

**MULTISTATE CORPORATE INCOME TAX:
NEXUS AND PUBLIC LAW 86-272**

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1. PUBLIC LAW 86-272.

Jurisdiction to tax is not present where a state is prohibited from imposing its tax because the corporation's activities do not exceed the standard of mere solicitation of sales established by Public Law 86-272. Public Law 86-272 provides in pertinent part:

No state, or political subdivision thereof, shall have power to impose, . . . a net income tax on the income derived within such state by any person from intrastate commerce if the only business activities within such state by or on behalf of such a person during the taxable year are either, or both, of the following...

1. The solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside of the state; ...and

2. The solicitation of orders by such a person, or his representative, in such State in the name of or for the benefit of a prospective customer of such a person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

States are thus prevented under Public Law 86-272 from taxing out-of-state corporations on income derived from business activities within the state if their activities are limited to "mere solicitation of orders" for the sale of tangible personal property and the orders are approved and filled from outside the state. If the standard of mere solicitation of orders is not exceeded in a destination state, the throw-back rule will apply to such sales. On the other hand, if the standard is exceeded, the sales would not be subject to the throw-back rule.

2. MULTISTATE TAX COMMISSION ON PUBLIC LAW 86-272

The member states of the Multistate Tax Commission have promulgated guidelines with respect to the application of P.L. 86-272. Following are the salient points from Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States under Public Law 86-272, third revision adopted July 27, 2001.

Arizona has promulgated its own ruling on Public Law 86-272. It is based on the Multistate Tax Commission guidelines with several notable changes: consignment sales under certain circumstances will not be an unprotected activity; shipping or delivering goods into Arizona by means of a private vehicle will not be an unprotected activity; and Arizona follows the *Finnigan/Airborne Navigation Rule* rather than the *Joyce Rule*. Arizona's Public Law 86-272 guidelines are found in Arizona Corporate Tax Ruling, CTR 99-5. Arizona's changes from the Multistate Tax Commission guidelines are noted below.

I

NATURE OF PROPERTY BEING SOLD

Only the solicitation to sell personal property is afforded immunity under P.L. 86-272; therefore, the leasing, renting, licensing or other disposition of tangible personal property, or transactions involving intangibles, such as franchises, patents, copyrights, trademarks, service marks, and the like, or any other type of property are not protected activities under P.L. 86-272.

The sale or delivery and the solicitation for the sale or delivery of any type of service is not either (1) ancillary to solicitation or (2) otherwise set forth as a protected activity under the Section IV.B. hereof is also not protected under P.L. 86-272 or this ruling.

II

SOLICITATION OF ORDERS AND ACTIVITY ANCILLARY TO SOLICITATION

For the in-state activity to be protected activity under P.L. 86-272, it must be limited solely to *solicitation* (except for *de minimis* activities described in Article III and those activities conducted by independent contractors described in Article V, below). Solicitation means (1) speech or conduct that explicitly or implicitly invites an order; and, (2) activities that neither explicitly nor implicitly invite an order, but are entirely ancillary to requests for an order.

Ancillary activities are those activities that serve no independent business function for the seller

apart from their connection to the solicitation of orders. Activities that a seller would engage in apart from soliciting orders shall not be considered as ancillary to the solicitation of orders. The mere assignment of activities to sales personnel does not, merely by such assignment, make such activities ancillary to solicitation of orders. Additionally, activities that seek to promote sales are not ancillary because P.L. 86-272 does not protect activity that facilitates sales, it only protects ancillary activities that facilitate the request for an order. The conducting of activities not falling within the foregoing definition of solicitation will cause the company to lose its protection from a net income tax afforded by P.L. 86-272, unless the disqualifying activities, taken together, are either *de minimis* or are otherwise permitted by this ruling.

III

DE MINIMIS ACTIVITIES

De minimis activities are those that, when taken together, establish only a trivial connection with the taxing state. An activity conducted within a taxing state on a regular or systematic basis or pursuant to a company policy (whether such policy is in writing or not) shall normally not be considered trivial. Whether or not an activity consists of a trivial or non-trivial connection with the state is to be measured on both a qualitative and quantitative basis. If such activity either qualitatively or quantitatively creates a nontrivial connection with the taxing state, then such activity exceeds the protection of P.L. 86-272. Establishing that the disqualifying activities only account for a relatively small part of the business conducted within the taxing state is not determinative of whether a *de minimis* level of activity exists. The relative economic importance of the disqualifying in-state activities, as compared to the protected activities, does not determine whether the conduct of the disqualifying activities within the taxing state is inconsistent with the limited protection afforded by P.L. 86-272.

IV

SPECIFIC LISTING OF UNPROTECTED AND PROTECTED ACTIVITIES

The following two listings (IV.A and IV.B) set forth the in-state activities that are presently treated by the signatory state as "Unprotected Activities" or "Protected Activities."

The state has included on the list of "Protected Activities" those in-state activities that are either required protection under P.L. 86-272, or, if not so required, that the state, in its discretion, has permitted protection. The mere inclusion of an activity on the listing of "Protected Activities," therefore, is not a ruling or admission by the state that said activity is required any protection under the Public Law.

A. UNPROTECTED ACTIVITIES

The following in-state activities (assuming they are not of a *de minimis* level) are not considered as either solicitation of orders or ancillary thereto or otherwise protected under P.L. 86-272 and will cause otherwise protected sales to lose their protection under the Public Law.

1. Making repairs or providing maintenance or service to the property sold or to be sold.
2. Collection of current or delinquent accounts, whether directly or by third parties, through assignment or otherwise.
3. Investigating credit worthiness.
4. Installation or supervision of installation at or after shipment or delivery.
5. Conducting training courses, seminars or lectures for personnel other than personnel involved only in solicitation.
6. Providing any kind of technical assistance or service including, but not limited to, engineering assistance or design service, when one of the purposes thereof is other than the facilitation of the solicitation of orders.
7. Investigating, handling, or otherwise assisting in resolving customer complaints, other than mediating direct customer complaints when the sole purpose of such mediation is to ingratiate the sales personnel with the customer.
8. Approving or accepting orders.
9. Repossessing property.
10. Securing deposits on sales.
11. Picking up or replacing damaged or returned property.
12. Hiring, training, or supervising personnel, other than personnel involved only in solicitation.
13. Using agency stock checks or any other instrument or process by which sales are made within this state by sales personnel.
14. Maintaining a sample or display room in excess of two weeks (14 days) at any one location within the state during the tax year.
15. Carrying samples for sale, exchange or distribution in any manner for consideration or other value.
16. Owning, leasing, using, or maintaining any of the following facilities or property in-state:
 - a. Repair shop.

