

Unified Commerce and the Tax Implications for Retailers

by **Douglas P. Clement**, Multichannel Merchant

The pandemic-driven acceleration of e-commerce has highlighted and amplified the challenges online sellers face in an ever-shifting landscape of sales and use taxes imposed by states, municipalities and special taxing districts.

As e-commerce penetration has jumped roughly 10 years ahead in the past 12 months, merchants once comfortably operating below thresholds requiring them to collect and remit remote seller tax are suddenly confronting compliance issues that they're not capable of handling.

The evolution of the retail sales burden since *South Dakota vs. Wayfair*, the U.S. Supreme Court's 2018 decision on remote seller tax obligations, combined with the rapid acceleration of tax exposure brought on by this recent pandemic surge, have brought some critical points into clearer focus:

- For the most part, omnichannel and remote sellers are not equipped to effectively handle tax compliance on their own
- Technology to help automate indirect tax processes can ensure compliance and streamline operations
- The integration of this technology across the entire sales footprint can unify commerce and provide salutary effects such as optimizing the customer experience

How We Got Here: Nexus, Marketplaces and Wayfair

"Pre-*Wayfair*, if you managed your business correctly and you only sold from a particular location and did it online, you didn't have to worry about any of collecting, reporting and remitting of sales tax," said attorney Jordan Goodman, a partner in Chicago-based Horwood Marcus & Berk's State and Local Tax (SALT) Group.

Amid attempts by Congress to pass versions of a Marketplace Fairness Act in the mid-2010s, Amazon and others began collecting and remitting taxes to a

growing number of states on behalf of third-party sellers, based on the legal principle of nexus. Until *Wayfair*, that meant having a physical location in a taxing jurisdiction, but the ruling changed everything. Suddenly, e-commerce sellers were obligated to report in 45 states on a monthly basis.

The tax obligation is based on revenue thresholds ranging from \$100,000 to \$500,000 or the number of transactions per year. Many states add an either/or component, for example Georgia's more than \$250,000 or 200 separate transactions, while others combine dollar amount and volume as New York's threshold of \$500,000 and 100 transactions.



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Peter Olanday, a retail practice leader of consulting for Vertex Inc., a provider of tax automation software, points out a wrinkle: Thresholds are determined on an annual basis but states define different starting points ranging from calendar year or prior year to fiscal year.

“The states also did a remarkable thing once they adopted the *Wayfair* standard, pushing the burden onto the marketplaces,” Goodman said. “In a number of ways, marketplace facilitator laws make sense, equalizing the burden for smaller sellers. The large marketplaces have more resources and are already obligated to collect and remit taxes. The laws just add sales that they have to collect the tax on.”

Olanday notes complications here, too. “Who’s responsible for paying and filing what?” he asks. “Maybe Amazon pays the California tax and I, as a seller on Amazon, have to pay the local taxes like in San Francisco, or the other way around. How do you calculate tax and then who files? It’s just very confusing and still needs to be ironed out.”

Remote sellers still have to collect and remit taxes on sales through their other ecommerce channels, including their own website.

The Changing Tax Compliance Landscape

“Tax complexity is becoming more prevalent,” said Nichole Prendergast, a Microsoft partner leader at Vertex. “There are different jurisdictions, different countries and business model types and all of those have varied taxability models. With COVID, as governments try to recoup their losses, tax laws and compliance rules are rapidly changing, making it very difficult for an individual company to be able to keep up with all of those changes.”

A Tax Foundation report on state and local sales tax rates in 2020 notes that local sales taxes are collected in 28 states, and state taxes in 45 plus the District of Columbia. Alaska, Delaware, Montana, New Hampshire, and Oregon don’t have a state sales tax, though Alaska charges locally.

More to the point are the stunning array of taxation layers as sales taxes trickle down from states to municipalities and special taxing districts.

