



E-Book

Win the Tax Game in 2021: 4 Ways for Marketplace Facilitators to Adapt to Market Changes



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When the Supreme Court handed down its decision in favor of South Dakota in *South Dakota vs. Wayfair*, it set the stage for digital marketplaces in 2018 and beyond.

Ever since the *South Dakota vs. Wayfair* decision, states have sought a convenient way to enforce sales and use tax collection and remittance obligations on the out-of-state remote sellers that would not – or could not – scale up their tax operations.

Marketplace facilitators (MPF), which can be defined as the businesses that provide digital platforms to facilitate remote sales, quickly fell into the spotlight: by requiring MPFs to collect and remit on behalf of sellers, states could significantly reduce the effort and cost required to enforce compliance on thousands of individual sellers. The largest marketplace facilitators include Amazon, eBay, Etsy and Rakuten.

For MPFs, however, this adds significant pressure to accurately assess and remit tax liability. In many instances, MPFs can be audited by states at any time to assess whether or not they're in compliance with state law. In addition, they're responsible for providing accurate information on invoices and they must maintain accurate records for every transaction, even as their operations scale to millions of customers and into every state in the United States.

These sellers must navigate this shifting landscape of tax responsibility without negatively impacting the incredible growth ahead of the e-commerce space – already several years into double-digit growth, with more to come as a result of the coronavirus pandemic.¹

In this playbook, we'll explore four common questions about the tax laws and provisions that are in place for MPFs today and what tax leaders can do to ensure they stay aware and ahead of their responsibilities.

1 "US ecommerce sales jump 37% in Q3," DigitalCommerce 360, <https://www.digitalcommerce360.com/article/quarterly-online-sales/>



“The *Wayfair* ruling expanded the tax responsibility of an e-commerce retailer on online transactions. Tax regulations are fairly new and continue to emerge, thus impacting the seller and the facilitator. Both have an added burden to now interpret the law in a given state, responsibility on taxes collected and remittance of the tax into a given state or locale. This creates significant complexity for both the sellers and marketplace platforms.”

Satish Prabhakar, Senior Product Manager, marketplaces and e-commerce at Vertex Inc.

Question #1

Who is responsible for recordkeeping, audit exposure and proper tax calculation, and what level of detailed sales information should the MPF pass to the 3rd party seller?

Generally, the MPF is the audited entity, responsible for recordkeeping and liable for improper sales tax collection (unless the MPF receives erroneous information from the seller). Information about requirements should be distributed to sellers by the MPF so that sellers can file their tax returns. However, in some cases, states are leaning toward requiring sellers to provide accurate information about their products so MPFs can categorize their product for taxability more accurately.

This arrangement puts the burden on the MPF to create a system that captures the correct tax amount for every transaction based on the state's tax law for each item. For example, states often tax different products at different rates. When a customer purchases a TV or a refrigerator through an online marketplace, it's up to the MPF to accurately calculate the tax rate on the purchase. Advanced tax automation software can apply machine learning to these scenarios in order to estimate the tax at a high level of accuracy and confidence, working through the product description to note the proper tax amount.

