

# Net Income Tax Nexus Standard

In 1959, the U. S. Supreme Court, for the first time, held that a state could tax exclusively interstate commerce so long as the tax did not create any effect forbidden by the Commerce Clause. Northwestern concerned the constitutionality of a direct net income tax imposed on that portion of a non-domiciliary corporation's net income earned from, and fairly apportioned to, business activities within the taxing state, where such business activities were in furtherance of interstate commerce.

Immediately following the decision in Northwestern, the 86th Congress moved to limit the power of the states to impose a net income tax on income derived from interstate commerce. The Interstate Income Law, PL 86-272, was the result. Generally, the law prohibits any state from imposing an income tax on income derived from within the state from interstate commerce if the only business activity within the state consists of the solicitation of orders of tangible personal property by or on behalf of a corporation by its employees or representatives. The law also provided for a study to be made of all matters pertaining to state and local taxation of interstate commerce. After more than five years of study and hearings, the Special Subcommittee on State Taxation of Interstate Commerce introduced an Interstate Taxation Bill (H. R. 11798) embodying its recommendations. Hearings on this bill indicated that both the states and business had many objections to it. Since 1966 many versions of the Interstate Taxation Bill have been introduced but none has been enacted.

There would appear to be no question that the solicitation of orders in a taxing state by employees and representatives of a non-domiciliary corporation is sufficient to constitutionally subject that corporation to the imposition of a fairly apportioned, direct corporate net income tax. Public Law 86-272 protects only those businesses engaged in the sale of tangible personal property whose activities in the taxing state are limited to the solicitation of orders from the imposition of net income based taxes.

Public Law 86-272, provides:

No State, or political subdivision thereof, shall have power to impose, for any taxable year..., **a net income tax** on the income derived from 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:

- a. 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*

b. The solicitation of orders by such person, or his representative, in such State 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 a.”

There are many situations conceivable to which the limitations thus imposed may not apply, such as the income derived from services rendered in interstate commerce and sales of intangibles. For the in-state activity to be a protected activity, it must be limited solely to solicitation (except for de minimus activities and certain activities conducted by independent contractors). Solicitation means (1) speech or conducts 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 PL 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 PL 86-272, unless the disqualifying activities, taken together, are either de minimis or are otherwise permitted.

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 following 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 PL 86-272.

### **Differing Interpretations Between States**

The various states have slightly differing interpretations and standards of activity permitted under PL 86-272. Recent state Supreme Court cases in Virginia and Massachusetts are leading some states to recognize that delivery of goods by private vehicle, as referenced in item 20 above, is protected activity. Since the U. S. Supreme Court declined to hear an appeal of the Massachusetts case in May of 1998, other states are joining in the view that this activity fall within the statutory protections. The interpretation of de minimis activity is also subject to differing interpretations. It is also not entirely uncommon for a state to allow a business to conduct specified activities exceeding the limits of PL 86-272 either by statute, regulation or practice without subjecting the business to the state’s net income tax.

## Activities Protected From Net Income Taxation

Under PL 86-272 as interpreted by the Multistate Tax Commission, 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 certain "in-home" offices.
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 similarly 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 shall not, by itself, remove the protection under this Statement.

## Activities Not Protected Under PL 86-272

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 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 certain in-home offices.
  - 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 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 Public Law 86-272.
19. 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.
20. 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.
21. 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.
22. 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.

23. Shipping or delivering goods into this state by means of private vehicle, rail, water, air or other carrier, irrespective of whether a shipment or delivery fee or other charge is imposed, directly or indirectly, upon the purchaser. **No longer the MTC's position.**
24. Conducting any other activity which is not entirely ancillary to requests for orders, even if such activity helps to increase purchases.

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