- b. Parts department.
 - c. Any kind of office other than an in-home office as described as permitted under IV.A.18 and IV.B.2.
 - d. Warehouse.
 - e. Meeting place for directors, officers, or employees.
 - f. Stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation.
 - g. Telephone answering service that is publicly attributed to the company or to employees or agent(s) of the company in their representative status.
 - h. Mobile stores, i.e., vehicles with drivers who are sales personnel making sales from the vehicles.
 - i. Real property or fixtures to real property of any kind.
17. Consigning stock of goods or other tangible personal property to any person, including and independent contractor, for sale.
 [Arizona Version] Consigning a stock of goods or other tangible personal property to any person, unless: (1) The in-state presence of the consignment inventory is a requirement of a contract with an in-state customer; and (2) The consignment inventory is located on the in-state customer's property.
18. Maintaining by any employee or other representative, an office or place of business of any kind (other than an in-home office located within the residence of the employee or representative that (i) is not publicly attributed to the company or to the employee or representative of the company in an employee or representative capacity, and (ii) so long as the use of such office is limited to soliciting and receiving orders from customers, for transmitting such orders outside the stated for acceptance or rejection by the company, or for such other activities that are protected under P.L. 86-272 or under paragraph IV.B of this ruling).

A telephone listing or other public listing within the state for the company or for an employee or representative of the company in such capacity or other indications through advertising or business literature that the company or its employee or representative can be contacted at a specific address within the state shall normally be determined as the company maintaining within this state an office or place of business attributable to the company or to its employee or representative in a representative capacity. However, the normal distribution and use of business cards and stationery identifying the employee's or representative's name, address, telephone and fax numbers, and affiliation with the company shall

not, by itself, be considered as advertising or otherwise publicly attributing an office to the company or its employee or representative.

The maintenance of any office or other place of business in this state that does not strictly qualify as an "in-home" office as described above shall, by itself, cause the loss of protection under this ruling. For the purpose of this subsection it is not relevant whether the company pays directly, indirectly, or not at all for the cost of maintaining such in-home office.

19. Entering into franchising or licensing agreements, selling or otherwise disposing of franchises and licenses, or selling or otherwise transferring tangible personal property pursuant to such franchise or license by the franchiser or licensor to its franchisee or licensee within the state.
20. Shipping or delivering goods into this state by means of private vehicle, rail, water, air or other carrier, is irrespective of whether a shipment or delivery fee or other charge is imposed, directly or indirectly, upon the purchaser.
21. Conducting any activity not listed in paragraph IV.B. below which is not entirely ancillary to requests for orders, even if such activity helps to increase purchases.

B. PROTECTED ACTIVITIES

The following in-state activities will not cause the loss of protection for otherwise protected sales:

1. Soliciting orders for sales by any type of advertising.
2. Soliciting of orders by an in-state resident employee or representative of the company, so long as such person does not maintain or use any office or other place of business in the state other than an "in-home" office as described in IV.A.18. above.
3. Carrying samples and promotional materials only for display or distribution without charge or other consideration.
4. Furnishing or setting up display racks and advising customers on the display of the company's products without charge or other consideration.
5. Providing automobiles to sales personnel for their use in conducting protected activities.
6. Passing orders, inquiries, and complaints on to the home office.
7. Missionary sales activities; i.e., the solicitation of indirect customers for the company's goods. For example, a manufacturer's solicitation of retailers to buy the

manufacturer's goods from the manufacturer's wholesale customers would be protected if such solicitation activities are otherwise immune.

8. Coordinating shipment or delivery without payment or other consideration and providing information relating thereto either prior or subsequent to the placement of an order.
9. Checking of customers' inventories without a charge therefor (for re-order, but not from other purposes such as quality control).
10. Maintaining a sample or display room for two weeks (14 days) or less at any one location within the state during the tax year.
11. Recruiting, training, or evaluating sales personnel, including occasionally using homes, hotels, or similar places for meetings with sales personnel.
12. Mediating direct customer complaints when the purpose thereof is solely for ingratiating the sales personnel with the customer and facilitating requests for orders.
13. Owning, leasing, using, or maintaining personal property for use in the employee's or representative's "in-home" office or automobile that is solely limited to the conducting of protected activities. Therefore, the use of personal property such as a cellular telephone, facsimile machine, duplicating equipment, personal computer, and computer software that is limited to the carrying on of protected solicitation and activity entirely ancillary to such solicitation or permitted by this ruling under paragraph IV.B. shall not, by itself, remove the protection under this ruling.
[Arizona Version] Shipping or delivering goods into this state by means of common carrier, contract carrier, private vehicle, or by any other method or carrier, irrespective of whether a shipment or delivery fee or other charge is imposed, directly or indirectly, upon the purchaser.
14. [Arizona Version] Consigning inventory to an in-state customer if: (1) The in-state presence of the consignment inventory is a requirement of a contract the in-state customer; and (2) The consignment inventory is located on the in-state customer's property.

V

INDEPENDENT CONTRACTORS

P.L. 86-272 provides protection to certain in-state activities if conducted by an independent contractor that would not be afforded if performed by the company or its employees or other representatives. Independent contractors may engage in the following limited activities in the state without the company's loss of immunity:

1. Soliciting sales.
2. Making sales.
3. Maintaining an office.

Sales representatives who represent a single principal are not considered to be independent contractors and are subject to the same limitations as those provided under P.L. 86-272 and this ruling.

Maintenance of a stock of goods in the state by the independent contractor under consignment or any other type of arrangement with the company except for purposes of display and solicitation is not a protected activity.

