BEFORE THE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination under the Sales and Use Tax Law of

Borders Online, Inc.
SC OHA 97-638364
56270

Appearances:

For Petitioner:	Scott L. Brandman Attorney at Law
	Douglas D'Agostino Associate Director, Tax
For Sales and Use Tax Department:	David H. Levine Tax Counsel IV
For Appeals Section:	Jeffrey G. Angeja Tax Counsel III

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination for the period April 1, 1998, through September 30, 1999. At the Board hearing, petitioner protested a determination related to petitioner's sales to California purchasers.

Petitioner, an out-of-state corporation, makes online retail sales of tangible personal property (e.g., primarily books, videos, music and gift items) via the Internet. The goods petitioner sells to California purchasers are delivered by common carrier from outside California. Petitioner alleges that it is a separate and distinct legal entity from Borders, Inc. (hereafter Borders), an affiliated corporation that sells similar goods in "brick-and-mortar" stores throughout California. Petitioner further alleges that it did not maintain, occupy or use any place of business in California during the period in question. (See Rev. & Tax. Code, § 6203, subd. (c)(1).)

In a letter dated July 29, 1999, the Sales and Use Tax Department (hereafter the Department) informed petitioner that the Department had concluded that petitioner was a retailer engaged in business in California and was obligated to collect use tax from petitioner's California customers. (See Rev. & Tax. Code, § 6203, subd. (a).) The Department based its conclusion, at least in part, on the significance of a paragraph, which petitioner had posted on petitioner's web site under the heading of "RETURNS." The record of this matter reflects that this paragraph stated, in pertinent part, that:

> "You may return items purchased at borders.com to any Borders Books and Music store within 30 days of the date the item was shipped. All returns must be accompanied by a valid packing slip (your online receipt and shipping notification are not valid substitutes for a packing slip on returns to stores). Gift items may be returned or exchanged if they are accompanied by a valid gift packing slip. You may not return opened music or video items, unless they are defective."

Petitioner alleges that this paragraph first appeared on petitioner's web site some time in June of 1999. Petitioner further alleges that petitioner's internal records reflect that this paragraph was removed from petitioner's web site on or around August 11, 1999. Thus, petitioner apparently removed the paragraph in question shortly after petitioner received notice that the Department considered this paragraph to be evidence that petitioner had a use tax collection obligation under California law. Petitioner has not presented any evidence that would establish that petitioner ever expressly disavowed, either publicly or internally, the policy reflected by the paragraph in question.

Petitioner contends that, notwithstanding the restrictions stated in the posted paragraph, petitioner's customers could return merchandise at a Borders store without a valid packing slip and receive a store credit. Additionally, petitioner admits that, throughout the period in question, petitioner's California customers could obtain cash refunds by returning merchandise purchased from petitioner, together with a valid packing slip, to a Borders store. In other words, petitioner's customers' ability to obtain such cash refunds from Borders was not dependent on whether the paragraph at issue was posted on petitioner's web site. According to petitioner, Borders also provided return services to individuals who had purchased merchandise from one of Borders's or petitioner's competitors; however, Borders did not, and would not, provide cash refunds to customers of Borders's or petitioner's competitors.

Petitioner alleges that any merchandise petitioner's customers returned to Borders was not sent back to petitioner but, instead, was added to Borders's inventory. Petitioner claims that Borders did not charge petitioner for return and exchange services. Finally, petitioner further claims that Borders absorbed any losses associated with accepting returns of defective merchandise from petitioner's customers.

OPINION

With certain exceptions that are not relevant to this matter, Revenue and Taxation Code section (hereafter Section) 6203 imposes a use tax collection obligation on ". . . every retailer engaged in business in this state and making sales of tangible personal property for storage, use, or other consumption in this state . . . ." Under subdivision (c)(2) of Section 6203, the meaning of "retailer engaged in business in this state" includes:

> "[a]ny retailer having any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, installing, assembling, or the taking of orders for any tangible personal property."

When, as here, no dispute exists with respect to an out-of-state seller's status as a retailer, three additional requirements must be satisfied for the seller to be a "retailer engaged in business in this state" under Section 6203, subdivision (c)(2).

First, the out-of-state retailer must have a representative, agent, salesperson, canvasser, independent contractor or solicitor (hereafter, collectively, representative). Second, this representative must be operating in California under the authority of the out-of-state retailer or its subsidiary (i.e., the in-state representative must be authorized to act on the out-of-state retailer's behalf). Third, the out-of-state retailer's authorized representative's operations in California must include one of the following activities: selling, delivering, installing, assembling or taking orders for tangible personal property. Applying this analysis to the instant matter, these three requirements are met if: (1) Borders was petitioner's authorized representative in this state for purposes of taking returns from petitioner's California customers; and (2) the taking of such returns constitutes "selling."[1] The first issue is a matter of fact, the second is a matter of law.

