

Department of Legislative Services
 Maryland General Assembly
 2008 Session

FISCAL AND POLICY NOTE

Senate Bill 908 (Senator Klausmeier)
 Budget and Taxation

Sales and Use Tax - Exemptions - Tax-Free Weeks

This bill exempts from the State sales and use tax, after a specified “refund period,” the purchase of any • item of clothing or footwear, excluding accessories, if the taxable price of the item of clothing or footwear is \$100 or less; and • specified Energy Star products or solar water heaters. If the refund period ends prior to July 1, 2008, the tax-free period must occur during the seven-day period from August 10, 2008 through August 16, 2008.

Refund period is defined as the period of time when advance payment of income tax refunds or other payments made by the federal government as part of any federally legislated economic stimulus package enacted in calendar year 2008 are distributed to U.S. citizens.

The bill takes effect July 1, 2008.

Fiscal Summary

State Effect: General fund revenues could decrease by \$8.5 million in FY 2009 and Transportation Trust Fund (TTF) revenues could decrease by \$0.6 million. Expenditures would not be affected.

(\$ in millions)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
GF Revenue	(\$8.5)	\$0	\$0	\$0	\$0
SF Revenue	(.6)	0	0	0	0
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	(\$9.1)	\$0	\$0	\$0	\$0

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 clothing and footwear.

Analysis

Current Law: Chapter 6 of the 2007 special session created two sales tax-free periods beginning in fiscal 2011. Beginning February 2011, Chapter 6 exempts from the State sales and use tax the purchase of specified Energy Star products or solar hot water heaters made on the Saturday immediately preceding the third Monday in February through the third Monday in February. In addition, beginning August 2010, Chapter 6 exempts from the State sales and use tax the purchase of any item of clothing or footwear, excluding accessories, if the taxable price of the item of clothing or footwear is \$100 or less during the seven-day period beginning the second Sunday in August through the following Saturday.

Background: The following is a brief history of similar tax-free holidays in Maryland and other jurisdictions.

Previous Maryland Legislation: 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. Chapter 191 of 2005 exempted from the State sales and use tax the sale of clothing or footwear (except accessories) for the period of August 23 through August 27, 2006, if the taxable price of the item of clothing or footwear was \$100 or less.

Among its numerous provisions, Chapter 296 of 2000, the Maryland Clean Energy Incentive Act, provided a sales tax exemption for certain products that met or exceeded Energy Star efficiency requirements, including • clothes washers purchased on or after July 1, 2000 but before July 1, 2003; • room air conditioners purchased on or after January 1, 2001 but before July 1, 2004; and • refrigerators (standard size) purchased on or after July 1, 2001 but before July 1, 2004.

The U.S. Environmental Protection Agency and the U.S. Department of Energy have developed the “Energy Star” labeling program to help consumers identify the most energy-efficient products available on the market.

Federal Legislation: The federal Energy Policy Act of 2005 includes tax credits for consumers for implementing specified home improvements including adding insulation, replacement windows, and certain high-efficiency heating and cooling equipment. The

maximum amount of the tax credit for all improvements is \$500 during the two-year period of the tax credit. This tax credit applies to improvements made between January 1, 2006 and December 31, 2007.

The federal Act also provides tax credits to purchasers of hybrid gasoline-electric, diesel, battery-electric, alternative fuel, and fuel cell vehicles. The tax credit amount is based on a specified formula determined by vehicle weight, technology, and fuel economy compared to base year models. The credits are available for vehicles placed in service starting January 1, 2006. The credit phases out for each manufacturer of qualified vehicles once that company has sold 60,000 eligible vehicles. When that sales figure is reached, the tax credit for each company's vehicles will be gradually reduced over the course of another year.

Federal tax credits are also available for qualified solar water heating and photovoltaic systems. The credits are available for systems placed in service in 2006 and 2007 and are for 30% of the cost of the system, up to \$2,000. This credit is not included in the \$500 home improvement tax credit cap. Consumers are also eligible for a tax credit of up to 30% of the cost (up to \$500 per 0.5 kilowatt of capacity maximum) for the installation of a qualified fuel cell and microturbine system placed in service in 2006 and 2007; it is also not subject to the \$500 home improvement cap.