VI

APPLICATION OF DESTINATION STATE LAW IN CASE OF CONFLICT

When it appears that two or more sales have included or will include the same receipts from a sale in their respective sales factor numerators, this state may review what law, regulation, or written guideline, if any, has been adopted in the state of destination with respect to the issue. The state of destination shall be that location at which the purchaser or its designee actually receives the property, regardless of f.o.b. point or other condition of sale.

In determining which state is to receive the assignment of the receipts at issue, preference shall be given to any clearly applicable law, regulation, or written guideline that has been adopted in the state of destination. However, except in the case of the definition of what constitutes "tangible personal property," this state is not required by this ruling to follow any other state's law, regulation, or written guideline should this state determine that to do so (i) would conflict with its own laws, regulations, or written guidelines, and (ii) would not clearly reflect the income-producing activity of the company within this state.

Notwithstanding any provision set forth in this ruling to the contrary, as between this state and any other state, this state will apply the definition of "tangible personal property" that exists in the state of destination to determine the application of P.L. 86-272 and issues of throwback, if any. Should the state of destination not have any applicable definition of such term then this state shall treat such property in a manner that will clearly reflect the income-producing activity of the company within this state.

VII

MISCELLANEOUS PRACTICES

A. APPLICATION OF STATEMENT RULING TO FOREIGN COMMERCE

P.L. 86-272 specifically applies, by its terms, to "interstate commerce" and does not directly apply to foreign commerce. The state may, however, apply the same standards set forth in the Public Law and in this ruling to business activities in foreign commerce to ensure that foreign and interstate commerce are treated on the same basis. Such an application also avoids the necessity of expensive and difficult efforts in the identification and application of the varied jurisdictional laws and rules existing in foreign countries.

This state will apply the provisions of P.L. 86-272 and of this ruling to business activities conducted in foreign commerce. Therefore, whether business activities are conducted by (i) a foreign or domestic company selling tangible personal property into a country outside of the United States from a point within this state, or by (ii) either company selling such property into this state from a point outside of the United States, the principles under this ruling apply equally to determine whether the sales transactions are protected and the company immune from taxation in either this state or in the foreign country, as the case may be, and whether, if applicable, this state will apply its throwback provisions.

B. APPLICATION TO CORPORATION INCORPORATED IN STATE OR TO A PERSON RESIDENT DOMICILED IN STATE

The protection afforded by P.L. 86-272 and the provisions of this ruling do not apply to any corporation incorporated within this state or to any person who is a resident of or domiciled in this state.

C. REGISTRATION OR QUALIFICATION TO DO BUSINESS

A company that registers or otherwise formally qualifies to do business within this state does not, by that fact alone, lose its protection under P.L. 86-272. Where, separate from or ancillary to such registration or qualification, the company receives and seeks to use or protect any additional benefit or protection from this state through activity not otherwise protected under P.L. 86-272 or this ruling, such protection shall be removed.

D. LOSS OF PROTECTION FOR CONDUCTING UNPROTECTED ACTIVITY DURING PART OF THE YEAR

The protection afforded under P.L. 86-272 and the provisions of this ruling shall be determined on a tax year by tax year basis. Therefore, if at any time during a tax year the company conducts activities that are not protected under P.L. 86-272 or this ruling, no sales in this state or income earned by the company attributed to this state during any part of said tax year shall be protected from taxation under said Public Law or this ruling.

E. APPLICATION OF THE JOYCE RULE

In determining whether the activities of any company have been conducted within this state beyond the protection of P.L. 86-272 or paragraph IV.B. of this Statement, the principle established in *Appeal of Joyce, Inc., Cal. St. Bd. Of Equal. (11/23/66)*, commonly known as the "Joyce Rule", shall apply. Therefore, only those in-state activities that are conducted by or on

behalf of said company shall be considered for this purpose. Activities that are conducted by any other person or business entity, whether or not said person or business entity is affiliated with said company, shall not be considered attributable to said company, unless such person or business entity was acting in a representative capacity on behalf of said company.

F. [ARIZONA VERSION] APPLICATION OF THE *FINNIGAN/AIRBORNE NAVIGATION RULE*

Pursuant to the principle reported in *Airborne Navigation Corporation v. Arizona Department of Revenue*, Feb. 5, 1987, CCH Ariz. Tax Reports, Paragraph 200-744, when a group of companies is conducting a unitary business and a part of that unitary business is conducted within this state, the activities of all members of the unitary group will be included in both the numerator and denominator of the sales factor.

3. THE WRIGLEY CASE

The U.S. Supreme Court addressed for the first time the solicitation limitations of P.L. 86-272 in *Wisconsin Department of Revenue v William Wrigley, Jr.*, 505 U.S. 214, 112 S.Ct. 2447 (1992). The Supreme Court's decision addressed two points. (1) what is the scope of protected solicitation; and (2) *a de minimis* exception.

3.1 WHAT IS PROTECTED SOLICITATION?

The extent of the protection afforded by P.L. 86-272 depends largely on the interpretation of the phrase "solicitation of orders," which the statute does not define.

The Supreme Court began its analysis by referring to the dictionary definition of "solicitation." It found that the term includes not only explicit verbal requests for orders, but also "any speech or conduct that implicitly invites an order." The Court saw the key question to be "whether, and to what extent, 'solicitation of orders' covers activities that neither explicitly nor implicitly propose a sale".

The Court rejected Wisconsin's argument that "solicitation of orders" should be construed narrowly, covering only the ultimate act of inviting an order. This limited definition would render P.L. 86-272 meaningless. Moreover, the Court noted, "this extremely narrow interpretation of 'solicitation' would cause P.L. 86-272 to leave virtually unchanged the law that existed before its enactment." Under the definition of solicitation proffered by Wisconsin, the decisions in *Brown Forman* and *International Shoe* would, today, remain unchanged--not the result that Congress intended when it enacted P.L. 86-272.

The Court also rejected Wrigley's interpretation of solicitation: any activities that were "ordinary and necessary business activities' accompanying the solicitation process" or were "routinely associated with deploying a sales force to conduct the solicitation..." Wrigley's routinely-associated-with standard was overly broad because it looked beyond a particular activity (solicitation) to all activities routinely carried on by those who engage in that particular activity (salesmen). The Court also concluded that Wrigley's approach was unworkable because it

permitted solicitation to be whatever a particular industry wanted. This would render P.L. 86-272 "toothless."

