

Application and Interpretation of Public Law 86-272

State of California – Franchise Tax Board

Guide to Jurisdictional Standards Under the Uniform Division of Income Tax Purposes Act

Introduction

California signed a resolution adopting the “Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272.” It is the policy of the State signatories to that document to impose their net income tax, subject to state and federal legislative limitations, to the fullest extent constitutionally permissible. Interpretation of the solicitation of orders standard in Public Law (P.L.) 86-272 requires a determination of the fair meaning of that term in the first instance. The United States Supreme Court has recently established a standard for interpreting the term “solicitation” and this Statement has been revised to conform to such standard. (*Wisconsin Department of Revenue v. William Wrigley, Jr., Co.* (1992) 505 U.S. 214, 112 S.Ct.2447.) In those cases where there may be reasonable differences of opinion as to whether the disputed activity exceeds what is protected by P.L. 86-272, the signatory states will apply the principle that the preemption of the state taxation that is required by P.L. 86-272 will be limited to those activities that fall within the “clear and manifest purpose of Congress.” See *Department of Revenue of Oregon v. ACF Industries, Inc., et al.*, 510 U.S. 332, 114S.Ct. 843, 127 L. Ed.2d 165 (1994), *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 112 S.Ct. 2608, 120 E.Ed.2d 407, 422 (1992); *Heublein Inc. v. South Carolina Tax Com.*, 409 U.S. 275, 281-282(1972).

The following information reflects the signatory states’ current practices with regard to: (1) whether a particular factual circumstance is considered under P.L. 86-272 or permitted under this Statement as either protected or not protected from taxation by reason of P.L. 86-272; and (2) the jurisdictional standards that will apply to sales made in another state for purposes of applying a throwback rule (if applicable) with respect to such sales. It is the intent of the signatory states to apply this Statement uniformly to factual circumstances, irrespective of whether such application involves an analysis for jurisdictional purposes in the state into which such tangible personal property has been shipped or delivered or for throwback purposes in the state from which such property has been shipped or delivered.

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 that 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 Statement.

II. Solicitation of Orders and Activities Ancillary to Solicitation

For the in-state activity to be a 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 under this Statement.

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 non-trivial 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.” Such listings may be subject to an amendment by addition or deletion that appears on the individual signatory state’s signature page attached to this Statement

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

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 P.L. 86-272:

1. Making repairs or providing maintenance or service to the property sold or to be sold.
2. Collecting 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 agents of the company in their representative status.
 - h. Mobile stores, 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 an independent contractor, for sale.
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 state 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 Statement).

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, 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 Statement.

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 franchisor or licensor to its franchisee or licensee within the state.
20. 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 and 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 therefore (for re-order, but not for 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 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 Statement under paragraph IV.B. shall not, by itself, remove the protection under this Statement.

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 Statement.

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, shall remove the protection.

VI. Application of Destination State Law In Case of Conflict

When it appears that two or more signatory states have included or will include the same receipts from a sale in their respective sales factor numerators, at the written request of the company, said states will in good faith confer with one another to determine which state should be assigned said receipts. Such conference shall identify 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 freight on board point or other conditions 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 state of

destination. However, except in the cases of the definition of what constitutes "tangible personal property," this state is not required by this Statement 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 Statement to the contrary, as between this state and any other signatory state, this state agrees to 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 so that it could be reasonably determined whether the property at issue constitutes "tangible personal property," then each signatory state may treat such property in any manner that would clearly reflect the income-producing activity of the company within said state.

VII. Miscellaneous Practices

A. Application of Statement to Foreign Commerce.

P.L. 86-272 specifically applies, by its terms, to "interstate commerce" and does not directly apply to foreign commerce. For purposes of P.L. 86-272, "interstate commerce" includes commerce between the 50 states and The Commonwealth of Puerto Rico.