Consider these examples in the report as indicative of the broader trend:

- Marion City, IL raised its sales tax from 8.75% to 9.5% in 2020
- East Baton Rouge, LA increased its parish sales tax by 0.5%
- Tuscaloosa, AL raised its local sales tax by 1%
- Clark County, NV, including Las Vegas, raised its tax by 0.125%
- The Iowa cities of Bondurant, Clive, Grimes, Johnston and Urbandale all adopted a 1% sales tax

It gets even more complex:

- Qualifying sellers in the Urban Enterprise Zones of some New Jersey cities are allowed to collect half of the statewide sales tax of 6.625% to assist retailers competing with counterparts in Delaware, which doesn’t have a sales tax

As levels of government adopt new and increased taxes to address COVID-fueled revenue losses and deficits, the challenges will grow. The number of new taxing cities (69) and new district taxes (177) that materialized in 2020 mark one of the top changes in each category during the past 10 years, according to a Vertex report.

The report also listed these cautionary statistics for sellers:

- Since 2011, there have been 2,202 new sales and use taxes, an average of 220 per year
- In that time, there have been 3,555 sales and use tax changes, an average of 355 per year
- The combined number of new and changed sales and use tax rates since 2011 is 5,757, an average of 575 per year



These types of changes, once adjusted annually or mid-year, are now updated almost constantly.

For instance, sales tax holidays for things like school supplies and children's clothing are sometimes announced with just a couple days' warning. Or consider sales tax breaks on hurricane preparedness items like the one declared by Florida in May 2020. A battery-powered radio costing less than \$50 was exempt, for example, while a more expensive model wasn't.

"You not only have to be on top of where you sell but also what you sell," Olanday said. "It's definitely a Herculean task to manage all of your things even in a single location."

Omnichannel Transactions: Stores, Websites, Vendors, Apps

The challenge of sales and use tax compliance amid the Gordian knot of tax codes and laws across the U.S. and internationally — in 2019 France was the first European Union member to require a VAT collection — is also viewed as an opportunity by ecommerce thought leaders.

Compliance involving automated tax software helps unify commerce and improve customer experience across diverse sales channels that previously lacked integration.

Outdoor apparel brand Patagonia had been using different systems for its ecommerce, retail and wholesale channels. The lack of integration challenged Patagonia's IT and tax teams, and also frustrated consumers. "A customer coming to a Patagonia retail store to pick up an online order experienced a disconnected experience where the retail associate had no way of finding any information about the original, online purchase," according to a Vertex blog post.

Using a Vertex tax automation solution integrated with Microsoft Dynamics 365, Patagonia is able to ship from store throughout the country and calculate the correct sales tax on every transaction. This also gives its customers a seamless omnichannel experience in store and online.

When brands unify through tax compliance solutions, it integrates sales channel silos to provide a seamless experience for shoppers.

It is important for tax automation solutions to have a built-in failover feature. If there aren't any online connections, a continuity in tax calculations needs to be ensured.

The Risks of Noncompliance

"What states are doing now is auditing with a finer tooth comb, and they will look for retailers selling enough in the state and start to go after them," Olanday said. "I think it's critical that they have some solution in place. There could definitely be some legal problems if you don't comply." The scrutiny also arrives from other directions.

"Customers are very sensitive and very aware of how much tax they're paying," Olanday said. "They definitely know when they're paying tax and shouldn't be." Taxation inconsistencies and problems can reach a magnitude that inspires customers to complain en masse, spurring an investigation, or even occasion a class action lawsuit. At the very least, negative feedback going viral on social media can be a PR nightmare. Then there are false claims actions.

"Pre-Wayfair, under Quill, hundreds of claims were filed in Illinois about companies that should be paying taxes," Goodman explains. "The False Claims Act allows people to identify a business by saying, 'I've got information that this company sold me a product but didn't collect tax on it.'"

So-called "relators" would sue on behalf of the state, arguing the seller failed to follow a state's sales tax laws. These types of lawsuits are filed in camera, meaning not available for public review. Once filed, the state's attorney general or the agency being represented decides if they want to take over the action; often they don't.

