The Continuing Evolution of E-Commerce Issues

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Agenda

– E-Commerce Remote Sellers
– Marketplace Providers
– Consumer Digital Goods
– Omni-Channel Retailing
– Sharing Economy
– Third-Party Payment Processors
E-Commerce Remote Sellers

Business Description

- Limited, if any, store fronts
- Seller of record (as distinguished from market place provider)
- May sell own brand or the brands of others
- Online advertising and use of social media
- May use “affiliates” that get paid a commission
- May drop ship products
- Start ups are often acquisition targets
E-Commerce Remote Sellers

Sales Tax Issues – Tax Collection/Remittance

– Taxability determinations
– Implications of product mix
– Exemption certificate issues
  • Process to obtain, monitor and document exemption
  • Seller of record issues
– Tax rate implications (e.g., Louisiana In-Lieu of Tax and Alabama Simplified Seller Use Tax)
E-Commerce Remote Sellers

Sales Tax Issues

- Use Tax Reporting
  - Cost/benefit concerns-easier to collect tax than implement reporting
  - Customer service issues

- Due Diligence
  - Exposure calculations
  - Integration strategy
  - VDAs?
  - Impact on sales price
E-Commerce Remote Sellers


— Direct Marketing Association (DMA) asked for an injunction to prevent enforcement of Colorado’s notice and reporting obligations for out-of-state retailers.

— In 2012, the federal district court in Colorado declared the law unconstitutional and issued a permanent injunction.

— In 2013, the 10th Circuit Court of Appeals reversed the injunction and held that the Tax Injunction Act (TIA) bars federal jurisdiction.

— In 2015, the US Supreme Court held that the notice and reporting requirements do not violate TIA.

— In 2016, the 10th Circuit Court of Appeals held that the notice and reporting requirements did not violate the Commerce Clause.

— On December 12, 2016, the U.S. Supreme Court denied review.

— On February 22, 2017, the parties settled the matter, allowing the state to enforce the reporting requirements beginning July 1, 2017.
E-Commerce Remote Sellers

Justice Kennedy’s Concurrence

– In *DMA*, Justice Anthony Kennedy went out of his way to invite reconsideration of *Quill*.

  • “Given these changes in technology and consumer sophistication, it is unwise to delay any longer a reconsideration of the Court’s holding in *Quill*. A case questionable even when decided, *Quill* now harms States to a degree far greater than could have been anticipated earlier….It should be left in place only if a powerful showing can be made that its rationale is still correct.”

– In response, states have taken legislative efforts to force remote vendors to collect sales tax.
E-Commerce Remote Sellers

Nexus Litigation – Statutory and Regulatory Challenges

— South Dakota’s Statutory Challenge
  • S.B. 106 asserts nexus against remote sellers with $100,000 gross revenue from annual sales in the state or 200 separate transactions involving delivery into the state.
  • Positioned for an expedited appeals process.
  • South Dakota v. Wayfair, Inc., et al., No. 32CIV16-00092 (6th Judicial Cir., S.D. 2017)
    ▪ State trial court found the remote sales tax law to be unconstitutional under Quill.
  • Am. Catalog Mailers Ass’n v. Gerlach, No. 32CIV16-____ (6th Judicial Cir., S.D.)

— Alabama’s Regulatory Challenge
  • Rule 810-6-2-.90.03 asserts nexus against remote sellers with at least $250,000 in annual sales in the state.
  • Newegg Inc. v. Ala. Dep’t of Revenue, No. S 16-613 (Ala. Tax Tribunal)
E-Commerce Remote Sellers

Legislative Activity

Several state legislatures are considering (or have considered) similar actions in the 2017 session.

- Arkansas, Florida, Georgia, Hawaii, Kansas, Maine, Maryland, Massachusetts, Mississippi, Nebraska, New Mexico, North Carolina, Rhode Island, Texas, Utah and Washington.
- Economic nexus thresholds vary and many of the bills are coupled with other nexus expanding provisions and/or use tax reporting requirements.

