

## The NetChoice Coalition

*Promoting Convenience, Choice, and Commerce on The Net*

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July 24, 2011

Senator Edward J. Kasemeyer  
Senate Budget and Taxation Committee  
Maryland General Assembly  
Annapolis, Maryland

Dear Chairman Kasemeyer and Members of the Committee:

Please accept this statement from NetChoice, a coalition of online and e-Commerce businesses who share the goal of promoting convenience, choice, and commerce on the Net.

Now is a critical point in the evolution of e-commerce, online services, and social media. Online companies are experimenting with new ways to deliver products, services, and content, and business of all kinds are going online to reach consumers and advertise to receptive audiences. At the same time, state governments are looking online for additional revenue.

We fully understand the need for states to seek out additional tax revenue. However, we worry that legislation designed to force collection of taxes by out-of-state online retailers could bring costs and unintended consequences on Maryland businesses and consumers.

At the outset, we encourage your consideration of broad goals as you weigh revenue options. We believe that there are three key considerations to guide you:

1. Keep Maryland competitive in economic development and job creation
2. Avoid additional taxes and collection burdens on Maryland businesses and consumers
3. Reduce barriers to the competition, convenience, and choice offered by e-commerce

While many forms of taxation are within the state's legal prerogative, questions of tax policy come down to *what should be taxed* and *how should those taxes be collected*. We suggest applying the above principles when answering these questions about Maryland's Internet tax policies:

1. Should Maryland attempt to impose tax collection burdens on retailers who spend advertising dollars with Maryland website publishers?
2. Should Maryland make significant efforts to collect from remote retailers, when taxes on most e-retail sales are already being collected?
3. Should Maryland embrace the Streamlined Sales Tax Agreement?
4. Should Maryland attempt to impose a likely unconstitutional Use Tax reporting requirement on out-of-state retailers?

## 1. Should Maryland attempt to impose tax collection burdens on retailers who spend advertising dollars with Maryland website publishers?

Maryland should avoid the failed attempts of other states that have used online advertising as a basis to force out-of-state companies to collect sales taxes. These attempts have failed to raise new revenue and created unintended losses for in-state businesses.

New York was the first legislature to pass the so-called “Amazon Tax”. The law applies to companies that use an extended network of websites for displaying online ads. It changes the definition of what it means to be “soliciting business” in the state, and creates a rebuttable presumption of nexus when an out-of-state retailer advertises through New York websites.

The law is particularly tenuous because Internet sales pose a unique set of administrative challenges for nexus determination. Sellers generally cannot determine whether affiliates are legal residents of a particular state. Generally, sellers do not control the affiliate websites, and can’t determine whether a specific ad is a direct or indirect solicitation for business. Moreover, websites aren’t location specific.

This approach also raises constitutional questions. For instance, in reaction to concerns of being overly broad, New York issued a technical bulletin drawing a distinction between a “commission” on sales and a “set fee” on clicks. And an agreement to compensate a NY website for a click-through that results in a completed sale falls under the presumption.

Moreover, a New York state court further narrowed the law by proposing a safe harbor that Amazon (and other online retailers) can use to rebut the presumption of active solicitation. The court, in dicta, stated that

“Out-of-state sellers can shield themselves from a tax collection obligation by altogether prohibiting in-state solicitation activities referring to them or encouraging sales on their behalf that would subject them to a tax collection requirement and, as a condition of compensation, requiring that their NY contractors attest to compliance.”

Despite two attempts to clarify the law, it still remains an open question as to what constitutes “active solicitation” or “encouraging sales.” As a consequence, retailers will either avoid advertising in New York, or contort their advertising practices so they can avoid jurisdiction in New York.

Beyond tax policy, these laws have the detrimental effect of enshrining non-commission ads as the preferred form of online advertising. This has the effect of letting tax law dictate how to advertise online without incurring tax collection burdens, at the exclusion of all other potentially superior methods of advertising. Nobody wins if we settle for inefficient advertising that generates fewer ad dollars for in-state publishers and websites.

The net effect is a lot of pain with little gain. There hasn’t been a flood of new taxes flowing into the states enacting these laws. The Performance Marketing Association (PMA) estimates that when the affiliate nexus tax passes, affiliate marketers lose a third of their revenue. With that level of losses, affiliates have been laying-off employees or moving out of state. Either way, the state loses tax revenue for the businesses and employees affected.

