MID-ATLANTIC COMMUNITY PAPERS ASSOCIATION

Re: Grave Concerns About Advertising, Small Business Treatment and SUT Expansion in Competing Tax Swap Plans

Mid-Atlantic Community Papers Association Comments to the Senate Finance Committee

June 10, 2015

Dear Chairman Eichelberger, Minority Chair Blake, and Members of Senate Finance Committee:

The hometown publishers of the Mid-Atlantic Community Papers Association operate on the front lines of the economy, providing the glue that bonds neighbors and the merchants on Main Street. We share a singular perspective on the condition of truly local commerce. Our collective enterprise serves the unique and most critical function of communicating between Mom and Pop businesses and their customers. We promise you that Pennsylvania's fragile local economies simply cannot withstand an avalanche new taxes.[1]

We are deeply concerned by the proposed broad expansions to the Sales and Use Tax in both the Governor's budget framework, as well as SB 76 of the prior session. From our vantage on Main Street, PA, we believe that the proposed treatment of advertising and interdependent services will yield outcomes counter to the worthy intentions[2] of the authors and sponsors. Further, as small businesses serving small businesses, we also fear a realignment of obligations now shared relatively proportionately across all businesses to a new, disproportionate burden placed on smaller enterprises.[3]

[1] Make no mistake, for all operational and practical purposes, expanding the scope of Sales and Use Tax cannot be euphemised as "just getting rid of some loopholes" -- these are brand new taxes for those pressed into collection duties, and brand new taxes for those suddenly forced to forfeit more coin. Putting aside administrative burdens for a moment, a new surcharge of 6-8% exceeds the slim margins of most publishers and their advertisers. The difference between what can neither be swallowed nor passed along equals job loss -- even enterprise failure.

[2] MACPA publishers appreciate the consensus aim of attempting to remedy real and serious harms resulting from our Commonwealth's current local property tax as local school funding source mechanism. We are well aware that preventable casualties including real property loss befall our neighbors in many of the communities we serve, and agree that remedy is overdue for the inequities inherent in the system. We note, however, that expanding SUT is a recurring proposition for numerous revenue challenges -- in any case, putting small businesses out of business, will only make the original problems worse.

[3] As with any comprehensive overhaul of the status quo, in this case multiple taxing structures, there will be a recalibration of net impacts and ultimate effects. Compounding the costs of small business services artificially inflates by orders of magnitude the competitive disadvantage against larger firms with scale to render similar services in-house.

After close analysis of both the Governor's plan and prior SB 76 (as introduced as well as amended), it remains unclear the extent to which the ultimate implementation and enforcement will directly capture our members' collective services. Our primary focus is on the proposed changes to the Tax Reform Code at Sec. 204, Current Exclusions, specifically the modifications to (30) Newspapers, (35) Direct Mail, and limitations on Advertising introduced under (76), services narrowed to business to business transactions. At prior public hearings on this complex and sweeping legislation, supporters have reiterated the underlying philosophy of retaining exemptions for services rendered between enterprises, and adding new tax liabilities for same if client is a member of the general public.

Under stated goals, we can be certain that personal classified advertising, including popular categories like garage sales and other casual sales and services, would become ripe for taxation. Additionally, the removal of exemptions for the sale at retail of "newspapers" and the ambiguous category of "direct mail advertising literature or materials" opens the door to future taxation of advertising, along with components of manufacturing and production. Common sense and past experience dictates that an entity charged with filling the state's coffers will err on the side of maximizing collections in both rulemaking and compliance enforcement. For our industry, this means paralyzing uncertainty, combined with the loss of valuable time and expense wasted in efforts to clarify and comply. The unintended outcome of such new taxes will most likely result in a net loss of revenues for our publishers, their small business advertisers, as well as to the Commonwealth of Pennsylvania.

