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You May Look, But You Can't Pay – Structuring Payment Transactions for Online Marketplaces Under Tennessee's Marketplace Facilitator Rules

On June 1, 2021, the Tennessee Department of Revenue published Letter Ruling # 21-05,[1] providing new, fact-based guidance related to application of Tennessee's "marketplace facilitator" sales and use tax rules in the context of an online marketplace. Over the last several years, many states have enacted "marketplace facilitator" legislation that provides state taxing authorities with the power to impose sales tax collection obligations on businesses that might not be making direct, taxable sales into the taxing jurisdiction, but who are facilitating a "marketplace" for remote and online sellers (who themselves may not otherwise have nexus in the taxing jurisdiction).[2] Tennessee, following suit and leveraging new sales taxation opportunities arising after *Wayfair*,[3] enacted its own marketplace facilitator rules effective as of October 1, 2020.[4]

Generally, a marketplace facilitator is a company that contracts with third parties to sell goods and services on its virtual platform, or "marketplace," and helps facilitate sales from this forum by providing a bevy of services to the seller, including listing the product, offering payment and collection services along with various other forms of logistical help.[5] Put another way, a marketplace facilitator is a matchmaker of sorts, acting as an enabler of transactions between sellers and buyers. For a further and more detailed discussion of the history of and underlying logic supporting marketplace facilitator laws, see the article "Do Not Pass Go. Do Collect $200 – States Quickly Adding Marketplace Facilitator Collection Requirements Will Lead to New Strategies, Complications and Disputes." In summary, if a business falls under Tennessee's statutory definition of a "marketplace facilitator" and is providing a platform that enables sales of taxable property to

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Tennessee-based purchasers, then the marketplace facilitator (and not the seller of the taxable property) may be obligated to collect sales tax from Tennessee-based purchasers and remit such collections to the state.

Tennessee law defines a "marketplace facilitator" as a person, including any affiliate of the person, that:

- For consideration, regardless of whether characterized as fees from the transaction, contracts, or otherwise agrees with a marketplace seller to facilitate the sale of the marketplace seller's tangible personal property or things or services taxable under this chapter through a physical or electronic marketplace operated, owned, or otherwise controlled by the person or the person's affiliate; and
- Either directly or indirectly through contracts, agreements, or other arrangements with third parties, collects the payment from the purchaser of the marketplace seller's tangible personal property or things or services taxable under this chapter and transmits payment to the marketplace seller (emphasis added).[6]

Letter Ruling # 21-05 involves a taxpayer who created an online platform to display and market products on behalf of independent product dealers who purchase products from the taxpayer's affiliates and resell such products to customers in Tennessee and other states. The taxpayer's platform was created for participating dealers so dealers could create "an inventory listing and make business-to-business sales to customers." Along with receiving a fee from the dealers in exchange for access to the online platform, the taxpayer would receive a negotiated percentage of user sales made via the platform. Under the facts described so far, the taxpayer's platform clearly seems to fall under the first prong of the marketplace facilitator definition.

The facts continue, however, and involve the important second prong of the "marketplace facilitator" definition – whether or not the taxpayer "directly or indirectly . . . collects the payment from the purchaser . . . and transmits payment to the marketplace seller."[7] Purchasers utilizing taxpayer's platform could utilize one of two

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methods of paying sellers for products purchased through the platform, a "dealer account" or a credit card.

Under the dealer account method, purchasers use a pre-existing line of credit between the purchaser, as debtor, and the seller, as creditor. If the purchaser selects the dealer account method, the taxpayer's platform would alert the seller, who would subsequently approve or reject the initial order. After the seller is notified of the purchaser's preferred payment method, the platform "provides no further role in facilitating payment."[8]

Under the credit card method, a seller who desires to allow purchasers to use credit cards must "enter into its own direct agreement with the credit card processor."[9] The taxpayer would not be a party to this agreement. Upon a purchaser's selection of the credit card payment method, the platform would generate an initial payment invoice (which would include estimated sales tax levied on the order), but would also prompt another window to open, ultimately linking the purchaser to a "payment gateway." The next steps in the transaction involve the platform communicating back and forth between the credit card processor and the seller:

