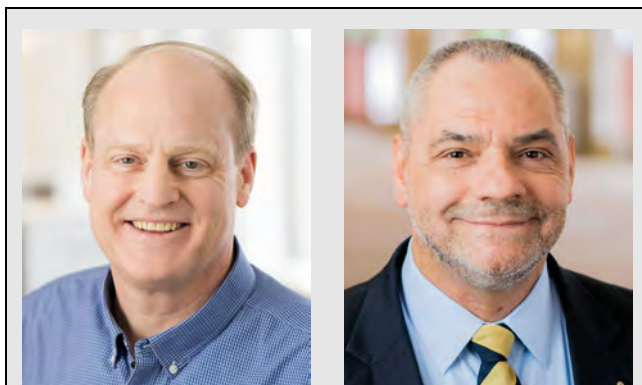


## The Potential Tax Impact of an ‘Unprecedented’ Product Liability Ruling

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In this article, Bernard and Salis explore *Bolger v. Amazon* and its potentially far-reaching implications on marketplace transactions.

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In its September petition to the California Supreme Court, Amazon used vivid language (“unprecedented leap”) to challenge a landmark product liability ruling of *Bolger v. Amazon*, whose “blast radius” would send disruptions rippling throughout the retail industry, affecting

marketplace facilitators in particular.<sup>1</sup> We hope those colorful terms will capture the attention of tax executives, who have compelling reasons to monitor *Bolger* and similar court cases and related legislative efforts that could ultimately lead to a burst of tax policy changes concerning e-commerce platforms.

Tax professionals should familiarize themselves with the case, assess its potentially far-reaching implications on marketplace transactions, and the master service agreements that govern them. Tax leaders should consider how a transformational shift in product liability applicability raises the stakes on tax compliance risks at a time when post-*Wayfair*<sup>2</sup> sales tax changes targeting marketplace facilitators and online transactions more broadly are multiplying.

### A Battery of Rulings

On August 13, 2020, California’s Fourth District Court of Appeals ruled that Amazon could be held liable for a defective product sold through its online marketplace.<sup>3</sup> The product in question is a replacement laptop battery, bought by plaintiff Angela Bolger from a Chinese manufacturer, Lenoge Technology (HK) Ltd. Bolger alleged that she suffered severe burns when the battery exploded a few months after its purchase.

The ruling reversed an earlier trial court decision that sided with Amazon, which had argued the legal doctrine of strict product liability did not apply to the company because, as an

<sup>1</sup>Todd Bishop, “Amazon Appeals Product Liability Ruling to CA Supreme Court, Citing ‘Potentially Vast Blast Radius,’” *GeekWire*, Sept. 23, 2020.

<sup>2</sup>*South Dakota v. Wayfair Inc.*, 138 S. Ct. 2080 (2018).

<sup>3</sup>*Bolger v. Amazon.com LLC*, Case No. D075738 (Cal. App. 4th 2020).

online marketplace, Amazon did not distribute, manufacture, or sell the replacement battery. Bolger, the Fourth District wrote, “argues that Amazon is strictly liable for defective products offered on its website by third-party sellers like Lenoge. In this circumstance of this case, we agree.”<sup>4</sup>

As indicated by the California Court of Appeals, “strict [product] liability is a common law doctrine in California. It was created by the courts, which have expanded and contracted the doctrine where warranted by its purposes.” It is clear from the *Bolger* holding that marketplace facilitators will be held to the traditional “distribution chain” standard in products liability cases, as applied to all commercial suppliers of a (defective) product. Without differentiation for marketplace facilitators, such as Amazon, and as cited in the judgment, the appellate court had ruled before that “strict liability extended to ‘any person engaged in the business of selling products for use or consumption therefore including any manufacturer, wholesaler or retail dealer or distributor as well as operators of restaurants.’”<sup>5</sup>

The court’s ruling indicates that online marketplace sales represent a “new transaction now in widespread use.” The court laid out several reasons for its ruling that Amazon should be held liable if a product sold through its website turns out to be defective, including:

- Amazon may be the only company in the supply chain available to an injured consumer using a product liability claim;
- the company plays “a substantial part in ensuring the products listed on its website are safe,” typically by pressuring manufacturers and third-party sellers to bolster safety; and
- Amazon can “adjust the cost of liability between itself and its third-party sellers.”<sup>6</sup>

While this ruling could have widespread implications on how product liability is

determined when products are purchased via online marketplaces, few can influence sellers and other third parties the same way Amazon can, given its unique position as a marketplace facilitator.

