

NO. CV 07 4013027 S : STATE OF CONNECTICUT
SCHOLASTIC BOOK CLUBS, INC. : SUPERIOR COURT
v. : JUDICIAL DISTRICT OF
NEW BRITAIN
COMMISSIONER OF REVENUE
SERVICES : APRIL 9, 2009

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MEMORANDUM OF DECISION

The plaintiff, Scholastic Book Clubs, Inc. (SBC), brings the present tax appeals from the decision of the defendant, the commissioner of revenue services (commissioner), imposing sales and use tax deficiency assessments, including interest and penalties pursuant to the Sales and Use Tax Act, General Statutes § 12-406 et seq., upon SBC for business it conducted during the periods June 1, 1995 through May 31, 2002 and June 1, 2002 through May 31, 2005 (hereinafter the audit periods) relating to the marketing and sale of books and other educational products. The issue in this case is whether the commissioner can justify imposing a tax on SBC because of the role played

by Connecticut schoolteachers.

The procedural history of these cases is as follows. On March 1, 2003, the commissioner issued a Notice of Assessment against SBC for the period of June 1, 1995 through May 31, 2002 alleging sales and use taxes due from SBC in the amount of \$2,048,339.69 plus interest and penalties. On September 11, 2006, the commissioner issued a Notice of Assessment against SBC for the period of June 1, 2002 through May 31, 2005, alleging sales and use taxes due from SBC in the amount of \$1,250,403.11 plus interest and penalties.

SBC duly protested these deficiencies by filing petitions for reassessment under General Statutes § 12-418. On January 10, 2007, in response to SBC's petitions, the commissioner issued a written determination in each case upholding the deficiencies based upon SBC's "use of in-state representatives . . . pursuant to . . . [General Statutes] § 12-407 [a] (15) (A)." SBC appealed from the commissioner's determination, and the court conducted a trial on October 14-15, 2008.

The court makes the following findings of fact:

1. SBC is a wholly-owned subsidiary of Scholastic, Inc., a "for profit" company. SBC is also a "for profit" company, making approximately a 20% return on investment. Scholastic, Inc. employees are allocated to SBC for staffing purposes.
2. SBC is a Missouri corporation with its principal place of business in Jefferson City, Missouri.

3. While Scholastic, Inc. products are available through direct purchase or in retail stores, SBC distributes books and related items only through schools. A Scholastic, Inc. edition of a book is significantly different in quality from the same book issued by SBC.
4. SBC has been in operation for sixty years and has a known reputation in the elementary and secondary school community.
5. Thirteen to fourteen thousand Connecticut teachers participate in SBC programs.
6. There are four categories of students, and a catalog is designed for each. Early childhood students are in the “firefly” group. Kindergarten and first grade are in “seesaw.” Grades two and three are in “lucky.” Grades four, five and six are in “arrow.”
7. SBC does not own or lease any real estate in Connecticut. It does not own or lease personal property in Connecticut.
8. SBC has no principal place of business in Connecticut. It has no temporary facility or office.
9. SBC has no employees, representatives,¹ independent contractors, salesmen or agents in Connecticut. It has no canvassers, solicitors or other personnel in Connecticut.
10. SBC has no telephone number in Connecticut. It has no web address or mailing address in Connecticut.
11. SBC has no bank accounts in Connecticut.

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The court finds as a fact that there are no other SBC “representatives” in Connecticut, but discusses below as a matter of fact and law whether schoolteachers are “representatives.”

12. SBC does not advertise in the local media or direct advertising to Connecticut customers only.
13. SBC has never used state or local government services, such as the police or fire departments.
14. SBC has not communicated with residents of Connecticut by means other than mail or internet from locations outside of Connecticut.
15. SBC does not, and did not, use Connecticut vendors to design, prepare, print, store or mail catalogs.
16. SBC has not retained any security interests in any product sold to Connecticut customers.
17. SBC has no franchisees or licensees operating in Connecticut.
18. SBC does not conduct credit investigations or collection activities in Connecticut.
19. SBC does not solicit orders by telephone, telegraph, computer, cable or other communication systems in Connecticut.
20. SBC conducts its mail order business by mailing catalogs monthly during the school year to classrooms at nursery, primary and secondary schools throughout the United States, including Connecticut.
21. Solely as a result of their academic interest in choosing books and other items for their students and themselves, Connecticut teachers play a role in SBC's sales and distribution process as follows:

- (a) The classroom teacher receives a grade appropriate catalog. This catalog contains

flyers to be distributed to students. It also contains an order form and a “teacher memo” which relates the bonus point system that a completed order brings to the classroom.

