

## Episode 07 | Wayfair Wayside

The United States is poorly named.

The states are not united – states have their own laws and even legal systems. We acknowledge 50 states and often fail to remember the other 6 million U.S. citizens who live in territories or districts who do not have voting representation at the federal level of our government. That’s shameful, but not a topic for this show about business, entrepreneurship, technology, and software development. My other show: “The History of Now” does explore this issue.

Back on track, each state makes its own rules about charging taxes with the sale of goods or services. The United States does not have a united approach to sales tax, goods tax, service tax or the like.

For decades, internet-based firms exempted themselves from charging or collecting sales tax. Bigger companies took on limited solutions. As a small company with limited offerings and based in a state with a rather tiny population, we were opting to ignore sales tax entirely.

Oops!

The dam broke when our accounting team explained South Dakota versus Wayfair Inc. Vision opened wide at that moment, my resistance to keeping PayPal and not collecting sales tax ceased instantly. We shifted focus knowing we needed an immediate solution for calculating and collecting sales tax for internet products and services.

**South Dakota v Wayfair, Inc.**

Sales tax in the United States obscures the complex history of North America from the founding to the present. The federal government of the United States does not charge sales tax. The tax is charged by states, municipalities, and counties. Thankfully, states have coalesced on the idea that states will collect sales tax on behalf of counties and municipalities. There are 58 states and territories, approximately 3,000 counties and the number of municipalities defies definition. Some states have no sales tax. And the State of New York has over 2,500 separate tax jurisdictions.

North America was not founded as a nation, but a series of competing colonial territories, held by competing crowns of Europe. During the Revolutionary War, the boundaries remained fluid. New Englanders invaded Montreal. Florida joined the United States in 1845 having been a Spanish colony twice, a French colony, a British colony, part of the United States, then the Confederate States of America, then part of the United States again. Vermont, firmly established as a New England state stood as an independent republic from 1777 to 1791. Vermont joined the United States eight years after the Revolutionary War with the British crown.

How does this matter two hundred years later? States possess significant freedom to enforce legislation and collect taxes. The U.S. Constitution contains the following statement:

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

Both my hometown in Massachusetts and my current town in Vermont both have town government structures that pre-date the founding of the nation. Town's assumed significant authority. They raised and funded militias. They governed themselves. They taxed themselves. They established their own boundaries (and defended them). States invaded each other and fought battles with each other. We, New Englanders, fought against indigenous people, fought alongside indigenous people. We fought battles against New York. We fought alongside the British, then against them twice. All of this in the first two hundred years of European settlement here.

The traditional seat of power in New England rested with towns. Town organized to form state governments. States existing well before the nation formed, and to form a "more perfect union", states negotiated as equals with other states to create a national government.

We could not envision an economy where goods were purchased via a global fiber optic infrastructure and goods were delivered nearly everywhere or anywhere within days of placing an order with a credit card.

For almost 400 years, North Americans engaged in commerce regulated and taxed, primarily at the local level. Correspondingly, we have a 400-year tradition of manipulating the local rules for personal gain. Sometimes, we call that smuggling. Sometimes, prudence. Our state borders and local laws often created economic and social refuges.

Evidence exists from the Atlantic to the Pacific.

Fireworks, illegal in Massachusetts maybe bought in New Hampshire tax free in several towns located on the border. Here in the southern extreme of Vermont, we can buy goods twenty minutes south in Massachusetts paying 6.25 percent sales tax or drive to the nearest Vermont town twenty minutes away. We pay 7% tax there. Or we can drive another ten minutes to pay no sales tax in New Hampshire.

I can hold and carry a loaded shotgun in Vermont, then drive to New Hampshire and do the same thing legally. Cross the state line into Massachusetts to commit a felony with the same action of standing in an empty farm field with a shot gun.

Internet commerce largely ignored these complexities. If New York State has 2,500 separate tax jurisdictions with varied rates, the laws are more punitive to follow the law than to skirt them.

If we drive to New Hampshire to buy lumber and gardening soil must I inform the State of Vermont that I spent \$50 goods. Is there a booth astride the Connecticut River where I make my declarations, and pay duties? Do I owe duties and taxes as I travel across the United-ish States. The answer is: "It depends".

The rules of internet commerce followed the ancient patterns of face-to-face commerce. In short, if the seller had a presence in the same state as the buyer, then the sales tax rules could be enforced.

Britain imposed taxes on the American colonies. The English taxed paper documents as a result of the Stamp Act. Taxes on tea imported from China. The British government at various times required that all exports from their colonies go to Britain. And at other times, requiring that the colonies buy only British goods.

Historically, a buyer does not pay taxes to a state unless the state affirmatively knows that the transaction took place, thereby initiating a game played by both the buyer and the seller.

It is both cheaper and less risky for a seller to avoid any visibility in a state. Our firm once engaged in a contract with the State of Louisiana. We sold them subscription-based software. We had no employees in the state. We didn't work in the state. We never opened an office in the state. Our equipment was not in Louisiana. And we never shipped any tangible goods to Louisiana. The State of Louisiana require that we register in their state as a foreign limited liability company (LLC). To register as a vendor in the state, we also had to apply for a state reseller's certificate, which obliges us to report sales revenue and remit sales tax to Louisiana.

