** Sales tax exemptions create administrative difficulties for state governments, and for the retailers who must collect the tax. For examples, exempting groceries requires a sheaf of government regulations to police the border between nontaxable groceries and taxable snack foods. A temporary exemption for clothing (or for any other back-to-school item) requires retailers and tax administrators to wade through a similar quantity of red tape for an exemption that lasts only a few days.
- **Sales tax holidays are poorly targeted:** If the goal is to provide tax relief to low income families for whom sales tax is the most burdensome, sales tax holidays are poorly targeted, providing tax breaks to even the wealthiest taxpayers. In addition, the benefits of sales tax holidays are not limited to state residents, but also extend to consumers visiting from other states. For states struggling with continuing budget deficits, sales tax holidays offer less “bang for the buck” than more targeted tax breaks such as low income sales tax credits.
- **Those needing help may be least able to receive it:** Many low income tax payers spend most of their income just getting by – which means that they have less disposable income than wealthier taxpayers. These taxpayers may not have the luxury of shifting the timing of their consumption to coincide with week-long sales tax holidays. By contrast, wealthier taxpayers are more likely to be able to time their purchases to coincide with the sales tax holiday without throwing their finances out of kilter.
- **Subject to abuse:** Retailers know that many consumers will shift their spending toward sales tax holidays to take advantage of the temporary tax exemption. Unscrupulous retailers can take advantage of this shift in consumer behavior by increasing their prices (or failing to reduce them by the full amount of the sales tax break) during the tax holiday. There is some evidence that Florida retailers did exactly this during a recent sales tax holiday there: one study found that up to 20 percent of the potential benefits from that state’s sales tax holiday were reclaimed by retailers in the form of higher prices.
- **Sales tax holidays are costly:** Perhaps the most important for cash strapped lawmakers, sales tax holidays are costly. Revenue lost through sales tax holidays will ultimately have to be made up somewhere else, either through painful spending cuts or increasing other taxes. If the long-term consequence of sales tax holidays is a higher sales tax rate, low-income taxpayers may ultimately be worse off as a result of these tax breaks.

A sales tax holiday is not really sound tax policy; its benefits do not necessarily extend to those intended; it is subject to abuse both by consumers and retailers; and, is costly to both the state and local governments because of the revenues that are lost. Revenues that are lost must be made up some other way – either by decreasing services or increasing other sources of revenue, including property taxes.

For these reasons the League stands in opposition to HB 2328.

STATE OF KANSAS  
HOUSE OF REPRESENTATIVES

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CLOUD, LINCOLN, OTTAWA  
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ELAINE S. BOWERS  
107TH DISTRICT

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**House Tax Committee**

**March 3<sup>rd</sup>, 2009**

**Testimony on House Bill 2324 regarding population requirement change**

**Sales Tax exemption requirements for certain Retail businesses under Kansas enterprise zone act**

**Thank you Chairman Carlson and House Tax Committee for allowing me to present this testimony for a change in existing law that would continue to promote new businesses and expansions in rural Kansas and at the very least keep current with population trends.**

**I was contacted this summer by a veterinarian who was building a new business and building in Cloud County. He had worked with the Department of Commerce and applied for a sales tax exception with the belief that he met the requirements of a project exemption certificate. I have included the letter from KDOR telling him that he didn't meet the 3<sup>rd</sup> requirement – based on the population figure from the last US Federal Census. The current population “estimate” for Cloud County is currently 9382 which is a number from the US Census Bureau and is an estimate only. However, the official 2000 Federal Census was at 10,268 for Cloud County thus the denial of his certificate and which is correct according to current Kansas law.**

**I would have to believe that when this concept was presented and passed into law that it was with the idea that it would help rural counties draw businesses and their expansions with tax exemption as an economic incentive. With this case, my county's population steadily decreased but this population requirement was still based on the last US Census number. I feel we should change this number to a more current and “real time” recognized figure. After talking with the researchers, revisers and the agency, I would propose using the Kansas Division of Budget revised population number which is certified by the Secretary of State each year to replace the latest US Federal Census number.**

**This change won't help my new vet clinic in north central Kansas now but perhaps in the future it would be beneficial to another business desiring to locate or expand in a rural region even if the population is declining but where life is still good!**

**Thank you for your time.**

**Rep. Elaine Bowers District #107**

House Taxation Committee

3-3-09

Attachment 6

**KANSAS**

DEPARTMENT OF REVENUE

*Kathleen Sebelius, Governor*  
*Joan Wagnon, Secretary*[www.ksrevenue.org](http://www.ksrevenue.org)

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September 8, 2008

Mr. Randall Hobrock  
Tallgrass Veterinary Hospital, PA  
516 Somerset Circle  
Concordia, KS 66901

Dear Mr. Hobrock:

We wish to acknowledge receipt of your request for a project exemption certificate.

K.S.A. 79-3606(cc) provides an exemption from sales tax for "all sales of tangible personal property or services purchased for the purpose of and in conjunction with constructing, reconstructing, enlarging or remodeling a business or retail business which meets the requirements established in K.S.A. 74-50,115 and amendments thereto, and the sale and installation of machinery and equipment purchased for installation at any such business or retail business."

The request you have submitted is based on a retail business. In order to qualify for a project exemption certificate, K.S.A. 74-50,115(c) provides the following requirements must be met by a retail business:

- the retail business must provide evidence of job expansion involving the employment of at least two additional full-time employees; and
- the retail business must locate or expand to a city having a population of 2,500 or less, as determined by the latest United States federal census; or
- the retail business locates or expands outside a city but in a county having a population of 10,000 or less, as determined by the latest United States federal census.

According to your request form, you will be expanding within the county of Cloud. Unfortunately according to the 2000 United States federal census, Cloud County has a population over 10,000. Therefore, the request for a project exemption certificate must be denied.