As to the first issue, the greater weight of the available evidence establishes that, for the period in question, Borders was petitioner's authorized representative in this state for the purpose of accepting returns from petitioner's California customers. As indicated above, petitioner expressly stated on its web site that Borders was petitioner's authorized representative for this purpose. Petitioner has submitted no evidence showing that Borders ever objected to being designated as petitioner's authorized representative or that petitioner ever revoked this designation. Rather, the evidence shows that petitioner removed the web site declaration of this designation in response to the Department's July 29, 1999, letter, not because Borders's status as petitioner's authorized representative had changed.

Although petitioner's express web site declaration is sufficient to establish that Borders was petitioner's authorized representative for returns, in addition to this direct evidence, circumstantial evidence sufficient to establish this fact also exists. Specifically, by petitioner's own admission, Borders provided unique and preferential return services to petitioner's customers. As discussed above, Borders purportedly would allow anyone to exchange for store credit any merchandise Borders stocked, regardless of whether that merchandise was purchased from Borders or petitioner or from one of their competitors. Such exchange transactions presumably would result in little, if any, net loss for Borders and would promote good will. However, even if petitioner were to establish, which petitioner has not, that Borders's practice of

[1] The Department has not alleged that Borders, during the period at issue, engaged in any activities on petitioner's behalf in California that would constitute "delivering, installing, assembling, or the taking of orders for any tangible personal property" as these terms are used under subdivision (c)(2) of Section 6203.

accepting returns from petitioner's customers was wholly independent of petitioner's published return policy, Borders's willingness to provide cash refunds to petitioner's customers, when Borders refused to do this for customers of Borders's or petitioner's competitors, indicates that Borders made such refunds because Borders was petitioner's authorized representative. While not exhaustive of the circumstantial evidence indicating that Borders was petitioner's authorized representative for returns in California, Borders's preferential treatment of petitioner's customers suffices to establish this fact.

As to the legal issue that remains, we conclude that, when accomplished through an authorized representative, the taking of returns constitutes "selling" under subdivision (c)(2) of Section 6203. Because neither the Sales and Use Tax Law in general, nor Section 6203 in specific, contains a definition of "selling," following the accepted canons of statutory construction, we construe this term according to its common usage. In other words, "selling" is inclusive of all activities that are an integral part of making sales.

When out-of-state retailers that make offers of sale to potential customers in California authorize in-state representatives to take returns, these retailers acknowledge that the taking of returns is an integral part of their selling efforts. Such an acknowledgement comports with common sense because the provision of convenient and trustworthy return procedures can be crucial to an out-of-state retailer's ability to make sales. This is especially evident in the realm of e-commerce.

For example, in this case, petitioner identified Borders as petitioner's authorized in-state representative for effecting the generous, convenient return policy petitioner published on its web site. It is apparent that petitioner announced this favorable return policy to induce potential customers, who might otherwise be wary of making purchases from a remote seller, to place orders. Indeed, many potential online customers would not place an order with an online retailer whose return policy was not worthy of confidence. An online retailer's ability to offer these potential customers convenient returns and exchanges at nearby reputable "brick-and-mortar" stores, as petitioner did, would assuredly help promote such confidence. Moreover, some online purchasers will not be satisfied with their purchases. An online retailer that offers convenient, local return and exchange options is much more likely to obtain repeat business from such purchasers. The important role that an online retailer's return policy plays in obtaining repeat business further underscores how integral the taking of returns is to selling in e-commerce transactions.

In *Quill Corp. v. North Dakota* (1992) 504 U.S. 298 [hereafter *Quill*], the United States Supreme Court held that, pursuant to the Commerce Clause of the United States Constitution, a state cannot impose a use tax collection obligation on out-of-state retailers unless those retailers have "substantial nexus" with that state. The *Quill* court explained that, to establish commerce-clause nexus, a state must show that the out-of-state retailer, or a representative of the out-of-state retailer, has a sufficiently substantial physical presence in the state to justify the imposition of a use tax collection obligation. (*Ibid.*) In this case, petitioner had a substantial physical presence in California through the many places of business and employees of Borders,

petitioner's authorized representative in this state for the purpose of selling tangible personal property. Petitioner's substantial physical presence in this state more than suffices to establish that petitioner had commerce-clause nexus with California during the period in question. (See *ibid.*)

In sum, both the direct and circumstantial evidence are sufficient to establish that Borders, acting as petitioner's authorized representative, performed return and exchange activities in California. Such activities, when performed through an authorized representative, are an integral part of selling tangible personal property. Thus, due to Borders's actions in California on petitioner's behalf, petitioner was a "retailer engaged in business in this state" during the period in question. Accordingly, the petition should be denied as to these issues because petitioner was obligated to collect, and remit, use tax from petitioner's California customers. (Rev. & Tax. Code, §§ 6203, subds. (a) & (c)(2), 6204.)

Adopted at Sacramento, California, on September 26, 2001.

Claude Parrish, Chairman

John Chiang, Member

Johan Klehs, Member

Dean Andal, Member

Marcy Jo Mandel, Member*
*For Dr. Kathleen Connell, pursuant to Government Code section 7.9.