Our only customer was the State of Louisiana which is tax exempt. We had no expectation or desire to sell any software retail in Louisiana. Therefore, we would never collect sale tax in Louisiana.

When our contract with that state ended, we cancelled our sales tax certificate and withdrew our foreign LLC registration. That is when the fines and penalties started piling up. We likely should have paid the small annual fee to Louisiana and submitted the routine zero-dollar tax return. Instead, they charged us thousands of dollars for unremitted sales tax. It took months or more to extricate ourselves from this mess. We had a similar problem in the State of New York in 2012. As a result, we continue to pay small fees in various states to keep useless registrations valid.

The fines for violating some state or county sales tax rules defy logic.

Imagine pulling over to a booth at the Massachusetts border to declare the taxes due on the fireworks and booze you bought in New Hampshire. In fact, this is a daily occurrence at the Canadian border. I know of folks who live in Quebec whilst keeping shipping addresses in Vermont. Amazon delivers to Vermont. While in Vermont picking up your

brown box, might as well fill the car with fuel. The drive north back home becomes a retail version of smuggling.

In June of 2018, the Supreme Court of the United States (SCOTUS) declared an end of these practices. The State of South Dakota desired to collect sale tax revenue from the internet reseller Wayfair, Inc. With the stroke of a pen, SCOTUS created a novel industry – interstate sales tax compliance service provider.

According to SCOTUS, the seller of a product or service must now collect sales tax. Given impossibly complex tapestry of sales tax laws, we may now hire a firm that will take care of these problems for us. Someone created provisions for partial immunity to vendors.

The big print and broad descriptions obscure the real risks and liabilities that are buried in the ruling.

SCOTUS and their Wayfair decision provided clarity and uniformity. Amazon had already been paying sales taxes in twenty-five states. And other companies were not. The Wayfair ruling instructed companies to follow state's rules.

The ruling did nothing to standardize the sales tax laws. In Vermont, software-as-a-service is not taxable. In another state it is. In California, a firm doesn't pay sales tax until they have had \$500,000 in sales. In Georgia, the threshold is either \$100,000 or 200 transactions. New Hampshire and Alaska have no sales tax.

Some states banded together presenting the streamlined sales tax process. This body of rules sounds better than it is. The SST is riddled with exceptions and variances. Promises exceed delivery. Apparently, a firm can get the same identification number and use a standardized set of forms with the states who participate except when... And in the exception, lives regulatory compliance misery.

The supreme court announced to business that you must follow thousands of separate laws. And maybe, if you did everything right and still make a mistake your sales tax vendor will absorb those fines, penalties, and failures.

I don't believe that: I tried to follow the rules but could not. There is little forgiveness for a team standing in front of a judge saying: "I really, really, really tried to follow California's tax law". I could throw in another "really". Failure to follow tax law must be punitive, correct? The cost of failure must exceed the cost of compliance otherwise these laws are useless.

Way back in the old days, an interstate commercial transaction avoided some messiness. I drive a few firecrackers back home. I didn't pay taxes on an item that was illegal anyway—fireworks are illegal in Vermont. I buy some lumber and fuel before crossing a state line.

Today, we must all follow the thousands tax laws in thousands of jurisdictions under the scrutiny of any state (or territory) who desires participation in the game. If a state plays, they get revenue and fines and penalties for a rather modest investment.

In 2020, Podcast Flow LLC will likely pay no sales tax to any state. Our costs for compliance with this law is approximately \$600 on day one. The cost of this service seems to be a dollar per transaction for every transaction, whether taxed or not. Then related sales tax returns will cost over \$50 per return. If a state wants a return per month, the total cost for supporting one state starts at \$600, plus a \$300 registration fee.

When Podcast Flow LLC registered for sales tax in Vermont, they told us to file monthly. We save \$300 by filing with our home state for free. The monthly tax returns would cost us \$600 annually. I wrote the state tax agency asking for quarterly reports, thereby reducing our costs to only \$200 per year. How much tax will we owe the State of Vermont? None. Vermont does not tax software-as-a-service. And we will now spend \$200 per year to prove we owe no taxes.

We examined the costs for sales tax compliance. We are unable to estimate the cost of compliance nationwide. We guess that a buck per transaction is a minimum.

Imagine being a business owner that sold a \$5 product via the internet. 20% gone, one dollar, one buck.

Today, our fees for tax compliance look like this: \$150 activation fee. \$35 connector fee. \$1.26 per transaction for the first 250 transactions (sales). On our 250<sup>th</sup> transaction, we'll buy another block of transactions. \$660 buys us 500 transactions, so \$1.32 per transaction. It is possible that the cost of registration and filing tax returns in 25 states could cost as much as \$25,000. At their best pricing, the tax service company stated we could eventually pay as little as twenty cents per transaction, if we hit 50,000 transactions. Tack on another \$10,000. Compliance will cost Podcast Flow between \$600 and \$35,000 depending on factors we can't forecast.

This is what the Wayfair decision means to us. We need a service that will precisely calculate the sales tax based on a buyer's location, the service or product purchased, and inform us within a few milliseconds.

PayPal could not perform this trick.

Recurly, while not responsible for the tax resolution process, did have a means of solving the problem.

And our firm will work comfortably within the rules of these United-ish States.