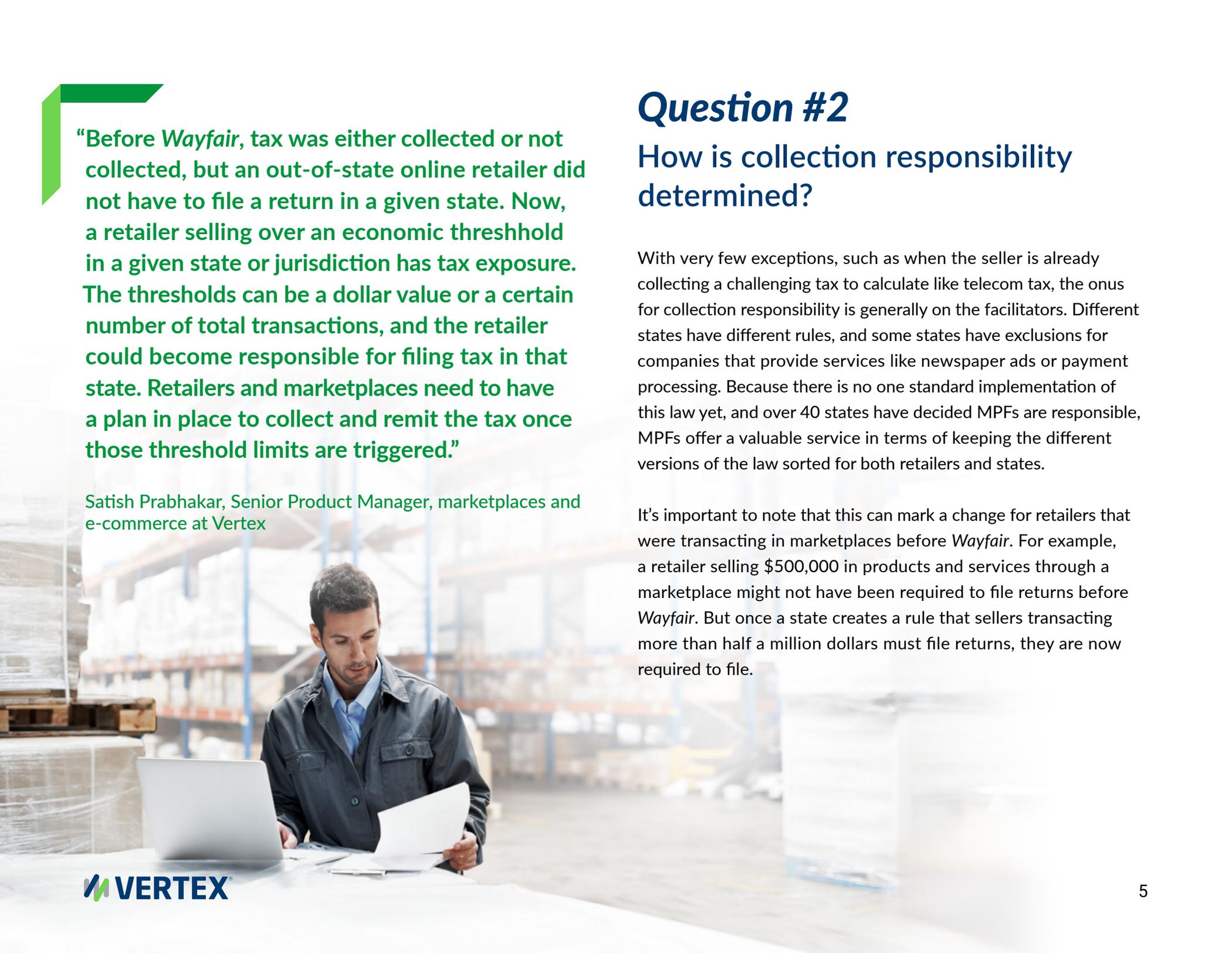
Understanding the Key Players in E-commerce Tax

What is a marketplace facilitator?

States have various definitions of a marketplace facilitator (MPF), but most definitions remark that a MPF must be a party that has access to the financial transaction information and payment. Some states have adopted exclusions for companies that provide certain services, such as newspaper or internet advertising, payment processing or delivery of local products.

What is a retailer?

The retailer typically refers to the business that sells a product or service to the consumer. Under most states' new requirements, the MPF now essentially acts as the retailer. During a transaction, the MPF "steps into the shoes" of the retailer, assuming a range of responsibilities such as claiming bad debts and handling refunds. The retailer sometimes is the originator of the product or service that is sold through the MPF.



“Before *Wayfair*, tax was either collected or not collected, but an out-of-state online retailer did not have to file a return in a given state. Now, a retailer selling over an economic threshold in a given state or jurisdiction has tax exposure. The thresholds can be a dollar value or a certain number of total transactions, and the retailer could become responsible for filing tax in that state. Retailers and marketplaces need to have a plan in place to collect and remit the tax once those threshold limits are triggered.”

Satish Prabhakar, Senior Product Manager, marketplaces and e-commerce at Vertex

Question #2

How is collection responsibility determined?

With very few exceptions, such as when the seller is already collecting a challenging tax to calculate like telecom tax, the onus for collection responsibility is generally on the facilitators. Different states have different rules, and some states have exclusions for companies that provide services like newspaper ads or payment processing. Because there is no one standard implementation of this law yet, and over 40 states have decided MPFs are responsible, MPFs offer a valuable service in terms of keeping the different versions of the law sorted for both retailers and states.

