Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: S.B. 264 of the 131st G.A.

Date: February 23, 2016

Status: As Reported by Senate Ways & Means

Sponsor: Sen. Bacon

Local Impact Statement Procedure Required: Yes

Contents: Creates a three-day sales tax holiday in August 2016 for sales of specified clothing and school supplies

State Fiscal Highlights

STATE FUND	FY 2016	FY 2017	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	Loss up to $14.6 million	- 0 -
Expenditures	- 0 -	- 0 -	- 0 -

Note: The state fiscal year is July 1 through June 30. For example, FY 2016 is July 1, 2015 – June 30, 2016.

- The bill creates a three-day sales tax holiday, starting with the first Friday in August 2016, for sales of specified clothing and school supplies. The bill exempts sales of clothing (up to $75), school supplies (up to $20 per item), and school instructional materials (up to $20).
- The sales tax holiday is estimated to decrease state sales tax receipts by up to $15.1 million in FY 2017. Sales tax revenue is distributed to the state GRF, the Local Government Fund (LGF), and the Public Library Fund (PLF). Thus, the bill would reduce the amounts distributed to all three funds, and the reduction to the GRF may be up to $14.6 million.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2016	FY 2017	FUTURE YEARS
Counties, municipalities, townships, and libraries (LGF and PLF)			
Revenues	Loss of up to $0.5 million	- 0 -	- 0 -
Expenditures	- 0 -	- 0 -	- 0 -
Counties and transit authorities			
Revenues	Loss of up $3.7 million	- 0 -	- 0 -
Expenditures	- 0 -	- 0 -	- 0 -

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- The sales tax holiday will reduce revenue from permissive county and transit authority sales taxes by up to $3.7 million in August 2016. Those local permissive taxes share the state sales and use tax base.
- A share of GRF tax revenues is distributed under permanent law to the LGF and the PLF. LGF revenues are distributed to counties, municipalities, and townships, while PLF revenues are distributed to public libraries. Thus, any reduction to GRF sales tax receipts would also reduce the amount distributed to the LGF and PLF. The loss to the local government funds may be up to $0.5 million annually.

Detailed Fiscal Analysis

S.B. 264 exempts from the sales tax sales occurring on August 5, 6, and 7 in 2016 of the following items: clothing (up to $75), school supplies (up to $20 per item), and school instructional materials (up to $20). The bill is estimated to reduce state revenue from the sales and use tax by up to $15.1 million in FY 2017.[1] A similar sales tax holiday was held on August 7, 8, and 9, 2015. The legislation creating that tax holiday, S.B. 243 of the 130th General Assembly, authorized it only for that year, and S.B. 264 creates another temporary tax holiday.

Under permanent law, the GRF receives 96.68% of the revenue from the sales and use tax, while 1.66% of the receipts are transferred each to the Local Government Fund (LGF, Fund 7069) and the Public Library Fund (PLF, Fund 7065) for distribution to counties, municipalities, townships, and public libraries.[2] Thus, sales tax revenue to the GRF would decline by up to $14.6 million in FY 2017, and distributions to the LGF and PLF would be reduced by a total of about $0.5 million.

The bill will also reduce the tax base for permissive county and transit authority sales taxes. Those local permissive taxes share the state sales and use tax base. The potential revenue loss to local governments from local sales taxes, at approximately 24.5% of state sales tax revenues, would be up to $3.7 million. Thus, total revenue reductions for local governments, including reduced LGF and PLF distributions, may be up to $4.2 million.

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[1] Data available from Texas and Maryland report estimated revenue losses from those states' sales tax holidays at $65.3 million and $11.4 million, respectively, for FY 2016. Corresponding fiscal losses for Ohio would be $27 million and $21 million, respectively, after adjusting for differing population and tax rates. (Please note that, instead of a $75 limit on clothing as in the bill, the maximum price of a clothing item is $100 in those states.)

[2] Am. Sub. H.B. 64, the current operating biennial budget act, temporarily increased the PLF share to 1.70%.

The estimates are based on data primarily from surveys from the National Retail Federation (NRF) on back-to-school and back-to-college shopping, and also on personal consumption expenditures from the U.S. Bureau of Economic Analysis. Estimated Ohio spending was obtained by adjusting national data using an index of Midwest spending patterns (relative to national average spending) from the U.S. Bureau of Labor Statistics (Consumer Expenditure Survey for 2014). Though this Fiscal Note utilizes school enrollment data for 2014 by age from the U.S. Census Bureau (American Community Survey) both for K-12 and college-age students, please note that the sale of tax-free items is not limited to households with school-age or college-age children.