B. Application to Corporation Incorporated in State or to Person Resident or Domiciled in State.

The protection afforded by P.L. 86-272 and the provisions of the Statement 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 Statement, such protection shall be removed.

D. Loss of Protection for Conducting Unprotected Activity during Part of Tax Year.

The protection afforded under P.L. 86-272 and the provisions of this Statement 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 Statement, 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 P.L. or this Statement.

E. Application of the **Throwback Rule**.

In the *Appeal of Finnigan Corporation*, 88-SBE-022, August 25, 1988, the State Board of Equalization (SBE) ruled that the word taxpayer, as used in Revenue & Taxation Code Section 24135(b)(2), means "all of the corporations within the unitary group." Therefore, the SBE held that when sales were shipped from California to another state by a member of a group conducting a unitary business in California, the throwback rule did not apply if **any** corporations within the unitary group is taxable in the other state. In the *Appeal of Finnigan Corporation*, Opn. On Pet. For Rehg., 88-SBE-022A, January 24, 1990, the SBE expressly overruled the apportionment rule announced in the *Appeal of Joyce, Inc.*, 66-SBE-070, November 23, 1966, that

the income attributable to the California activities of a corporation exempt from taxation by this state because of P.L. 86-272 had to be separately computed by application of the apportionment method and then excluded from the measure of the franchise tax. In practice, the *Joyce* rule was accomplished by excluding from the numerator of the apportionment formula, but not the denominator, the California factors of the corporations, within the unitary group that were not themselves taxable by this state. Under *Finnigan*, this restriction no longer applied.

In the *Appeal of Huffy Corporation*, 99-SBE-005, April 22, 1999, the SBE ruled that the apportionment method announced in *Joyce* should be applied to taxable years beginning on or after April 22, 1999, on a prospective basis. Thus, for those taxable years, the income attributable to the California activities of a corporation exempt from taxation by this state because of P.L. 86-272 must be separately computed by application of the apportionment formula and then excluded from the measure of the franchise tax. In practice, the *Joyce* rule is accomplished by excluding from the numerator of the apportionment formula, but not the denominator, the California factors of the corporations within the unitary group that were not themselves taxable by this state.

For taxable years beginning on or after January 1, 2011, California reverts back to the *Finnigan* rule. For purposes of determining which sales are included in the California sales factor numerator, sales delivered or shipped to a purchaser in California will be included in the numerator if any member of the combined reporting group is taxable in California. Sales delivered or shipped to a purchaser outside of California will be assigned to California if no member of the combined reporting group is taxable in the state of destination.

Accordingly, the Franchise Tax Board's administrative practice with respect to multi-entity apportionment formula rules is as follows:

For Taxable Years Beginning Before April 22, 1999 and for Taxable Years Beginning on or After January 1, 2011.

1. Sales of goods shipped from California to other states are to be assigned to this state under the throwback rule only when no member of the seller's unitary group is taxable within the destination state.
2. The California property, payroll, and sales of each corporation within a unitary group will be taken into account in the apportionment of business income to this state, including amounts attributable to entities exempt from taxation in this state because of P.L. 86-272. The total business income thus apportioned to California will be assigned to the individual corporations taxable by this state by use of the "revised method" currently authorized by Legal Ruling 234.

For Taxable Years Beginning on or After April 22, 1999 and for Taxable Years Beginning Before January 1, 2011.

1. Sales of goods shipped from California to other states are to be assigned to this state under the throwback rule only when the selling corporation is itself not taxable within the destination state.
2. The California property, payroll, and sales of those corporations within a unitary group that are taxable in this state will be taken into account in the apportionment of business income to this state. The total business income thus apportioned to California will be assigned to the individual corporations taxable by this state by use of the "revised method" currently authorized by Legal Ruling 234.

Internet and Telephone Assistance

Website: ftb.ca.gov

Telephone: 800.852.5711 from within the United States
916.845.6500 from outside the United States

TTY/TDD: 800.822.6268 for persons with hearing
or speech impairments