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Wayfair: Marketplaces and Foreign Vendors

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In this installment of Academic Perspectives on SALT, the third of a series of articles on *Wayfair*, the authors offer suggestions for how states can enforce their sales and use tax laws against marketplaces and foreign sellers.

The U.S. Supreme Court's recent decision in *South Dakota v. Wayfair Inc.* is perhaps the most important development in state and local tax law in the past decade.[1] This is the third in a series of articles we have written to evaluate the *Wayfair* decision and to analyze key questions it has raised.[2]

In this article, we consider issues regarding marketplaces such as Amazon.com and eBay and foreign vendors. We conclude that state governments should apply their new nexus standards to the major marketplaces and should not let fears about in-state citizens shifting to purchasing from foreign vendors stand in the way of efforts to apply more inclusive nexus standards to out-of-state vendors.

Marketplaces

Wayfair is already ushering in a new regime for interstate sales and use tax transactions wherein state governments should be able to successfully tax most transactions between in-state citizens and out-of-state vendors. However, for this new regime to be successful, it is critical for state governments to reach sales by small out-of-state vendors conducted through the major marketplaces like Amazon and eBay.

As we have previously discussed, there are limits to the extent *Wayfair* allows state governments to impose collection obligations on out-of-state vendors.[3] Importantly, the Court explained that it was upholding South Dakota's law in part because that law provided a "reasonable degree of protection" for smaller vendors by exempting out-of-state vendors that deliver less than $100,000 of goods or services into the state or engage in less than 200 separate transactions for the delivery of goods or services into the state on an annual basis.[4]

[1] *South Dakota v. Wayfair Inc.*, 138 S. Ct. 2080 (2018).

[2] The two prior articles are Adam Thimmesch, Darien Shanske, and David Gamage, "*Wayfair*: Substantial Nexus and Undue Burden," *State Tax Notes*, July 30, 2018, p. 447 ("Undue Burden"); and Thimmesch, Shanske, and Gamage, "*Wayfair*: Sales Tax Formalism and Income Tax Nexus," *State Tax Notes*, Sept. 3, 2018, p. 975 ("Tax Nexus").

[3] *Id.*, "Undue Burden."

Major marketplaces such as Amazon, eBay, and Google will certainly facilitate sales that, in the aggregate, exceed small vendor thresholds of this sort. But this then raises the question whether states can require these marketplaces to collect sales or use tax on transactions between in-state consumers and small out-of-state vendors that are themselves protected from having to collect that tax. If not, the result would be to create a substantial tax advantage for small out-of-state vendors selling via the major marketplaces as compared with their larger competitors. Because there is already an abundance of small vendors selling through these marketplaces and there are many more small retail vendors that could easily set up similar operations to make interstate sales, this would likely create major gaps in the new interstate sales and use tax regime.

Although *Wayfair* does not specifically address marketplaces, we see nothing in that decision that should prevent state governments from imposing sales and use tax obligations on the major marketplaces. We thus urge state governments to clearly apply their new nexus standards to the major marketplaces.

Of course, states will have to carefully consider how they will define the marketplaces that are subject to these new requirements. Marketplaces come in many different forms. Some are run by companies that make sales themselves, like Amazon. Those companies have tax collection processes in place and are already subject to state tax collection obligations. On the other end of the spectrum are marketplaces like Craigslist or Facebook Marketplace. Those marketplaces do not sell their own goods, do not facilitate payments, and generally cater to sellers who are making casual or isolated sales that are likely exempt from tax. Somewhere in the middle of the spectrum is a marketplace like eBay, which takes an active role in facilitating sales and payments, has a well-developed website that guides consumers to particular goods and retailers, and is a platform often used for sales by businesses.

States with marketplace facilitator laws on the books have thus far conditioned their tax collection obligations on different factors. In Connecticut and Pennsylvania, for example, the marketplace facilitator must participate, directly or indirectly, in the payment for the good.[5] The statutes in Washington and Alabama look at a variety of other factors that involve the marketplace facilitator in the sale to some degree, including the provision of fulfillment services, price setting, branding, and return assistance, among others.[6]

We believe that states are well within their powers to require companies like Amazon to collect tax on sales that are made using its platform. States are also on firm footing if they want to require the collection of tax by vendors like eBay that take an active role in promoting and facilitating sales, including by facilitating payments and returns and by providing money-back guarantees to those who use its platform. State power regarding passive marketplaces like Facebook Marketplace or Craigslist is less certain, but it seems that states have less of an interest in pursuing those marketplaces. Many of the sales taking place on those platforms, though certainly not all, will likely be tax exempt under states' casual or isolated sales exemptions. We suggest that states focus their efforts on the first two marketplace categories but closely monitor the development and evolution of other types of marketplaces.

Foreign Vendors

There is broad consensus that the *Wayfair* decision about nexus also applies to remote sellers based in foreign countries.[7] That is, assuming a state nexus statute passes the *Wayfair* regime, a non-U.S. vendor must collect and remit the sales or use tax on the same terms as a U.S. vendor.[8]

[4] *Id.*

[5] Conn. Pub. Acts No. 18-152 stat 4 (2018); and 72 Penn. Stat. 7213(c).