Consumers may opt to shift their purchases by delaying or accelerating their purchases into the tax holiday period. The estimates include temporal substitution effects of up to two weeks (based on previous NRF surveys on the timing of back-to-school purchases). If the temporal substitution is less, then the revenue loss from the bill would be less than estimated. If these effects are larger than presumed, the revenue loss could be greater. However, LSC expects these potential effects to fall within the holiday month.

The Department of Taxation will incur additional expenses associated with the implementation of this tax exemption. These expenses will be informational bulletins explaining the exemption. There may also be an increase in auditing costs, as more information will need to be verified. Costs associated with the implementation of the bill may be absorbed as part of the normal operations of the Department of Taxation. Businesses, in particular small retailers, may experience additional costs due to the need to reprogram cash registers and train staff to deal with the tax exemption.

As noted above, most additional sales during the tax holiday weekend will be delayed or accelerated purchases to take advantage of the exemption. However, other economic factors are at play. They include price and income substitution effects, cross border sales effects, and a shift of some sales from remote to store sales during the holiday weekend. The lack of precise empirical data regarding the magnitude of such factors makes this fiscal analysis more complex, and revenue loss estimates may be somewhat overstated, though the bill would result in a fiscal loss of state and local government sales tax revenue.

Price and substitution effects

The temporary sales tax exemption would effectively decrease prices of the tax-exempt items by a percentage equal to the combined state and local sales tax rates. A share of those savings will result in added purchases. Also, lower prices enhance consumer "real" income or purchasing power. This additional income from the sales tax exemption is likely to be spent on both taxable and nontaxable items, and some additional tax revenues may be collected. Also, demand for certain goods would rise during the sales tax holiday weekend, and some research had found evidence that retailers may respond by raising prices, and curtailing their customary "sales prices."[3]

Cross-border sales

Two cross-border effects are likely to take place with this bill. It is probable that some Ohioans already purchase clothing in other states and most do not pay Ohio use tax on those purchases. Such cross-border sales may remain in Ohio during the sales tax holiday. Also, Ohio stores may increase sales to residents of neighboring states.[4] Therefore, cross-border effects may be present, although impossible to quantify based on available data. However, the total cross-border effect on tax revenue may be small.

An analysis of potential cross-border effect would require estimating sales tax receipts from the sale of clothing and school supplies before, during, and after the tax holiday month. However, comparing sales tax receipts in border counties with those in nonborder counties would be greatly influenced by the development of the Ohio shale industry and other macroeconomic factors unrelated to consumer behavior precipitated by the recent sales tax holiday.[5] The table below provides average monthly county sales tax base growth (compared to the corresponding month in 2014 in border counties), based on data available on the Tax Department's website. Growth rates in the table are based on the weighted average of county sales tax base for each group of counties.

Monthly Sales Tax Base Growth

	Border Counties	Interior Counties
Sep-15	7.6%	4.6%
Aug-15	7.0%	7.4%
Jul-15	3.5%	4.3%

The sales tax base growth was higher for interior counties than for border counties in August 2015, the month of the sales tax holiday, and in July 2015; sales tax base growth in border counties was higher than that of interior counties in September 2015. If growth in sales tax receipts was higher in border counties than in interior counties due to the effects of the sales tax holiday, that result is not discernible in aggregate county tax collections reported in the third quarter of calendar year (CY) 2015. As of this writing, data on county sales tax collections by various segments of the retail industry are not yet available for CY 2015.

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[3] Richard Harper, and al. (2003): *Price Effects Around a Sales Tax Holiday: An Exploratory Study,* 23 Public Budgeting and Finance, 108-113.

[4] Increased sales to residents of Pennsylvania would be limited, because that state excludes clothing from its sales tax base.

[5] County sales tax receipts derived from clothing and clothing accessory stores were 2.34% of total county sales tax collections. Thus, changes to receipts from the sale of clothing are likely to have a relatively small impact on total county sales tax collections growth.

Shift from remote sales to store sales

A number of consumers purchase clothing and footwear through mail order and the Internet, in part as a tax avoidance strategy. Therefore, the bill would reduce the appeal of such remote purchases, and thus transfer some of the remote sales to store sales in Ohio. One of the largest online retailers is now collecting use tax from Ohio consumers. Thus, the shift from remote to store sales is assumed to be relatively small and would have a negligible impact on sales tax revenue.

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