*The state loses 100% of tax revenue when affiliates leave the state.*

Other states are reconsidering similar laws. For example, Rhode Island is working to repeal its affiliate law after advertisers simply cancelled their affiliate programs. Retailers like Amazon and Overstock discontinued their affiliate programs after Rhode Island, North Carolina, Illinois, California,

and Connecticut enacted this law. The result was that these states lost jobs and income taxes without realizing additional sales tax revenue.

Maryland has much to lose if major e-retailers were to cancel their affiliate programs here. Consider the example of Discovery, a world-class media company based in Silver Spring, with over 2,000 employees. To pay the costs of creating and hosting online content, Discovery relies on advertising by retailers seeking to reach its website visitors. As seen in the screen below, one of Discovery's popular sites, *howstuffworks.com*, shows what a consumer would see if she turned to *howstuffworks.com* to determine whether to repair or replace her aging kitchen blender:

The screenshot shows the howstuffworks.com website interface. At the top, the logo "howstuffworks" is on the left, and a search bar with the text "blender" and a "search" button is on the right. Below the search bar is a navigation menu with categories like Home, Adventure, Animals, Auto, Communication, Computer, Electronics, Entertainment, Food, Geography, Health, History, Home & Garden, Money, People, and Science. The main content area displays search results for "blenders". On the left, there are navigation options for Articles, Images, Videos, Expert Reviews, and Web Results. Below that, there are "other areas to explore" such as Household Appliances, Home, Home Appliances, Cooking 101, Food, How to Cook, Kitchen Cleaning Tips, Home & Garden, Appliance Repair, and Food Safety & Storage. The search results section shows several sponsored links: "Vita-Mix 5200. Free ship.", "Kitchen Blenders at CHEFS", "KitchenAid Stand Mixers", "Cuisinart", and "Need Smoothie Blenders?". Below the sponsored results, there is a section titled "howstuffworks search results for: blenders" which indicates that 500 articles were returned. This section includes a sub-section "Types of Blenders" with a small image of a blender and links to Images, Videos, and Reviews. It also features an "Introduction to How Blenders Work" section.

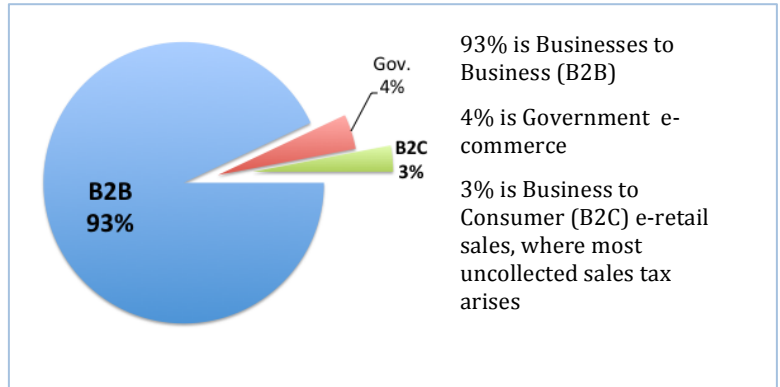
Of the five retailers who purchased ads on this web page, four have no presence in Maryland and therefore have no obligation to collect and remit sales tax for Maryland purchasers. A critical question before your committee is whether these out-of-state retailers would continue to advertise with Discovery if Maryland enacted affiliate-nexus as a means to force advertisers to collect state sales taxes.

Looking beyond Discovery, Maryland has over 4,000 website publishers who earn ad revenue through affiliate programs. Each of these publishers would see a significant loss of ad revenue, causing them to eliminate jobs or leave the state.

We would therefore caution Maryland against following this aggressive and constitutionally dubious approach and to refrain from imposing tax collection burdens on retailers that spend their advertising dollars with publishers and businesses based in Maryland.

## 2. Should Maryland make significant efforts to collect from remote retailers, when taxes on most e-retail sales are already being collected?

First, Maryland already collects sales or use taxes on nearly all business-to-business (B2B) sales, since business purchasing records are reviewed in routine audits for use tax compliance. Moreover, B2B transactions make-up 93% of all e-commerce.<sup>1</sup> Another 4% of e-commerce comes from sales made by Government.<sup>2</sup> That leaves just 3% of e-commerce for business-to-consumer (B2C) sales.



