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Date: 02.14.2022

Technical Advice Memorandum: 2022-01

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Requested Date: 08/02/2021
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SUBJECT: Determining whether the protections of 15 U.S.C. Sections 381-384 (Public Law ["PL"] 86-272) apply to fact patterns that are common in the current economy due to technological advancements for purposes of California income and franchise tax.

QUESTIONS PRESENTED

General: For all fact patterns below, the business at issue makes sales to California customers, is commercially domiciled outside of California, and has no other activities in California other than those mentioned in the fact pattern. The issue in each fact pattern is whether the business has exceeded the protections of PL 86-272. The general analysis is: (1) Are there business activities taking place in California; and (2) Do those activities exceed the protection of PL 86-272 such that the business becomes subject to California income or franchise tax?

(1) Business A has an employee who telecommutes on a regular basis from within California performing business management and accounting tasks.

(2) Business B regularly provides post-sale assistance to California customers via either electronic chat or email that customers initiate by clicking on an icon on the business's website. For example, the business regularly advises customers on how to use products after they have been delivered.

(3) Business C solicits and receives on-line applications for its branded credit card via the business's website from California customers. The issued cards will generate interest income and fees for the business.

(4) Business D has a website that invites viewers in California to apply for non-sales positions with Business D. The website enables viewers to fill out and submit an electronic application, and also to upload a cover letter and resume.

(5) Business E places Internet "cookies" onto the computers or other electronic devices of California customers. These "cookies" gather customer search information that will be used to adjust production schedules and inventory amounts, develop new products, or identify new items to offer for sale.

(6) Business F remotely fixes or upgrades products previously purchased by California customers by transmitting code or other electronic instructions to those products via the Internet.

(7) Business G offers and sells extended warranty plans via its website to California customers who purchase the business's products.

(8) Business H contracts with a marketplace facilitator that facilitates the sale of business's products on the facilitator's on-line marketplace. The marketplace facilitator maintains inventory, including some of the business's products, at fulfillment centers in various states where the business's customers are located.

(9) Business I contracts with California customers to stream videos and music to electronic devices for a charge.

(10) Business J provides post-sale assistance to California customers by posting a list of static Frequently Asked Questions ("FAQs") with answers on the business's website.

(11) Business K places Internet "cookies" onto the computers or other devices of California customers. These cookies gather customer information that is only used for purposes entirely ancillary to the solicitation of orders for tangible personal property, such as: to remember items that customers have placed in their shopping cart during a current web session, to store personal information customers have provided to avoid the need for the customers to re-input the information when they return to the seller's website, and to remind customers what products they have considered during previous sessions. The cookies perform no other function, and these are the only types of cookies delivered by the business to its customers' computers or other electronic devices.

(12) Business L offers for sale only items of tangible personal property on its website. The website enables customers to search for items, read product descriptions, select items for purchase, choose among delivery options, and pay for items. The business does not engage in any in-state business activities that are not described here.

CONCLUSIONS

(1) Unless the activities of the employee telecommuting from California on a regular basis constitute solicitation of orders for sales of tangible personal property or are entirely ancillary to solicitation, these activities would cause Business A to lose protection of PL 86-272. These are business activities in California as an employee works from within the state, and the activities are non-sales activities, therefore the protection of PL 86-272 is lost.

(2) The activity of Business B in California disqualifies the business from PL 86-272 immunity because the activity does not constitute, and is not entirely ancillary to, the in-

state solicitation of orders for sales of tangible personal property. There is business activity in California because Business B is providing live chat and email through the website available to customers through computers or other electronic devices located in California. This post-sales activity is not solicitation or ancillary to solicitation as the sale has already taken place.

(3) The activity of Business C disqualifies the business from PL 86-272 immunity in California because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property. The business activity in California is making applications for credit cards available to California customers via the Internet through computers and other electronic devices located in California. This business activity exceeds solicitation as offering to provide credit to customers is an activity outside of seeking to make orders of tangible personal property in California. In addition, funds loaned through the credit cards would not be limited to purchases of tangible personal property and may not be limited to purchases from Business C.

(4) The activity of Business D in California disqualifies the business from PL 86-272 immunity in California because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property. The business activity in California is providing access to job applications, allowing upload of applications, cover letters and resumes through computers or other electronic devices located in California. This business activity exceeds solicitation as it involves human resource outreach to fill jobs that are not limited to sales.

(5) The activity of Business E in California disqualifies the business from PL 86-272 immunity because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property. The business activity in California is the inserting of cookies into computers or other electronic devices of California customers. This activity exceeds solicitation as gathering information for purposes of adjusting production schedules and inventory amounts, developing new products, or identifying new items to offer for sale are not activities related to facilitating a sale of tangible personal property.

(6) The activity of Business F disqualifies the business from PL 86-272 immunity because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property. The business activity in California is the transmittal of code or other electronic instructions to a computer or other electronic device located in California. This business activity exceeds solicitation as providing repairs or upgrades to previously sold products are not activities related to facilitating the request for orders for sales of tangible personal property, but rather are post-sales activities.

