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Governor

ARIZONA TRANSACTION PRIVILEGE TAX RULING TPR 16-3

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BACKGROUND:

With the proliferation of the internet into everyday lives, sales through electronic commerce have exploded. Buyers can instantly shop and compare among competing retailers without having to physically travel to a store to consummate a sale. Retailers no longer have to maintain a physical presence. Instead, they are able to operate websites that function as a storefront with the ability to ship goods to customers quickly. Some retailers have been so successful in streamlining the e-commerce process that they have created marketplaces that allow other merchants to list their products and provide a platform through which merchandise is sold under a single identifiable brand.

In addition to providing a platform on which to sell products, marketplace businesses also provide support services including being the primary point of contact for customers, providing order status information, payment processing services, inventory management and fulfillment services.

Though customers visiting an online marketplace may be aware of other merchants selling their products there, they seek out the online marketplace because of its identifiable brand regardless of who the retailers may be. In other words, the third-party merchants play no role in the customer's decision to shop on a specific marketplace, rather it is the marketplace brand that is seen as the retailer.

However, it may be unclear who in fact the retailer is for tax purposes as a result of the online marketplace and third-party merchants operating in the same space. This is particularly true where the online marketplace is itself a retailer conducting its own sales. Thus, for the purposes of clarity, the Department is issuing this ruling to specify when and in what circumstances an online marketplace is the retailer for the purposes of the retail TPT on sales to Arizona customers.

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 16-3

Page 2

ISSUE:

Is a business with Arizona nexus for transaction privilege tax (“TPT”) purposes that operates an online marketplace through which third-party merchants sell tangible personal property at retail (hereinafter “online marketplace”), a “retailer” making “sales” on behalf of third-party merchants and therefore, responsible for the retail TPT on sales to Arizona customers?

RULING:

A business that operates an online marketplace and makes online sales on behalf of third-party merchants as evidenced by the marketplace providing a primary contact point for customer service, processing payments on behalf of the merchant and providing or controlling the fulfillment process, is a retailer conducting taxable sales. The gross receipts of that marketplace business derived from the sales of tangible personal property to Arizona purchasers are subject to retail TPT, provided that the business already has nexus for Arizona TPT purposes.

DISCUSSION:

Arizona's TPT differs from the sales tax imposed by most states. It is a tax on the privilege of conducting business in the State of Arizona. Differing from a true sales tax, the TPT is levied on income derived by the seller, who is legally allowed to pass the economic expense of the tax on to the purchaser. However, the seller is ultimately liable to Arizona for the tax. In other words, this tax is not one levied on the sale itself but on the privilege of engaging in business in Arizona, measured by the gross receipts from sales or the volume of business attributable to the taxable activity. *Arizona Department of Revenue v. Mountain States Telephone and Telegraph Co.*, 113 Ariz. 467, 556 P.2d 1129 (1976); *Tower Plaza Investments, Limited v. DeWitt*, 109 Ariz. 248, 508 P.2d 324 (1973); *State Tax Commission v. Quebedeaux Chevrolet*, 71 Ariz. 280, 226 P.2d 549 (1951).

A.R.S. § 42-5061 imposes the TPT under the retail classification. The retail classification is comprised of the business of selling tangible personal property at retail. A.R.S. § 42-5061(V)(4) defines “selling at retail” as a sale for any purpose other than for resale in the regular course of business. The tax base for the retail classification is the gross proceeds of sales or gross income derived from the business. All sales of tangible personal property

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 16-3

Page 3

are subject to the TPT under the retail classification unless specifically exempted or excluded by statute.

A.R.S. § 42-5001(13) provides that a "retailer":

includes every person engaged in the business classified under the retail classification pursuant to section 42-5061 and, when in the opinion of the department it is necessary for the efficient administration that definition includes dealers, distributors, supervisors, employers and salesmen, representatives, peddlers or canvassers as the agents of the dealers, distributors, supervisors or employers under whom they operate or from whom they obtain the tangible personal property sold by them, whether in making sales on their own behalf or on behalf of the dealers, distributors, supervisors or employers.

A.R.S. § 42-5001(14) defines "sale" as:

any ***transfer of title or possession***, or both, exchange, barter, lease or rental, conditional or otherwise, ***in any manner or by any means whatever***, including consignment transactions and auctions, of tangible personal property or other activities taxable under this chapter, for a consideration ... (Emphasis added).

The definitions of "retailer," "sale" and "selling at retail" are broad enough to encompass transactions that do not fit traditional retailers with physical storefronts. For example, the statute indicates that dealers, distributors, representatives, peddlers or canvassers may be considered retailers; those persons may or may not have a store location and may or may not be selling on their own behalf. In the same spirit, the statute indicates that a retail sale includes transfers of title or possession "in any manner or by any means whatever." Thus, Arizona law recognizes instances where a person other than the retailer of record may be held liable for the remittance of the TPT under the retail classification.

