

State Coffers Make Land Grab For E-Commerce

Due to concerted lobbying efforts of the E-Commerce industry, Congress has historically upheld the moratorium on state taxes attributed to e-commerce sales. According to Forrester, in 2004, US e-commerce transactions have been estimated at \$3.5 Trillion.

Consequently, state taxing authorities have been angling for the opportunity to levy taxes against the online industry to beef up state coffers. With state budget deficits increasing, state taxing authorities are on the offensive to capture e-commerce revenues.

In *Borders Online v. State Board of Equalization*, (Sup. Ct. No. 414210)(2005), the California Court of Appeals ruled on the issue of state taxing authority over e-commerce activities which warrants the attention of all e-commerce vendors, large and small. In this case, Borders Online, an affiliated sister company of Borders Bookseller, had sold merchandise through its web site from 1998 through 1999. Part of its sales strategy was to integrate its marketing initiatives for the e-store with its bricks and mortar presence by allowing customers to return products purchased online at the Borders retail chain. Additionally, employees at the bricks and mortar stores were encouraged to refer customers to the Border's website which included a link to the ecommerce site, and sales receipts included invitations for customers to visit the Borders web site.

The California Board of Equalization relied upon California's Revenue and Taxation Code Section 6203 (a) which requires retailers engaged in business in this state [CA] to collect and pay a use tax. Additionally 6203 (c)(2) of the statute defines a "retailer engaged in business in this state" as "[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 taking of orders of any tangible personal property." The Board argued that as the promotion of allowing customers who purchase online to return items to the bricks and mortar locations, that such promotion was a material part of the selling process to induce customers to make purchases. The Board further argued that the employees of Borders' retail facilities were acting as agents of Borders Online by accepting its product returns and promoted customer visits to the Borders web site.

Borders argued that the return policy was not an act of selling and claimed the Board was overreaching in its interpretation of the statute. Additionally, Borders argues that no agency relationship existed because it did not meet the four factor test set forth under *Michelson v. Hamada* (1994) 29 Cal. App.4th 1566, 1588

which stipulates an agency



relationship exists if (1) the agent has the power to alter legal relationships of the principal, (2) the agent acts as the fiduciary of the principal, (3) the principal can control the agent, and (4) the agent consents to act as the principal's agent.

The court, however, rejected Border's arguments and determined that: (1) Borders' promotional return policy was a material basis for a consumer to make a purchasing decision and was therefore substantially attributed to the "selling" process, and (2) Borders' use of retail employees to accept returns on behalf of its online affiliate as well as cross-promotional activities warrant a sufficient basis to establish an agency relationship. As such, the court concluded the integrated marketing and sales practices between Borders' online and brick and mortar facilities created a sufficient nexus to warrant California's taxing authority.

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While many E-tailers are pure online plays, one must be careful about doing cooperative marketing, joint venturing and other cross-medium promotions which may trigger tax implications. Although this case is

limited to California, the implications of the court's holding is that the analysis may open a potential floodgate of sales tax claims from other states.

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