(b) The “teacher memo” states that no agency is created between the teacher and SBC.

(c) The teacher distributes the flyers to the students, who are expected to bring the flyers home to their parents. If there are not enough flyers, the teacher contacts SBC for more. Sometimes the teacher sends a “student memo” to the parents. (SBC supplies the teacher with a draft memo.)

(d) The teacher may also purchase books from the catalog for the classroom or for gifts to the students.

(e) Whether the teacher decides to participate in the program or any other book club is entirely the teacher’s decision.

(f) New teachers or teachers new to that grade receive an additional letter from SBC in September explaining the program.

(g) The individual selections are returned to the teacher with cash or checks from the parent. (The student, as well, may have allowance money and provide cash.) Presently, the teacher might order “online” from SBC with a credit card. The teacher also may have the option to use a discount coupon. SBC contacts the teacher if the

order is calculated incorrectly.

(h) The teacher collects orders and submits them to SBC. The teacher may add his or her own order to the total.

(i) All orders are processed and filled in Jefferson City, Missouri.

(j) The books are delivered to the teacher by “common carrier” with a packing slip addressed to the teacher. A list addressed to the teacher is enclosed with the order and shows the boxes contained in the delivery. The teacher distributes the order to the students.

(k) If a book is unavailable, SBC includes a coupon for the affected student or sometimes a different book. SBC tries to fill the order eventually. If the order cannot be filled, the teacher receives a refund check for the student.

(l) Students with torn or defective books also receive a refund check from SBC, which is sent to the teacher.

22. The classroom receives bonus points, which do not expire, based on the number of books ordered each month. Teachers (not parents or students) decide how the bonus points will be spent and parents are not informed regarding the teachers’ redemption choices.
23. The bonus points may be redeemed for book catalog items. They may also be redeemed from a separate catalog for goods that require a greater number of bonus points. These items include telephones, camcorders, fax machines,

televisions, microwaves, mini-refrigerators, toaster ovens and VCRs.

24. The “items catalog” states that the teacher may redeem bonus points for “classroom use” only. Because SBC does not police this requirement, a teacher could obtain a television, for example, and use it at home. SBC trusts the teachers and does not know of any patent abuse by teachers.
25. While the teacher might delegate the collecting of the order to a “parent helper,” the order is submitted under the teacher’s name and account number.
26. Where there is a new teacher or a teacher new to a grade, SBC sends a catalog known as a “slug.” The slug contains the same information as that sent to established teachers, but omits the teacher’s name on the catalog.
27. SBC suggests that the new teacher call its offices in Missouri to “walk through” the process. The new teacher then learns about grade specific catalogs and special catalogs – such as those oriented to history or African-American studies.
28. There is no restriction on a teacher that would prohibit the teacher from giving a flyer to a teacher trainee, neighbor or friend.
29. There is no limit on the size of the order or the dollar amount, but SBC audits certain orders. Where there is a large amount of the same book order, this flags a problem, as the teacher may be conducting a side business.
30. SBC considers that the teacher is acting to assist the minor students, in their purchase of books, “in loco parentis” or as “surrogate parents.”

The first issue² to be resolved in this appeal concerns the commissioner's January 10, 2007 letters indicating that SBC is subject to sales and use taxes pursuant to § 12-408 and § 12-411 as it engaged in business in the state through "the use of in-state representatives." The commissioner relies upon § 12-407 (a) (15) (A) that provides, in relevant part, as follows: "'Engaged in business in the state' means . . .(iv) . . . having any representative³ . . . operating in this state for the purpose of selling, delivering or taking orders[.]" The court must therefore address whether schoolteachers in Connecticut function as SBC's "representatives."

