States go after third-party sellers on Amazon Marketplace

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A chapter in Amazon.com's long tax saga closed this spring when the online retailer began collecting sales tax on purchases in all 45 states that have one, long a goal of the online retailer's brick-and-mortar rivals.

But another chapter has opened, because while Amazon handles sales taxes on purchases from its own inventory, it's up to third-party merchants selling on its marketplace to tally and send in their own sales-tax payments. Many aren't doing it.

Now state lawmakers and tax regulators are going after the sellers in this last tax-free corner of Amazon.com, and lawsuits and legislation are entangling the company itself.

Amazon Marketplace, which rents space on Amazon's website to independent merchants, is an increasingly important part of Amazon's retail empire, accounting for half the company's sales. The program has more than 2 million sellers and, Amazon says, has thousands of small-business success stories.

But as consultants and tax-policy experts see it, the program has also generated unpaid tax bills that likely total billions of dollars a year.

A group of state tax authorities, the Multistate Tax Commission, is trying to nudge Amazon's sellers to start paying. They've set up an amnesty program for sellers on Amazon and other online marketplaces that would wipe out their back taxes if they start to tax future sales.
Only about 700 of the 45,000 Amazon sellers that the tax commission estimates have significant tax liability signed up by the last Wednesday's deadline, the group said.

Some sellers say the cost of registering with tax authorities and the paperwork required to remit taxes in dozens of states would wipe out their modest profits. They're willing to take the risk of state tax audits to keep the status quo.

Others blame at Amazon, contending that the company is the de facto seller and should be responsible for sales-tax bills.

Amazon, which declined to comment on the record for this article, has for years voiced support for national legislation that sets a uniform sales-tax regime on internet sales. The company likens its marketplace to a mall or farmers market, where individual stall operators are responsible for collecting and paying their own sales and income tax, and says its marketplace sellers' agreement makes that clear.

Regardless of who is responsible for tax payments, consultants who advise Amazon sellers warn of a crackdown by authorities seeking to tax a bigger share of online sales.

That, they say, could push some sellers out of business, threatening the marketplace that Amazon CEO Jeff Bezos calls a pillar of the company's business.

Consultant James Thomson, a former Amazon employee who worked on the company's marketplace, said tax bills mean some sellers "are going to cease to exist as sellers on Amazon. That's when it gets ugly."

Taxes, and the competitive advantage of not paying them, have factored into Amazon's thinking since the company was founded.
A 1992 Supreme Court decision related to mail-order catalog sellers determined that states could compel retailers to collect sales tax on purchases only if those sellers had a significant physical presence - or "nexus" - in the state.

The ruling was applied to internet sales, and it is part of the reason that Bezos moved to little Washington state to start what became Amazon.com. The company would have to pay sales tax only on sales within its home state, and Washington, with just 2 percent of U.S. residents, seemed ideal.

Amazon for years tried to preserve the online discount it had over sales-tax-bound brick-and-mortar booksellers, arguing that subsidiaries and distribution centers in the U.S. didn't create a sales-tax nexus in those states.

As states sought more tax revenue after the financial crisis that began in 2007, and growing e-commerce sales became an appealing target, tax authorities fought back. The company eventually gave in, state by state, until this year, when Amazon began collecting sales tax nationwide on items purchased from its inventory.

Amazon does not automatically collect taxes on items sold from the third-party marketplace, however. In documentation online for sellers, Amazon offers to calculate and collect sales taxes on behalf of the merchants, but the service is not required. Few sellers use it to collect taxes on sales outside their home states, consultants say, and when they do, registration and payment of the taxes is still their responsibility.

Amazon benefits when its sellers do well. On top of fees to join the marketplace and use Amazon's warehousing and delivery program, third-party sellers pay Amazon an 8 to 15 percent cut of their sales on most items.
If third-party sellers list their products tax-free, it gives them - and by extension, Amazon - a competitive edge over taxpaying brick-and-mortar retailers.

The tax-free edge can be significant. For instance, a 64GB Samsung Galaxy S8 smartphone from Amazon's inventory was on offer last week to ship to Seattle for $690.30, including $63.32 in state and local sales tax. The same model, listed on Amazon.com by an independent seller called ShopMonk, can be had tax-free for $626.98.

For small-time sellers with operations in a single state, complying with state sales-tax law seems to be simple.

A seller of used DVDs operating from his garage in Tennessee would need to collect sales tax on shipments to Amazon buyers within the state, but faces no such obligations on sales in, say, Colorado, because his business has no physical footprint there.