Similar product liability cases involving marketplace transactions are working their way through courts in New York, Ohio, Pennsylvania, Texas, and other states. The *Bolger* ruling — which Amazon appealed to the California Supreme Court — could influence other legal decisions. Although the California Supreme Court denied the appeal on November 18, 2020,<sup>7</sup> state lawmakers are considering legislation that would adjust brick-and-mortar-era product liability rules to the e-commerce marketplace era. California has already proposed such a law, which some smaller marketplaces have opposed.

Further, on December 8, 2020, in *State Farm Fire & Casualty Co. v. Amazon.com Services Inc.*, the Supreme Court in Onondaga County, New York (a trial court), addressed whether Amazon can be strictly liable under New York law for injuries caused by an allegedly defective product offered through its website by a third-party seller. This court, joined by only a few other state courts, also held that liability did attach to Amazon, following a rationale similar to that the court provided in *Bolger*.<sup>8</sup>

### This Matters to Tax

Why should tax leaders in retail companies care about *Bolger v. Amazon* and other cases concerning how product liability is determined in marketplace transactions? For starters, tax executives, like all their strategic business partners, have an obligation to keep an eye on legal, policy, and regulatory changes that could have significant effects on their company’s risk profile and bottom line.

The case is important to monitor for reasons that relate more directly to tax policy and tax compliance. *Bolger*, similar cases, and related legislative activity concerning product liability in marketplace transactions show that courts and

<sup>4</sup> *Id.*

<sup>5</sup> *Bolger v. Amazon.com LLC*, 53 Cal. App. 5th 431, 451 267 Cal. Rptr. 3d 601 (2020), quoting *Barth v. B.F. Goodrich Tire Co.*, 265 Cal. App. 2d 228, 250-51 (1968).

<sup>6</sup> *Bolger*, Case No. D075738.

<sup>7</sup> *Bolger v. Amazon.com LLC*, Case No. S264607, petition for review denied (Cal. Nov. 18, 2020).

<sup>8</sup> *State Farm Fire & Casualty Co. v. Amazon.com Services Inc.*, N.Y. slip op. 20326 (Sup. Ct. Dec. 8, 2020).

policymakers are paying more attention to online marketplaces as their consumption soars. More than 50 percent of global e-commerce sales were transacted via online marketplaces in 2019, according to WebRetail.com research, and an average of about 50 products are added to a marketplace every second. Since 2017, more products have been sold by third-party sellers on Amazon than by Amazon itself, according to *The Wall Street Journal*.<sup>9</sup>

The explosive growth of marketplaces all but guarantees that regulators and other outside stakeholders (for example, state department of revenue officials) will intensify their scrutiny of all marketplace dynamics, including enhanced tax rules and digital compliance processes. Tax influencers, including the Multistate Tax Commission, are well aware of this heightened scrutiny. The MTC Uniformity Committee, a group that encourages individual states to adopt consistent tax and fiscal policies, has invested substantial time and research to identify ways that the flood of post-*Wayfair* tax rule changes affecting marketplace facilitators can be improved from a standardization and ease-of-compliance standpoint.

The MTC Uniformity Committee and the National Conference of State Legislatures Task Force on State and Local Taxation produced a white paper and related draft model legislation for use by state legislatures when considering post-*Wayfair* sales tax changes affecting marketplace facilitators.<sup>10</sup> The groups considered addressing class-action lawsuit protections related to product liability in this guidance. Although that issue was not included in the final draft of the white paper and model legislation, its consideration shows that product liability is a significant concern to sales and use tax.