There are no Connecticut cases interpreting the term "representative," but it has received interpretation in other states where similar statutory language exists in those

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The court should not consider the due process or commerce clause challenges until it concludes that the commissioner was correct that SBC is statutorily subject to the sales tax. See *DaimlerChrysler Services North America, LLC v. Commissioner of Revenue Services*, 274 Conn. 196, 205, 875 A.2d 28 (2005) (where court ruled that plaintiff is a retailer pursuant to § 12-407 (a) (12) without reaching constitutional issues).

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The court notes that at the common law, a representative was subject to the "general control" of an employer. See *Electrolux Corp. v. Danaher*, 9 Conn. Sup. 237, 240 (1941). Section 12-407 (a) (15) (A) (iv) also provides that if a taxpayer has an "agent . . . selling, delivering or taking orders[.]" then the taxpayer is engaging in business in the state. But the commissioner does not claim that the classroom teachers covered by these appeals are agents acting "on behalf of [a] principal and subject to his [or her] control[.]" *Heise v. Rosow*, 62 Conn. App. 275, 282, 771 A.2d 190, cert. denied, 256 Conn. 918, 774 A.2d 137 (2001). See defendant's post-trial brief, dated February 19, 2009, p. 16, n.16. Nor is a schoolteacher, on the facts found by the court, a "salesman, canvasser or solicitor" as set forth in this definitional statute.

states' sales tax statutes. In one recent case, *Commissioner of Revenue v. Jafra Cosmetics*, 742 N.E.2d 54, 60 (Mass. 2001), the Massachusetts Supreme Judicial Court noted that “[t]he nature and extent of this out-of-State taxpayer’s involvement with its in-State sales force is sufficient to establish that these independent sales people were ‘representatives’ under [the Massachusetts tax statutes].”

In *Alpine Industries, Inc. v. Strayhorn*, Court of Appeals of Texas, Docket No. 03-03-00643 (July 15, 2004), the court reached a similar result in a protest suit over sales tax. The taxpayer developed a network of independent salespersons. For a yearly fee, the taxpayer provided anyone interested in being a salesperson certain promotional materials, including a videotape and a copy of a manual entitled “Your Alpine Success and Evaluation Manual.” The taxpayer paid bonuses to salespersons based on the dollar volume of products ordered. The taxpayer argued that its dealers were not “salesmen, representatives, peddlers, or canvassers,⁴” but were “independent contractors.” The court rejected the taxpayer’s claim because its dealers “function in the same way as salesmen, representatives, peddlers, or canvassers function.” See also *Williams & Co. v. Dailey*, 303 S.E.2d 737 (W.Va. 1983), a sales tax case, where a Pennsylvania company established representatives in West Virginia to solicit orders and forward them to Pennsylvania for

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The court notes that this phrase is virtually identical to the language in § 12-407 (a) (15) (A) (iv).

acceptance. The court noted that the representatives were expected to generate revenue for the out-of-state taxpayer. It held that the sales tax should apply to this situation or the technicalities of the situation would govern over the substance. See *id.*, 739.

The court concludes that the term “representative” in § 12-407 (a) (15) (A) (iv) means a person who participates in an in-state “sales force,” to sell, deliver or take orders to generate revenue. It is true that a taxpayer’s personnel need not be employees; they may be independent contractors or take another employment structure. But “representatives” in the statutory definitions of Connecticut and other states are kept in the same class as “salesmen, canvassers or solicitors.” See e.g., *Associated Beverage Company, Inc. v. Board of Equalization*, 273 Cal. Rptr. 639, 647 (Cal. App. 2d Dist. 1990) (in California sales tax statute, “salesmen, representatives, peddlers or canvassers” are treated as synonyms).

On the facts found here, the teachers provide SBC an important administrative role by distributing catalogs to the students and collecting student orders. The teachers then mail orders to Jefferson City. When the books are delivered to their classrooms, the teachers distribute them. The teachers also resolve such issues as damaged books or SBC’s failure to send a particular book. Further, the orders earn “bonus points” that the teachers may redeem for books or goods.