Within that 3% slice of e-commerce, 22 of the top 25 online retailers *already* collect sales tax on sales to Maryland consumers, since they already have a retail presence in the state, as seen below:

### 22 of the Top 25 e-Retailers Already Collect in MD

Top 25 e-Retailers	Collecting Maryland Sales Taxes
Amazon.com Inc.	No
Staples Inc.	Collects
Dell Inc.	Collects
Office Depot Inc.	Collects
Apple Inc.	Collects
OfficeMax Inc.	Collects
Sears Holdings Corp.	Collects
CDW Corp.	Collects
Newegg Inc.	No
Best Buy Co.	Collects
QVC Inc.	Collects
SonyStyle.com	Collects
Walmart.com	Collects
Costco Wholesale Corp.	Collects
J.C. Penney Co. Inc.	Collects
HP Home & Home Office Store	Collects
Circuit City Stores Inc.	Collects
Netflix Inc.	Collects
Victoria's Secret	Collects
Target Corp.	Collects
Systemax Inc.	No
L.L. Bean Inc.	Collects
Macy's Inc.	Collects
Williams-Sonoma Inc.	Collects
Gap Inc. Direct	Collects

<sup>1</sup> Department of Commerce, 2009 Electronic Commerce Industry Assessment.

<sup>2</sup> *Id.*

The table above was drawn from a 2010 analysis of the top 500 e-retailers, prepared by economists at Empiris LLC.<sup>3</sup> The Empiris study concluded that a growing share of online purchases by taxpayers are from larger retailers who operate both retail stores and websites, where online sales result in tax collection, not tax avoidance. The fact is, Maryland consumers buy online for convenience, selection, and lower prices, not to avoid paying their sales taxes.

The Empiris study included state-by-state forecasts of uncollected sales tax on e-commerce sales, showing \$85 million for Maryland in 2012, less than half of the often-quoted study by University of Tennessee economists. The Empiris forecast shrinks to about \$53 million if small sellers are exempted from collection requirements.<sup>4</sup>

These modest potential tax revenues should be carefully weighed against the imposition of new burdens on Maryland businesses and taxpayers.

### 3. Should Maryland embrace the Streamlined Sales Tax Project?

Advocates of Streamlined Sales Tax (SST) typically complain that *'it's not fair that online retailers don't pay taxes.'* But it's just not true. Just like brick-and-mortar stores, online retailers collect sales tax for sales they make in every state where they have a physical presence.

For example, the Book Escape has a store in Fells Point, Baltimore (web page below).

**Your Shopping Cart**

Book ID	Title	Author	Price	Remove
405404	Ocean City: Going Down the Ocean	Morgan, Michael	\$19.99	<a href="#">X</a>

Totals:	
Sub-total	\$19.99
Shipping Fee	\$3.75
Maryland Sales Tax (if applicable)	\$0.00
<b>Estimated Total</b>	<b>\$23.74</b>

If shipping to Maryland or picking up In-Store, check here.

Shipping Methods	
<input checked="" type="radio"/> Flat-rate Domestic Standard 4-10 business days	\$3.75
<input type="radio"/> Domestic Expedited* 1-4 business days	\$7.25
<input type="radio"/> Canada* 5-12 business days	\$11.00

Book Escape sells their new and used books across the country. And while they collect Maryland sales tax on every sale they make in Maryland, Book Escape collects no sales tax for any other state. Book Escape is typical of many 'Main Street' retailers who have learned that the Internet is their best way to survive against competition from big-box stores, since the Internet lets them reach customers across the country and around the world.

<sup>3</sup> Eisenach and Litan, "Uncollected Sales Taxes on Electronic Commerce: A Reality Check", <http://www.netchoice.org/library/new-estimate-of-uncollected-taxes-from-e-commerce/>

<sup>4</sup> *Id.*, at <http://www.amplify-pa.info/wp-content/uploads/eisenach-litan-state-estimates.pdf>


So is the complaint about fairness unfounded? No. Maryland retailers rightly say that out-of-state catalog and web retailers have an unfair advantage since they don't have to collect sales tax on shipments to Maryland customers. However, business purchasers rarely avoid sales tax since nearly all Maryland businesses file and remit use tax on any item where the sellers did not collect sales tax.

Also, individual consumers – who might avoid Maryland sales tax by buying an item from out-of-state often discover that sales tax “savings” is offset by shipping costs, delivery time, and the inconvenience of doing returns and exchanges via UPS or the Post Office.