(7) The activity of Business G constitutes selling, or offering to sell, a service that is not entirely ancillary to facilitating the request for orders for sales of tangible personal property. In addition, PL 86-272 immunity only applies to sales of tangible personal property. Sales of extended warranties are not sales of tangible personal property but rather are sales of intangible property and therefore are not activities within the protection of PL 86-272. Accordingly, Business G has business activities in California by offering extended warranties

for sale to California customers, and this activity exceeds solicitation of orders of tangible personal property and disqualifies the business from PL 86-272 immunity.

(8) The activity of Business H disqualifies the business from PL 86-272 immunity because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property. The business activity is the maintaining of inventory within California. This activity exceeds solicitation of orders for sales of tangible personal property as it amounts to consignment of stock of goods to another person, including an independent contractor, for purposes of sale.

(9) The activity of Business I disqualifies the business from PL 86-272 immunity because streaming does not constitute the sale of tangible personal property for purposes of PL 86-272. The immunity provided by PL 86-272 only applies to sales of tangible personal property. Sales of digital video and music streaming are not sales of tangible personal property but rather are services and thus are not activities within the protection of PL 86-272. Accordingly, Business I has business activities in California by offering streaming services for sale to California customers, but this activity exceeds solicitation of orders of tangible personal property and defeats Business I's PL 86-272 immunity.

(10) The activity of Business J does not disqualify the business from PL 86-272 immunity because it does not constitute a business activity within California. Viewing of static FAQs through the internet does not provide the requisite interaction between the California customer and Business J and is similar to reading a pamphlet on a product.

(11) The activity of Business K does not disqualify the business from PL 86-272 immunity because it is entirely ancillary to the in-state solicitation of orders for sales of tangible personal property. This business activity is in California because Business K downloads cookies onto computers or other electronic devices located in California. However, since these business activities are entirely ancillary to solicitation, Business K remains protected by PL 86-272.

(12) The activity of Business L does not disqualify the business from PL 86-272 immunity because the business engages exclusively in in-state activities that either constitute solicitation of orders for sales of tangible personal property or are entirely ancillary to such solicitation. This business activity is in California due to the interaction between the website, including the download of "cookies," and the customer's computer or other electronic device located in California. However, this business activity does not exceed solicitation of orders for tangible personal property and therefore Business L remains protected by PL 86-272.

APPLICABLE LAW:

15 U.S.C. Sections 381-384 (PL 86-272).

ANALYSIS AND DISCUSSION

Congress adopted PL 86-272 in 1959. PL 86-272 prohibits a state from imposing a net income tax on the income of a person derived within the state from interstate commerce if the only business activities within the state conducted by or on behalf of the person consist

of the solicitation of orders for sales of tangible personal property. The protections provided by PL 86-272 only apply to orders that are sent outside of the state for acceptance or rejection. If the orders are accepted, they must be filled by shipment or delivery from a point outside the state to maintain PL 86-272 immunity.

In the decades since PL 86-272 was enacted, the way in which interstate business is conducted has changed significantly. Congress, however, has neither created a federal mechanism to provide administrative guidance to taxpayers nor has it updated the statute to indicate how it applies to new business activities. (See *Wisconsin Department of Revenue v. William Wrigley, Jr. Co.* (1992) 505 U.S. 214, 223.)

The guiding principle is that sovereign authority of states to impose tax will not be preempted unless it is the "clear and manifest purpose of Congress" to do so. (*Dept. of Revenue of Oregon v. ACF Industries, Inc.* (1994) 510 U.S. 332, 345; See also *Heublein, Inc. v. South Carolina Tax Comm'n* (1972) 409 U.S. 275, 281 [noting that Congress must convey "its purpose clearly" or "it will not be deemed to have significantly changed the Federal State Balance."])

The United States Supreme Court recently opined, in *South Dakota v. Wayfair, Inc.*, construing the Commerce Clause, that an Internet seller "may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term." (138 S. Ct. 2080, 2095 (2018).) Although the United States Supreme Court was not interpreting PL 86-272 in *Wayfair*, California considers the Court's analysis as to virtual contacts to be relevant to the question of whether a seller is engaged in business activities in states where its customers are located for purposes of PL 86-272.

Finally, PL 86-272 not only affects the determination of whether a state into which tangible personal property is delivered (the "destination state") may tax the income of the seller, but it also affects the determination of whether the state from which tangible personal property is shipped (the "origin state") may subject the related receipts to that state's throwback rule. This would apply irrespective of whether the destination state is determining if it can tax the income of the seller, or whether the origin state is determining if the related receipts are subject to that state's throwback rule.

To determine whether a seller of tangible personal property via the Internet is shielded from taxation by PL 86-272 requires the same general analysis as sellers of tangible personal property by other means. Thus, an Internet seller is shielded from taxation in the customer's state if the only business activity it engages in within that state is the solicitation of orders for sales of tangible personal property, which orders are sent outside that state for approval or rejection, and if approved, are shipped from a point outside of that state.