DEPARTMENT OF TAXATION
2001 Fiscal Impact Statement

1.Patron: Reid

2. Bill No. HB 2511

House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

3. Committee: House Finance

4. Title: Retail Sales and Use Tax: Temporary Exemption for School Supplies, Clothing, Footwear, and Computer Products

Second House:
_____ **In Committee**
_____ **Substitute**
_____ **Enrolled**

5. Summary/Purpose:

This bill would provide a once-a-year exemption from the state and local sales and use taxes on certain items of tangible personal property. The exemption would occur on an annual basis, beginning in 2001, and would be in effect for a seven-day period beginning on the Monday fourteen days before the first Monday in September and ending at midnight on the following Sunday. The exemption would apply on a per item basis to:

- School supplies priced at $100 or less;
- Clothing and footwear priced at $100 or less;
- Computer systems priced at $1,500 or less;
- Computers, computer hardware, computer software priced at $500 or less; and
- Portable or hand-held calculators priced at $500 or less.

The bill would also remove the prohibition against absorption of the tax for the exemption period and fourteen days prior to such period for advertisement.

In determining the selling price for purposes of this exemption, any discount, coupon, or other credit offered either by the retailer or by a vendor of the retailer which reduces the final price to the customer must be taken into account.

The exemption does not apply to sales of the qualifying items at theme parks.

This bill requires the Department of Taxation to develop guidelines describing the items that would qualify for the exemption and to make such guidelines available electronically and in hard copy by August 1 of each year.

6. **Fiscal Impact Estimates are:** Tentative. (See Line 8.)

6a. Expenditure Impact: (See Line 8).

Fiscal Year	***Dollars***	***Fund***
2001-02	$74,400	GF
2002-03	$74,400	GF

6b. Revenue Impact:

Fiscal Year	***Dollars***	***Fund***
2001-02	($9.6 million)	N+F
2001-02	($2.8 million)	Local
2002-03	($10.2 million)	N+F
2002-03	($3.0 million)	Local

7. **Budget amendment necessary:** Yes.
Page 1, Revenue estimates.
Item 279, Department of Taxation.

8. **Fiscal implications:**

Expenditure Impact

This bill would result in administrative costs to the department of $74,400 in fiscal year 2002 and beyond. These costs are associated with personnel, printing, and postage charges to educate dealers about the provisions of this bill.

Revenue Impact

This bill would affect: (1) revenues dedicated to the General Fund for unrestricted use by the Commonwealth, (2) revenues returned to the localities for educational purposes, (3) the Transportation Trust Fund revenues, and (4) the local option sales tax revenues.

The negative revenue impact for this bill is estimated to be $12.4 million (state: $9.6 million; local: $2.8 million) in fiscal year 2002 and $13.2 million (state: $10.2. million;

local: $3.0 million) in fiscal year 2003. The revenue estimate incorporates data from the U.S. Census and taxable sales reported to the department. The Census data is organized by merchandise line sales which takes into account sales of a given type of merchandise regardless of store type, i.e., sales in department stores are counted, as well as sales at specialty clothing and footwear stores. The data from both sources is grown into the future for appropriate number of years using the sales and use tax collections historic and forecasted growth rates.

There is no reliable data source or rigorous methodology available for use in adjusting the estimates for the ceilings on the per item values. New York and Florida use a range of acceptable values based on retail marketing research. The revenue estimates assume an average of the Florida and New York calculations (85%) to account for the price limitation on the qualifying items. The estimates are likely to change depending on the local climate, cost of living, presence of upscale retailers and other factors.

Additionally, the estimates assume a 63% increase in sales attributable to the temporary exemption. This percentage represents an average of the increase in sales for New York, Pennsylvania, and Iowa (which are other states with “sales tax holiday” legislation). The experience of New York suggests that the majority of the increase is attributable to taxpayers shifting their purchases into the “tax-free” time period in order to take advantage of the exemption. New York compared sales occurring in the quarters of the temporary exemptions. While sales increased during a “tax-free” time period, sales did not increase over the period of the quarter when other factors, such as growth in sales nationally, were taken into consideration. In the case of a recurring exemption (as provided each year by this bill), purchasers would likely plan to make purchases during the “tax-free period” in order to take advantage of the sales and use tax exemption.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: None.

11. Other comments:

Generally

This bill would provide a once-a-year exemption from the sales and use tax for certain items of tangible personal property. Beginning in 2001, the exemption would be effective for a seven-day period beginning on the Monday fourteen days before the first Monday in September and ending on the following Sunday. The dates of the temporary exemption suggest that this bill is intended to primarily benefit purchasers of back-to-school items.

