DEPARTMENT OF STATE REVENUE

02-20120309.LOF

Letter of Findings Number: 02-20120309
Income Tax
For Tax Year 2010

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ISSUE

I. Income Tax–Adjusted Gross Income Tax.

Authority: Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992); 15 U.S.C. § 381; Indiana Dept. of Revenue v. Kimberly-Clark Corp., 416 N.E.2d 1264 (Ind. 1981); IC § 6-3-2-2; 45 IAC 3.1-1-38.

Taxpayer protests that its Indiana activities are protected by Public Law 86-272.

STATEMENT OF FACTS

Taxpayer is an out-of-state corporation. Taxpayer was assessed Indiana corporate income tax by the Indiana Department of Revenue ("Department"). Taxpayer protested the assessment. This Letter of Findings results from Taxpayer's protest. Further facts will be supplied as required.

I. Income Tax–Adjusted Gross Income Tax.

DISCUSSION

Taxpayer's protest letter states the following:

Per a discussion with a representative in the Corporate Tax Section... we were notified that the department has disallowed the above-referenced taxpayer's Public Law 86-272 (15 U.S.C.A. §381) claim for tax year ended 12/31/2010. The disallowance is the direct result of all 3 apportionment factors being present on Form IT-20, Schedule E. (Emphasis in the original).

Taxpayer references to Public Law 86-272 (15 U.S.C. § 381) in its protest letter; that law prohibits the states from imposing a net income tax on a foreign taxpayer if the foreign taxpayer's only business activity within that state is the solicitation of sales.

In Indiana, the adjusted gross income tax is imposed under IC § 6-3-2-2, which states in relevant part:

(a) With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

(1) income from real or tangible personal property located in this state;
(2) income from doing business in this state;
(3) income from a trade or profession conducted in this state;
(4) compensation for labor or services rendered within this state; and
(5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

Income from a pass through entity shall be characterized in a manner consistent with the income's characterization for federal income tax purposes and shall be considered Indiana source income as if the person, corporation, or pass through entity that received the income had directly engaged in the income producing activity. Income that is derived from one (1) pass through entity and is considered to pass through to another pass through entity does not change these characteristics or attribution provisions. In the case of nonbusiness income described in subsection (g), only so much of such income as is allocated to this state under the provisions of subsections (h) through (k) shall be deemed to be derived from sources within Indiana. In the case of business income, only so much of such income as is apportioned to this state under the provision of subsection (b) shall be deemed to be derived from sources within the state of Indiana. In the case of compensation of a team member (as defined in section 2.7 of this chapter), only the portion of income determined to be Indiana income under section 2.7 of this chapter is considered derived from sources within Indiana. In the case of a corporation that is a life insurance company (as defined in Section 816(a) of the Internal Revenue Code) or an insurance company that is subject to tax under Section 831 of the Internal Revenue Code, only so much of the income as is apportioned to Indiana under subsection (r) is considered derived from sources within Indiana.

Also of relevance is 45 IAC 3.1-1-38, which provides:

For apportionment purposes, a taxpayer is "doing business" in a state if it operates a business enterprise or activity in such state including, but not limited to:

(1) Maintenance of an office or other place of business in the state
(2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods
(3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated

vehicles where title to the goods passes at the time of sale or distribution
(4) Rendering services to customers in the state
(5) Ownership, rental or operation of a business or of property (real or personal) in the state
(6) Acceptance of orders in the state
(7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L.86-272 to tax its net income.

As stated in Regulation 6-3-2-2(b)(010) [45 IAC 3.1-1-37], corporations doing business in Indiana as well as other states are subject to the allocation and apportionment provisions of IC 6-3-2-2(b)-(n). (Emphasis added.)

Regarding Public Law 86-272, the Indiana Supreme Court in Indiana Dept. of Revenue v. Kimberly-Clark Corp., 416 N.E.2d 1264 (Ind. 1981) noted that "Public Law 86-272 (15 U.S.C.A. § 381)" states in part:

" * * *

(a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such 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 the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such 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)-"

Id. at 1265. The Indiana Supreme Court also noted in Kimberly-Clark Corp.:

We also believe that Congress perceived "solicitation" as embodying "sundry activities so long as those activities (are) closely related to the eventual sale of a product." Id. at 139, 386 A.2d at 478. Finally, when a corporate representative performs an "act of courtesy" in order to accommodate a customer, he has not ventured beyond the realm of "solicitation." Id.

The aforementioned activities of the petitioner in this case may be properly categorized as "inextricably related to solicitation," or as "acts of courtesy." As such, the exemption provided by Public Law 86-272 is applicable. Accordingly, the decision and opinion of the Court of Appeals are ordered vacated and the judgment of the trial court is affirmed.

