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BORDERS ONLINE, LLC V. STATE BOARD OF EQUALIZATION

129 Cal. App. 4th 1179 (Ct. App. 2005)

The California Court of Appeals held that an online retailer that allowed a local retailer to accept returns on its behalf was required to collect and remit use taxes on local sales to the California Board of Equalization, and that this relationship was sufficient to establish the nexus required for the state to impose taxes on the online retailer.

Borders Online (“Online”) is a subsidiary of Borders Group, Inc., a Delaware corporation. Borders Group also owns Borders, Inc. (“Borders”), which operates brick-and-mortar Borders Books and Music stores. From April 1, 1998 to September 30, 1999, Online sold over \$1.5 million in merchandise to California customers, but neither collected taxes from its California customers nor paid sales or use taxes to the California Board of Equalization. During this period, Online posted a return policy providing customers with the option of exchanging or returning merchandise purchased from Online at any Borders store, many of which are located in California.

In 1999, the Board issued a letter to Online stating that, under the California Revenue and Taxation Code Section 6203, it was required to collect and remit use taxes on all sales to California purchasers because Borders acted as Online’s agent by accepting return merchandise. Online paid the use taxes, and then submitted a claim for refund, which the Board rejected. Online then filed suit seeking the refund, arguing that (1) it was not a California retailer and therefore was not required to pay use taxes, and (2) the Commerce Clause prohibited California from imposing taxes on the company. The trial court granted summary judgment for the Board, and Online appealed.

The California Court of Appeals affirmed. The court held that because Borders accepted returns on behalf of Online and granted its own store credit and merchandise for Online exchanges, Borders qualified as Online’s “representative” or “agent” “operating” in California under Section 6203(c)(2). The court also adopted the Board’s interpretation of “selling” under the statute, defining it as including “all activities that are an integral part of making sales.” The court concluded that, because providing “convenient and trustworthy return procedures” is an important part of an out-of-state retailer’s ability to encourage and make sales, Borders’s actions on behalf of Online sufficed as “selling” and required Online to collect and pay use taxes.

The court held that Borders's actions as a representative of Online satisfied the Commerce Clause nexus requirement set out in *Tyler Pipe Industries v. Washington Department of Revenue*, 483 U.S. 232, 250 (1987). Specifically, the court found that the return policy and cross-selling techniques in which Online and Borders cooperated demonstrated that Online had a representative with a physical presence in the state, and that the representative's activities were significantly associated with Online's ability to establish a market in the state. The court further held that, although evidence that the local representative's activities have a de minimis impact on local sales could factor in the nexus test, the burden of showing this impact rests on Online because "one who claims an exemption from taxation has the burden of proving it."