That's not how many states look at it, though.

Richard Cram, who works for the Multistate Tax Commission, traveled to a conference for Amazon sellers in Las Vegas in March. He was there to deliver some bad news: The sellers in the audience probably owed a lot of sales tax.

The reason? Fulfillment By Amazon (FBA). Under the program, sellers can pay Amazon to store and ship their products, offering the benefits of a logistics network that spans dozens of warehouses in 27 states.

Items included in Amazon's inventory through FBA are eligible for free two-day shipping and other guarantees, perks that Amazon says boost sales. Outside analysts estimate that most Amazon Marketplace sellers participate in FBA.
But because the program stores sellers' inventory in Amazon's far-flung warehouses, it creates an in-state nexus for the seller. (Users of Amazon rival eBay don't encounter this issue, as they hold their own inventory).

A few DVDs sitting in Amazon's Aurora, Colo., depot, in other words, trigger sales taxes on purchases by the Tennessee DVD seller's customers in Colorado.

After Cram laid out that case in Las Vegas, he was approached by several sellers who told him they wanted to get on the right side of the law, but were worried that back taxes and penalties would put them out of business.

Cram's organization, a group of state tax officials who coordinate policy across state lines, devised a program to get sellers up-to-date without bankrupting them. The states had a fall deadline in mind, to secure the tax boost associated with peak holiday sales.

The result was the Online Marketplace Seller Voluntary Disclosure Initiative. Under the agreement, 24 participating states and the District of Columbia offered amnesty to taxpayers who faced in-state liability because of Amazon's FBA or a similar setup at Walmart.com.

Cram reached out to Amazon to ask for help advertising the offer, but he never heard back. "They didn't try to kill it," he said. "But they didn't want anything to do with it."

Amazon avoids offering sellers tax advice, part of a hands-off approach that observers say helps avoid the liability associated with steering sellers the wrong way. It also limits the kind of ties that states might use to try to prove that Amazon, rather than its sellers, should be on the hook for back taxes related to its marketplace.
The Multistate Tax Commission initially offered a two-month window to apply for the amnesty, but many sellers balked, saying that wasn't enough time to make such a crucial business decision. The group voted last month to extend the application window by two weeks, to Nov. 1, but still, less than 2 percent of the sellers estimated to have significant tax liabilities signed up for the amnesty offer.

"No one has a clue what to do," Matthew Turner, a Texas-based Amazon seller, said on a conference call with state-tax officials last month. "I have no time to figure out how to deal with this, and no funds to pay a lawyer or accountant to figure it out for me."

Don't like the tax liability? "Then don't list your stuff on Amazon," said Michael Pachter, a former tax attorney and longtime financial analyst who tracks Amazon at Wedbush Securities. "Do it yourself."

Some marketplace sellers look at their relationship with the online giant and contend that taxes on Amazon's platform should be the company's responsibility, pointing to features that put it at the center of the e-commerce transaction. Amazon, for example, processes payments, can destroy seller inventory it believes to be counterfeit or hazardous, and bans third-party sellers from sending marketing materials to previous customers.

The company says its marketplace rules are necessary to protect customers and maintain their trust in the system.

Paul Rafelson, a corporate tax attorney who is helping to organize a campaign to advocate for Amazon sellers, looks at it differently.

"What Amazon has done is structured a supplier relationship to make it look like a retail relationship," he said. He argues that existing tax law likely makes Amazon liable for marketplace sellers' taxes.
Some state legislatures are trying to put Amazon on the hook for that.

A few have passed laws that require online marketplaces like Amazon's to collect or report tax on behalf of sellers. That's a task Amazon is already required to complete for individual marketplace users in the European Union.

Amazon hasn't addressed such laws publicly, but the national tax legislation it lobbies for - on the table but stalled in Congress - could supersede state collection efforts.

Other states are taking Amazon to court in their hunt for marketplace sales tax.

South Carolina sued the company in August, seeking $12 million that the state estimates should have been levied on Amazon Marketplace sellers during the first three months of 2016. Massachusetts, meanwhile, this month ordered Amazon to turn over a list of the third-party sellers who held inventory in warehouses in the commonwealth during the last six years, a move viewed as a prelude to a wider crackdown on back taxes owed by independent sellers.

Amazon declined to comment on the cases.

On Amazon's Marketplace, "nobody out there is collecting tax," said Cram, of the Multistate Tax Commission. "They all think it's somebody else's responsibility."

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