Wal-Mart's E-Commerce Expansion Could Have Unintended Results

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Wal-Mart Stores Inc.'s plans to purchase an upstart rival of Amazon.com Inc. may undercut one of its new acquisition's biggest strengths — a lack of a physical presence in most of the country.

The transaction, which was reported to be worth more than $3 billion — making it the largest e-commerce start-up purchase in history — would merge a fledgling online marketplace with a corporate behemoth whose 11,000 bricks-and-mortar establishments give it a physical presence in every state. That presence requires Wal-Mart to comply with sales tax collection requirements on virtually every domestic transaction, whether in a store or online. Contrast that with its hopeful partner, Jet.com, a small but growing operation with a physical presence in only Kansas, Nebraska, Nevada, New Jersey, New York, Ohio, and Utah.

Jet's short list of states in which it has physical presence leaves the company free to make tax-free sales to almost 85 percent of the nation, giving it an advantage over competitors like Amazon, which has to collect on sales to 85 percent of the country and has seen an 8 percent drop in sales in states where it began collecting sales taxes, according to a 2015 Ohio State University study.

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That advantage could disappear with its acquisition by Wal-Mart, depending on how the transaction is structured. Wal-Mart did not respond to a request for comment on how it might structure the transaction to preserve Jet's sales tax advantage, but Matt Schaefer of Brann & Isaacson LLP said that such a focus could be misplaced.

If Wal-Mart's real goal is to take on — or at least beat back — Amazon, he said, then it doesn't need to worry about a tax disadvantage, as Amazon's collection obligations already cover the vast majority of the United States and seem likely only to expand.

"They may just decide to treat it as though it has nexus, sort of volunteer to collect tax in every state because of Wal-Mart's nationwide presence," Schaefer said. "There is a good reason to think that the objective in competing with Amazon is really based more on online presence and possibly the level of service and responsiveness that they can deliver to online consumers." If that's the case, the transaction may be far more fruitful if Wal-Mart is willing to bite the bullet on sales taxes.

Preserving Sales Tax Benefits May Have Unintended Consequences

The alternatives could impose serious restrictions on either entity's ability to leverage the other's resources, according to Jeffrey Reed of Kilpatrick Townsend & Stockton LLP. Looking back to the history of cases against online booksellers, he said that maintaining a separation between the companies would limit Jet's ability to take advantage of Wal-Mart branding, to allow customers to make pickups or returns at local stores, or tap into Wal-Mart's discount and rewards programs.

Reed couldn't comment on whether those benefits could make it worthwhile to integrate more fully, but he warned that trying to maintain a separation would also invite serious scrutiny from the states. "If Jet.com continues doing what it's doing — not collecting where it doesn't have warehouses — I would expect that the state tax administrators are going to look very carefully at the degree of integration," Reed said.

And even if Wal-Mart and Jet could prove that they were sufficiently independent to pass muster under the rules from those bookseller cases, Schaefer said the transaction could just open up a whole new set of questions about affiliate nexus laws. "Depending upon how they structure those deals, those laws may come into play quite significantly if Wal-Mart intends to have [Jet] continue to have a nexus-limited position," Schaefer said.

Because many of those statutes are triggered merely by shared ownership, Jet and Wal-Mart could be attractive targets for tax administrators, even in the absence of case law supporting the constitutional viability of such an approach. "As a constitutional matter, I'm not aware of any decision where the mere ownership . . . or a corporate relationship between a non-nexus entity and an in-state entity has been deemed to be enough to support the assertion of nexus where you don't have services performed," Schaefer said. Nonetheless, "they'd get a lot of attention under those statutes," he said.

Why Structure a Major Purchase Around a Threatened Legal Theory?

Beyond the attention they'd attract from auditors, Wal-Mart and Jet may be reluctant to build their relationship around a sales tax benefit that could be fleeting. With neither entity eligible for any small-seller exemption likely to be included in federal legislation permitting states to impose collection obligations on remote sellers, and the added possibility of *Quill v. North Dakota* being struck down before Congress can act, it may not make sense to base a business plan on the assumption that you can engage in e-commerce without charging sales taxes.

"It depends on the business model . . . what your online presence is versus where your stores are," Reed said. But for big businesses like Wal-Mart, he sees a general trend away from efforts to compete based on sales tax collections.

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"The trend is that more and more online companies will have to collect, whether through legislation or court decision," Reed said. "It may not be all 50 states, but for bigger businesses, that's what long term seems to be the bet." ■

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