House Judiciary Committee
Examining the Wayfair Decision and its Ramifications on Consumers and Small Businesses
July 24, 2018

Chairman Goodlatte, Ranking Member Nadler, and Members of Committee,

Engine is a non-profit advocacy and research organization that works with a community of hundreds of entrepreneurial startups, pioneers, innovators, investors, and technologists across the country. The startups we represent are among the most innovative and fastest growing companies in the country, fundamentally altering and challenging entrenched business models, ideas, and institutions across all industries. They are businesses that drive our economic prosperity, create jobs, and improve our lives.

Engine writes today to urge the Committee to consider legislative solutions to address the problems caused by the Supreme Court's recent decision in *Wayfair v. South Dakota*. The Supreme Court's decision risks creating a complex web of state-by-state tax rules that startups will have difficulty navigating. This ruling will likely increase costs for small Internet startups trying to sell products across the nation. Forcing early-stage companies to devote scarce resources to understanding dozens of different tax jurisdiction rules will put them at a clear disadvantage to large incumbents. We urge Congress to step in to help prevent this ruling from hurting the very startups that are driving our nation's economic growth and innovation.

Startup Growth in the E-Commerce Sector.
In the span of a few decades, the Internet has become the world's dominant medium for economic growth and creative expression. By allowing anyone with a computer and a good idea to build a company and reach a global audience, the Internet has sparked a new industrial revolution led by hundreds of thousands of small entrepreneurs disrupting industries and challenging dominant incumbents. The value attributable to this boom in startup activity is staggering: virtually all new net jobs in this country are created by startups,[1] and the Internet sector now constitutes more than 6 percent of U.S. GDP.[2] Startups are driving the development of the next wave of innovative technologies that will reshape the economy in the coming years, and many of these are in the e-commerce space.

Even with limited resources and untested ideas, startups generate incredible economic value from a consistent and predictable Internet framework. An Engine report from 2013 showed that "during the last three decades, the high-tech sector was 23 percent more likely and the information and communication technology sector 48 percent more likely than the private

[1] John Haltiwanger, Ron S. Jarmin, and Javier Miranda, "Who Creates Jobs? Small Versus Large Versus Young." The Review of Economics and Statistics, May 2013, available at http://www.mitpressjournals.org/doi/pdf/10.1162/REST_a_00288
[2] Internet Association. "New Report Calculates the Size of the Internet Economy." Dec. 2015, available at https://internetassociation.org/121015econreport/.

sector as a whole to witness a new business formation."[3] The high-tech jobs these businesses create accounted for 5.6 percent of the job market in the United States in 2012 and almost certainly constitute a higher proportion of total employment today.[4] Moreover, these e-commerce jobs spur further job creation and stimulate the local economy, as workers spend money in their communities.[5]

This technological innovation and economic potential is only possible because today's startup founders can launch their businesses at extremely low cost—often merely the expense of hard work, cloud computing tools, and off-the-shelf laptops and mobile devices. These costs generally drop each year, allowing entrepreneurs to launch businesses with ever smaller amounts of seed capital. From 2000 to 2011, the cost of running a basic Internet application fell from $150,000 a month to $1,500 a month.[6] According to recent studies, the average startup launches with $78,000 of funding[7] and the ever-decreasing cost of launching a startup has democratized the tech sector and has allowed new startup hubs outside of Silicon Valley to flourish. According to the most recent Kauffman Foundation Index of Startup Activity, 16 of the 20 fastest growing metropolitan areas for high-growth startups are outside of California, New York, and Massachusetts,[8] which have traditionally accounted for more than 70 percent of venture capital investments.[9]

However, launching a startup is an inherently risky proposition. With minimal funding and little consumer awareness, an early stage startup's future prospects are always uncertain. To survive, a startup usually needs to be able to quickly and easily reach as wide of an audience as possible—a task made significantly easier by the Internet's ubiquity and relatively low cost of participation.

The Wayfair Decision's Potential Impact.

The Supreme Court's ruling in Wayfair impacts startups in two important ways. First, the costs associated with tracking and complying with thousands of different tax jurisdictions will

[3] Ian Hathaway, "Tech Starts: High-Technology Business Formation and Job Creation in the United States," Kauffman Foundation, Aug. 2013, available at http://www.kauffman.org/~/media/kauffman_org/research%20reports%20and%20covers/2013/08/bdstechstartsreport.pdf at p. 2.

[4] Ian Hathaway, "High-Tech Employment and Wages in the United States," Bay Area Council Economic Institute, Dec. 2012, available at http://www.bayareaeconomy.org/media/files/pdf/TechReport.pdf, at p. 10.

[5] Id. at 12 ("For each job created in the local high-tech sector, approximately 4.3 jobs are created in the local non-tradable sector in the long run.").

[6] Marc Andreessen, "Why Software Is Eating The World," The Wall Street Journal, Aug. 20, 2011, available at http://on.wsj.com/1gt4wRH.

