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PRIVATE TAXPAYER RULING LR11-006

May 4, 2011

The Department issues this private taxpayer ruling in response to your request of September 22, 2009, as supplemented by your letter of February 18, 2010, submitted on behalf of your client . . . (the "Company"). You requested a determination regarding the manner in which sales tax shall be refunded to the Company and its customers when a customer receives less than the original purchase price in exchange for returned merchandise. Pursuant to Arizona Revised Statutes ("A.R.S.") § 42-2101, the Department may issue private taxpayer rulings to taxpayers and potential taxpayers on request. In accordance with A.R.S. § 42-2101(I), the Department issues this private taxpayer ruling, addressing the Company's future transactions and tax liabilities accruing from the date the Company receives this ruling, to provide guidance on prospective actions the Company may choose to undertake in substantially similar transactions.

Statement of Facts

Below is a restatement of the facts, as provided in your September 22, 2009 and February 18, 2010 letters:

[The Company] is a specialty retailer of luxury, designer and fashion merchandise. [The Company] sells its merchandise through brick-and-mortar stores located in Arizona ("State") as well as numerous other states, and through [the Company's] catalogs and websites. When [the Company] makes a retail sale of merchandise, [the Company] collects sales tax based upon the original purchase price from the customer and remits such amounts to the State.

In March 2009, [the Company] instituted a new return policy ("New Policy") for merchandise purchased from its catalogs and websites. Under the New Policy, customers making returns to [the Company] more than 60 days after their receipt of merchandise will be entitled to a partial refund of their original purchase price, as follows:

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<u>Return Within</u>	<u>Amount of Credit</u>
0 -60 days from receipt of merchandise	100% of original purchase price
61-120 days from receipt of merchandise	75% of original purchase price
121-180 days from receipt of merchandise	50% of original purchase price
181 + days from receipt of merchandise	0%

The percentage reduction reflects the fact that the value of the merchandise decreases with the passage of time. This reduction in value stems from the fact that product models go out of date, fashions and styles change with seasons, and previously returned merchandise generally is less valuable than merchandise that has not been previously sold. [The Company] contacted its customers via letters and emails before implementing the New Policy, which is now available on its website. It is anticipated that the New Policy will encourage customers to return merchandise more promptly and discourage late returns.

Issue

When a customer returns merchandise pursuant to the New Policy and receives less than the original purchase price, is the customer, and thus, [the Company], entitled to: (a) a full refund of sales tax based upon the original purchase price, (b) a partial refund of sales tax based upon the percentage of the original purchase price actually refunded to the customer, or (c) no refund of sales tax?

Taxpayer's Position

Below is a restatement of your position as provided in your letters dated September 22, 2009 and February 18, 2010:

When a customer returns merchandise pursuant to the New Policy, [the Company] and the customer have rescinded the original contract for sale, and thus [the Company] and the customer are entitled to a full refund of tax paid. In the event the percentage reduction specified in the New Policy is viewed as a nontaxable adjustment for the decrease in product value associated with the delay return, [the Company] and the customer are entitled to a full refund or credit of the tax paid based upon the original

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purchase price. Arguably, this result is correct because the merchandise is returned to inventory to be resold as “new” and the percentage reduction is charged to reflect the decrease in value associated with the delayed return. In the alternative, [the Company] and the customer are entitled to a partial refund or credit of the tax paid based upon the percentage of the original purchase price actually refunded to the customer.

Applicable Law

A.R.S. § 42-5008 levies a transaction privilege tax measured by the amount or volume of business transacted by persons on account of their business activities.

A.R.S. § 42-5061(A) states that “[t]he retail classification is comprised of the business of selling tangible personal property at retail. The tax base for the retail classification is the gross proceeds of sales or gross income derived from the business.”

A.R.S. § 42-5001(6) provides that “gross income” and “gross proceeds of sales” do not include goods, wares or merchandise, or value thereof, returned by customers if the sale price is refunded either in cash or by credit, nor the value of merchandise traded in on the purchase of new merchandise when the trade-in allowance is deducted from the sales price of the new merchandise before completion of the sale.

A.R.S. § 42-5023 states that “[i]t is presumed that all gross proceeds of sales and gross income derived by a person from business activity classified under a taxable business classification comprise the tax base for the business until the contrary is established.”

A.R.S. § 42-5002(A)(1) provides that gross income, gross receipts or gross proceeds of sales do not include transaction privilege taxes imposed by the state, counties, cities or Indian tribes. A person who imposes an added charge to cover the tax, or which is identified as being imposed to cover the tax, shall not remit less than the amount so collected to the Department.

Arizona Administrative Code (A.A.C.) R15-5-129(B) states that “[r]efunds in cash or credit given on returned merchandise are considered to be a reduction of sales.”

Discussion

A.R.S. § 42-5061 imposes the transaction privilege tax under the retail classification. The retail classification is comprised of the business of selling tangible personal property at retail. A.R.S. § 42-5061(A) states that “[t]he tax base for the retail classification is the gross proceeds of sales or gross income derived from the business.” A.R.S. § 42-5001(6), in turn, provides that “gross income” and “gross proceeds of sales” do not include goods, wares or merchandise, or value thereof, returned by customers if the sale price is refunded either in cash or by credit, nor the value of merchandise

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traded in on the purchase of new merchandise when the trade-in allowance is deducted from the sales price of the new merchandise before completion of the sale.

Pursuant to the Company's new policy, when a customer returns merchandise more than 60 days after the date of purchase, the customer is entitled to a partial refund of the sales price or purchase price according to the schedule outlined above. Although the full "sales price" is not refunded, a portion of the sales price is refunded. While other states with similar statutes specifically require that the full or total sales price be refunded, A.R.S. § 42-5001(6) is not so limited. In addition, A.A.C. R15-5-129(B) simply provides that "[r]efunds in cash or credit given on returned merchandise are considered to be a reduction of sales." Given that a portion of the sales price is refunded under the new policy, the Company is entitled to a partial refund of the transaction privilege tax paid proportionate to the sales price refunded to the customer provided that the tax is also refunded to the customer. To the extent that the transaction privilege tax is not refunded to the customer, it must be paid to the state.

Finally, the amount retained by the Company constitutes gross income derived from the Company's business and continues to be subject to transaction privilege tax.

Conclusion and Ruling

The Department rules that the Company is entitled to a partial refund of transaction privilege tax proportionate to the reduced sales price refunded to a customer under its new policy provided that the same proportionate tax is refunded to the customer.

The conclusions in this private taxpayer ruling do not extend beyond the facts presented in your letters dated September 22, 2009 and February 18, 2010.

This response is a private taxpayer ruling and the determinations herein are based solely on the facts provided in your request. The determinations are subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the department's making of an accurate determination, this private taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different department position.

The determinations in this private taxpayer ruling are only applicable to the taxpayer requesting the ruling and may not be relied upon, cited nor introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the private taxpayer ruling. In addition, this private taxpayer ruling only applies to transactions that occur or tax liabilities that accrue from and after the date the taxpayer receives the ruling.