The Court concluded that only "those activities that are *entirely ancillary* [emphasis in original] to requests for purchases--those that serve no independent business function apart from their connection to the soliciting of orders" (as opposed to "those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force") fall within the immunity afforded by P.L. 86-272. The Court stated that, for example, providing a car and a stock of free samples to salesmen is part of the solicitation process; employing salesmen to repair or service the company's products is not.

3.2 DE MINIMIS RULE

The Court declined to conclude that, as Wisconsin suggested, all post-sale activities were necessarily beyond the scope of solicitation of orders. Although activities that take place after a sale ordinarily are not "entirely ancillary" to requests for purchases, the Court was not prepared to say this was always true. Moreover, the Court found the presale/post-sale distinction to be unworkable. Manufacturers and distributors ordinarily have ongoing relationships with their customers that involve continuous sales, making it difficult to determine whether a particular activity was related to the sale that preceded or followed it.

The Wisconsin Supreme Court had applied *a de minimis* standard, holding that a company does not necessarily forfeit immunity under P.L. 86-272 merely because it performed some in-state activities that exceeded solicitation. The U.S. Supreme Court agreed. Under the standard articulated by the Court, however, activities not ancillary to requesting purchases will subject a foreign seller to tax only if the activity creates "a nontrivial additional connection with the taxing State."

3.3 SPECIFIC ACTIVITIES ADDRESSED

In applying its newly established guidelines to Wrigley, the Court focused its attention on six specific activities engaged in by Wrigley's Wisconsin representatives:

Not protected:

1. Replacing stale gum.
2. Supplying gum through agency stock checks.
3. Storing gum, display racks, and promotional materials.
4. Renting storage space.

Protected:

5. Recruiting, training, and evaluating employees.
6. Intervening in credit disputes.
7. In state sales meetings.

The Court found that replacing stale gum, supplying gum through agency stock checks, storing

gum, and renting storage space were not ancillary to requests for purchases. In the Court's view, these activities served an independent business purpose separate and apart from requesting orders. On the other hand, the Court concluded that in-state recruitment, training, and evaluation of employees, intervention in credit disputes, and the use of in-state locations for sales meetings served no purpose other than to facilitate solicitation.

Since the Court concluded that Wrigley had engaged in activities that were not ancillary to requesting orders, the Court considered whether its *de minimis* exception applied. The Court concluded that the activities in question were not *de minimis*. The Court noted that Wrigley's sales representatives engaged in non-immune activities on a continuing basis as a matter of company policy.

4. PUBLIC LAW 86-272 - CASES

4.1 DE MINIMIS ACTIVITIES

Kelly-Springfield Tire Co. v. Bajorski, 635A. 2d 771 (Conn. 1993). *Multistate corporations that sold motor vehicle and truck tires to dealers throughout the United States was immune from the Connecticut corporation business tax under Public Law 86-272, because its Connecticut activities were de minimis.* The taxpayer had registered to transact business in Connecticut, but did not maintain any inventory nor owned any real property in the state. The taxpayer's Connecticut business operations were carried out through the services of one or more local sales representatives whose sole authority was the solicitation of orders from tire dealers. The taxpayer's only other operational presence consisted of annual visits by its credit manager to the taxpayers' accounts in the state. The Commissioner of Revenue failed to establish that the taxpayer's activities in the state were more than *de minimis* so that they were not within the terms of P.L. 86-272 and, therefore, the state was precluded from imposing a corporation business tax on the intrastate activities of the taxpayer.

The Upjohn Company, et al, v. State of Arizona Department of Revenue, Tax Court, TX-1997-0000438 (October 18, 2001). *Court held that: Public Law 86-272 does not protect Upjohn from Arizona corporate income taxation because its activities exceeded protected "solicitation of sales" and was not "de minimis."* The Court observed that Public Law 86-272 in short precludes a state from imposing its income tax on an out of state business whose only activities in the state are "solicitation of sales." The Department argued that three types of Upjohn's conduct went beyond the mere solicitation of sales, thereby subjecting Upjohn to state income tax. The Department argued that Upjohn tested drugs in Arizona before they were marketed. However, the court found that Upjohn did not conduct testing in Arizona. Upjohn's sales representatives, in addition to soliciting sales, provided customers with product information and treatment suggestions, checked the customers' stock and informed them when stock had expired, provided customers with forms to exchange the expired stock and forwarded customers' complaints to the home office. In emergency situations, sales representatives transferred products between hospitals. The court concluded that the sales representatives' activities facilitated the "requesting of sales" and served no independent business function apart from the solicitation of orders. Thus, this activity did not go beyond the protected activity of "solicitation of sales." The education MSLs consulted with people in the medical education field and suggested ways to train and

assist physicians in diagnosis, treatment and care. The science MSLs exchanged information about medical developments, discussing basic medical research that needed to be done in potential studies with medical leaders in that area to develop new products. The court concluded that these activities have an independent business purpose other than the solicitation of sales in that the activities of the MSLs facilitate research and product development. The court thus concluded that the activities were not ancillary to the solicitation of sales, nor were they performed by sales representatives. The court further concluded that the activities of the MSLs were significant and, therefore, do not qualify as de minimis contacts with the state (which will not result in taxation), thereby subjecting Upjohn to Arizona income tax.