Often, states reward the relator with 10% to 30% of proceeds recovered by the state, plus attorney's fees and expenses. Because of the high risk associated with these cases, they were often settled prior to trial.

"The number of states allowing this type of action is only increasing," Goodman said. He added New York and Washington, D.C. have changed statutes to allow false claim and qui tam actions targeting sales taxes.

"These lawsuits are getting down to local rates," he said. This can be significant considering that there are 1,500 parishes in Louisiana with their own taxes, for

example. “Everyone you sell to could potentially turn you in,” Goodman said.

Size Matters in Tax Compliance

While tax compliance software was already in the marketplace, the speed and scale of *Wayfair* implementation made access an issue.

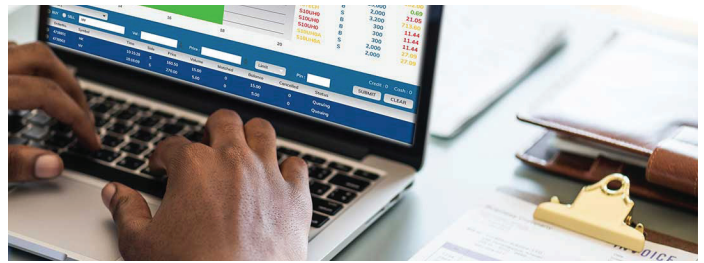
Many of Goodman’s clients have achieved compliance, though he continues to encounter companies that have not. “But it’s now 2020 and the states are saying, ‘We adopted our *Wayfair* statute in 2018, where have you been?’ Technically, the states can go back to day one. It’s scaring the heck out of a number of remote sellers who know they weren’t compliant from day one in most of the states.”

That has led to a focus in his practice of working to obtain relief for the gap period between the adoption of *Wayfair*-driven tax laws and when sellers were able to get compliant.

He advises remote sellers who haven’t yet achieved compliance to look at a plan of voluntary disclosures, which might prompt a three- to four-year look back and a requirement to fulfill those tax obligations, thus avoiding interest and penalties.

“If you didn’t collect the tax, it comes out of your pocket,” Goodman warns. “If all of the states have not found you but you received a nexus questionnaire, you should consider reaching out to a software provider to get up and running. If the states don’t yet know who you are, you can use that as leverage. To have a software provider ready to go and switch on immediate compliance is important. It sits well with the state you’re dealing with.”

Goodman is working with an online seller that received a \$100,000 bill from the state of Wisconsin, as well as noncompliance notices, but didn’t know how to respond. “They now have a \$100,000 final assessment against them,” he said. “They have no state tax sophistication, no resources, and really did not have much use for someone other than a general accountant.” The re-



tailer’s sales fall below the standards set in *Wayfair* and shouldn’t have been targeted, Goodman said.

He added the explosive growth in ecommerce for many sellers in 2020 was a mixed blessing, suddenly requiring new tax reporting requirements.

What’s Next: Sales and Use Taxes for Streaming and SaaS

Sales tax started out as a tax on the transfer of tangible personal property for consideration, and it keeps expanding from there.

“Digitalization has created a whole new level of taxation,” Goodman said. “The changes in technology have the states trying to fit the new types of products into the traditional sales of tangible personal property. Some jurisdictions, like Chicago, have expanded transaction taxes to software and SaaS.”

Meanwhile, Maryland has moved toward imposing a digital advertising tax. A Tax Foundation fact sheet calls it “incredibly vague on vital definitions” and said it creates “uncertainty about where revenue is sourced and when it is subject to the tax,” as it would “certainly create substantial—and costly—confusion.”

That dangerous status quo makes addressing tax compliance a priority for any ecommerce seller.

From established retailers to ecommerce startups suddenly responsible for collecting and remitting remote tax, a unified approach integrating their ecommerce platform with tax automation software can achieve compliance while maintaining a great customer experience.

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