

Department of Legislative Services
Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE

Senate Bill 374

(Senator Hafer, *et al.*)

Budget and Taxation

Sales and Use Tax - Tax-Free Weekend

This bill creates an annual tax-free weekend that begins with the second Friday in August and ends on the following Sunday during which the sale of any school supply or any item of clothing or footwear (except accessories), or personal computer (if the taxable price is less than \$1,000) is exempt from the State sales and use tax. The Comptroller is required to report to the General Assembly by December 1, 2006 on the fiscal impact of the bill.

The bill takes effect July 1, 2005.

Fiscal Summary

State Effect: General fund revenues could decrease by approximately \$13.8 million in FY 2006. The revenue loss in future years is projected to increase by 10% each year. General fund expenditures could increase by approximately \$94,700 in FY 2006. Future year expenditures reflect inflation.

(\$ in millions)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revenue	(\$13.8)	(\$15.1)	(\$16.7)	(\$18.3)	(\$20.2)
GF Expenditure	.1	.1	.1	.1	.1
Net Effect	(\$13.9)	(\$15.2)	(\$16.8)	(\$18.4)	(\$20.3)

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.

Analysis

Current Law: Current law does not provide for any sales tax-free weekend or holiday. Chapter 576 of 2000, which created a similar tax-free week for clothing and footwear in August 2001, 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: It is estimated that sales tax revenues would decline by approximately \$13.8 million due to the tax-free period.

The clothing exemption could decrease revenues by \$8.5 million in fiscal 2006, based on the following estimates and assumptions:

- The 2001 tax-free week caused an estimated \$5.1 million revenue decline.
- Projected growth in the consumer portion of sales tax revenue is 3%, on average, as estimated by the Bureau of Revenue Estimates.
- One tax-exempt weekend would be the equivalent to 10 business days' clothing sales due to diversion from sales that would have occurred immediately before or after the tax-free weekend.
- There is no price limitation on clothing items, as compared to the \$100 limit under Chapter 576.

In addition, the exemption for school supplies could result in a revenue decrease of approximately \$5.3 million in fiscal 2006. It is estimated that because the bill provides

for an annual tax-free period, revenues could decrease by about 10% annually, as awareness and utilization of the exemption grows.

The exemption is drafted broadly and could include almost any item sold from an office supply store 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.

State Expenditures: The Comptroller’s Office would incur approximately \$94,700 in administrative expenses to implement the tax-free week. This estimate is based on the \$102,400 that the agency incurred implementing the prior tax-free week, less certain computer programming that can be reused from the prior initiative. In addition, the agency advises that the substantial amount of work involved in the first tax-free week diverted some staff from audit activities. There could be a decline in audit revenues from such a diversion.

Small Business Effect: According to the 1998 *Survey of U.S. Business* by the U.S. Census Bureau, 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 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: A similar bill was introduced as SB 321 in the 2004 session. It received an unfavorable report from the Senate Budget and Taxation Committee. A similar bill was introduced as SB 66 in the 2003 session and as SB 29 in the 2002 session. SB 2002 received an unfavorable report from the Senate Budget and Taxation Committee and SB 66 was withdrawn.

Cross File: None.

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

Fiscal Note History: First Reader - March 18, 2005
ncs/hlb

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