4.2 CONSTRUCTION AND APPLICATION OF “SOLICITATION OF ORDERS”

***Amgen Inc. v. Mass. Com'r. of Rev.*, 427 Mass. 357, 693 N.E. 2d 175, 1998 Mass. LEXIS 179 (April 23, 1998).** *Drug company's sales force exceeded "solicitation of orders" by reviewing patient charts and answering questions about use and dosage of company's products for specific patients.*

***Kennametal Inc. v. Mass. Com'r. of Rev.*, 118 S. Ct. 1386, 1998 U.S. LEXIS 2319, 140 L. Ed. 2d 646; petition for writ of certiorari denied, 426 Mass. 39, 686 N.E. 2d 163 (April 6, 1998).** *Sales force exceeded "solicitation of orders" by providing technical information to customers and assisting customers in determining what product to order.*

***National Private Truck Council v. Corn 'r. of Rev.*, 426 Mass. 324, 688 N.E. 2d 936 (1997).** *Massachusetts regulation which limited immunity only to delivery by common carrier, and not taxpayer's own trucks, was invalid.*

***National Private Truck Council v. Virginia*, 253 Va. 74, 1997 Va. LEXIS 12, 480 S.E. 2d 500 (January 10, 1997).** *The same result was reached by The Virginia Supreme Court in this case as in the Massachusetts.*

***Alcoa Bldg. Prods. Inc. v. Comm'r*, 440 Mass. 224 (2003).** *Certain Warranty Services are Not Ancillary to Solicitation and are Not de minimis.* Alcoa, an Ohio corporation, manufactured and sold building products. Although it never maintained a place of business in Massachusetts, it employed 4-5 district sales managers (hereinafter DSMs) who, in addition to soliciting sales, participated in the warranty process. After completing sales, they consistently visited construction sites to investigate warranty claims, assisted customers in completing paperwork for defective products, and remitted defective product samples. The court held that Alcoa had reason to provide these warranty services if it had no sales force in Massachusetts and, therefore, the DSM's warranty activities served some independent business purposes. Specifically, the warranty services served to increase Alcoa's general sales, enhance its reputation among buyers, and possibly decrease the amount of direct calls to its warranty claims office. Further, the court noted that post-sale activities that are apart from the solicitation of orders will “ordinarily not be entirely ancillary to the solicitation of orders.” *Id.* at 228. The court also held that the warranty activities constituted a “nontrivial additional connection to the Commonwealth” due to the DSM's activities, taken as a whole, and because these claims comprised more than one-third of

the corporation's nationwide claims. *Id.* at 231. Alcoa was therefore ordered to pay, in addition to the minimum excise tax, the additional corporate excise taxes for the 1994-1996 tax years.

In re *Westward Seafoods, Inc.*, No. 35-OTA-2000, 2004 Alas. Tax LEXIS 1 (Dep't of Revenue Jan. 6, 2004). *Approving and Accepting Orders, Resolving Customer Complaints, and Hiring and Training Personnel are Unprotected Activities When They are Not de minimis.* Westward Seafoods (hereinafter WSI), an Alaskan corporation, produced and exported food products. It exported one of its food products, surmi, to its corporate owner and primary customer in Japan, Maruha. The Alaska Department of Revenue (hereinafter DOR) needed to determine whether Japan had jurisdiction to tax WSI in order to determine whether to preclude the DOR from taxing the corporation. In order for the court to make this determination, it had to determine whether WSI's activities on behalf of Maruha in Japan exceeded those protected by P.L. 86-272 and whether to attribute those activities to WSI.¹ The court determined that WSI exceeded the solicitation of orders based on the following three factors. First, Mr. Kuramoto, a WSI salesman, made seven trips to Japan during 1994-1995 where he negotiated sales terms and accepted orders. Second, two WSI plant managers traveled to Japan in 1995 to investigate and resolve customer complaints. The Plant Managers did not engage in the solicitation of orders but rather addressed serious customer concerns. Third, WSI employed 12-13 surmi technicians to supervise its production of surmi who, according to a contract, Maruha recruited and trained in Japan. Therefore, according to the Multistate Tax Commission, WSI engaged in unprotected activities by approving and accepting orders, resolving customer complaints, and hiring and training personnel. Further, even though WSI sent the Plant Managers to Japan on only one occasion, the court determined that it was not *de minimis* because of WSI's strategy to market its seafood products to Japanese customers.

Consequentially, the court held that the DOR could not apply the throwback rule for the purpose of apportioning WSI sales in Japan to Alaska.

Colgate-Palmolive Co. v. Comm'r, No. C255116, 2003 Mass. Tax LEXIS 27 (Appellate Tax Bd. Apr. 3, 2003). *Certain Product Demonstrations, "In-Service" Demonstrations, and Troubleshooting Activities are Not Protected Activities.* Colgate, a Delaware corporation, owned Kendall, a Delaware corporation with its principle place of business in Massachusetts, during the tax year in question (1988). Kendall employed account managers and product specialists in 33 states that frequently (1) conducted product demonstrations in hospitals; (2) accompanied doctors and nurses into operating rooms, providing "in-service" advice regarding the proper use of Kendall products; and (3) conducted troubleshooting activities, such as investigating claims of product malfunctions, assisting customers in filling out forms, remitting samples to Kendall's quality assurance department, and withdrawing defective products from the shelves. The court found that Kendall's activities were very similar to three cases where courts determined that these activities exceed the solicitation of orders and, therefore, came to the same conclusion. First, the product demonstrations were very similar to the activities in *Kennametal*, where the sales force provided technical information to customers and assisted customers in selecting products to order. *Kennametal, Inc. v. Commissioner*, 20 Mass. App. Tax Bd. Rep. 6, 8 (1996). Second, the "in-service" demonstrations were very similar to the activities in *Amgen*, where the sales force reviewed patient charts and answered questions about the proper use of

¹ See discussion *infra* Part IV.A.2 where the court attributed WSI's activities on behalf of Maruha to WSI.

pharmaceutical products. *Amgen Inc. v. Commissioner*, 427 Mass. 357 (1998). Third, the troubleshooting activities were very similar to the activities in *Alcoa*, where the sales force investigated warranty complaints and assisted customers in resolving their complaints. *Alcoa Building Products, Inc. v. Commissioner*, 2002 ATB Adv. Sh. 402, *aff'd*, 440 Mass. 224 (2003). Therefore, Kendall's activities in each of the jurisdictions were sufficient to subject it to taxation in those states because its activities went beyond the solicitation of orders. Consequentially, the court held that the Commissioner could not apply the throwback rule, treating Kendall's sales in the 33 states as Massachusetts sales.

