

# ARIZONA DEPARTMENT OF REVENUE

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## ARIZONA CORPORATE TAX RULING CTR 99-5

(This ruling supersedes Arizona Corporate Tax Ruling CTR 95-2)

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

### **ISSUE:**

What is the interpretation and application of Public Law 86-272 to activities of out-of-state taxpayers within this state?

### **APPLICABLE LAW:**

Public Law 86-272, 15 U.S.C. §§ 381-384, places restrictions on the imposition of income tax, by a state, on income of out-of-state companies with limited activity within the state.

*Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 112 S. Ct. 2447 (1992), provides additional guidance in the interpretation of Public Law 86-272.

*Airborne Navigation Corporation v. Arizona Department of Revenue*, Feb. 5, 1987, CCH Ariz. Tax Reports, Paragraph 200-744, provides for the attribution of sales by a corporation which does not itself conduct business in Arizona but which is part of a unitary group of corporations which operate in Arizona and file a combined return to Arizona.

### **DISCUSSION:**

Public Law 86-272 sets forth certain business activities which may be conducted within a state by an out-of-state business without subjecting income from those activities to the state's income tax provisions. This law has been interpreted in a number of court cases, including the U.S. Supreme Court decision in *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*

The Multistate Tax Commission, in an attempt to provide its members and other states with a uniform interpretation of Public Law 86-272, drafted a guideline of recommended practices regarding the interpretation of Public Law 86-272. Based on this guideline, Public Law 86-272 and related court cases, the department issued Corporate Tax Ruling CTR 95-2 which provided the state of Arizona's position regarding Public Law

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86-272. Public Law 86-272 applies only to those businesses engaged in the interstate commerce of selling tangible personal property; it does not apply to the sale of services.

### **RULING:**

Public Law 86-272, 15 U.S.C. §§ 381-384 (hereafter P.L. 86-272), restricts a state from imposing a net income tax on income derived within its borders from interstate commerce if the only business activity of the company within the state consists of the solicitation of orders for sales of tangible personal property, which orders are to be sent outside the state for acceptance or rejection, and, if accepted, are filled by shipment or delivery from a point outside the state. The term "net income tax" includes a franchise tax measured by net income. If any sales are made into a state which is precluded by P.L. 86-272 from taxing the income of the seller, such sales remain subject to throwback to the appropriate state which does have jurisdiction to impose its net income tax upon the income derived from those sales.

It is the policy of the State of Arizona to impose its net income tax, subject to state and federal legislative limitations, to the fullest extent constitutionally permissible. Interpretation of the solicitation of orders standard in P.L. 86-272 requires a determination of the fair meaning of that term in the first instance. The United States Supreme Court has established a standard for interpreting the term "solicitation" and this ruling has been drafted to conform to such standard. *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 112 S. Ct. 2447 (1992). 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, Arizona will apply the principle that the preemption of 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.*, 114 S. Ct. 843, 127 L. Ed. 2d 165 (1994); *Cipollone v. Liggett Group, Inc.*, 112 S. Ct. 2608, 120 L. Ed. 2d 407, 422 (1992); *Heublein, Inc. v. South Carolina Tax Com.*, 409 U.S. 275, 281-282 (1972).

The following information reflects the Arizona Department of Revenue's current practices with regard to: (1) whether a particular factual circumstance is considered under P.L. 86-272 or permitted under this ruling as either protected or not protected from taxation by reason of P.L. 86-272; and, (2) the jurisdictional standards which 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 department to apply this ruling 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.

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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 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; or (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 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

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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 State of Arizona 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. 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

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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.



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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.

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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 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'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.
14. 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.
15. 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.<sup>1</sup>

## **V**

### **Independent Contractors**



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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 states 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 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 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

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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 Person Resident or 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.

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#### **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 Tax 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 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.

Mark W. Killian, Director

Signed: May 25, 1999

#### **Explanatory Notice**

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law that are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, detail, or supplementary information concerning application of the law. Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax

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ruling. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.

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<sup>1</sup> Laws 1999, Ch. 191, § 1, effective August 6, 1999, unless revoked by referendum, and applicable to tax years beginning from and after December 31, 1998.