

Online retailers have clear advantage by not collecting sales tax

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Two independent studies use two very different approaches to reach the same conclusion: some online retailers really do have an advantage over traditional brick-and-mortar stores.

The studies find evidence from investors, analysts and consumers themselves that suggest online stores have a competitive edge when they don't have to collect sales tax from shoppers.

Both studies were conducted by researchers at the Fisher College of Business at The Ohio State University and their colleagues.

In one study, Brian Baugh, Itzhak Ben-David, and Hoonsuk Park from Ohio State's Department of Finance found that sales fell 9.5 percent at Amazon.com in five states when the online retailer began collecting taxes on online purchases.

In the other study, Jeffrey Hoopes, assistant professor of accounting, and his colleagues found that the stock prices of online retailers dropped when news broke about possible legislation that would require them to collect sales tax.

Overall, the two studies show that consumers do indeed spend less at online retailers when they have to pay sales tax – and investors are quite aware of the threat these firms face from new tax-collection laws.

"Internet taxation is an important issue that will be debated for years to

come," Ben-David said.

"But we're starting to learn how much internet retailers really benefit from not having to collect sales tax from customers in some states."

In their study, posted on the Social Science Research Network and [National Bureau of Economic Research](#), Baugh, Ben-David, and Park used anonymized data from a personal finance website.

The researchers examined retail transactions for about 1.3 million households in 2012 and 2013 from five states that began collecting tax on Amazon purchases during this time: Texas, Pennsylvania, California, New Jersey and Virginia.

They found that after the introduction of the tax collection, Amazon sales fell 9.5 percent among these consumers.

The effect was particularly pronounced on larger purchases. Consumers decreased their spending at Amazon by nearly 24 percent on purchases of \$300 and above.

"If you're going to make a big-ticket purchase like a big-screen TV or a laptop, there are currently huge incentives to go online to avoid the sales tax. These incentives are much stronger for large purchases than for small purchases, and our findings confirm that large purchases are indeed more sensitive to the introduction of this tax," said Baugh, a doctoral student.

Added Park, who is also a doctoral student, "If that advantage disappears, like it did in these states, you're more likely to find another [online retailer](#) where you don't have to pay the tax or go to a local store where you can see the product and return it easier."

But if the goal of these new tax-collection laws was to help local brick-and-mortar stores compete against Amazon, they only had limited success.

"For the most part, consumers simply switched their spending to other online retailers that didn't have to collect the tax," said Ben-David, associate professor of finance.

The researchers estimate that households use local brick-and-mortar retailers for about half of the lost Amazon purchases. Other purchases are done online.

These findings show that, overall, the piecemeal state-by-state legislation to tax online purchases will only give slight benefits to local brick-and-mortar stores.

"Unless there is some kind of national legislation, there will be loopholes that consumers can use to continue to avoid sales tax on some online purchases," Park said.

"It is clear that one of Amazon's advantages in the competition against other retailers was lower total price since Amazon did not collect sales tax. Our study shows that about 10 percent of sales were driven by this advantage," Baugh said.

But the drop in sales at Amazon in these five states shows why investors and analysts are clearly worried about how sales-tax legislation may affect online firms that are forced to collect the tax.

The Fisher College's Hoopes, along with colleagues Jacob Thornock and Braden Williams of the University of Washington, showed this in their study, which is [posted](#) on the *Social Science Research Network*.

They looked at proposed federal bills that, if passed, would force online retailers to begin collecting sales tax. They then identified major event dates for each piece of legislation in which there was news coverage suggesting that passage of the bills was more likely.

The question was, what happened to the stock values of these online retailers in the days following these news announcements?

Hoopes and his colleagues found the online retailers saw their stock returns drop 0.7 percent more than expected on days when these proposed laws hit the news.

"Investors perceive that these e-tailers have a competitive advantage because they don't have to collect sales tax, and when that advantage is threatened, their stock prices go down," Hoopes said.

However, the researchers did not find that other retailers – those firms that are suspected to be at a disadvantage compared to online retailers – had an abnormally high stock return on days when the proposed sales tax legislation was in the news, Hoopes said. Instead, their returns were just about what would have been expected on these days.

In addition, the study found that, around the times of these news events, stock analysts forecast about a 1.5 percent decline in projected future sales revenue for online retailers as a result of potential federal sales tax legislation.

Hoopes and his colleagues also used a case study to show how Amazon sales in particular may suffer in states where they have to collect sales tax.

In this case, the researchers compared changes in internet searches for the word "Amazon" surrounding dates when Amazon first began

collecting sales tax in various states. The hypothesis is that consumers may search for the word "Amazon" to get to the firm's website when they want to buy something online.

Results showed that weekly Google search volume for the term "Amazon" decreases in a given state after Amazon begins collecting sales tax in that state.

Overall, Hoopes said this study provides a company-level view of the effects of sales-tax legislation in the states.

"Most of the previous research focuses on the consumer, and whether they will buy fewer products from e-tailers if they have to pay sales tax," Hoopes said. "We examined if collecting [sales tax](#) would actually hurt the firms themselves, and found evidence that it would.

"The concerns that there isn't a level playing field for all [retailers](#) may be justified, as least as it is perceived by the market."

Provided by The Ohio State University

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