Kimberly-Clark Corp., 416 N.E.2d at 1268.

The United States Supreme Court, in Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992), has also stated:

We proceed, therefore, to describe what we think the proper standard to be. Once it is acknowledged, as we have concluded it must be, that "solicitation of orders" covers more than what is strictly essential to making requests for purchases, the next (and perhaps the only other) clear line is the one between those activities that are entirely ancillary to requests for purchases-those that serve no independent business function apart from their connection to the soliciting of orders-and those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force. Cf. National Tires, Inc. v. Lindley, 68 Ohio App.2d 71, 78-79, 22 O.O.3d 69, 73-74, 426 N.E.2d 793, 798 (1980) (company's activities went beyond solicitation to "functions more commonly related to maintaining an on-going business"). Providing a car and a stock of free samples to salesmen is part of the "solicitation of orders," because the only reason to do it is to facilitate requests for purchases. Contrariwise, employing salesmen to repair or service the company's products is not part of the "solicitation of orders," since there is good reason to get that done whether or not the company has a sales force. Repair and servicing may help to increase purchases; but it is not ancillary to requesting purchases, and cannot be converted into "solicitation" by merely being assigned to salesmen. See, e.g., Herff Jones Co. v. State Tax Comm'n, 247 Or. 404, 412, 430 P.2d 998, 1001-1002 1967) (no § 381 immunity for sales representatives' collection activities).

Wrigley, 505 U.S. at 228-30 (internal footnotes omitted). The United States Supreme Court further explained:

By contrast, Wrigley's in-state recruitment, training, and evaluation of sales representatives and its use of hotels and homes for sales-related meetings served no purpose apart from their role in facilitating solicitation. The same must be said of the instances in which Wrigley's regional sales manager contacted the Chicago office about "rather nasty" credit disputes involving important accounts in order to "get the account and [Wrigley's] credit department communicating." App. 71, 72. It hardly appears likely that this mediating function between the customer and the central office would have been performed by some other employee-some company ombudsman, so to speak-if the on-location sales staff did not exist. The purpose of the activity, in other words, was to ingratiate the salesman with the customer, thereby facilitating requests for purchases. Finally, Wrigley argues that the various nonimmune activities, considered singly or together, are de minimis. In particular, Wrigley emphasizes that the gum sales through "agency stock checks" accounted for only 0.00007% of Wrigley's annual Wisconsin sales, and in absolute terms amounted to only several hundred

> dollars a year. We need not decide whether any of the nonimmune activities was de minimis in isolation; taken together, they clearly are not. Wrigley's sales representatives exchanged stale gum, as a matter of regular company policy, on a continuing basis, and Wrigley maintained a stock of gum worth several thousand dollars in the State for this purpose, as well as for the less frequently pursued (but equally unprotected) purpose of selling gum through "agency stock checks." Although the relative magnitude of these activities was not large compared to Wrigley's other operations in Wisconsin, we have little difficulty concluding that they constituted a nontrivial additional connection with the State. Because Wrigley's business activities within Wisconsin were not limited to those specified in § 381, the prohibition on net-income taxation contained in that provision was inapplicable.

Id. at 234-5. Thus Kimberly-Clark and Wrigley both explain that sales staff may engage in certain activities which may not be the strict solicitation of sales, but which aid in the solicitation of sales, and still enjoy the protection of P.L. 86-272.

Taxpayer also states in its protest letter that its "activities within the State of Indiana" were limited to sales solicited by a few resident salespeople, with the orders being "sent outside of the state for approval and were filled by shipment of delivery from a point outside of the state." Taxpayer then states, "This activity results in both the payroll and receipt factors." Regarding the property factor, Taxpayer states that the "resident salespeople were provided with company vehicles which were leased from a third party vendor." Further, Taxpayer states that it "maintained no business location within the State of Indiana." Taxpayer concludes, "It is our belief that the above activities do fall within the scope of Public Law 86-272 and that it was correct to show a 0.000[percent] apportionment percentage for tax year 2010."

Taxpayer's receipts and payroll factor for the apportionment schedule were from a few salespeople soliciting orders in Indiana; Taxpayer's property factor was from the leased vehicles for those salespeople; and finally, Taxpayer has no Indiana business location. The Department finds that based upon these facts Taxpayer's Indiana activities did not exceed solicitation. Given that Taxpayer's protest is being sustained, Taxpayer is also by extension sustained regarding the penalty and interest that it was assessed.

FINDING

Taxpayer's protest is sustained.

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