



State of California
Franchise Tax Board

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12.05.12

CHIEF COUNSEL RULING 2012-07

Subject: Chief Counsel Ruling Request for ***** * ***** ***** and Subsidiaries

Dear M*. *****:

By letter dated September 7, 2011, you requested on behalf of your client, ***** *
***** ***** and Subsidiaries, CCN ***** , a Chief Counsel Ruling that its subsidiary, **
***** ***** Co., Inc., FEIN **-***** , is considered to be "doing business" in
California and has sufficient nexus so as to be required to file California corporate income or
franchise tax returns for tax years 2000 to 2010 for purposes of California Revenue & Tax
Code ("R&TC") section 23101.

FACTS

***** ***** * ***** ***** and Subsidiaries represent the following facts:

***** ***** * ***** ***** ("Parent") is a Delaware corporation with its executive offices
located in California. Parent and its subsidiaries ("Company") manufacture and sell various
products for consumer and professional use.

The Company produces some of its products at various Company-owned manufacturing
facilities in the United States and obtains other products from contract manufacturers in
China. The Company employs a domestic sales force and logistics network, consisting of
*** facilities, and provides service and promotion of its proprietary brands to customers.
One segment of the Company's business is operated via a wholly-owned subsidiary, **
***** ***** Co, Inc. ("Subsidiary").

All of Subsidiary's management is ultimately controlled from Parent's executive offices, by
officers of Parent, in California. Parent maintains a showroom of products in its California
headquarters, including Subsidiary's products, and provides a place at Parent's California

executive offices for Subsidiary's directors and officers to meet for corporate business. Direct management of Subsidiary's manufacturing, operations, and sales is located outside of California. Subsidiary sells its products ("Subsidiary's products") to distributors ("Distributors") in California, one of which is Parent. The Distributors sell Subsidiary's products to various retailers.

Subsidiary has a single full-time employee in California ("Employee") who performs the following activities within California:

1. Employee calls on Distributors who are delinquent in their accounts and requests payment, which in some cases is handed over to Employee. Employee does not authorize new shipments until the account is paid.
2. About once per month, after a Distributor sells and delivers Subsidiary's products to a retailer, Employee visits the retailer and assists in the set-up and establishment of the delivered Subsidiary products.
3. There are approximately six distributor sales meetings held annually in California, where Employee demonstrates the use of Subsidiary's products to Distributors and instructs the Distributors' sales personnel on promotions and sales techniques.
4. Approximately six times a year, Employee holds "in store" seminars on Subsidiary's products for local retailers who are customers of Distributors. At such seminars Employee gives presentations on Subsidiary's products and provides on-site instruction to the employees of the Distributor's customer (the retail store) as to the proper use and function of Subsidiary's products. In addition, Employee instructs the retail store's employees on general sales techniques. Employee also instructs the retail store's customers on Subsidiary's products.
5. Employee is responsible for participating in four to five trade shows per year in California where Subsidiary's products are on display to the attending Distributors and retailers. Employee gives training to other Distributors' employees and retailers in the use and attributes of Subsidiary's products and Employee endeavors to enlist new distributors to sell Subsidiary's products or for retailers to order Subsidiary's products through a Distributor. In addition to giving out samples to attendees during the show, at the termination of the trade show, Employee sells to attendees any of Subsidiary's products that were utilized for demonstration purposes at the show and collects revenue averaging \$*** to \$***.
6. Two to three times per week, Employee provides services related to the design and construction of custom Subsidiary products for customers of a particular retail customer of a Distributor.
7. If a Distributor fails to properly deliver or otherwise causes a retail customer of the Distributor to be dissatisfied with Subsidiary's products, Employee investigates and

resolves customer complaints by whatever means necessary, including taking steps necessary to make sure the retail customer receives a replacement product.

8. Employee details Distributor's customers (the retail stores) almost every day during the week, where Employee will restock store shelves from the retailers' existing inventory, place Subsidiary's products on the shelves, clean, and dust Subsidiary's products presently on shelves, and take orders of Subsidiary's products from retail store personnel for placement with a California in-store Distributor.
9. Employee trains retail store clerks, store managers, and store owners of retailers who are not direct customers of Subsidiary on general sales techniques not specific to Subsidiary's products.
10. On a regular weekly basis, Employee takes orders from a retail store and passes those purchase orders not to Subsidiary, but to a California Distributor (a customer of Subsidiary) for fulfillment.

