

myStateTaxOffice

A Washington National Tax Services (WNTS)
Publication

March 23, 2012

Connecticut Supreme Court determines out-of-state bookseller is liable for sales and use tax

 Follow @twitter

Authored by: Amy St Clair

The Connecticut Supreme Court overturned a trial court ruling, determining an out-of-state bookseller is liable for sales and use tax because local school teachers who distribute flyers, take orders and deliver books are the seller's in-state representatives with substantial nexus under the US Commerce Clause. Therefore, the bookseller owed the sales and use taxes that it failed to collect on its Connecticut sales for a 10 year period [*Scholastic Book Clubs, Inc. v. Commissioner of Revenue Services*, Connecticut Supreme Court (3/27/2012)].

Background

Scholastic Book Clubs, Inc. (Scholastic), a Missouri bookseller, distributes books and related items to Connecticut residents through approximately 14,000 participating Connecticut teachers. Scholastic has no personnel or property in state, and does not perform any direct marketing or advertising in the state. During the school year, Scholastic mails monthly catalogs containing age appropriate flyers to the participating teachers. The teacher can decide whether or not he or she will distribute the flyers to students. Students who want to order books from Scholastic return order forms along with cash or checks to their teacher. The teacher collects all of the student orders, along with a personal order if desired, and submits the orders and consideration to Scholastic. Orders are processed and filled in Jefferson City,



Missouri, and the books are delivered to the teacher by common carrier with a packing slip addressed to the teacher. The teacher then distributes the orders to the appropriate students.

On March 1, 2003 and September 11, 2006, the commissioner of revenue imposed two sales and use tax deficiency assessments, respectively, covering a ten year period. The total tax assessment, including interest and penalties equaled \$3,298,742.80. Scholastic protested the assessments, which were upheld by the commissioner, who ruled that Scholastic sold its products by using in-state representatives. Scholastic appealed to the trial court, which held the teachers did not function as in state representatives and that to impose a tax liability would violate constitutional principles. The commissioner challenged the statutory and constitutional grounds for the decision before the Connecticut Supreme Court (court).

Statutory challenge

The commissioner contested the trial court's conclusion that the teachers did not serve as Scholastic's in-state "representatives." Under Connecticut General Statute §12-407(a)(15)(A)(iv), "Engaged in business in the state means and includes . . . having any representative, agent, salesman, canvasser or solicitor operating in this state for the purpose of selling, delivering or taking orders."

Scholastic contended that the commissioner interpreted the term "representative" too broadly. The teachers were not acting in the capacity of "representatives" as defined in the Connecticut statutes, but rather were customers who also act 'in loco parentis' (*i.e.*, stand in the place of parents in a surrogate role).

The court analyzed the statutory language and stated that an objective reading of the statute suggests it was intended to encompass a wide range of conduct and the commissioner has discretion in determining what type of conduct falls within its purview. Because the statute distinguishes between persons who may be acting as representatives, agents, salesmen, canvassers and solicitors, the court "infer[red] that the legislature was describing the different roles a person may assume" and the use of these different terms within the same statute "suggests that the legislature acted with complete awareness of their different meanings . . . and that it intended the terms to have different meanings." Thus, the court found, the term "representative" had a different meaning than salesman or canvasser, but otherwise stands in the place of the out-of-state retailer for purposes of selling, delivering or taking orders.

The court held that since the teachers served as the sole conduit through which Scholastic advertised, marketed, sold and delivered its products, they were "representatives."

The court further rejected the 'in loco parentis' argument, stating it is the effect of the teachers' activities on Scholastic's goal of selling its products, not the motivation of the teachers, that is addressed in the statute. Although the teachers may have been customers when purchasing books for themselves or participating in a bonus point system to obtain additional materials, their principal function was to serve as the exclusive vehicle for selling Scholastic products to their students.

Constitutional Challenge

The Court next analyzed whether the teachers' activities provided the requisite nexus under the Commerce Clause to justify the imposition of sales and use tax.

The court noted that under *Scripto v. Carson*, 362 US 207 ((1960)), the test is simply the nature and extent of the activities of the seller. Under *Tyler Pipe Industries, Inc. v. Dept. of Revenue*, 483 U.S. 232(1987), "the crucial factor is . . . whether the activities performed in [the] state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in [the] state for the sales. " The court held that "because the teachers who participate in the program serve as the only means through which [Scholastic] communicates with Connecticut school children, they provide the substantial nexus required to permit imposition of sales and use taxes."

The court noted that while *Scripto* has been described as representing the furthest extension of the state's taxing power, it does not necessarily mean that a substantial nexus between an out-of-state seller and the state could not be found in other, as of yet undefined circumstances. Under a "practical analysis" of the "nature and extent of the activities," the court found it clear that the Connecticut school teachers provided the substantial nexus required under the Commerce Clause to permit imposition of sales and use tax.

Consequently, the judgments were reversed and the case was remanded with direction to deny Scholastic's appeals and to render judgments for the commissioner of revenue services.

For more information, please do not hesitate to contact:

Stephen Larosa (860) 241-7053 stephen.j.larosa@us.pwc.com

Amy St Clair (702) 691-5445 amy.c.st.clair@us.pwc.com

This document is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

SOLICITATION

© 2012 PricewaterhouseCoopers LLP. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers LLP, a Delaware limited liability partnership, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.