Ill. Dep't of Revenue Priv. Ltr. Rul. IT-05-0003-GIL (Jan. 24, 2005), 2005 Ill. PLR LEXIS 3. *Making Repairs and Providing Maintenance or Service to the Property Sold or to be Sold are Unprotected Activities.* The Illinois Department of Revenue (hereinafter DOR) issued a non-binding General Information Letter in response to a Wisconsin corporation's inquiry as to whether it was subject to Illinois income tax due to its furniture retail activities by independent contractors in Illinois. The corporation retailed furniture to customers in southeastern Wisconsin and northern Illinois and employed independent contractors to deliver the furniture to Illinois customers and repair the furniture upon customer's requests. The DOR determined that the corporation engaged in unprotected activities according to the Illinois Income Tax Regulations (hereinafter IIT) and therefore was not protected by P.L. 86-272. The IIT Regulations provide a list of unprotected activities, including "making repairs or providing maintenance or service to the property sold or to be sold." ILL. ADMIN. CODE tit. 86, § 100.9720(c)(4) (2005). Further, the Illinois regulation protected independent contractors from soliciting sales, making sales, and maintaining an office, which did not include making repairs or providing installation services upon delivery.

Mo. Dep't of Revenue Priv. Ltr. Rul. LR2257 (Dec. 17, 2004), 2004 Mo. Tax Ltr. Rul. LEXIS 82. *Selling Tangible Personal Products Via the Internet is a Protected Activity.* The Missouri Department of Revenue issued a binding Letter Ruling in response to an out-of-state corporation's inquiry as to whether it would be subject to Missouri income tax if it sold nutritional products via the internet. The corporation, which had no physical presence in Missouri, was considering a proposed agreement to post its website link on various Missouri retailer's websites in exchange for commission payments on each purchase routed through their websites. The court held that the corporation's activities did not exceed the protections of P.L. 86-272 and, therefore, it was not required to remit sales and use tax, pay income tax, or file a franchise tax return with the state of Missouri according to state law, the Commerce Clause and P.L. 86-272.

4.3 CONSTRUCTION AND APPLICATION OF "INCOME TAX"

***Bantam Doubleday Dell Publ'g v. Dep't of the Treasury*, No. 243672, 2004 Mich. App. LEXIS 588 (Ct. App. Feb. 24, 2004).** *P.L. 86-272 Does Not Apply to Michigan's Single Business Tax Because it is Not a Tax Upon Income but Rather Upon the Privilege of Doing Business in the State.* Bantam, a Delaware corporation with its principle place of business in New York, published and sold books. It employed two sales representatives to solicit orders and administer its cooperative advertising reimbursement program in Michigan and had no place of business in the state. Bantam's activities in Michigan did not exceed the solicitation of orders

according to P.L. 86-272. The court held that the restrictions in P.L. 86-272 did not apply to Michigan's Single Business Tax Act and therefore required that Bantam pay the tax. Although it did not discuss the reasons for its holding, the court affirmed *Gillette Co. v. Mich. State Dep't of Treasury*, 198 Mich. App. 303 (Ct. App. 1993), which held that the single business tax was a "consumption-type value added tax" that was imposed upon the "privilege of doing business and not upon income." *Id.* at 308-309. P.L. 86-272 thus did not apply to Michigan's Single Business Tax because P.L. 86-272 imposed requirements concerning the imposition of net income tax while the single business tax was not a tax imposed upon net income. Further, although Bantam merely solicited orders in Pennsylvania, this was sufficient to meet the single business tax requirement that a foreign corporation engage in "business activity" in the state.

***INOVA Diagnostics, Inc. v. Strayhorn*, No. 03-04-00503-CV, 2005 Tex. App. LEXIS 4002 (App. May 26, 2005).** *P.L. 86-272 Does Not Apply to the Capital Component of the Texas Franchise Tax Because it is a Tax Upon the Privilege of Doing Business in the State.* INOVA, a California corporation, developed and manufactured products for medical testing. It employed one salesman in Texas whose activities included visiting existing and prospective customers, providing promotional materials, and demonstrating INOVA products. Both parties agreed that, for the purposes of providing protection under P.L. 86-272, INOVA only engaged in the solicitation of orders in Texas. The Texas state franchise tax imposed tax on net capital and earned surplus. Since earned surplus tax was measured by net income, the Comptroller only imposed the franchise tax on net capital. The court interpreted P.L. 86-272 (hereinafter the Act) narrowly, holding that the Act did not apply to the capital component of the Texas franchise tax and requiring INOVA to pay the tax. The court looked at the legislative history and past case interpretation of the Act and determined that Congress did not intend to exempt taxes that used net income as only one factor in calculating another tax. In a footnote, the court cited language of the Senate report stating, "We are not here considering licensing or fees which might truly set up barriers to interstate commerce." *Id.* at *17. According to the court, the purpose of the franchise tax was to "impose a tax upon corporations for the privilege of doing business in the state" and, in order to assess this tax, the capital component used net income as one, distant factor. Specifically, taxable capital was the stock value plus surplus, surplus was the net assets minus capital and was also equal to retained earnings, and retained earnings equaled current net income plus income over time. *Id.* at *13.

***Drummond Am. Corp. v. Commonwealth*, 2004 Pa. Tax LEXIS 2656; 944 Fed. Reg. 2004 (Commw. Ct. 2004).** *P.L. 86-272 Does Not Apply to the Pennsylvania Franchise Tax Assessment of Capital Stock Because it is a Tax Upon the Privilege of Doing Business in the State.* Drummond, an Illinois corporation, wholesaled chemical products. The corporation employed independent contractors to solicit sales in Pennsylvania but did not have a place of business or lease or own any real property in the state. Drummond's activities in Pennsylvania likely did not exceed the solicitation of orders according to P.L. 86-272. The court held that P.L. 86-272 did not apply to the 2000 Pennsylvania Franchise Tax and therefore required Drummond to pay the tax. Although the state based the tax on its assessment of a corporation's capital stock, the court declared that it was not a tax on income but rather a tax on the privilege to conduct business within the state. *Id.* at *21-*22 (*citing Clairol, Inc. v. Commonwealth*, 513 Pa. 74 (1986)). Therefore although Drummond may have merely solicited orders in Pennsylvania, this was sufficient to meet the franchise tax requirement that a foreign corporation have an "active

presence” in the state. *Id.* at *22. The court also held that it was irrelevant that Drummond used independent contractors instead of traditional employees because P.L. 86-272 did not apply in this case and because the Pennsylvania Franchise Tax made no distinction between categories of employees.