RULING REQUESTED

Company requests a ruling that Subsidiary is considered to be "doing business" in California and has sufficient nexus so as to be required to file California income or franchise tax returns for tax years 2000 to 2010 for purposes of R&TC section 23101.

HOLDING

For purposes of R&TC section 23101, Subsidiary is considered to be "doing business" in California and has sufficient nexus so as to be required to file California income or franchise tax returns for tax years 2000 to 2010. Subsidiary engages in "unprotected activities" as defined in FTB Information Publication 1050, and accordingly, is not afforded protection under Public Law 86-272 (15 U.S.C. § 381).

APPLICABLE LAW

For taxable years beginning before January 1, 2011, R&TC section 23101 defines "doing business" as actively engaging in any transaction for the purpose of financial or pecuniary gain or profit. The scope of R&TC section 23101 is limited by Public Law 86-272 ("P.L. 86-272"). P.L. 86-272 establishes a "minimum standard" for imposition of a state net-income tax based on solicitation of interstate sales:

- (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, the following:

- (1) The solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which 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 of 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).

...

- (c) For purposes of subsection (a) of this section, a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

15 U.S.C. § 381.

Congress enacted P.L. 86-272 to restrict states from imposing a tax on income arising from a corporation's sale of tangible personal property within the state when the only business activity engaged in by the corporation in the state is the presence of representatives involved in the "solicitation of orders" for tangible personal property—activities that do not involve the "solicitation of orders" are considered outside the protection of P.L. 86-272 and are within the definition of doing business for purposes of R&TC section 23101.

In *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, (1992) 505 U.S. 214, the United States Supreme Court defined the term "solicitation of orders" to mean activities that are essential or entirely "ancillary" to making requests for orders. Activities "essential" to making requests for orders are self explanatory. Ancillary activities are those that serve no independent business function apart from their connection to the solicitation of orders. Activities that go beyond the solicitation of orders, which are neither essential nor ancillary, are "those activities that that company would have reason to engage in anyway but chooses to allocate to its in-state sales force." (*Id.* at 229.)

In *Wrigley*, the Court determined that the taxpayer's following activities were beyond the solicitation of orders:

1. Replacement of stale gum in customers' displays,
2. The supplying of gum to retailers through the issuance of "agency stock checks," for which retailers were to be billed later,
3. Storage of gum, display racks, and promotional literature, and
4. Rental space within the state for such storage.

(*Id.* at 233.) The taxpayer in *Wrigley* argued that these activities were minimal; however, the Court, while creating an exception to address de minimis or trivial activities, considered the activities as a whole and determined that the activities were conducted in the state on a regular basis. The de minimis exception created by the Court applies to activities that are not ancillary to solicitation but that, when taken together, establish only a trivial connection with the taxing state.

The Court held that the activities cited above were "an independent business function quite separate from requesting orders" and stated that, "it is not enough that the activity facilitate sales; it must facilitate the *requesting of sales*..." (*Id.* at 233 [Emphasis in original].)

In contrast, the Court determined that the taxpayer's in-state recruitment, training, and evaluation of sales representatives, its use of hotels and homes for sales-related meetings, and its employee's involvement in resolving credit disputes with important accounts were ancillary activities which served no purpose other than their role in facilitating solicitation.

Since *Wrigley*, the California Court of Appeal has followed the standard established for interpreting the term "solicitation." (*Brown Group Retail v. Franchise Tax Bd.*, (1996) 44 Cal. App.4th 823.) In *Brown Group Retail*, the taxpayer was engaged in the manufacturing and sale of shoes. It sold no products in California, but its California customers ordered goods and the taxpayer shipped those orders to California. The taxpayer's California-based employees consisted of sales representatives and two representatives of its independent retail distributor division. The division employees did not solicit sales themselves, but instead, performed the following functions: analyzed retailers' financial feasibility and potential for new businesses; assisted retailers' site selection, engaged in lease negotiations, store design, training office personnel, and assisting with sales seminars. The Court of Appeal determined that while these activities could ultimately result in increased sales for the taxpayer, these activities were not ancillary to the "solicitation of orders" since the activities did not facilitate the requesting of sales.

