SB 66

Department of Legislative Services
Maryland General Assembly
2003 Session

FISCAL AND POLICY NOTE

Senate Bill 66 (Senator Hafer, *et al.*)
Budget and Taxation

Sales and Use Tax - Annual Back-to-School Tax-Free Week

This bill designates one week in August annually during which the sales and use tax would not apply to the sale of school supplies or clothing or footwear (excluding accessories) if the taxable price of the individual items is less than $100.

The bill takes effect July 1, 2003.

Fiscal Summary

State Effect: State sales tax revenues (general funds) could decline by $9.6 million in FY 2004, based on assumptions about the scope of school supply sales. Future year revenue losses reflect projected increases in sales tax collections. To the extent that school supply sales under the bill are greater than assumed, then the fiscal impact could be significantly larger. General fund expenditures by the Comptroller's Office to administer the program would increase by approximately $92,800 in FY 2004, increasing by approximately 1% per year thereafter.

(in dollars)	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
GF Revenue	($9,600,000)	($9,801,600)	($10,007,400)	($10,217,600)	($10,432,200)
GF Expenditure	92,800	93,700	94,700	95,600	96,600
Net Effect	($9,692,800)	($9,895,300)	($10,102,100)	($10,313,200)	($10,528,800)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: Potential meaningful impact from increased sales (offset by administrative costs) for small businesses selling apparel and/or school supplies.

Analysis

Bill Summary: The exemption period would apply beginning on the second Friday in August and ending on the following Thursday each year. School supplies are defined to include items purchased for use in the classroom, for schoolwork completed in school, or for any school activity. Electronic devices are excluded from the exemption.

Current Law: Current law does not provide for any sales tax holiday or tax-free week. Chapter 576 of 2000, which created a tax-free week for clothing and footwear, applied only to a specified week in 2001.

Background: Chapter 576 of 2000 exempted from the sales and use tax the sale of clothing or footwear (except accessories) for the week of August 10 through August 16, 2001, if the taxable price of the item of clothing or footwear was less than $100. The Comptroller's Office estimates that the tax-free week resulted in lost sales tax revenue of $5.1 million. This estimate is based on regression analysis of historical sales tax collection trends in the categories of vendors (apparel stores, department stores, etc.) that sell a large share of the exempted clothing and footwear. The Comptroller's Office reports that sales tax collections from the categories of vendors most likely to sell exempted items declined by 5.2% for the month including the tax-free week, versus the same month in 2000. The agency believes that the majority of this decline is associated with the exemption, rather than nationwide or other economic factors. The agency estimates that total apparel sales likely increased by 2.6% during the period and that most of the increase would have occurred in any event, and hence any offsetting revenue increase was minimal. The agency reports that any impact on income tax revenues is difficult to estimate but expected to be minimal.

State Revenues: Sales tax revenue losses under the bill derive from two sources: school supplies and clothing/footwear. It is estimated that sales tax revenues would decline by approximately $5.4 million in fiscal 2004 due to the exemption for clothing and footwear. This estimate is based on the $5.1 million estimate of sales tax losses from the prior tax-free week, adjusted for growth in the consumer portion of sales tax projections between fiscal 2002 and 2004.

It is estimated that sales tax revenues would decline by approximately $4.2 million in fiscal 2004 due to the exemption for school supplies. This estimate is based on the following information and assumptions:

- an estimate that 14 different categories of retail vendors (from grocery stores to university book stores) with total sales tax collections of approximately $50 million per month sell products that could be exempt;
- assumptions about the amount of tax-free sales that each such vendor class would experience (ranging from 2.5% to 75%);
- assumptions about the amount of sales that would be diverted from taxable periods immediately before and after the tax-free period; and
- adjustment for growth in sales tax between the fiscal 2002 actual collections and the applicable fiscal 2004 period.

The exemption is drafted broadly and could include almost any nonelectronic device sold from an office supply store for under $100 (because it would be almost impossible to determine whether the product was purchased "for use in the classroom, for schoolwork completed in school, or for any school activity.") To the extent that school supply sales under the bill are greater than assumed, then the fiscal impact could be significantly larger.

In total, it is assumed that State sales tax revenues would decline by $9.6 million as a result of the exemption. This estimate corresponds, on a proportionate basis, with the impact of a sales tax holiday period in South Carolina in 2000 that applied to both clothing and school supplies. Future year revenue losses are assumed to grow at approximately 2.1%, the rate of future growth of the consumer portion of sales tax collections.

State Expenditures: The Comptroller's Office would incur approximately $92,800 in administrative expenses to implement the tax-free week. This estimate is based on the approximately $100,000 that the agency incurred implementing the prior tax-free week, less certain computer programming that can be reused from the prior initiative. Future year expenditures are forecasted to grow at approximately 1% per year. In addition, the agency advises that the substantial amount of work involved in the first tax-free week diverted some staff from audit activities. For this bill the agency advises that staff diversion may result in up to $100,000 in lost tax revenues from the loss of one-half of an auditor's time.

Small Business Effect: According to the 1998 Survey of U.S. Business by the U.S. Census Department, 91.7% of the retail firms in Maryland had less than 50 employees. This bill could cause a net increase in sales for small businesses to the extent that sales would be made in Maryland during the period that would otherwise have been made out-of-state, through the Internet, or by mail order. Small businesses located in shopping malls or other areas with a number of stores in close proximity may experience increased sales for nonapparel and/or nonschool supply items because of increased foot traffic due to the tax-free week. On the other hand, compliance costs for small businesses could increase, if changes to cash register programming and accounting systems are required. The net effect would vary from business to business, but it is likely to be positive.

Additional Information

Prior Introductions: SB 29 of 2002 received an unfavorable report from the Senate Budget and Taxation Committee. Several other sales tax holiday bills were introduced during the 2002 session; none passed.

Cross File: None.

Information Source(s): Comptroller's Office, Department of Legislative Services

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mdf/jr

Analysis by: Matthew D. Riven

Direct Inquiries to:
(410) 946-5510
(301) 970-5510