As you consider ways to collect unpaid sales and use taxes, bear in mind why remote retailers don't collect Maryland's sales taxes. Whether online or offline, out-of-state retailers have never been required to collect remote state sales taxes because the Supreme Court ruled that the complexity of thousands of taxing jurisdictions – with different rates and rules – is an undue burden on interstate commerce.<sup>5</sup>

SST member states have always known that they could go back to the Supreme Court and attempt to show they have truly eliminated the unreasonable burdens on interstate commerce. Instead, SST states are asking Congress to grant them the power to impose their collection burdens on out-of-state businesses—whether or not the burdens are reasonable.

Despite a decade of effort, the actual simplification achieved by SST is not nearly enough to convince Congress that it should abandon its role in protecting interstate commerce.



*SST is not ready  
for primetime*

Instead, the SST has shown that simplification is now merely a slogan – not a standard. The SST Governing Board has repeatedly amended the Agreement to make it easier for states to conform—without significantly making their sales tax systems any simpler. While this may seem to make SST more attractive to Maryland, Congress will not give SST states the authority to collect from remote sellers without first attaching minimum simplification requirements that go beyond what's in the present SST Agreement.

For instance, one key simplification requirement in federal SST legislation is “uniform rounding.” This would require all states to adopt a uniform rounding mechanism for tax collection. For Maryland, this rounding adjustment results in a significant loss of tax revenue that offsets much of the gain Maryland might realize by joining SST.

If Congress passes the mandate, sellers everywhere would be forced to collect remote taxes – even sellers in states that haven't joined the Agreement. And the Congressionally-authorized SST Governing Board will impose new collection burdens on the many Maryland businesses that sell to customers in other states. With a federal mandate in place, Maryland has no way to protect its businesses from a national tax system that's not so simple, lacks a small-business exception, and fails to compensate sellers for new collection costs.

The cost of changing the rounding rule argues strongly for Maryland to stay on the sidelines of SST until Congress passes a collection mandate. At that time, Maryland can make a fully informed decision whether to become an SST member state.

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<sup>5</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

#### **4. Should Maryland attempt to impose a constitutionally questionable Use Tax reporting requirement on out-of-state businesses?**

A reporting requirement typically requires out-of-state sellers to report purchases made by citizens to the Department of Revenue as part of year-end tax reporting. But passage of such legislation exposes Maryland to potential privacy and constitutional problems.

A requirement for out-of-state sellers to report to the Maryland Comptroller the resident's name, date of sale, and/or dollar amount of each sale would tell the Comptroller from whom a citizen buys their products and services, revealing some deeply personal and sensitive purchases. For example, if a citizen bought products from a pharmaceutical distributor, the Comptroller would learn of that citizen's medical or psychiatric condition.

An out-of-state reporting law could lead Maryland into the same constitutional problems as Colorado's HB 10-1193. A Colorado judge recently enjoined that legislation, stating:

“looking to the practical effect of the Act and the Regulations, I conclude that the burdens imposed by the Act and the Regulations are inextricably related in kind and purpose to the burdens condemned [by the US Supreme Court] in Quill.”<sup>6</sup>

If Maryland follows Colorado, it could find itself in court arguing the constitutionality of its law. And when a state loses these court battles, it must pay the opposing party's attorney's fees as well as any legal costs the state incurs. Maryland should defer consideration of out-of-state reporting mandates until it is certain this would not expose the state to an expensive legal battle.

#### **Maryland should consider carefully before enacting new internet tax laws**

We appreciate your decision to take a careful and considered approach to enacting new tax legislation. This can be a difficult process, and if not done properly can result in unintended consequences for Maryland consumers and businesses – without generating the anticipated tax revenue.

We thank you for considering our views. Please let me know if I can provide further information for your deliberations on these important issues.

Sincerely,



Steve DelBianco  
Executive Director, NetChoice  
cc: Members of the Committee

*NetChoice is a coalition of trade associations and e-Commerce businesses who share the goal of promoting convenience, choice and commerce on the Net. More information about NetChoice can be found at [www.netchoice.org](http://www.netchoice.org)*

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<sup>6</sup> *The Direct Marketing Ass'n v. Roxy Huber*, No. IO-CV-01546-REB-CBS (June 30, 2010).