In accordance with *Wrigley* and *Brown Retail Group*, the Franchise Tax Board's publication FTB 1050 "Application and Interpretation of Public Law 86-272," ("FTB 1050") conforms to the standard interpreting the term "solicitation."

FTB 1050 defines protected activities under P.L. 86-272 to be activities limited solely to "(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." Activities are considered ancillary if they serve no independent business function for the seller apart from their connection to the solicitation of orders. De minimis activities and activities conducted by independent contractors as described within FTB 1050 do not need to be limited solely to solicitation in order to be considered protected activities under P.L. 86-272.

FTB 1050 identifies twenty unprotected activities:

1. Making repairs or providing maintenance or service to the property sold or being 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 for 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 the 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 any 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 paragraph 18.

- d. Warehouse.
 - e. Meeting place for officers, directors, 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 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-house office that is used for soliciting and receiving orders from customers). Maintaining a telephone listing or other public listing within the state for the company or employee or representative of the company through advertising or business literature that the company or its employee or representative can be contacted at a specific address within the state.
19. Entering into franchising or licensing agreements; selling or otherwise disposing of franchises or 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 Publication 1050's "Protected Activities" that is not entirely ancillary to requests for orders, even if the activity helps to increase purchases.

If a corporation engages in both protected and unprotected activities, the protected activities will lose their protection under P.L. 86-272.

DISCUSSION

In order for Subsidiary to be doing business in accordance with R&TC section 23101, and be subject to filing California franchise tax returns for tax years 2000 to 2010, Subsidiary must be actively engaging in a transaction or transactions for the purpose of financial or pecuniary gain or profit, and its in-state activities cannot be protected by P.L. 86-272.

Subsidiary has a full-time employee in California who is engaging in transactions that include, but are not limited to, training Distributors and retailers on Subsidiary's products, and providing customer support by resolving disputes and replacing products. Employee's transactions are for the purpose of Subsidiary's financial or pecuniary gain or profit, and as a result, Subsidiary is doing business in California under R&TC section 23101.

Subsidiary also engages in activities that are neither essential nor ancillary to the solicitation of orders for tangible personal property that are filled out of state: Subsidiary's employee collects delinquent accounts; installs Subsidiary's product for retailers; trains retailers on general sales techniques that are not specific to Subsidiary's product; provides technical assistance to retailers by providing services related to the design and construction of custom Subsidiary's products; resolves customer complaints; sells Subsidiary's products that were used for demonstrations at trade shows; and, on a regular weekly basis, takes orders from a retail store and passes those purchase orders not to Subsidiary, but to a *California* Distributor (a customer of Subsidiary) for fulfillment. These activities serve an independent business function that is separate from facilitating solicitation for orders of tangible personal property that are filled outside of California.

By participating in the above described in-state activities, Subsidiary is not protected by P.L. 86-272. Accordingly, Subsidiary is considered to be doing business in California and has sufficient nexus so as to be required to file California income or franchise tax returns for tax years 2000 to 2010.

Please be advised that the tax consequences expressed in this Chief Counsel Ruling are applicable only to the named taxpayer and are based upon and limited to the facts you have submitted. In the event of a change in relevant legislation, or judicial or administrative case law, a change in federal interpretation of federal law in cases where our opinion is based upon such an interpretation, or a change in the material facts or circumstances relating to your request upon which this opinion is based, this opinion may no longer be applicable. It is your responsibility to be aware of these changes, should they occur.

This letter is a legal ruling by the Franchise Tax Board's Chief Counsel within the meaning of paragraph (1) of subdivision (a) of section 21012 of the Revenue and Taxation Code. Please attach a copy of this letter and your request to the appropriate return(s) (if any) when filed or in response to any notices or inquiries which might be issued.

Sincerely,

Delinda R. Tamagni
Tax Counsel