Connecticut Legislation: Recent legislation in Connecticut created a temporary sales and use tax exemption for specified home appliances that meet the federal Energy Star standards. The exemption applies to the sale of qualified refrigerators and freezers, clothes washers, dishwashers, room air conditioners, dehumidifiers, room air cleaner units, water coolers, and battery chargers occurring between June 4, 2007 and September 30, 2007. The legislation also exempts the sale of compact fluorescent light bulbs occurring on or after June 1, 2007 and makes permanent an existing sales and use tax exemption for home weatherization products.

Economic Stimulus Package

On February 13, 2008 President Bush signed a two year \$168 billion economic stimulus package. One key element of the package calls for tax rebate checks of up to \$600 for single taxpayers and up to \$1,200 for married couples, plus \$300 for dependent children. It is estimated that refund checks could be delivered to taxpayers in May.

State Revenues: General fund revenues could decrease by \$8.5 million in fiscal 2009 and TTF revenues could decrease by \$0.6 million as discussed below.

Tax-free Periods – Energy Star Products

The bill applies to purchases of eligible Energy Star air conditioners, clothes washers or dryers, furnaces, heat pumps, standard size refrigerators, compact fluorescent light bulbs, dehumidifiers, programmable thermostats, and solar water heaters for a one week period in August 2008. Sales tax revenues could decrease by \$531,400 in fiscal 2009. Average price and market penetration data were provided by the Maryland Energy Administration (MEA) and the Energy Star web site.

The estimate assumes that during the week long tax-free period, 14 days of sales will occur for Energy Star clothes washers, refrigerators, room air conditioners and fluorescent light bulbs; and 6 days of sales for dehumidifiers, central AC units, air source heat pumps, ground source heat pumps, furnaces, solar water heaters, and thermostats. To the extent the actual prices and number of products purchased differ from those used in the estimate, the associated revenue decrease would vary accordingly. Also, to the extent that the bill generates or contributes to sales of other products that might not normally have occurred, the sales tax decrease attributable to the bill could be mitigated.

As a point of reference, a recent proposal in New York State would have provided a sales tax exemption for specified Energy Star products for two one-week periods. The fiscal estimate for the proposal assumed 20 days of sales both before and after each 7-day tax-free period would instead occur during the tax-free period for a total of 47 days worth of sales occurring during each period. In addition, the recently concluded Connecticut tax-free period for Energy Star appliances is estimated to reduce state revenues by approximately \$7.0 million. The exemption for fluorescent light bulbs and weatherization products is expected to reduce state revenues by an additional \$7.0 million in fiscal 2008.

Tax-free Periods – Clothing and Footwear

The Comptroller's Office estimates that the 2001 tax-free week resulted in lost sales tax revenue of \$5.1 million, with another \$5.5 million in lost revenue from the 2006 tax-free period. This estimate is based on a 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.

Sales tax revenues could decrease by approximately \$8.6 million in fiscal 2009 due to the week long tax-free period. This estimate is based on the impacts from previous tax-free shopping periods and an assumed 3% annual increase in taxable sales from fiscal 2006 to 2008 and a 5% increase from fiscal 2008 to 2009. **Exhibit 1** shows the estimated

revenue effect on general fund and TTF revenues of the tax free periods for both Energy Star products and clothing and footwear.

Exhibit 1
Impact of Sales Tax-free Holidays
(\$ in Millions)

	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>
General Fund	(\$8.5)	\$0.0	\$0.0	\$0.0	\$0.0
TTF	(0.6)	0.0	0.0	0.0	0.0
Total	(\$9.1)	\$0.0	\$0.0	\$0.0	\$0.0

Small Business Effect: According to the 2005 *Survey of U.S. Business* by the U.S. Census Bureau, 94.3% of the retail firms in Maryland had less than 100 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 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.

Small businesses that sell Energy Star appliances could realize increased sales during the tax-free period; however, this increase could also realize a corresponding decrease in the weeks surrounding the tax-free period. In addition, home contractors and builders could benefit significantly. It is assumed that a large percentage of home heating and cooling systems are purchased by contractors and builders, who then pass the cost on to the consumer. Contractors and builders could realize significant savings on these purchases during the tax-free period.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Maryland Energy Administration,
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