Remarks By

Tom S. Saquella

Before The

Commission on Maryland's Fiscal Structure

October 10, 2002

Thank you for the opportunity to present the views of the Maryland Retailers Association (MRA) on state taxation of purchases made online or from other remote sellers (e.g. catalogues and 800 numbers). As commission members are aware, the State of Maryland cannot require sellers without a *nexus* in Maryland to collect the Maryland sales tax on purchases made by Maryland residents.

MRA is the retail community's largest statewide organization with 800 members at some 1400 locations. MRA is a diverse organization with a membership that I often describe as "*all sizes, all kinds, all across Maryland*". The common thread is all are merchants selling goods and this issue is of immense importance to MRA and its member businesses.

MRA greatly appreciates the responsiveness of the General Assembly to our concerns about a level playing field and tax fairness. The efforts of the General Assembly place Maryland among those states working to reform state sales tax laws in order to enhance states ability to levy a sales tax on Internet and other remote seller transactions. Legislation enacted in 2000 (HB 1421) authorized the Comptroller to work with other states in developing a more uniform and streamline system through what became the Simplified Sales Tax Project (SSTP). 2001 legislation (HB 1390) permitted Maryland's participation in the Streamline Sales Tax Implementing States (SSTIS) project to review and make changes to the agreement developed by SSTP.

I want to particularly complement Maryland's SSTIS delegation of Delegate Sheila Hixson, Senator P.J. Hogan, Deputy Comptroller Steve Cordi and Kevin Hughes of the Governor's Office. Although the SSTIS meetings can sometimes be politically charged, it is more often very tedious work, some discussions bordering on the metaphysical, that make our legislative hearings look almost adventuresome. And to have one of the meetings in Philadelphia gives new meaning to the old joke: *First prize is one week in Philadelphia and second prize is two weeks!*

MRA fully supports the position taken by Comptroller Schaefer in his September 16 letter to Governor Glendening and the General Assembly's presiding officers -- i.e. <u>that Maryland not implement changes to the Maryland sales tax law conforming to the SSTP agreement before Congressional action</u>. The 2003 General Assembly could choose to either enact no legislation or enact legislation with a delayed effective date until after Congressional action. The later course would show Maryland's commitment to the reform principles of SSTP while not putting the horse before the court. Experience has shown that remote sellers simply will not <u>voluntarily</u> collect sales tax in large enough numbers to reduce any state's fiscal risk.

The good news is that SSTIS has probably made more progress than many expected. The number of implementing states has grown to 34 and a final vote on a multi-state agreement <u>could</u> occur before the end of the year. The bad news is that Maryland should not expect any immediate relief for its fiscal problems from either the SSTIS or SSTP. Certainly not in FY 03. FY 04 is doubtful and even 05 could be a stretch. The absence of California and New York is a major problem both politically for required Congressional action and their size in the retail marketplace.

Still, MRA urges Maryland to stay the course despite the expected difficulties. Any transition to a new sales tax system will not be without bumps in the road. Policy makers, however, must realize that there will be some short term pain to achieve the greater long term gain. I also realize the short term pain may be more acute in today's difficult fiscal situation.

The SSTP and SSTIS projects have a value beyond collecting sales tax on Internet and other remote sales. These efforts point up the long overdue need for reform so as to maintain the sales and use tax as a reliable and efficient source for state revenue. Professors Donald Bruce and William Fox of the Center for Business and Economic Research at the University of Tennessee, who probably have done more economic analysis of taxation of remote sales than anyone else in the country, write that the "sales tax base erosion that is stimulated by e-commerce is part of a downward trend in the sales tax base that has been underway for many years. However, e-commerce has accelerated the trend which otherwise appeared to have been slowing in the middle 1990's." Bruce and Fox point to a shrinking of the sales tax base relative to personal income which declined from 51.4% of personal income in 1979 to 42% by 2000. Likewise, the portion of personal consumption attributed to services rose from 47.4% in 1979 to 58.8% in 1998. This <u>long term</u> trend probably has less to do with remote sales and e-commerce than with the shift in consumer spending towards greater consumption of services than goods.