[6] Ala. Act 2018-529 section 3; and Wash. Rev. Code section 82.13.010(3).

[7] *See, e.g.*, William Hoke, "Enforceability of *Wayfair* Decision on Foreign Companies Unclear,"[italicized Wayfair in title because it's italicized on TN website] *State Tax Notes*, July 2, 2018, p. 73; and Deloitte, "State Tax Implications of *Wayfair* for Non-U.S. Companies With U.S. Customers," External Multistate Tax Alert (June 27, 2018).

[8] We refer to use taxes in the remainder of this article, but it may be that states will impose their sales taxes on foreign sales instead. As we discussed in a prior article, this may be significant, and the foreign dimension may raise issues that have not yet been considered. Thimmesch, Gamage, and Shanske, "Tax Nexus," *supra* note 2.

Imposing a use tax obligation on foreign sellers implicates both the foreign dormant commerce clause and the import-export clause. Nevertheless, it seems hard to imagine that any state law that passes muster under *Wayfair* could offend either of these provisions. In either case, and painting in broad strokes, the state law would only likely fail under these provisions if state collection efforts antagonized our trading partners in such a way that the federal government would take the side of foreign vendors in litigation, but without Congress passing a law preempting state collection efforts.[9]

Commentators have wisely been much more concerned about whether and how states are going to get foreign vendors to collect use tax in the first place.[10] The consensus seems to be that enforcement could be a problem, both legally and practically. If this consensus is correct, then there is a further empirical question whether the result will be an uneven playing field between domestic and foreign vendors.

Let us start with the legal analysis. It is likely correct that states are not going to have much luck getting foreign governments to enforce their use tax collection obligations under current law.[11] Some analyses seem to imply that this is basically the end of the matter, but this is not so. A state can surely impose a tax lien on any property that the non-collecting vendor has in the state, for instance. For many states, such as New York with its banks, and California with its ports, this will likely be a significant aid in enforcement.

But what if the foreign vendor does not have property in the state? Again, the suggestion seems to be that if there is no property in the state, then the state is out of luck, but that too is incorrect. If a state takes the trouble of getting its tax lien reduced to a judgment in its own courts and then follows the procedures of the Uniform Enforcement of Foreign Judgments Act,[12] then the state can enforce its judgments in the courts of another state.[13] Forms of the foreign judgments act have been passed in 49 states.[14] In other words, Ohio can collect from a foreign vendor by enforcing its judgment against the funds it holds in a New York bank.

To be sure, this process could be burdensome and states do not typically go to this much trouble — but sometimes they do,[15] and in any event they would have enormous incentive to do so if the feared shift to foreign vendors were to occur. In short, we think that states will have considerable enforcement power if the shift to foreign vendors is significant enough to warrant such an effort.

As an empirical matter, we don't expect there to be a need for a large number of cross-state enforcement actions. We say this for several reasons beyond our legal analysis as to state power. First, as discussed previously, states almost certainly can and should impose collection obligations on major marketplaces like Amazon and eBay. This should greatly reduce the scope for foreign vendors to sell to in-state customers while evading collection obligations. Second, business-to-business use tax compliance rates are high,[16] so we are only concerned with direct sales to consumers. Third, the shift of sales to smaller foreign vendors does not present any unique

[9] As happened in *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), but not *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983). *See also* Leanne M. Wilson, "The Fate of the Dormant Foreign Commerce Clause After *Garamendi* and *Crosby*," 107 *Colum. L. Rev.* 746 (2007) (arguing that the key test involves a preemption analysis in light of nontax cases decided after *Container*).

[10] *See* Hoke, *supra* note 7. *See also* Ryan Prete, "Foreign Sellers Likely Safe From State Online Tax Frenzy Post-*Wayfair*," *Bloomberg Tax*, July 12, 2018.

[11] Restatement (Fourth) Foreign Relations section 489; Brian J. Kirkell and Mo Bell-Jacobs, "E-Flight Risk? *Wayfair* and the Revenue Rule," *State Tax Notes*, Aug. 6, 2018, p. 551. This is not to say that governments could not and should not change this state of affairs. William S. Dodge, "Breaking the Public Law Taboo," 43 *Harv. Int'l. Law J.* 161 (2002).

[12] *See generally* C. Joseph Lennihan, "Cross-Border Collection of State Tax Assessments: A Primer,"[double check title of article? he lists it as "Enforcement" rather than "Collection" on his LinkedIn] 19 *J. Multistate Tax'n & Incentives* 8 (2009).

[13] The key Supreme Court decision establishing that states must enforce each other's judgments under the full faith and credit clause is *Milwaukee County v. M.E. White Co.*, 296 U.S. 268 (1935). Note that this case was about a county in Wisconsin attempting to enforce a tax judgment in Illinois.