On the other hand, the decision to participate in the SBC program remains with

the teachers⁵ so that their administrative functions do not rise to the level of a “sales force.” In addition, the teachers may purchase books as customers of SBC. Finally, bonus points remain with the classroom and do not adhere to a particular teacher.⁶ As the teachers are not in-state “order-takers” seeking to produce “revenue” for themselves or SBC, the court concludes that Connecticut schoolteachers are not “representatives” of SBC for the purposes of § 12-407 (a) (15) (A) (iv).

Simply stated, the teachers are acting “in loco parentis.” As noted in *Kelley v. Bonney*, 221 Conn. 549, 582, 606 A.2d 693 (1992)⁷: “[T]eachers exercise almost

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The commissioner argues that such free choice is irrelevant, because once the teachers decide to participate, then the teachers become SBC’s “representatives,” subject to SBC’s direction. The teachers are not agreeing to cooperate with SBC in order to profit through a revenue-producing sales force. They are basing their decision to participate voluntarily on educational considerations and the 60-year custom of distributing catalogs to grade school students. Mr. Gregory Bell, Scholastic Inc.’s vice president of finance, testified that teachers are “essential to [SBC’s] business.” (Trial transcript (hereinafter Tr.), p. 138.) On the other hand, Mr. Bell also testified that SBC did not have “any right or ability to direct or control whether a teacher would respond to the classroom mailing that was sent to him or her.” (Tr., 37.) Furthermore, Mr. Bell testified that teachers were not under any obligation to promote the SBC program to their students. See Tr., p. 40.

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As discussed below, in California, SBC originally was subject to sales tax, but this was changed once bonus points became part of the classroom and did not benefit the teacher directly.

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While the court acknowledges that this and similar cases arose in Connecticut in the context of teacher discipline, decisions from other jurisdictions show that the phrase “in loco parentis” has a wider meaning.

unlimited responsibility for the daily implementation of the governmental interest in educating young people. In the classroom, teachers are not mere functionaries.” One well-respected judge put it this way: “For approximately seven hours a day, five days a week – nearly half of a child’s waking existence – the children of this State are a captive audience of the teachers hired by local boards of education. During the impressionable school-age years, teachers are not merely instructors in sciences and letters. They are authority figures, role models, behavioral examples, surrogate parents. After a fashion, teachers stand *in loco parentis*.” *Rogliano v. Fayette County Board of Education*, 347 S.E.2d 220, 226 (W. Va. 1986) (*Neely, C. J., dissenting*). A schoolteacher stands in the place of a parent when he or she helps a student select and order a book.

A Michigan case brought by SBC supports the court’s position. In *Scholastic Book v. Dept. of Treasury*, 567 N.W.2d 692, 696 (1997), the Michigan Court of Appeals concluded that teachers participating in an SBC program identical to the one at issue in Connecticut, were “not a sales force that works for” SBC. The court also declared that the teachers “are analogous to parents who order an item from a mail-order catalog for their children; no one would seriously argue that such parents are a ‘sales force’ for mail-order vendors.” *Id.*⁸

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Other cases that consider the scope of the imposition of the sales tax on SBC or similar companies are split over whether the teachers are “agents” of the out-of-state vendor. See *Pledger v. Troll Book Clubs, Inc.*, 871 S.W.2d 389 (Ark. 1994) (no agency relationship).

To impose tax liability as the commissioner has, because Connecticut schoolteachers are SBC's "representatives," would also violate constitutional restraints. As the Supreme Court declared in *SFA Folio Collections, Inc. v. Bannon*, 217 Conn. 220, 227, 585 A.2d 666, cert. denied, 501 U.S. 1223, 111 S. Ct. 2839, 115 L. Ed. 2d 1008 (1991): "[T]he relevant legal inquiry in reviewing the constitutionality of imposing the duty of collection of such a tax upon an out-of-state seller is whether there exists some definite link, some minimum connection, between a state and the person, property or

The concurrence therein implies that it would conclude differently if the tax commissioner had addressed whether the teachers were "representatives" of Troll. See *id.*, 393.

