
Barnes & Noble.com Gets Booked for Failing to Collect Use Taxes

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In August 2002, Barnes & Noble.com became the latest on-line bookseller to be targeted successfully by California for use tax liability. It now joins Borders Online on a growing list of Internet retailers that California and other states have sought to tax based solely on their business relationships with in-state brick-and-mortar companies.

State governments traditionally have had difficulty imposing their sales and use taxes on out-of-state (sometimes referred to as "remote") Internet retailers because the United States Supreme Court has ruled in *Quill Corp. v. North Dakota* (1992), that a state can impose these taxes only on businesses that have a "physical presence" within the state. States are further hampered by the Internet Tax Freedom Act, in which Congress declared that the mere presence within a state of an Internet retailer's server is insufficient to justify the state's sales and use taxation of the retailer. For a discussion of the Internet Tax Freedom Act, see our Internet Alerts of [August 1, 1999](#), [October 26, 2001](#) and [November 20, 2001](#).

Under this framework, Internet retailers typically have been able to sell products into states in which they maintain no physical presence without having to charge their customers sales or use taxes. A growing coalition of state governments and brick-and-mortar businesses therefore has argued that Internet retailers, like mail-order retailers, enjoy an unfair competitive

advantage over brick-and-mortar businesses, which must collect sales and use taxes often on the very same products sold by their Internet competitors.

While continuing to press for a Congressional grant of authority to tax remote Internet retailers, states like California, New York, and Arkansas have simultaneously asserted, with increasing regularity, that remote Internet retailers may in any event be subject to sales and use taxation if they utilize agents or other representatives that have an in-state physical presence. In effect, these states have argued that, for sales and use tax purposes, Internet retailers that utilize in-state agents and representatives should have the physical presence of these agents and representatives attributed to them. For a discussion of the Arkansas statute which takes this position, see our [June 26, 2001 Internet Alert](#).

Following in this trend, in *The Petition for Redetermination of Barnes & Noble.com*, No. 89872 (Sept. 12, 2002), the California Board of Equalization ruled that Barnes & Noble.com, which apparently had no independent physical presence in California, nevertheless had to collect California use taxes because it was selling items in California with the help of an in-state representative, Barnes & Noble Booksellers ("Booksellers"). Booksellers operates several brick-and-mortar stores within California, where it indisputably has a physical presence.

More specifically, California alleged that Barnes & Noble.com arranged to have Booksellers place \$5 Barnes & Noble.com coupons in promotional shopping bags that had the "Barnes & Noble" logo printed on one side and the "bn.com" logo printed on the other side. Booksellers then distributed these coupons and bags to customers that made purchases in Bookseller's California stores.

Under these circumstances, the Board of Equalization held that Barnes & Noble.com, through its relationship with Booksellers, had a sufficient physical presence within California to justify taxation of its sales to

California customers: "In this case, petitioner had a substantial physical presence in California through the many places of business and employees of Booksellers, the petitioner's authorized representative in this state for the purpose of selling tangible personal property."

The apparent fate of Barnes & Noble.com is somewhat similar to that of Borders Online. Last year, the California Board of Equalization ruled that Borders Online, which again had no direct physical presence within California, was required to collect California use taxes solely because its affiliate, Borders, Inc., had agreed to have its brick-and-mortar stores accept returns of merchandise purchased online in exchange for either cash or store credit. See *The Petition for Redetermination of Borders Online, Inc.*, No. 56270 (Sept. 26, 2001).

Nevertheless, despite the outcomes of these two recent cases, it may not be entirely bleak for Internet retailers. Not all states have been successful pursuing the types of agency claims that California made in *Barnes & Noble.com* and *Borders Online*. See, e.g., *Bloomington's v. Dept. of Revenue*, 527 Pa. 347, *cert. denied*, 504 U.S. 955 (1992); and *SFA Folio Collections, Inc. v. Bannon*, 217 Conn. 220, *cert. denied*, 501 U.S. 1223 (1991), in which the acceptance of returns by in-state affiliates was ignored where they were not shown to be significant in quantity and where the in-state affiliates had independent business reasons for accepting returns. Moreover, both Barnes & Noble.com and Borders Online are expected to appeal the determination of the California Board of Equalization.

Yet, the California cases do make it more clear than ever that Internet retailers must exercise extreme caution in states in which their affiliates have a direct physical presence. States like California can be expected to scrutinize all relationships to determine whether the Internet retailer has an in-state physical presence through the actions of an agent, a representative, or otherwise.

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