The term "retailer" includes agents and representatives of those who sell on another's behalf. The TPT statutes do not define either the word representative or agent. When that is the case, as a general rule of statutory construction, courts will consult an established and widely used dictionary to determine the common and ordinary meaning of undefined words. See, e.g., *United Dairymen of Ariz. v. Rawlings*, 217 Ariz. 592, 596, 177 P.3d 334, 338 (Ct. App. 2008). Dictionary.com defines an agent as a person who acts on behalf of

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 16-3

Page 4

another person and defines representative as a person or thing that represents another or others.¹

In addition to the e-commerce infrastructure provided by online marketplace businesses, such businesses normally do the following on behalf of their third-party merchants:

- Provide a primary point of contact for general customer service including providing customers with information on their orders (confirmation of orders, shipment notification, delivery notification, refund status etc.)
- Provide payment processing services, including any refund processing
- Provide marketing of the online marketplace under a single brand (i.e. the brand itself is marketed not each merchant listed on the marketplace)

Regardless of which merchant a customer makes his purchases from, he goes through the same process and relies on the online marketplace for answers to purchasing questions. The services provided by the marketplace are normally offered through a streamlined approach whereby every customer is treated similarly in accordance with a set of standards set by the online marketplace business not by each merchant. The online marketplace is normally itself a merchant and sells goods on its own website as well. In those instances where there are two retailers conducting sales on the same website in relation to the same sale, there may be confusion as to who should be responsible for collecting and remitting the taxes. Because of the activities undertaken by the online marketplace on behalf of the third-party vendors, the online marketplace is considered to be representing the merchant(s) collectively and should be treated as the “retailer” for Arizona TPT purposes under A.R.S. § 42-5001(13).

In addition to being a retailer, to be liable for the retail TPT, there must be a sale of tangible personal property. Under A.R.S. § 42-5001(14), a “sale” includes transfers of title or possession “in any manner and by any means whatever.” While the online marketplace does not normally take title to goods sold by the third-party merchants listing on their websites, they may have possession of such goods or otherwise be able to transfer or authorize the transfer of possession of those goods to the ultimate purchasers. Possession in this sense would include actual possession as well as constructive possession of goods.

The use of constructive possession to determine whether and when a sale occurs is not uncommon in the TPT context. For example, in the case of *Salt River Project Agr. Imp.*

¹ Black’s Law Dictionary (10th ed. 2014) defines representative as “someone who stands for or acts on behalf of another.” In addition, an agent is defined as “someone who is authorized to act for or in place of another; a representative.”

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 16-3

Page 5

and Power Dist. v. City of Phoenix, 645 P.2d 1251, 1252, 132 Ariz. 337, 338 (Ariz. App., 1982), the Court concluded that where diesel fuel was stored in California and was shipped by pipeline to Phoenix, the fuel in possession of the common carrier was in constructive possession of the buyer from the time it left California because the buyer made arrangements for and bore costs of transportation and risk of loss for the shipments. Therefore title and possession were transferred at the same time and a sale had taken place.

Black's Law Dictionary (10th ed. 2014), defines constructive possession as having "control or dominion over a property without actual possession or custody of it." In the online marketplace context, this means that possession is established where the online marketplace has dominion or control over tangible personal property such that it is able to direct the person with actual custody or physical possession of the property to deliver that property to the ultimate purchaser by means of common carrier. It does this as agent for the third-party merchant on its marketplace website. Control over the property is also seen in the ability of the online marketplace business to accept returns and issue refunds as agent on behalf of the third-party merchant. In such cases, the online marketplace business may not physically take possession of the property but directs that it is satisfactory for the custodian to accept the returned goods and put them back into the third-party merchant's inventory. Thus, even though the online marketplace business does not have physical possession of goods, it has as much control over the goods as if it were the seller itself.

Accordingly, an online marketplace business with Arizona nexus that derives gross receipts from acting as agent of third-party merchants by providing customer service, processing payments and refunds *and* has control over the fulfillment process will be deemed to be the retailer for the purposes of the retail TPT. Under the broad definition of the terms 'retailer' and 'sale' and based on the fact that the sales are consummated by the business, the business is a retailer subject to the tax, regardless of what party may hold title to the underlying merchandise before the sale.

Because A.R.S. § 42-5001(14) requires that there be a transfer of possession or title to constitute a sale, if the online marketplace vendor does not itself conduct fulfillment or have control over or is able to direct when the goods are delivered, then though that online marketplace business may be a retailer it is not making any sales on behalf of third-party merchants. In such cases, it is not responsible for the Arizona retail TPT and the third-party merchant is the retailer provided it has nexus with Arizona.