The reason for the net loss of revenues to our Commonwealth and schools under the proposed new taxes is found in the multiplier effect of advertising. For every dollar invested in this discreet economic stimulation, a compounded return nearly twenty-fold is realized in the broader economy. Conversely, taxing or artificially discouraging these economic multiplier investments leads to less advertising. Depressed advertising weakens consumption of goods and services, which directly corresponds with diminished collections of sales and use taxes. Further, any direct impediments to the economic multiplier effect of advertising throw a wet blanket over the entire supply chain, where lost sales mean lost jobs.[4]

The bottom line: Any gains from these new taxes would be more than offset by the combination of lost sales taxes from interrelated businesses, lost income taxes from lost jobs and lower business / corporate tax receipts. The appreciation of these counter-intended fiscal outcomes is the reason why states universally do not tax advertising and related services. Even those that dabbled in such mischief were quick to learn, and ultimately repealed the counterproductive tax schemes.

Beyond the broader economics outlined above, we have an industry-specific concern about disproportionate costs of compliance. Should these provisions be enacted, our publishers will almost certainly be staring at a minefield of taxable and non-taxable events in their daily operations. The

[4] We are beyond confident -- we are certain -- of diminished Advertising as a result of a new 6-8% tax. Publishers answer consistently in our membership Tax Surveys that their own efforts to raise rates are met with small business pullback -- in both size and frequency. As one publisher sums it: "We can't raise display and insert prices to clients as they are at their spending limit in a lot of cases. If their prices go up they will cut back on size or frequency to maintain same cost outlay. Taxes that would increase their costs would be met with the same response. They would adjust accordingly. It is hard for small advertisers to maintain ad budgets when they have to pay for rent, electric, water, phone, etc., first." Note: a new 6-8% tax would be higher than any publisher surveyed has even attempted to raised their own rates since the Great Recession. Also note: nearly half of publishers surveyed have not even raised their own rates since 2008.

extraordinary efforts to sort, clarify and comply would be a nightmare considering we don't have a simple cash register to reprogram. Instead, we rely upon highly specialized, proprietary software that integrates the complex system of orders, production, layout, distribution, billing and on. Our industry-customized software will need reprogramming at the least, and upgrades or entirely new systems -- software and computers -- at the worst.[5]

The costs anticipated from the handful of vendors that cater to our industry will start in the thousands of dollars and can easily exceed tens of thousands of dollars and more. This fortune of real dollars and unproductive energy would need to be spent by our publishers before they even try to collect the first penny for the state's coffers. This scenario would still occur even if the ultimate scope of taxation was personal classified advertising, with the cruel irony for many being immediate outlays to comply being far greater than ultimate tax collections carried into the foreseeable future.[6]

To summarize, we believe that expanding Sales and Use Taxes -- including new taxes on advertising services -- will likely lead to net lost revenue for the state and our schools. At the same time, the counterproductive outcome would place destructive and dangerously disproportionate costs of compliance on the Free Community Paper Industry. Further, the range of new taxes will have an asymmetric impact on small businesses and otherwise depress discretionary consumption in a still-fragile economic recovery. For these reasons, we have grave concerns about prior SB 76, as well as the Governor's tax shifting proposal -- and otherwise urge at least stripping the damaging provisions relating to advertising.

Respectfully submitted,

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[5] Our member publishers would be forced to collectively spend hundreds of thousands of dollars -- money they do not have -- on new software before even attempting to collect the first penny for our Commonwealth. Then double that with costs of programming, training, administration and compliance, and even new computers -- again: all incurred before even attempting to collect the first penny of sales tax. Here's a sampling of responses to the recent Tax Survey question relating to making systems tax collection-ready: "several thousand dollars, if we can patch, tens of thousands more likely " "based on recent rfp, roughly $40-80k to upgrade and flow" "At least $20,000 for bare bones function" "$25k in software costs...minimum $20k in training" "$50,000 minimum..."

[6] It all adds up -- and badly: Costly expenditures to modify or replace systems that meet our needs today; more unproductive payroll outlays for a new regime of tax compliance; diminished net sales from reduced advertising -- from small businesses whose own operating expenses have risen dramatically, as they also confront lower sales volumes and lower gross margins thanks to new sales taxes they just can't fully pass along. How will hometown publishers adjust? Again, sample responses from the most recent Tax Survey: "We would stop publishing." "Reduce circ. And staff. Cut payroll." "Both and possibly an end of publication." "Consider scaling back circulation or cutting zones...if we were to stay in business." "...would put us on the brink of going out of business"