It's important to note that this can mark a change for retailers that were transacting in marketplaces before *Wayfair*. For example, a retailer selling \$500,000 in products and services through a marketplace might not have been required to file returns before *Wayfair*. But once a state creates a rule that sellers transacting more than half a million dollars must file returns, they are now required to file.

Question #3

What economic nexus thresholds are required, and how should they be calculated?

Economic nexus thresholds vary by state and must be calculated accordingly. One complication that can arise is determining the economic nexus threshold for sellers who have a combination of direct remote sales that did not go through an MPF as well as facilitated sales. Only eight states allow the exclusion of facilitated sales, of which five do not collect sales tax at all, with the rest requiring both types of sales to be included in the calculation.

Some states use only annual gross sales volume as the threshold, whereas two states require both a sales volume and transaction volume for threshold determination. The question of goods sold for resale complicates this issue, as does the status of remote wholesalers.

Regardless of the economic nexus threshold, at least 11 states – as of 2021 – require certification from the facilitator to sellers that collection on sales has begun.

“The key for marketplace facilitators is to have a technology environment robust enough to handle the volume being sold in order to create as frictionless a sales process as possible for the consumer, including the proper amount of tax and an accurate invoice, whether it’s a first-party sale or a third-party sale.”

Michael J. Bernard, Chief Tax Officer, transaction taxes at Vertex Inc.

Question #4

How is taxability determined, and how is confidential taxpayer information protected?

There are no specific guidelines on how taxability is determined. Currently, states assess taxability based on how a product will be used and the existing rules and regulations for taxing particular products. Businesses are pressing tax agencies to publish specific guidance to help remote sellers know which items incur sales and use tax and which are exempted.

When it comes to the handling of confidential taxpayer information, such as the reported sales and revenues of retailers and sellers, tax agencies that are participants in the Uniform Exchange of Information Agreement can exchange taxpayer information, but states should avoid information-sharing actions that might discourage businesses from coming forward to register. For example, if a seller or MPF comes forward in voluntary disclosure with one state to come to terms and avoid penalties, that state would want to avoid sharing that information with other states where the seller or MPF has not yet come forward, in order to avoid compromising the seller or MPF's confidential taxpayer information.



“One of the biggest challenges facing marketplace facilitators is the breadth of products offered by third party sellers, which can require a substantial amount of resources to calculate accordingly. If the tax is wrong, at some point, somebody is going to be liable for that, and in many states it will be the marketplace facilitator.”

Michael J. Bernard, Chief Tax Officer,
transaction taxes at Vertex Inc.

A Prudent Path Forward

The complexities around this legislative trend show no sign of going away. If anything, tax requirements around e-commerce MPFs will only grow in complexity as more customers choose to transact via online marketplaces and states, hard-hit by lost tax revenues due to COVID-19, witness that revenue flowing from consumer to e-commerce retailer.

Prudent retailers and MPFs will prepare for this continued scrutiny in the following ways:

- 1.** Gathering and organizing granular data in a single source of truth, which makes it easier to understand the complexities of different state tax requirements
- 2.** Reviewing current processes, controls and data sources
- 3.** Prioritizing states by highest transaction amounts, economic nexus thresholds and marketplace facilitator requirements
- 4.** Weighing the risks and assessing the need for voluntary disclosure to certain states, potentially negotiating an offer in compromise to avoid past penalties
- 5.** Automating the tax management lifecycle to ensure compliance, maintain accurate records, capture efficiencies and save resources



Setting the Stage for Success in 2021 – No Matter What

As e-commerce tax laws continue to evolve and expand across the globe, MPFs will need to adapt their approach to stay in compliance with sales and use tax rules, not to mention the ever-shifting landscape of consumer behavior in response to the continued uncertainty of COVID-19 and other cultural changes in the coming years.

We cannot predict the future – but we can reasonably expect marketplace tax laws to fluctuate as the world recovers from the events of previous years and pushes forward.

Tax automation partners help enable retailers to remain compliant and provide an excellent and consistent customer experience across their sales channels, including marketplaces. By increasing productivity, improving data consistency, streamlining audits and delivering accurate reporting, tax automation allows MPFs to manage the burden of collecting and remittance without redirecting valuable time and resources to taxes.



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[Click here](#) to learn more about Vertex's tax automation software, which helps retailers navigate these challenging legislative changes



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