"When the purchaser enters its information [into the payment gateway application], the credit card processor requests an initial authorization from the credit card issuer for the preliminary order amount and then relays either an approval or rejection notification to the Platform. Then, if the Platform receives an approval notification for the preliminary invoice amount from the credit card processor, the Platform will send the order to the Dealer Users' DMS and provide a confirmation message to the Purchaser. As the Purchaser's credit card is not charged at this time, the communication between the Platform and the credit card processor essentially functions as a sufficiency of funds inquiry."[10]

Though the credit card method involves several additional actions on the part of the taxpayer, the Department of Revenue noted that, like the dealer account method, the platform, when facilitating credit card payment transactions, "performs no further role in facilitating payment for the order beyond its provision of a

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confirmation to the [customer]."[11]

Ultimately, the Department of Revenue determined the taxpayer was not a marketplace facilitator (and thus not obligated to collect sales and use tax from platform users) because the taxpayer's role was limited to displaying the dealer inventory and "communicating a preliminary order approval or rejection."[12] The Department's decision was supported by facts establishing the taxpayer was "not involved in collecting or transmitting payments" in connection with transactions facilitated through the platform and, in the case of both a dealer account and credit card, "the billing and payment procedures occur outside the platform."[13]

The Department of Revenue's focus on the method and mode of payment suggests taxpayers with a platform that otherwise looks and feels like a taxable marketplace facilitation could avoid Tennessee's marketplace facilitator tax regime by ensuring the ultimate payment transaction and exchange of funds occurs outside the taxpayer's platform and is instead handled directly between seller and buyer. Taxpayers operating online marketplaces who want to mitigate the likelihood of being characterized as marketplace facilitators in Tennessee should:

- not collect payments directly from purchasers on behalf of sellers;
- not *indirectly* collect payments from purchasers on behalf of sellers, such as through a payment processing gateway hosted by the platform operator or through a payment processing arrangement to which the platform operator is a contracting party; and
- provide sellers whose products are sold on the platform with the ultimate ability to approve or reject sales initiated through the platform.[14]

The definitional concept of "indirectly" collecting payments from purchasers on behalf of sellers might serve as the most likely trap for taxpayers who desire to avoid marketplace facilitator characterization. Online marketplaces, by their nature, necessitate electronic (e.g., credit card) payment transactions, and the aggregation of electronic payment processing functions away from

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individual sellers to a single marketplace operator certainly creates efficiencies in pricing and function. Exploiting such efficiencies may very well be the foundation for the creation of many online marketplaces, and operators that anticipate a high transaction volume through their platforms may attempt to engage and contract directly with payment processors to obtain favorable payment processing pricing. Nevertheless, if operators of such marketplaces want to avoid being characterized by the Tennessee Department of Revenue as taxable marketplace facilitators, the operators should ensure no transaction funds are handed by the taxpayer or through the marketplace platform, whether via a contractual relationship with a payment processor or otherwise.

For more information about your state and federal taxes, visit Frost Brown Todd's Tax Law Defined Blog.

**Megan Aschenbrenner contributed to this article. Megan is not a licensed attorney.*

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[1] Tennessee Dept. of Revenue Letter Ruling #21-05 (April 28, 2021). Published June 1, 2021, and available at https://www.tn.gov/content/dam/tn/revenue/documents/rulings/sales/21-05.pdf).

[2] Daniel Mudd, "Do Not Pass Go. Do Collect $200 – States Quickly Adding Marketplace Facilitator Collection Requirements Will Lead to New Strategies, Complications and Disputes," Tax Law Defined Blog (October 1, 2019), https://fbtgibbons.com/do-not-pass-go-do-collect-200-states-quickly-adding-marketplace-facilitator-collection-requirements-will-lead-to-new-strategies-complications-and-disputes

[3] S. Dakota v. Wayfair, Inc., 585 U.S. ___, 138 S.Ct. 2080, 201 L.Ed.2d 403 (2018)

[4] *See* Tenn. Code Ann. § 67-6-501(f)-(h).

[5] Mudd, *Do Not Pass Go*.

[6] Tenn. Code Ann. § 67-6-102(58)(A), emphasis added.

[7] Tenn. Code Ann. § 67-6-102(58)(A)(ii).

[8] Tennessee Dept. of Revenue Letter Ruling #21-05.

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[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] Although Letter Rulings are not binding on the Department and therefore cannot be used as precedent, they are a helpful way to gauge how the Tennessee Department of Revenue will decide threshold questions.

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