- Indiana: Enacted H.B 1129 on April 28, 2017
- North Dakota: Enacted S.B. 2298 on April 10, 2017
- Maine: Enacted S. 483 on June 21, 2017
E-Commerce Remote Sellers

Enforcement Efforts

— Certain states have declined to formally enact tax increases by expanding their sales tax collection requirements to remote sellers.
  • Instead, these states have increased enforcement efforts through:
    ▪ Creating a nexus task force;
    ▪ Hiring nexus auditors; and
    ▪ More aggressive nexus positions.
  • E.g., Mass. DOR issued Directive 17-2 (June 28) that revoked Directive 17-1 (Apr. 4, 2017) (distinguishing remote Internet vendors from mail order vendors through: (1) in-state software and “cookies” placed on customers’ computers; (2) use of content distribution networks; and (3) other representative in-state contacts.) But, Mass. DOR plans to adopt remote seller regulations after public notice and comment process.
Marketplace Providers

Business Description

- Online platform that facilitates transactions between consumers and third-party (seller of record)
  - Marketplace provides services such as payment processing and billing, including assumption of fraud risk, and possibly fulfillment and/or sales/use tax collection
  - Sellers of record retain title, control pricing/placement/customer service (possible fulfillment), and advertising
  - Owner of platform may also be seller of record
  - Tax collection may vary depending on Marketplace

- Online sellers or traditional brick-and-mortar sellers have established online marketplaces to promote core businesses and connect new customers with third-party sellers of record
Marketplace Providers

Due to the ambiguity in approaches to tax collection and remittance by Marketplaces, sellers should consider:

- Who collects and/or remits tax – Marketplace or Seller?
- Where is tax collected and remitted – nexus of the Marketplace or the Seller?
- What is sold may impact tax collection, does Marketplace or Seller make the tax determination/characterization?
- How is tax collected and remitted – tax engine of the Marketplace of the Seller?
Marketplace Providers

Sales Tax Issues

- Compliance, in light of bifurcation of transaction between Sellers and Marketplaces and information known to Parties
  - Filing obligations (nexus footprint), sourcing, exemption certificates, etc.
  - Hold harmless provisions – indemnity clause?
  - Type of tax may impact compliance, e.g., CST, amusement, utility, or other entity-based tax

- Constitutional concerns remain – Commerce Clause and Due Process
  - Entity nexus?
  - Transactional nexus?
Marketplace Providers

Different Approaches to Sales Tax Collection and Remittance

- A Marketplace may choose to collect tax only where it is instructed to do so by the Third-Party Seller, based on the Third-Party Seller’s nexus profile and taxability decisions, or

- A Marketplace may choose to collect tax based on its nexus profile and taxability decisions, notwithstanding seller of record’s nexus profile and taxability decisions
Marketplace Providers

— After collection, Marketplace pays tax collected along with sales price to Third-Party Seller who then remits tax to the state, or locals where applicable

— Because Third-Party is “seller of record,” collection and remittance obligations and related liabilities remain with that Seller
  • When Third-Party Seller is evaluating its nexus profile, nexus expansion rules should be considered, e.g., affiliate, attributional, click-through, etc.

— Of note, marketplaces may sell goods through their platform, in which case they may be a retailer under state law
Marketplace Providers

Recent Developments

— Legislation
  • Proposals to shift collection liability from non-nexus sellers to marketplaces with nexus in the state seeking to tax the transactions
  • Sellers held harmless for collection if Marketplaces are registered and collect, and obtain documentation to that effect
  • However, Sellers are liable if they provide incorrect tax decision information to the Marketplaces

— Minnesota HF 1 (eff. 7/1/2019)
— Washington EHB 2163 (eff. 1/1/2018)
— New York Legislative Proposal
— Arizona TPT Ruling 16-3, Sept. 20, 2016
— Audit Developments
Consumer Digital Goods