Absorption of the Tax

Currently, the law prohibits any person from absorbing all or any part of the sales and use taxes. A person may not advertise or hold out to the public that he will relieve a purchaser, consumer, or lessee of the payment of all or any part of the tax, except as authorized under the tax bracket system provided in Code of Virginia §§ 58.1-627 and 58.1-628.

Historically, dealers have not been permitted to collect and remit the tax in a manner other than that provided in Code of Virginia § 58.1-625, except in limited instances when the collection of the tax is impractical. In such instances, the Tax Commissioner is authorized to approve the remittance of the tax in an amount based on a percentage of gross receipts which takes into account the inclusion of the sales tax. Code of Virginia § 58.1-614(D).

This bill would remove the prohibition against absorption of the tax for the exemption period. In addition, for fourteen days prior to such period, dealers would be permitted to advertise that they will absorb and pay the tax on any sale during the exemption period. The bill requires that dealers electing to absorb the tax on sales of taxable items must remit the tax in the same manner as if the dealer collected the tax from the purchaser. In other words, the dealer would be required to remit the 4½% sales tax from the proceeds of the sales of taxable items made during the exemption period. For example, a dealer that sells a taxable item for $50.00 would be required to remit $2.25 sales tax ($50.00 sales price x .045 tax rate) to the department (assuming no dealer's discount applies). In the case of qualifying food items, dealers would be required to remit the tax at the rate of 4%.

Impact on Dealers

The bill allows dealers to elect to absorb the tax during the exemption period. Dealers who do not elect to absorb the tax would be required to reprogram their computerized cash register systems for a seven-day period to account for the exempt sales. Smaller retailers with less sophistocated systems may not be able to program registers to accommodate the change. Dealers who elect to absorb the tax may incur additional record-keeping expenses in order to remit the proper tax on taxable sales resulting from the temporary exemption. Additionally, dealers may incur significant expenses for hiring and training staff to accommodate the temporary exemption.

Under this bill, the dealer would be required to take into account a manufacturer's or retailer's coupon or any other discount or credit which reduces the final price to the customer in determining the selling price for purposes of this exemption.

Other States

The other states that provide or have recently provided a temporary exemption from the sales and use tax are New York, Florida, Texas, Connecticut, South Carolina, Pennsylvania, Iowa, Maryland, and the District of Columbia.

New York: New York provided a temporary exemption for clothing and footwear for seven days each in January and September, over a period of three years. The exemption applied to qualifying items priced at $500 or less, except in one instance the exemption applied to items priced at $100 or less. As of March 1, 2000, New York implemented a permanent year round exemption for clothing and footwear priced at $110 or less per item.

Florida: Florida provides a temporary exemption for clothing, footwear, and accessories. Initially, the exemption applied to qualifying items priced at $50 or less and was effective for seven days (August 15-21, 1998). For 1999 and 2000, the time period was extended to nine days and the cost limitation increased to $100. The exemption does not apply to sales of the qualifying items at theme parks, entertainment complexes, public lodging establishments, and airports.

Texas: Beginning in 1999, Texas provides a temporary exemption for clothing and footwear priced at $100 or less per item. The exemption is effective during the first weekend in August and occurs annually.

Connecticut: Connecticut provides a permanent exemption for clothing and footwear priced at $75 or less. In order to take advantage of the "sales tax holiday" idea, Connecticut opted to expand its exemption in 2000 to items priced at $300 or less. The expanded exemption is provided annually for seven days in August.

Pennsylvania: Pennsylvania also provides a permanent exemption for clothing and footwear and chose a different approach by providing a one-time temporary exemption for computer products for personal use. The exemption was effective for eight days each in February and August of 2000.

South Carolina: South Carolina provides a much broader temporary exemption than the other states offering such exemptions. The exemption applies to “back-to- school” items and there is no price limitation. Beginning in 2000, South Carolina provides a three-day temporary exemption that occurs on an annual basis.

Iowa: Effective in 2000, Iowa provided a temporary exemption for clothing and footwear priced at $100 or less per item. The exemption was a one-time event effective for two days in August.

Maryland: The Maryland legislature approved a one-time temporary exemption effective for seven days in August 2001. The exemption will apply to clothing and footwear priced at $100 or less.

District of Columbia: The District recently adopted a one-time sales tax holiday effective for ten days in August 2001. The temporary exemption would apply to school supplies and clothing priced at $100 or less. The sales tax holiday is contingent upon revenue growth projections to be certified in early 2001.

Other Legislation

The following bills would provide a once-a-year exemption for certain qualifying items such as school supplies, clothing, footwear, and computer products: HB 2252, SB 1255 (identical to this bill), and SB 1310. HB 2251 would provide a once-a-year exemption for any item or article of tangible personal property.

cc: Secretary of Finance

Date: 01/16/01/VHM
Document: S:/2001leg/WorkInProcess/OTPWork/HouseBills/HB2511F161.DOC