[14] *See* Lennihan, *supra* note 12; *see also* Uniform Law Commission, "Act: Enforcement of Foreign Judgments Act."

[15] For instance, there are numerous cases involving New York trying to enforce judgments in Florida. *See, e.g.*, *New York State Commissioner of Taxation and Finance v. Hayward*, 902 So.2d 309, 310 (Fla. Dist. Ct. App. 2005). For an example of a local government successfully enforcing a judgment, see *City of Philadelphia v. Austin*, 86 N.J. 55, 56, 429 A.2d 568 (1981). For examples of businesses using the act to collect from other businesses, see Sheldon H. Laskin, "The Enforcement of Foreign Judgments: A Government Service Designed to Benefit Nonresidents," *State Tax Notes*, Jan. 7, 2008, p. 41.

[16] *See, e.g.*, California State Board of Equalization, "Revenue Estimate: Electronic Commerce and Mail Order Sales, Rev. 8/13," at 9 (2013) ("Through one means or another BOE believes that registered sales and use tax is paid on 90 percent of California taxable B-to-B electronic commerce.").

enforcement problem for states given the legal and administrative need for small-seller exemptions. It is just that it will always be difficult for states to collect use tax on sales made by smaller vendors, regardless of where they are located.

Fourth, the form of goods arguably most susceptible to evasion — digital goods — does not strike us as relatively problematic for states. This is because digital goods, though growing in importance, are still only a small slice of the market. Also, many common business-to-consumer digital goods are sold through platforms that can clearly be targeted for enforcement, such as the Apple App Store, Google Play, Netflix, and Amazon Prime Video. And if a foreign vendor attempted to operate independently of these platforms, it would still need to establish a payment mechanism to collect revenue from U.S. customers. Any sizeable foreign firm would likely want to access the U.S. capital markets, creating another opportunity for states to collect.

Fifth, although the potential price advantage from not collecting the use tax is real and substantial, we think that many of the commentators concerned about "e-flight" exaggerate the cost of use tax compliance in the same way that many remote vendors did pre-*Wayfair*. Not only would the compliance costs for a foreign vendor with sales above the thresholds set by the states likely face a small cost relative to the value of its sales, but these compliance cost will not likely stand out relative to the compliance costs associated with other consumption taxes.

For instance, consider a Canadian vendor. At the national level, Canada has a credit-invoice VAT that is, on its own, at least as complex as any state's retail sales tax, if not more so.[17] If the Canadian vendor sells abroad, then it already must cope with border tax adjustments (BTAs) because basically every other country on earth has a VAT, and BTAs are a standard part of a VAT. Once in the new jurisdiction, the foreign vendor will again need to deal with a VAT, assuming it is making sales in the foreign country itself.[18]

Further, there is a significant body of literature to the effect that businesses generally want to comply with the law. This is not just a matter of altruism, but good sense for the business and for the individual managers.[19] A large state tax liability will show up on financial statements and will hover over any future plans to operate in the United States.[20] It seems improbable that large vendors are likely to just ignore the laws of states in which they make substantial sales. Remember that in the pre-*Wayfair* world, big businesses like Wayfair were complying with current law when not remitting the use tax. In the new post-*Wayfair* world, this will no longer be the case.

Finally, and perhaps most importantly, if a shift to foreign sellers ends up being a large problem, despite the reasons we explained above to think this will not be the case, then we would expect Congress to intervene on the side of the states. After all, this would be a situation in which *all* U.S. domestic vendors would be at a disadvantage — we would not have the same issue as regarding the *Quill* rule, under which the interests of different states diverged based on whether they had a sales tax.

For these reasons, we do not expect that foreign sellers will create any major gaps in the new post-*Wayfair* sales and use tax enforcement regime. State governments should not let fears about in-state citizens shifting to purchasing from foreign vendors stand in the way of efforts to apply more encompassing nexus standards for imposing collection obligations on out-of-state vendors. ■

[17] *See, e.g.*, Sebastian Eichfelder and François Vaillancourt, "Tax Compliance Costs: A Review of Cost Burdens and Cost Structures," at 28 (Nov. 2014 draft) ("VAT seems to be significantly more costly than more simple sales taxes."). Many Canadian provinces also have their own consumption taxes. On the complicated system in Canada generally, see Richard M. Bird and Pierre-Pascal Gendron, "Sales Taxes in Canada: The GST-HST-QST-RST 'System,'" 63 *Tax L. Rev.* 517 (2010).

[18] Foreign countries generally have *de minimis* rules that protect smaller vendors from VAT obligations, but the threshold amounts vary considerably. Emily Ann Satterthwaite, "On the Threshold: Smallness and the Value Added Tax," 9 *Colum. Tax L.J.* 177, 194-195 (2018).

[19] *See* Wei Cui, "Taxation Without Information: The Institutional Foundations of Modern Tax Collection," 20 *U. Pa. J. Bus. L.* 93-146 (2017).

[20] Kirkell and Bell-Jacobs (*supra* note 11) make this point.