Business Description

- Sellers of retail consumer digital products, including music, movies, books, and software-related products like video games

- Digital retailers sell products under various channels, terms, and conditions
  - Delivery methods: streaming or cloud-based, downloads, or combination thereof
  - Rights of use transferred: permanent rights of use (purchases) or less than permanent (rentals)
  - Payment streams: A la carte (one-time) payment, subscription

- Limited store fronts, but may have brick-and-mortar affiliates

- Content creators (e.g., movie studios) have begun selling direct-to-consumer
Consumer Digital Goods

Sales Tax Issues

— Nexus
  • Similar to E Commerce Retailers, but unique considerations for rentals in states that characterize digital products as TPP

— Characterization of Transaction
  • “Products transferred electronically” or “specified digital products”
  • TPP
  • Taxable services (e.g., CT computer and data processing, FL communication services)
Consumer Digital Goods

Sales Tax Issues

— Tax Consequences of Characterization (or Mischaracterization)
  • Bundled Transactions
  • Sourcing
    ▪ Sometimes depends on the seller (MTSA)
  • Exemption Certificate Issues
  • Trials or “free samples” and use tax accrual

— ...and Non-Tax Consequences
  • Communications service provider
  • False Claims Acts/Qui Tam
  • Class actions
Consumer Digital Goods

Recent Developments

- Alabama
- Arkansas
- Iowa
- Kentucky
- Maine
- Pennsylvania
- South Carolina
- Chicago
- California UUTs
- Federal Legislation – ITFA, DGSTFA
Omni-Channel Retailing

Business Description

- Stores in multiple locations, whether virtual and physical/traditional or multiple virtual storefronts over various platforms
- Adding “online” presence
- Leveraging physical/traditional or virtual assets to offer multiple purchasing channels
- Loyalty efforts
- Data analytics
Omni-Channel Retailing

Sales Tax Issues

- Impact of systems on tax calculations-POS vs. Online system

- Tax rate issues
  - Returns
  - Local jurisdictions outside store locations

- Investments in technology (software and hardware)

- Class Actions
Omni-Channel Retailing

Sales Tax Issues

- Shipping and Handling Taxability

- Loyalty Rewards
  - Points representing a “discount’
  - Points representing “consideration”
  - GA Letter Ruling LR SUT-2015-22, Georgia Department of Revenue, 12/16/15, released 5/10/16
    - Redemption of reward points for free accommodations were taxable because the hotel received a “reimbursement” from a fund created when the points were earned

- Gift Card Issues
Sharing Economy

- Related to the Marketplace Business Model, sharing economy businesses use application-based platforms to facilitate transactions between consumers and the actual service provider (peer-to-peer networks)

- Examples – Uber, Airbnb, TaskRabbit, DogVacay, Lending Club
Sharing Economy

— Transaction Taxes – Sales and Use, Occupancy
  • Compliance and collection obligations: is characterization the P2P service or underlying good/service? And who collects – sharing business or provider?

— Property Tax
  • How does rental income impact valuation?

— Licensing and Fees

— Income and Employment Taxes
  • Worker Classification

— Legislative Updates and Other Current Developments
Third Party Payment Processors

Business Description

– Online third-party payment processors allow retailers to accept credit and debit card payments through point-of-sale SaaS, without requiring the retailers to open a merchant account with a bank

– The processor has a merchant account with a bank, with access to the credit card network and settlement process, that it uses to process the retailers’ payments

– Examples – PayPal, Google Wallet, Square, Apple Pay, Amazon Payments
Third Party Payment Processors

Sales Tax Issues

- Sellers that accept payments from online payment process services may have no information about their customers, which creates compliance difficulties with respect to taxability, rates, sourcing, etc.

- Income Tax Issues
  - Sales Factor Sourcing – where is the market?

- Information Reporting
  - 1099-K compliance
Questions?