On October 1, 2020, Tennessee's Marketplace Facilitators Sales Tax Bill (Public Chapter 646 [2020]) went into effect. This new law provides that a marketplace facilitator is considered the seller and retailer for each sale facilitated through

its marketplace for the sole purpose of the sales and use tax laws. This new regulation makes the marketplace facilitator ultimately liable for Tennessee sales of taxable tangible property or services, regardless of whether the marketplace seller has a sales tax certificate of registration or would have been required to collect sales or use taxes had the sale not been facilitated by the marketplace. However, this type of (imputed) tax liability does not apply to the franchise and excise tax provisions related to marketplace facilitators in Tennessee.

Additionally, a major change to the legal treatment of product liability involving marketplace transactions would affect the master service agreements that govern all aspects, including tax-related requirements, of transactions among facilitators, sellers, and customers. Tax groups should be aware of and understand any changes to master service agreements.

### Be Prepared for Potential Fiscal Leaps

Staying informed on *Bolger* and developing cases will help retailers respond quicker and more effectively if legal decisions necessitate internal changes. Tax teams can stay on their toes by keeping the following considerations top of mind:

**Tax rule changes affecting marketplaces have increased since *Wayfair*.** The U.S. Supreme Court's 2018 *Wayfair* decision, which ruled that states can require retailers to collect and remit sales taxes on online transactions in a state, even when those companies do not have a physical presence there. Today, only three states that impose sales tax do not have marketplace legislation in place. Further, many states are extending marketplace facilitator tax collection requirements to taxes other than sales and use. During the past 12 months, Georgia, North Carolina, Tennessee, and a handful of other states have extended marketplace facilitator collection and remittance requirements to excise, local meal, and local occupancy taxes. These changes add new layers of complexity to tax compliance activities.

***Bolger*-driven scrutiny raises the stakes on tax compliance.** Increasing complexity combined with the heightened attention

<sup>9</sup> Vertex E-book, *Reimagining Supply Chains in the Wake of Disruption with SAP and Mirakl* (2020).

<sup>10</sup> Multistate Tax Commission, "*Wayfair* Implementation & Marketplace Facilitator Work Group: July 2020 White Paper" (July 6, 2020).

legislators, plaintiff lawyers, and tax authorities are concentrating on marketplaces raises the stakes on tax compliance accuracy. In this environment, inaccuracies and errors have a stronger likelihood of triggering audits and negative publicity.

**COVID-19-driven deficits will increase tax policy volatility.** While it seems unlikely that new approaches to determining product liability responsibility on marketplace transactions will trigger related tax policy changes, other factors could do so at any point soon. The sizeable state budget deficits, because of the COVID-19 pandemic's vexing combination of high healthcare costs and sales tax revenue declines, make a range of tax rule and rate changes all but certain to occur in 2021 and beyond. These budget gaps also ensure that state tax auditors will be paying far more attention to compliance with new tax rules.

**Tax automation offers a bulwark against rising uncertainty and complexity.** *Wayfair*, *Bolger*, and related legal cases and rulings should make it clear that marketplaces are going to be treated as Main Street storefronts moving forward. Today, nexus is economic, no longer just physical, as are the transactional and bargaining costs in e-commerce. This economic factor has always been present in product liability cases. Tax authorities, lawmakers, and the public will hold marketplaces responsible for collecting and remitting taxes in an accurate and timely manner, even as those rules and rates continue to change at a hectic pace. Managing compliance responsibilities requires a tax automation solution that ensures compliance while promoting frictionless commerce. By passing any transaction through well-designed, expertly maintained technology, a company can verify that it is calculating the proper tax and avoid manually reworking incorrectly calculated invoices.

It will be especially important to focus on those considerations as state supreme courts weigh in on *Bolger* and similar cases. The colorful language being used on both sides of *Bolger v. Amazon* signifies that the outcome of this disagreement will have far-reaching repercussions. As a result, it does not require an "unprecedented leap" for tax groups in the retail

industry to expect profound questions about product liability in the platform economy to blast their way into the tax realm. ■