Some have described the sales tax system as a "horse and buggy system trying to navigate the 21st Century". Indeed, what we are seeing today is the clash between 7500 separate sales taxing jurisdictions and a more nationalized if not globalized economy. It was this complex and costly maze that caused the U.S. Supreme Court in the Quill case to rule that allowing states to extend tax collection responsibilities would be an "*undue burden*" on interstate commerce. The hallmark of the sales tax is its efficiency and administrative ease as a tax collection system. This efficiency, however, is now being eroded by broad economic changes. The drive toward uniformity and simplicity is an attempt to restore this efficiency and administrative ease in a world vastly changed from the Great Depression when the sales tax was first instituted in this country as an emergency revenue measure.

The dramatic changes in the landscape of Internet sellers also underscores the need for sales tax reform. Except for some notable exceptions like Amazon.com and E-Bay, pure "dot coms" are almost dinosaurs. It is no longer clicks vs. bricks, but now mostly click and bricks together where merchants see online sales as an extension of their store. This click and brick trend is not limited to national chains as more and more smaller independent merchants see the Internet as a means to greatly expand their market area. Online retailing is very much a small retailer medium and is much more pervasive than five years ago. MRA has small retail members with annual sales well under $1.0 million doing 10-20% of their business on the Internet and much of it to out of state customers. Maryland is certainly not unique in this respect, and policy makers must recognize this change. Online retailing is now common and runs through all sizes and all segments of the industry with much greater capacity to reach the consumer. Online selling will continue to spread with the potential for greater revenue loss for Maryland.

Internet sales growth continues to grow, albeit at a slower rate in recent years due to the slowing economy. Reports indicate Internet sales to consumers increased 31% in 2001 as compared to doubling in 1998 and 1999. But its growth still far exceeds store sales growth and its upside continues to be enormous.

1998 was the breakthrough year for Internet retailing as it moved beyond the techies to the mainstream. It reached a broader slice of shoppers, 60% of Internet shoppers are now women, and a greater variety of merchandise. By 1999, retailers realized that Internet selling was not a short-term phenomena, but a sea change that will forever change retailing.

Forrester Research, Inc., probably the foremost follower of e-commerce, estimates that e-commerce sales in 2003 will reach $127.4 billion in business to consumer sales. This would be close to 10% of total merchant sales to consumers. Forrester forecasts $1.78 trillion in business to business for a 2004 total e-commerce of $1.9 trillion.

In conclusion, the Internet presents nothing new in terms of tax law. What is new are technology and economic trends that weaken what had been a stable and efficient revenue source for many states. Bringing reform through simplification and more uniformity should benefit everyone in the long run. I would hope Maryland's fiscal future would not flounder on whether a handkerchief is clothing or not, or what the definition of food is.

I am somewhat bemused by people who say that Internet sales are overblown and not a real fiscal problem for states. Just think if the situation was reverse -- i.e. the Supreme Court ruled otherwise in Bella Hess and Quill and states were now requiring collection of sales tax by online and other remote sellers. How do you think the General Assembly would react if these remote sellers sought an exemption from collection? I am sure the fiscal note would make the bill **D**ead **O**n **A**rrival!

Any look at Maryland's fiscal future must take this issue into account. Unfortunately, it is still not clear as to how this issue will be resolved. Will the success of SSTIS and SSTP permit states to tax sales of presently-off-limits transactions that would provide new revenue for Maryland and equity for Maryland retailers and their in-store customers? Or, will Maryland and other states see the continued erosion of the sales tax in the face of the technological and economic changes? MRA hopes it will be the former as the latter perpetuates a competitive imbalance and puts pressure to raise the sales tax rate that can only exacerbate our situation.

Finally, I would hope that this commission strongly recommends to our next governor that he or she take a strong position with the Maryland Congressional Delegation and make this a priority item for Congressional action. In the final analysis, nothing the states do will have an impact unless there is Congressional action.

Thank you.