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 16-3

Page 6

Because retail TPT is not levied on individual sales or transactions, but rather, on the privilege of conducting business in the state, as measured by the taxpayer's gross receipts, all of an online marketplace's Arizona gross receipts would be presumed to be subject to tax except to the extent it can demonstrate that it offers other services that constitute a separate line of business from its retail operation.

Example 1

Company A is an online marketplace business that allows third-party merchants to list products for sale on its website. Company A is also a retailer and sells its own products on its website. Company A provides customer service to its own customers as well as other customers purchasing goods from third-party merchants. It also provides purchasing information to all customers such as order status and shipping information. It provides payment and refund processing to all customers and also controls the fulfillment process but does not have actual possession or title to any inventory. The marketplace is considered agent for third-party merchants on the site as a result of providing customer service, payment processing and being able to control the fulfillment process. Thus, the marketplace is responsible for collecting and remitting the retail TPT on any Arizona sales (whether its own or on behalf of a third-party merchant) made to Arizona customers provided the online marketplace has nexus with Arizona.

Example 2

Same facts as in Example 1 above, except that Company A does not have control over the delivery/fulfillment process. Because Company A does not have any control over the delivery/fulfillment process it is not considered an agent for third-party retailers on its site and is not liable for the Arizona TPT. In that case, the retailer who sells on the marketplace is responsible for collecting and remitting the Arizona TPT provided it has nexus with Arizona.

Example 3

Company B is an online retailer that sells products on its website. Company B does not have third-party merchants selling on its website. It provides customer service and is able to control the fulfillment process. It offers customers the option to make payments and purchase the same items it sells on another online marketplace website that is open to third-party merchants. A customer browses Company B's website and adds items to his shopping cart but then opts to make the purchase from the marketplace website instead by clicking the appropriate button. If that marketplace also directs the fulfillment process in addition to making payment processing, then the customer is deemed to be purchasing from the online marketplace and not the online retailer. Thus the online marketplace is

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 16-3

Page 7

responsible for collecting and remitting the Arizona TPT, provided the online marketplace has nexus with Arizona.

Example 4

Company C is an online marketplace that provides a platform for casual sellers to sell products. It does not provide customer services or payment processing, and it does not have any control over the delivery/fulfillment process. Because casual sales occur on the marketplace, the casual sellers are not liable for TPT on sales. In addition, because the marketplace itself is not a retailer and does not provide customer service, payment processing or fulfillment, no Arizona TPT is due.

Example 5

Company D is an online marketplace that provides a platform for other retailers to sell products. Company D does not sell any merchandise on its own website and so is not otherwise a retailer. It provides customer service and payment processing, but it does not have any control over the delivery/fulfillment process. Because Company D does not have any control over the delivery/fulfillment process and is not otherwise a retailer, Company D is not considered an agent for third-party retailers on its site and is not liable for the Arizona TPT. The retailer who sells on the marketplace is responsible for collecting and remitting the Arizona TPT provided it has nexus with Arizona.

Example 6

Same facts as in Example 5 above, except that Company D also has control over the delivery/fulfillment process. Because Company D provides customer service, payment processing and has control over the delivery/fulfillment process, it is considered a retailer because it has full control over the entire selling process. As a result, it is acting as an agent for the third-party retailers selling on its site. Thus, Company D is responsible for collecting and remitting the Arizona retail TPT on purchases made by Arizona customers, provided Company D has nexus with Arizona.

Nexus Considerations

Nexus is an important consideration in determining whether an online marketplace business is taxable for Arizona TPT purposes. The Due Process and Commerce Clauses of the United States Constitution require that a business have a sufficient connection or nexus to a state before that state can impose an obligation to collect taxes on its behalf. In the context of retail TPT, this requirement for nexus does not mean that a sale must occur within Arizona for it to be taxable. "Under the United States Constitution and applicable

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 16-3

Page 8

Arizona statute, there is no requirement that a sale occur in Arizona before transaction privilege tax may be imposed. Instead, the business activities which surround the sale must occur in Arizona before assessment of the tax is permitted.” *Arizona State Tax Commission v. Southwest Kenworth, Inc.* 114 Ariz. 433, 438 (1977). Arizona cases have established, however, that nexus may be shown where a taxpayer’s activities are “significantly associated with the taxpayer’s ability to establish and maintain a market in this state for the sales.” See for example *Arizona Dep’t of Revenue v. Care Computer Sys., Inc.*, 197 Ariz. 414, 416, 4 P.3d 469, 471 (Ct. App. 2000). See also TPR 16-1 dealing with remote sellers generally and examples on nexus.

Grant Nülle, Deputy Director

Signed: September 20, 2016

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law that are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, detail, or supplementary information concerning application of the law. Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.