In *Troll Book Clubs v. Tracy*, Ohio Board of Tax Appeals, Case No. 92-Z-590 (August 1, 1994), the court concluded that the teachers were not agents. It also stated that the term "representative" was "simply different names for the same relationship."

The Supreme Court of Kansas held that under its state's broad definition of "agent," the teachers were agents of SBC. See *In re Appeal of Scholastic Book Clubs*, 920 P.2d 947 (Kan. 1996).

Finally in *Scholastic Book Clubs, Inc. v. State Board of Equalization*, 255 Cal. Rptr. 77 (Cal. App. 1st Dist. 1989), the court held that the teachers were agents, but also relied on the then-existing plan, that awarded bonuses personally to teachers depending on the number of the books sold in the classroom. SBC subsequently changed the bonus program so that the *classroom* earned points, not the teachers. In 1999, the state board of equalization reversed its position, concluding that the teachers were not agents and that SBC was not liable for a sales or use tax. It should be noted that in the subject appeals, the commissioner argued that the teachers are "representatives" of SBC under Connecticut law, not agents. According to the commissioner, the Connecticut General Assembly intended that the terms "representative" and "agent" have a "different meaning." See defendant's 2/19/09 post-trial brief, p.16, n.16.

transaction it seeks to tax.” (Internal quotation marks omitted).⁹

The commissioner argues that this connection or “nexus” is established by the teachers’ activities, as set forth above. But there is a substantial difference here from the conduct found to supply a nexus in *Tyler Pipe Industries v. Dept. of Revenue*, 483 U.S. 232, 249-50, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987). In the *Tyler Pipe* case, the in-state sales representatives established and maintained the taxpayer’s market by calling on long-standing customers to solicit orders. The sales representatives maintained Tyler Pipe’s name recognition, market share, good will and customer relations. It was irrelevant that the taxpayer called their sales representatives “independent contractors.” *Id.*, 250.

Furthermore, *National Bellas Hess v. Dept. of Revenue*, 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967)¹⁰, points out that *Scripto, Inc. v. Carson*, 362 U.S. 207, 80 S. Ct. 619, 4 L. Ed. 2d 660 (1960), extends taxation to its constitutional limit. The *Scripto* case found physical presence where ten “wholesalers, jobbers or salesmen” engaged in

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See also *Dell Catalog Sales, L.P. v. Commissioner of Revenue Services*, 48 Conn. Sup. 170, 179-80, 834 A.2d 812 (2003) (quoting 2 J. Hellerstein & W. Hellerstein, ¶ 19.02 [2] [a], p. 19-11): “[Various United States Supreme Court cases] make it clear that nexus over an out-of-state seller may be established by the activities of unrelated third parties who act on behalf of the seller in the state. What remains unclear is the extent to which activities of independent contractors in a state will subject an out-of-state seller to use tax collection responsibilities.” (Internal quotation marks omitted.)

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See 2 J. Hellerstein & W. Hellerstein, ¶ 19.02 [3] [a - c] for further discussion regarding the effect of the more-recent decision *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992) on *National Bellas Hess*.

“continuous local solicitation.” *Id.*, 211.

There is no question that SBC and the participating teachers have a satisfying symbiotic relationship. But to conclude that these relationships, drawn from school classrooms, amount to the teachers being “representatives,” carries the matter constitutionally too far.

The Michigan Court of Appeals in *Scholastic Book v. Dept. of Treasury*,¹¹ *supra*, 567 N.W.2d 695-96, also rejected the argument that the teachers supplied a physical presence, relying on the *Quill* decision.

Accordingly, judgment may enter in favor of the plaintiff, sustaining its appeals, without costs to either party.

Henry S. Cohn, Judge

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See *id.*, 696 (“[i]n the absence of plaintiff’s physical presence in Michigan, the substantial nexus with this state necessary to satisfy the Commerce Clause does not exist. Because no such substantial nexus exists, the department may not, under the constitution, impose upon plaintiff the obligation to collect Michigan use taxes on the goods purchased by residents of this state. We therefore affirm the decision of the trial court”).