[7] Fundable. "A Look Back at Startup Funding in 2014." Available at https://www.fundable.com/learn/resources/infographics/look-back-startup-funding-2014.

[8] "Metropolitan Area Rankings," Kauffman Foundation, 2017, available at http://www.kauffman.org/kauffman-index/rankings?report=growth&indicator=growth-rate&type=metro

[9] "Venture Capital Dollars and Deals by State, 2009-2014," National Venture Capital Association and PricewaterhouseCoopers, Jan. 16th, 2015, available at: http://ssti.org/blog/useful-stats-venture-capital-activity-capitagdp-state-2009-2014.

disproportionately disadvantages small startups. Second, the decision creates tremendous uncertainty that will impact development and investment in the e-commerce space.

Costs. While the aggregate amount of money invested in startups is massive, the average startup launches with surprisingly little capital, making even small increases in startup costs potentially ruinous for new enterprises. As previously noted, the average startup launches with approximately $78,000 of funding, with 57 percent of startups getting their seed funding from personal loans and credit cards and 38 percent of startups receiving from friends and family.[10] This leaves very little room for additional expenses, even for the scrappiest of startups.

In Wayfair, the Supreme Court argued that software could be available for small businesses to help them collect and remit sales taxes. However, the most accurate software currently available starts at $3,000 per year per state meaning the average e-commerce startup hoping to sell goods nationwide will need to pay $150,000 for software alone. This is almost double the amount of initial funding for a startup, immediately pricing many e-commerce business owners out of the market. Putting that number further into context, if the average sales tax is 6 percent in each state and you are a startup with $500,000 worth of sales (making you a relatively successful startup), you could be facing a $30,000 sales tax bill to collect and remit. What rational business owner can justify spending $150,000 per year on software to pay a $30,000 tax bill? Many will simply decide to stop selling products online.

Additionally, the barriers to entry for a startup do not end with merely the price tag for purchasing software to collect and remit sales taxes. Startups face other challenges when implementing tax collection software in e-commerce space, such as slowing a website or adding new check-out requirements. Almost half of consumers will abandon their shopping cart if the shipping cost is too high or if there are unexpected additional charges.[11] As for website loading time, "three out of five [users] say that poor performance will make them less likely to return" and two of five said, "they'd likely visit a competitor's site next."[12] Startups who do not have accurate and efficient software to quickly calculate added taxes in over 10,000 taxing jurisdictions will see potential consumers leave their sites before completing a purchase. Startups rarely get a second chance to earn trust with consumers. Slow service and added fees will only serve to give large companies an additional leg up in the e-commerce space.

Finally, for a startup, added layers of complexity to e-commerce transactions will significantly increase the cost of legal fees and engineering time. While large e-commerce platforms like Amazon and eBay have teams of lawyers to sort through the new regulations, a 10-person startup is unlikely to have the legal or accounting teams in place to fully implement new state

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[10] Fundable. "A Look Back at Startup Funding in 2014." Available at https://www.fundable.com/learn/resources/infographics/look-back-startup-funding-2014.
[11] Pienaar, Addi. "75 Ecommerce Stats that Will Blow Your Mind." Conversio. April 22, 2015, available at https://conversio.com/blog/75-ecommerce-facts-quotes-statistics-that-will-blow-your-mind/
[12] Jolie O'Dell, "Why Websites Are Slow and Why Speed Really Matters," Mashable, Apr. 5, 2011, available at http://mashable.com/2011/04/05/site-speed.

laws as they come into effect. Additionally, the Wayfair ruling means that a small startup is now 50x more likely to be audited, a threat that could shut down any small company.

Uncertainty. The quickest way to kill a growing startup sector is to create an uncertain regulatory framework that is subject to a patchwork of laws. It is nearly impossible for a small startup to plan for 2019 when 50 states are considering rewriting taxation laws that could add a significant financial burden. Large companies have the capital reserves to survive slight fluctuations in additional tax burdens, but many startups will be forced to delay rolling out new products or simply close up shop as they wait for the legal landscape to take shape.

Finally, placing additional burdens on nascent companies and entrepreneurs could create costs high enough to discourage the early investment that is so essential to startup growth. Most worrying to investors will undoubtedly be some of the new laws passed by states making failure to collect a sales tax a criminal act of tax fraud under some state laws.[13] Very few investors are willing to face jail time to back a growing e-commerce startup. The decision will certainly have a chilling effect on investment.

Conclusion

Congress needs to seriously consider the added costs the Wayfair decision will have on startups and small e-commerce companies. We have heard from startups in industries ranging from online streaming companies to energy drink sellers that the Wayfair decision will unduly burden small companies and is likely to seriously cripple investment and startup creation. Congress must consider the growth of the overall Internet economy and how to protect small, but thriving, e-commerce platforms.

[13] Tax Notes. “States Should Act with Care Following Wayfair.” June 26, 2018. https://www.taxnotes.com/editors-pick/states-should-act-care-following-wayfair