Home Impressions, Inc. v. Dir., Div. of Taxation, 21 N.J. Tax 448 (Tax Ct. 2004). *The Restrictions of P.L. 86-272 do Not Apply to the New Jersey Minimum Flat Tax Because it is Not Based on Net Income.* Home Impressions, a North Carolina corporation, manufactured and sold mailboxes and mailbox posts. It employed independent contractors to solicit orders in New Jersey and never maintained a place of business in the state. Home Impression’s activities in New Jersey did not exceed the solicitation of orders according to P.L. 86-272. The court held that P.L. 86-272 did not apply to New Jersey’s Minimum Flat Tax, a franchise tax, and therefore required that Home Impressions pay the tax. Although the corporation merely solicited orders in New Jersey, the court determined that this was sufficient to meet the flat tax requirement that a foreign corporation conduct business in the state. Further, although the Division of Taxation Director required that the corporations submit accounting records, he did not use the records to assess taxes based on net income but to identify the activities of corporations doing business in the state. The court also determined that the company’s use of independent contractors instead of traditional employees did not present a constitutionally significant distinction under the Commerce Clause or the Due Process Clause. Specifically, the independent contractor’s activities provided a sufficient nexus to the state under the Commerce Clause and sufficient minimum contacts under the Due Process Clause.

4.4 CONSTRUCTION AND APPLICATION OF “TANGIBLE PERSONAL PROPERTY”

Ill. Dep’t of Revenue Priv. Ltr. Rul. IT-03-0026-GIL (Aug. 13, 2003), 2003 Ill. PLR LEXIS 185. *Transportation Services are Not Afforded Immunity Under P.L. 86-272 Because They are Transactions Involving Intangible Property.* The Illinois Department of Revenue (hereinafter DOR) issued a non-binding General Information Letter in response to a Michigan corporation’s inquiry as to whether it was subject to Illinois income tax due to its transportation services through and within Illinois. The court held that P.L. 86-272 did not protect the corporation, thereby subjecting it to Illinois income tax, because the corporation sold intangibles by providing transportation services. Specifically, the court held that the DOR could allocate a portion of the corporation’s income because the corporation generated revenue miles in Illinois.

4.5 CONSTRUCTION AND APPLICATION OF “ON BEHALF OF”

1. UNITARY BUSINESSES

In re Disney Enters. No. 818378, 2004 N.Y. Tax LEXIS 21, (Div. of Tax Appeals Feb. 12, 2004). *A State May Tax a Corporation’s Activities if the Activities Arise Out of a Unitary Business That Has a Sufficient Nexus to the State.* Disney Enterprises (formerly the Walt Disney Corporation) was the parent corporation of a unitary group and was indisputably required to pay New York’s corporation franchise tax. In 1993, the Walt Disney Corporation requested, and the New York Division of Taxation agreed, that it would file New York combined reports with all of

its active subsidiaries. Even without Disney's desire to file a combined report, the court determined that, due to the interdependent nature of Disney and its three subsidiaries in this case, New York law required that they file such a report so that it did not distort its New York income. The court then determined, based on New York law, P.L. 86-272, and the Commerce Clause, that Disney must include the sales receipts from unitary group members in their New York receipts for the purpose of assessing New York franchise taxes. First, the court held that New York law required Disney to include its subsidiary's destination sales in its receipts simply because they were part of its unitary group. It stated, "The very status of being part of the combined group provides the justification for the imposition of New York corporation franchise tax on the fruits of their economic activity in New York, as measured by New York's reasonable apportionment formula as prescribed by statute and regulation." *Id.* at *62. Second, the court concluded that P.L. 86-272 permitted this outcome because Disney performed unprotected activities in New York "on behalf of" their unitary members. *Id.* at *66. The three subsidiaries and unitary members, Buena Vista Home Video, Childcraft, Inc. and The Walt Disney Catalog, Inc., shipped tangible personal property to New York and, therefore, their activities did not exceed the solicitation of orders. However, the court discovered that Disney and its subsidiaries shared management responsibilities and that the subsidiaries clearly benefited from the unprotected activities within New York, such as product promotions in many New York Disney Stores. Third, the court held that the Commerce Clause did not forbid this outcome because New York's apportionment formula included the subsidiaries' income in its preapportioned tax base and, therefore, it was not "extraterritorial taxation." *Id.* at *67-*68 (quoting *Shell Oil Co. v. Iowa Dept. of Revenue*, 488 U.S. 19, 30-31 (1988)).

In re *Alpharma, Inc.*, No. 817895, 2004 N.Y. Tax LEXIS 158 (Tax Appeals Tribunal Aug. 5, 2004). *Unitary Apportionment is Constitutional, Rendering P.L. 86-272 Inapplicable to New York's Apportionment Scheme* Alpharma, the parent company of the various unitary members in this case, manufactured pharmaceuticals for the animal health industry and sold fine chemicals. It did not lease or own any business property or equipment in New York during the years in question (1993-1995) but employed a sales representative (Mr. Wagner), the head of corporate information technology, to conduct business activities in New York. In 1992, Alpharma requested permission to file a combined return for New York franchise tax purposes, describing itself as a parent company comprised of divisions. New York Division of Taxation granted the petition based on Mr. Wagner's activities in New York. Even without Alpharma's desire to file a combined report, the court determined that, due to the "overwhelming synergy" between the companies in this case, New York law required a combined tax return in order to avoid a distorted computation of income to the state. *Id.* at *10-*11. The court then determined, based on New York law and the Commerce Clause, that Alpharma must include sales receipts from unitary group members for the purpose of assessing New York franchise taxes. The court then held that P.L. 86-272 did not apply to New York's unitary apportionment scheme because unitary apportionment was constitutional. *Id.* at *53-*54 (citing *Shell Oil*, 488 US 19). The court also stated that New York's use of unitary apportionment for the purpose of assessing a franchise tax did not violate P.L. 86-272 because the franchise tax was not based on net income. It described the relationship between the unitary group's income tax and New York's franchise tax in the following way. The apportionment formula combines the net income of the unitary group, which properly reflects the taxpayer member's tax liability by referencing the in-state activities of the unitary group. Further, the unitary group's inclusion of sales in the numerator of the

receipts factor does not impose taxes upon nontaxpayer members of the group but rather determines the appropriate business allocation percentage. The formula itself, therefore, does not give New York jurisdiction to tax.

