

# **How does an Obligation to Collect Sales Tax Affect Consumer and Firm Behavior?**

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Under current U.S. tax laws retailers who lack a physical presence in a state are not obliged to collect sales tax from customers in that state who purchase from a catalog or over the Internet. Once a retailer establishes a physical presence it must collect sales tax on all transactions, including catalog and Internet purchases. As Internet sales have grown, this preferential tax treatment has come under fire from offline retailers and policymakers.

In this paper, we show how opening a first store in a state affects both catalog and Internet sales. We compare purchases before and after the store-opening by customers who now have to pay taxes but who live too far away to shop at the store. We show that while Internet sales decrease significantly, catalog sales are not affected. We evaluate several explanations for these contrasting outcomes and find evidence that the disparity is consistent with customers incentive and ability to search for low prices. Customers have greater ability to search over the Internet and have more incentive to search when an item is offered at full price.

To examine whether current tax rules affect firm behavior, we analyze store opening decisions for a panel of multi-channel retailers. We find that retailers who earn a large proportion of their revenue from direct channels avoid opening a first store in high-tax states. We conclude that current United States sales tax laws have significant effects on both customer and firm behavior.