2. OTHER TYPES OF AGENCY

In re *Westward Seafoods, Inc., No. 35-OTA-2000, 2004 Alas. Tax LEXIS 1 (Dep't of Revenue Jan. 6, 2004)*. *A Corporation's Unprotected Activities on Behalf of a Customer who is Essentially a Middleman-Distributor are Activities on Behalf of Itself*. WSI, incorporated in Alaska with its headquarters and sales offices in Seattle, exported surimi to Maruha, its owner and primary customer in Japan. An Alaska regulation provides that Alaska will treat a foreign country like any other state when it determines its jurisdiction to tax, including its application of P.L. 86-272 to a foreign country. Although, pursuant to a treaty, Japan did not tax WSI, the Alaska Department of Revenue (hereinafter DOR) needed to determine whether Japan theoretically had jurisdiction to tax WSI in order to determine whether Alaska was precluded from taxing the corporation. This issue turned on whether WSI's activities on behalf of Maruha in Japan exceeded those protected by P.L. 86-272 and whether the court could attribute the activities to WSI.² After the court determined that WSI's activities in Japan exceeded the solicitation of orders, it attributed these activities to WSI based on the following factors. Contrary to the opinion of the DOR, Mr. Kuramoto did not work for Maruha but rather for WSI. He lived and worked in Seattle for ten years and WSI paid his salary and travel expenses. Additionally, his activities served the independent business purpose of planning for WSI's production because the prices he negotiated with Maruha customers established the price that Maruha would pay WSI. Additionally, two plant managers addressed serious concerns of Maruha customers in Japan in order to promote WSI's strategy of marketing its seafood products to Japanese customers. Lastly, it was important to WSI's production and marketing strategy that Maruha recruit and train the Japanese surimi technicians. Therefore, following the Multistate Tax Commission's list of unprotected activities and P.L. 82-272, the court considered WSI's unprotected activities on behalf of Maruha as activities on behalf of itself because Maruha was essentially a middleman-distributor.

4.6 MEASUREMENT YEAR TO DETERMINE P.L. 86-272 APPLICABILITY

LSDHC Corp. v. Ziano, 98 Ohio St. 3d 450 (2003). *P.L. 86-272 Does Not Prohibit a State From Imposing a Tax, Measured by Net Income, Based on a Corporation's Unprotected Activities During Its Prior Fiscal Year*. LSDHC, a Delaware corporation, maintained a customer service center in Ohio during part of its fiscal year prior to the 1993 calendar year. LSSC, also a Delaware corporation, maintained certain assets in Ohio during part of its fiscal year prior to the 1994 calendar year. The court held that the Ohio Tax Commissioner was correct to assess corporate franchise tax, measured by net income, for the calendar year based on the corporation's fiscal year before the calendar year. It reasoned that, for franchise tax purposes, the time period to determine P.L. 86-272's applicability must be the same as the time period for measuring net

² See discussion *supra* Part I.B where the court determined that WSI's activities exceeded the solicitation of orders.

income. Therefore, the court required LSDHC and LSSC to pay Ohio's franchise tax because their activities exceeded the solicitation of orders during the fiscal years before the calendar years in question. Specifically, the court required that LSDHC pay the franchise tax for 1993, based on its former fiscal year's adjusted net income (July 1 1991 - June 30 1992), and LSSC to pay the franchise tax for 1994, based on its former fiscal year's adjusted net income (July 1 1992 - June 30 1993).

4.7 MERITLESS ATTEMPTS TO INVALIDATE TAX BASED ON P.L. 86-272

Sea & L, LLC, No. 213225, 2004 Cal. Tax LEXIS 52 (State Bd. of Equalization Feb. 18, 2004). *California Taxpayers Will be Subject to Late Penalties and Interest Charges if They Base Their Decision Not to Pay State Taxes on an Unreasonable Belief That P.L. 86-272 Provides an Exemption.* Sea & L, a Delaware corporation and an LLC, employed two members that solicited contracts in California and then performed the contracts outside of California (the record does not reveal the nature of the contracts or the work). The corporation believed that its activities were protected under P.L. 86-272 and so did not pay the annual California LLC tax for corporations doing business in the state. The court held that the corporation had to pay a California LLC tax with interest and late fees for 1998 and 1999 because it unreasonably believed that its activities were protected under P.L. 86-272. Regarding late payments, the court stated that, in order to find reasonable cause why a taxpayer should not have to pay a late payment penalty, "the law must be unclear or ambiguous such that there is reasonable doubt as to how the legal issue will ultimately be resolved." *Id.* at *8. Further, in California, the "standard of ordinary business care" obligated the taxpayer to spend the necessary time to acquaint himself with California law requirements. *Id.* Regarding interest charges, the court stated that it would only relinquish a taxpayer from paying interest where there was an unreasonable error or delay by an employee of the Franchise Tax Board in performing "a ministerial or managerial act." *Id.* at *12. The court held that, although Sea & L maintained a good faith belief that it was not subject to the tax, the belief was not sufficiently reasonable for two reasons. First, it was clear that the annual LLC tax was not based on net income because, regardless of the net income of the corporation, the state assessed corporations \$800. Second, Sea & L's business description did not reasonably fall into the description of protected business activities in P.L. 86-272. Specifically, the corporation did not solicit orders for tangible property from a point outside the state, it did not send the orders outside the state for approval, and it did not fill the orders by shipping tangible property into California.

Judgment of July 17, 2003, 2003 Tex. Tax LEXIS 115, (Comptroller of Public Accounts) (hearing No. 36, 728; hearing No. 40, 439). *The Throwback Rule is Not Unconstitutional.* A Texas corporation regularly shipped goods to various states and claimed that sales receipts of these items should not be thrown back to Texas. In this hearing, the Comptroller of Public Accounts of the State of Texas did not divulge the name of the Texas corporation or its specific business activities but denied the corporation's contentions that the throwback rule was unconstitutional and that it "violates the spirit and policies underlying P.L. 86-272 [by imposing a] franchise tax on net income outside the state."

